BEFORE THE AUTHORITY FOR ADVANCE RULINGS, (NCR BENCH)

NEW DELHI

23rd Day of August, 2019

A.A.R. No. 1290 of 2012/620(a)

Justice (Mrs.) Ranjana P. Desai, Chairperson
Mr. Narendra Prasad Sinha, Member (Revenue)
Mr. Ramayan Yadav, Member (Law)

Name & address of the Applicant	:	Domino Printing Science Plc. Trafalgar Way, Bar Hill Cambridge CB23 8TU United Kingdom.
Present for the Applicant	:	Mr. S Ganesh, Sr. Counsel Mr. Sandeep Gupta, AR Mr. Rohinton Sidhwa, AR Mr. Amit Pahwa, CA Mr. Keshav Agarwal, CA Mr. Varun Sachdeva, CA
Present for the Department	:	Mr. Ramesh Chander, CIT (DR) Mr. S. R. Kaushik, Addl. CIT Mr. Parikshit Singh, JCIT Mr. Abhishek Tripathy, ACIT

Ruling u/s 245R(4) of the Income Tax Act
(By Narendra P Sinha)

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Domino Printing Science Plc., United Kingdom, (the Applicant or Domino UK) has filed this application on 01.03.2012 seeking advance ruling under section 245Q(1) of the Income Tax Act, 1961. The same was admitted on 31.10.2013.

2618 US FT&TR-I(1)

2. Domino UK is a company registered in United Kingdom and is a tax resident of UK. The applicant had a wholly owned subsidiary company in India named Domino Printech India Private Limited (Domino India) which was incorporated on 16.05.1996. Out of total 40,80,000

equity shares issued by Domino India; 40,79,998 equity shares were held by the Applicant and the balance two equity shares were held by Domino UK Limited (in the capacity of nominee of the Applicant). Domino India had proposed to be converted into a Limited Liability Partnership (LLP) in accordance with the provisions of Limited Liability Partnership Act 2008 and accordingly an application was filed with the Foreign Investment Promotion Board (FIPB) to obtain the requisite approval for conversion of Domino India from a company to an LLP. On conversion of the company into LLP, the equity shares held by the Applicant in Domino India would be converted into partnership interest in the LLP. The present application has been filed for obtaining a ruling in respect of applicability of capital gains tax in the hands of the shareholders of Domino India on its conversion from company into LLP. The Applicant has raised the following three questions on which a request is made for pronouncement of ruling: -

(1) On the facts and in the circumstances of the case, whether conversion of the equity shares held by shareholders in Domino Printech India Private Limited (Domino India) into partnership interest in an India Limited Liability Partnership consequent upon the conversion of Domino India into a Limited Liability Partnership, would be regarded as a transfer of those shares within the meaning of section 2(47) of the Act?

(2) On the facts and in the circumstances of the case, on conversion of Domino India into a Limited Liability Partnership, whether the computation provision under section 48 of the Act are workable and capable of being implemented, or whether the said provisions would breakdown and fail?

(3) On the facts and in the circumstances of the case, as the value for the partners' right or interest in the proposed Limited Liability Partnership cannot be said to be more than the value of the shareholders' interest in the private limited company, would the transaction give rise to any taxable capital gain?

Authority for Advance Rulings, NCR Bench, New Delhi

Submissions of the Applicant

3. At the outset the Applicant's learned counsel informed that an approval was obtained by the Applicant for conversion of Domino India into LLP in May 2012 subject to certain conditions. Based on the approval from FIPB and meeting the conditions mentioned therein, Domino India was subsequently converted into Domino Printech LLP: ("Domino LLP") vide certificate of registration dated 28 November 2016. The amount of capital held by the Applicant in Domino LLP was Rs.40,799,980/- identical with the amount of paid-up share capital held in Domino India pre-conversion.

4. The Applicant's learned counsel explained that the charging provision of section 45(1) of the Income Tax Act on capital gain brings to tax any profit or gain arising from the transfer of a capital asset. The term capital asset was defined in section 2(14) of the Act and the equity shares held by the Applicant in Domino India, which would be converted into an interest in the LLP on the conversion of Domino India into LLP, would be considered as a capital asset within the meaning of that section. He explained that the term 'transfer' as per provisions of section 2(47) of the Act consists of different limbs, of which the following four were relevant to the facts of the case:

(a) the sale of the asset; or
(b) the exchange of the asset; or
(c) the relinquishment of the asset; or
(d) the extinguishment of any right in an asset.

The Applicant submitted that the partnership interest received on conversion of Domino India into Domino LLP cannot be considered as consequent to the 'sale' of shares. It was further submitted that the term 'exchange' requires transfer of property by one person to another and for an exchange transaction, there must exist two persons, as a single person cannot exchange goods with himself. Therefore, the receipt of partnership interest by the Applicant on conversion of Domino India into an LLP cannot be termed as 'exchange'. Regarding the third limb of transfer, it was submitted that 'relinquishment' of an asset is not defined under tax or general law and that by interpreting the terms in the light of judicial pronouncements, whenever a property/asset is relinquished it continues to exist and is owned by some person other than the one who relinquishes the property/assets. According to the Applicant, for a transaction to be categorised as relinquishment of an asset, the following must exist:

(a) two parties i.e. the renouncer and a renouncee; and
(b) continued existence of the assets, post such relinquishment.

It was contended that both these conditions were not fulfilled in the case as subsequent to conversion of shares into partnership interest into an LLP, the shares do not continue to exist and ownership in such shares is also not transferred to any other person. It was, therefore, contended that the transaction of parting with the shares did not constitute 'relinquishment' of shares and was not within the purview of 'transfer'.

5. As regards the fourth limb of the transfer "extinguishment of rights" the Applicant contended that extinguishment means where a right in one is being merged or consolidated with another. The term signifies existence of two entities where a right in one is either merged or consolidated in another. In the present case of the Applicant, there was a conversion of a private limited company into a LLP and the LLP came into existence only when company ceased to exist. Therefore, there was no merger or consolidation of the right of the company in the LLP; rather it was a substitution of shareholding with proportionate partnership interest. It was fairly conceded by the Applicant that the Supreme Court in the case of CIT vs. Grace Collis [2001](115 Taxman 326) had observed that the rights of the shareholders in the shares of amalgamating company stand extinguished upon the amalgamation of the amalgamating company with the amalgamated company and such extinguishment would lead to transfer of shares in the amalgamating company. It was, however, contended that this decision of Supreme Court was discussed and distinguished by the Special Branch of ITAT in the case of Bennett

Coleman & Co. Ltd. Vs. Additional CIT, Mumbai [2011] 12 ITR (Trib.) 97 (Mumbai)(SB), wherein it was held that in the case of reduction of share capital of the company, the rights of the shareholders were not extinguished as the percentage of shareholding immediately before reduction of share capital and immediately after such reduction remained the same. Drawing analogy from this decision, the Appellant submitted that in the present case also there was no change in the rights of the shareholders held in Domino India as the shareholders would continue to hold the partnership interest in the same proportion as their shareholding in the existing company. It was, therefore, contended that since the rights of the shareholders would remain the same in the LLP, there was no extinguishment of any rights of the shareholders.

