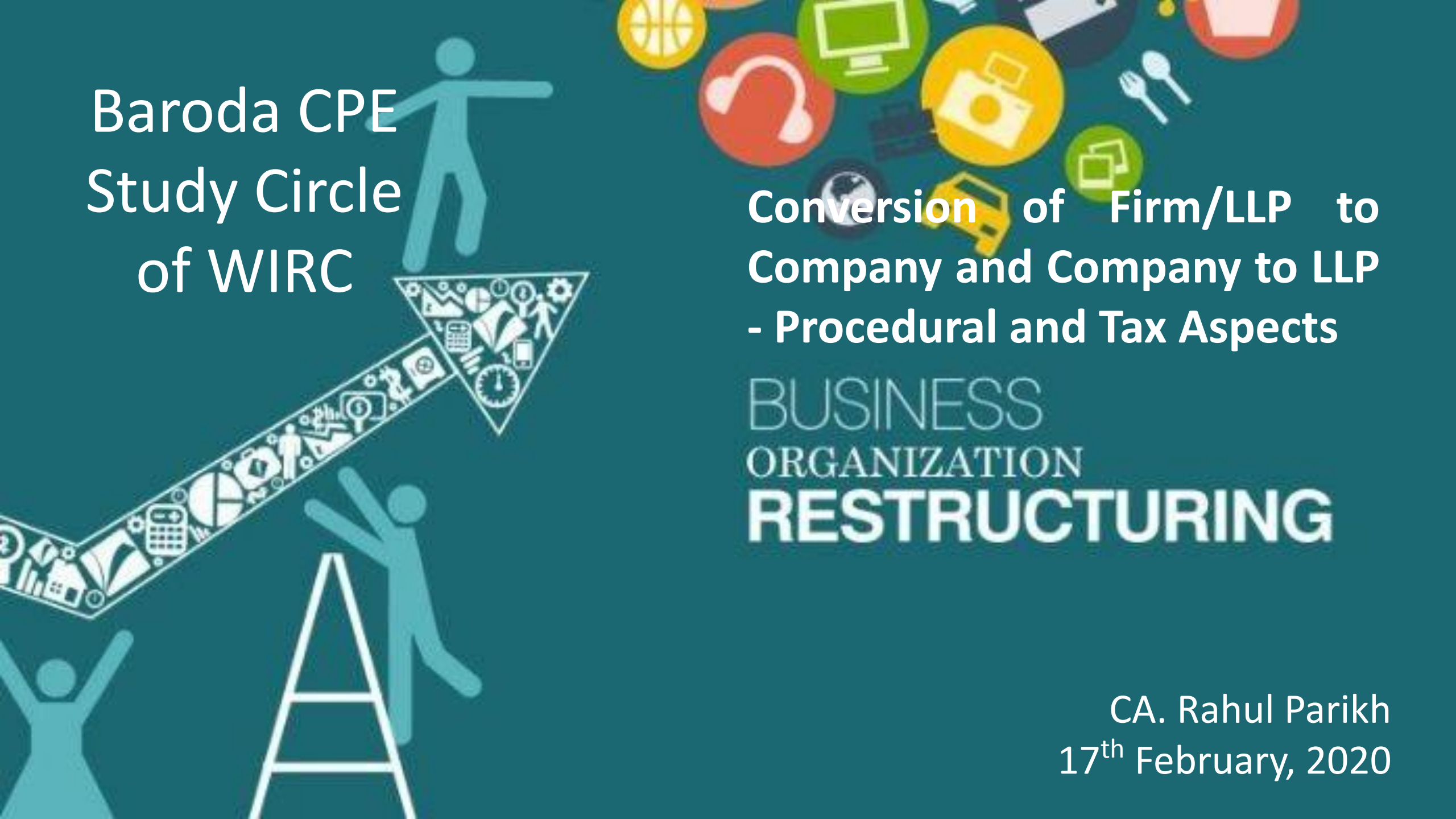


Baroda CPE
Study Circle
of WIRC

The background is a teal color. In the top right corner, there is a cluster of colorful circular icons representing various business and technology concepts, such as a basketball, a computer monitor, headphones, a printer, a fork and spoon, a globe, and a smartphone. On the left side, there are three stylized human figures in teal. One figure is at the top, another is in the middle standing on a white ladder, and a third is at the bottom with arms raised. A large white arrow points from the bottom left towards the top right, filled with small white icons of business tools like a calculator, pie chart, bar chart, and clock. The text is overlaid on this background.

