Limited Liability Partnership in China - A Long Way Forward

Lin Lin, National University of Singapore

Available at: https://works.bepress.com/lin-lin/8/
The Limited Liability Partnership in China: A Long Way Ahead

Lin Lin¹

(2010) 7 International Company and Commercial Law Review 259

Keyword: China, Special General Partnership, Limited Liability Partnership

Abstract: Describes the introduction of the Special General Partnership in China. Introduces the basic features of the Special General Partnership. Discusses the problems which have not been addressed or addressed well by the Partnership Enterprise Law 2007. Suggests amendments for future legislations on the Special General Partnership.

Introduction

In August 2007, a new business vehicle, the Special General Partnership (“SGP”, in Chinese: 特殊普通合伙, pinyin: Teshu Putong Hehuo),² was adopted under the revised Partnership Enterprise Law of the People’s Republic of China (“the PEL”). The SGP resembles an overseas Limited Liability Partnership (“LLP”, 有限责任合伙, pinyin: Youxian Zeren Hehuo) in that it shields co-partners from liabilities due to the misconduct or negligence of other partners. The introduction of the SGP increases the options available for professional practitioners in China. Before the revision of this particular statute, the general partnership was the only partnership vehicle allowed under Chinese law.³

On 1 March 2010, the Administrative Measures for Foreign Enterprises and Individuals to Establish Partnerships in China came into effect. The Measures for the first time allows foreign investors to establish various

¹ A previous draft of this paper has been presented in the 5th International Conference on Law 2008 at Athens, Greece.
² The drafter of the PEL clarified in the press briefing of the PEL that the special general partnership under the PEL can be translated into “the limited liability partnership” in English. See “Partnership Enterprise Law Specified the Liability of Partners in Professional Firms”, Xinhua Net (27 August 2006) online: <http://news.xinhuanet.com/legal/2006-08/27/content_5012933.htm>.
partnership forms, including the General Partnership, the Limited Partnership and the SGP) in China. Previously, the business vehicles available for foreign investors included wholly foreign-owned enterprises, equity joint ventures and cooperative joint ventures only.

The article highlights key elements of China’s introduction of the SGP and examines the uncertainties over the protection shield of partners. It explains the safeguards for creditors concerning financial reporting obligations and professional insurances. It concludes that the fact that the SGP does not grant full protection shield to partners may undermine the advantage of the SGP. It suggests that more rules must be provided to balance the interests of the partners and the creditors so as to facilitate the development of Chinese professional services market.

Background

The LLP was created by the US legislation in the early 1990s to response to the rising trend of malpractice claims against law and accountancy firms.4 The most significant feature of the LLP is that all partners in the LLP have a form of limited liability. One LLP partner is not liable for another partner's misconduct or negligence.5 With the combination of limited liability, management flexibility and tax transparent treatment, the LLP has been regarded as the preferred business vehicle for professional services firms.6 Many jurisdictions have adopted the LLP in the recent years, such as the UK, Singapore, India and Japan.7

The introduction of the SGP in China is in line with the international trend. The major purpose for introducing the SGP is to meet the needs of the local professional services firms in China, which feel the pressure of severe

---


5 It is noteworthy that the liability shield of LLP partners varies from jurisdiction to jurisdiction.

6 For example, the four largest international accountancy and professional services firms, the “Big four” are organized as LLPs.

7 The UK Limited Liability Partnership Act was enacted in 2000. Singapore Limited Liability Partnership Act was enacted in 2005. The Limited Liability Partnership Act 2008 has come into effect in India since 31 March 2009. The LLP was introduced in Japan in 2006.
competitions with overseas LLP firms and the increasing intentional tort litigations against the partners.⁸

On the one hand, the inadequate menu of business vehicles for the professional community and the harsh tax system has become a major barrier in the development of the professional services firms in China. Before the enactment of the PEL and the revised PRC Lawyer Law 2008,⁹ the available organizational choices for law firms were the general partnership, the stated-owned firm and the cooperation firm. As for accountancy firms, they could only organized as the general partnership or the limited liability company. Statistics show that currently the general partnership and the limited liability company are the major business forms for Chinese law firms and accounting firms respectively.¹⁰ However, due to the weak liability protection of the general partnership and the double taxation burden of the limited liability company, neither of these business forms are the idea choice for the professional services firms.¹¹ It is hoped that the introduction of the SGP, with tax transparent treatment and limited liability shield to partners, may facilitate the expansion of domestic professional services firms in China. On the other hand, making the SGP available to foreigners is a part of China’s series WTO commitments to develop and open the professional service sector.

