

Limited Liability Partnership – The Way Forward ?

INTRODUCTION

As the world moves into 21st century, the trend in corporate law reform in influential jurisdictions e.g. the UK, US, Australia, Singapore and Dubai, which are Malaysia's major trading partners, has been to focus on the needs of small businesses. Similarly for Malaysia, a new form of business vehicle is required to enhance and expand business opportunities for entrepreneurs and professionals and enable the country to be more competitive in the era of globalization and liberalization.

Such business vehicle must possess 2 important features:

- (1) flexibility in terms of its formation, maintenance and termination;
- (2) dynamism and ability to compete regionally and internationally.

Thus, Companies Commission of Malaysia ("CCM") is proposing to introduce Limited Liability Partnership ("LLP"), a new concept of business vehicle which is a hybrid company-partnership with conventional partnership features and limited liability company ("LLC") privileges. Pursuant thereto, CCM issued 2 initial Consultative Documents in December 2003 and April 2008.

From the 2 Consultative Documents, CCM has studied and researched on the various models and legislations from those countries which have practiced LLP and come up with preliminary proposals on LLP in Malaysia and invited and sought inputs, responses and views thereto from the public and professional bodies. All the inputs and views received will be consolidated and incorporated into a fresh and updated proposals on LLP, particularly taken into consideration in formulating a comprehensive legal framework for the proposed LL Partnership Act ("LLP Act").

LLP has the following benefits, i.e. it:

- (1) is a body having continuing legal existence independent of its members as compared to traditional partnership, the legal existence of which is dependent upon membership. So it can hold and own assets, enter into contract, sue and be sued etc;
- (2) enjoys perpetual succession where changes in members will not affect legal entity of LLP;
- (3) enjoys protection of limited liability for its members against unlimited liability without strict management procedures of an incorporated body; and
- (4) offers a degree of flexibility of partnership arrangement for internal management of business compared to companies which are required to adhere to statutory management controls imposed by the Companies Act 1965 ("CA") and other legislations.

Further, the introduction of LLP is said to be in line with Government's aspiration and call since April 2007 to improve public and Government service delivery system, cut bureaucracy and red tapes, simplify procedures, reduce administrative and compliance burdens relating to doing business in order to create and maintain a friendly business environment in Malaysia.

REASONS JUSTIFYING LLP

There are other various reasons justifying the introduction of the LLP as follows:

- (1) Unlike LLC, sole proprietorship and partnership have some inherent disadvantages e.g. unlimited liability, absence of separate legal entity, difficulty to raise capital, lack of business continuity etc. So, there is little or no mechanism for expanding business. A partnership of more than 20

partners which wishes to have flexibility of operating as a partnership does not have much choice but to either:

- (a) convert its status to a company as required by S 14(3) of the CA but any profits made are subject to corporation tax and dividends paid can then be taken as income of the shareholders; or
 - (b) limit its membership.
- (2) Not all types of business activities could be carried out through companies under the CA. The only option for many professional practices, in the past, has been to operate as partnerships, since either the general law or the rules and regulations of their professional regulatory bodies and/or legislations governing their professions denied them the ability to incorporate a company. This requirement of professionals operating as partnership was generally appropriate when all partnerships were small and the partners were of same profession working closely with one another. However, this may not be so any more in view of the general increase in:
- (a) the growth in size of partnerships and specialization among partners and coming together of different professions within a partnership. In a very large partnership, not all the partners will be personally known to one another and hence there has been increasing concerns about their liability for the conduct of their fellow partners;
 - (b) the incidence of litigation claims for professional negligence and size of claims against professional advisers on liabilities in respect of financial losses to stakeholders. Professional firms were confronted with potential increase in personal bankruptcies of partners and rising costs and premium for insurance for partnerships. This may hinder professional firms' ability to provide much needed service to the community.
- (3) In Malaysia however, the circumstances giving rise to the proposal of LLP are more than above factor. The main reason is to spur the growth of small and medium enterprises ("SMEs") against the backdrop of international business environment and enhancement of domestic business activities. At the same time, LLP will be equally attractive for professionals such as accountants and lawyers.