6. Our attention was drawn to provision of section 47(*xiiib*) of the Act which provides that any capital gain arising on transfer of shares held in the company by a shareholder as a result of conversion of company into an LLP shall not be regarded as transfer within the meaning of section 45(1) of the Act subject to fulfilment of specified conditions. One of the specified conditions is that 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. It was admitted by the Applicant that this condition as stipulated in clause (e) of section 47(*xiiib*) was not fulfilled as the sales/ turnover of Domino India in any of the three previous years preceding the year of conversion did exceed the limit of Rs. 60 Lakh. Our attention was also drawn to section 47A(4) of the Act which stipulates for withdrawal of exemption granted under section 47(*xiiib*) of the Act when the condition laid down in the proviso to that section are not complied with. It was, however, contended that the deeming provision of section 47A(4) of the Act was not absolute. It was submitted that if no profit or gain arose when the conversion of the company into an LLP took place, or if there was no transfer at all of the capital asset in the hands of the shareholder at that point of time, the deeming provisions under section 47A(4) cannot be invoked to levy the capital gains tax.

The Appellant relied upon the ruling of the AAR in the case of Umicore Finance Luxembourg, (323 ITR 25) (AAR-New Delhi) in support of this contention.

7. The Ld. Counsel for the Appellant drew our attention to legal consequences and implications of conversion of a private limited company into a LLP under the provisions of the LLP Act of 2008 and took us through the sections 55 to 57 of the LLP Act which deal with the:

(a) Conversion of an existing partnership firm into a LLP (Section 55);
(b) Conversion of an existing private company into a LLP (section 56); and,
(c) Conversion of an unlisted public company into a LLP (section59).

It was submitted that the LLP Act regards the conversion of an existing partnership firm into a LLP as being conceptually and legally on exactly the same footing as the conversion of a private limited company into a LLP. Both these types of conversions are governed in the very same manner by section 58(4) of the LLP Act which provides for transfer of all the tangible (movable or immovable) as well as intangible property of the erstwhile firm or company to the LLP. In the case of a conversion of a partnership firm into a LLP, the erstwhile partnership firm remains a partnership firm, the only change occurring being that its liability is now limited. The person remains the same, only his legal status is changed. It was emphasized that the LLP Act regards and places on exactly the same footing the conversion of a private limited company into a LLP. Here also, there is merely a change in the legal status of the private limited company with the persons, interested in and beneficially owning the assets, remaining exactly the same. There is no transfer to a third party involved in this conversion as well. The Applicant's shareholding in Domino India only stood converted into partnership capital of exactly the same amount and value; and the erstwhile shareholders became partners. Therefore, there was no transfer in the hands of the shareholders pursuant to conversion of a private limited company into an LLP. It was further contended that in the scheme of conversion no consideration was flowing to the company. A shareholder of the company got partnership interest in the LLP but it had no co-relation to the transfer of properties by the company to the LLP. Therefore, the computation of capital gain was not possible in such circumstances.

8. The Applicant strongly relied on the judgement of the Bombay High Court in the case of **CIT vs. Texspin (263 ITR 345) (Bom.)** In that case, a partnership firm got registered as a company under Chapter IX of the Companies Act, 1956. The shares of the newly formed company were allotted to the partners of the erstwhile firm, and the question which arose was whether this gave rise to a taxable capital gain in their hands. The High Court held that the vesting of properties in the Company under Chapter IX was a statutory vesting and was not consequent or incidental to a transfer. It was further held that, on such vesting, the cloak given to the firm was replaced by a different cloak and the same firm was now treated as a company, and that this did not constitute a transfer under section 45(1) of the IT Act read with section 2(47). Further, the allotment of the shares to the erstwhile partners had no correlation with the vesting of the properties in the company under Chapter IX and, therefore, even if one were to assume that there was a transfer, it would not give rise to a taxable capital gain. It was also held that there was no consideration received by or accruing to the transferor firm as a result of the transfer, within the meaning of section 48 of the IT Act. The Applicant submitted that this decision directly and squarely covers the present case as the provisions of Chapter IX of the Companies Act, 1956 are in parimateria with the provisions of the LLP Act. The Applicant further submitted that the judgment of the Bombay High Court in the case of Texspin was followed in a number of cases and accordingly reliance was placed on the following decisions-:

(a) United Fish Nets (A.P. High Court) – 372 ITR 67
(b) Umicore – (AAR) 189 Taxmann 250/323 ITR 25
(c) Umicore – (Bombay High Court) 291 CTR 174
(d) Unity Care – (Bangalore ITAT) 103 ITD 53
(e) Ravishankar R. Singh (Mumbai Tribunal) 45 taxmann.com 359

(f) Ravishankar R. Singh (Mumbai HC) (ITA 207 of 2015)

(g) CADD Centre (Madras HC) 65 Taxmann.com 291

9. It was further submitted that the decision of Grace Collis (supra) relied upon by the revenue was wholly distinguishable and it had no relevance or applicability to the present case. It was also submitted that the Section 45 and Section 48 of the Act are to be read together as the charging section and the computation section constitute one package and where computation mechanism fails, the charging provisions cannot be applied.

Submissions of the revenue

10. On the other hand the revenue has submitted that the definition of 'transfer' as per provision of Section 2(47) of the I.T. Act is an inclusive definition and, therefore, what is normally understood as transfer would always be transfer even if it is not specifically mentioned in Section 2(47) of the Act. The conversion of company into a LLP is a 'transfer' for the reason that company and LLP are two distinct legal entities and the shareholding of the shareholders in the company has got transferred into partnership interest. Thus one distinct asset had got converted into another asset, as what the shareholder of the company got on conversion of the company into LLP, was a different asset. Therefore, the transaction was a clear case of transfer under the general definition.

11. The revenue further pointed out that the transaction was also specifically covered in Section 2(47) of the Act under "extinguishment of any rights". It was emphasised that the precise question to be decided by the Authority in this case was whether on conversion of the company into LLP; the conversion of shares of the shareholder in the company into partnership interest in the LLP, was transfer or not. It was stressed that when the company gets converted into LLP, the right of shareholders in shareholding of the company (in the form of shares) gets extinguished. Our attention was drawn to Section 58(4) of LLP Act which stipulates that the company shall be deemed to be dissolved and removed from the records of the Registrars of

Companies, on its conversion into a LLP. It was submitted that when the company is deemed to be dissolved, the equity shares held by the shareholders get extinguished and thus there was a transfer within the meaning of Section 2(47) of the Act. The revenue has disputed the submission of the Applicant that extinguishment take place only when there is a merger and submitted that merger is one example of relinquishment, but not the only way. The revenue has relied upon the decision of the Supreme Court in the case of CIT -Vs- Grace Collis (2001)(115 Taxman 326)(SC), wherein it was held that amalgamation amounts to transfer of shares in the hand of shareholders. Reliance was also placed on the decision of the Supreme Court in the case of Kartikeya V. Sarabhai Vs. Commissioner of Income-Tax (1997)(94 Taxman 164)(SC). It was held in that case that reduction in face value of preference share was proportional extinguishment of right. Further, reliance was also placed on the judgement of the Hon'ble Supreme Court in the case of Anarkali Sarabhai Vs. Commissioner of Income Tax (1997)(90 Taxman 509)(SC) wherein it was held that redemption of preference shares was relinquishment and there was no requirement that asset must continue to exist.

