

Institute of Chartered Accountants of India

Direct Taxes Committee

Direct Tax Applicability on LLPs including effect on Conversion of LLP



By CA Dr. Vijay Kewalramani
B. Com., LL. M., F. C. A., CFAP, CMA (Aus), DipIFR (UK), D. Sc. (Hon)

Presented on 3rd June, 2025

Limited Liability Partnership Act – Taxation Aspects.

TOPICS COVERED

- Taxation of LLP Under the Income Tax Act, 1961.
- Taxation effect on Conversion to LLPs.
- Important Judicial Precedents.
- Comparisons with Income Tax Bill, 2025

Legislations enacted

- Limited Liability Partnership Act, 2008.
- Limited Liability Partnership Rules, 2009.

Salient Features

- Benefits of Company and Partnership.
- Separate Legal Identity.
- Perpetual Succession.
- Limited Liability.
- Minimum 2 partners.
- No maximum limit on number of partners.
- Individuals, LLPs, Companies can be partners.

Taxation of LLP

➤ Current Tax Structure for LLPs

Particulars	Rate %	Remarks
Basic Tax	30	
Surcharge	12.50	Income Exceeding ₹ 1 Crore
Education Cess	4	
AMT	18.50	Adjusted Total Income exceeds ₹ 20 Lakhs
New vs Old Regime		New regime No Applicable to LLP

Basic features

- LLP to be taxed as a Partnership Firm.
- Partners Shares to be exempt u/s 10 (2A).
- Returns to be signed by designated partners.
- Remuneration and Interest to Partners Tax Deductible.
- All partners jointly and severally liable for tax dues in case of winding up.

Taxation of LLP

- Sec 2 (23) (i) includes LLP within the definition of firm.
- Sec 2 (23) (ii) includes partner of LLP as a Partner.
- Sec 2 (23) (iii) includes LLP as a partnership.
- Sec 140 Returns of LLP to be signed by Designated Partners
- Sec 167C tax dues on liquidation to be joint and several liability of all partners.

Taxation of LLP

- Sec 45 (3) Introduction of capital Asset by Partner.
- Sec 45 (4) Transfer of Capital Asset on Dissolution / Retirement to Partner.
- Sec 40(b) Remuneration and Interest to Partners.
- Sec 40 (A) (2) Payments to related parties.

Limited Liability Partnership Act – Important Provisions affecting LLPs.

Salary and Remuneration

➤ Section 40 (b)

- Salary to Partners
- Interest on Capital paid to Partners.

Book Profit/Loss Slab	Maximum Allowable Deduction
First ₹6,00,000 of book profit or in case of loss	₹3,00,000 OR 90% of book profit (whichever is higher)
Balance book profit (above ₹6,00,000)	60% of remaining book profit

Salary and Remuneration

Remuneration

S.No.	Condition	Compliance Requirement	Consequences of Non-Compliance
1	Working Partner Requirement	Only individual partners actively engaged in business affairs	100% disallowance of remuneration
2	LLP Agreement Authorization	Clear authorization in LLP Agreement with quantum/manner specified	Complete disallowance
3	Prospective Application	Payment period must be after LLP Agreement date	Retrospective payments disallowed
4	Ceiling Limit Compliance	Within prescribed monetary limits	Excess amount disallowed

Salary and Remuneration

Interest on Capital

Parameter	Requirement	Limit/Condition
Authorization	LLP Agreement must authorize interest payment	Mandatory provision
Rate Limitation	Maximum 12% per annum simple interest	Excess rate disallowed
Interest Type	Only simple interest, not compound interest	Compound interest disallowed
Period Restriction	Not applicable for pre-agreement periods	Retrospective disallowance

Related Party Transactions

Section 40A(2) – Payment to Related Parties

- **Scope:** Disallowance of excessive payments to related parties
- **Key Test:** Whether payment exceeds amount that would ordinarily be paid between unrelated parties
- **Burden of Proof:** On assessee to prove reasonableness
- **Consequence:** Disallowance of excess amount
- **LLP Context:** Partners and their families are "related parties" under the provision

