Capital Gains Tax in case of conversion of a firm into company

Recently, the Gujarat High Court in the case of DCIT v R. L. Kalathia & Co. [2016] 66 (249) Guj, held that sale of business of a firm as a going concern to a company for consideration of paid-up share capital does not amount to transfer and it is not taxable as capital gains.

The High Court observed that for the taxability of capital gain under Section 45(4) of the Income-tax Act, 1961, there has to be distribution of capital assets, which factor is totally missing in the taxpayer's case since there is no distribution of capital assets either by way of dissolution of the firm or otherwise. Therefore, such transfer cannot be treated as a transfer of capital asset and not liable to capital gains tax.

Earlier the department had held that the consideration received in the form of shares of the company shall be liable for capital deduction tax.