

INTERNATIONAL JOURNAL OF LEGAL STUDIES AND SOCIAL SCIENCES [IJLSSS]

ISSN: 2584-1513 (Online)

Volume 4 | Issue 3 [May, 2026] | Page 63 – 71

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LEGAL ONTOLOGIES AND FISCAL REALITIES: A COMPREHENSIVE ANALYSIS OF COMPANY-TO-LLP CONVERSION IN INDIA

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ABSTRACT

India's business environment is increasingly shifting from the traditional corporate model to the Limited Liability Partnership (LLP) structure due to its operational flexibility, reduced compliance burden, and limited liability benefits. This paper examines the legal framework governing company-to-LLP conversion under the LLP Act, 2008 and the tax-neutral conversion provisions u/s 47(xiiiib) of the Income Tax Act, 1961, along with developments under the Income Tax Act, 2025. It analyses the doctrine of "continuity of entity," whereby an LLP succeeds the converted company without winding up. The study highlights the disconnect between corporate restructuring objectives and restrictive fiscal conditions, particularly turnover and asset thresholds that exclude many medium-sized businesses from tax benefits. It further evaluates recent reforms under the Corporate Laws (Amendment) Bill, 2026 and argues for a more flexible, proportionate, and inflation-indexed framework to facilitate business restructuring in post-2025 India.

INTRODUCTION

With the advent of the Limited Liability Partnership (LLP) Act in 2008 in India, the corporate landscape has undergone a structural transformation. The Act gave way to formation of Limited Liability Partnerships (LLPs) in our country, which essentially blends the limited liability protection of a company with the operational flexibility of a traditional partnership.² As defined under Section 3(1) of the LLP Act, an LLP is a "body corporate" having an identity, distinct and separate from its partners

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²Rucha K, *Limited Liability Partnership (LLP) Registration in India*, cleartax (Dec. 15, 2025), <https://cleartax.in/s/limited-liability-partnership-registration-procedure-india>.

and one which has the capacity for owning a property, entering into contracts, suing and being sued in its own name.³

Pertinently, before 2008, the businesses in India used to have two choices: either to comply with the strict regulations concerning incorporation of a company under the Companies Act or to be burdened with unlimited and personal liability by choosing to enter into a partnership business under the Indian Partnership Act, 1932. The LLP Act has provided considerable relief to various businesses by bridging this wide gap. As per the statistics, over 2.6 lakh LLPs were registered in India as of March 2023.⁴ Infact, this number grew by approximately 15% annually. This proves how well the businesses have utilized the advantages of operating under an LLP.

The provisions that led to possibility of conversion of an existing unlisted public company or a private company into an LLP, instead of following the process of dissolution of an existing entity and subsequent incorporation into another corporate form, are Sections 56 and 57 of the LLP Act, read with Schedules III and IV respectively. Notably, the same is implemented through the LLP Rules of 2009.⁵ As far as tax aspect of the concerned conversion is concerned, the same is reinforced fiscally BY way of the Finance Act, 2010, by virtue of which Section 47(xiiib) has been duly inserted into the Income Tax Act, 1961. Accordingly, the concerned conversion has been deemed as “non-taxable” transfer. This non-taxable transfer is however, subject to stringent cumulative conditions and certain specific restrictions.⁶ For instance, clause (ea) to Section 47(xiiib) limits the “tax-neutral” conversion to companies having total asset book value not exceeding Rs. 5 crore in any of the three (3) preceding financial years. Consequently, the medium-sized or asset-intensive companies get excluded from the benefit.⁷ This narrow scope of extension of the benefit of non-taxable transfer has led to several academic debates and contests before courts. This also raises important questions concerning proportionality, equity and the economic rationality of the current framework.

This paper seeks to conduct a detailed analysis of the legal ontology of company-to-LLP conversion in India as far as the nature, identity, and continuity of the converting entity is concerned, along with its fiscal realities. Thereby, it seeks to further examine how tax law governs, constrains and/or

³ Limited Liability Partnership Act, 2008, No. 6 of 2009, Section 3(1) (India).

⁴Ministry of Corporate Affairs, Annual Report 2022–23, 47 (2023), <https://www.mca.gov.in/MinistryV2/annualreport.html>.

