

## An Analysis on Nature of Limited Liability Partnerships in Malaysia

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### Abstract

*Limited Liability Partnership (LLP) is an additional form of business entity available for an entrepreneur who decides to carry on a business in Malaysia. The Companies Commission of Malaysia introduces this business entity under the Limited Liability Partnership Act (LLPA) in 2012. This paper looks into the history of the legislation of LLPA in Malaysia while using the doctrinal approach in analysing the nature of LLP. The conceptual understanding of LLP and a valid definition of LLP is presented by referring to provisions of LLPA. Evaluation of the best features of LLP is provided, and the important provisions of LLPA are included and discussed in details. This paper also reviews the relevant authorities and their responsibilities in monitoring LLP in Malaysia. By doing so, a clear exposure in the application of LLP can be provided. Finally, a recommendation for future research and a conclusion is provided at the end of the paper.*

**Keywords:** Limited Liability Partnership; Companies Act 2016; Doctrinal Approach

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## INTRODUCTION

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The advancement of business and trade in South East Asia warrants the growth of new forms of business entities that can be considered necessary, due to the demands and needs of investors and traders. In reaching an optimal resolution in the competitive business environment for both local and international interests, many countries have legislated to expand their standing laws to adapt to new forms of business entities. At the same time, they can benefit widely in economic, social and political aspects, from the stable flow of investment, trade and business. From such a position, the choice comes in the form of limited liability partnerships (LLP), to be made available for locals and international interests, to decide on the most appropriate business entities to form. LLPs can be lucrative because they benefit from the best features of corporations

(companies) and partnerships, LLPs offer a unique hybrid business structure for starting a business.

The focus of this paper is on the Malaysian LLPs. The paper looks into the reality of LLPs, and its applications through the legislated provisions, as codified under Malaysian law. This analysis aims to examine the nature and key features of LLPs. Such analysis is considered critical to provide a comprehensive legal examination, while promoting LLPs to local and international business interests. From a methodological point of view, the traditional black-letter law approach or doctrinal research strategy (McConville & Wing, 2007, p.3) is employed, in constructing the conceptual legal analysis about the nature of LLPs.

In presenting the ideas, this paper is organized into five main sections. Following the introduction, section 2 provides a discussion on the concept of LLPs. While providing the brief history of LLP, the insights on understanding and definition of LLP are given. The best features of LLPs, which stand in combination with principles of partnership and company laws, are analysed in section 3. By referring to the Limited Liability Partnership Act (LLPA) 2012, an in-depth exploration of its provisions are made and presented in section 4. The discussion in section 5 appreciates the relevant authorities and their responsibilities in applying LLP in Malaysia. Lastly, conclusions and a discussion of the potential research areas in the field is provided in section 6.

## **HISTORY, CONCEPT AND DEFINITION OF LLP**

Texas in the United States of America is the birthplace of LLPs, following the downfall of real estate and energy prices during the early 1990s (Hamilton, 1995). Such a downfall brought a crisis of failures in loans and bank savings, which warranted accountabilities on firms and companies, and also extended to their partners. The hunt for the recovery of debts by the creditors placed risks not only towards the partners guilty of malpractice, but also to innocent partners (*United States v Vineyard*, 1988). Through enforcement of Texas House Bill 278 on 26th August 1991, the concept of the LLP was introduced officially. After this introduction, the concept of LLP was accepted and adopted by several countries, including the United Kingdom, Singapore, India, and Malaysia.

### **History of LLP in Malaysia**

Malaysia is the second country in South East Asia to legislate on LLPs, in 2012, after Singapore. Singapore legislated their LLP law based on the recommendation of the

Committee on Company Legislation and Regulatory Framework (Yeo, 2003). Likewise in Malaysia, the introduction of LLPs can be traced from the issuance of the consultative document by the Companies Commission of Malaysia in 2008 (Ghadas, 2009). There are three main objectives for introducing LLPs. First, as a preparation for Malaysia's local market for progressive environment of international business, secondly, a stimulus for growth of small and medium enterprises, and thirdly, an enhancement for domestic business activities (Ghadas, 2009). After more than four years since the issuance of the consultative document, the law concerning LLPs were formally legislated when the Malaysian Parliament passed it into law as the Limited Liability Partnership Act 2012.

