

# India Recognizes Limited Liability Partnerships— Any Attraction for U.S. Investors?

By Vikas Varma

The Indian markets have never been more desirable for United States (“U.S.”) manufacturers and investors, as U.S. buyers are holding back spending in the U.S. markets in the wake of the present market conditions.<sup>1</sup> The U.S. is the largest trading and investment partner of India, with direct investment in India estimated at more than \$9 billion through 2006. The population of India is estimated at more than 1.1 billion and is growing at 1.3% a year. Real GDP growth in India for the fiscal year ending March 31, 2007 was 9.4%, up from 9.0% growth in the previous year. Although its growth for the fiscal year ending March 31, 2009 is expected to be 7.0% or less because of the financial crisis and resulting global economic slowdown, it has the world’s 12th largest economy and the third largest in Asia behind Japan and China, with a total GDP in 2007 of around \$1.1 trillion (\$1,100 billion).<sup>2</sup>

Recognition of Limited Liability Partnerships (“LLP”) as legal entities in India is likely to open significant business, professional, investment and market opportunities for U.S. investors, manufacturers and professionals who can team up with mid-size and small businesses and professional entities to harvest the Indian markets. As Limited Liability Companies, Professional Corporations and Limited Partnerships are not recognized as a form of body corporate in India, the LLP form of legal entity will be the first form of body corporate providing the hybrid benefits of a partnership with limited liability, i.e., the liability of a partner is limited to the extent of equity held by him.

After years of deliberations and waiting, the President of India on January 7, 2009, gave his assent to the Limited Liability Partnership Act, 2008. The Limited Liability Partner-

ship Act, 2008 (hereinafter “the LLP Act”) was published in *The Gazette of India*, and was notified as law on March 31, 2009.

The Indian form of LLP is broadly comparable to New York Registered Limited Liability Partnerships (“NY LLP”) and to some extent to New York Limited Liability Companies (“NY LLC”). This article aims to highlight the important provisions of the LLP Act and its broad comparison to certain key aspects of NY LLP laws as well as certain aspects of NY LLC laws.

## Formation<sup>3</sup> of a Limited Liability Partnership Under the LLP Act

Every LLP is required to register with the Registrar of Companies (“Registrar”) by filing its incorporation document<sup>4</sup> with the Registrar of the State in which the registered office of the LLP is to be situated. The incorporation document, in addition to other information, shall state the names and addresses of the partners of the LLP as well as the names and addresses of the designated partners.

The LLP Act provides that an LLP formed under its provisions shall be a body corporate having a legal entity separate from that of its partners, and will have perpetual succession.

## Partners of a LLP Under the LLP Act

The LLP Act provides that any two or more persons (“Subscribers”) can form an LLP, by subscribing to the incorporation document,<sup>5</sup> for the conduct of any legitimate business, trade, profession or for the provision of services, including professional services. Any individual or body corporate may be a partner in an LLP.<sup>6</sup> The LLP structure is not restricted to any particular class of professionals

and can be adopted by any enterprise which fulfills the requirements of the LLP Act.<sup>7</sup> Thus, interestingly, a limited company, a foreign company, an LLP, a foreign LLP or a non-resident of India can be a partner of an LLP formed under the LLP Act.

Note, however, that the LLP shall have at least two Designated Partners.<sup>8</sup> These two Designated Partners must be individuals and at least one of them must be a resident of India.<sup>9</sup> Thus, subject to certain exceptions,<sup>10</sup> the LLP Act prohibits formation of an LLP with Designated Partners that are *exclusively* corporate bodies. Further, the LLP Act prohibits an LLP with *only* non-resident partners. The legislative intent behind such provision might have been to ensure that there is an individual resident in the country to shoulder the legal responsibilities and to be held accountable for the doings of the entity in case the circumstances call for the piercing of the corporate veil.

## Comparison with NY LLP and NY LLC Laws

The provisions of LLP Act are quite distinctive from the provisions of NY LLP and NY LLC laws. Under NY LLP laws,<sup>11</sup> only professionals (i.e., individuals) authorized by law to render a professional service within the state of New York can be the partners of a NY LLP.<sup>12</sup> However, NY LLC laws do not impose restrictions on corporate entities being partners, known as “members” in the statute.<sup>13</sup> Any association, corporation, joint stock company, estate, general partnership, registered limited liability partnership or foreign limited liability partnership, limited association, limited liability company (including a professional service limited liability company), foreign limited liability company (including a foreign professional service limited liability company), joint venture, limited

partnership, natural person, real estate investment trust, business trust or other trust, custodian, nominee or any other individual or entity in its own or any representative capacity can be a member of a NY LLC.

