

**Conversion of a Private Company to a LLP****Stamp duty applicability on property transfer in case of conversion to an LLP in comparison to an amalgamation order under Section 394 of the Companies Act, 1956.**

- I. The purpose of this note is to analyse the implication of Stamp Duty levy in case of property being transferred pursuant to a company being converted to a Limited Liability Partnership (for short 'LLP'). An analysis into this aspect can be done by looking into the Limited Liability Partnership Act, 2008 (for short '**the LLP Act**') can be understood by comparing it with Mergers/Demerger under the Companies Act, 1956 (for short '**the Companies Act**') the reason being that both the provisions provide for vesting of properties automatically. Further, an analysis has to been done in the Transfer of Property Act (for short '**TOP Act**') for the same. This note covers the arguments against levy of stamp duty in an LLP and also the other confusions prevalent under the legislation which expose it to the payment of stamp duty.
- II. LLP can be defined as a corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership. It allows the partners to restrict their liability in the firm to an agreed limit unlike a normal partnership concern. It is a form of business which does not involve the complexities of a company while at the same time allowing its Partners to be safe from the risk of unlimited liability caused by adverse actions of other partners. LLP's are monitored by the LLP Act in India along with certain other rules for the same.
  1. Section 56 of the LLP Act lays down that:

*"a private company may convert into a limited liability partnership in accordance with the provisions of this Chapter and the Third Schedule"*
  2. The LLP Act, under Section 58 and under Clause 6 of the third Schedule lays down the Effect of Conversion and the Effect of Registration respectively. It states under sub-clause (b) that:

*"all tangible (movable or immovable) and intangible property vested in the company, all assets, interests, rights, privileges, liabilities, obligations relating to the company and the whole of the undertaking of the company shall be transferred to and shall vest in the limited liability partnership without further assurance, act or deed"*
  3. Thus a plain reading of the LLP Act implies that no separate deed is required to be executed for the transfer of properties from the Company to the LLP and these properties are automatically vested in the LLP at the time of incorporation. Another implication of it being that no Stamp Duty would be rendered payable on such transfer.
  4. However **Section 394 of the Companies Act** speaks about the Provisions for facilitating reconstruction and amalgamation of Companies. It lays down that:

*"Where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of, the transferee company; and in the case of any property, if the order so directs, freed from any charge which is, by virtue of the compromise or arrangement, to cease to have effect"*

5. In spite of the above provision, any order passed by the court under Section 391-394 of the Companies Act is subject to stamp duty though the properties and liabilities of the transferor companies are vested upon the transferee company by operation of law<sup>1</sup>.
6. A need hence arises to analyse the two legislations and certain precedents which could help clarify the legislative intent behind the framework of these two acts and help solve the ambiguity as to payment of stamp duty. Further an assessment is also required to undermine the cause of difference behind the payment of Stamp Duty if any, between the two legislations in spite of them being similarly worded.

### III. Stamp Duty on Mergers/Demergers

1. In the landmark judgment of **Hindustan Lever v. State of Maharashtra**<sup>2</sup> the Supreme Court held that:

*“The consent decree which purports to convey the title in the property was an instrument liable for stamp duty and it was only by way of abundant caution that the legislature had included the consent decree in the definition of the word conveyance”.*

It further held *“that the basic foundation for passing an order of amalgamation is an agreement between two or more companies”. The scheme of amalgamation exists because of an agreement between the prescribed majority of shareholders and creditors of the transferor company with the prescribed majority of shareholders and creditors of the transferee company. The intended transfer is a voluntary act of the contracting parties. The transfer has all the trappings of a sale. The transfer of assets and liabilities takes effect by an order of the Court. The order also provides for passing of consideration from the transferee-company to the shareholders of the transferor-company. The consideration for sale in a transaction like this is the shares”.*

The Court thus held that the definition of 'conveyance' in the Stamp Act was an inclusive definition and included within its ambit an order of the High court under section 394 of the Companies Act. It was therefore subject to payment of stamp duty.

2. West Bengal also faced similar debatable issues in reference to the Stamp Duty on mergers and demergers. In the case of **Gemini Silk Limited v. Gemini Overseas Limited**<sup>3</sup> the court held that the:

*“order sanctioning a scheme of reconstruction amalgamation under section 394 was covered by the definition of ‘conveyance’ and ‘instrument’ under the Indian Stamp Act and therefore liable to stamp duty”.*

This was the case even though “conveyance” was not defined to expressly include an order of amalgamation under the West Bengal Stamp Act.