12. The revenue has submitted that the present transaction was also covered under the term 'exchange' as the two persons involved were the Applicant shareholder and the LLP, and the capital asset being exchanged was equity share holding with LLP interest. It was submitted that the shareholder had surrendered its interest in the equity holding of the company and the LLP in turn had given him the interest in the newly formed LLP in return, which amounts to exchange and is, therefore, transfer. In support of this proposition the revenue has relied upon the decision of A.P. High Court in the case of the The Nizam Second Supplementary Family Trust (102 ITR 248)(AP). Reliance was also placed on the decision of ITAT, Kolkata in the case of Aravali Polymers LLP (2014) (47 taxman.com 335), which is a direct ruling on identical issue where company got converted into LLP and it was held that capital gain can arise in such case.

Authority for Advance Rulings, NCR Bench, New Delhi

13. The revenue has also placed reliance on the Memorandum of Finance Bill 2010 wherein the reasons for bringing the amendment in the Income-Tax Act by insertion of provision u/s 47(*xiiib*) was explained. Reliance was also placed on the judgment of the Supreme Court in the case of Sole Trustee, Lok Shiksha Trust Vs. CIT (101 ITR 234)(SC) regarding interpretation of a statute. The revenue has further submitted that the decisions and case laws relied by the Applicant were not relevant as they were distinguishable on facts.

14. As regards contention of the Applicant that the computation provision u/s 48 of the Act was not workable and not capable of being implemented in the present case, the revenue submitted that in the case of Texspin (supra) the High Court had come to conclusion that there was no profit or gain as there was no consideration qua the transferor. However, in the present case consideration had arisen in the hands of shareholders as they got partnership interest in LLP in return. It was submitted that on dissolution of the company u/s 58(4)(c) of the LLP Act, the shareholders are entitled to get the money's worth of their shares, in the form of the partnership interest in LLP. Further, reliance was also placed on the provision of Section 50(D) of the Act which deems the fair market value on the date of transfer as the full value of the consideration received or accruing as a result of transfer. It was reiterated that as consideration in the form of partnership interest in LLP was flowing, the computation mechanism does not fail.

15. As to the question regarding whether value of partner's right or interest in LLP is more than value of shareholder's interest in the company, the revenue submitted that the decisions as relied upon the Applicant were different on facts. It was submitted that in the present case the consideration was partnership interest which was higher in value than the face value of the equity shares. The specific submission made by the revenue on the value of partner's interest is as under:

The Applicant has not given statement of account as on date of dissolution 28th Nov 2016. As on 31st March 2016 share capital was 4.08 crore and reserves and surplus were 197.8 crore. And this too at book value. Thus even at book value there is consideration flowing of 201.9 crore against investment of 4.08 crore. This would only increase when market value of assets is taken. Hence, the market value of assets (less liability) of the company would be the consideration at the date of transfer (28th Nov 2016). It is against this market value (arrived at under section 50D) of asset transferred that the applicant got partnership interest.

Rejoinder of the Applicant

16. On the issue of deeming fiction of transfer as contended by the revenue the Applicant submitted that the statutory deeming provision was considered by Hon'ble Bombay High Court in the case of Texspin (supra) and specifically held that the conversion of firm into a company constituted a mere changing of cloak which was not a 'transfer'. It was also specifically held that a transfer requires two distinct parties and this requirement was not fulfilled. On the contention of the revenue that section 58 of LLP Act provided that there shall be transfer of the assets of the erstwhile company and their vesting in the LLP firm and there was no such language in the provisions of Part - IX of the Companies Act and, therefore, the decision of Texspin (supra) and the other decisions following it were inapplicable in the given circumstances; the Applicant submitted that the meaning and effect of section 565 of the Companies Act was same as section 58 of the LLP Act. As there was no material difference between these two sections, the judgments on section 575 of the Companies Act were fully and directly applicable to section 58 of the LLP Act. As regards enactment of statutory provisions of section 47(*xiiib*) and 47A of the Act as well as section 50D of the Act subsequent to the decision of Texspin (supra), it was submitted that this issue was considered by this Hon'ble Authority in the case of Umicore Finance Luxembourg (supra), which was upheld by the Hon'ble Bombay High Court and has become final. It was further submitted that merely because an assessee is unable to avail of the benefit/exclusion provision, it does not lead to the conclusion that the transaction falls within the charging provision or is taxable. On the reliance

of the revenue on section 50D of the Act, it was contended that it was not relevant to decide the issue whether taxable transfer was involved in the conversion of company into a LLP. As regards reliance of revenue on the judgement of the Supreme Court in Grace Collis as well as on the other decisions, it was submitted that the facts of those cases were wholly distinguishable.

Findings:

17. We have carefully considered the facts of the case and the submissions of the Applicant as well as the Revenue. The first issue to be decided is whether conversion of the equity shares held by shareholders in Domino India into partnership interest in Domino LLP, consequent upon the conversion of Domino India into a Limited Liability Partnership, is transfer within the meaning of section 2(47) of the I. T. Act. The second related issue to be decided is that on conversion of Domino India into Domino LLP, whether the computation provision under section 48 of the Act are workable and capable of being implemented. It will be, therefore, relevant to first examine the provisions of the I.T. Act in respect of definition of transfer and the charging of capital gain on transfer of a capital asset.

Whether transfer?

18. The provision of section 2(47) of the Act defines transfer as under:

(*47*) "transfer", in relation to a capital asset, includes,—

(*i*) the sale, exchange or relinquishment of the asset ; or

(*ii*) the extinguishment of any rights therein ; or

(*iii*) the compulsory acquisition thereof under any law ; or

(*iv*) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment ; or

(*iva*) the maturity or redemption of a zero coupon bond; or (*v*) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882) ; or

(*vi*) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Explanation 1.—For the purposes of sub-clauses (*v*) and (*vi*), "immovable property" shall have the same meaning as in clause (*d*) of section 269UA.

Explanation 2.—For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India;

19. Thus, section 2(*47*) defines 'transfer', in relation to a capital asset, to include the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law. The definition of 'transfer' in section 2(*47*) of the Act is an 'inclusive' definition and, therefore, extends to events and transactions which may not otherwise be 'transfer' according to its ordinary, popular and natural sense. The deeming provision of Explanation-2 of section 2(47) stipulates that "transfer" includes disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever. The Applicant has contended that conversion of equity shares held in the company in the partnership interest in the LLP, on the conversion of the company into the LLP, was not covered in the definition of 'transfer' as given in section 2(*47*) of the Act. It was neither sale nor exchange nor relinquishment of asset nor extinguishment of any right in the asset. There is no dispute about the fact that the Applicant was holding shares in Domino India. On conversion of Domino India into Domino LLP, the shares held by the Applicant in Domino India were no longer in existence. The Applicant had got partnership interest in Domino LLP which was not

independent of its shareholding in Domino India. In fact the Applicant's shareholding in Domino India was replaced by the partnership interest in Domino LLP. On conversion of a company into LLP, the company is dissolved and removed from the records of the Registrar of Companies. The provision of section 58(4) of the LLP Act provides as under:

> (4) Notwithstanding anything contained in any other law for the time being in force, on and from the date of registration specified in the certificate of registration issued under the Second Schedule, the Third Schedule or the Fourth Schedule, as the case may be,-
>
> (a) there shall be a limited liability partnership by the name specified in the certificate of registration registered under this Act;
>
> (b) all tangible (movable or immovable) and intangible property vested in the firm or the company, as the case may be, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, as the case may be, and the whole of the undertaking of the firm or the company, as the case may be, shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed; and
>
> (c) the firm or the company, as the case may be, shall be deemed to be dissolved and removed from the records of the Registrar of Firms or Registrar of Companies, as the case may be.