### **Concept of LLP**

Conceptually, LLPs are a form of shield which protects innocent partners of firms, or any member who is tied to the partnership, from liabilities that are not accredited to them or their actions. LLP exists as a hybrid form of business with a business structure that combines the best features of a private company and a conventional partnership. Under an LLP, the partners enjoy limited liability status, and at the same time, the partners are free to arrange the internal structure of their business flexibly, based on a concluded agreement between them. Such combination is advantageous for traders, investors, and business interests, in controlling the operation and structure of their businesses flexibly, so that they do not have to follow strict requirements, such as is stipulated under the Companies Act 2016, yet at the same time, they can gain benefit from simple procedures in terms of formation, maintenance and termination of LLP as provided under the LLPA (Morse, 2002).

### **Definition of Limited Liability Partnership**

According to Section 2 of the LLPA, a 'limited liability partnership' refers to a local corporate body registered under Section 11, or a foreign corporate body registered under Section 45. Both Sections 11 and 45 of LLPA (2012) provide provisions on the formal registration process for LLPs. Section 11 details out the requirements for registration for local LLP, while Section 45 provides the details for registration of foreign LLP. These two provisions indicated that registration under LLPA is essential for the valid existence of LLPs in Malaysia.

Based on Section 3(1) of the LLPA (2012), it defines LLPs by referring to the best features of LLP itself, such as LLP having a separate legal personality from its partners, and it being a body corporate. Similarly the LLPA does not remain silent in mentioning

about the LLP agreement between the partners. Section 2 of the LLPA (2012) appreciates that the LLP agreement has a written agreement between the partners of the LLP, or between the LLP and its partners. The LLP agreement therefore regulates the partners' mutual rights and duties, not only towards the partnership, but also among themselves.

In short, by referring to the provisions under LLPA, an LLP can be defined as a registered corporate body which is internally regulated based on an agreement of its partners in matters of mutual rights and duties, and has the external advantages of separation of legal personality, perpetual succession, possesses unlimited capacity as a legal person, and changes of its partners do not affect its existence.

### **BEST FEATURES OF A MALAYSIAN LLP**

The best features of LLPs based on the LPPA (2012) fall under two main areas. They include (a) internal features and (b) external features. The partners can determine the internal features of the LLP based on their concluded agreement. The LLP agreement, which is concluded between the partners, stands as the primary reference for their mutual rights and duties. At this juncture, the LLP appears similar to conventional partnership. The partners can even agree on the portion of profits that they are entitled to, by carrying out the business through the LLP.

The external features of LLP can be seen as regulated under Section 3 of LLPA. Such external features are:

- (a) Separation of legal personality: this principle derived from incorporating a body corporate (Sulaiman & Effendy, 2015). Since an LLP is a body corporate, it has a separate legal entity or legal personality separated from its members or partners. The separate legal personality is the key feature of LLP that differentiates it from a regular partnership firm. Despite this, there is still an absence of a report on cases concerning LLP in Malaysia, the general application of this principle remains the same for LLP. In a situation where an LLP is sued for defamation or negligence, the LLP will stand to face the claim independently, where the partners are spared from the liabilities (if any). The application of separation of legal personality can be seen in case of *Pamol (Sabah) Ltd. & Anor v Joseph Bin Paulus Lantip & Ors* (2012). The court held that since all the defendants were at all material times, standing as separate legal entities who possessed all of the separate rights and liabilities, the court considered them not liable or responsible for any failure of the involved agreement for the sale and purchase.

- (b) Perpetual succession: this is also a doctrine attained from incorporating of a body corporate. With perpetual succession, despite the death, bankruptcy, insanity and any change in the membership of LLP, the LLP continues to exist until its official termination. The application of this doctrine can be traced in *Re Noel Tedman Holdings Pty. Ltd.* (1967). It was held by the court that, even though both of husband and wife who acted as the directors and shareholders of the company were already dead, it did not affect the existence of the company. The court allowed the deceased's appointed personal representative to elect new directors, so the transfer of shares could be given to the deceased's child.
  
- (c) Unlimited capacity: An LLP is a body corporate who possesses corporate personality. Under Malaysian law, an LLP is treated as a legal person and has its own capacity as acknowledged by the law. An LLP does not have limits in carrying out its capacity as a legal person, unless the laws provide otherwise. Section 3(4) of LLPA (2012) recognizes the unlimited capacity of an LLP as a legal person. An LLP can sue or be sued. An LLP can also own, acquire, hold, develop and dispose of its own property. For example, an LLP is recognized as a landowner, not its partners, if the LLP purchases land. It also may do or suffer any act or thing within the ambit of laws as a body corporate. If the LLP is sued for defamation and penalized for compensation, the LLP must obey the court's judgement. To apply the unlimited capacity of a body corporate, a reference can be made to *Macaura v Nothern Assurance Co. Ltd.* (1925). In this case, the plaintiff sold all the timbers that he owned to a company, where he owned all shares. Then, he insured the timbers which he already sold to the company under his own name. A fire broke out and left none of the timbers. The plaintiff sued for insurance of the timbers. A judgment was made by the House of Lords and agreed that the plaintiff was not entitled to claim the insurance since he already sold the timbers to the company. The company owned the timbers and not him.
  