⁵ Limited Liability Partnership Act, 2008, Sections 56–58, Schedules III–IV (India); Limited Liability Partnership Rules, 2009, Rules 32, 39 (India).

⁶ Finance Act, 2010, Section 36 (India) (inserting Section 47(xiiib) into the Income Tax Act, 1961, effective A.Y. 2011–12 onwards).

⁷ Finance Act, 2016, Section 52 (India) (inserting cl. (ea) into Section 47(xiiib) of the Income Tax Act, 1961, capping total asset book value at INR 5 crore for any three years preceding conversion).

incentivizes decisions concerning conversion. Various primary and secondary legal sources, case laws, articles and commentaries by practitioners have been referred to in conducting a structured as well as critical analysis of the framework concerning such conversion.

RESEARCH OBJECTIVES

The paper is based on the following research objectives:

- (i) To study the legal framework concerning the conversion of company-to-LLP under the LLP Act, 2008 and the Companies Act, 2013, primarily focusing on the ontological continuity of the entity, procedural steps and requirements and eligibility conditions.
- (ii) To critically analyze the fiscal conditions, restrictions or limitations and interpretation under Section 47(xiii b) of the Income Tax Act, 1961 that governs tax-neutral company-to-LLP conversions, including the ramifications of non-compliance.
- (iii) To examine the gaps between the corporate conversion framework and provisions concerning tax neutrality and to find relevant legal and policy reforms or solutions to make the conversion process more consistent across a wider range of businesses.

RESEARCH QUESTIONS

- (i) Whether conversion of company-to-LLP in India leads to preservation of the existing identity of company or the process of dissolution is followed and how does the LLP Act, 2008 and the Companies Act, 2013 deal with transfer of liabilities and contractual obligations?
- (ii) Whether the conditions prescribed under Section 47(xiii b) of the Income-Tax Act, 1961 successfully ensure fiscal neutrality in company-to-LLP conversions and what are the consequences of breach or deviation from such compliances?
- (iii) Whether the combined implementation of the legal framework governing conversion and fiscal conditions under Section 47(xiii b) of the Income Tax Act, 1961 leads to unfair or impractical outcomes for medium-sized and asset-heavy businesses and whether reforms are needed to address these issues?

RESEARCH METHODOLOGY

The research for the paper primarily follows a doctrinal legal methodology, accompanied by analytical and contextual approach. The doctrinal method entails a systematic examination of primary legal sources such as statutes, rules, case laws and regulatory circulars in order to understand the existing legal framework governing the conversion of company-to-LLP in India. The primary statutes that are being examined include the LLP Act, 2008, the LLP Rules, 2009, the Companies Act, 2013, the Income-Tax Act, 1961, the Finance Act, 2010 and 2016 and the LLP (Amendment) Act, 2021. Secondary sources include research papers from various reputed journals, articles, journal articles, websites, commentaries by practitioners and analytical reports by professional services firms such as Grant Thornton Bharat, KNAV CPA and PwC India, along with legal databases such as TaxGuru, Indian Kanoon and Taxsutra.

It is to be noted that the methodology being adopted is non-empirical i.e., no primary surveys or field data has been collected. However, for contextual significance, statistical data on LLP registrations sourced from Ministry of Corporate Affairs Annual Reports have been cited hereinunder.

LITERATURE REVIEW

Since the introduction and implementation of the LLP Act, 2008, various scholars and practitioners have given their respective comments and views, consistently highlighting the unique identity of an LLP under the Indian law. For instance, commentary by Ebizfiling on the LLP Act of 2008 points out to the “absence of mutual agency” as the most significant and striking features of the corporate form as it differentiates it from traditional partnership under the Indian Partnership Act of 1932. In other words, in an LLP, liability will not be imposed on one co-partner, if the other does something without any authority.⁸ On the procedural and eligibility aspects of conversion, Corpzo and TaxGuru discuss the pre-conditions for eligibility that are generally required such as requirement of no “subsisting security interest” over assets of the company, necessity of annual filings to be in order, every shareholder to become a partner and “No Objection” to be given by secured creditors.⁹ Furthermore, KNAV CPA and CRSPL add a bit of “commercial realism” to these aspects, by providing that while simplifying the procedure for partners, the governance mechanism simultaneously closes the door on

⁸Ebizfiling, India LLP Act 2008 and All You Need to Know About LLP in India (2022), <https://ebizfiling.com/blog/india-llp-act-2008/> (discussing the absence of mutual agency in LLP governance).