3. Subsequently in **Madhu Intra Limited v. Registrar of Companies**<sup>4</sup> the court laid down a contrary view of the Gemini case. It laid down that:

<sup>1</sup> The Karnataka High Court in the case of Miss Chandra Pardhanani And Ors., vs M/S Mac Charles on 14/10/09 laid down that *“The word ‘transferred’ requires at least that a proper instrument of transfer should have been executed and delivered to the transferee or the company in respect of the shares in question. Transmission by **operation of law means** some act in the law by which the legal estate passes even though there be some further act such as registration, to be done”*,

In the case of Re: Emami Biotech Ltd. and Another, Justice Sanjib Banerjee had laid down a transfer by operation of law to be where the parties were not involved in a deliberate act like carrying the petition to the court (Footnote 5).

<sup>2</sup> 2003 (48) SCL 630

<sup>3</sup> 2003 53 CLA 328

*“an order of amalgamation was not subject to stamp duty, because it did not fall within the definition of a “conveyance”; moreover even if such an order were to be taken as a “conveyance” or an “instrument” the transfer of assets and liabilities effected thereby is purely by operation of law”*

4. However in the case of **Re: Emami Biotech Limited and Another**<sup>5</sup>, Justice Sanjib Banerjee stated that a

*“transfer by operation of law would be where the parties to the transaction had no role to play and the transaction could have been completed without any of the parties seeking the courts imprimatur unlike doing any overt act like carrying a petition to court. The court further held that the decision of the apex court of Hindustan Lever was not considered by the court while deciding the case of Madhu Intra Limited. If the Division Bench of this court had noticed Hindustan Lever and had rendered the opinion in Madhu Intra, it would have been binding on the company Judge of this court and hence a court order sanctioning a scheme of amalgamation or demerger was an instrument as per the Stamp Act and hence subject to stamp duty”.*

Thus the opinion of the Court was that the Supreme Court decision had to be considered by deciding on the issue which was omitted by the division bench in the case of Madhu Intra Ltd and hence the court answered the question based on the former.

5. The current position in the Indian Stamp Act, 1899 (for short '**the Stamp Act**') as amended by the Indian Stamp (West Bengal Amendment) Act, 2012 states the definition of conveyance under Section 2(10)<sup>6</sup>. It is defined to include:

*“a conveyance on sale every instrument and every decree or final order of any Civil Court or every order made by the High Court under section 394 of the Companies Act, 1956, in respect of amalgamation, merger, reconstruction, or demerger of companies, other than amalgamation, merger, reconstruction or demerger, of two banking companies or a banking company with a non-banking financial company by which property, whether moveable or immovable, or any estate or interest in any property is transferred to, or vested in any other person, inter vivos and which is not otherwise specifically provided for by Schedule I; or by Schedule IA, as the case may be”.*

Thus necessary changes had been brought about owing to the ambiguity present in the applicability of the Stamp Act resulting in disputes. Similarly changes were brought about in the Stamp Act of many other States which has now clarified the position.

#### IV. **Stamp Duty on Conversion of a Company to an LLP**

1. The LLP Act also has a similar provision to vest assets in case of Conversion of a company to an LLP under Section 58(4) (b) and under Clause 6(b) of the Third Schedule.
2. The implication of this however, cannot be understood as nonpayment of Stamp duty to the State on account of automatic vesting of property to the LLP on conversion. The LLP act may face similar confusion in reference to the levy of Stamp Duty as faced by amalgamation orders under 391-394 of the Companies Act. This is more so that till date the confusion has not come before the Hon'ble Court for adjudication.
3. Section 5. of the TOP Act defines Transfer of Property as:

<sup>4</sup> (2006) 130 CompCas 510

<sup>5</sup> (2012) 170 CompCas 212 (Cal)

<sup>6</sup> Page 1.3 Indian Stamp Act (Bare Act)

*“an act by which a living person conveys property, in present or in future, to one or more other living persons, or to himself and one or more other living persons; and to transfer property is to perform such act”.*