### Designated Partners

Any partner of an LLP formed under the LLP Act may become, or cease to be, a Designated Partner under the terms of its limited liability partnership agreement. The prior consent of each partner to act as a Designated Partner<sup>14</sup> is required to be filed with the Registrar.

A Designated Partner is responsible for ensuring compliance of the LLP with the provisions of the LLP Act, and is liable for all penalties imposed on the LLP for any contravention of the provisions of the LLP Act.<sup>15</sup> If no Designated Partner is appointed, or if at any time there is only one Designated Partner, each partner of the LLP is deemed to be a Designated Partner.<sup>16</sup>

Although the position of a Designated Partner appears to be analogous to the position of a General Partner in a limited partnership constituted under the New York Partnership Law, this is not the case. Unlike the unlimited liability of a general partner in a New York limited partnership, the liability of a Designated Partner is limited. The Designated Partner, like any other partner of the LLP, is liable only for his or her own wrongful acts or omissions and not that of other partners or the LLP.<sup>17</sup> The obligations of the LLP, whether contractual or otherwise, are the sole obligations of the LLP and not that of its partners or Designated Partners.<sup>18</sup>

### Partnership Agreement

Subject to specific provisions of the LLP Act, partners of an LLP have the leverage to determine their mutual rights and duties, and their rights and duties in relation to the LLP, by and through a limited liability partnership agreement (“Partnership Agreement”). In the absence of a Partnership Agreement or the

failure by the partners to address specified matters, the rights and duties of the partners are determined by the First Schedule to the LLP Act, which acts as a default section setting out the rights and duties of the partners. The most important of such default provisions are: (1) all partners are entitled to share equally in the capital, profits and losses of the LLP, (2) partners cannot expel any partner unless a power to do so has been conferred by express agreement between the partners, and (3) all disputes between partners arising out of the Partnership Agreement, which cannot be resolved by the terms of the Partnership Agreement, shall be referred for arbitration.<sup>19</sup>

The Partnership Agreement is required to be filed with the Registrar. If the Partnership Agreement is executed between the subscribers to the incorporation documents before the registration of the LLP with the Registrar, the subscribers are required to obtain ratification of the Partnership Agreement by all partners before it will be binding on the LLP and such partners. The ratified Partnership Agreement is also required to be filed with the Registrar.

### Partnership Agreement Under the New York LLP Laws

The right of the partners of an LLP to contractually decide their relationships inter se through their Partnership Agreement is quite comparable to the rights of the partners under NY LLP laws. Under NY LLP laws, if there is no statutory prohibition to the contrary, the partners as among themselves may make such agreements as they wish with regard to partnership affairs. As between themselves, the powers, rights, duties and liabilities of partners are determined by the partnership agreement.<sup>20</sup> The partnership agreement is the basic document setting forth the rights and duties of the partners among themselves.<sup>21</sup> If it is evident that a written partnership agreement is a complete expression of the parties’ intentions, the language of such

partnership agreement controls the relationship between the parties and will not be questioned.<sup>22</sup>

### Limitation of Liability of the Partners and the Partnership Under the LLP Act

Every partner of an LLP formed under the LLP Act is an agent of the LLP but not of the other partners.<sup>23</sup> The obligations of the LLP whether arising in contract or otherwise, shall solely be the obligations of the LLP,<sup>24</sup> and not of the partners. The objective is to encourage persons to partner together, with a limitation upon liability, so that a partner is not personally responsible for the general obligations of the partnership or for the wrongful acts or omissions of the other partners.<sup>25</sup> A partner is, however, personally liable only for his or her own wrongful acts or omissions.<sup>26</sup> The LLP Act in its present form is silent as to the liability of the partners for the wrongful acts or omissions of the persons supervised by them in the partnership.

In case the number of partners of the LLP is reduced below two, the partner who carries on the business as the LLP for more than six months with less than two partners, *and* with the knowledge that he is carrying on the business alone, will incur personal liability for the obligations of the business during that period.<sup>27</sup>

### Estate’s Liability

In the instance that the LLP continues the business in the name of a demised partner, the mere use of the demised partner’s name will not render his legal representatives or estate liable for any acts of the LLP committed, or which fail to be taken, after his death.