20. On conversion of the Domino India into Domino LLP all tangible (movable or immovable) and intangible property vested in the company were transferred to and vested in the LLP. On such vesting, not only the share capital of Domino India but also the shareholder's interest in the shares of Domino India got extinguished. Thus, this transaction is clearly covered in the definition of 'transfer' as per section 2(47) of the Act. The contention of the Applicant that conversion of the company into LLP does not amount to transfer is contrary to the provisions of the LLP Act as well as the Income Tax Act. The Explanation-2 of section 2(47) covers such situation of shareholder parting with their rights in the shareholding. The revenue has submitted that such conversion was transfer also for the reason that shareholding interest of the shareholder was exchanged with the partnership interest in the LLP. The inclusive definition of transfer in section 2(47) of the Act certainly covers the extinguishment of shareholder's interest on conversion of the company into LLP in its ambit.

21. The Applicant has placed great reliance on the judgement of Hon'ble Bombay High Court in the case of Texspin (supra). It is found that the facts of this case were completely different from the facts of the present case. In the case of Texspin the partnership firm was converted into a Limited Company under Part-IX of the Companies Act, which was specifically covered u/s 45(4) of the Income-Tax Act. The said section stipulated that the profit or gain arising from the transfer of capital asset by way of distribution of capital assets on the dissolution of a firm shall be chargeable to tax as the income of the firm. The precise question to be decided in this case was whether vesting of the erstwhile firm in the limited company was covered by the expression "transfer by way of distribution" in Section 45(4) of the Act. It is in this context that the Hon'ble Court had held that on such vesting the provision of Section 45(4) was not attracted as the very first condition of transfer by way of distribution of capital assets was not satisfied. The Hon'ble Court had also given a finding that there was no transfer of a capital asset as contemplated by Section 45(1) of the Act in this case. However, while giving this finding the Hon'ble Court had not considered the amendments brought vide insertion of clause (*xiii*) to Section 47 of the Act vide Finance (No. 2) Act 1998 which provided that where a Firm is succeeded by a company then such transaction shall not be regarded as transfer, subject to fulfilment of certain conditions. The concerned year involved in this case was A.Y. 1996-97, which was prior to the said amendment, and, therefore, the Court deliberately did not consider that amendment. To reproduce from the order:

> 6. As stated above, in this case we are concerned with the assessment year 1996-97. Therefore, in this case, we are not concerned with clause (*xiii*) inserted by Finance (No. 2) Act, 1998 in section 47 under which it is provided that where a Firm is succeeded by a company in the business carried on by it as a result of sale or otherwise, of any capital assets, then such transaction shall not be regarded as transfer. This clause was inserted with effect from 1st April, 1999. Therefore, we are not concerned with that amendment.

22. It was held by the Hon'ble Court in this case that when the Firm is treated as Company under Part-IX of the Companies Act, it is statutory vesting of properties in the Company and

the cloak given to the Firm is replaced by a different cloak and under the circumstances there was no transfer of a capital asset as contemplated by Section 45(1) of the Act. However, the Court had also acknowledged that in the case of reconstitution of firms and introduction of new partners there was extinguishment of the rights in the capital assets proportionately. The observation of the Court is reproduced below:

> As stated above, section 45(1) is a charging section. Section 45, read with the computation section *viz.* 48 etc., form one composite scheme. This point is very important. Section 45(1) provides that where any profit, arising from transfer of a capital asset is effected in the previous year then such profit shall be chargeable to income-tax under the head "Capital gains". The expression "transfer of a capital asset" in section 45(1) is required to be read with section 2(*47*)(*ii*) which states that transfer in relation to a capital asset shall include extinguishment of any rights therein. The moot point which arose on interpretation of section 45(1) in numerous matters was that on extinguishment of the rights in the capital assets, there was a transfer and in certain cases of reconstitution of **firms and introduction of new partners, there was a resultant extinguishment of the rights in the capital assets proportionately.** In order to get over this controversy, and keeping in mind the object of encouraging Firms being treated as Companies, the controversy is resolved by the Legislature by introducing clause (*xiii*) in section 47 with effect from 1st April, 1999. (Emphasis supplied).

23. Thus, it was held by the Hon'ble Court that there was extinguishment of the rights on reconstitution of firms and there was a transfer involved. The same principle applies on conversion of the Company into LLP. The Court had observed that to overcome this impediment and to encourage Firms to be converted into Companies, the Legislature had introduced clause (*xiii*) in section 47 which stated that where a Firm is succeeded by a company in the business, the transaction shall not be treated as a transfer, subject to fulfilment of certain conditions. A similar amendment was subsequently made by introducing clause (*xiiib*) in section 47 which was in respect of conversion of the Company into LLP. Thus, the decision of Texspin rather enunciates the principle that there was extinguishment of the rights in the capital assets on reconstitution of firm and introduction of new partners.

24. The finding that there was statutory vesting of properties in the Company and the cloak given to the Firm was replaced by a different cloak and there was no transfer of a capital asset as contemplated by Section 45(1) of the Act is not found applicable in this case for the following reasons:

(i) The issue decided in the case of Texspin was capital gains in the hands of the Firm and not its partners. We are not concerned with the capital gain arising in the hands of firm or the company. The capital gain to be considered in the present case is in the hands of the shareholder of the company and not in the hands of the company or the firm. Therefore, the ratio of this decision cannot be applied to decide the capital gain in the hand of shareholder.

(ii) The conversion of a company into a LLP is differently placed in comparison to succession of a partnership firm by a company. The provisions of LLP Act specifically provides for transfer of all assets and vesting thereof in the LLP.

(iii) The Court held that on vesting of properties of Firm in the Company the cloak was changed. However, on conversion of Company into LLP, there is no vesting of properties in the hands of shareholders. Hence, there cannot be any question of change of cloak. There might be a change of cloak for the company but not for its shareholders.

(iv) This case was specifically in the context of section 45(4) of the Act which was held as not attracted as the condition of transfer by way of distribution of capital assets was not satisfied.

(v) This decision was in the context of provisions *de horse* the amendment vide insertion of clause (*xiii*) to Section 47 of the Act, which was acknowledged in the order. The amendments regarding taxation of shareholders of company on conversion of company into LLP was brought much later on statute in 2010 vide clause (*xiiib*) to Section 47 of the Act.

The Applicant has relied upon various other decisions wherein the principle of 'change of cloak' as enunciated in the case of Texspin was followed. As the decision of Texspin is not applicable in the present case for the aforesaid reasons, no credence can be given to the decisions following this case, as relied upon by the Applicant.