4. If we closely look at the TOP Act it requires a transfer by one or more living person to another. The difference between the Stamp levy of such transfers under Section 394(2) of the Companies Act and under the LLP act can be on the basis that under the Companies Act pursuant to the transfer involving a demerger two different entities are formed and they continue their existence even afterwards. This results in a conspicuous transfer of properties from one entity to other by way of an instrument, hence attracting the levy of Stamp duty which also adheres to Section 5 of the TOP Act.
5. However, Section 56 of the LLP Act contemplates a conversion of a Company into a Limited Liability Partnership. This leads to the issue whether such transfer on conversion satisfies the criterion of transfer under the TOP Act and that if it can be considered to be a conveyance for the purpose of the Stamp Act.
6. In this scenario a necessary requirement to be looked into is the time at which such transfer takes place. It needs to be clearly specified in order to understand the applicability of the taxability provision failing which there can be different interpretation in this regards.
  - a. The first interpretation to this could be that the creation of the LLP takes place first, subsequent to which the transfer and then the dissolution of the firm takes place. This would result in the actual transfer of properties from one entity to thus satisfying the condition of Section 5 of the TOP Act and making the firm liable to Stamp Duty as in case of a normal transfer.
  - b. Another interpretation in this regard can be is that the LLP comes into existence once the transfer of assets takes place from the company to the LLP as a result of which the Company gets dissolved. Here there is no actual transfer of assets from one living/juristic entity to another as the creation of the LLP takes place on the transfer and dissolution of the Company which if not allowed, would not have taken place. In such cases it cannot be said that any actual transfer has taken place and hence no such liability to pay duty can be imposed.
- V. Thus after considering the various provisions of the Stamp Act, the LLP Act, the TOP Act and Companies Act, the following arguments arise for consideration.
  1. **The first argument** favouring nonpayment of stamp duty would be considering the scenario (b) stated above, wherein the coming into existence of an LLP happens with the transfer of assets and dissolution of the Company simultaneously as a result of which the stamp duty levy would be clearly inapplicable.
  2. **The second argument** for non levy of Stamp Duty would be by considering the following cases:
    - i. In the case of **Vali Pattabhirama Rao vs. Shri Ramanuja Ginning & Rice Factory (P) Ltd**<sup>7</sup> the court held that if the constitution of the partnership firm is changed into that of a company by registering it under Part IX of this Act, there shall be statutory vesting of the title of all the property of the previous firm in the newly incorporated company without any need for a separate conveyance
    - ii. In the case of **CIT vs. Texspin Engineering and Manufacturing Works**<sup>8</sup> the assessee, a partnership firm, had converted itself in to a limited company under Part IX of the Companies Act. In the process, the assets and

<sup>7</sup> 1986 60 CompCas 568 AP

<sup>8</sup> (2003) 263 ITR 345 (Bom)

liabilities of the firm got vested in the company. The contention of the Income Tax (IT) Authority was that there was a dissolution of the firm and hence a deemed distribution of assets. Invoking the provisions of section 45(4) of the IT Act, it computed capital gains in the hands of the assessee firm taking the market value of the capital assets as the consideration.

The assessee contended that the firm had been treated as company by virtue of the law under Part IX of the Companies Act. When a firm is treated as a company, the firm and company do not co-exist at the same time and hence, as there are no two parties, there cannot be a transfer between a transferor and a transferee. There cannot be therefore any capital gains under either the provisions of section 45(1) or 45(4). Further, the shares received by the partners were in lieu of the capital balances held by them in the firm and in that sense, it cannot be said that the shares formed any consideration to the firm.

The High Court held that:

- a. There were no party and counter party to the transaction as required to constitute a transfer transaction i.e. a transferor and transferee. The **assets which were held by the assessee when it was a firm continued to remain with it** when it was treated as a company by the statute. The Court gave the analogy of the **cloak of a firm replaced by the cloak of a company on the same person**. So section 45(1) was therefore held not to be attracted.
- b. The provisions of section 45(4) were also not attracted because there was **only vesting of the property** in the company and **no distribution involved**. A distribution presupposes division, realization, encashment of assets and apportionment of the realized amount etc, which acts were absent in that case.
- c. The shares in the new company were received by the partners were in lieu of their capital balances and as the firm does not receive it, the same cannot constitute its consideration.. The firm was found to have not received any consideration.