**Characteristics of the SGP**

**Partnership Nature**

The SGP is essentially a special form of the general partnership. It is regulated in a section entitled “Special General Partnership Enterprises” with five provisions in the PEL. Where this section does not provide, the provisions

---


⁹ The PRC Lawyer Law was enacted on 1 June 2008.


¹¹ Under the PEL, partners of the general partnership have to bear unlimited joint and several liability for the debts of the firm. Under the PRC Enterprise Income Tax Law, the limited liability company is subject to double taxation treatment.
on the general partnership and its partner shall apply.\textsuperscript{12}

Unlike the Delaware and the UK which deems an LLP as an entity with separate personality distinct from its partners,\textsuperscript{13} the PEL is silent on whether the SGP has a separate legal personality. The nature of the SGP is the same as that of the general partnership under Chinese partnership law. However, the SGP appears to possess certain attributes that are consistent with the entity approach - may have its own assets,\textsuperscript{14} the partners are not allowed to sever the partnership assets before the dissolution of partnership,\textsuperscript{15} and the SGP has the ability to sue or be sued in its own name.\textsuperscript{16}

In stark contrast to the common law jurisdictions where the concept of fiduciary is the prime regulator of partner’s relations \textit{inter se}, there is no equivalent concept of fiduciary duty under the Chinese partnership law. The mutual rights, duties and other internal relationships between partners are left largely to partners through their partnership agreements.\textsuperscript{17}

\textbf{Formation and Business Scope}

The PEL provides that the SGP should comprise at least two partners.\textsuperscript{18} A SGP is deemed to be constituted from the date of issue of the partnership enterprise business licence.\textsuperscript{19}

Unlike Delaware and the UK in which the LLP is available to all types of business, the PEL provides that the formation of the SGP is restricted to “professional service providers who provides clients with paid services on the

\begin{footnotesize}
\textsuperscript{12} PRC Partnership Enterprise Law 2007, Art.55.
\textsuperscript{13} See the UK Limited Liability Partnership Act, s 1 (2); Delaware Revised Uniform Partnership Act, § 15 -201(a). The UK LLP is deemed as a corporate body.
\textsuperscript{14} PRC Partnership Enterprise Law 2007, Art. 20.
\textsuperscript{15} PRC Partnership Enterprise Law 2007, Art. 21.
\textsuperscript{16} Art. 49 of PRC Civil Procedural Law reads with Art. 40 of Opinion on Several Issues of Applying the PRC Civil Procedure Law.
\textsuperscript{17} For the duties of partners, the PEL outlines the following broad rules only: (a) the managing general partner should regularly report to the other partners on the process of partnership activities, the business and financial status of the partnership; (b) the general partners should not carry on any business competing with that of the partnership; (c) the partners should not engage in activities which may harm the interests of the partnership. See Lin Lin & HY Yeo, “Limited partnership: new business vehicle in People's Republic” (2010) 25(2) B.J.I.B. & F.L.104 at 107.
\textsuperscript{19} PRC Partnership Enterprise Law 2007, Art. 11.
\end{footnotesize}
basis of professional knowledge and special skills". Nevertheless, as the definition of “professional” was unclear, the availability of the SPG to specific professional partnerships is left for other regulations to specify.

Recently, several legislations and policies have been promulgated to encourage the use of the SGP in China, including the PRC Lawyer Law 2008 and the Temporary Measure for Promoting Large and Medium-sized Accounting Firm to Adopt the Special General Partnership (draft) 2010. In particular, under the Administrative Measures for Law Firms 2008 to establish a domestic law firm as a SGP, the following conditions shall be satisfied: (1) having a written partnership agreement; (2) having at least 20 partners as founders; (3) the founders being lawyers with at least three years of practice experience and who practise full time; and (4) having assets of at least RMB10 million. It is argued that the ceiling of the threshold is a bit high for a start-up law firm as it is difficult for a small sized firm to have at a minimum RMB 10 million in assets and at least 20 partners.

As to the formation of foreign SGPs, other than having to satisfy the general conditions stipulated in the PEL, it is subject to the industry restrictions specified under the Catalogue for Guiding Foreign Investment in Industries (the “Foreign Investment Catalogue“). Foreigners are not permitted to establish partnerships and invest in industries which are categorized under Foreign Investment Catalogue as “prohibited”. Currently, there are still bans prohibiting the establishment of foreign law firms and accounting firms in China.

