SEAMLESS TRANSITION: UNDERSTANDING SECTION 47(XIIIB) FOR CONVERTING COMPANY TO LLP

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Introduction

The conversion of a company into a Limited Liability Partnership (LLP) under the Limited Liability Partnership Act, 2008, provides a strategic avenue for businesses to restructure their operations and capitalize on the benefits offered by the LLP framework. This provision allows private companies and unlisted public companies to seamlessly transition into LLPs, subject to certain conditions and procedures.

A registered limited company in India (Private or Public) has a lot of complex formalities and incurs additional overheads for managing affairs including mandatory board meeting, maintenance of statutory records, filling of e-forms with MCA etc. On the other hand, in case of Partnership firms, individual partners want to be free from the concept of joint liability of partners. By converting into an LLP, businesses can enhance operational flexibility, mitigate risks, and optimize their organizational structure. Accordingly, this article explores the procedure and provisions w.r.t. conversion of a Private Ltd. or unlisted Public Company into LLP

Process of Conversion

The conversion of a company into a Limited Liability Partnership (LLP) under Section 47(xiiib) of the Limited Liability Partnership Act, 2008, involves a series of steps and procedures. This process is designed to ensure that the conversion is legally valid and complies with all regulatory requirements. Here is a brief note on the conversion process:

➢ **Eligibility Check:**

- Verify that the company meets the eligibility criteria for conversion, i.e., it is a private company or an unlisted public company.

➢ **Obtain Consent:**

- Obtain unanimous consent from all shareholders or members of the company for the conversion.

- **Verify Solvency:**
  - Ensure that the company is solvent, with assets exceeding liabilities. This may require a solvency declaration signed by the majority of directors.

- **Seek Creditor Approval:**
  - Obtain consent from all secured creditors for the conversion. If any creditor objects, the conversion cannot proceed under Section 47(xiiib).

- **Draft LLP Agreement:**
  - Prepare a Limited Liability Partnership Agreement outlining the rights, duties, and responsibilities of partners in the LLP.

- Compliance in relation to Company:
  - At least one balance sheet and annual return should have been filed by the Company after its incorporation
  - No open (unsatisfied) charges should be pending against the Company.
  - No eForms should be pending for payment or processing or approval in respect of the Company
  - Under Companies Act, no prosecution should have been initiated procedure to be followed
  - There is no security interest in its assets subsisting or in force at the time of application.
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- File Conversion Application:
  - Apply for DPIN
  - Apply for Name reservation
  - Prepare and file an application with the Registrar of Companies (ROC) for conversion, along with the prescribed fees and documents, including:
    - Statement of solvency.
    - Consent of shareholders or members.
    - No objection certificate from creditors.
    - LLP Agreement.
    - Other required documents.

- Publication of Notice:
  - Publish a notice of the proposed conversion in a newspaper circulating in the district where the registered office of the company is situated, inviting objections, if any, to the conversion.

- Registrar's Approval:
  - The ROC will review the application and, if satisfied, issue a Certificate of Registration of Conversion, specifying the date of conversion.

- Transfer of Assets and Liabilities:

- Upon conversion, all assets, liabilities, rights, and obligations of the company are transferred to the LLP.

- Update Statutory Records:

- Update all statutory records, including the LLP Agreement, Register of Members, Register of Partners, etc., to reflect the conversion.

- Compliance with Post-Conversion Requirements:

- The LLP must fulfill all post-conversion compliance requirements, such as filing annual returns, maintaining accounts, conducting audits (if applicable), etc., as per LLP regulations.

- Commencement of LLP Operations:

- Once the conversion is complete, the LLP can commence its operations and conduct business as per the LLP Agreement.

Exemption provided under Section 47 from levy of capital gains tax

Section 47 of the Income Tax Act, 1961, provides for certain transactions that are not considered as transfers and, therefore, are not subject to capital gains tax. These transactions are exempt from tax under the Income Tax Act. One such exemption is provided under Section 47(xiiib) for the conversion of a company into a Limited Liability Partnership (LLP).

Section 47 (xiiib) of the Income Tax Act provides an exemption from levy of capital gains tax on the abovementioned transfers pursuant to conversion of a company to LLP subject to fulfilment of all the below specified conditions:

a) Transfer of all assets and liabilities:

All the assets and liabilities of the company immediately before conversion become the assets and liabilities of LLP.

b) All shareholders to become partners in LLP:

All the shareholders of the company immediately before conversion become the partners of LLP and their capital contribution and profit-sharing ratio in the LLP are in the same proportion as their shareholding in the company as on the date of conversion.

c) Consideration to shareholders:

The shareholders of the company does not receive any consideration or benefit, other than by way of share in profit and capital contribution in LLP.

d) Profit sharing ratio of shareholders in LLP:

The aggregate of the profit-sharing ratio of the shareholders of the company in LLP should not be less than 50% at any time during a period of five years from the date of conversion

e) Total sales, turnover or gross receipts in the business of the Company:

Total sales, turnover or gross receipts of the Company must not exceed INR 60 lakhs in any of the three previous years preceding the previous year in which the conversion takes place

f) Total value of the assets as appearing in the books of account of the Company:

Total value of the assets of the Company must not exceed INR 5 crores in any of the three previous years preceding the previous year in which the conversion takes place

g) No amount to be paid to any partner out of accumulated profits of the company as appearing on conversion date for a period of three years from the date of conversion

Consequences of violation of section 47(xiiib):

i. Transfer of capital Assets:

If the above conditions are violated, the transfer of capital asset is to be done at the market rate and accordingly capital gain is to be calculated. The private limited company which is a transferor has to pay the capital gain tax on such transfer.

ii. Transfer of Other Assets:-

The other assets like, stock in trade, current asset etc is also transferred at the market value and the applicable taxes is to be paid.

iii. Impact on Share Holders if section 47(xiiib) is violated

The shares in the hands of the shareholders of the private limited company will be converted as capital of the LLP. The shareholder will surrender the shares and acquire capital in the LLP. The shareholder has to pay tax on the capital gain arising to him from such transfer. The Value of capital is the consideration for the transfer of shares. The cost of share is the amount paid by such share holder at the time of purchase of shares. The receipt of bonus share will not have any cost since it is out of the reserves of the company.

Conclusion

Section 47 (xiiib) was introduced to exempt transfer of assets and shares on conversion of a company into an LLP from capital gains tax under Section 45 of the IT Act, subject to fulfilment of certain stipulated conditions. It is worthwhile to note that prior to Finance Bill 2010, conversion of a company into an LLP had definite tax implications and the transfer of assets on conversion attracted levy of capital gains tax. Owing to flexibility in its structure, compliances, tax and operation, LLP would be useful for small and medium enterprises, in general, and for the enterprises in services sector and professional firms, in particular. Internationally, LLPs are the preferred vehicle of business, particularly for service industry or for activities involving professionals.