Based on the above findings, it was held that no capital gains accrued to the firm on its conversion to company under Part IX of the Companies Act.

If we apply the same principal of Vali Pattabhirama Rao and Texspin Engineering here, a conversion of a company to an LLP would not be liable to stamp duty.

3. **Thirdly**, an essential prerequisite to be fulfilled for taxation of an entity by way of transfer is that there must be a valid consideration received by the transferor in order to make such transfer validly chargeable to duty. However when a Company is converted into a LLP, no consideration is received by such an LLP or any of its partners. It is only the shareholders of the Company who are given a partnership status in the Company. This is opposed to the demerger where a valid consideration is paid to the existing shareholders in the share exchange ratio. Hence a conversion from a company to an LLP cannot have stamp duty imposed upon it as opposed to a compromise or rearrangement under section 394.
4. **Fourthly**, a registration of an LLP under Sections 55-58 is unlike any normal registration of an LLP pursuant to which assets are transferred to it from another. A registration under these Sections is occasioned by a dissolution and transfer of assets. In such cases there cannot be levied any normal stamp duty because there are no two separate entities but one and the same entity which have been merely cloaked in a different corporate veil.

#### VI. Conditions necessitating payment of Stamp Duty

1. The reason for confusion for payment of Stamp duty levy in LLP arises because of the fact that it is made subjective to the respective State Stamp Act for determination of duty. A stamp duty is made chargeable on an instrument and not on a transaction. Further, there is no proper information provided in reference to the transfer of assets from the

Company to an LLP under Section 56 and the method to be undertaken for it. Thus an ambiguity persists in the framework of the LLP Act wherein no procedure to transfer assets is provided.

2. The Act further under Clause 7 requires Registration in relation to property. It requires the necessary steps to be taken as required by the relevant authority and to notify the authority of conversion in such form and manner as determined. This can lead to further problems while transferring the property in the name of the LLP as it would affect disputes in between the authorities and the parties and effort to transfer would lead to creation of an instrument and hence chargeable to a stamp duty levy.
  3. Also another problem for stamp duty liability for conversion to LLP's is that, unlike partnership firms wherein the Indian Stamp Act and relevant State Acts have specified entries for stamp duty liability pertaining to partnerships, there are no similar entries for LLP. Also, there are specific entries in the Stamp Acts levying duty on orders passed by the jurisdictional High Court under Sections 391-394 of the Companies Act. However, no insertion has been for anything regarding LLP Act which further causes ambiguity.
- VII. Thus an overall analysis reveals an essential gap persisting in the LLP Act in reference to Stamp Duty on property similar to the one which earlier persisted in Mergers and Demergers. This has often led to ambiguity amongst the stakeholders involved in the conversion of a company to an LLP leading to deterrence in conversion to an LLP as opposed to what was intended by the government. It hence calls for much needed amendments in the LLP Act and the Stamp Act be made and to clarify the legislative intent.
- VIII. In such cases of a conversion to an LLP one such suggestive measure which can be taken to ensure that there is no adverse levy of Stamp Duty is provided. This would ensure that more people opt for the LLP option as intended without any fear of adverse implications of duty. The option which can be pursued is by way of a declaration deed as required in case of transfer of properties from the owner and/or builder/developer to the buyer of an apartment. A declaration as per the oxford dictionary is *"a statement asserting or protecting a legal right"*. This can serve as a way out through which the assets of the Company can be vested into the LLP pursuant to a conversion through a declaration. Here one thing to be kept into consideration would be the fact that a deed of declaration is not enforceable per se as under the Apartment Ownership Act's of various States. These deeds hence act as supplemental documents to the original apartment agreement or the sale deed determining the transfer of a particular apartment. Similarly in such circumstances, pursuant to the assets of a Company being converted in to an LLP the requirement can be met by filing the incorporation document of the LLP along with the deed of declaration which could serve the purpose. This could be hence used as a way out for registration of the assets in favour of the LLP provided requisite notifications are given in this regard.
- IX. The last alternative available in case of no clarifications being made available to give a clear view about the intended effect on such conversion would be to file a writ petition to the High Court so as to ensure certain guidelines are given by the court clarifying the position in this regard. This can be used only as a last resort provided no clarification is made available or if there is failure to bring about necessary amendments.