25. The Applicant has also relied on the observation of the Hon'ble High Court in the case of Texspin (supra) that in the case of a transfer of a capital asset there has to be the existence of a party and a counter party. Such a condition is found not mandatory for charging of capital gains under the provisions of Income Tax Act. The provisions of the Act stipulates for situation where the transferor as well as the transferee can be the same person. As per definition of transfer where the asset is converted by the owner into stock-in-trade of a business carried on by him, such conversion is included in transfer. Further, the provision of Section 45(2) of the Act stipulates that profit arising on transfer by way of conversion of capital asset into a stock in trade is chargeable to tax. Thus, even if the same person changes the nature of his asset it constitutes a transfer and the existence of two parties for transfer is not mandatory. As already mentioned earlier the extinguishment of rights in the capital assets on reconstitution of firm was acknowledged in this case, which constitutes transfer under the provisions of the Act. The deeming provision of Explanation-2 of section 2(47) stipulates for "transfer" on disposing of or parting with an asset or any interest therein, and the extinguishment of the shareholder's interest in the shareholding of the company on its conversion into LLP is certainly covered under the ambit of this deeming provision.

26. The Hon'ble Supreme Court has held in the case of Grace Collis (supra) that the expression 'extinguishment of any rights therein' as occurring in section 2(47)(ii) of the

Income-tax Act extends to mean extinguishment of rights independent of or otherwise than on account of transfer. Accordingly, it was held that there was transfer of shares of amalgamating company within meaning of section 2(47), read with section 47(vii) of the Act. To quote from the order:

> **15.** We have given careful thought to the definition of 'transfer' in section 2(*47*) and to the decision of this Court in *Vania Silk Mills (P.) Ltd.'s* case (*supra*) . In our view, the definition clearly contemplates the extinguishment of rights in a capital asset distinct and independent of such extinguishment consequent upon the transfer thereof. We do not approve, respectfully, of the limitation of the expression 'extinguishment of any rights therein' to such extinguishment on account of transfers or to the view that the expression 'extinguishment of any rights therein' cannot be extended to mean the extinguishment of rights independent of or otherwise than on account of transfer. To so read, the expression is to render it ineffective and its use meaningless. As we read it, therefore, the expression does include the extinguishment of rights in a capital asset independent of and otherwise than on account of transfer.
>
> **16.** This being so, the rights of the assessees in the capital asset, being their shares in the amalgamating company, stood extinguished upon the amalgamation of the amalgamating company with the amalgamated company. There was, therefore, a transfer of the shares in the amalgamating company with the meaning of section 2(*47*). It was, therefore, a transaction to which section 47(*vii*) applied and, consequently, the cost to the assessees of the acquisition of the shares of the amalgamated company had to be determined in accordance with the provision of section 49(2), that is to say, the cost was deemed to be the cost of the acquisition by the assessees of their shares in the amalgamating company.

The Applicant has contended that the facts of this case were different and, therefore, this decision may not be relied upon. The facts might be different but the meaning of "extinguishment" as propounded in this decision cannot be disputed and has to be followed. The Hon'ble Court has held in this case that there can be extinguishment of rights in a capital asset independent of and otherwise than on account of transfer. And once there is extinguishment of such rights, it is deemed to be transfer under the provisions of section 2(47) of the Act. As held by the Apex Court the rights of the shareholder in the shares of the amalgamating company were extinguished upon the amalgamation of the amalgamating company with the amalgamated company. Following the same principle, the rights of the Applicant in the shares of Domino India were extinguished on its conversion into LLP.

Therefore, the extinguishment of such right was a transfer under the provision of section 2(47)(ii) of the Act.

27. As per Applicant the decision of the Supreme Court in the case of Grace Collis was distinguished by the Special Bench of ITAT in the case of Bennett Coleman & Co. Ltd. [14 taxmann.com 1 (Mum)]. It was held by the Ld. ITAT in this case that the assesse did not receive any consideration for reduction of share capital. The number of shares held by the assesse was reduced to 50% but nothing had moved from the side of the company to the assessee. It was on these facts that it was held that until and unless consideration was present, the computation mechanism of section 48 was not workable. It was, therefore, held that loss arising on account of reduction of share capital cannot be subjected to provision of Section 45 read with section 48 and accordingly such loss was not allowed as capital loss. The fact that even extinguishment of rights in a particular asset would amount to transfer was never disputed in this decision.

28. In the case of Kartikeya V Sarabhai (supra) the Apex Court had held that reduction of share capital by company paying a part of the capital by reducing face value of its share would result in extinguishment of proportionate right in shares held by shareholders and the amount paid by the company to shareholder on reduction of share capital would be exigible to capital gains tax in the hands of the shareholder. The Hon'ble Court held in this case as under:

> Relinquishment of the asset or the extinguishment of any right in it, which may not amount to sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under section 45 of the Act.
>
> When as a result of the reducing face value of the share, the share capital is reduced, the right of the preference share holder to the divided or his share capital and the right to share in the distribution of the net assets upon liquidation is extinguished proportionately to the extent of reduction in the capital.

29. In another case of Anarkali Sarabhai (224 ITR 422) the Supreme Court had held that redemption of preference share amounted to 'sale, exchange or relinquishment of asset' within

meaning of section 2(47)(I) of the Act. It was also held that the definition of words "transfer" under Section 2(47) of the Act was not an exhaustive definition and that subsection (1) of clause (47) of Section 2 implies that parting with any capital asset for gain would be taxable under Section 45 of the Act. It has also been held by the AP High Court in the case of Trustees of H.E.H. The Nizam Second Supplementary Family Trust (102 ITR 248) that conversion of preference shares into ordinary shares was transfer by way of exchange within meaning of section 45 of the Act.

30. When a company is converted into LLP there is transfer of assets not only by the company to the LLP but also transfer of shares held in the company by the shareholder. In the present case we are not concerned with the transfer of assets by the company but only with the transfer of shares held in the company by the shareholder. The LLP was incorporated in the taxation scheme of India effective from the 1st day of April 2010 *i.e.*, assessment year 2010-11 on the same lines as the taxation scheme for general partnerships, *i.e.*, taxation in the hands of the entity and exemption from tax in the hands of its partners. An LLP and a general partnership was treated as equivalent and the conversion from a general partnership firm to an LLP was having no tax implications if the rights and obligations of the partners remained the same after conversion and if there was no transfer of any asset or liability after conversion. However, if there was a violation of these conditions, the provisions of section 45 was applicable. The provision regarding conversion of a private company or an unlisted public company into a limited liability partnership (LLP) was brought on statute with effect from 1st April, 2011 by insertion of clause (*xiiib*) to section 47 of the Act, which is as under:

47. Nothing contained in section 45 shall apply to the following transfers:

(*xiiib*) any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or **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 (6 of 2009):

Provided that—

(*a*) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;

(*b*) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and 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;

(*c*) 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;

(*d*) 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;

(*e*) 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; [***]

(*ea*) the total value of the assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed five crore rupees; and

(*f*) 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.

Explanation.—For the purposes of this clause, the expressions "private company" and "unlisted public company" shall have the meanings respectively assigned to them in the Limited Liability Partnership Act, 2008 (6 of 2009); (emphasis supplied).

