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Merger of Limited Liability Partnership and Company
An Analysis

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Executive Summary

This article highlights the proposition of a LLP or firm merging into a company a landmark judgement passed by the National Company Law Tribunal, Chennai Bench.

Reaping the benefits of a merger or acquisition is a tricky business. Outcomes are uncertain, previously unknown or unimportant facts suddenly emerge as critical, and there are many moving parts to control. The article primarily discusses on the facts of the case, the judgment along with the regulatory and tax implications.

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Issue for discussion - whether merger of LLP into a Company is permitted under the Companies Act, 2013?

Legal Provisions

The Companies Act, 2013 and the LLP Act, 2008 does not contain any express provisions which provide for such cross-entity amalgamation. The provisions under the Companies Act, 1956 allowed for the amalgamation of a body corporate (including an LLP) with the Company whereas, Companies Act, 2013 and the LLP Act, 2008 allows for the merger for LLPs and companies respectively.

Facts of the Case

The issue was brought before the Chennai NCLT with the following brief facts.

1. A Joint Petition No 123/CAA/2018 was filed for the purpose of considering and approving, the Scheme of Amalgamation of M/s Real Image LLP, the Transferor LLP, by transferring and vesting operation with M/s. Qube Cinema Technologies Private Limited, the Transferee Company.
2. The Scheme provided that the whole of the undertaking of the Transferor LLP shall be transferred to the Transferee Company as a going concern.
3. On issue and allotment of shares by the Transferee Company to the partners of the Transferor LLP as a consideration for the amalgamation, the investment held by the Transferor LLP in the capital of the Transferee Company shall stand adjusted or cancelled.

Judgement

The Chennai Bench of the National Company Law Tribunal recently approved a scheme of amalgamation between an Indian Limited Liability Partnership (LLP) and a Private Limited Company.

It was held by the Hon'ble Bench, in the matter that Real Image LLP (Transferor LLP) is allowed to amalgamate with Qube Cinema Technologies Private Limited (Transferee Company) under a scheme of amalgamation filed before the NCLT. It is a landmark judgement passed by the NCLT, Chennai Bench taking resort to "*casus omissus"* since the Companies Act, 1956 categorically allowed a transferor to be a body corporate (including an LLP).

The term ***'casus omissus'*** refers to a situation omitted from or not provided for by statute or regulation and therefore governed by the common law.

The provisions relating to mergers and amalgamation governed under Section 394(4) clause (b) of the earlier Act, (Companies Act, 1956) states that "transferee company" does not include any company other than a company within the meaning of this Act; but "transferor company" includes any body corporate, whether a company within the meaning of this Act or not.

Wherein, under the Companies Act, 2013 the word 'Company' includes both Transferor and Transferee Company. However, attention must be drawn towards the explanation to sub-section (2)

of Section 234 states *"For the purposes of sub-section (2), the expression "foreign company" means any company or body corporate incorporated outside India whether having a place of business in India or not.*

The bench discussed in the following terms:

Para 14 of the Order states: "Council for the petitioner companies submitted that Sections 60 to 62 of the LLP Act 2008 and Sections 230 to 234 of the Companies Act 2013 deal with the merger, amalgamation and arrangements. The wordings used in both these provisions are almost identical and both the Acts empower only the National Company Law Tribunal to sanction the scheme proposed by the LLP or Company. He has further submitted that under Section 394(4) (b) of the Companies Act, 1956, there was no bar for a transferor in a Scheme of Amalgamation to be body corporate including a LLP. The underlying rationale was to ensure that the resultant company out of a scheme of amalgamation is only a company as defined under the Companies Act and such prohibition was not imposed on the transferor. However, Section 232 of the Companies Act 2013 does not contain the same clause as has been stipulated under Section 394(4) (b). He further submitted that Section 234 of the Companies Act 2013 permits that the foreign company may merge into a Company registered under the Companies Act 2013 or vice versa and the foreign company as defined under the said section, within its ambit, also includes a body corporate incorporated outside India including a foreign LLP. Therefore, as per section 234, foreign LLP and Indian Company can merge with each other but such benefit has not been provided under Section 232 of the Companies Act 2013 for permitting an Indian LLP to merge with an Indian Company.

Para 15 of the Order states: "After hearing the counsel for the petitioners, it is concluded that the legislative intent behind enacting both the LLP act 2008 and the Companies Act 2013 is to facilitate the ease of doing business and create a desirable business atmosphere for companies and LLPs. For this purpose, both the Acts have provided provisions for merger or amalgamation of two or more LLPs and Companies. The issue involved in the present petition has been categorically dealt with by the Companies Act, 1956 but there is no specific provision in the Companies Act 2013. Therefore, this is the clear case of casus omissus. If the intention of the parliament is to permit a foreign LLP to merge with an Indian Company, then it would be wrong to presume that the Act prohibits a merger of an Indian LLP with an Indian Company. Thus, there does not appear any express legal bar to allow/sanction merger of an Indian LLP with an Indian Company".

