

TAXATION OF LLP

WIRC OF ICAI

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COVERAGE

→ PART A – TAXATION OF LLPS

→ PART B – CONVERSION OF LLP

FEATURES – LLP

- Body Corporate
- Own and separate identity - Can acquire and own immovable property
- Can sue and be sued in its own name
- Change in partners does not impact LLP's existence, rights or liabilities
- Limited Liability of Partners- Some exceptions
- No limit on maximum number of partners
- Perpetual Succession
- Only with Profit Motive
- LLP Agreement governs an LLP
- No agency relationship between partners and LLP
- Registration of Charge – **Not Direct** - Declaration of Solvency – Form 8 – Open for public viewing

Partnership firm vs Private Company vs LLP

FACTORS	PARTNERSHIP	PVT LTD CO	LLP
Legal Person / Body Corporate	No	Yes	Yes
Perpetual Succession	No	Yes	Yes
Minimum Partners / Members	2	2 /1 (OPC)	2
Maximum Partners / Members	50	200	No limit
Liability of entity separate from that of its partner / members	No	Yes	Yes
Partner / Member personally liable for debts of entity	Yes	No	No
Registering Authority	RoF	RoC	RoC
Rate of Income-tax	30% + SC	30% + SC	30% + SC
Dividend Distribution Tax	No	Yes	No
MAT/AMT	AMT (Different threshold)	MAT (On book profits)	AMT (Different threshold)

Partnership firm vs Private Company vs LLP

FACTOR	PARTNERSHIP	PVT LTD CO	LLP
Expln to s.73 applicable (losses treated as Speculative Losses)	No	Yes	No
Deductibility of remuneration / interest to Partners / Directors	Yes	Yes	Yes
Statutory Audit required?	No	Yes	Yes
Statutory Filing requirements	Least – almost minimal	Maximum	Annual return and some documents
Can it buy property in its own name?	No	Yes	Yes
Can it own shares in a Co.?	No	Yes	Yes
Can it be a partner in a Firm?	No	Yes	Yes
Can it be a partner in an LLP?	No	Yes	Yes
NBFC Provisions applicable?	No	Yes	No

Private Company vs LLP

<u>Key Factors</u>	<u>Private Company</u>	<u>LLP</u>
<u>Method of Accounting</u>	<u>Accrual</u>	<u>Cash or Accrual</u>
<u>CSR</u>	<u>Applicable if Threshold crossed</u>	<u>Not applicable</u>
<u>Public Deposits</u>	<u>Detailed Rules – exempt, not exempt.</u>	<u>No restrictions</u>
<u>Loan to Directors</u>	<u>Co. cannot lend to Directors & Interested Concerns- Exemptions</u>	<u>No restrictions</u>
<u>Limit on Loans & Investment</u>	<u>Limits & Compliance requirements</u>	<u>No restrictions / compliance</u>
<u>Related Party Transaction</u>	<u>Long List of RPT compliances</u>	<u>No restrictions / compliance</u>
<u>MAT Applicability</u>	<u>Yes</u>	<u>No</u>
<u>NBFC Hurdle</u>	<u>Yes</u>	<u>No</u>

LLP LIMITATIONS

- Not widely recognized
- Limitation on types of instruments that can be issued
 - Debentures
 - Preference shares
 - Warrants
 - Other convertible instruments
- Limitations for raising private equity investments
 - Difficulty in providing for Drag Along Rights, Tag Along Rights, Anti Dilution Rights etc.
- ESOPs cannot be issued
- Partner's interest in the LLP though transferable is not tradable like shares
- IPO and Listing