Contributions

A partner of the SGP may offer contributions in the form of cash, tangible goods, intellectual property, land use rights, other property rights and

---

20 PRC Partnership Enterprise Law 2007, Art. 55. It is noted that some states in the US, such as New York, California, Nevada and Oregon only permit professional firms to establish as LLPs.
21 The draft Measures is available at the home page of the Accounting Standard Committee of the Ministry of Finance of the People’s Republic of China, online: <http://www.casc.gov.cn/gnxw/201001/t20100128_1143497.htm>. It is noted that the revision on the PRC Accounting Law is undergoing in China.
22 Administrative Measures for Law Firms 2008 , Art. 5.
service. The PEL does not provide a minimum capital requirement for establishing a SGP.

The PEL provides that a partner is obliged to make contribution as per the partnership agreement. A failure to do so shall constitute a breach of partnership agreement on the part of the defaulting partner. He has then to make up for the contribution. However, the SGP also allows a partner to contract for the additional flexibility of increasing, reducing or varying contribution to the partnership with the unanimous agreement of all partners. To keep the public informed, such a change to his contribution amount requires consequential amendment to the register.

**Transfer of Partner’s Shares**

The partners of the SGP are allowed to transfer their partnership shares to outsiders (subject to different requirements). A partner must obtain the consent of all the partners before the transfer (unless otherwise provided by the partnership). A notable feature of the PEL regarding transfer of partner’s shares is that an assignee will become a partner and be subject to the rights and obligations according to the amended agreement and the PEL. In stark contrast, the assignee’s position is quite weak under the US law. A transfer in whole or in part of a partner’s transferable interest in the partnership does not entitle the transferee to participate in the management of the partnership business.

It is submitted that Chin should adopt the US position to facilitate greater certainty of the partnership and protection for the creditor. A change in partner will have adverse effects on the liability of creditors who rely on the personal liability of the partner to pay the debts of the firm. In addition, any change of the identity of the general partner is likely to result in to serious consequence.

---

24 PRC Partnership Enterprise Law 2007, Art.16.
26 PRC Partnership Enterprise Law 2007, Art. 34.
27 PRC Regulations on Administration of Registration of Partnership Enterprises Art. 18 (2007).
29 PRC Partnership Enterprise Law 2007, Art. 24; See also Li Fei, *Interpretation of the PRC Partnership Enterprise Law* (Law Press China, 2006) at 37.
30 The Uniform Partnership Act, §503.
for the existing partnership.

**Protection Shield of Partners**

Article 57 of the PEL is the key liability provisions of the SGP. It provides that “if one or more partners commit intentional or grossly negligent act in the ordinary course of the partnership business that results in liability on the part of the partnership, those errant partners shall bear unlimited joint and several liability, while the other partners will bear limited liability to the extent of their shares in the partnership. All partners shall bear unlimited joint and several liability for the debts incurred arising out of non-intentional or non-negligent acts of a partner when he acts in the ordinary course of the partnership business.”

Compared to the Delaware LLP which grants full shield protection to its LLP partners, partners in a SGP have a partial shield only. On the one hand, all partners of the SGP still generally assume unlimited joint and several liabilities for the debts of the partnership according to general principles of law. Only “innocent” partners would not assume unlimited liabilities on a joint and several bases for liabilities incurred to the partnership due to the

---

31 Delaware Revised Uniform Partnership Act, § 15-306 (c). It provides that “an obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract or tort or otherwise, is solely the obligation of the partnership. A person is not personally liable, directly or indirectly, by way of indemnification, contribution, assessment or otherwise, for such an obligation solely by reason of being or acting as a partner.”

32 In the US, there are basically two liability shields provided by the LLP statutes in the US. One is a partial shield of liability, which does not limit liability for contract action or other commercial dealings. It shields “innocent” partners from liability created by “errors, omissions, negligence, incompetence, or malpractice committed by other partners or by employees supervised by other partners.” The other is a more complete, full shield of liability, which covers ordinary contractual debts of the partnership. It gives limited liability partners the same protections granted to limited liability companies. Most US states have adopted the full shield version of the LLP statutes.