SPECIAL FEATURES AND BENEFITS OF LLP

(1) Limited liability status

CCM proposes that:

- (a) limited liability status will be conferred to LLP, which position differs markedly from general partnership law which imposes joint and several liability on general partnerships for all tortious acts of their co-partners acting within the scope of their actual or apparent authority;
- (b) partners should be accorded limited liability in respect of tort and contractual claims, meaning, individual partners will not be liable from the contracts, debts, obligations and liabilities of the LLP as well as personal liability from the conducts, wrongful acts, omissions, negligence or other tortious conduct of an employee, staff or co-partner, which were carried out during the course of business, and the personal assets of partners will not be at risk for such acts or matters;
- (c) however, this will not change the fact that the partner will still be personally liable for his own such acts etc but only 1 action under tort will be potentially available. Further, his liability to any person for his own such acts etc, including negligence, in the situations where law imposes liability on him to such person should not be affected or extinguished merely on the basis that the acts or omissions were carried out in his role as a partner;

- (d) persons dealing or contracting with a partner of an LLP will be dealing or contracting with the LLP rather than its partner. Hence, the obligation incurred and liability arising therefrom, whether arising in contract, tort, or otherwise, should be that of LLP and not its partners personally;
- (e) in the event that the LLP becomes insolvent, a partner's liability should be limited to the amount of his capital contribution to the LLP subsisting at the time.

(2) Partner's binding authority

- (a) For above to work, the LLP Act will provide that each partner of an LLP is deemed to be its agents but not agent to each other and can thus act for, represent and bind the LLP provided that they have authority to perform such acts which are made in the course of business. Any limitation on authority of a partner provided in LLP agreement will not prejudice any 3rd party. Therefore, the partners should avoid in any documentation between themselves any suggestion that there are any mutual agency relations between them and it is suggested by some advisers that, to avoid problems in this area, the use of term "partner", "partnership" or "firm" should be avoided and instead replaced with "member" and "LLP" respectively.
- (b) The LLP will not be bound by acts of its partners in dealing with a 3rd party if:
 - (i) the partner does not have necessary authority to act on behalf of LLP; or
 - (ii) the 3rd party dealing with the partner is aware of this; or
 - (iii) the 3rd party does not know or believe that partner is a partner of LLP.
- (c) For cases of transactions with a former partner, CCM opines that a former partner has authority to act and such transactions are still valid binding unless the 3rd party has actual notice that the partner is no longer a partner at the time of transaction. In another words, constructive notice does not apply i.e. no person is deemed to have notice of any records by reason only that they are made available by the Registrar for inspection. It is viewed that this will be in the best interest of the public in their daily dealings with LLP.

However, some professional bodies e.g. Bar Council Malaysia ("BCM") opines that such doctrine of constructive notice should apply because actual notice may not be practical in the ordinary course of professional business and the duties of partners of LLP should not be made more onerous than that in a general partnership. However, being mindful and in agreement to protect public and consumer interest, it is proposed by BCM that LLPs should be required to maintain a current list of partners made available for inspection for bona fide purposes by those who have or had dealings with the LLPs in course of its business or profession.

(3) Registration procedures

- (a) In consistency with the aim of providing a friendly legal framework and Government's aspiration to facilitate process of setting up a business in Malaysia, CCM agrees that the LLP Act will provide a fast, cheap, convenient and straightforward registration process through a single registration instrument be made available.
- (b) Unlike the requirement contained under 5(2) of the Registration of Businesses Act 1956 ("ROBA") where particulars of partnership agreement shall be stated in the prescribed form, such requirement is not necessary to maintain privacy of arrangement between and amongst the partners, and to minimize administrative and compliance costs on the LLP.

- (c) As conclusive evidence that the registration requirements have been complied with, a certificate of registration will be issued where an unique registration number will be allocated to the LLP.
- (d) An LLP must use the words “LL Partnership” or the abbreviation “LLP” as part of its name and that such name must be publicised at its place of business and official documents together with the unique LLP number. This will serve to inform the public that such entity is an LLP and not a general partnership registered under ROBA or a company incorporated under CA.

(4) Membership structure and eligibility

- (a) CCM proposes that the proposed membership of an LLP is a minimum of 2 without any upper limit as the changing business environment may necessitate businesses to expand and grow.
- (b) Undoubtedly, the flexibility to allow a sole partner to continue to operate without having to wind up the business will make the LLP more convenient and attractive as it increases business flexibility and avoid cost of winding up when number of partners falls below 2. However, CCM opines that single-partner LLP is a misnomer because this will be in contradiction with definition of “partnership” under S3(1) of the Partnership Act 1961 (“PSA”) which is defined as *‘the relation which subsists between persons carrying on business with a common view of profit’* and not in line with international norms. Hence CCM proposes that should an LLP operate below minimum number of 2, it should dissolve, cease to operate and be wound up and the limited liability privilege accorded should be withdrawn, if after a certain grace period, it still cannot find replacement partners.
- (c) Further, the membership should be open to both natural and legal persons (including LLPs) in line with the PSA.

(5) Raising loans and creating security

CCM agrees that since an LLP possesses a separate legal personality and can own assets in its own name, it should be allowed to raise capital or create charges over its assets. However, a food for thought is that the prevalent banking practice of requiring partners to furnish personal guarantees may nullify such claimed benefit of raising capital over LLP’s assets.

