LLP Mergers: Regulatory Possibility, Tax Impossibility, and the Case for Reform

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Binoy Parikh
Partner, Katalyst Advisors

Padmanabh Neema
Associate, Katalyst Advisors

Introduction: The Forgotten Frontier of Indian M&A

The Limited Liability Partnership, as a vehicle of business organisation, has enjoyed remarkable adoption since the enactment of the Limited Liability Partnership Act, 2008 ("LLP Act"). Its appeal is well understood: limited liability for partners, a flexible internal governance structure unconstrained by the rigidities of the Companies Act, one-point taxation at the LLP level, without further extraction cost, and lower compliance overhead as compared to a company.

And yet, when it comes to one of the most fundamental instruments of corporate restructuring, the merger or amalgamation, the LLP remains a regulatory orphan and a tax casualty. While the LLP Act does contemplate mergers between LLPs, the Income-tax Act, 1961 (‘’IT Act”) and the Income-tax Act, 2025 ("New IT Act") offers no tax-neutral framework for such transactions, rendering them commercially unviable in most cases. This article analyses the regulatory architecture governing LLP mergers, dissects the income tax implications for all three stakeholders involved (the transferor LLP, the transferee LLP, and the partners), examines the stamp duty landscape, and explores a structural mitigant that could reduce the tax friction.

The Regulatory Framework: Sections 60 to 62 of the LLP Act

Chapter XII of the LLP Act, comprising Sections 60, 61, and 62, provides the statutory mechanism for compromises, arrangements or reconstruction of LLPs. These provisions are modelled closely on the language and structure of Sections 230 to 232 of the Companies Act, 2013, and vest jurisdiction in the National Company Law Tribunal ("NCLT") to sanction schemes of arrangement or amalgamation involving LLPs.

The statutory framework for LLP-to-LLP mergers is, therefore, unambiguously present within the LLP Act. However, the practical deployment of these provisions has remained exceedingly rare, primarily because the tax consequences render most such transactions commercially unattractive.

It bears noting that where an LLP has sought to merge into a company (as opposed to another LLP), the jurisdictional question has been far more contested. The NCLT Chennai Bench in the case of Real Image LLP merging into Qube Cinema Technologies Private Limited[1], sanctioned the scheme, and held that the absence of an explicit provision in the Companies Act, 2013 permitting such a cross-form merger was a case of casus omissus and not a legislative prohibition. However, on appeal by the Regional Director and the Registrar of Companies, the NCLAT reversed the order and held that the principle of casus omissus could not be applied by tribunals except in cases of clear necessity and that the legislature had, through Section 366 of the Companies Act, already provided an alternative route by allowing an LLP to first convert into a company and thereafter pursue a merger under the Companies Act framework.

The NCLAT's ruling in the Qube Cinema matter effectively closed the door on direct LLP-to-company mergers. For mergers of one LLP into another LLP, however, the position is distinct and far clearer under Sections 60 to 62 of the LLP Act which expressly provide for such amalgamations, and the NCLT has undisputed jurisdiction to sanction them, and in fact, the NCLT Mumbai Bench, amongst others, had recently approved a merger of Pulit Trading LLP and Nyzel Trading LLP with and into Raojee Landmarks LLP. The question, therefore, is not whether an LLP-to-LLP merger can happen, but whether it should happen, given the tax consequences that follow.

Income Tax Implications: The Three-Party Analysis

Any merger involves three sets of stakeholders whose tax positions must be analysed independently: the transferor entity, the transferee entity, and the interest-holders (in this case, the partners). In the context of an LLP merger, the analysis reveals an asymmetry that makes the transaction structurally unviable for most taxpayers.