31. It is thus crystal clear from the above provisions of the Act that transfer of a capital asset or intangible asset by a company to a LLP or 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 was a transfer, to which provisions of section 45 of the Act regarding charging of capital gains tax were applicable. However, it was provided vide clause (*xiiib*) of section 47 that such transfer will not be subjected to capital gains tax if the conditions as contained in the said clause were fulfilled. The Memorandum of Finance Bill 2010

Authority for Advance Rulings, NCR Bench, New Delhi

explained that conversion of a company into an LLP had definite tax implications and the transfer of assets on conversion attracted levy of capital gains tax and it was proposed that the transfer of assets on conversion of a company into an LLP in accordance with section 56 and section 57 of the LLP, 2008 shall not be regarded as a transfer for the purposes of capital gains tax under section 45, subject to certain conditions. We find from perusal of the 'Memorandum' explaining the purpose and intent behind the enactment of sub-section (*xiiib*) to Sec. 47, that prior to its insertion, the 'transfer' of assets on conversion of a company into a LLP attracted levy of "capital gains" tax. The legislature vide the Finance Act, 2010 introduced Sec. 47(*xiiib*) on the statute, with the purpose that the transfer of assets on conversion of a company into a LLP in accordance with the Limited Liability Partnership Act, 2008, subject to fulfillment of the conditions contemplated therein, shall not be regarded as a 'transfer' for the purposes of Sec. 45 of the Act. In the instant case the cumulative fulfillment of the prescribed conditions has not been satisfied. Therefore, the transaction is a 'transfer' exigible to capital gains tax under the provisions of section 45 of the Act.

32. In view of the specific provisions and also considering the judicial pronouncements as discussed earlier, we have no hesitation in ruling that conversion of the equity shares held by the shareholders in Domino India into partnership interest in Domino LLP, consequent upon the conversion of the company into LLP, was a transfer within the meaning of section 2(47) of the Act.

Whether computation provision fails?

33. The Appellant has contended that no profit or gain arose on conversion of the company into LLP and, therefore, the computation provision u/s 48 of the Act was not workable and capable of being implemented. Section 45 of the Act states that any profits or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income-

tax under the head 'Capital gains' and shall be deemed to be the income of the previous year in which the transfer took place. Section 47 excludes certain transactions from the levy of capital gains tax and lays down that nothing contained in Section 45 shall apply to the 'transfers' mentioned therein. Clause (*xiiib*) of Section 47 stipulates that transfer of a capital asset or intangible asset by a company to a LLP or transfer of shares held in the company by a shareholder, as a result of conversion of the company into LLP in accordance with the provision of section 56 or 57 of the LLP Act 2008, will be excluded from the purview of section 45, subject to fulfilment of the conditions as mentioned in the proviso therein. Thus, the transactions referred in section 47 are "transfers". However, they fall beyond the sweep of chargeability of capital gains tax u/s 45 of the Act subject to cumulative satisfaction of the conditions prescribed therein. There is no doubt about the position that prior to insertion of clause (*xiiib*) of Section 47 such transaction was subject to capital gains tax. In the present case all the conditions as stipulated in the proviso to section 47(*xiiib*) have not been satisfied. The Applicant has admitted that clause (*e*) of the proviso which stipulated that total sales, turnover or gross receipts in the business of the company in any of three previous years preceding the previous year in which the conversion took place does not exceed Rs. 60 lakhs, was not satisfied in this case. Thus, the transaction was squarely covered u/s 45 of the Act and was liable for capital gains tax.

34. The provision of section 47A(4) of the Act stipulates for charging capital gains tax on failure to comply with the conditions prescribed in clause (*xiiib*) of section 47 of the Act as under:

(4) Where any of the conditions laid down in the proviso to clause (*xiiib*) of section 47 are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible assets or share or shares not charged under section 45 by virtue of conditions laid down in the said proviso shall be deemed to be the profits and gains chargeable to tax of the successor limited liability partnership or the shareholder of the

predecessor company, as the case may be, for the previous year in which the requirements of the said proviso are not complied with.

In the instant case the requirement of the proviso to Section 47(*xiiib*) was not complied in the year of conversion of the company into LLP itself. Therefore, the profit or gain arising in the hand of the shareholder was chargeable to capital gains tax in his hand in the year of conversion of the company into LLP. The mode of computation of capital gains tax is prescribed in section 48 of the Act as under:

> **48.** The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—
>
> (*i*) expenditure incurred wholly and exclusively in connection with such transfer;
>
> (*ii*) the cost of acquisition of the asset and the cost of any improvement thereto.

Thus the capital gain shall be basically computed by deducting from the 'full value of consideration', the cost of acquisition of the asset, if there is no other expenditure involved. In the present case the asset transferred was shares of Domino India held by the Applicant and in order to work out the capital gains tax, one has to consider the full value of consideration of the shares in the transfer pursuant to conversion of Domino India into Domino LLP and also the cost of acquisition of those shares.

35. On the conversion of a company into a LLP, the shares in the hand of the share-holders of the company are converted into capital in the LLP. Thus, the shareholders relinquish their shareholding in the company and acquire capital in the LLP in the same proportion as was the shareholding in the private limited company. The **full value of the consideration received / accrued** to each shareholder, as a result of relinquishment of shares, will be the **Value of the Capital** in the newly formed LLP for the purpose of computation of Capital Gains under section 48 of the Act. If any of the shareholders of the private limited company receives any extra consideration or benefit, directly or indirectly, in any form or manner, the full value of

the consideration received has to be enhanced accordingly for the purpose of computation of capital gains under section 48 of the Act. Further, necessary adjustments also has to be made to the full value of the consideration, if the capital contribution and profit sharing ratio in the limited liability partnership are not in the same proportion, as their shareholding in the company, as on the date of conversion. On the other hand the **cost of acquisition of shares** shall be the **amount paid** by such share holder at the time of **purchase of shares**, for the purpose of computation of capital gains under section 48 of the Act. The receipt of bonus share, if any, will not have any cost since it is out of the reserves of the company.

36. The full value of consideration received by the Applicant shareholder in the instant case will be the value of capital/partnership interest in the LLP. The revenue has pointed out that the consideration received in the form of partnership interest in LLP was certainly higher than the face value of the equity shares foregone. As against share capital of Rs. 4.08 crores as on 31st March 2016, the reserves and surplus were Rs. 197.08 crores and accordingly the revenue worked out the book value of the partnership interest at least to the extent of Rs. 201.90 crores as against investment in share capital of Rs. 4.08 crores only. According to revenue the full value of consideration of the shares will be much higher if their market value is taken as prescribed under section 50D of the Act, which stipulates as under:

> **50D.** Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

As per provision of section 50D of the Act, fair market value of the asset is taken as full value of consideration only where the consideration received or accruing as a result of transfer of the capital asset is not ascertainable or cannot be determined. In the instant case the Applicant's interest in the share capital of Domino India has been extinguished and in return it has got partnership interest in Domino LLP. So the full value of consideration of the shares foregone will be equivalent to the value of partnership interest in Domino LLP. Even if the assets of the company were transferred to LLP at their book value, the value of partnership interest in LLP will be certainly more than the face value of the shares foregone by the Applicant considering the reserves and surpluses transferred. The full value of consideration of the shares foregone by the Applicant can be worked out from the accounts of the LLP and the erstwhile company. If the value of partnership interest cannot be ascertained or determined for any reason, then the fair market value of the same has to be taken as stipulated under section 50D of the Act.

