


Income Tax implications on conversion of a Company into LLP

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The onset of Companies Act 2013 has ushered a paradigm shift in operation and management of companies. The benefits which, hitherto were available to Private Companies in the erstwhile Companies Act, have to a large extent receded. While some call it an era of greater transparency, others (particularly small corporates) feel that the new law has hampered them from operating as a body corporate. As a substitute, people have started favouring LLPs as a medium for carrying on the businesses.

With much lower compliance burden and almost very little restrictions, coupled with status of a body corporate, LLP has become the new hot selling cake in the business world. The LLP Act contains enabling provisions pursuant to which a private company or unlisted public company (incorporated under Companies Act) would be able to convert themselves into LLPs. Provisions of clause 58 and Schedule II to Schedule IV to the Act provide procedure in this regard. (More details can be found at http://www.mca.gov.in/LLP/faq_conversion.html)

Income Tax treatment of a company converted into LLP is more or less tax neutral provided conditions specified in Section 47(xiii b) are satisfied.

Section 47(xiii b)

Following shall not be regarded as a "transfer", therefore, no capital shall arise on the following :

1. Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a limited liability partnership
2. Any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act, 2008

Conditions for claiming exemption

Exemption shall be available only if the conversion satisfies all the below mentioned six conditions.

1. All the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership.
2. (a) All the shareholders of the company immediately before the conversion become the partners of the limited liability partnership

(b) Their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion.

3. The shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership.

4. The aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion.

5. The total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees.

6. No amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

Section 47A : Withdrawal of exemption in certain cases

Where any of the conditions specified above are not complied with, exemption from capital gains shall not be available. The conditions should be satisfied at the time of conversion.

Additionally, condition 4 and 6 should be satisfied for respective period specified therein. Where benefit is taken under section 47(xiiib) at the time of conversion, and subsequently there is non-compliance of requirement 4 or 6, benefit availed shall be charged to tax in the manner specified below :-

1. Capital Gains exempted of the predecessor company will become income of LLP by way of capital gain in the year in which non-compliance takes place, and
2. Capital Gains exempted of the shareholder of the predecessor company on transfer of shares at the time of conversion shall become income by way of capital gain in the year in which non-compliance takes place

Other relevant points

1. Cost of acquisition & improvement

As per section 49(1)(e)

Cost of acquisition of the asset : Shall be deemed to be the cost of acquisition of predecessor company

Cost of Improvement : Any cost incurred on improvement of the assets by predecessor company and LLP shall be the cost of improvement.

2. Period of holding of asset

As per Section 2(42A)(b), for the purpose of determining period of holding of capital asset for determining nature of capital gain, period for which the asset was held by predecessor company shall be included.

3. Set-Off and Carry-Forward of losses

As per section 72A (6A), accumulated loss under head business/profession (Except speculative loss) and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor LLP of the year in which conversion takes place.

However, if any of the aforementioned six conditions are not complied with, the set off of loss or allowance of depreciation made in any previous year by LLP, shall be deemed to be the income of the LLP chargeable to tax in the year in which such conditions are not complied with.

4. MAT Credit

MAT credit in the hands of the predecessor company shall not be allowed to the successor LLP

5. Deprecation apportionment of the year of conversion between the Company and LLP

As per 5th proviso to section 32(1), depreciation of the year in which conversion took place, shall be apportioned between the predecessor company and succeeding LLP in the ratio of number of days for which assets were used by them.

(For any feedback, comment or suggestion author may be reached at parasdawar@gmail.com)

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