33 As a general rule under the PEL, a judgment creditor of a partnership in debt may levy execution against the assets of the partnership first. If the partnership asset is insufficient to satisfy the judgment, the partners are jointly and severally liable up to the full amount of the relevant debts. This applies both to contractual or tortious debts. If the partnership asset is sufficient to satisfy the judgment, the partners do not have to bear any personal liability to the debts. Nevertheless, the PRC legislature is of the view that the existing default rule is unfair to the innocent partner in the Special General Partnership when the debts is caused by another partner’s misconduct or gross negligence. Considering that it is pertinent to let the errant party to shoulder the burden of damages, Article 58 of the PEL thus provides: “For the debts arising out of a partner’s intentional or grossly negligent act, if the partnership’s assets are sufficient to pay the debts of the firm, the errant partner has to compensate the partnership according to the partnership agreement.”
intentional or grossly negligent act of any other errant partner(s).

On the other hand, unlike the Delaware LLP that generally shields partners from contractual and tortious obligations incurred in the course of the partnership business, the SGP protects innocent partner from tortious liability that arose from intentional or grossly negligent act of another partner in the course of the partnership business only.

The lack of a full protection shield in the SGP may fall short of professionals’ expectations and undermine the advantage of the SGP. In addition, such a radical and stringent provision contains several uncertainties which may increase difficulties for the users of the SGP in practise.

First, pursuant to Article 57 of the PEL, an innocent partner in a SGP will not be personally liable for the intentional or grossly negligent act of other partners in the firm. However, the PEL does not define the terms “intentional” and “gross”. Without clarification by the statute and a comprehensive case law system in China, partners would be more vulnerable to unlimited liability. It is thus submitted that a precise meaning of “gross” and “intentional” shall be developed by Chinese courts with consideration for the current and future stage of China’s professional services market, and by making reference to the overseas jurisprudence.

Second, Article 57 provides that if the debts of the partnership are caused by other partner’s intentional or grossly negligent act, the innocent partner’s liability will be limited to the extent of his “partnership shares” in the firm. Nevertheless, it is difficult to quantify a partner’s shares in professional services firms which generally do not have many tangible assets and which do not specify each partner’s shares in their partnership agreements. It is suggested that China shall follow the international practise which grants innocent partner a liability shield to the extent of his capital contribution for the acts of another partner carried out in the course of business.

Indeed, many Chinese law firms do not specify partners’ shares in their partnership agreements. The observation comes from the author’s interviews with several Chinese lawyers in several leading Chinese law firms in August 2008 and August 2009. Interviewees include Mr. Liu, partners of Guangzhou Fa Zhi Sheng Bang Law Firm and Mr. Feng, associate of Chongqin Zhong Hao Law Firm. (File kept with the author).
of the LLP.

Third, who shall bear the burden of proof remains unclear. According to the ordinary rule under the PRC Civil procedural law—“the necessity of proof lies with he who complains”, we may assume that the burden of proof is on the third party. Unless the third party can prove that the errant partner they believe injured them acted with at least negligence to cause their injury, the PEL will not compensate them. 35 Considering that the partner is generally in a better position than the third party to produce the evidence, it is suggested that the burden of proof should be on the errant partner. 36

Fourth, the PEL does not address a situation where the partners have knowledge or notice of another’s misconduct but failed to take reasonable steps to prevent or cure the malfeasance. It is regrettable that the PEL has not taken its original version which provides: “partners have to bear unlimited joint and several liability for the debts incurred arising out of his acts or supervision in the ordinary course of the partnership business.” 37

One might argue that imposing supervisory liability may be a disincentive for partners in a firm’s management and supervisory activities since they may try to avoid providing direct monitor or supervision to their co-partners. 38 However, such assumption might not be significance in the context of China. Given that no fiduciary duty is owned by the partner to the partnership or other partners, it is pertinent for the PEL to impose direct supervisory responsibility to the partner who is in control of the partnership business. It is thus submitted that any intentional act or gross negligence in monitoring or supervising others shall constitute “intentional or gross misconduct in the ordinary course of partnership business” for the purpose of Article 57 of the PEL.