Related Party Transactions

Transaction Types Covered

Payment Type	Reasonableness Benchmark	Documentation Required
Professional Fees to Partners	Market rates for similar services	Service agreements, benchmarking
Rent to Partner Properties	Fair rental value	Lease deeds, valuation reports
Interest on Partner Loans	Market lending rates (beyond 12%)	Loan agreements, bank rates
Commission to Partners	Industry standards	Performance metrics, comparables
Technical Services	Arm's length pricing	Scope of work, deliverables

TDS on Partners Remuneration

➤ 194T

➤ Applicable wef 1st April, 2025 (AY 2026-27).

Entity Type	Coverage	Statutory Basis	Applicability
Indian LLPs	✓ Covered	LLP Act 2008, Section 2(1)(n) + IT Act Section 2(23)(i)	Mandatory compliance
Partnership Firms	✓ Covered	Indian Partnership Act 1932	Mandatory compliance
Foreign LLPs	✗ NOT Covered	Not registered under LLP Act 2008	No TDS obligation
Company Partners	✓ Covered as Payees	Section 2(23)(ii) definition	Subject to TDS

TDS on Partners Remuneration

Mechanism

Aspect	Requirement	Compliance Detail
Rate	10%	Fixed rate, no surcharge/cess for individuals
Threshold	₹20,000 aggregate per partner per FY	Once crossed, TDS on entire amount
Timing	Earlier of credit or payment	No deferment allowed
Scope	All covered payments combined	Aggregate calculation mandatory

TDS on Partners Remuneration

Taxable Payments (Subject to TDS)

Payment Type	TDS Rate	Threshold	Timing of Deduction	Documentation Required
Salary	10%	Aggregate >₹20,000 p.a.	Credit/Payment (whichever earlier)	LLP Agreement provision
Remuneration	10%	Aggregate >₹20,000 p.a.	Credit/Payment (whichever earlier)	Clear authorization
Commission	10%	Aggregate >₹20,000 p.a.	Credit/Payment (whichever earlier)	Performance linkage
Bonus	10%	Aggregate >₹20,000 p.a.	Credit/Payment (whichever earlier)	Profit-sharing terms
Interest on Capital	10%	Aggregate >₹20,000 p.a.	Credit/Payment (whichever earlier)	Capital contribution records
Interest on Loans	10%	Aggregate >₹20,000 p.a.	Credit/Payment (whichever earlier)	Loan agreements

TDS on Partners Remuneration

Exempt Payments

Payment Type	Rationale	Documentation	Key Considerations
Capital Repayment	Return of partner's own contribution	Capital account statements	Must be genuine capital withdrawal
Business Expense Reimbursements	Actual expense recovery	Bills, vouchers, proof of payment	Must be for firm's business
Share of Profits	Distribution of firm's income	Profit sharing ratio in agreement	Exempt under Section 10(2A)
Drawings Against Capital	Partner's own money withdrawal	Capital account tracking	Not income in partner's hands

TDS on Partners Remuneration

Whether Lower Deduction applicable

Exemption Type	Availability	Impact	Alternative
Section 197 Certificate	✗ NOT Available	No lower/nil TDS rate	None
Form 15G/15H	✗ NOT Available	Senior citizens cannot avoid TDS	Claim refund in ITR
Threshold Exemption	✗ NOT Available	No payment-wise exemption	Aggregate calculation only

TDS on Partners Remuneration

Deduction Timeline

Payment Frequency	TDS Deduction Requirement	Example Scenario
Monthly Salary	TDS at each monthly payment	₹30,000/month = ₹3,000 TDS monthly
Quarterly Commission	TDS at each quarterly payment	₹25,000/quarter = ₹2,500 TDS quarterly
Annual Interest	TDS at year-end or payment	₹50,000 annual = ₹5,000 TDS at year-end
Ad-hoc Bonus	TDS at time of credit/payment	₹1,00,000 bonus = ₹10,000 TDS immediately

TDS on Interest to Partners

➤ Section 194A

- Section 194A(3)(iv) specifically exempts TDS on Interest on Loans from Partners.

