



## Global Business Tax Alert

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**<sup>1</sup>Conversion of a private limited company into an LLP, is a transfer, but no capital gains as the transfer was at 'book value'**

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<sup>1</sup> ACIT v/s. Celerity Power LLP [2018] 100 taxmann.com 129 (Mumbai Trib)

## Facts of the case

- Celerity Power LLP (the taxpayer), a Limited Liability Partnership (LLP) was engaged in the business of power generation and had e-filed its original return of income for the year, declaring total income of Rs. 5,41,90,840/-.
- Thereafter, on the same date, the taxpayer had e-filed a revised return of income declaring total income of Rs. NIL, after claiming set-off of brought forward losses of Rs. 5,79,93,084/-.
- During the course of the scrutiny assessment proceedings, the Tax Officer (TO) observed that the taxpayer had acquired the status of a LLP, w.e.f. 28 September 2010, prior to which, it was a private limited company, known by the name Celerity Power Pvt. Ltd.
- It was noticed by the TO that from 28 September 2010 the entire business, assets and liabilities of the said company were transferred to the taxpayer LLP.
- Before the TO, it was submitted that the conversion of the company into an LLP did not involve any 'transfer' of the property, assets, liabilities, etc. In the alternative, it was also submitted that the capital gains, if any, could only be brought to tax in the hands of the erstwhile company.
- The TO was not convinced with the aforesaid submissions and held that the conversion ought to be considered as a 'transfer' for the purposes of the Income-tax Act, 1961 (Act) giving rise to taxable 'capital gains'. This is because the taxpayer had failed to fulfill one of the conditions prescribed to be considered as a tax neutral conversion, in terms of section 47(xiiib)(e) of the Act (viz. the total sales in the business of the company exceeded the prescribed limit of sixty lakh rupees in one of the three preceding previous years).
- Accordingly, on an estimated basis an amount of Rs. 1,76,50,566/- was considered as capital gains arising on account of the transfer of assets from the Company to the LLP, which was liable to be taxed in the hands of the LLP in terms of section 47A(4)<sup>i</sup> of the Act.
- The TO also denied the taxpayer set-off and a carry forward of unabsorbed losses and depreciation of the erstwhile company, since one of the conditions prescribed for being considered as a tax neutral conversion, was not fulfilled.
- The Order passed by the TO was challenged before the Commissioner of Income-tax (Appeals) (CIT(A)), who held that, on conversion of a private limited company to a LLP, there was a transfer of assets from the erstwhile private limited company to the LLP as one of the conditions prescribed for a tax neutral transfer was not fulfilled. However, since the difference between the transfer value and the cost of acquisition was Nil (both being at book values), the machinery provision contemplated in section 48 in the Act for computing the capital gains were rendered unworkable.
- The CIT(A) also held that the taxpayer was not entitled to carry forward and set-off the unabsorbed losses from the erstwhile company since the taxpayer failed to fulfil one of the prescribed conditions.

The Order passed by the CIT(A) was challenged before the Tribunal both by the taxpayer and the TO.

## Issue under consideration

### The following questions were *inter-alia* raised by the Tribunal:

- Whether, in the given circumstances when one of the prescribed conditions for a tax neutral transfer is not fulfilled, can the conversion of a private limited company to a LLP, be regarded as a 'transfer'?
- If yes, can the 'book value' of assets and liabilities only be regarded as 'full value of consideration' for purpose of computation of capital gain?
- Whether the taxpayer was entitled to claim unabsorbed business loss/ unabsorbed depreciation of the company?

## Ruling of the Tribunal

The Tribunal after considering the arguments of the tax department and the tax payer has *inter-alia* observed/held as under:

### On the conversion being considered as a 'transfer' giving rise to 'capital gains':

- Transaction involving conversion of a private limited company or an unlisted public company to a LLP would be a 'transfer'. However, on cumulative satisfaction of the conditions prescribed in section 47(xiii) of the Act, the same would not be chargeable to 'capital gains'.
- Reliance placed by the taxpayer on the judgment of the Hon'ble High Court of Bombay in the case of CIT v/s. Texspin Engg. & Mfg. Works [2003] 263 ITR 345 (in context of there being no transfer a partnership firm being treated as a company under the statutory provisions of Part-IX of the Companies Act) is distinguishable.
- The issue under consideration, involves/pertains to conversion of a private limited company to a LLP (as per Sec. 56 of the Limited Liability Partnership Act, 2008 read in accordance with the provisions of Chapter X and the Third Schedule thereof).
- From a perusal of the definition of the term 'convert' (as given in clause 1(b) of the 'Third Schedule' to the Limited Liability Partnership Act, 2008) it can safely be gathered that the conversion of a private company into a LLP involves transfer of the property, assets, etc.
- This is unlike the succession of a partnership firm by a company as per Part IX, where there is only "vesting" of the property of the partnership firm in the company from the date of its registration as per section 575 of the Companies Act, 1956.

### Taxability in whose hands:

- While, 'capital gains', if any, arising on the transfer of capital assets on conversion of the private limited company to a LLP would principally not be liable to be assessed in the hands of the taxpayer LLP, the same would be taxable in the hands of the taxpayer LLP as a 'successor entity' to the erstwhile company in terms of section 170 of the Act.

### **Computation of 'capital gains':**

- The conversion of the assets and liabilities of the erstwhile company to the LLP took place at the 'book value' itself and therefore, no separate cost other than the 'book value' was attributable to the individual assets and liabilities.
- As the assets and liabilities of the erstwhile private limited company were vested in the LLP at their 'book values', hence such 'book value' could only be regarded as the 'full value of consideration' for the purpose of computation of 'capital gains'.
- The Tribunal agreed with the view taken by the CIT(A), that though there was a transfer of capital assets from the erstwhile private limited company to the assessee LLP, however, as the difference between the transfer value and the cost of acquisition was Nil, therefore, while computing the capital gains the machinery provision was rendered as unworkable.

### **Re: Carry forward of losses on conversion of Company to LLP:**

- Upholding the decision of the lower authorities, it was observed that section 72A(6A) of the Act, which entitles a LLP to 'carry forward' the losses of the erstwhile private limited company, was preconditioned by a statutory requirement that the taxpayer should have complied with all the conditions prescribed in the proviso to section 47(xiii) of the Act.
- While doing so, it also negated the taxpayer's contention that by purview of section 58(4) of the Limited Liability Partnership Act, 2008 on conversion, the taxpayer LLP also stood vested with the right to carry forward the losses of the erstwhile private limited company along with all tangible (movable or immovable) and intangible property.
- The Tribunal observed that section 58(4) of Limited Liability Partnership Act, 2008 was only in context of the tangible and intangible property and had nothing do with the carry forward of losses, which is the creature of a specific statute in the form of the Act (i.e. the Income-tax Act, 1961).

## **Conclusion**

This ruling lays down that the conversion of a private limited company into an LLP not fulfilling the prescribed conditions is a 'transfer'. However, there would be no capital gains as the said conversion/transfer was at 'book value'.

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<sup>1</sup> Section 47A lays down circumstances under which exemption in certain cases would be withdrawn. In the case of conversion of a private limited company to a LLP, where any of the conditions laid down in the proviso to section 47(xiiib) of the Act are not complied with, the amount of profits or gains arising from the transfer of such capital asset, etc. not charged under section 45 as "capital gains" shall be deemed to be the profits and gains chargeable to tax of the successor limited liability partnership, etc., as the case may be, for the previous year in which the requirements of the said proviso are not complied with.