(6) Creditors’ protection mechanism

- (a) CCM opines that, to accord creditors’ protection, the LLP Act should contain claw-back provisions requiring contributions from partners and former partners (limited only to the amount withdrawn/distributed) who have withdrawn any property (including salaries, profits, loan interest and return/refund of capital by LLP) from LLP within a stipulated time frame prior to commencement of winding up, if:
 - (i) it can be shown that the LLP was insolvent at the time of withdrawal. It is deemed to be insolvent if at anytime the LLP it unable to pay its debts as they become due in the normal course of business or at any material time, the value of LLP’s assets is less than the value of its liabilities. However, BCM opines that it is difficult to determine insolvency of a legal firm because of nature of such firm and its professional business, particularly:
 - (aa) the legal profession is service oriented and not capital intensive and hence the proposed solvency test is subjective and unsafe. The concept of “deemed insolvency” is inappropriate and if at all the test of insolvency is to be applicable, it should be a test of “actual insolvency” to be determined by the Courts having regard to general principles of insolvency law;

- (bb) the terms of payment and cash flow vary according to firms and areas of practices;
 - (cc) the legal partnership may be subject to contingent liability e.g. in case of suits filed against it for negligent acts and hence effect of such suit in the firm's financial position in respect of its accounts may be difficult to ascertain with certainty; and
- (ii) that the partners knew or have reasonable grounds for believing that LLP was or would not be able to pay its debts. It is proposed to follow the definition stated in S218(2) of the CA regarding the "inability to pay debts" to mean "when the company is indebted in a sum exceeding RM500-00".

(7) Financial reporting

- (a) CCM opines that there is need to provide safeguards for those dealing with this new form of corporate business including public disclosure of information about LLP, particularly its finances and safeguards in case of insolvency. At the same time, LLP should be accorded some degree of flexibility with regard to financial reporting to make the LLP module attractive. However, such flexibility must balance good corporate governance practice to enable it to be well respected amongst the business community and investors alike.
- (b) As such, CCM proposes that:
- (i) all LLPs are to keep their accounting reports that will enable true and fair financial statements to be prepared and for 7 years after the completion of transactions or operations to which they respectively relate;
 - (ii) their financial statements are not required to be audited or filed with the Registrar. Such exemption offers an attractive benefit to business especially the professions opting for conversion into LLPs compared to the stringent audit requirements under the CA and requirements of LLPs should also not be more onerous than what it currently imposed by each profession's regulatory body.
- (c) However, CCM proposes that LLPs are to file an annual solvency or insolvency statement with the Registrar, as the case may be. BCM however disagrees on following grounds:
- (i) it is not feasible for professional LLPs to provide such statement based on the same reasoning stated in para 6(a)(i) above;
 - (ii) other reasons include, that:
 - (aa) in the usual course of business, insurance, personal guarantees and other general representations would suffice as security/proof of creditworthiness;
 - (bb) there would be ramifications to LLPs if the solvency certificate turns out to be untrue including breaching of relevant provisions of the LLP Act and/or rules; a possible criminal offence being committed if so provided under the LLP Act; client engaging the firm based on reliance on the solvency certificate suffering a loss in terms of their extent of recovery in event of liability;
 - (cc) such certificate being a declaration only and to be provided as at a particular date may not be conclusive proof of solvency of the LLP;
 - (dd) such certificate may be derived from the LLPs' statement of accounts but for legal professions, issues on solvency may be difficult to assess and hence such certificate would not be of real practical value. Issues like risk of

contingency liability and their extent especially in professional negligence cases and professional indemnity insurance coverage add to the complexities of deciding whether such a solvency certificate can be properly given;

- (ee) the Legal Profession Act 1976 ("LPA") provides sufficient disciplinary rules to disqualify members on grounds of bankruptcy, misconduct etc which would address public interest element.

(8) Conversions of partnerships and companies into LLPs (and vice versa)