Conversion of Firm/LLP to
Company and Company to LLP
- Procedural and Tax Aspects

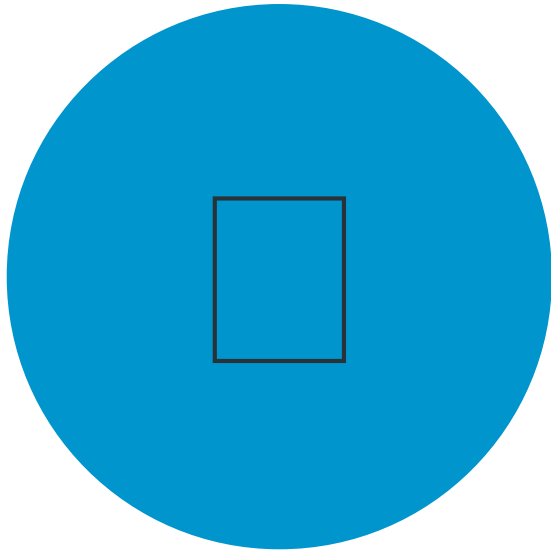
BUSINESS
ORGANIZATION
RESTRUCTURING

CA. Rahul Parikh
17th February, 2020

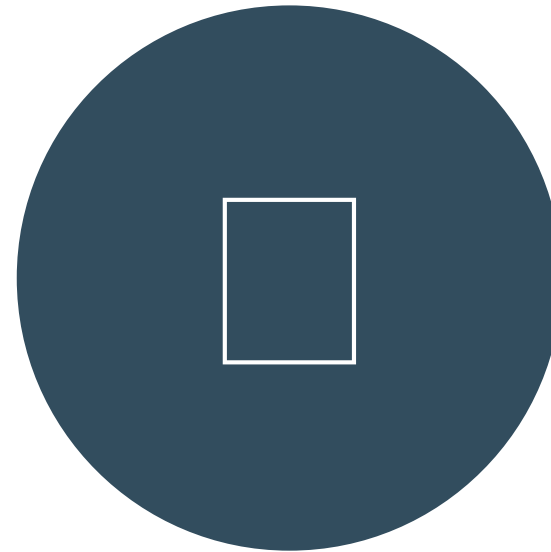
What is Business Organization Restructuring?

- **Restructuring** is a management term for the act of reorganizing the legal, ownership, operational, or other structures of a business organization for the purpose of making it more profitable, or better organized for its present needs
- Business Organization can restructure in multiple ways:
 - Convert its form of business. For eg. Firm to Company or vice-versa
 - Mergers / Demergers
 - Debt Restructuring
 - Internal Organizational Restructuring.
 - Change of Business Model

Our Topics of Discussion today:



Conversion of Firm /
LLP into Company



Conversion of
Company into LLP

Why Conversion of Firm / LLP into Company

- Factors which lead to a desire for conversion to Company
 - Migration to Corporate Entity is considered as a natural progression indicating progress and growth of an entity and leads to better recognition
 - Increases the fund raising capabilities of an entity
 - Ring-fences the Promoters' liability by providing limited liability structure
 - Separation of Ownership & Management
 - Enhances Professional Management and Corporate Governance
 - Exit opportunities to investors by way of sale of shares, listing of shares etc.
 - Valuation perception
 - Perpetual existence
 - Tax efficient organic growth by enabling mergers / demergers
 - Ability to attract talent to the organization increases