- **The Transferee LLP**

The transferee LLP, as the surviving entity that absorbs the undertaking of the transferor, would ordinarily be the first candidate for a potential tax charge under Section 56(2)(x)[2] of the IT Act, which taxes the receipt of property without consideration or for inadequate consideration. However, in a typical merger sanctioned by the NCLT, the transferee LLP is vested with the assets and liabilities of the transferor LLP on a going-concern basis, and the partners of the transferor receive interests in the transferee LLP as consideration. The full value of the consideration is, therefore, discharged in the form of LLP interests allotted to the incoming partners of the Transferor LLP. Where the value of interests allotted corresponds to the fair market value of the Transferor LLP, there is no element of inadequacy or absence of consideration, and Section 56(2)(x)2 should not be triggered. Even in the absence of a specific exemption for LLP amalgamations under Section 56(2)(x)2, the position of the transferee LLP should be defensible on the ground that full consideration has been discharged, albeit in kind.

- **The Transferor LLP**

The transferor LLP, which stands dissolved upon the scheme becoming effective, presents a more nuanced question. The transfer of its undertaking to the transferee LLP is, in substance, a transfer of the 'undertaking' as a whole being considered as a capital asset. However, the transferor LLP does not itself receive any consideration; the consideration (in the form of interests in the transferee LLP) flows directly to the partners of the transferor LLP. Arguably, the transferor LLP does not trigger a capital gains charge under Section 45[3] read with Section 48[4], because the computation mechanism under Section 485 requires a "full value of the consideration received or accruing" to the transferor, and in this case, no consideration receives or accrues to the transferor LLP itself. The dissolution of the transferor pursuant to the NCLT order is a statutory vesting, not a sale, and the transferor receives nothing in return.

- **The Partners: Where the pain resides**

The most significant tax exposure in an LLP merger falls on the partners of the transferor LLP. When the transferor LLP is dissolved, the partners' interest in the transferor LLP is extinguished, and in lieu thereof, they receive interests in the transferee LLP. As the Supreme Court held in Grace Collis, this constitutes a transfer of a capital asset (the interest in the transferor LLP) in exchange for another capital asset (the interest in the transferee LLP), triggering capital gains under Section 454 of the IT Act.

The capital gain is computed as the difference between (a) the full value of consideration, being the fair market value ("FMV") of the interest received in the transferee LLP, and (b) the cost of acquisition of the interest in the transferor LLP, and the capital gains exposure could be on the delta computed by reckoning the true FMV, and not just the net book value.

To illustrate: if an LLP has a contributed capital of INR 1 crore but true FMV is INR 100 crore, the FMV of a partner's interest in the transferee LLP upon amalgamation would be derived from the INR 100 crore as the FMV. If the partner's original cost of acquisition is the capital contribution of, say, INR 25 lakh (representing a 25% interest in the INR 1 crore capital), the capital gain could be computed on the difference between the FMV of the 25% interest in the transferee LLP (approximately INR 25 crore) and the cost of INR 25 lakh, yielding a gain of INR 24.75 crore, subject to ~15% long term capital gains tax, or tax at ordinary rates, in case of short-term capital gains tax

This is the central obstacle that makes LLP mergers commercially unviable. For company amalgamations, the IT Act provides specific relief under Section 47(vi)[5] and 47(vii)[6] wherein it exempts the transfer by a shareholder of shares in the amalgamating company and the transfer of a capital asset by the amalgamating company to the amalgamated company, provided the conditions of Section 2(1B)[7] are satisfied. No equivalent exemption exists for LLP amalgamations.

Stamp Duty: An Additional Friction

Beyond income tax, stamp duty presents a further layer of cost that disincentivises LLP mergers. In the context of company amalgamations, several states (notably Maharashtra, under Article 25(da) of the Maharashtra Stamp Act) provide a concessional stamp duty rate of approximately 0.7% on the value of shares issued pursuant to the amalgamation, rather than the standard conveyance rate of 3%. This concessional treatment, however, is specific to amalgamations involving companies as defined under the Companies Act and does not extend to LLP amalgamations. Consequently, the transfer of immovable property from a

transferor LLP to a transferee LLP pursuant to a scheme of amalgamation would attract stamp duty at the standard conveyance rate.

