Understanding the difference between: Limited Liability Partnerships (LLP) and Private Limited Company (Pvt. Ltd.)

Since LLP has been introduced in India, apart from incorporating a traditional Limited Liability Company, it has become an option for entrepreneurs, business owners and investors starting new ventures to start their business as an LLP. In light of this, it is important to understand the advantage of each of these formations, the differences between them and consider carefully which ones suits the need of the business best.

LLP vs LLC

Process of formation of LLP and Private Limited Company

Incorporation of LLP	**Incorporation of LLC (Private Limited)**
For formation of an LLP , minimum of 2 Partners are required. There is no limit to the maximum number of Partners. A body corporate can be a member of an LLP.	The minimum number of shareholder required for a company is 2 and there can be upto 50 shareholders, in case of a private limited company.
Steps for Incorporation	**Steps for Incorporation**
For the formation of LLP, firstly you need to apply for Designated Partner Identification Number(DPIN) for the 2 designated partners of LLP and obtain Digital Signature for one of the Partners of the Proposed LLP.	The first step for incorporation of a company is selection of name for the proposed company. Then apply for Directors Identification Number and Digital Signatures.
Application for Name Availability & Obtaining the Name for the proposed LLP.	Drafting of Memorandum and Articles of Association.
Drafting of LLP Agreement for the LLP and filing of incorporation document consisting of Form 2, 3 and 4 available on llp.gov.in with the registrar of companies.	Stamping, digitally signing and e-filing of- MoA, AoA, E-Form 1, 18 and 32 under Companies Act, 1956, and other documents if any which has been stated in MoA with the Registrar.
Obtaining Certificate of Registration of LLP	Obtaining Certificate of Incorporation of LLC

Both LLP and LLC are incorporated under Registrar of Companies and both the entities protect the partners/ members from the legal risk stemming from the activities of LLP or LLC.

The biggest difference that a business must understand and take into account is the difference in taxation and compliance requirement.

Difference in Taxation

Unlike countries such as UK, in India LLPs are not pass through structures, but are taxed as entities. A Limited Liability Partnership is subjected just to income tax and alternate minimum tax. LLC on the other hand is liable to pay various taxes that are income tax, dividend distribution tax and minimum alternate tax.

1. Taxes levied on a Limited Liability Company

Firstly, a company is liable to pay tax on the income of the corporate. Income tax on a limited liability company is levied at the rate of 30%.

A company is subjected to dividend distribution tax when it pays dividend. Under the Income Tax Act, Dividend distribution tax is charged at the rate of 16%.

Third kind of tax applicable on a company is Minimum Alternate Tax. Many companies charge depreciation in their books on straight line method. Thus, the profit shown is higher in the accounts maintained for company law purposes and they can declare dividend. However, for income tax purposes, they charge depreciation on written down value which is higher. Thus, for income tax purposes, they may show low profit or even loss. These companies are known as zero tax company. However, as said earlier such companies show higher profits in their balance sheets. Such profit is known as book profit.

A company has to pay MAT on its book profit if the income tax payable on the total income as calculated under the Act is less than the minimum. From April 2011, MAT will be accessed at the rate of 18% according to the latest Finance Act.

2. Taxes levied on a Limited Liability Partnership

Taxation structure for LLP is simpler. LLP is subjected only to Income tax and Alternate Minimum Tax. Dividend Distribution is not applicable on LLP. Once profit is declared and tax is paid by LLP, the distributed income is tax free in the hands of the partners. Tax is levied on the firm at the rate of 30%.

From the assessment year 2012-13, LLP will be subjected to Alternate Minimum Tax. The purpose behind implementation of this tax is to rationalize taxation of LLP's with companies. As in order to avail tax benefits many companies converted to LLPs, hence, Union Budget 2011 introduced a new Chapter XII-BA under the Income Tax Act 1961 which provided for Alternate Minimum Tax (AMT) at the rate of 18.5% on the adjusted total income of Limited Liability Partnerships. According to the new rule, when the regular income tax payable by a LLP for a particular financial year is less than the corresponding alternate minimum tax computed at the rate of 18.5% on its adjusted total income; such alternate minimum tax shall be deemed to be the income tax liability of such LLP.