⁹ TaxGuru, Conversion Process from Private Limited Company to LLP (2023), <https://taxguru.in/company-law/conversion-process-private-limited-company-llp.html>; Corpzo, Convert Private Company into LLP in India, <https://www.corpzo.com/conversion-of-private-company-into-llp>.

traditional institutional equity investment for shareholders, which is a cost that growth-oriented businesses feel acutely but one that the framework does not expressly acknowledge.¹⁰

As far as the fiscal aspects of the conversion are concerned, Sandeep Ahuja & Co., writing in 2025, has put forth that Section 47(xiiib) of the Income-Tax Act of 1961 is not a “one-time relief” that businesses can claim and then move on. Rather, the same is a “continuing compliance covenant,” which means that the benefit of tax neutrality is at all times, subject to the risk of “retrospective withdrawal” as long as the conditions post the conversion remains in force.¹¹ Further, the analysis by PwC India in December 2018 of “*ACIT v. Celerity Power LLP*” discusses what commentators call twin-penalty principle. As per this twin-penalty principle, if a converted business step outside any one of the statutory conditions, it will face not only capital gains exposure under Section 47A(4) but will also lose the right to carry forward the accumulated losses of their predecessor company under Section 72A(6).¹²

However, the existing literature has not yet diverted its attention to or has not addressed workable solutions towards two significant definitional problems on the topic. The first is the use of words “security interest” under Schedule III of the LLP Act as a disqualifier from eligibility for the conversion. The problem lies in the fact that “security interest” is not defined anywhere. This in turn leaves a gap between formulation and the defined concept of “charge” under Section 2(16) of the Companies Act, 2013. Pertinently, this gap is wide enough for a converting floating charge arrangement or company’s pledge to fall through, without anyone having the intention to do so.¹³ The second problem is being delved into in the expert analysis by Taxsutra. It puts forth that position taken by the tax authorities is that rental income does not fall under “total sales, turnover, or gross receipts” for Rs. 60 lakh threshold under Section 47(xiiib)(b), which leaves the companies whose revenues are property-derived and makes it completely uncertain for them as to whether they qualify

¹⁰ CRSPL, How to Convert a Private Limited Company into LLP?, <https://crspl.in/blog/conversion-of-private-limited-company-into-llp>; KNAV CPA, Company to LLP Conversion: Strategic Tax Move or Fading Trend? (Mar. 2025).

¹¹ Sandeep Ahuja & Co., Tax and Judicial Analysis of Conversion of Private Limited Company into LLP under Section 47(xiiib) (2025), <http://www.casahuja.com/2025/10/tax-and-judicial-analysis-of-conversion.html> (characterising the conditions as a 'continuing compliance covenant').

¹² PwC India, Tax Insights: Taxability of Conversion of Company into LLP (Dec. 12, 2018), https://www.pwc.in/assets/pdfs/news-alert-tax/2018/pwc_news_alert_12_december_2018_taxability_of_conversion_of_company_into_llp.pdf (analysing *Celerity Power LLP v. DCIT* and the dual-penalty principle).

¹³ Compare Limited Liability Partnership Act, 2008, Schedule III, cl. 1(c) (India), with Companies Act, 2013, Section 2(16) (India).

or not.¹⁴ KNAV CPA further notes that if the conversions do not meet legal thresholds on time, scrutiny under the General Anti-Avoidance Rules under Sections 95 to 102 of the Income-Tax Act of 1961 may be attracted. The best way of minimizing this risk is to have proper documentation showing how there had been “genuine” reasons for restructuring.¹⁵ Overall, a key issue being highlighted in the existing literature is the interplay between corporate governance and fiscal laws. In other words, a loophole in one may create risk(s) under the other. Accordingly, this is the significant gap that this paper seeks to examine.