36 Ibid.
37 Draft PEL, Art. 2 (4). Nevertheless, Art. 43 of the Code of Conducts for Lawyers (for Trial Implementation) provides that a lawyer shall take measures to prevent or give remedy to the mistakes made by the auxiliary personnel who handle affairs by his/her assignment. Otherwise the lawyer shall bear liabilities.
38 Broomberg and Ribstein, supra note 4 at 127.
In view of the above, it is suggested that Article 57 of the PEL shall be revised and a wider protection shield should be granted to the SGP partners. One possibility is to consider Delaware’s approach which specifies that a partner of a SGP should not by reason only of being a partner of the SGP be held personally liable for the conduct of other partners or the transactions or liabilities of the LLP, whether arising in contract, tort or otherwise.

**Safeguards**

The PEL seek to deal with creditor protection by providing different safeguards in the SGP regime, including the preservation of partnership assets and sufficient disclosure requirements. Nevertheless, it is argued that these safeguards may not be effective in reducing creditor’s risk.

**(a) Disclosure of Limited Liability Status**

In China, the words “Special General Partnership” must be incorporated into the name of every SGP firm.\(^\text{39}\) It is regrettable that Chinese legislature had not been persuaded by the original proposal suggesting the name of the new business vehicle as “LLP”. The reason why the legislature finally chooses the name LLP is the concern that since both the Limited Partnership and the SGP are newly adopted business vehicles in China, one may get confused between these two terms.\(^\text{40}\)

It is argued that unlike the term “Limited Liability Partnership” which makes it clear that the partner’s liability is “limited”, the term “Special General Partnership”, either in English or Chinese, fails to indicate the limited liability protection of the partners. For Chinese business community who are not familiar with this new concept, it would be more difficult for them to tell the difference among the general partnerships, the limited partnership and the SGP. In line with the international practise, it is recommended that the term “Special General Partners” shall be replaced by the “Limited Liability Partnership”. It is also suggested that the words “Limited Liability Partnership” or the

\(^{39}\) PRC Partnership Enterprise Law 2007, Art. 56.

\(^{40}\) Li Fei, *supra* note 29 at 89.
abbreviation “LLP” shall be included in the business names and letterheads of the LLP firms in China.

(b) Professional Insurance

To protect the third party who deals with the SGP and the professional practitioners, the PEL resembles many US and Jersey statutes,\(^{41}\) in that it also requires the SGP to carry on a professional liability insurance.\(^{42}\) However, this requirement may not be effective in addressing the concerns of creditors in the context of China.

First, unlike the US-California\(^{43}\) and Jersey\(^{44}\) which provide a minimum capital requirement in the insurance, the PEL does not impose minimum capital requirement and duration requirement on the insurance. The lack of such requirements may potentially render creditors helpless to receive insurance payouts when negligence occurs due to insufficient funds to maintain the insurance premiums.

Second, the PEL shields an innocent partner against the debts incurred by errant partners’ intentional or grossly negligent act, while the existing Chinese liability policies typically cover only “the negligence in the ordinary course of the business” of the insured. Hence, the insurance of a SGP partner only covers those liability incurred due to the “negligence” but not the “intentional acts”. In particular, pursuant to the PRC People’s Insurance Company (“PICC”) Insurance Provisions on Certified Public Accountant, the accountancy professional liability insurance policies only cover the negligence or omission of the insured.\(^{45}\) It is submitted that the narrow scope of liability

---

\(^{41}\) Jersey Limited Liability Partnership Act 1997, s 6; Several US states, such as Texas, California, Connecticut, Massachusetts, New Mexico, Oklahoma, Rhode Island, South Carolina, Washington have such requirement.


\(^{43}\) California Corporation Code, §16952 requires for LLPs a minimum insurance amount of US$100,000; the total aggregate limit of liability under the policies of insurance for partnerships with fewer than five licensed persons shall not be less than US$500,000.

\(^{44}\) Section 6 of Jersey Act requires an LLP to make financial provision for a sum of £ 5 million to be paid by a bank/insurance company to creditors of the LLP upon the dissolution of the LLP. See Singapore Law Reform and Revision Division, Limited Liability Partnerships Consultation Paper, LRRD No.3/2002.

insurance inevitably renders of the compulsory insurance less effective. It is suggested that a wider insurance cover and a more detailed conditions and terms should be provided to the SGP.