TAXATION OF LLPs

- LLP Act promulgated in 2008. Taxation of LLPs was not clarified in 2008
- Finance Act 2009 (FA 2009) made amendments to ITA for LLP.
- Definition u/s 2(23) of “Firm”, “Partner” and “Partnership” amended to include LLP.
- A “Limited Liability Partnership” and a general partnership will be accorded the same tax treatment (*Excerpts from Explanatory Memorandum to Finance Bill No.2 of 2009. Reiterated also in CBDT Circular 5/2010 dated 3rd June 2010*).
- All provisions of ITA applicable to firm and partners apply to LLP and its partners
- General Tax Rate – 30%. SC 12% above Rs.1 crore, SC for company 12% above Rs.10 crores
- No double taxation – No DDT - Share of Profit – exempt u/s. 10(2A)

CONSEQUENCES OF LLP BEING TREATED AS FIRM

- S 184 – Assessment as a firm when LLP is evidenced by instrument of LLP and individual share of partners are specified in the instrument.
- Submission of certified copy of instrument of LLP
 - In the year of creation and in every year where amendment is made
 - Implication under E-filing of tax returns
 - Non-submission of certified copy of partnership along with return of income is a procedural default which can be cured during the course of assessment proceedings - CIT vs M/s. S.R. Batliboi & Associates ITO 190 (Calcutta HC)
- LLP shall be assessed as AOP in case of failure to comply with provisions of Sec 184 or failure as mentioned in Sec 144
- In case of above non-compliance, interest, remuneration, salary paid to partners not deductible while computing income of LLP
- If disallowed in LLP – not to be included in income of partner u/s 28(v)

PARTNER

- Eligibility : Individual, Company, another LLP (including Foreign Company/ LLP)
- Not Eligible – persons not competent to contract - Unsound mind, Undischarged insolvent, where application for adjudication for insolvency is pending
- No limit on number of partners
- **Issue : Can minor / HUF be a partner in LLP?**
 - No provision for admitting minor to benefits unlike in S. 30 of Partnership Act
 - No specific provision for partner in representative capacity - Guardian
 - **Transfer / Assignment of rights in LLP to Minor / HUF – S. 42 ??**
 - General Circular No.13/2013 dated 29th July 2013 issued by MCA clarifies that HUF or its Karta cannot be designated partner in LLP. General Circular No.2/2016 dated 15th January 2016 further clarifies that HUF or its Karta cannot be a partner

CAPITAL CONTRIBUTION

- S. 32 of LLP Act
- Can be in cash/kind, tangible / intangible , movable / immovable
- Can be by way of promissory notes, contract for services performed or to be performed
- Contribution to be accounted & disclosed in books in prescribed manner
- Rule 23(2) - Contribution in kind to be valued – CA, Cost Accountant or approved valuer – whether gift possible ???
- Partner bound to bring agreed contribution

CAPITAL CONTRIBUTION

→ Issue : Capital contribution in kind - Tax implications

- S. 45(3) of ITA – Capital gains at value credited in books
- “Accounted and disclosed” in prescribed manner as per S. 32(2) of LLPA
- Rule 23(2) – prescribes valuation of contribution in kind by approved valuer
- Would presume that accounting at such valuation
- S. 56(2)(viia) – Where it receives shares of a company not being a company in which public is substantially interested:
 - ✓ Without Consideration- if aggregate FMV exceeds Rs. 50,000/- FMV is taxable
 - ✓ With consideration being less than FMV- Difference exceeds Rs. 50,000/- Entire difference is taxable

CAPITAL CONTRIBUTION

→ **Issue : On transfer of Land or building to a firm which sec is applicable sec 45(3) or 50C?**

- Section 50C - specific - class of asset (land and building)
 section 45(3) - specific - assessee/ situation (introduction by partner in a Firm)
- Spirit of S. 50C vis a vis introduction by partner in a Firm
- Section 50C & 45(3) both are deeming provisions
- 50C is part of computation provision. 45(3) part of charging section
- It can be argued that the section which is more beneficial to assessee must be applied.
- However, due to lack of any High Court or Supreme Court decisions on this subject post the amendment in Section 50C, this controversy remains outstanding
- Carlton Hotel (P.) Ltd. vs ACIT 35 SOT 26 (LUCK.) - Held that where a sale transaction is registered by paying stamp duty - 50C applicable
- DCIT vs Summit Securities Limited ITA 4977 (Mumbai Tribunal) – Land & Building transferred in Slump sale – 50C not applicable

