

**IN THE INCOME-TAX APPELLATE TRIBUNAL, MUMBAI“C” BENCH, MUMBAI
BEFORE SHRI NARENDER KUMAR CHOUDHRY, JUDICIAL MEMBER AND
SHRI BIJAYANANDA PRUSETH, ACCOUNTANT MEMBER
ITA No. 5343/MUM/2025(AY: 2017-18)**

Padmaja Rajesh Harve 1201-A, 64 Greens Building, Tagore Road, Santacruz West, Mumbai-400054.	vs.	ACIT-41(1)(1) Room No. 425, 4 th floor, KautilyaBhavan, C-41 to C-43, G block, BandraKurla Complex, Bandra East, Mumbai -400051.
PAN/GIR No:AAXPH1769E		
(Appellant)		(Respondent)

Appellant by	Shri Hitesh P Shah
Respondent by	Shri Virabhadra Mahajan, Sr. DR
Date of Hearing	24.12.2025
Date of Pronouncement	22.01.2026

ORDER

PER BIJAYANANDA PRUSETH, AM:

This appeal filed by the assessee emanates from the order passed under section 250 of the Income-tax Act, 1961 (in short, 'Act') by the Commissioner of Income-Tax, National Faceless Appeal Centre, Delhi [in short, 'CIT(A)'], dated 05.08.2025 for the assessment year(AY)2017-18.

2. The grounds of appeal raised by the assessee are as under:

"1. The Hon. CIT(A) and the Ld. AO erred in considering the Long-Term Capital Gain of Rs. 8,28,41,514/- as Short-Term Capital Gain.

2. The Ld. A.O. failed to appreciate the fact that the Company Harve Tube Tekniqs Private Limited was not entitled to claim benefit u/s. 47(xii)(b).

3. The Hon. CIT(A) erred in holding that the time limit of 36 months for withdrawal of reserves and surplus was applicable in the case of appellant.

4. The Hon. CIT(A) and the Id. AO ought to have allowed the investment made in House Property and Bonds u/s. 54F and 54EC.

5. The Hon. CIT(A) and the Ld. AO., were not justified in disallowing the claim of indexation shares as claimed in Return.”

3. Facts of the case, in brief, are that the assessee filed her return of income electronically on 31.07.2017 declaring total income at Rs.2,26,04,590/-. The case was taken up for scrutiny and various statutory notices were issued to the assessee, which were duly responded. The assessee was a director and shareholder of M/sHarve Tube Tekniqs Pvt. Ltd. (in short, 'company'). The company was converted into LLP i.e. M/s Harve Tube TekniqsLLP on 15.09.2016. On conversion, all assets and liabilities were transferred to the LLP on book value. The total reserves and surplus of Rs.16,56,83,027/- was transferred to both the partners current account in the LLP at Rs.8,28,41,414/- each on 16.09.2016. In the assessment order, the AO has reproduced provisions of Section 47 of the Act which deals with "Transactions not regarded as transfer"u/s 45 of the Act. Clause (xiiib) of the Section 47 deals with conversion of Pvt. Ltd. company to LLP. If the conditions enumerated in the Section 47 are violated, the transaction becomes a transfer and Section 47A of the Act applies. As per sub-section (4) of Section 47A, the amount of profits and gains arising from transfer of capital assets or intangible assets shall be deemed to be the profits and gains

chargeable to tax of the successor LLP or the shareholder of the company. Since the turnover of the company in the last 3 years was more than 60 lakhs and the total value of assets transferred for last 3 years was more than Rs.5 crore, the conditions of (e) and (ea) were not satisfied. The AO considered the above withdrawals of reserves and surplus by the partners as violation of the conditions of Section 47(xiii b) and taxed the same amount as short-term capital gain (STCG) because the assessee has withdrawn the funds from the newly formed LLP shortly after its formation before the mandatory period of 3 years on transfer of funds from LLP to partners. The AO did not allow benefit of deduction u/s 54 EC and 54 F of the Act of Rs.50,00,000/- and Rs.5,80,11,910/- respectively by holding that the gain was a STCG. Accordingly, the LTCG offered at Rs.1,97,62,416/- by the assessee was treated as STCG and the deduction claimed u/s 54F, 54EC of the Act and indexed of cost of acquisition of the shares of Rs.67,188/- were disallowed. The total income was assessed at Rs.8,56,83,688/- as against the returned income of Rs.2,26,04,590/-.