Conversion of Firm / LLP into Company

- The Legal Provisions

- The Companies Act 2013 (Chapter XXI – Part 1)
 - Section 366.....Enabling Provision
 - Section 366 lists out the organizations capable of being registered as a Company under the Act including:*
 - a) Partnership Firm*
 - b) Limited Liability Partnership*
 - c) Co-operative Society*
 - d) Society*
 - e) Any other business entity formed under any other law in force*
 - Section 367 to 374.....Provisions for giving effect to conversion
 - The Companies (Authorised to Register) Rules, 2014Procedure For conversion

Conversion of Firm / LLP into Company

- The Legal Provisions

- The Income Tax Act

- Section 47(xiii) of the Income Tax 1961

- Section 47 lists out the instances of transfer of assets, which would not be considered as transfers for the purpose of applicability of Capital Gains Provisions.
 - Sub-Section (xiii) of the said provision provides that a succession of a Firm by a Company shall not be considered as a transfer if following conditions are fulfilled:
 - i. All assets and liabilities of the Firm should become the assets and liabilities of the Company.
 - ii. All Partners of the Company should become the Shareholders of the Company in the same proportion in which their Capital stands in the books of the Firm as on date of succession.
 - iii. Partners of the Firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the Company
 - iv. The shareholding of the Partners of the Firm in the Company should not be below 50% and should not fall below 50% at any time for a period of at least 5 years from the date of succession.

Conversion of Firm / LLP into Company

- The Legal Provisions

- The Income Tax Act

- *Issues to be considered*

- *Conversion of Firm / LLP into Company possible under two methods:*

- Takeover of running business of Firm by Existing Company by slump sale
 - Follow conversion process prescribed under Chapter XXI Part 1 of the Companies Act, 2013
 - Possible to achieve tax neutrality under both methods by adhering to provisions of Section 47(xiii)

- *Section 47A(3) - Consequences if conditions u/s 47(xiii) not fulfilled*

The Profits & Gains arising from transfer of such capital asset / intangible assets which were not charged under the head "Capital Gains" in the year of transfer shall be charged to tax as **Business Profits** in the year in which the conditions u/s 47(xiii) are violated.

However, Conversion of Firm into Company under Chapter XXI of the Companies Act 2013 (Erstwhile Part IX of the Companies Act, 1956) may still not be regarded as a transfer under Income Tax as the conversion is statutory vesting and duality of transferor and transferee are missing.

- i) Texspin Engg. And Mfg. Works – 263 ITR 345 (Bom)
- ii) DCIT v. Vishal Engineering and Galvanizers (ITA no. 2316/Ahd/2014)
- iii) DCIT v. R. L. Kalathia & Co. 66 Taxman.co 249 (2016) (Gujarat)

Conversion of Firm / LLP into Company

- The Legal Provisions

- The Income Tax Act

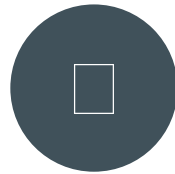
- *Issues to be considered*

- Revaluation of assets and crediting of revaluation reserve to Partners' capital prior to conversion ? Impact of newly introduced Section 45(4) & 45(4A)
 - Conversion of Part of Partner's capital into share capital and the balance to Unsecured Loans. Violation of Section 47(xiii) ?

- Stamp Duty

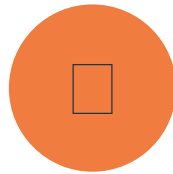
- Respective State Law will apply
 - However, it is possible to argue that in absence of duality of transferor and transferee and since no registered instrument of transfer is required, no stamp duty would be payable
 - Rama Sundari Ray V. Syamendra Lal Ray - ILR (1947) 2 Cal 1
 - Vali Pattabhirama Rao V. Sri Ramanuja Gining and Factory P. Ltd. – 60 Company Cases 568 (AP-DB)

Key Checkpoints for Conversion of Firm / LLP to Company



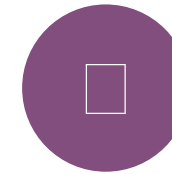
Registered Partnership Deed

In case of Partnership Firm, registration of the Partnership Firm with the Registrar of Firm is an essential condition for conversion.