CAPITAL CONTRIBUTION

→ Difficulty in valuation

- The determination of the cost in terms of money may be difficult but is nonetheless of a money value and the best valuation possible must be made - *A.R. Krishnamurthy v CIT [1989] 43 Taxman 30 (SC)*
- Valuation is not an exact science. Mathematical certainty is not demanded, nor indeed is it possible - *Viscount Simon in Gold Coast Selection Trust Ltd. v. Humphrey (Inspector of Taxes) [1949] 17 ITR (Suppl.) 19 (HL)*

DESIGNATED PARTNER

- At least 2 individual DPs, one of whom should be Resident of India as per FEMA
- Nominee of Co/ another LLP can be DP
- DP responsible for carrying out all compliance obligations & is liable to all penalties imposed
- Designated partner v/s Working partner

- **Issue: Remuneration to non working partner – who is a DP**
 - Working partner defined in S. 40(b) – Expl. 4
 - Needs to be an individual
 - One who is actively involved in conduct of affairs of LLP
 - Being a DP - Onerous responsibility
 - Merely agreeing to be a DP – may not fit the requirement of being a working partner

TRANSFER OF PARTNERS RIGHTS

- Assignment / transfer of partner's interest – S. 42:
 - To share profits and losses;
 - To receive distribution in accordance with LLP Agreement
 - Both can be separately assigned in part or whole
 - Such a transfer does not cause the disassociation of the partner
 - Cannot be regarded as dissolution of LLP
 - Assignee / Transferee
 - ✓ does not become partner - implications under ITA – s. 40(b). S. 10(2A)
 - ✓ Does not get right of management in the LLP
- Can it be used to transfer right to receive profits to Minor/HUF ??
- Can be assigned for a stated consideration
- Since rights are granted by the LLP Act, can it be abrogated by contract between parties

TRANSFER OF PARTNERS RIGHTS

→ Issue: Tax implications for Transfer of Right of Partner?

- Nature of rights of a partner – “capital asset” or personal privilege
- By virtue of S. 42 – separately assignable – hence can be “capital asset” u/s. 2(14)
- Under Partnership Act, 1932 – Transferability subject to mutual consent of partners
- What is the cost of such right
- Can it capital contribution – see deeming provision u/s. 49(2AAA) – conversion
- Can we apply BC Srinivasa Shetty 21 CTR (SC) 138 – good arguable case
- Can it be regarded as right to carry on business - S. 55(2)(a)/55(1)(b) which deems COA & COI as NIL – seems no

RETIREMENT OF PARTNER

→ **Issue: Whether Surplus on retirement from LLP whether taxable**

Arguments – Taxable

- Indian Partnership Act- Partnership firm not a distinct legal entity apart from partners constituting it
- LLP – separate legal Entity
- No provision in LLP Act - on retirement – interest of the partner to be evaluated
- Under LLP Act – on retirement Partner entitled to share in accumulated profits
- Mohanbhai Pamabhai – 165 ITR 166(SC) – surplus is not taxable as partner receiving what is due to him. Argument does not directly apply to LLP
- N. A. Mody – 162 ITR 420 (Bom) – assignment of rights – taxable as Capital Gains
- Assignment / Transfer u/s. 42 is specific and cannot be presumed
- Needs to be to a partner / other person – cannot be LLP / other partners

RETIREMENT OF PARTNER

→ Issue: Whether retirement of partner from LLP is taxable

Arguments – Not Taxable

- Partnership firm and LLP – treated on the same plank in Income tax
- Circular 5 of 2010 – “conversion of partnership firm into LLP will have no tax implications. The separate entity status of LLP is not significant factor in determining tax implication” – binding even if deviating
- All provisions as applicable to Firms to apply to LLPs, including SC decision
- On retirement- partner receives Capital, Share in profits, share in valuation of assets including goodwill – Taxation of surplus will lead to double taxation.
- Determination of Cost – whether original capital or capital at retirement etc.