- (a) In view of the above benefits of LLP, CCM opines that the availability of conversion procedures under the LLP Act either from general partnerships and private companies will further provide an impetus for such conversion of status.
- (b) The most apparent reasons for a general partnership or a company to convert into an LLP are:
 - (i) structural flexibility. As mentioned earlier, there are various benefits and advantages for LLPs, therefore the ability to convert existing companies and partnerships into LLPs (and vice versa) would constitute a natural progression in this context;
 - (ii) as CCM promises, conversion of an existing form of partnership will be a fast, cheap, convenient and straightforward registration (in comparison to formation of a corporate entity) and a more flexible legal form for small businesses and, at the same time, afford them advantages of separate legal personality;
 - (iii) besides flexibility, opportunity for such conversion into an LLP simply makes economic sense for small private companies, especially those seeking to further downsize capacity of their respective companies, as it will relieve them from obligations of keeping up with requirements for maintaining a corporate entity.
- (c) In relation to the above, CCM proposes as follows:
 - (i) Such conversion must necessarily involve transfer to and vesting in LLP of all the affairs, business, contracts, assets, properties, undertaking, liabilities and obligations of the partnership to LLP and the assumption by LLP at the same time of all liabilities and obligations of the partnership subsisting at the time.
 - (ii) To protect creditors from being prejudiced as a result of the conversion, :
 - (aa) the partners of the general partnership should continue to remain liable for all liabilities and obligations of the partnership incurred prior to conversion, i.e. the liability of a partner will not be extinguished or limited by way of the conversion;
 - (bb) further, since all assets of the general partnership are transferred to the LLP, it would be appropriate for the partners to be conferred a right to be indemnified by the LLP in respect of such liabilities or obligations;
 - (cc) the LLP is required to state in its invoice, receipts and official correspondences that it had been so converted for a period of 1 year after such conversion;
 - (dd) the partners of the LLP are required to be the same partners of the general partnership and no one else.

- (iv) To ensure that the shareholders' and creditors' interests are protected, consent is required from the shareholders before such conversion could be effected.
- (d) On another note, BCM proposes that:
- (i) full relief is granted from the stamp duty and real property gains tax (if applicable) on instruments conveying the partnership property e.g. immovable property, certain types of moveable property like accounts receivable (book debts), chose in action etc to a newly established LLP to achieve complete stamp duty neutrality. Hence the taxing statutes and all other relevant legislations should have to be amended as deemed appropriate;
 - (ii) the registration and vesting of converted entity should be simple and a single notification with the relevant regulatory body under the LLP Act and/or of that business or profession should suffice as conclusive proof of conversion and the right to transfer the business, assets and other affairs of the partnership. There should be no need to further file or notify the courts, other registries, licensing authorities, clients, relevant body or persons etc;
 - (iii) in respect of the LLP's obligation to give notice of conversion, there should be no charges imposed for filing of notices of change with the relevant authorities;
 - (iv) in converting partnerships to LLP, there should be no differences in tax treatment or there should be a "seamless transition" on:
 - (aa) the nature, extent and type of relief, deductions and allowances available;
 - (bb) the members' contribution to a trade;
 - (cc) carrying forward of unrelieved losses;

(9) Taxation

- (a) The element of taxation in relation to an LLP is an area that has invited mixed views. At this juncture, it is said that this issue shall be addressed by CCM with the Inland Revenue Board (IRB).
- (b) However, the general feedback from the various professional bodies is that:
 - (i) the LLP should be tax transparent, i.e. each member can (subject to certain restrictions) participate in LLP in such a way that there is no higher a tax charge than if it had carried out the business itself and there is no special tax treatment or relief available to the LLPs or members beyond those available to partners in partnership, and no differences in tax liabilities or compliance requirements under the relevant taxing statutes. This ensures that the commercial choice between using a LLP or a partnership is a tax neutral one;
 - (ii) taxes pass through like a partnership, i.e. LLP's income is passed through to the partners and taxed at the individual partner level, without any separate business income tax returns and assessment at the LLP entity level required, and the tax liability falls on individual members, not LLP itself. Profits, gains and incomes are taxed as if the business was carried on by members as partners in partnership, with separate legal identity, rather than a body corporate.

CONCLUSION

The intention of implementing LLP is to complement the existing ways and provide wider choice of doing business in Malaysia besides incorporation of companies, registration of partnerships or sole proprietorship.

Under the conventional concept, the main predicaments facing the professionals are that if the firm is sued, all the partners would be liable. Further, such form of business rarely has opportunity to expand whether locally or overseas.

Through LLP, liability of the partners in such firms can be limited and the LLP is responsible for the debts which it incurs instead of the individual partners, except where action of a partner causes the LLP to commit tortious act. It could thus attract more people to own a business and expand, especially SMEs and professionals in partnerships and sole proprietorships such as lawyers, engineers, accountants as there would be less personal risk involved in operating business.

This will also help to spur the business environment in Malaysia and ensure that Malaysia remains an attractive location for business, allowing registered firms to operate competitively locally, regionally and globally with their overseas counterparts. This is of particular value to those very large professional partnerships operating in global markets, who might otherwise be tempted to incorporate outside Malaysia. LLP is internationally recognised and has been touted by various commentators as the "world's best practice" structure, designed to attract venture capital from offshore institutional investors and retain domestic investment.

CCM now has about 810,000 registered companies and 3.5 million business (comprising of partnerships and sole proprietorships) under its belt. With the numbers increasing, it is optimistic of a positive outcome for LLP and it further believes that LLP can be successfully implemented by 2009. So, LLP is the way forward.

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