DISCUSSION AND ANALYSIS

PROCEDURE AND EFFECT OF CONVERSION

Schedule III of the LLP Act, 2008 and Section 58 provides for the registration and effect of conversion into an LLP. Upon conversion, a company is “deemed dissolved” and the LLP is “deemed to carry on” the business of the company. Accordingly, all contracts, property, obligations and pending proceedings vest in or continue against the LLP as “statutory successor”.¹⁶ This deeming mechanism is not a kind of “dissolution” in any conventional insolvency or commercial law sense as it does not involve distribution of assets to shareholders, formal liquidation process or winding up. Rather, the concerned obligations, legal identity as well as business continuity is preserved.

The fiscal aspect of conversion is governed by Section 2(47) and Section 47(xiiib) of the Income-Tax Act of 1961. Section 2(47) defines “transfer” inclusive of exchange, extinguishment, and relinquishment of rights. Thus, by implication, the conversion falls under this expansive definition.¹⁷ Section 47(xiiib) further acts as a “necessary carve-out” which exempts the application of capital gains tax in cases of conversion.

It is to be noted that the use of words “security interest” under Schedule III of the LLP Act is, as a disqualifier from eligibility for the conversion. The problem lies in the fact that “security interest” is not defined anywhere. This in turn leaves a gap between formulation and the defined concept of

¹⁴Taxsutra, Demystifying LLP Conversion Taxation, https://database.taxsutra.com/articles/e79c8cd4f4c460d5d195b173688acf/expert_article (discussing classification of rental income for eligibility threshold purposes).

¹⁵ Vodafone Int'l Holdings B.V. v. Union of India, (2012) 6 SCC 613 (India); McDowell & Co. v. Commercial Tax Officer, (1985) 3 SCC 230 (India); Income Tax Act, 1961, Sections 95–102 (India) (General Anti-Avoidance Rules).

¹⁶Limited Liability Partnership Act, 2008, Schedule III, cl. 1–3 (India); Sections 58(4)(a)–(c) (India) (providing that all pending proceedings, contracts, and obligations continue against and in favour of the successor LLP).

¹⁷Income Tax Act, 1961, Section 2(47) (India) (defining 'transfer' inclusively to include exchange, extinguishment, and relinquishment of rights); TaxGuru, Taxability on Conversion of Private Limited Company to LLP (2020).

“charge” under Section 2(16) of the Companies Act, 2013.¹⁸ Pertinently, this gap is wide enough for a converting floating charge arrangement or company’s pledge to fall through, without anyone intending to do so. Thus, this is a lacuna which directly frustrates legal continuity.

TAX-RELATED COMPLIANCE UPON CONVERSION AND CONSEQUENCES OF BREACH

Section 47(xiiib) of the Income Tax Act of 1961 though operates as an exemption from capital gains tax but it also acts as a “conditional covenant” which must be maintained even after fulfilling all the conversion compliances. The conditions are prospective and cumulative and are as follows: (i) All assets and liabilities must vest in the LLP immediately (ii) All shareholders must become LLP partners proportionately (iii) no consideration other than profit-sharing rights may be received; the aggregate profit-sharing ratio of original shareholders must not fall below fifty per cent for five years (iv) total sales, turnover, or gross receipts must not have exceeded Rs. 60 lakh in any of the three preceding years (v) asset book value must not have exceeded Rs. 5 crore and (vi) accumulated profits must not be distributed to partners for three years from the date of conversion.¹⁹ However, the consequences of breach are in a way “disproportionately punitive” as it seeks to retrospectively apply the tax obligations which were initially exempted. In other words, breach makes the entire conversion, a taxable transfer as of the original date of conversion, with capital gains being computed along with interest. Further, the asset book-value threshold of Rs. 5 crore, which has been introduced by the Finance Act, 2016, is commercially inconsistent as a company holding Rs. 4.9 crore in passive real estate qualifies while a manufacturing enterprise with Rs. 6 crore in heavy productive assets does not.²⁰ Further, the fact that the threshold has not been revised yet raises concerns about its effectiveness towards ensuring “fiscal neutrality”.

Further, the issue of characterization of income regarding Rs. 60 lakh turnover threshold adds to the legal uncertainty. Moreover, position taken by the tax authorities is that rental income does not fall under “total sales, turnover, or gross receipts” for Rs. 60 lakh threshold under Section 47(xiiib)(b),

¹⁸Companies Act, 2013, Section 2(16) (India); Limited Liability Partnership Act, 2008, Schedule III, cl. 1(c) (India).