CHANGE IN CONSTITUTION OF LLP

- S. 79 does not apply to LLP; however S. 78 applies on retirement or death of a partner
- S. 78 to ITA – Restriction for carry forward and set off of losses in case of change in constitution of firm on retirement or death of partner
- Implications:
 - Firm not entitled to carry forward and set off loss proportionate to share of the retired or deceased partner exceeding his share of profits in the previous year
- Restriction not applicable to unabsorbed depreciation or change in constitution due to admission of partner or change in PSR
- No provision for protection of losses in case of inheritance (as contained in S. 79)

INTEREST ON PARTNERS CAPITAL

- S. 36(1)(iii):
 - Capital Contribution of partners are capital borrowed for the purposes of business or profession and for allowance of deduction of interest payments, requirement of S. 36(1)(iii) need to be fulfilled - *Munjil Sales Corp v CIT [2008] 298 ITR 298 (SC)*, *ACIT vs. Pahilajrai Jaikishin ITA 994 (Mumbai ITAT)*
- S. 40(b)(iv): Restriction on payment of interest to partners
- “Representative capacity” – Explanation 1, 2 and 4 of S. 40(b) of ITA
- S. 40(b) v S. 40A(2):
 - No disallowance u/s 40A(2) is warranted if the conditions as specified in S. 40(b) are complied with. (*CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All) (HC)*); *Chhajed Steel Corp. V/s Asst. CIT (2001) 77 ITD 419 (Ahmedabad)*

OTHER TAX ADVANTAGES

- Deemed dividend - S. 2(22)(a) to 2(22)(e) - Not Applicable to LLPs
- No MAT based on Book Profits – AMT u/s. 115JC – based on Adjusted Total Income
- Expl. to S. 73 - share trading loss deemed as speculation Loss – does not apply to LLP
- S. 2(24)(iv)– Benefit/perquisite of director/ specified person - does not apply to LLP
- Share of Profit not subject to MAT in the hands of Company partner – exempt u/s. 10(2A) – See CBDT circular 8/ 2014 dt. 31.3.2014

TAX DISADVANTAGES

- LLP may not qualify for certain deductions :
 - S. 35D – Amortization of **certains** preliminary expenses
 - S. 35DD – expenditure in respect of amalgamation / demerger
 - S. 35(2AB) – weighted deduction for Scientific Research and Development
 - Tax neutrality on amalgamation / demerger – S. 47(vi), (via), (vib), (vid),(vii)
 - S. 80-IA(4)(i) – deduction on profits of infrastructure projects
- Entitled for deduction at lower rate
 - S. 80-IB – Residual Period - Firm @ 25% vs. Company @ 30%
- No similar provision like those in S. 10AA(5), 80IB(12) for claiming deduction for the balance period in case amalgamation or demerger

ALTERNATE MINIMUM TAX

→ AMT - S. 115JC & S. 115JD

- Rate 21.3416 % or 19.055%
- Adjusted Total Income = Net Taxable Income + Deduction under part C of Chap VI A (other than section 80P) + deduction u/s. 10AA (SEZ Units) + deduction u/s 35AD (net of notional depreciation otherwise allowed)
- Not like MAT for companies which is on **Book Profits**
- Credit of amount allowed to be c/f. for 10 Assessment Years. No interest – S. 115JD
- Credit limited to excess of normal tax over AMT liability

AMT SET OFF U/S. 115JD

➔ **Issue: LLP converted into Company under Part IX– Impact of AMT Credit u/s 115JD**

■ **Arguments in favour**

- ❖ AMT credit – allowed – person paying the taxes under the AMT provisions
- ❖ Firm – Succeeded by Company – for all legal purposes entity remains the same
- ❖ U/s 115JAA – Specific provision restricting MAT Credit - Co to LLP
- ❖ Similar restriction missing in AMT Provision – Indicates Legislative intention