A Structural Mitigant: Reducing the Tax Base Through Capital Restructuring

Given the absence of a legislative exemption, one structural workaround to minimise the capital gains that merits analysis involves restructuring the balance sheet of the transferor LLP prior to the merger so as to reduce the net book value of partners' capital.

Consider an LLP with contributed capital of INR 1 crore and accumulated reserves of INR 99 crore, resulting in net assets of INR 100 crore. If the partners introduce a loan to the LLP of INR 99 crore (either in a single tranche or in multiple rounds), the LLP can utilise those funds to distribute profit share or return capital to the partners (to the extent permissible under the LLP agreement and applicable law). Alternatively, the existing reserves can be distributed as profit share to the partners, who then re-introduce the same amount as a loan to the LLP. The end result is a balance sheet where the LLP has contributed capital of INR 1 crore and partner loans of INR 99 crore, with the total net assets remaining at INR 100 crore but the equity base having been compressed to INR 1 crore.

Upon the subsequent merger, the FMV of the partners' interest in the transferor LLP, for the purpose of computing capital gains, would be derived from the equity value of the LLP. Since the INR 99 crore now sits as debt (owed to the same partners), the equity value is only INR 1 crore. The capital gains exposure of the partners would, therefore, be reduced. The partner loans are simply assumed by the transferee LLP as part of the going-concern transfer and repaid in due course, or continue as partner loans in the merged entity.

This approach, while elegant, is not without risk. The principal vulnerability is Section 50D6 of the IT Act. Revenue authorities could argue that the FMV of the consideration received by the partners (i.e., their interest in the transferee LLP) should be determined not by reference to the compressed book value of capital but by reference to the FMV of the business of the LLP, on the theory that the consideration is not genuinely ascertainable. If Section 50D6 is invoked, the capital gains could be based on the deeming fiction after taking into account the FMV of the LLP.

Additionally, if the capital restructuring is undertaken immediately before the merger with no independent commercial rationale, it could attract scrutiny under the General Anti-Avoidance Rules ("GAAR") under Chapter X-A[8] of the IT Act, or could be challenged as a colourable device.

The Bigger Picture: Why Tax Neutrality for LLP Mergers Is Overdue

The absence of tax-neutral treatment for LLP mergers is not merely a technical gap in the statute; it is a substantive impediment to economic efficiency. The LLP form is now deeply embedded in the Indian business landscape, and there is no principled reason why the restructuring of two LLPs operating in the same industry, or within the same promoter group, should attract a punitive tax cost that an equivalent restructuring of two companies would not. The policy rationale for granting tax neutrality to company amalgamations, namely that reorganisation of business should not be impeded by tax friction where the economic substance of the enterprise continues, applies with equal force to LLP amalgamations.

The legislative architecture already engages with the LLP form extensively; what is missing is the final piece is an exemption for amalgamations involving LLPs.

Until this reform is enacted, LLP mergers will remain a regulatory possibility but a commercial impossibility for any LLP with significant accumulated value. The result is that LLPs must resort to cumbersome workarounds, such as registration of an LLP as a company under Section 366 of the Companies Act followed by an amalgamation under Section 230 to 232, or asset-level slump sales that carry their own tax complexities. None of these alternatives are as clean or as efficient as a direct tax-neutral merger, and all of them impose unnecessary transactional costs on businesses that are simply trying to reorganise their operations in the most rational manner possible. The tax legislature would do well to address this lacuna so as to bring LLP amalgamations within the fold of tax-neutral reorganisations. The regulatory infrastructure under the LLP Act is already in place. It is only the tax law that stands in the way.

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[1] CP/123/CAA/2018 order dated 11th June 2018

[2] Section 92(2)(m) of the New IT Act

[3] Section 67 of the New IT Act

[4] Section 72 of the New IT Act

[5] Section 70(1)(e) of the New IT Act

[6] Section 70(1)(f) of the New IT Act

[7] Section 2(6) of the New IT Act

[8] Chapter XI of the New IT Act