

Understanding Tax Liability of Limited Liability Partnership

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Introduction

The actual profit for any business entity is what remains after disbursement of tax liability under the taxation laws. As the name suggests, Income Tax is a tax on income and it is one of the forms of the Direct taxes¹. The Direct taxes mainly comprises of income-tax which is paid out of the profits of the business entity while the Indirect taxes like excise, custom, service taxes etc. are passed on to the customers.

Just like the taxation concerns of company and partnership are not addressed in the Companies Act, 1956 and the Indian Partnership Act, 1932 respectively; likewise, it was predestined that the LLP Act would be silent on the issue of tax implications for a LLP. The taxation matters of all individuals and business entities are dealt with under the Income Tax Act, 1961. The taxation issues of a LLP in India are cleared by equating it to a partnership firm on the lines of UK and Singapore structure. As per the Union Budget 2009-10, LLP is treated as a firm as defined under the Income Tax Act, 1961 for the purpose of taxation meaning thereby that LLP is conferred the same position as that of a traditional partnership (as under the Indian Partnership Act, 1932). By following the flow-through system for taxation matters, the tax formula/slab does not act as a deterrent against this form of business organization. It implies that LLP, like a partnership firm, will pay tax on its profits after deduction of business expenditure, salaries and interest paid to partners. Partners will then be taxed on their salary and interest receipts; whereas share in profits is exempt and it would not be included in computing the total income in terms of the provisions of Section 10 of the Income Tax Act, 1961. The LLP is taxable at the rate of 30%.

Accordingly, all the provisions relating to taxation of traditional partnership firms would apply *mutatis mutandis* to LLPs. This ensures that the business-related choice between using a LLP or a partnership is not warped by levying taxing taxation criteria. Sections 182 to 189

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¹ In case of Direct Taxes the burden is directly on the payer.

under Chapter XVI of the Income Tax Act, 1961 provide for the assessment of firms and their partners. Among them Section 182 prescribes the manner in which registered firms are to be assessed to tax; Section 183 makes similar provision in the case of unregistered firms, and since certain concessions are permitted to the assesseees in the case of registered firms (registered with the Income Tax Act and not under the Indian Partnership Act), the registration of firms with the Income Tax Authorities assumes significance. Sections 184 and 185 provide for the registration of partnership firms with the Income Tax Authorities. The amended definition of 'firm', 'partner' and 'partnership', under the Income Tax Act is as under:

- 1) Firms shall have the meaning assigned to it in the India Partnership Act, 1932 and shall include a LLP as defined in the LLP Act.
- 2) Partner shall have the meaning assigned to it in the Indian Partnership Act, 1932 and shall include:
 - Any person, being a minor has been admitted to the benefits of partnership; and
 - A partner of a LLP as defined in the LLP Act.
- 3) Partnership shall have the meaning assigned to it in the Indian Partnership Act, 1932 and shall include a LLP as defined in the LLP Act.

Criteria under Income Tax Act, 1961

Owing to the tasks shouldered on the designated partner, the designated partner is required to sign the income tax return of a LLP or where for any reason such designated partner is not able to sign the return, any partner will sign it. For a LLP to be assessed as a firm under the Income Tax Act, it has to satisfy the criteria laid down under the Income Tax Act:

- I. The LLP is evidenced by an instrument *i.e.* there is a written LLP Agreement.
- II. The individual shares of the partners are undoubtedly specified in the deed.
- III. A certified copy of the LLP Agreement must accompany the return of income of the LLP of the previous year in which the partnership was formed.
- IV. If during a previous year, a change takes place in the constitution of the LLP or in the profit sharing ratio of the partners, a certified copy of the revised LLP Agreement shall be submitted along with the return of income of the previous years in question.
- V. There should not be any failure on the part of the LLP while attending to notices given by the Income Tax Officer for completion of the assessment of the LLP.

Deductions

The LLP can claim the following deductions:

- i. Interest paid to partners, provided such interest is authorized by the LLP Agreement.
- ii. Any salary, bonus, commission, or remuneration (by whatever name called) to a partner will be allowed as a deduction if it is paid to a working partner who is an individual.
- iii. The remuneration paid to such working partner must be authorized by the LLP Agreement and the amount of remuneration must not exceed the given limits.

Tax Benefits

A few tax benefits that a LLP structure enjoys above a company include the following:

- i. 10% exemption is given in case of surcharge.
- ii. Tax payment is lower than a private limited company.
- iii. Tax will be imposed only on 40% of the income since the firm would be allowed to pay 60% to the partners as remuneration. So there will be no double taxation of the income.
- iv. Further there is no precondition to fill DDT.
- v. Deemed dividend under Section 2 (22) (e) need not be paid.
- vi. No carry forward or set off under Section 79 in case of major change of ownership.
- vii. Share of profits at the hands of the partners of the LLP is exempt from tax.