■ **Arguments against**

- ❖ AMT and MAT are different levies and are not interchangeable
- ❖ AMT – Non corporate assessee – cannot be utilised by a corporate entity

RESTRUCTURING OF LLPs

- LLP Act (Sec 60) - detailed framework for Compromise or arrangements of LLPs – similar to S. 391 – S. 394 in case of companies
- Types
 - Merger of 2 or more LLPs
 - Compromise or arrangement between LLP and partners
 - LLP Converted into Firm - considered later
 - LLP Converted to Company - considered later
 - Compromise or arrangements with creditors
 - Demerger of LLP

LLP RESTRUCTURING - TAXATION

- No provisions / neutrality on taxation aspects – like S. 47 exemptions
- Taxation of such compromise / arrangement – untested - under normal provisions
- Merger / Demerger of LLP
 - Capital Gains to LLP - Yes
 - Whether Capital Gains / taxation for partners – debatable but possible
- Arrangements between LLP and Partners
 - S. 45(4) implications in case of distribution – “or otherwise” wide enough to cover
- If company converted u/s. 47(xiiib) and restructuring before completion of 5 years
 - withdrawal of exemption provision if failure to fulfill conditions – S. 47A(4)

PART B

TAXATION OF CONVERSION OF OR TO LLP

LLP CONVERSION

- Firm to LLP
- Private Limited Company (PLC) to LLP
- Unlisted Public Company (UPC) to LLP
- LLP to Company
- LLP to Firm

MODES OF CONVERSION TO LLP

→ Under the LLP Act

- Firm to LLP – S. 55 read with 2nd Schedule
- Private Limited Company to LLP – S. 56 read with 3rd Schedule
- Unlisted Public Company to LLP – S. 57 read with 4th Schedule
 - ✓ Compliant with provisions of S. 47(xiii b)
 - ✓ Does not comply with S. 47(xiii b)

OR

→ Other Modes

- Commence business in LLP and close down business in Firm / Company
- Full or partial transfer of assets / business to LLP

FIRM TO LLP – TAX IMPLICATIONS

- Both “Firm” and “LLP” different entities under normal law—but same entity for taxation
- Reliance on para 5.6 of CBDT explanatory Circular 5/2010 dated 3rd June, 2010
 - No tax implications if rights & obligations of partners remain same
 - No transfer of assets/ liabilities after conversion
 - No legal backing of this Circular & hence may not bind Assessee
- Under Second Schedule – registration as an LLP leads to dissolution of firm
- Whether implications under section 45(4) of ITA
- Texspin Engg. & Mfg. Works – 263 ITR 345 (Bom):
 - Statutory vesting is not distribution u/s. 45(4)
 - For “transfer” u/s. 2(47) – there need to be 2 parties
 - No consideration accruing to the ‘**transferor firm**’ even if there is transfer
- Leads to statutory vesting of assets from Firm to LLP
 - Old case laws in context of Part IX Conversion under Co. Act – still relevant
- Hence no taxation

CONVERSION – TAX IMPLICATIONS

- ➔ Valuation of stock in trade – whether ALA Firm applies [1991] 189 ITR 285 (SC)
 - Refer also – *Sakthi Trading Co. [2001] 250 ITR 871 (SC)*
 - No need to value at market value since business continues
- ➔ No step up in asset basis (for depreciation etc.) for new LLP
- ➔ Will need independent clause in the LLP agreement for remuneration and interest
- ➔ Tax benefits u/s. 80IA , 80IB, 80IC, 10A etc. should continue for unexpired period - Board's letter F. No. 15/5/63 dated 12.5.1963
 - *Chetak Enterprises (P) Ltd 325 ITR 405 (Rajasthan HC)*
 - *Tech Books Electronics Services P Ltd. 100 ITD 125 (Del)*
 - *Kumaran Systems (P) Ltd 106 TTJ 484 (Chennai)*
 - *Asstt. CIT v. SIL Investment Ltd.[2012] 54 SOT (Delhi)*
 - *Foresee Information Systems (P.) Ltd 592 (Karnataka HC)*