### Liability in the Case of Fraud

Where an LLP or any of its partners acts with intent to defraud the creditors of the LLP or any other person or engage in any other fraudulent act, the LLP and all partners who participated in such fraudulent

act shall lose their limited liability protection and shall have unlimited liability for any and all debts or other liabilities of the LLP.<sup>28</sup> Furthermore, in addition to being liable for such debts and liabilities, every person who is a party to such fraudulent conduct is punishable with incarceration for a term which may extend to two years and a fine which may extend to five lakh rupees<sup>29</sup> (approx. U.S. \$10,000).<sup>30</sup>

The LLP Act provides whistleblowing concessions for the persons who participated in the fraudulent act. Section 31 of the LLP Act gives discretion to the courts to reduce or waive any penalty that can be levied against any partner or employee of the LLP under Section 30 of the LLP Act, if the court is satisfied that: (1) such partner or employee has provided useful information during investigation of the fraudulent act; or (2) any information provided by such partner or employee leads to conviction of LLP or its partners. From the plain reading of the Section 31 of the LLP Act, it appears that the court is empowered to waive or reduce only the monetary penalty levied under Section 30 of the LLP Act. The LLP Act does not empower the Court to restore the limited liability protection for such partners against their unlimited liability for any and all debts or other liabilities of the LLP.

### **Limitation of Liability of the Partners and the Members Under New York LLP and LLC Laws**

The liability position of a partner in an LLP formed under the LLP Act is quite similar to the position of a partner in a NY LLP or a member in a NY LLC. Under the New York Partnership Law, a partner of a registered limited liability partnership is not liable for the debts or liabilities of the registered limited liability partnership or of other partners. Nevertheless, a partner of a registered limited liability partnership is personally and fully liable and accountable for any negligent or wrongful act or misconduct committed by him or her or by any person under his or her

direct supervision and control while rendering professional services on behalf of such registered limited liability partnership.<sup>31</sup>

Similarly, a member of a New York limited liability company is not liable for any debts, obligations or liabilities of the limited liability company or of another member, whether arising in tort, contract or otherwise, solely by reason of being a member or participating in the conduct of the business of the limited liability company.<sup>32</sup>

Furthermore, all or specified partners of a registered limited liability partnership may be liable in their capacity as partners for the debts and liabilities of such partnership if the majority of the partners so agree and unless the partnership agreement provides otherwise.<sup>33</sup> It is also worth mentioning here that in a registered limited liability partnership in New York, the partners are insulated only against the debts to third parties, and that the liability for breaches of partners' obligations inter se is not insulated by New York Partnership Law.<sup>34</sup>

In *Institute of Physical Medicine & Rehabilitation, LLP v. Country-Wide Insurance*, 752 NYS.2d 232 (NY City Civ. Ct. 2002) the court held that a limited liability partnership may sue and be sued as if it were a partnership formed pursuant to the general provisions of the partnership law except for the limitation on liability of the partners because, under New York law, a limited liability partnership is a partnership even though the partners have limited liability.

### **Conversion of Existing Entities in India into the Newly Permitted LLP Form**

The LLP Act makes specific provisions for conversion<sup>35</sup> of existing entities into LLPs. An existing partnership, private company or unlisted<sup>36</sup> public company may convert into an LLP in accordance with the procedure provided in the LLP Act.

An existing partnership can convert itself into an LLP only if the partners of the LLP after conversion are identical to the partners prior to conversion and no one else is added.<sup>37</sup>

A private company may convert itself into an LLP if there is no security interest in its assets, subsisting or in force at the time of application to the Registrar for conversion and the partners of the LLP, after conversion, are identical to the partners of the existing private company prior to conversion.<sup>38</sup>

An unlisted public company<sup>39</sup> may convert into an LLP if there is no security interest in its assets, subsisting or in force at the time of application to the Registrar for conversion and the partners of the LLP, after conversion, are identical to the shareholders of the unlisted public company prior to the conversion.<sup>40</sup>

### **Cessation of Partnership Interest Under the LLP Act**

In addition to the occurrence of any disqualifying event provided for in the LLP Act, such as death, insolvency or incompetency, a partner may also cease to be a partner of an LLP under circumstances provided for within the terms of the Partnership Agreement or, in absence of a Partnership Agreement or such terms, by such withdrawing partner giving a thirty-day notice to the other partners.<sup>41</sup> Cessation of a partner from the LLP does not discharge the partner from any obligation to the LLP, to other partners or to the third parties which he incurred during his partnership.<sup>42</sup>