37. The Applicant has contended that the value of partnership interest in LLP was equal to the value of shareholder's interest in the company. In other words, the cost of acquisition of the partner's interest in the LLP was deemed to be the cost of acquisition of the shares held in the company and, therefore, the transaction does not give rise to any taxable capital gain and the computation mechanism fails. Such an interpretation is contrary to the computation mechanism of capital gains as prescribed in the Act and as discussed above. The meaning of 'cost of acquisition' is defined in section 55(2) of the Act which does not stipulate that the cost of acquisition of the partner's interest in the LLP, will be deemed to be the cost of acquisition of the shares held in the company. The cost of acquisition of the shares is always the price at which the shares were acquired by the shareholder and if not directly acquired then as prescribed in section 49 of the Act. It is not necessary that the shares are reflected in the books of the company at the same price at which it was acquired by the shareholder. Further, the cost of acquisition may vary from person to person. If a shareholder had acquired the shares at market value higher than the face value of the shares his cost of acquisition will certainly be higher than another shareholder who acquired it on face value. Therefore, the value of partnership interest in LLP cannot be taken as cost of acquisition of shares. The cost of

acquisition of shares will remain the price at which the shares were acquired by the shareholder.

38. The Applicant has also contended that no consideration was accruing or arising to the transferor company which was dissolved and ceased to exist. Further that there would be no taxable gain considering that the amount or value of the capital account balance in the books of account of the firm would be exactly the same as the amount of share capital and reserves in the books of account of the erstwhile company. When a company is converted into LLP, the capital gain arises not only in the hands of the company but also its shareholders. The contention of the Applicant might be applicable and may have to be considered while working out the capital gains arising in the hands of the erstwhile company but the same is not applicable in the case of the capital gains arising in the hands of the shareholder. In the present case we are concerned with the capital gains arising in the hands of the shareholder and not the company. In the case of shareholder consideration was flowing in the form of partnership interest in the LLP and the capital gain has to be worked out by deducting the cost of acquisition of the shares from the full value of the consideration received.

39. The argument regarding failure of the computation mechanism is also found to be flawed. There can be three situations in computation of capital gains by deducting from the 'full value of consideration', the cost of acquisition of the asset (presuming that no other expense is involved):

(a) If the full value of consideration is more than the cost of acquisition, it will result in capital gains.

(b) If the full value of consideration is less than the cost of acquisition, it will result in capital loss.

(c) If the full value of consideration is equal to the cost of acquisition, it will have neither gain or loss and will be tax neutral.

Simply because in a case there is no gain or loss due to full value of consideration being equal to the cost of acquisition, we can not say that the computation mechanism fails. The computation mechanism encompasses a situation which may be tax neutral. The mechanism is meant not only to tax the capital gains but it allows carry forward of the capital loss and their set off with the capital gains in future. In such computation mechanism, a neutral capital gains situation may arise but that does not render the computation mechanism otiose.

40. In the case of Texspin (supra), relied upon by the Applicant, the Hon'ble Court had held that section 45(4) was mutually exclusive to section 45(1) and the stipulation in section 45(4) that A.O. was entitled to treat the market value of the asset on the date of transfer as full value of the consideration received was missing in section 45(1). Under the circumstances, the market value of the asset could not have been treated as full value of consideration u/s 45(1) so as to apply the provision of section 48 of the Act to compute the capital gains. According to the Court, section 48 did not empower the AO to take market value as full value of consideration. as in the case of section 45(4). Under the circumstances it was held that the computation was not possible under the provision of section 45(1) of the Act. Thus, the precise issue involved in this case was computation of capital gains tax u/s 45(1) vis-à-vis 45(4) of the Act, in the context of which the decision was rendered. The provision of section 50D of the Act was also not on statute when this decision was given. Further, this decision was not in the context of capital gains in the hands of the shareholders of the company converted into LLP. Therefore, the ratio of this decision cannot be applied to the facts of the present case.

41. The Applicant has also relied upon the decision of this Authority in the case of Umicore Finance Luxemborg (supra). The issue involved in that case was capital gains arising at the

time of conversion of partnership firm into a private limited company under Part IX of the Companies Act. Section 47(*xiii*) specifically excluded such transfer from the purview of capital gains taxation, subject to the fulfillment of the conditions laid down in clauses (a) to (d). In that case the requirement in the second part of clause (d) i.e. shareholding of fifty percent or more should continue to be as such for a period of 5 years from the date of succession, was not fulfilled. By virtue of the premature transfer, the transferor company which succeeded the firm, had forfeited the protection given under section 47(*xiii*). As a result the deeming provision of section 47A(3) was applicable, which presupposes that there was a transfer of capital asset and that the profit or gain resulted therefrom which has not been charged to tax earlier, was to be charged. It was observed that the deeming in sub-section (3) of Section 47(A) was not absolute and it was held that if no profits or gains arose earlier when the conversion of the firm into a company took place or if there was no transfer at all of the capital assets of the firm at that point of time, the deeming provision under Section 47A(3) cannot be invoked to levy the capital gains tax. It was further held that in a transaction involving the conversion of firm into Company under Part-IX of Companies Act, with all the assets automatically vesting in the newly registered company as per the statutory mandate contained in Section 575, it can hardly be said that the partners have made any gain or received any profit, as the worth of the shares allotted to the erstwhile partners was not different from the interest of the partners in the extinct firm when quantified in terms of money. The transaction did not give rise to any profit or gain as the value of shares was nothing more than the value of the sum total of their interest in the firm or the worth of their shareholding in the firm. It was ruled that no capital gains accrued or arose at the time of conversion of partnership firm into a private limited company under Part IX of the Companies Act and, therefore, notwithstanding the non-compliance with clause (d) of proviso to Section 47(xiii) of the Income Tax Act, by reason of premature transfer of shares, the said company was not liable to pay capital gains tax. This ruling was upheld by the Hon'ble Bombay High Court.

42. It can be seen that facts in the case of Umicore Finance Luxemburg as decided by this Authority and upheld by Hon'ble Bombay High Court, were completely different. The observation that the deeming provision u/s 47A(3) cannot be invoked to levy capital gains tax for the reason that the transaction did not give rise to any profit or gain as the value of shares was equal to the value of the sum total of their interest in the firm might be applicable in the case of the company which is converted into LLP but the same cannot be extended to the capital gain arising in the hands of shareholders of the erstwhile company. Further this ruling was delivered by relying upon the decision of Hon'ble Bombay High Court in the case of Texspin (supra) and as already discussed earlier the ratio of the said decision cannot be applied to the facts of the present case. The Hon'ble Bombay High Court had upheld this ruling by endorsing that transferee company was not liable to pay capital gains tax. However, in the present case we are not concerned with the capital gain arising in the hand of the transferee LLP or the transferor company but in the hand of the shareholder. Therefore, the decision in the case of Umicore also does not come in the way of charging capital gains in the hands of the shareholder.

43. In the case of United Fish Nets (supra) relied upon by the Applicant, the firm was converted into a company and it was held by the A.P. High Court that section 45(4) was not attracted as the very first condition of transfer by way of distribution of capital asset was not satisfied. In the circumstances the latter part of section 45(4) which refers to computation of capital gain u/s 48 by treating fair market value of the asset on the date of transfer, did not arise. This decision being specific on the issue of distribution of capital asset u/s 45(4) of the Act does not help the Applicant.