CONVERSION – TAX IMPLICATIONS

- S. 43B – benefit of deduction if Firm’s liability paid by LLP
- Similar disallowances u/s. 40(a)(ia), 40(a) – LLP Should get benefit
- Deduction for firm’s bad debts if written off by LLP – Veerbhadra Rao...
155 ITR 152 (SC)
- AMT paid by Firm u/s. 115JC, whether credit would be available to LLP
- S. 115JD(1) – credit for tax paid by a person shall be allowed to him
 - Does it mean same person or different person
 - In case of losses – the term used is “assessee”
 - Firm and LLP both assessed in same category of person
 - Seems a good case
- Carry forward of losses of the firm to the LLP – “Assessee” is same– see. S. 78(2) – a good arguable case

COMPANY TO LLP - TAXATION

- Tax neutrality introduced by way of s. 47(xiiiib) of ITA
 - No “transfer” for transferor company
 - No “transfer” for the shareholders
 - Conversion as per S 56 / 57 of LLP Act
- Conditions under proviso to S. 47(xiiiib) to be fulfilled
- Carry forward of losses and unabsorbed depreciation of Company - s. 72A(6A)
 - Becomes accumulated losses and unabsorbed depreciation of the LLP
 - Of the year in which the conversion takes place -
 - ✓ **Possible to argue that a fresh lease of life**
 - Violation of 47(xiiiib) –loss / depreciation adjusted by LLP – taxable in LLP
- Section 79 – may not have applicability in respect of losses of predecessor company ??
- Depreciation on assets to LLP as per WDV of Company - Expl. 2C to S. 43(6)
 - No step up in WDV – same WDV to continue
- Cost of other non depreciable assets – cost to previous owner – company – s. 49(iii)(e)

COMPANY TO LLP - TAXATION

- Cost of rights of partner under section 42 of the LLP Act on such conversion
 - Cost of the shares of the predecessor company – s. 49(2AAA)
 - Only if rights as a partner in the LLP separately assigned under section 42
 - Accumulated profits or reserves credited to the partners account – not eligible as cost
- Carry forward MAT credit of company will not transfer to LLP – S. 115 JAA(7)
- Violation of conditions - S. 47A(4)
 - Profit not charged to company – will become capital gains for LLP
 - Profit not charged to shareholder– will become income for shareholder
 - Provision similar to that for conversion of firm – S. 47(xiii) – additional coverage for shareholders

CONVERSION U/S 47(xiiib)– CONDITIONS

- **Condition 1** – All assets and liabilities of Co. before conversion become A / L of LLP
 - Since automatic statutory vesting – will be fulfilled
 - Not possible to have a situation of non transfer –
 - If required – transfer before conversion - check implications
- **Condition 2** - All shareholders of Co. before conversion become partners:
 - Their **capital contribution (CC)** and **profit sharing ratios (PSR)**
 - Are in proportion of shareholding before conversion
 - In view of 3rd and 4th Schedule to LLPA - not possible to have non shareholders as partners at time of conversion
 - ✓ can add non shareholders as partners subsequently – subject to minimum 50% profit-sharing to shareholder partners for 5 years from conversion
 - If shares held in name of minor or through HUF – how to fulfill
 - ✓ Since no representative capacity is permissible in LLP – can be road block
 - ✓ May need to transfer to other persons prior to conversion
 - ✓ Check S. 56(2)(vii) / (viia) implications