4. Aggrieved by the order of the AO, the assessee filed appeal before the CIT(A). The CIT(A) has reproduced relevant part of the assessment order, grounds of appeal, statement of facts, submissions of the assessee and decided the appeal at para 8 onwards. He has stated that both AO and the assessee agreed that the transaction is taxable as capital gain but the treatment of such

capital gain was different i.e. the AO considered it as STCG whereas the assessee treated the same as LTCG. He has extracted provision of Sections 47(xiii b), 45, 2(14), 2(29AA) and 2(42A) of the Act and observed that the reserves and surplus of the erstwhile company were transferred to LLP as assessee's share in LLP. As long as it was held as reserve and surplus of the company, it was liability in the hands of the company, which is a separate legality. When the reserve and surplus, i.e. profit is transferred to the LLP in the form of share of the respective shareholders, it becomes partner's contribution to the LLP. Hence, the appellant received her share of reserve and surplus from the company through the LLP on and after 15.09.2016, i.e. the date of conversion of company to LLP. According to the CIT(A), the impugned amount is nothing but the bonus received by the assessee over and above her shares. Thus, the impugned amount was capital asset in her hand, which was withdrawn on 14.11.2016. Since the period between 15.09.2016 and 14.11.2016 is less than 36 months, the said asset was a short-term capital asset u/s 2(42A) of the Act. Hence, the corresponding capital gain does not qualify for exemption u/s 54 F and 54 EC of the Act. Accordingly, the appeal of the assessee was dismissed.

5. Further aggrieved, the assessee has filed appeal before the Tribunal. The Ld. AR of the assessee filed a paper-book enclosing various details and written submissions filed before the lower authorities. It is submitted that the

company, M/s Harve Tube Technique Pvt. Ltd., was incorporated on 20.05.2004 with total share capital of Rs.1,00,000/- (10,000 shares of Rs.10 each). Mr. Rajesh Harve and Mrs. Padmaja Rajesh Harve (assessee herein) were holding 5000 shares of Rs.50,000/- each. The company was converted to LLP on 15.09.2016. All the assets and liabilities were transferred to the LLP and the "reserves and surplus" was transferred to the partners' current account in the LLP on 16.09.2016. Since the turnover of the company was more than Rs.60 Lakhs and total value of assets transferred for last 3 years was more than Rs.5 crores, the conditions of clause (e) and clause (ea) of Section 47(xiiib) were not satisfied. Hence, the benefit of exemption provided could not be availed by the company or the LLP. Therefore, the company had considered the said transaction as transfer and declared the transfer amount of Rs.16,57,83,027/- as STCG in the hands of the company. The cost of acquisition was taken at the book value of the asset at Rs.16,57,83,027/- and hence, the STCG was Rs. Nil. The share of profit of the partners in LLP was 50% each and hence, their fixed capital in LLP was Rs.50,000/- each, totaling to Rs.1,00,000/-. On 14.11.2016 both partners withdrew Rs.7.14 crore each from their current capital account. The said amount was considered as LTCG, out of which both partners had invested in house property and capital gain bonds. On the balance amount, they had paid LTCG tax. The Ld. AR submitted that the AO has wrongly considered the

withdrawal of the reserves and surplus as STCG. He further submitted that the CIT(A) failed to appreciate that under the Companies Act, the reserves and surplus are the part of the capital employed in the form of retained earnings and are always considered as shareholders' equity. In the balance sheet, the reserve and surplus are shown as shareholders' fund, as the company being a separate entity, owes it to the shareholders just like the share capital. He further submitted that once the company was converted to LLP on 15.09.2016, there was transfer u/s 2(47) of the Act. As there were no other liabilities, only the shareholders had exclusive right on the said reserve and surplus. He also submitted that the capital gain arose from the appreciation of appellants' shareholding in the company, which she was holding since the year 2004. The period of holding was more than 12 years from 20.05.2004 to 16.09.2016. Therefore, the assessee has rightly shown the impugned gain as LTCG and claimed exemption u/s 54 EC and 54 F of the Act after satisfying the conditions contained therein. Therefore, he requested to set aside the order of CIT(A) and allowed the ground raised by the appellant.

6. On the other hand, the Ld. Senior AR of the Revenue supported the order of lower authorities. He submitted that the company was converted into LLP on 15.09.2016 and the appellant withdrew Rs.7.14 crore on 14.11.2016. Hence, the period of holding was less than 3 years; therefore, both AO and CIT(A) have

rightly treated the subject gain as STCG. The exemption claimed by the assessee u/s 54 EC and 54F of the Act were rightly denied by the lower authorities.