Minimum Number of Partners

For conversion to Private Company, now only 2 Partners required. For conversion to Public Company 7 Partners required.



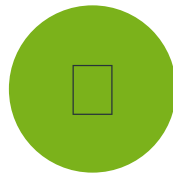
Check Name Availability

Check in advance whether the desired name will be available as per MCA Guidelines or decide on an alternative name before commencing process.



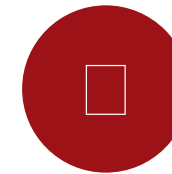
Desired Capital

Partners' Capital as per the Audited Accounts as on date of conversion will be converted in Share Capital



Preparatory Work for Mandatory Documents

Ensure that all ground work for all mandatory documents is completed. For eg. Consent of Secured Creditors, NOC of Registrar of Firm etc.



No Pending Legal Compliances

Ensure that all due returns under Income Tax Act, GST etc are filed and readily available.

Conversion Process – Firm / LLP to Company

Section 366

- Execute supplementary deed to ensure:
 - Mandatory / Desired Number of Partners (2 for Private and 7 for Public Company)
- Partners' Meet and Resolution for Conversion by Majority of Partners
- Authorise one or more partners to carry out the process
- Written Consents of all secured creditors

Name Reservation

- Apply for proposed name through Part A of Spice+
- Ensure before starting conversion process that proposed name will be available, else time-lines can be disturbed
- Proposed Name, if made available, will be available for a period of 20 days only.
- Extension of 20 days period would be necessary. Possible up to a maximum of 60 days on payment of additional fees.

Form URC-2

- Publish the advertisement for conversion in Form URC 2 in 1 English and 1 vernacular newspaper with a notice of 21 clear days from the date of publication for objections to conversion, if any.
- Objections to be sent to the Registrar of Company, CRC, Ministry of Corporate Affairs and to the Registered Office of the Firm / LLP.

Form URC-1

- Form URC-1 to be filed within
 - 30 days of Publication of URC-2
 - 15 Days of the date on Financial Statements of the Firm / LLP are drawn up
- Incorporation Form SPICE+ (INC 32) & AGILE Pro, MOA & AOA to be filed along with URC-1
- **On Approval of URC-1, Registration Certificate will be issued in INC-11**

<ul style="list-style-type: none"> • List of Partners with their names, address, occupation and share held • Address Proof & Identity Proof of Partners • Written Consent of Partners to continue as Members of Proposed Company 	<ul style="list-style-type: none"> • Notarised Copy of Latest Partnership Deed / LLP Agreement • Certified Copy of Partners' resolution for conversion. • Certificate of Registration issued by Registrar of Firm in case of P. Firm / ROC in case of LLP 	<ul style="list-style-type: none"> • NOC of Registrar of Firms / ROC • Notarised Affidavit of all Partners confirming dissolution on conversion and undertaking that intimation to ROC / ROF will be submitted in 15 days from date of conversion • Statement of Proceedings pending against Firm / LLP 	<ul style="list-style-type: none"> • Copy of Latest Income Tax Returns • Audited Statement of Accounts as on a date not later than 15 days from the date of Filing of URC-1 • Written Consent of Secured Creditors
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<ul style="list-style-type: none"> • List of Proposed Directors showing their names, surnames / family name / DIN, PAN, Passport Number (If any) with expiry date, residential address • Maximum 3 new DIN can be applied for. 	<ul style="list-style-type: none"> • Consent to act as First Directors in DIR-2 • Declaration of Interest in other entities in DIR-8 • Affidavit of non-disqualification u/s 164(1) from all proposed Directors 	<ul style="list-style-type: none"> • Draft MOA / AOA along with declaration of First Subscribers (In this case, all Partners as on date of conversion) & First Directors (INC 9) Proof of Registered Office Address • MOA to include specific clauses related to conversion including Statement of Assets & Liabilities 	<ul style="list-style-type: none"> • Certificate of CA / CS / ICWA certifying compliance with provision of Stamp Act, to the extent applicable • Copy of Advertisement in URC-2
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- After Filing of URC-1 along with incorporation Forms / Documents, the ROC will issue a Certificate of Incorporation in Form INC 11. Date of Conversion will be the date of approval by ROC and **not the date on which Financial Statements were drawn up.**
- Within 15 days of conversion, file notice of conversion with ROF (In case of P. Firm) / ROC (In case of LLP)