CONVERSION U/S 47(xiiib)– CONDITIONS

- **Issue** - Where company has both preference and equity shares – how to fulfill:
- ✓ Alt 1
 - ❖ Take profit sharing ratios as per Equity shareholding
 - ❖ Total capital contribution as per both Equity and Preference
 - ❖ Seems more equitable but not backed by law – hence could be debatable
 - ✓ Alt 2
 - ❖ Aggregate both Equity and Preference – take PSR on aggregate proportion
 - ❖ Take CC on both aggregate of nominal value of Equity and Preference
 - ❖ Seems compliant with law – but can be inequitable – hence some litigation
 - ✓ Alt 3
 - ❖ Equalize proportion for both Equity and Preference
 - ❖ Shareholders proportion is same Equity and Preference
 - ❖ Seems safest
 - ✓ Alt 4
 - ❖ Redeem preference shares

CONVERSION U/S 47(xiiib)– CONDITIONS

→ Condition 3 -

- Shareholders do not receive any consideration / benefit
 - ✓ Directly or indirectly
 - ✓ Other than by way of PSR and CC
- **Issue** - Where consideration / benefit should be at time of conversion
 - ✓ Should be at time of conversion
 - ✓ However wordings are tricky – hence safer view – till period of 5 years –better
- **Issue** - payment of remuneration or interest – does it violate
 - ✓ If interest / remuneration is part of LLP Agreement on conversion – can create difficulty
 - ✓ If subsequent – good arguable case – but safer view better
- **Issue** - provision of mobile, car etc. to partner – does it violate
 - ✓ Can be regarded as benefit – can create difficulty

CONVERSION U/S 47(xiiib)– CONDITIONS

- **Condition 4** – The **aggregate** profit sharing ratio of shareholders **shall not be < 50%** at any time during 5 years from date of conversion
- Ratio is to be maintained on an aggregate basis or individual basis - aggregate
 - Internal changes amongst partners not to impact condition
 - LLP needs to be continue – no merger / other re-organisation of the LLP permissible
 - LLP not to be converted into a company
 - Tax Implications on the Change in Profit sharing ratio due to involuntary events like death of partner or winding up/merger of a company-partner
 - ✓ No exception created like in s. 79
 - ✓ Old decisions – mischief rule of interpretation
 - ✓ Good arguable case

CONVERSION U/S 47(xiiib)– CONDITIONS

- **Condition 5** – The total sales, turnover or gross receipts **in business** of Co. shall not exceed Rs. 60 lacs in the 3 preceding PYs.
- Aggregate Sales etc. if > Rs. 60 lacs – disqualified for S. 47(xiiib) conversion
 - Total sales etc. ‘in business’ – Hence Non – Business Receipts not to be considered
 - Where Co. has been in existence for less than 3 years – only for post incorporation period
 - Total sales etc. can exceed Rs. 60 lacs in the year of conversion
 - Criteria of Rs 60 lacs is too small – needs upward revision
 - Interpretation made by the courts in the context of S. 44AB would be relevant

CONVERSION U/S 47(xiiib)– CONDITIONS

→ Whether following includible in Total sales etc.

- Receipt of exempt dividend received by Investment Co.
 - ✓ CBDT Circular 1 dated 6.4.2011 – Circular Explaining Amendment to Finance Act, 2010
 - ❖ the total sales, turnover or gross receipts in business of the company [which are taxable under the head “Profits and gains of the business or profession”] do not exceed sixty lakh rupees in any of the three preceeding previous years
 - ❖ Only amounts that are taxable under the head profits and gains of business – to be considered. Hence – good argument – exclude exempt income
- Capital Gains on sale of Shares etc. held as investments & Share of Profit from a Firm / LLP
 - ✓ not to be included based on above CBDT circular
- Reimbursement towards packing, freight etc.
 - ✓ If reimbursement on actuals – not part of turnover, receipts, etc.