- (d) Changes of its partners do not affect its existence: regardless of changes that happen to partners of an LLP, an increase or decrease in numbers of partners does not have any significant effect on the existence of the LLP. However, such changes must not cause the numbers of the partners to be less than two. Since the minimum requirement for partners in LLP is two, and there is no limit for the maximum numbers of partners.

## IMPORTANT PROVISIONS OF LLPA

The LLPA covers several aspects of LLP, including starting, maintaining, and terminating the LLP. The provisions are divided into six main sub-headings. They are:

- (a) Registration of LLP: in order to confirm the existence of LLP under Section 10(1) of the LLPA (2012), the said LLP must accordingly be formally registered with the Companies Commission of Malaysia. Under Section 10(2) of the LLPA (2012), the LLP agreement, which concluded between its partners is not essentially required to be lodged together with the incorporation documents to the Registrar. Section 6 of the LLPA (2012) states that upon registration of LLP, the minimum numbers for partners shall be two. In the case where the number of partners is less than two, the lodged documents are treated as invalid and the registration process will be placed under pending status until the requirement on the minimum number of partners is met. Subsequently, according to Section 7(1) of the LLPA (2012), if the LLP's number of partners becomes less than two, the LLP can still be operated, but not for longer than 6 months or for a period as determined by the Registrar. However, failure to meet the required number of partners in the LLPA renders all partners liable under LLPA. They will be responsible for the LLP's duties and responsibilities. In Malaysia, in order to make the registration of an LLP easier for those who intend to incorporate it, the Companies Commission of Malaysia offers an online registration process, and the service is available on the CCM website known as MyLLP (Companies Commission of Malaysia, 2020).
- (b) The legal status of an LLP: after the implementation of the Act, an LLP is treated as a body corporate and not as a partnership. Even with the existence of an LLP agreement between partners to determine the mutual rights and duties, such a position is clear under Section 3(1) of the LLPA (2012).
- (c) Liability of an LLP's partners: when the LLP is formally registered, partners of the LLP are not accountable or personally liable, either directly or indirectly, for any liability as imposed on the LLP, just simply because they are the partners. Such liabilities of the LLP may arise from obligations of the LLP by way of indemnification, assessment, contribution, or otherwise (in contract or tort). Furthermore, Section 3(4) of the LLPA (2012) provides that any changes of the partners in the LLP will not disturb the existence or continuation of the LLP or its rights and duties – especially towards its business. Section 21(2) of the LLPA (2012) makes an LLP solely liable for any claim made against it. As for any

partner who defaults or commits any malpractices or contributes to the liability as claimed by any third party, the said defaulted partner will be jointly liable with the LLP, as according to Sections 21(3) and 21(4) of the LLPA (2012). In contrast, Section 27(3) of the LLPA (2012) protects innocent partners from any liability of the claim. The partners can be either natural persons or legal persons.

- (d) The internal structure of an LLP: subject to the LLP agreement, the internal structure of an LLP remains flexible to be determined by the partners. In the absence of such an LLP agreement, the default rules provided under the Second Schedule of LLPA are enforceable. This default rules is made essential under Section 9(1) of LLPA (2012). According to Section 23(1) of the LLPA (2012), while carrying out the business of LLP, the partners are treated as the agents of the LLP. However, the LLP is liable for the acts of its partners which are carried out within the partners' authority as agreed in the LLP agreement. Since the LLP is a body corporate, the LLP is also subjected to have the appropriate form of corporate governance structure within its internal structure. However, the LLPA (2012) does not provide any specific provisions that indicate the application of corporate governance. In this sense an LLP as a body corporate, the formulation of corporate governance is considered automatic, since the LLP also shares the attributes of a company.
- (e) Protection for the third party: the LLPA (2012) appropriately considers the protection of innocent third parties or creditors. In a situation where the LLP is insolvent, any distribution as received by partners from the LLP for a specific period of two years before the commencement of the winding-up procedure shall be accredited to the third party. Subsections 22(1)(a) and (b) of the LLPA (2012) specify that partners who receive such distribution from the LLP are accountable for the third party.
- (f) Dissolution or termination of LLP: Under the LLPA (2012) there are two ways to dissolve or terminate an LLP, which include (a) dissolution by way of striking-off by the Registrar (Section 51); or (b) voluntary winding up by any partner (Section 50). For option (b), the LLP must cease to operate, and have no debts and liabilities. A notice must be given to all partners and published in the national newspaper, which states the intention to wind up the LLP. The absence of objections from a creditor or partner, and the Inland Revenue Board of Malaysia, are necessary for dissolving the LLP. For option (a), the LLP may be struck-off due to certain grounds, which include: (i) the LLP no longer carries out any