Preparation of URC-1 – Details & Documents

Conversion of Firm / LLP into Company

- Practical Issues

• Income Tax

- New PAN & TAN will be allotted
- Conversion during the year – Two separate returns
- Proportionate Depreciation based on number of days.....Proviso to Section 32(1)
- Carry forward of unabsorbed depreciation & losses.....Section 72A(6)
- Claim of deductions on payment basis.....No specific provision..... 155 ITR 152(SC) may help

• Accounts

- Date of Incorporation of Company i.e. conversion and date on which financial statements were drawn up different. Treatment of transactions in intervening period?
- Conversion during the year – Two sets of account – Pre-Conversion – Post Conversion
- Transfer of Balances to new entity at book value
- In case of Fixed Assets, Original Cost of all assets will need to be ascertained and Depreciation will also need to be ascertained in accordance with Schedule II of Companies Act 2013. FA Register also to be prepared.
- Loans from persons, other than those permitted under Companies Act, 2013 ?

Conversion of Firm / LLP into Company

- Practical Issues

- **Goods & Service Tax**

- New GST Registration will be granted
- How to treat transactions till new GST Registration granted ?
- Transfer of GST Input Credit ?
- Refer Section 18(3) of CGST Act and Rule 41 of CGST Rules 2017

- **General**

- Transfer of Bank Limits
- Transfer of all registrations / title deeds / investments / permissions
- Stamp Duty issues at the time of transfer of title deeds
- New PF / ESI Registrations will be granted (Migration of Employees from Old Registration to New)

Why Conversion of Company into LLP ?

- Lower Compliance Cost
- Statutory Audit applicable only if Turnover above Rs. 40 lacs / Capital above Rs. 25 lacs.
- Flexibility in raising funds from friends and relatives for business purposes
- No restrictions in respect of related party transactions
- Better Tax efficiency on following points:
 - Non-Applicability of MAT (AMT is applicable but only in very specific situations)
 - Non-taxability of profit distributions.
 - Deductibility of Interest on Capital
 - Option to opt for Cash Basis of Accounting

Conversion of Company into LLP

- The Legal Provisions

- The Limited Liability Partnership Act 2008
 - Section 56 & Third Schedule of LLP Act
 - Conversion of Private Company to LLP
 - Section 57 & Fourth Schedule of LLP Act
 - Conversion of Unlisted Public Company into LLP
 - Companies not eligible for conversion
 - Listed Public Company
 - Companies engaged in banking, finance & insurance
 - Companies engaged in a business governed by sector specific regulator and where such regulator does not permit LLP
 - Companies having FDI and where performance linked conditions are applicable
 - Companies having External Commercial Borrowings
 - Companies having FDI under approval route
 - Section 8 Company (Not for Profit Companies)
 - Company Limited by Guarantee
 - Companies having existing charge / security interest over their assets
 - Companies which has not filed at least 1 Annual Accounts and Annual Return with ROC

