CONVERSION OF PARTNERSHIP TO LIMITED LIABILITY COMPANY

A partnership business may be converted to a company in order to position a firm for particular benefits. Some of this advantages that a company has over a partnership business include:

i. Legal Personality – A company is a legal entity, unlike a partnership business. A company can acquire and sell property in its own name. It can sue and be sued in its own name.
ii. Perpetual Succession – The death of a member (owner) in a company does not affect the continual legal existence of the company. That is not the case when a partner dies in a partnership business. The long-term existence of a company is more assured than that of a partnership.
iii. Access to funds – While a company can go to the capital market to raise funds (equity and debentures), a partnership cannot do so. Furthermore, it is easier for a company to access loans from banks than partnership businesses; as a result of the fact that the company has assets in its own name which can be pledged as collateral.
iv. Limited Liabilities of Members – The liability of members (owners) of a company is limited only to the amount, if any, remaining unpaid on shares allotted to them. However, Partners in a partnership do not have such protection.

Purchase Consideration

Like in the case of Amalgamation, it is to be assumed that the new Company formed is taking over the partnership business that is to be converted. The purchase consideration when a partnership business is being converted to a company may include any/any combination of the following:

i. Cash;
ii. Shares of the Company; and
iii. Debentures of the Company

Closing the books of the partnership (Steps involved):

i. Close current accounts and reserves to Capital Account;
ii. Assets: close all assets to realisation account, except cash and bank;
iii. Assets not taken over by new company will either be sold or taken over by partners;
iv. Liabilities: close all liabilities to be taken over to the realisation account
v. Liabilities not taken over by new company may be paid off or taken over by partners.
vi. Realisation/Dissolution Costs: if borne by the firm being converted, it should be debited to the realisation account; otherwise ignore.
vii. If balance of cash/bank is to be taken over by the New Company, transfer the balance to Realisation account; otherwise it should be paid to partners as agreed.
viii. Ascertain the purchase consideration; debit the amount to the New Company account and Credit Realisation account.
ix. Profit or Loss on realisation should be ascertained and written off to the capital account in the profit sharing ratio.

x. When purchase consideration is received, cash account, shares in new company account, and debentures in new company account are respectively debited, while new company account is credited.

xi. The shares and debentures received from the company are allotted to the partners in the specified ratio, or in the absence of a ratio, in the ratio of the balances on the partners' capital accounts immediately after the entry for the profit or loss on realisation.

xii. Close off the capital accounts to the bank/cash account (with payments to/withdrawal by partners).