(c) Occupational Risk Fund

Besides the professional insurance, the PEL requires the SGP to allocate a portion of their revenue to setting up an “occupational risk fund” (职业风险基金, “Zhiye Fengxian Jijin”) to offset their operational debt.\(^\text{46}\) The SGP is also required to open a separate bank account to administer the fund.\(^\text{47}\) However, the detailed rules governing the occupational risk fund, such as the establishment, management, taxation and supervision of the occupational risk fund are uncertain.\(^\text{48}\) Moreover, when there are debts to the partnership caused by partners in the ordinary course of the partnership business, shall the debts be paid with the professional insurance or the occupational risk fund? Furthermore, as accounting firms are generally not permitted to raise risk funds should there be no profits after tax for the year, there exists difficulty for these firms to raise funds in practise. Detailed implementing measures should be promulgated to provide clarification to all these issues.

(d) Financial Reporting

In the UK where the LLP is created as a body corporate, it seems necessary for the LLP to file audited accounts.\(^\text{49}\) On the contrary, Delaware does not impose any financial disclosure requirement or audit requirement to the LLP. Only an annual report, containing information relating to non-financial items such as the names, address and number of partners in the LLP is required.\(^\text{50}\)

In China, maintaining accounting records and filing audit report is not a


\(^{47}\) Ibid.

\(^{48}\) Nevertheless, there are some regulations specifying the arrangement of the occupational risk funds in specific occupations. These regulations include the Measures for the Administration of Occupational Risk Funds of Accounting Firms 2007 and the Measures for the Administration of Occupational Risk Funds of Asset Evaluation Institutions 2009.

\(^{49}\) UK Limited Liability Partnerships Regulations 2001, Part II stipules that the accounting and auditing provisions of the Companies Act 1985 should for the most part be applied by LLPs.

\(^{50}\) Delaware Revised Uniform Partnership Act, §15-105.
compulsory requirement for the SGP, but proper maintenance of accounting records is a must under national and local accounting regulations.\(^{51}\) It is submitted that requesting the SGP to fully disclose its financial affairs is too onerous. It would increase the costs of doing business under a SGP structure and would inevitably deter some professional services firms from structuring themselves as SGPs. Considering that the SGP is targeting at professional services firms but not all enterprises, and the conduct of several professional practitioners, such as lawyers and accountants is already regulated by relevant government authorities with specific occupational risk funds requirements,\(^{52}\) a lower reporting standard should be imposed on the SGP. This is also in line with the nation’s view of creating a business-friendly environment for professional firms.

(e) Capital Withdrawal

The UK, Jersey, US-Delaware and Singapore LLPs all have a special “claw-back” provision which provides that if a partner receives an amount he invested in the LLP knowing that the assets of the LLP may be unable to pay its debts, he is then liable to repay the withdrawals made within a specific period.\(^{53}\)

In stark contrast to the jurisdictions highlighted above, the PEL is silent on the question of what happens in the event of capital withdrawal by a partner. The PEL only provides that partners are not allowed to transfer or sever the

---

\(^{51}\) These regulations include the Enterprise Accounting Measures 2001 and the Accounting Measures on Accounting Firms, Asset Valuation Firms and Tax Agent Firms 2001.

\(^{52}\) These regulations include the Administration Measures of Law Firms 2008 and the Measures for the Administration of Occupational Risk Funds of Accounting Firms 2007.

\(^{53}\) It is noted that the “specific period” varies from jurisdictions. In the UK, the partner who knew or had “reasonable grounds” at the time of withdrawal for believing that the LLP was unable to repay its debtors or would become unable to repay its debts after the withdrawal, has to repay the withdrawal made within two years prior to the commencement of the firm’s winding up. (UK Insolvency Act 1986, s.214A) In the Delaware, partners are liable to make a contribution for a distribution if they knew at the time of the receipt that the net asset value of the LLP would exceed liability and if less than three years have passed since the date of distribution. (Delaware Revised Uniform Partnership Act, §15-309) In Jersey, the knowing partner will also be punished similarly if he or she withdraws property during a period of six months before the LLP becomes unable to pay its debts. (Jersey LLP Law, s.5(3)) In Singapore, the time limit seems longer that the other jurisdictions. It is within a period of three years prior to the commencement of the winding up of the LLP. (Singapore Limited Liability Partnership Act, Fifth Schedule, para.84).
partnership assets before the liquidation of the partnership.\textsuperscript{54} This silence is a severe lacuna in the law. Allowing a partner to withdraw his capital contributions freely may disadvantage the judgment creditor of the firm. Under the current SGP regime, judgment creditors of the firm must exhaust partnership assets before proceeding against general partners. Since partners’ contributions normally constitute a substantial part of the partnership’s assets,\textsuperscript{55} it is likely that the partnership’s assets will be insufficient to pay the debts of the firm if partners are allowed to take out their contributions without restrictions.

