

# Income Tax Provisions relating to Section 45(4) and Section 9B

**PRESENTATION BY:**

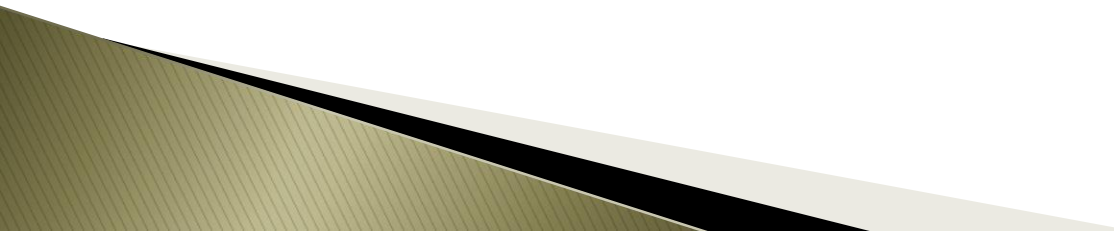
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# ANALYSIS OF SECTION 9B

## Applicability

- ❖ Applicable only when Capital Asset or Stock-in-trade(in kind) is given to the specified person / outgoing partner.
  - ❖ No applicability of section 9B if asset in kind is not given or only money is given.
  - ❖ Applicable when Fair Market Value of the asset given is more than its Book Value.
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# ANALYSIS OF SECTION 9B

## Applicable to whom

- Specified Entity i.e Partnership Firm/ LLP/ AOP/BOI
- In case of Reconstitution of specified entity---
  - some partner leaves
  - Some new partner joins
  - Change in sharing ratio of existing partners
- In case of Dissolution of firm.

# CHARGING AS PER SECTION 9B

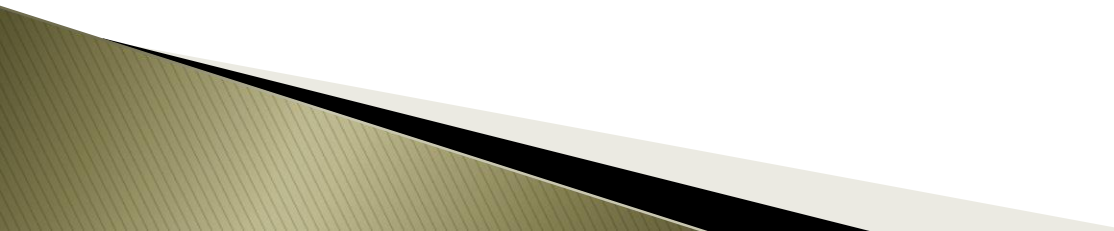
- ❖ Transfer of asset in kind to the outgoing partner to be treated as “Deemed Transfer” in the hands of Specified entity/ firm.
- ❖ Fair Market Value of asset or stock-in-trade to be taken as value of sale consideration to the firm.
- ❖ Taxable in the hands of firm as Capital gain if it is capital asset and business profits if it is stock-in-trade.

# Rationale of Section 9B

- a) When Capital Asset or Stock-in-trade is given to outgoing partner the difference of Book Value and Fair Market Value of the asset is profit/ gain to the firm and is taxable in the hands of firm.
- b) Section 9B is in fact, in substitution to erstwhile section 45(4), enlarging its scope.
- c) This provision of section 9B has been provided in Chapter II of the Income Tax Act because it is treating as “Deemed Transfer” to Capital Asset or Stock-in-trade given to the outgoing partner. Tax on such ‘deemed transfer’ may fall in Chapter of “Capital Gains” as well as “Income from Business and Profession”. Therefore, it seems that instead of making the provisions in both the Chapters separately, new section 9B has been provided in Chapter II as charging section.

# ANALYSIS OF SECTION 9B

## COMPUTATION OF TAX

- ❖ How to calculate Fair Market Value of Capital Asset or Stock-in-trade.
  - ❖ Whether LTCG or STCG
  - ❖ Whether Indexation allowed
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## ANALYSIS OF SECTION 9B

### CONTENTIOUS ISSUES

- ▶ Definition of 'Transfer' of Capital Asset u/s 2(47) not amended.
- ▶ As per section 9B taxability arises in the year in which asset is received by the specified person. In case reconstitution of firm and receipt of asset by outgoing partner falls in different years---what would be the implications?? (section 45(4) also on receipt basis, concept of accrual basis diluted. Why???)
- ▶ Whether receipt by partner to be actual receipt of asset or it may be constructive receipt.
- ▶ What about some asset not covered within the definition of capital asset u/s 2(14) eg. Agricultural land.
- ▶ In case of Capital Gain whether deduction u/s 54EC can be claimed.
- ▶ Section 28 regarding Business Income not amended to include Deemed Transfer of Stock-in-trade at Fair Market Value.
- ▶ How to calculate Fair Market Value in case of Stock-in-trade which is nowhere provided in the Act.