➤ Section 194T

- Any interest paid to partner shall be liable to the provisions of this section.

Presumptive Taxation

➤ Section 44AD

- Explanation (a) to Section 44AD expressly excludes LLP from the purview of this section.

➤ Section 44ADA

- The basic provision expressly excludes LLP from the purview of this section.

Audit

Primary Turnover Thresholds

Business Category	Turnover Limit	Audit Mandatory
Business Income	> ₹1 Crore	✓ YES
Professional Income	> ₹50 Lakhs	✓ YES
Enhanced Limit (Digital Transactions)	> ₹10 Crore	✓ YES (if cash transactions exceed 5%)

Conditions for Rs, 10 Crore threshold

- Cash receipts \leq 5% of total receipts AND / OR
- Cash payments \leq 5% of total payments
- Note: Non-account payee cheques/drafts treated as cash

Limited Liability Partnership Act – Alternate Minimum Tax

AMT Provisions

➤ Section 115JC(1) - Scope

- Applies when total income includes profits/gains from business or profession.
- Adjusted Total Income exceeds ₹20 Lakhs.

➤ Section 115JD - AMT Credit

- **Credit Available:** When $AMT > \text{Regular Tax}$
- **Utilization:** Against future regular tax liability
- **Carry Forward:** Up to 15 assessment years

AMT Provisions

Section 115JC (AMT Applicability)

Particulars	Yes / No	AMT Applicability
Income includes Profits and Gains from Business / Profession	Yes	✓
Adjusted Total Income > ` 20 Lakhs	Yes	✓

Section 115JD (AMT Credit)

Particulars	Credit Applicability
Credit Available	AMT > Normal Tax
Utilisation	Against Future Tax Liability
Carry Forward	Upto 15 Assessment Years

Limited Liability Partnership Act – Impact on Startup LLPs.

Start Up benefits

Key Benefits Available to Start-up LLPs

1. **Section 80IAC Tax Holiday:** 100% exemption for 3 consecutive years
2. **Angel Tax Exemption:** Abolished in Budget 2024 (historical relevance)
3. **Regulatory Compliance:** Simplified procedures for recognized start-ups

Limited Liability Partnership Act – Taxation Impact on Conversion.

Types of Conversions

- Partnership Firm to LLP (Second Schedule to LLP Act, 2008).
- Private Limited Company to LLP (Third Schedule to LLP Act, 2008).
- Public Limited Company to LLP (Fourth Schedule to LLP Act, 2008).
- LLP to Company (Section 366 of Companies Act, 2013).

Tax Effect on Conversion

- Section 47 (xiiib) provides that Conversion of Private limited or Public Limited Company shall be exempt from Capital gains if certain conditions fulfilled. s Act, 2013).
- All Conditions laid down need to be satisfied.
- Non Satisfaction of even one condition may result in withdrawal of exemption.

Provisions of S. 47 (xiiib)

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

S. 47 (xiiib) (Cont'd)

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

S. 47 (xiiib) (Cont'd)

- The total sales, turnover or gross receipts in business of the company, in any of the three previous years preceding the previous year in which the conversion takes place does not exceed Rs. 60 Lakhs.
- The total value of assets of the company as per the books of accounts, in any of the three previous years preceding the previous year in which the conversion takes place does not exceed Rs. 5 Crores

S. 47 (xiiib) (Cont'd)

- 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.

Checklist for S. 47 (xiiib)

Checklist for Section 47 (xiiib) applicability

Condition

Whether all Assets and Liabilities Transferred

Whether All Shareholders become Partners

Whether Capital Contribution and Profit Sharing remain same

Whether Shareholders have received any Direct or indirect benefit

Whether Cumulative Profit Sharing Ratio of all partners goes below 50% in five years post conversion

Whether Sales / turnover in any of three preceding years exceeded ₹ 60 Lakhs

Whether value of Total Assets in any of the three preceding years exceeded ₹ 5 Crores

Whether any Partner has withdrawn any amount from accumulated Profits as on date of conversion in any of the three years post conversion

Effects on conversion of LLP

- S. 32 The proviso has been amended to state that the aggregate depreciation allowable to the predecessor company and the successor LLP shall not exceed the depreciation at the prescribed rates, as if the conversion had not taken place.
- S. 115JAA (7) has been inserted to provide that no credit for MAT paid by the predecessor company shall be allowed to the successor LLP.