CONVERSION U/S 47(xiiib)– CONDITIONS

→ Condition 6

- No amount paid to the partners, directly or indirectly,
- out of balance of accumulated profits in the accounts as on the date of conversion;
- for a period of 3 years from the date of conversion
- Term “Accumulated Profits” not defined in the S. 47(xiiib). Used in the provisions of sec 2(22) – deemed dividend .
- Accumulated profits as per the books of accounts and not taxable profits
- To ensure “accumulated profits” are not withdrawn
 - ✓ Transfer to separate account in LLP
 - ✓ provide separate clause in the LLP agreement for non-withdrawal / non-distribution
- The restriction is on withdrawal of accumulated profits and not of capital balance – capital balance i.e. share capital transferred to capital account – can be withdrawn

CONVERSION U/S 47(xiiib)– CONDITIONS

→ Condition 6

- Whether following form part of the accumulated profits:-
 - ✓ Statutory Reserves like SEZ Reserves - yes
 - ✓ Debenture Redemption Reserves – yes
 - ✓ Capital Reserves – yes if realized
 - ✓ Revaluation Reserves – no
 - ✓ Share Premium – no
- If accumulated profits capitalized as bonus shares, credited as capital contribution and withdrawal out of the same within 3 years – Does it violate the Condition 6
 - ✓ Once capitalized – Bonus shares are not part of “accumulated profits”
 - ✓ Good arguable case
 - ✓ However exercise extreme caution

NON COMPLIANT CONVERSION

→ Where conversion does not fulfill conditions of S. 47(xiii b)

→ For Company:

- Statutory Vesting
- Transfer involves 2 parties ... transferor and transferee
- Reliance on Part IX related decisions of statutory vesting – not a transfer
- CIT vs. Texspin Engg. & Mfg. Works - (2003) 263 ITR 345 (Bom)
- Rita Mechanical Works 344 ITR 544 (P&H)
- Gulabdas Printers 4 ITR (Trib) 264 (Ahd)
- Well Pack Packaging 78 TTJ 448 (Ahd)
- Umicore Finance Luxembourg, In Re(2010) 323 ITR 25
- Good case Still not taxable as capital gains
- **However unabsorbed depreciation or unabsorbed loss will lapse**

NON COMPLIANT CONVERSION

→ For Shareholders:

❖ Whether any CG Implications??

▪ Conversion leads to extinguishment of rights in shares ... Covered by Grace Collis 248 ITR 323 – [SC]- Hence Transfer u/s 2(47)

▪ **What is consideration on transfer?**

✓ Sunil Sidharthbhai - 156 ITR 509 (SC) - consideration credited to partners capital account is not what finally comes to him

✓ However new section 50D – where consideration “not ascertainable” or “cannot be determined”

❖ take FMV of asset transferred i.e. shares

❖ Valuation of shares- Rule 11UA or Independent Valuation ??

✓ Hence potential taxation in hands of shareholder

CONVERSION – OTHER MODES

- Commence new business in LLP and close business of company
 - Transfer of goodwill / other benefits / registrations – difficult
 - If accompanied by transfer of assets –check capital gains / stamp duty / other implications
 - For Immovable Property – S. 50C Implications
 - Land and Building – Developer – S. 43CA Implications
 - GAAR Provisions – still not applicable - post GAAR – additional complications

CONVERSION – OTHER MODES

- Set up new LLP – transfer business to LLP
 - Transfer of goodwill / other benefits / registrations – not automatic
 - Check capital gains / stamp duty / other implications
 - Can be at Book Value except for Immovable Property – S. 50C, Land and Building – Developer – S. 43CA Implications
 - Capital Gains only at value realised

CONVERSION – LLP TO FIRM

- No specific provision under LLP Act for reverse conversion
- Will need to either dissolve
 - S. 45(4) implications
- Transfer business to a new Firm
 - Capital gains implications, S. 50C etc.
 - Stamp Duty Implications
- Law and practice not developed

CONVERSION – LLP TO COMPANY

- Companies (Authorised to Registered) Amendment Rules, 2014
 - Wide enough to register both – Company limited by shares and company limited by guarantee
 - Would include LLP soon – Notice issued dated 17th February, 2016 inviting comments on draft Companies (Authorised to Registered) Amendment Rules, 2016.

- Transfer / Sale of business from LLP to Company
 - Would invite capital gains / tax implications
 - Would involve stamp duty implications

QUESTIONS

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THANK YOU