

Can LLP be a subsidiary under the Companies Act?

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In the recent times, Limited Liability Partnership ('LLP') is the most preferred form of business organisation in India. Some of the advantages of LLP as a business organisation are ease of decision making and administration, ease of compliance, tax-efficient and also limited liability (in certain cases). However, in my view, LLP is an apt for consulting, advisory and service provider. Considering this, many large corporates are doing business through LLP. Taking into consideration the other aspects of related party transactions, accounting related provisions and disclosures, an important issue that needs to be addressed is – Can LLP be a subsidiary of a company under the Companies Act? If a company is holding the entire contribution of LLP then whether such LLP is a subsidiary company? If all the directors of a company are the partners / designated partners of LLP, then whether such LLP is a subsidiary company?

'Subsidiary Company' under the Companies Act

Sub-section (87) of section 2 of the Act relates to the definition of 'subsidiary' or 'subsidiary company'. It is defined in relation to any other company *i.e.* holding company in which the holding company:

- (i) Controls the composition of the Board of Directors; or
- (ii) Exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

According to the explanation to the section 2(87) of the Act, the composition of a company's board of directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors.

The expression 'total voting power' referred to in sub-section (87) of section 2 of the Act means the total number of votes which may be cast in regard to that matter on a poll at a meeting of a company if all the members thereof or their proxies having a right to vote on that matter are present at the meeting and cast their votes [defined in section (89) of the Act].

In the Explanation to sub-section (87) of section 2 of the Act, the expression 'company' includes any body corporate *i.e.* a company incorporated outside India is also a 'subsidiary company'.

Discussion on the relevant provisions of the Limited Liability Partnership Act, 2008

Section 3 of the LLP states that a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners. LLP shall have perpetual succession and any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP. The LLP Act has not precisely defined 'Designated Partner' and 'Partner'.

Designated Partner means any partner designated as such pursuant to section 7 of the Act. Every LLP shall have at least 2 designated partners who are individuals and at least one of them shall be a resident in India. In case of a LLP in which all

the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least 2 individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

Partner, in relation to a LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement. LLP agreement is any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that LLP. The LLP Act further states that every partner of LLP is, for the purpose of the business of the LLP, the agent of the LLP, but not of other partners.

According to the LLP Act, the mutual rights and duties of the partners of LLP, and the mutual rights and duties of LLP and its partners, shall be governed by LLP Agreement between the partners, or between LLP and its partners. The LLP Agreement and any changes, if any, made therein shall be filed with the Registrar.

Contribution in LLP vis-a-vis Share Capital in company

According to Section [32](#) of the LLP Act, a contribution of a partner may consist of tangible, movable or immovable or intangible property or other benefit to LLP, including money, promissory notes, other agreements to contribute cash or property, and contracts for services performed or to be performed. The monetary value of contribution of each partner shall be accounted for and disclosed in the accounts of the LLP in the manner as may be prescribed.

In case of share capital of the company, 'share' means a share in the share capital of a company (and includes stock). The shares (or debentures or other interest) of any member in a company shall be movable property transferable in the manner provided by the articles of association of the company.

Partner's ownership in LLP is indicated by 'contribution' which is not transferrable, whereas shareholder's ownership in company is indicated by 'shares' which is transferable in accordance with the articles of association of the company. This, in my view, is a significant difference between the company and LLP in terms of ownership in the two business organisations.

Decision making process in Company vis-a-vis LLP

In LLP form of business structure, the decision making process is in accordance with the LLP Agreement *i.e.* the decisions of the partners or designated partners. There is no specific provision in the LLP Act or Rules which requires the approval of partners or designated partners by passing an ordinary resolution or special resolution at respective meetings.

In company form of business structure, there is a mandatory provision of the meetings of the board of directors, quorum, recording of decisions, preparation and maintenance of minutes of the meetings. In company form of business structure, there is a mandatory provision of the meetings of the shareholders, quorum, passing of resolutions (ordinary resolution or special resolution) recording of decisions, preparation and maintenance of minutes of the meetings. Such provisions are not mandatory for LLP under the LLP Act.

LLP does not have the concept of 'directors' though there is a reference to the provisions of 'designated partners'. However, the role, responsibilities, disqualifications related provisions of a 'director' of a company cannot be

compared to the 'designated partner' of the LLP. LLP does not have the concept of 'shareholders' though there is a reference to the provisions of 'partners'.

In LLP form of business structure, the decision taken by the partners or designated partners can be unanimous or by majority, in accordance with the LLP Agreement. In LLP form of business structure, the Act does not define the mode of voting by partners *i.e.* voting by show of hands or voting by poll. However, under the Companies Act, certain decisions (as prescribed by the Act) require unanimous approval of board of directors and in other cases, the approval by majority directors is required. Under the Companies, the decisions by the shareholders are taken either by passing an ordinary resolution or special resolution.

Conclusion

In order to establish the relationship between a company and LLP as holding company and subsidiary company, respectively, any of the following 2 tests are required to be satisfied:

- (i) Holding company controls the composition of the board of directors;
- (ii) Holding company exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies.

Taking into consideration the above discussion w.r.t. the 2 tests for establishing the relationship of holding – subsidiary company, below analysis for reference:

- (i) *Holding company controls the composition of the board of directors* – As discussed above, the LLP does not have the structure of board of directors. Therefore this test cannot be fulfilled;
- (ii) *Holding company exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies* – As discussed earlier, the LLP does have a prescribed or defined mechanism of voting *i.e.* voting by poll or voting by show of hands. Voting in LLP is defined by the LLP Agreement. In case of LLP, there is no prescribed voting system like – voting by show of hands or voting by poll or holding 30% of the contribution signifies 30% voting rights, etc.

Since both the tests are not satisfied, LLP cannot be a subsidiary of a company. This is irrespective of the fact that company holds the entire contribution of LLP and directors of company are partners/designated partners of LLP.

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