It is suggested that the PEL should similarly incorporate a claw-back provision to restrict a partner from withdrawing all or part of his agreed capital contribution while he is a partner.

The Conversion from a Company or General Partnership to a SGP

Considering the advantages offered by the SGP (especially the limited liability shield, lower establishment costs and tax incentives), a number of professional services firms may wish to convert to SGPs for the conduct of their professional services activities. However, the PEL does not provide any rules spelling out how an existing company or partnership may convert to a SGP.

Nevertheless, the nation is taking steps to enlist the procedure for the conversion of some existing professional services firms to the SGP. Pursuant to the Temporary Measure for Promoting Large and Medium Sized Accounting Firms to Adopt the Special General Partnership 2010 (draft), an existing accounting firm may convert to a SGP type accounting firm subject to the approval from the provisional financial authority. The supporting documents for approval include the conversion application, the resolution of partners or shareholders, the summary table of partners, photocopies of accountant certificates or other financial qualification certificate of partners and the new

\textsuperscript{54} PRC Partnership Enterprise Law 2007, Art. 21.

\textsuperscript{55} Article 20 of PRC Partnership Enterprise Law 2007 provides that the partnership’s assets include the contribution made by the partners and property acquired in the name of the partnership.
partnership agreement.\textsuperscript{56} Once the application is approved, the converting firm shall register with the relevant registration authority. \textsuperscript{57} Under the Administrative Measures for Law Firms 2008, the conversion of an existing law firm to a SGP type law firm is subject to the examination by the local judicial authority and the approval by the original examination and approval authority.\textsuperscript{58}

As the above regulations only apply to law firms and accounting firms, it is suggested that a conversion option shall be made available for any existing professional services firms, either in forms of general partnerships or limited liability companies. Moreover, the Chinese position is less efficient and flexible as it requires administrative approval and re-registration. One may consider the Delaware’s rules for the conversion process: an existing firm is merely required to file a certificate of conversion to a LLP with the Secretary of State after the proposal for conversion is approved internally by the company or partnership.\textsuperscript{59} It is also suggested that an existing firm shall be able to retain its name and business registration number after conversion to avoid unnecessary administrative cost and inconvenience.

Further, the PEL does not prescribe any rules or procedures which facilitate the transfer by an exiting firm of its business, undertaking, assets and liabilities to the LLP. The Administrative Measures for Law Firms 2008 and the Temporary Measure for Promoting Large and Medium Sized Accounting Firms to Adopt the Special General Partnership 2010 (draft) merely provides that these matters shall be decided by partners internally and be specified in the new partnership agreement.\textsuperscript{60}

For the purpose of protection to the third parties who are dealing with the firm, one may consider Singapore’s approach which allows the properties,
assets, interests, rights and privileges as well as liabilities, obligations and undertakings of the general partnership or private company to be transferred to the SGP.\textsuperscript{61} In addition, to ensure that the creditors of the converting firm should not be prejudiced by the conversion process, the converted SGP shall make a public announcement on the conversion.

**Newly Admitted Partners**

Delaware and English statutes do not require a newly admitted partner to be personally liable for the prior obligations of a partnership.\textsuperscript{62} Interestingly, the PEL adopts a radically different approach by specifying that a partner will assume joint liability with the existing partners for the debts incurred by the partnership before he joins the firm. Correspondingly, a new partner will bear liabilities to the extent of his shares in the partnership even for the partnership’s debts incurred before he joined the firm.\textsuperscript{63}

Logically, the newly-admitted partner ought not to bear any liability for the prior debts of the firm since he was not a partner then and has not been involved in any management of the firm. However, such a radical and stringent PRC approach may perhaps be understandable in light of the following:\textsuperscript{64}

- First, Article 44 of the PEL provides that new partner assumes same rights and obligations as the existing partners. Accordingly, new partners shall bear unlimited liability for the debts of the firm.

- Second, Article 43 of the PEL provides that existing partners shall report to the incoming partner on the financial and business status of the partnership at the time of concluding the agreement. Therefore, the incoming partner is fully cognizant of the firm’s financial situation and agreeable to the existing risks associated with his investment before he decides to joint the firm.