Effects on conversion of LLP (Cont'd)

- S. 49 (1) (iii) (e) has been amended to provide that in case of a conversion of private company or unlisted public company to LLP, the cost of acquisition of assets of the successor LLP shall be deemed to be the cost of acquisition of the predecessor company.
- S. 49 (2AAA) Cost of acquisition of rights of partner shall be deemed to be cost of acquisition of shares of company prior to conversion.

Effects on conversion of LLP (Cont'd)

- S. 35DDA (4A) has been added to state that in case of a conversion of a private company or an unlisted public company to a LLP, the provisions of the section relating to amortization of expenses relating to lump sum payments to employees under a voluntary retirement scheme, would be allowed to the successor company.
- S. 35DDA (5) has also been amended to state that no deduction would be allowed under this section to the predecessor company in the year of conversion.

Effects on conversion of LLP (Cont'd)

- S. 43 (1) Explanation 13 of the said section has been amended to state that in case deduction under s. 35AD has been allowed or is allowable in respect of any capital asset to the predecessor company, then the cost of cost shall be taken as “Nil” at the time of conversion.
- S. 43 (6) has been amended to state that the actual cost of assets at the time of conversion of private company or unlisted public company to LLP shall be the WDV in the hands of the predecessor on the date of conversion.

Effects on conversion of LLP (Cont'd)

- S. 72A (6A) has been added to provide for carry forward of business loss or unabsorbed depreciation of the predecessor company in the LLP, subject to fulfillment of conditions laid in S. 47 (xiiib).
- It further provides that in case the conditions laid down in S. 47 (xiiib) are not complied then the benefit availed under this section shall be chargeable to tax in the hands of the successor LLP in the year in which the conditions are not complied with.

Effects on conversion of LLP (Cont'd)

Available Carry-forwards:

Deduction Type	Carry-forward Allowed	Conditions	Time Limit
Business Loss	Yes (Section 72A(6A))	Section 47(xiiib) compliance	8 years
Depreciation	Yes (Section 32)	Aggregate limit applies	No limit
Section 35DDA	Yes	Section 47(xiiib) compliance	Remaining period

Effects on conversion of LLP (Cont'd)

- S. 47A Withdrawal of Exemption in Certain Cases
 - **Capital Gains Taxation** When conditions of section 47(xiiib) are not complied with, profits and gains arising from transfer of capital asset shall be deemed to be the profits and gains chargeable to tax of the successor LLP or the shareholders of the predecessor company.
 - Applicable in the year the Conditions are not complied with.

Limited Liability Partnership Act – Important Judicial Precedents.

Judicial Scrutiny

➤ The Taxation on LLPs have gone through a lot of Judicial Scrutiny at various levels as under.

➤ Authority for Advance Ruling (AAR)

➤ Income Tax Appellate Tribunal (ITAT) - Various Benches

➤ High Courts - Bombay, Madras, Karnataka

➤ Supreme Court - Limited but foundational precedents
Scrutiny

Texspin Engg. & Mfg. Works

➤ **Texspin Engg. & Mfg. Works - : [2003] 263 ITR 345 (Bom.)**

➤ **High Court Decision**

➤ **No Transfer:** Conversion is mere change of form, not transfer between entities.

➤ **No Consideration:** Absence of monetary consideration negates capital gains.

➤ **Business Continuity:** Same business continues under different legal form.

➤ **Substance over Form:** Focus on business reality rather than legal technicalities

Umicore Finance Luxembourg

- **Umicore Finance Luxembourg - (2010) 323 ITR 25 (AAR)**
- **AAR Decision upheld by Bombay High Court**
 - No capital gains accrued at the time of conversion of the partnership firm into a private limited.
 - The said company was not liable to pay capital gains tax..