7. We have heard both the parties and perused the materials available on record. The appellant was one of the two shareholders of Harve Tube Tekniqs Pvt. Ltd., which was incorporated on 20.05.2004. The appellant was holding 5000 shares worth Rs.50,000/-. The company was converted to LLP on 15.09.2016. All the assets and liabilities were transferred to the LLP. The total reserves and surplus of Rs.16,56,83,027/- were also transferred to the current account of the partners in the LLP at Rs.8,28,41,514/- each on 16.09.2016. Since the turnover of the company for the last 3 years was more than Rs.60 lakhs and the total value of the asset transferred was more than Rs.5 crores, the conditions of (e) and (ea) of Section 47(xiiib) were not satisfied. Therefore, it was not liable to get exemption from taxation u/s 45 of the Act. There is no dispute in this regard and both the parties have agreed that there was capital gain on account of the impugned transactions. The only dispute is whether the impugned gain was STCG or LTCG. According to the AO, it was STCG since the period of holding was less than 3 years whereas the Ld. AR of the assessee submitted that it was LTCG, because the period of holding was more than 12 years. We find that the appellant was an original shareholder having 50% shareholding of the company worth Rs.50,000/- from the date of formation of

the company on 20.05.2004. The appellant has not made any further investment in the shares of company or incurred any further cost till withdrawal of Rs.7.14 crore from her capital account on 14.11.2016.As submitted by the Ld. AR, the reserves and surplus are the part of the capital employed in the form of retained earnings and are considered as shareholders' fund. In the balance-sheet also the "Reserves and Surplus" are shown as part of "Shareholders'funds". In the paper-book, the appellant has enclosed financial statements for the years ended 31.03.2013, 31.03.2014, 31.03.2015, 31.03.2016 wherein the reserves and surplus are shown as part of shareholders'funds. In the balance-sheet of the company as at 14.09.2016 i.e. immediately before its conversion to LLP, the reserve and surplus were shown at Rs.16,56,83,028/-. Once the company was converted into LLP on 15.09.2016, there was transfer u/s 2(47) of the Act. As there were no other liabilities, only the shareholders had exclusive rights on the said reserves and surplus. Since the company or LLP had not claimed any benefit u/s 47(xiiib), the condition for maintaining the said reserves and surplus for a period of 3 years is not applicable in the instant case. The conversion from company to LLP on 15.09.2016 was the event when the transfer took place u/s 2(47) of the Act. Such transfer has triggered the taxability of capital gain in the hands of the shareholders who were holding the share of the erstwhile company from 20.05.2004 till 14.11.2016. Therefore, the above period of 12 years 5

months was required to be considered for calculation of the period of holding u/s 2(29B)/2(42A) of the Act for the purpose of capital gain u/s 45 of the Act. This was the period for which the appellant was holding the shares which were acquired on 20.05.2004 by paying Rs.50,000/-. The “indexed cost of acquisition” and “indexed cost of any improvement” on Rs.50,000/- are to be reduced as per the provisions relating to the mode of computation u/s 48 of the Act.

7.1 In the case of Domino Printing Science PLC, 433 ITR 215 (AAR), the Hon’ble Authority for Advance Rulings held that conversion of company into LLP constitutes a transfer of shares, making the shareholder liable for capital gain tax, if certain conditions for tax neutral conversion are not met. It held that conversion of tax-payers shares into partnership interest was a transfer u/s 2(47) of the Act as the shareholders right were extinguished upon conversion into LLP. Conversion can be tax neutral if conditions u/s 47(xiiiib) of the Act are met, which is not the case in the present appeal. Hence, there was a transfer u/s 2(47) of the Act as shareholders’ rights were extinguished. Since the assessee was holding the shares of the company from 20.05.2004 for more than 12 years, as discussed above, the same was required to be taxed as LTCG. The cost of acquisition was Rs.50,000/-, the price at which the assessee had purchased the share of the company. Benefit of indexation is required to be allowed on this cost of acquisition. Since the assessee has purchased a residence and invested in

capital gain bonds within one year of the said capital gain,deductions u/s 54F and 54EC of the Act are allowable to the extent of such purchase and investment made by the assessee. In view of the above facts and the clear statutory provisions, the addition made by the AO by holding that there was STCG, which was confirmed by the CIT(A), is not liable to be sustained. The denial of deductions u/s 54F and 54EC of the Act are also not justified. Accordingly, the order of CIT(A) is set aside and grounds raised by the appellant are allowed.

8. In the result, the appeal of the assessee is allowed.

Order is pronounced on 22.01.2026

Sd/-
(NARENDER KUMAR CHOUDHRY)
JUDICIAL MEMBER

Sd/-
(BIJYANANDA PRUSETH)
ACCOUNTANT MEMBER

*Aniket Chand; Sr. PS

MUMBAI

Date: 22.01.2026

Copy of the Order forwarded to:

1. The Assessee
2. The Respondent
3. The CIT(A)
4. CIT
5. DR/AR, ITAT, MUMBAI
6. Guard File

ByOrder

Assistant Registrar
ITAT, MUMBAI