In spite being subjected to AMT, LLP offers lesser tax liability in comparison to LLC. Hence, it is preferable for a freelancer and sometimes a startup to set up the business in form of LLP rather than LLC.

Compliance requirement

The yearly cost of compliance in case of LLC can be substantial. Under the Companies Act, 1956 and the Rules made thereunder, a limited liability company is required to consider balance sheet, profit and loss account, hold meetings, directors report and auditors report; make a declaration with regard to dividend and appoint auditors, while annual compliance in case of LLP consists of presentation of statement of account and solvency along with annual report under Section 34(2) and 35(1) respectively of LLP Act. Practically, the effort and cost of compliance in case of LLPs is a fraction of what is required in case of a private limited company.

Private Limited Company is preferred by Venture Capitalists over Limited Liability Partnerships

In India, VCs are not yet comfortable with LLPs, and insist that the startups they will consider should be in the form of Private limited Company. VCs are risk averse and generally have proven to be slow adopters despite significant benefits of the LLP form in case of many business models as far as India is concerned. This is surprising given that several VC funds were quick in forming LLPs instead of private trusts in order to administer and manage their funds. If you are planning to raise venture capital in the near future, private limited company is the way to go.

Feature Comparison

In order to help you decide on which legal form to choose, here's a feature comparison between the LLP and a Company:

Features	Company	LLP
Registration	Compulsory registration required with the ROC. Certificate of Incorporation is conclusive evidence.	Compulsory registration required with the ROC
Name	Name of a public company to end with the word "limited" and a private company with the words "private limited"	Name to end with "LLP"" Limited Liability Partnership"
Capital contribution	Private company should have a minimum paid up capital of Rs. 1 lakh and Rs.5 lakhs for a public company.	Not specified.
Legal entity status	Is a separate legal entity.	Is a separate legal entity.
Liability of shareholders/ LLP partners	Limited to the extent of the unpaid capital.	Limited to the extent of the contribution to the LLP.
No. of shareholders / Partners	Minimum of 2. In a private company, maximum of 50 shareholders	Minimum of 2. No maximum.
Foreign Nationals as shareholder / Partner	Foreign nationals can be shareholders.	Foreign nationals can be partners.
Taxability	The income of domestic companies is taxed at 30% + surcharge+cess.	Income tax is levied at the rate of 30%+ surcharge+cess.
Meetings	Quarterly Board of Directors meeting, annual shareholding meeting is mandatory.	Not required.
Annual Return	Annual Accounts and Annual Return to be filed with ROC.	Annual statement of accounts and solvency & Annual Return has to be filed with ROC.
Audit	Compulsory, irrespective of share capital and turnover.	Required, if the contribution is above Rs.25 lakhs or if annual turnover is above Rs. 40 lakhs.
Bankers' perception of creditworthiness of the entity	High creditworthiness, due to stringent compliances and disclosures required.	Creditworthiness is higher compared to that of a partnership but lesser than a company.
Whistle blowing	No such provision.	Protection provided to employees and partners who provide useful information during the investigation process.

Dissolution	Very procedural. Voluntary or by Order of National Company Law Tribunal.	Less procedural compared to company. Voluntary or by Order of National Company Law Tribunal.
Foreign Investment	Foreign investment allowed on automatic or approval basis on various sectors in accordance with FDI policy. There are percentage restrictions, and performance linked conditions, such as minimum capitalization in various sectors. For details, refer to latest FDI Circular.	Foreign investment in LLPs has been allowed on May 11, 2011, but it is restricted to only those sectors where 100% foreign investment for companies is permitted, and which do not have any performance linked conditions. All foreign investment in LLP on approval basis.

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