The LLP Act also provides that with respect to third parties dealing with the LLP, a person or entity who ceases to be a partner of the LLP will be deemed to continue as a partner in relation to such third parties, unless notice of the cessation is given to the third party or to the Registrar. A failure to provide proper notice of his cessation, to the third party or Regis-

trar, continues the obligations of the former partner to the third parties dealing with the LLP.<sup>43</sup>

## Recognition of Foreign Limited Liability Partnerships Under the LLP Act

Section 2(1)(m) of the LLP Act defines a foreign limited liability partnership as a limited liability partnership formed, incorporated or registered outside India which establishes a place of business within India.

The Central Government of India is empowered under the provisions of the LLP Act Section 59, read with Section 79, to make rules for establishment of places of business by foreign limited liability partnerships within India and carrying on the business of foreign limited liability partnerships in India. In exercising such powers, the Government of India, Ministry of Corporate Affairs, established Limited Liability Partnership Rules, 2009 (the "Rules"), as notified on April 1, 2009. The Rules provide as follows:

- (1) A foreign limited liability partnership shall, within thirty days of establishing a place of business in India, file the requisite form with the Registrar along with: (a) its incorporation documents; (b) list of partners and designated partners, if any; and (c) name and address of two or more persons resident in India, authorized to accept on behalf of the LLP, service of process and any notices or other documents required to be served on the LLP.
- (2) In case any alteration is made in the incorporation documents, partners or designated partners, or names or addresses of any person authorized to accept process and notice of service, the LLP shall notify the Registrar within the prescribed time and file the prescribed forms.

- (3) Every foreign limited liability partnership is required to file a statement of accounts and solvency in the prescribed form within a period of 30 days after the end of six months of the financial year.

## Taxation

The LLP Act does not provide any insight into the taxation of the LLP. However, the [Indian] Finance Act, 2009, amended the [Indian] Income Tax Act, to provide that the LLPs shall be taxed in the same manner as partnership firms are taxed in India. It is pertinent to mention here that under the [Indian] Income Tax Act, a Partnership firm is taxed as a separate entity, distinct from the partners. Under the provisions of the [Indian] Income Tax Act, the share of the partner in the income of the LLP is not included in computing his total income, i.e., his share in the total income of the LLP shall be exempt from double taxation.

## Federal Taxation of NY LLPs and NY LLCs

NY LLP is taxed as a partnership. Partnerships are "flow-through" entities for taxation purpose, meaning that the entity does not pay taxes on its income. Instead, the owners of the entity pay tax on their distributive share of the entity's taxable income.

NY LLCs have an option either to be taxed as partnership (S corporation), i.e., pass-through taxation, or as a C corporation. The check box regulations of the Treasury Regulations provide that an LLC will be treated as partnerships for Federal tax purposes unless it specifically chooses to be taxed as a corporation.

## Application of Provisions of [Indian] Companies Act, 1956

The LLP Act provides that [one or more] provisions of the [Indian] Companies Act, 1956 may be made applicable to LLPs formed under the LLP Act, with or without modifica-

tion, as the Central Government of India may notify from time to time.<sup>44</sup>

Thus, the limited liability partnerships in India offer the foreign investors the much awaited form of business organization with limited liability and without double taxation. The LLP Act will have a remarkable effect on the ability of small and closely held U.S. businesses to target the impending and ever-growing Indian market. However, the LLP Act being a recent enactment, the various legal nuances pertaining to formation, operation and taxation of LLPs are yet to be discovered.