¹⁹Income Tax Act, 1961, Section 47(xiiib)(a)–(f) (India); KNAV CPA, Company to LLP Conversion: Strategic Tax Move or Fading Trend? (Mar. 2025).

²⁰Finance Act, 2016, Section 52 (India); Taxsutra, Demystifying LLP Conversion Taxation, https://database.taxsutra.com/articles/e79c8cd4f4c460d5d195b173688acf/expert_article (observing that the threshold excludes medium-sized enterprises with asset-intensive balance sheets while admitting companies with low asset values regardless of commercial scale).

which thereby excludes the companies whose revenues are property-derived and makes it completely uncertain for them as to whether they qualify or not.^{21 22}

OUTCOMES AND IMPACT OF CONVERSION AND THE NEED FOR REFORM

The legal framework governing conversion generate outcomes which appear to be asymmetrical on a comprehensive analysis. Firstly, the requirement that all shareholders who become partners in converted LLP, have to be in strict proportion to their existing shareholding, outrightly eliminates “ownership restructuring” at the point of conversion. Consequently, existing shareholders cannot be bought out, new capital partners cannot be admitted and the management buyout arrangements cannot be effected. This restriction affects the family-owned enterprises the most, as generational succession is actively preferred by them.²³ Further, the post-conversion prohibition on “distribution of accumulated profits” for three (3) years leads to considerable amount of retained earnings being locked within the LLP and makes it inaccessible to partners. Regarding this, some practitioners suggest conversion of the retained earnings into share capital before conversion for reducing tax risk. However, this can attract scrutiny under GAAR if it is unsupported by genuine business reasons and done only for tax benefits.²⁴ Stringent consequences of breach of compliances post conversion is another significant drawback, which has already been detailed above.

RECOMMENDATIONS

In order to realign the threshold with commercial reality, the Rs. 5 crore asset book-value must be revised to at least Rs. 25 crore, indexed thereafter to an inflation or GDP benchmark. Further, the scope of definition of “security interest” under Schedule III must be defined in reference to “charge” under Section 2(16) of the Companies Act of 2013, which would consequently eliminate inadvertent

²¹Taxsutra, Demystifying LLP Conversion Taxation, https://database.taxsutra.com/articles/e79c8cd4f4c460d5d195b173688acf/expert_article (discussing classification of rental income for eligibility threshold purposes).

²²Taxsutra, supra note 13; Income Tax Act, 1961, Section 47(xiii)(b) (India) (limiting the threshold to 'total sales, turnover, or gross receipts,' a formulation that excludes rental income on conventional accounting and taxation analysis).

²³KNAV CPA, supra note 9; Corpzo, Convert Private Company into LLP in India, <https://www.corpzo.com/conversion-of-private-company-into-llp> (identifying the universal shareholder-to-partner transition requirement as a structural constraint on ownership restructuring).

²⁴Income Tax Act, 1961, Section 47(xiii)(f) (India); Taxsutra, supra note 13 (analysing the strategy of capitalising retained earnings as share capital before conversion, and associated GxAAR exposure under Income Tax Act, 1961, Sections 95–102).

disqualifications. Moreover, MCA and CBDT should issue joint circulars or guidelines to clarify the income characterization for the turnover threshold. Most importantly, the “all-or-nothing retrospective taxation structure” under Section 47A(4) essentially treats even the inadvertent breaches post-conversion similar to deliberate tax avoidance, without any grievance mechanism. Thereby, a proper segregation procedure and remedies for non-abusive or deliberate violations is the need of the hour.

CONCLUSION

Conversion of a Company to LLP is a legally complex exercise which demands an intersection of different rules and statutes such as the procedural aspects under the LLP Act, 2008 and the fiscal compliance under Section 47(xiiib) of the Income Tax Act of 1961. This provision introduced by the Finance Act, 2010 has been well-intended to avoid taxation in genuine business restructurings and has led to secure growth of LLPs in India. However, several significant issues still exist: Many businesses gets excluded due to low threshold limit of Rs. 5 crores and scope of terms such as “security interest” is still unclear. Moreover, there are stringent penalties for non-compliance and no remedy lies for non-deliberate and/or non abusive violations or mistakes. These issues abates the very purpose of the LLP Act and thereby, considerable reforms are the need of the hour to achieve a more flexible and proportionate compliance system for conversion.