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Tax Flash News

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Conversion of company into LLP is a taxable transfer unless prescribed conditions are satisfied

Executive summary

In the case of *ISC Specialty Chemicals LLP*[1], the Mumbai Bench of Income-tax Appellate Tribunal (Tribunal) held that the conversion of a private company into a Limited Liability Partnership (LLP) qualifies as a 'transfer' under the Income-tax Act, 1961 (the Act) if the prescribed conditions are not satisfied.

However, as the transaction took place at book value and the difference between the transfer value and the cost of acquisition was *nil*, no capital gains arose to the taxpayer as a result of the transfer.

Facts of the case

The taxpayer (an LLP) was incorporated upon conversion from a private limited company[2] (the predecessor company) under the Limited Liability Partnership Act, 2008 (the LLP Act).

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[1] *ISC Specialty Chemicals LLP* v. *ITO* (ITA No. 457/ MUM/ 2025)

[2] ISC Specialty Chemical Private Limited

As a result of this conversion, the entire undertaking—including all movable, immovable, and intangible assets, rights, interests, privileges, liabilities, and obligations—was transferred to and vested in the taxpayer. All the assets and liabilities were recorded at book value by the taxpayer upon conversion.

The company ceased to exist and in lieu of the shares in the company, the shareholders were given interest in the capital account of the taxpayer. No additional consideration was paid to the shareholders of the predecessor company.

The taxpayer contended that the conversion did not constitute a 'transfer' under the Act, and therefore, no capital gains tax was leviable.[3]

However, the Revenue treated such conversion as a taxable transfer, as all the conditions prescribed under the Act[4] to claim tax neutrality upon conversion were not satisfied. Accordingly, the book value of assets vested into the taxpayer (upon conversion) was taxed as capital gains in the hands of the taxpayer.

In this regard, the Revenue relied on the decision in the case of *Clerity Power LLP*[5] wherein the LLP had argued that the term 'transfer' means an act by which a person conveys property to another person. The conversion, on the other hand, involves automatic vesting of assets without any further act. However, the Tribunal rejected this contention, holding that automatic vesting still qualifies as a 'transfer' and the meaning of 'transfer' must be interpreted in the context of the Act and cannot be confined to the narrow definition under the Transfer of Property Act, 1882.

Relevant provisions

As per section 47(xiiib) of the Act, conversion of a private company / unlisted public company into an LLP shall not be considered as a 'transfer' under the Act for the purposes of capital gains tax, provided all specified conditions are cumulatively satisfied (exemption conditions). One such condition is that the total value of the assets as appearing in the books of account of the company in any of the three financial years (preceding the financial year in which conversion takes place) must not exceed INR 5 crore.

Section 47A(4) of the Act stipulates that if any of the exemption conditions under section 47(xiiib) are violated, the exemption shall be withdrawn and the gains arising upon conversion shall be taxable in the hands of the successor LLP or the shareholder of the

[3] Section 2(47) read with section 45
[4] Section 47(xiiib) read with section 47A(4)
[5] *ACIT* v. *Clerity Power LLP* [2018] 100 taxmann.com 129 (Mumbai Tribunal)

predecessor company, as the case may be, for the financial year in which the exemption conditions are not complied with.

Taxpayer's contentions

Conversion of a private company to LLP does not constitute a 'transfer' under the Act, and therefore, capital gains tax is not leviable, irrespective of non-fulfilment of exemption conditions under the Act[6].

The decision in *Clerity Power LLP* was *per incurium* considering the various judicial precedents under the LLP Act wherein conversion of company into LLP was not considered a transfer under the LLP Act.

Since no exemption under section 47(xiiib) was claimed either by the predecessor company or the taxpayer, the applicability of section 47A(4), which pre-supposes claim of exemption under section 47(xiiib), was not warranted.

As no consideration was received by the predecessor company at the time of conversion, the computation mechanism for determining capital gains under the Act failed, rendering the charging provisions unworkable.

Given that the assets and liabilities were transferred at book value, the cost of acquisition and full value of consideration were the same, resulting in *nil* capital gains.

Revenue's contentions

In the instant case, the total value of assets as appearing in the books of account of the predecessor company exceeded the threshold limit of INR 5 crore, thereby, breaching one of the exemption conditions.

Consequently, conversion of a private company into LLP constitutes a 'transfer' for the purposes of the Act and is therefore, subject to capital gains tax.

The taxpayer's view that conversion of company into LLP is not a transfer in the first place is not acceptable as this would render section 47(xiiib) otiose.

As transferring of assets at book value itself constituted a benefit, section 47A(4) is triggered upon violation of section 47(xiiib) conditions - even if tax exemption was not explicitly claimed by the taxpayer.

[6] *CIT* v. *Umicore Finance Luxemborg* [2017] 291 CTR 174 (Bombay*); CIT* v. *Madurai Mills Co. Ltd. [*1973] 89 ITR 45 (SC)

In the absence of actual consideration, book value of the assets (vested into the taxpayer upon conversion) as on the date of conversation was treated as capital gains and taxed in the hands of the taxpayer.

Tribunal's decision

The Tribunal upheld that conversion of a private company into LLP constitutes a 'transfer' for capital gains tax purposes, aligning with its earlier ruling in the case of *Clerity Power LLP*.

The Tribunal referred to the Memorandum to the Finance Bill, 2010 (which introduced section 47(xiiib)) and held that section 47(xiiib) was introduced to treat the conversion of company into an LLP as tax neutral, subject to fulfilment of the prescribed conditions. In the absence of fulfilment of conditions, the legislative intention has always been to treat such conversion as a taxable transfer.

Taxability of conversion of a company into LLP under the Act must be analysed independent of the LLP Act's classification of such conversion.

The Tribunal agreed with the taxpayer that section 47A(4) is an exemption withdrawal provision. As the taxpayer never claimed the exemption under section 47(xiiib), invoking section 47A(4) to tax capital gains was unwarranted.

As the difference between the transfer value and the cost of acquisition was *nil*, no capital gains arose as a result of the transfer.

Our comments

This ruling reinforces that even if conversion of company into LLP is a taxable transfer under the Act, it is essential to adhere to the Act's prescribed computation mechanism and the taxpayers are entitled to deduct the cost of acquiring the transferred assets when calculating capital gains.

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