44. In the case CADD Centre (supra) also the issue involved was conversion of partnership firm into company. The Hon'ble Madras High Court had observed in that case as under:

> It is not in dispute that the Partnership Firm transformed into a Private Limited Company. The Partnership Firm and a Private Limited Company are two different legal entities, with different legal liability. In other words, the liability of a Partner is different from that of the liability of a Director of a Company. The Company has an independent legal entity, de hors its share-holders, whereas the Partnership Firm has not such independent existence, de hors the partners. Therefore, when a Partnership Firm is transformed into a Limited Company with no change in the number of partners and the extent of property, there is no transfer of assets involved and hence, there is no liability to pay tax on capital gains.

The Hon'ble court held in this case that the company has an independent legal entity *de hors* its shareholders whereas the partnership firm has no such independent existence *de hors* its partners. In the present case we are concerned with the capital gain arising in the hand of the shareholder which has to be independently computed *de hors* the capital gain arising in the hands of the company. As held by the Court the liability of the partner is different from that of the liability of a shareholder director. Therefore, the decision as given in the context of the conversion of firm into company cannot be applied to the case of a shareholder.

45. In the case of Ravishankar R Singh (supra) the issue was conversion of firm into company and the Hon'ble Bombay High Court had upheld that there was neither distribution of assets nor any realization of assets. Neither there was dissolution of the firm nor distribution of assets of the firm amongst the partners. It was held that the revaluation of assets by the partnership firm would not attract any capital gain. In fact this decision was based on the earlier decision in the case of Texspin and the Hon'ble court only held that no substantial question of law arose.

46. In the case of United Breweries Ltd. [325 ITR 485 (Karnataka)] the assesse has renounced right to subscribe to shares in favour of general public for no consideration and it

was held by the Hon'ble Court that there was no transfer by the transferor and the loss claim by the assesse as a result of such renunciation was not allowable as capital loss. Thus, the facts of this case were totally different and the ratio of this decision is not applicable to the present case.

47. In the case of Aravali Polymers LLP [47 taxmann.com 335 (Kolkata-Trib.)] the facts were identical as the company was converted into LLP and all the conditions as stipulated in proviso to Section 47(*xiiib*) were not fulfilled. It was held that in such circumstances, section 45 comes into play and capital gain in respect of the transfer of assets by the company to the LLP was to be computed for which the matter was restored to the A.O. It was also held that as the shares were transferred at the book value, the capital gains had to be computed on the basis that the book value was the consideration received for the transfer by way of conversion.

48. In the case of Celerity Power LLP [100 taxmann.com 129 (Mumbai-Trib.)] also the facts were identical as a private limited company was converted into a LLP. The decision of the Texspin (supra) and the amendment brought in by incorporating the provision of Section 47(*xiiib*) of the Act was considered in this case and held that conversion of a company to a LLP was transfer but was not chargeable to capital gain u/s 45 on cumulative satisfaction of conditions as prescribed in the proviso to Section 47(*xiiib*). However, in case those conditions were not fulfilled, Section 47A(4) comes into play for withdrawing the exemption of amount of profit arising from transfer of capital assets or shares which had not been charged u/s 45 by virtue of conditions laid down in proviso of section 47(*xiiib*). It was further held that as the assets and liabilities of the erstwhile company got vested in the LLP at their book value, such book value could only be regarded as the full value of consideration for the purpose of computation of capital gains.

49. In the light of above discussions we are of the considered view that the computation mechanism under section 45 read with section 48 of the Act is workable and capable of being implemented in the present case. The full value of consideration for the purpose of computation of capital gains will be the value of the Applicant's partnership interest in Domino LLP and the cost of acquisition of shares shall be the amount paid by the Applicant share holder at the time of purchase of shares. The Applicant's partnership interest in the LLP is capable of being evaluated on commercial and accounting principles and if it cannot be done so their fair market value has to be taken as stipulated u/s 50D of the Act. Further, the computation mechanism of the capital gains does not break down or fail as the scheme envisages for not only taxing the capital gains but also allows carry forward of the capital loss incurred, if any, and their set off with the capital gains in future. Under such a mechanism a neutral capital gain situation may arise which does not render the computation mechanism nugatory and inapposite.

Whether value of partner's interest in the LLP is more than the value of shareholder's interest in the company to give rise to any taxable capital gain?

50. The Applicant has contended that it can be said to have gained from the conversion of the company into a LLP only in case the worth of the partnership interest was greater than the worth of the equity shares held in the company. It was submitted that shareholder's fund include share capital, reserves & surplus and money received against share warrants; and the accounting principles recognize the reserves and surpluses as part of shareholder's fund. On conversion of the company into LLP, the shareholder's right to shareholder's fund got converted into their partnership right and the interest in the LLP. It was further submitted that if all the shareholders got partnership interest in the LLP equal to their right in the

shareholder's fund in the company then there would be no profit or gain accruing to such shareholders pursuant to conversion of the company into LLP.

51. In the present case we are concerned that the capital gains arising in the hand of the shareholder and not in the hand of the erstwhile company. The value of total shareholder's fund as appearing in the books of the company might be equal to the value of total partnership right and interest in the LLP. But this factor is not relevant for working out the capital gains in the hand of the shareholder. The precise asset of the shareholder that got extinguished on the conversion of a company into a LLP was his specific shareholding in the company, which was different and distinct from the shareholder's fund as appearing in the books of the company. The reserves and surpluses remains the property of the company as long as it is not distributed to the shareholders as dividend. No shareholder can claim a right on the undistributed reserves and surplus of the company. Therefore, we cannot equate the reserve and surplus as appearing in the books of the company as part of shareholder interest to work out the capital gains in the hands of the shareholders. Further, even if the value of total shareholder's fund in the company is equal to the value of total partnership interest in the LLP, it does not have an impact on the capital gain arising in the hands of the shareholder. As already discussed earlier, the capital gain has to be worked out by deducting the "cost of acquisition" of the shares from the "full value of consideration" of the shares. For the shareholder the full value of consideration for the transfer of shares is his partnership interest in the LLP which might be equal to the value of shareholder's fund in the company. However, to work out the capital gains, the cost of acquisition of the shares incurred by the shareholder has to be reduced from this full value of consideration. The transaction will certainly give rise to capital gain as one has to reduce the cost of acquisition of the shares from the full value of consideration. Therefore, even if the value of partner's interest in the LLP is equal to the value of

shareholder's interest in the company, it does give rise to taxable capital gain in the hands of the shareholder.

52. In view of the foregoing, the questions raised by the Applicant are answered as under:

(1) The conversion of the equity shares held by the Applicant shareholder in Domino India into partnership interest in Domino LLP, consequent upon the conversion of Domino India into a Limited Liability Partnership, was a transfer within the meaning of section 2(47) of the Act.

(2) On conversion of Domino India into Domino LLP, the computation provision under section 48 of the Act are workable and capable of being implemented for working out the capital gains arising in the hands of the Applicant shareholder.

(3) Even if the value of partner's interest in the LLP is equal to the value of shareholder's interest in the company, it does give rise to taxable capital gain in the hands of the Applicant shareholder.

Accordingly, the ruling is given and pronounced on this the 23rd day of August, 2019.

-S.d.-
(Narendra Prasad Sinha)
Member (Revenue)

-S.d.-
(Ranjana P. Desai)
Chairperson

-S.d.-
(Ramayan Yadav)
Member (Law)