Domino Printing Science Plc

➤ **Domino Printing Science Plc - (2021) 433 ITR 215 (AAR)**

➤ **AAR Decision**

➤ **Transfer Confirmed:** Conversion constitutes 'transfer' as shareholder's rights get 'extinguished'

➤ **Computation Workable:** Full value of consideration = partnership interest value

➤ **Taxable Despite Equal Value:** Capital gains arise even if partnership interest equals share value

Aravali Polymers LLP

➤ **Aravali Polymers LLP- (I.T.A. No. 718/Kol./2014)**

➤ **ITAT Decision**

➤ The value at which the shares or the assets of the Company was taken over by the LLP, would be the sale price and the cost of acquisition thereof is to be as per books of the erstwhile Company.

➤ Book value, not market value, to be adopted for capital gains computation

Celerity Power LLP

- **Celerity Power LLP - [2018] 100 taxmann.com 129 (Mum.-Trib.)**
- **ITAT Decision**
 - The conversion of the company into an LLP is a transfer and the gains arising from such conversion should be taxed as capital gains.
 - Differentiated from Texspin case noting LLP Act specifically uses term 'transfer' unlike Companies Act provisions for partnership firm succession.
 - LLP shall not be allowed to carry forward and set off the losses because it had failed to cumulatively satisfy all the conditions laid down in the proviso to section 47(xiiib).
 - Book value was to be regarded as full value of consideration for purpose of computation of capital gains under section 48

Brizeal Realtors and Developers LLP

- Brizeal Realtors and Developers LLP - [2023] 146 taxmann.com 109 (Mumbai-Trib.)
- ITAT Decision
 - Goodwill arising out of the new admission of partner post-conversion cannot be treated as benefit out of conversion.
 - The shareholders of the company existed till the date of conversion.

ISC Specialty Chemicals LLP

- **ISC Specialty Chemicals LLP - (Kerala ITAT, 2025)**
- **ITAT Decision**
 - Aligns with Domino Printing Science and Celerity Power decisions.
 - Supports Aravali Polymers methodology on Book Value Computation
 - The shareholders of the company existed till the date of conversion.

Contradictory Analysis

➤ Judicial Conflict: Substance and Form

Firm to Company	Company to Firm
Texspin Engg. (2003)	Domino Printing (2021)
Substance over form	Legal form significance
Business continuity	Rights extinguishment
No consideration principle	Deemed transfer concept

Limited Liability Partnership Act – Comparisons with Income Tax Bill, 2025.

New Income Tax Bill, 2025

- Tax Rates remain unchanged.
- Provisions remain unchanged, only section / clause numbers are different.
- Not much changes related to provisions relating to LLPs.

Acknowledgements.

Sources

PRIMARY SOURCES: -

- Income Tax Act, 1961
- Limited Liability Partnership Act, 2008

SECONDARY SOURCES: -

- Grant Thornton Bharat - LLP Conversion Tax Implications (2022)
- Lakshmikumaran & Sridharan - Capital Gains Analysis (2018) –
- Taxmann Legal Database - Case Law Summaries - Professional tax practice insights and analysis
- KPMG Tax Flash News

Questions



Disclaimer

Scope & Purpose: This presentation has been prepared for educational purposes based on the Income Tax Act, 1961, Limited Liability Partnership Act, 2008, judicial precedents, and other authoritative sources current as of June 2025.

Professional Advice: The content shared herein constitutes general information only and should not be construed as professional tax or legal advice for specific situations. Participants are advised to consult qualified professionals before making any business or compliance decisions.

Liability Limitation: The author disclaims all liability for any loss or damage arising from reliance on this material. While every effort has been made to ensure accuracy, no warranty is provided regarding completeness or currency of information.

Independent Views: Opinions expressed may represent the author's professional interpretation and should not be treated as definitive legal positions. Tax laws and judicial interpretations are subject to change.

Compliance Responsibility: Practitioners are advised to verify current legal provisions and seek updated professional guidance before applying any concepts discussed herein.

Thank You