Conversion of Company into LLP

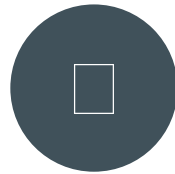
- The Legal Provisions

- The Income Tax Act

- Section 47(xiii b) of the Income Tax 1961

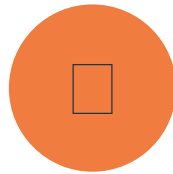
- Section 47 lists out the instances of transfer of assets, which would not be considered as transfers for the purpose of applicability of Capital Gains Provisions.
 - Sub-Section (xiii b) of the said provision provides that a conversion of a Private Company and Unlisted Public Company into a LLP shall not be considered as a transfer if following conditions are fulfilled:
 - i. All assets and liabilities of the Company should become the assets and liabilities of the LLP.
 - ii. All Shareholders of the Company should become the Partners of the LLP with their capital contribution and profit sharing ratio in the LLP in the same proportion as their shareholding in the Company
 - iii. Shareholders of the Company do not receive any consideration or benefit in the LLP other than share of profit or capital contribution in LLP
 - iv. The total profit sharing ratio of the Shareholder of the Company in the LLP should not be below 50% at any time for a period of at least 5 years
 - v. Total Sales, Turnover or Gross Receipts of the Company from its business should not exceed Rs. 60 lacs in any of the preceding three years from the year of conversion.
 - vi. Total value of the assets of the Company as per its Books of Accounts in any of the previous three years preceding the year of conversion does not exceed Rs. 5 crores.
 - vii. No amount is paid directly or indirectly to any partner out of the accumulated profits of the Company for a period 3 years from the date of conversion.

Key Checkpoints for conversion of Company to LLP



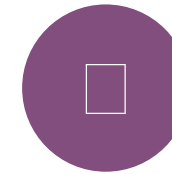
Align Shareholding

All Shareholders will become partners with their ratio of capital contribution profit sharing proportionate to Shareholding. Maybe necessary to buy-off some shareholders.



DIN for all Designated Partners

Ensure that all partners who are to be designated partners have DIN



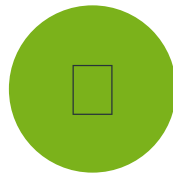
Check Name Availability

Check in advance whether the desired name will be available in RUN system or decide on an alternative name before commencing process.



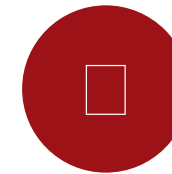
No Secured Creditors

Ensure that there are no Creditors, who have a security over the assets of the Company and all registered charges should be satisfied



Preparatory Work for Mandatory Documents

Ensure that all ground work for all mandatory documents is completed. For eg Consent of Shareholders / Unsecured Creditors / NOC of Regulatory Authority



No Pending Legal Compliances

Ensure that all pending MCA Forms, Due Returns under Income Tax Act, GST etc are filed and readily available.

Conversion Process – Company to LLP

Resolutions & Consents

- Convene Board Meeting and pass resolution by a majority for conversion of Company into LLP.
- Obtain consent of **all shareholders** of the Company
- Obtain consent of **all unsecured creditors** of the Company as on the date on which the financials are prepared for conversion.

Name Reservation

- Apply for proposed name through the RUN Facility of MCA.
- Ensure before starting process that proposed name will be available, else time-lines can be disturbed

Form 18 & FiLLiP

- File Form 18 with all necessary attachments for conversion
- File Form FiLLiP for incorporation of LLP
- On approval of Form 18 and FiLLiP, Certificate of Incorporation of LLP is issued certifying that the Company has converted into LLP

Post Conversion

- Execution of LLP Agreement
- File Form 3 with the signed LLP Agreement as attachment within 30 days of incorporation.

Preparation of Form 18 & FiLLiP

– Details & Documents

Form 18	Form FiLLiP
<ul style="list-style-type: none">• Statement of Consent of Shareholders• Consent of Unsecured Creditors• Copy of Acknowledgement of Latest Income Tax Return• Approval of any Sector Regulator, if applicable• Statement of Assets & Liabilities of the Company certified true and correct by Auditor not older than 30 days from date of filing of Form 18	<ul style="list-style-type: none">• Proof of Registered Office of LLP• Identity and Address Proof of all Partners including designated partners.• Fixed Capital Contribution of all Partners• Number and Name of LLPs, where Designated Partners are already partners
<ul style="list-style-type: none">• Details of No of Prosecution initiated / Show Cause issued against Company• Details of No of Proceedings by or against Company in any Court / Tribunal / Authority• If a conversion application has been rejected earlier, SRN of such application and reason for rejection• Details of any subsisting conviction / ruling / judgment in favour or against Company	<ul style="list-style-type: none">• Consent to act as Designated Partners in prescribed format• Board resolution of any Company becoming a Partner• Subscriber Sheet in prescribed format



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