business; (ii) there is a contravention with the provisions of LLPA; (iii) the LLP is prejudicial to the national interests; (iv) there is no liquidator action for the court's order for winding up; or (v) the LLP has been fully wound up with insufficient assets to pay for the cost in obtaining the court's order. The dissolution procedures for LLPs are stipulated under the Companies Act 2016. According to Section 619(6) of the Companies Act 2016, a company which is in the course of winding up immediately before the commencement of the Act shall continue to be wound-up under the Companies Act (1965), and Companies (Winding Up) Rules (1972).

## **RELEVANT AUTHORITIES AND THEIR RESPONSIBILITIES TOWARDS LLP**

The most relevant authorities in Malaysia which need to be considered in relation to start, maintain and dissolve the LLP are: (a) the Companies Commission of Malaysia, and (b) Inland Revenue Board of Malaysia such as:

- (a) Companies Commission of Malaysia and their responsibilities towards LLP: The commission is an important authority for the formation, conversion and existence of LLP. They are responsible for providing guidelines and giving advice to those who intend to incorporate an LLP in Malaysia. Starting from incorporating of LLP, through to its dissolution, either by ways of voluntary winding-up or striking-off by the Registrar, all the necessary documents concerning the LLP must be lodged to their responsible officers. Furthermore, in event of default by the LLP, the third party may make complaint to the commission for investigation, and record an official report with the Police.
- (b) The Inland Revenue Board of Malaysia and their responsibilities towards an LLP: Based on the official budget speech in 2013 as announced by the then Malaysian Prime Minister Dato' Seri Mohammad Najib Tun Abdul Razak (Abdul Razak, 2013), LLP is treated as a business entity which liable for taxation. By referring to the Income Tax Act (1967), the LLPA (2012) manages to extend the definition of "person", to include an LLP. Similar to a company, there is no specific definition for an LLP in Section 2 of the Income Tax Act (1967). However, instead the LLP is deemed to be treated as a company in terms of (i) determination of its tax residence status; (ii) ability to carry forward losses of unabsorbed business; (iii) ability to carry forward allowances of unabsorbed capital; (iv) basis period of LLP's business; and (v) the duties to lodge a tax return within seven months from



the closing date of the accounting period. Like with a company, an exemption of taxes is given to LLPs in payment of dividend and profits distributions for partners of an LLP. Based on Public Ruling No.3/2014, tax rate income is chargeable for LLPs in the year of assessment, at the rate provided in Part 1 of Schedule 1 of the Income Tax Act (1967). With this in mind, for the main reference for taxation of LLPs, one must be referred to the Inland Revenue Board of Malaysia and not the Companies Commission of Malaysia. The Inland Revenue Board of Malaysia, who is responsible for giving guidelines and providing necessary advice to those who intend to operate an LLP. Failure to pay the necessary taxes will make the LLP solely liable under the Income Tax Act (1967).

## **CONCLUSION AND FUTURE RESEARCH RECOMMENDATIONS**

LLP is one form of business entity in Malaysia, which was officially introduced through the enforcement of the LLPA (2012). LLPs enjoy the best features from both private companies and conventional partnerships. Due to the discussed similarities of these best features, the general application of principles from both company law and partnership law is applicable for LLPs, when finding resolutions in emerging legal issues before the courts (if any). The main reference for LLPs is the LLPA (2012), where the relevant provisions are accordingly provided. However, the Income Tax Act (1967) should be referred to in determining the tax for LLPs. The most important authorities for LLPs are the Companies Commission of Malaysia, and the Inland Revenue Board of Malaysia, in relation to start, maintain, and dissolve the LLP. In a breach of an LLP agreement between its partners, general principles of contract law and partnership law should be referred to. Based on the best features of LLPs, an LLP is a lucrative choice for a business entity structure.

Future research should investigate the integral structure of LLPs as they can be recognised as a body corporate, but still maintain the flexibility of an LLP agreement between partners. Moreover, the taxation position for LLPs as stipulated under the Income Tax Act (1967) is an interesting topic to be explored. Proper exposure to the advantages of LLPs can be used to attract investors, traders, and business interests, either locally or globally, while enriching the business environment of Malaysia.

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