Though the tribunal's order is affirmative and forward looking the companies are unclear on the tax implications attracted in this scheme of amalgamation.

Tax Implications

Under the Income Tax Act, 1961 "amalgamation", in relation to companies, means the merger of one or more companies with another company. A company is defined to include an Indian Company i.e. formed and registered under the Companies Act and foreign body corporates. There are no instances which talks about a situation of amalgamation of a firm/ LLP (incorporated in India) with a company or vice-versa. This leads to lacuna for implementing the specific exemptions stated in Section 47 of the Income Tax, Act, 1961.
Having said that the tax implications based upon the above-mentioned order can be probed in the hands of the Transferor firm/LLP, Partner and the Transferee Company.

Party	Section	Implication
Transferor Firm/ LLP	47(xiii)	Since the entire undertaking post the merger vests with the transferee Company and based upon the laws a business undertaking is a capital asset which attracts the computation of capital gains tax. However, one may argue taking resort to Section 47(xiii) of the Act, whereby capital gains shall not be charged on any transfer of a capital asset by a firm (including LLP) to a company as a result of succession of the firm/ LLP by a Company in the business carried on by the firm/ LLP, subject to fulfilment of certain conditions prescribed thereunder.
Partner	2(47)	Transfer represents the sale, exchange or relinquishment of the assets. However, the aforesaid section specifies instances which are not treated as transfer for the purpose of computing capital gains. In the present case the partners of the firm give up their "rights" in the interest of the firm/ LLP. However, in case of merger, they receive shares in the transferee company, and under the Income tax, capital gains may be computed in the difference between fair value of consideration so received and the cost of acquisition of the partnership interest. Further one must contest under the provisions of Section 2(47) that there is no transfer of rights by way of extinguishment in the hands of the partner since they would continue to exercise the same rights over the transferee company upon the issue and allotment of shares by the transferee company.
Transferee Company	56(2)(x)	The referred Section deems income in the hands of any person, being in receipt of any sum of money, immovable property or property for no consideration or inadequate consideration. In the mentioned case, transferee company is in receipt of capital asset, being a business undertaking. Since the definition of business undertaking does not fall under the definition of property under the Income Tax, Act 1961, there is no such provision under the Income Tax Act to widen its tax net to deem income in the hands of the transferee Company.

Valuation Methodology

The *valuation* process plays a significant role in any scheme of merger as it enables to decide upon the swap ratio.

It may be noted that none of the applicable statutes expressly provide for any specific method for purpose of valuation of LLP in the event of merger. Hence the general valuation methodologies as employed in valuation of other entities shall extend to LLP as well.

In the matter of Real Image LLP and Qube Cinema Technologies Private Limited, the asset approach by using the book value method has been considered for the determination of the exchange ratio. The partners of the Transferor LLP had no other assets and liabilities apart from investments in equity shares of the Transferee Company.

Accordingly, the individual valuation of the Transferor and Transferee Company was not required, and exchange ratio so determined involved for issuing equivalent number of equity shares to the

Transferor LLP in their profit-sharing ratio and the shares held by the Company and the LLP stands cancelled.

Thus, NCLT gave a judgement of substance over form in approving the scheme for the ease of doing business and for a prudent business environment. Yet there are issues that might arise in the backdrop of such restructuring and a clarity under the Companies Act, 2013, the LLP Act, 2008 and the Income Tax Act, 1961 shall be welcoming.

Other Jurisprudence

In the recent past the Mumbai Bench of the NCLT permitted a scheme of amalgamation for merger of Vertis Microsystems LLP with Forgeahead Solutions Private Limited. Initially the scheme was filed before the Hon'ble High Court of Bombay under sections 391 to 394 of the 1956 Act but was subsequently transferred to the Mumbai Bench of the NCLT once sections 230 to 232 of the 2013 Act were notified.

Further, a scheme of amalgamation of a partnership firm with an Indian company was filed at the Ahmedabad Bench of NCLT for its approval. However, the Hon'ble Bench stated since the transferor entity, being a registered partnership firm was not a company under the provisions of the Companies Act, 2013 it could not proceed with such amalgamation.

Considering different views of the Benches which do not seem to be aligned, yet it opens up way for such unconventional restructuring.

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