## Endnotes

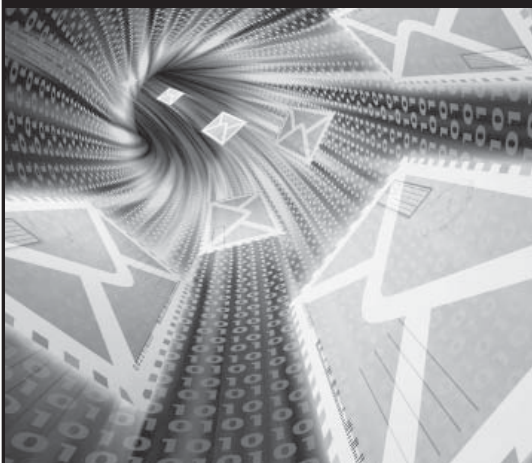
1. A monthly tally of 32 retail chains' sales found a 12th straight year-over-year decline in August 2009. <http://www.nytimes.com/aponline/2009/09/03/business/AP-U.S.-Retail-Sales-Summary.html>.
2. Based on a 2007 year-end exchange rate of 39.5 rupees to the U.S. dollar, <http://www.state.gov/r/pa/ei/bgn/3454>.
3. LLP Act § 11(1)(b).
4. Form 2 as prescribed under Rule 11 of the Limited Liability Partnership Rules, 2009.
5. Id.
6. The Limited Liability Partnership Act [LLP Act] § 5.
7. Press Release by Ministry of Corporate Affairs, India dated October 21, 2008.
8. LLP Act § 7(1).
9. LLP Act § (7)(1). The term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding one year.
10. An LLP can be organized in which all the partners are body corporate, or one or more partners are individuals or body corporate, if at least two individuals who are partners of such LLP or nominees of such body corporate, act as designated partners.
11. NY Partnership Law § 121-1500.
12. Seven states, including New York, limit the availability of Limited Liability Partnerships to professionals. Rhode Island permits only non-professionals and accountants to form Limited Liability Partnerships, and both Hawaii and Kentucky expressly prohibit attorneys from practicing in the Limited Liability Partnership form. *1 NY Prac., New York Limited Liability Companies and Partnerships* § 1:1.

13. NY LLC laws provide that an individual professional, a Professional Service Corporation, a Professional Service Limited Liability Company, a Foreign Professional Service Limited Liability Company, a Registered Limited Liability Partnership, a foreign limited liability partnership, a foreign professional service corporation or a professional partnership can be the member of a professional service limited liability company, i.e., a NY LLC, formed for the purpose of engaging in licensed professions. *NY Limited Liability Co. Law §§ 1207, 1201(c)*. Each member of a professional service limited liability company formed to provide medical services, dental services, veterinary services, professional engineering, land surveying, architectural services, landscaping services, clinical social services, creative arts therapy services, family and marriage therapy services and psychoanalysis services, shall be licensed to provide such services; and in case of members who are not individuals, each member, partner or shareholder of such member shall be licensed to provide such services; and all the members of such NY professional limited Liability Company shall be from the same professional discipline. *NY Limited Liability Co. Law § 1207(b)*.
14. All Designated Partners of the proposed LLP shall obtain "Designated Partner Identification Number (DPIN)" by filing an application individually online in Form 7.
15. LLP Act § 8.
16. LLP Act § 9.
17. LLP Act § 28(2).
18. LLP Act § 27(3).
19. Disputes to be referred according to the provisions of [Indian] Arbitration and Conciliation Act, 1996.
20. *Bogoni v. Friedlander*, 197 A.D.2d 281, 290 (1st Dept.), lv. to app. den., 84 NY2d 803 (1994).
21. *In re Sturman*, 222 B.R. 694, 711 (S.D.NY 1998).
22. *Silverman v. Caplin*, 150 A.D.2d 673 (2nd Dept.), app. dism., 74 NY2d 793 (1989).
23. LLP Act § 26.
24. LLP Act § 27(3).
25. LLP Act § 28(2).
26. LLP Act § 28(2).
27. LLP Act § 6(2).
28. LLP Act § 30(1).
29. LLP Act § 30(2).
30. Conversion rate \$1=INR50.
31. NY Partnership Law § 26(c).
32. NY Limited Liability Co. Law § 609(a).
33. NY Partnership Law § 26(d).
34. *Ederer v. Gursky*, 9 NY3d 514.
35. Provisions for conversion into LLP are contained in LLP Act §§ 55-57. These sections have not been notified and have not come into force.
36. "Unlisted Public Company" means a company which is not a Listed Company. A "Listed Company" means a listed company as defined in the Securities Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 issued by the Securities and Exchange Board of India under section 11.
37. LLP Act, Second Schedule Cl. 3.
38. LLP Act, Third Schedule Cl. 2(2).
39. Public Company means a company which is not a private company. Private Company means a company which by its articles of association:
  - a. Restricts the right of members to transfer its shares .
  - b. Limits the number of its members to 50. In determining this number of 50, employee-members and ex-employee-members are not to be considered.
  - c. Prohibits an invitation to the public to subscribe to any shares in or the debentures of the company.
40. LLP Act Fourth Schedule Cl. 2(2).
41. LLP Act § 24(1).
42. LLP Act § 24(4).
43. LLP Act § 24(3).
44. LLP Act § 67(1).

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