- Third, the partner’s contribution, together with the interest and property

\textsuperscript{61} Singapore Limited Liability Partnership Act 2005, Pt IV.
\textsuperscript{62} UK Partnership Act 1890, s 17 (1); Delaware Revised Uniform Partnership Act, §15-306 (b).
\textsuperscript{63} See Comments on § 306 of the Uniform Partnership Act.
\textsuperscript{64} PRC Partnership Enterprise Law 2007, Art. 44 and 77.
\textsuperscript{64} See further discussion in Li Fei, supra note 29 at 69 and 125.
acquired by a partnership constitute partnership assets.\textsuperscript{65} Under the PEL, the debts of the firm must be paid by the partnership assets first. If the new partner does not have to bear liability for the prior debts of the firm, presumably his contribution will not be exposed to the claims of the firm. This will throw up immense logistical difficulties as it would be impractical and difficult to sever the new admitted partner’s contribution from the existing partnership assets.

The above provisions on prior debt obligations are compulsory and cannot be excluded by the parties. Hence, when a creditor of a partnership exhausts remedies against the firm, he can pursue the assets of the new partner. Should he receive payment in full from the new partner, the latter can then pursue the other remaining partners for a contribution of their share of the liability (as per partnership agreement).\textsuperscript{66} Such an approach may be a great disincentive for any new partner to join the firms since his capital will be exposed to grave risk of claims of prior creditors. It is likely to severely undermine the attractiveness of the SGP.

It is thus submitted that the PEL should adopt the Delaware position and require a newly admitted partner to be personally liable for the prior obligations of a partnership. This approach would greatly boost the popularity of the SGP as a business vehicle amongst businessmen.

**Tax treatment**

In consistent with international practice, Article 6 of the PEL provides that the partnership itself will not be subject to taxation but the partners themselves will have to be taxed on the profits generated by the firm in accordance with their individual tax rates.\textsuperscript{67} The Ministry of Finance and the State Administration of Taxation jointly issued a circular in December 2008 (Caishui [2008] No.159) to reconfirm the flow-through tax treatment in that individual and enterprise partners are subject to individual income tax and enterprise income tax respectively on income allocable from the partnership in

\textsuperscript{65} PRC Partnership Enterprise Law 2007, Art. 20.  
\textsuperscript{66} PRC Partnership Enterprise Law 2007, Art. 33 read with Art. 44.  
\textsuperscript{67} PRC Individual Income Tax Law 2005, Art. 3(2); reads with Regulation on Income Tax on Sole Proprietorship and Partnership Enterprises2000, Art. 4. The income tax to be paid by an individual partner is based on a progressive rate ranging from 5\% to 35\%. 
which they are partners. Nevertheless, there remains uncertainty as the tax treatment on SGP s as there is no specific regulation on taxation on foreign SGP s.

**Dissolution and Bankruptcy**

The grounds for dissolution under the PEL are very similar to that under the Delaware Act, for example, expiration of partnership terms and revocation of partnership business license.\(^{68}\) A notable area under the PEL is that the death of a partner will not dissolve the SGP. The law specifically provides that, if a partner who is an individual dies or is judicially declared deceased, from the date of successor, the partner's successor may succeed to the status of the partner according to the partnership agreement or the unanimous consent of partners.\(^{69}\) The NPC was of the opinion that such an approach would provide continuity and certainty to the SGP.

Additionally, it is noted that the PEL gives creditors of SGP s two options when the partnership is unable to meet its obligations when due. They can either to apply to the people’s court for bankruptcy liquidation, or to claim directly against the general partners.\(^{70}\)

**Conclusion**

There is no doubt that the introduction of the SGP is a milestone in the development of the partnership law and professional services market in China. After the promulgation of the PEL, a number of professional services firms were established as SGP s in China, reflecting a receptive attitude in the Chinese professional community towards this new business vehicle.

Nevertheless, the SGP regime is a very Chinese version in that it does not provide a safe haven for professional practitioners as expected. It appears that China prefers to introduce the overseas LLP regime gradually, but it is doubted that the very limited provisions governing the SGP would be sufficient to address the pressing needs of Chinese professional practitioners. It is hoped that the authorities will issue additional guidance that clarifies the outstanding

---

\(^{68}\) PRC Partnership Enterprise Law 2007, Art. 85.

\(^{69}\) PRC Partnership Enterprise Law 2007, Art. 50.

issues so as to make the SGP a more viable and well-recognized business vehicle in China.