The Central Board of Direct Taxes announced on July 1, 2011 that all the individuals, HUFs and Partnership Firms who are liable to get their accounts audited under the Income Tax Act, 1961 will have to file their Income-Tax return online compulsorily using Digital Signature and LLPs are covered under this notification.

Alternate Minimum Tax on the Limited Liability Partnerships

A new Chapter XII-BA titled 'Special Provisions relating to certain LLP's has been introduced in the Income Tax Act *w.e.f* April 01, 2012 in order to preserve the tax base *vis-a-vis* profit-linked deductions. This Chapter will apply in relation to the assessment year 2012-13 and subsequent years. Under this Chapter, LLPs are now subject to Alternate Minimum Tax (AMT) at 18.5%, on the lines with MAT as imposed on the companies.

Comparison between MAT and AMT

The following table makes the comparison between MAT and AMT:

Sr. No.	Basis of Divergence	MAT	AMT
1.	Applicability	MAT is applicable to Companies.	AMT is applicable to LLPs.
2.	Relevant Chapter and Section	Chapter XII-B, Section 115JB.	Chapter XII-BA, Section 115JC.
3.	Tax on	Taxable on Book Profits.	Taxable on Adjusted Total Income.
4.	Source of Tax	Companies are required to pay MAT on book profits if the income tax payable on the total income, computed under the Income Tax Act, is less than MAT.	Where the regular income tax payable for a previous year by a LLP is less than AMT payable for such previous year, Adjusted Total Income shall be deemed to be the total income of the LLP for such previous year and LLP will be liable to pay income tax on such adjusted total income.
5.	Tax Rate	MAT Rate - 18% + surcharge @ 5% if book profit exceeds Rs. 1 crore + Education Cess @ 3% Effective Rate (including surcharge) 19.5%.	AMT Rate - 18.5% + Education Cess @ 3% Effective rate 19.05% (Surcharge is not applicable to LLPs).
6.	Tax Credit (Credit for Tax)	MAT paying companies can claim the credit for 10 assessment years starting from the year in which the credit becomes allowable.	AMT paying LLPs can claim credit for 10 assessment years starting from the year in which the credit becomes allowable.
7.	Exemption	Companies are liable to pay MAT on income exempt under Section 10(38) and 10(34).	LLPs are not liable to pay AMT on incomes exempt from tax.

Conclusion

As no such tax is levied on the other form of business organizations like partnership firms, sole proprietorship, association of persons, etc., it is analyzed that the introduction of the AMT on LLPs may be perceived as a disadvantage to the LLP business form, the LLP

nevertheless remains an attractive business form due to its inherent flexible structure along with the exemption from DDT.

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For partnerships (including limited liability companies). For CALENDAR YEAR 2016 or FISCAL YEAR beginning 2016, and ending 2016. SCHEDULE A Computation of Tax BEGIN WITH SCHEDULE B ON PAGE 3. COMPLETE ALL OTHER SCHEDULES. Transfer applicable amounts to schedule a. Payment Amount. What Is a Limited Liability Company? Classification of an LLC. Default classification. An LLC may be classified for federal income tax purposes as a partnership, corporation, or an entity disregarded as separate from its owner by applying the rules in Regulations section 301.7701-3. The information in this publication applies to LLCs in general, and different rules may apply to special situations, including banks, insurance companies, or nonprofit organizations that are LLCs or that own LLCs. If your limited liability company (LLC) elects a form of pass-through taxation—for example, partnership taxation, s-corporation taxation, or a single-member LLC electing disregarded taxation—then the LLC itself will not pay taxes. For example, you and your partner are the members of Good Times, LLC. You have a 20 percent membership interest and your partner has 80 percent. If Good Times, LLC's profits and losses are divided or allocated between you and your partner based on the percentage of membership interest, then they will be split 20/80. This year, Good Times, LLC made a profit of \$1, Limited Liability Partnerships that carry on a trade, profession—without a view to profit—General description of the measure. Current law relating to the making and delivery of Limited Liability Partnership and general partnership tax returns is contained within sections 12AA Taxes Management Act 1970, 863 Income Tax (Trading and Other Income) Act 2005 and 1273 Corporation Tax Act 2009 and s1(1) Partnership Act 1890. Proposed revisions. Legislation will be introduced in Finance Bill 20 with retrospective and prospective effect to affirm the long accepted and expected position by customers and HMRC, that deeming provisions that treat Limited Liability Partnerships as partnerships and their members as partners, continue