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## Cost of acquisition of asset to the partner receiving the asset

- ▶ Cost of Acquisition in the hands of the partner receiving the asset--  
-how much??
- ▶ Section 49 regarding Cost of Acquisition not amended.
- ▶ When FMV is debited to the capital Account of the partner, it tantamount to payment of FMV as sale consideration by partner to the firm.



## ANALYSIS OF SECTION 9B

### ACCOUNTING TREATMENT

- ▶ May account for in the books as if Capital Asset/ Stock-in-trade has been sold/ transferred to the outgoing partner at Fair Market Value.
- ▶ Profit / gain on such transfer after paying the taxes to be credited to the capital account of all the partners, including outgoing partner.
- ▶ FMV of asset to be debited to the capital A/c of the partner outgoing or receiving the asset.

# ANALYSIS OF SECTION 45(4)

## APPLICABILITY

- Applicable when Fair Market Value of asset, if any, and money given to the outgoing partner is in excess of credit balance in his capital account.
- No applicability of section 45(4) if value of money paid to the outgoing partner is to the extent the amount credited in his capital account.
- Not applicable in case of dissolution of firm.
- Excess amount paid to be allocated to the existing or self generated assets of the firm after revaluation.

# ANALYSIS OF SECTION 45(4)

## Excess Amount taxable in the hands of firm

- As per section 45(4) excess amount paid to the outgoing partner is taxable as **CAPITAL GAINS** in the hands of specified entity/firm.
- Taxable in the hands of firm, not in the hands of partner.
- Taxable as capital gain to the firm
  - whether LTCG or STCG (see Rule 8AA(5))
    - As per Rule 8AA(5) if amount paid is attributed to the long term capital asset, such amount shall be treated as LTCG and if such amount is attributed to short term capital asset, it shall be treated as STCG.
    - If amount paid is not attributed to any asset or if it is attributed to self generated asset or self generated goodwill of the firm, it shall be treated as STCG.
- whether indexation allowed in case of LTCG-----NO

# Attribution of excess amount to the existing assets

- ▶ Why attribution—to give benefit of COA in future.
- ▶ For attribution of excess amount as per section 45(4) revaluation of all existing assets/ self generated assets or goodwill to be got done by the registered valuer.
- ▶ No attribution/ revaluation required, if don't want to take benefit of COA in future, or may be recognized to self generated goodwill.
- ▶ Depreciation on such amount attributed to the assets not allowable. In fact, such excess amount represents partial revaluation of existing assets. Depreciation is allowable on historical cost.
- ▶ If excess amount is not attributed to any existing or self generated asset, it is to be ignored.

# Attribution – Case Study– as per Rule 8AB

firm having A,B,C three partners of 1/3 each. Partner 'A' outgoing, excess amount paid to A--100

Assets of firm	Cost	Revalued	Revalued difference	Attribution
Land	30	225	195	65
Building	20	20	-----	-----
Plant & Machinery	150	195	45	15
Stock	50	50	-----	-----
Goodwill	-----	30	30	10
Trade Mark	-----	30	30	10
Total	250	550	300	100

# RATIONALE OF SECTION 45(4)

- ▶ Excess amount paid to the outgoing partner is in fact compensation for increase in value of existing assets/ self generated Goodwill or assets of the firm, to the extent of his share. It is in effect share of the outgoing partner in the **unrealized gain in the value of existing or self generated assets.**
- ▶ In fact such excess amount should have been taxable in the hands of partner. Not able to understand the rationale why it has been taxed in the hands of firm.
- ▶ The rationale can't be drawn even from the erstwhile Dividend Distribution Tax (DDT) for companies or erstwhile section 45(4) of Income Tax Act.

# ACCOUNTING TREATMENT

- ▶ Excess amount paid to the outgoing partner to be attributed to the existing assets/ self generated Goodwill or assets as per Rule 8AB.
- ▶ In fact tax on such excess payment is being paid by the firm on behalf of outgoing partner. As per commercial prudence, it should be debited/ recovered from him or rather his share of excess amount to be paid should be calculated by giving effect to the applicable tax.
- ▶ In the books such excess amount paid to the outgoing partner may be accounted as---
  - To debit to the capital account of remaining partners, or
  - To add to the value existing assets to which such amount is attributed after revaluation of asset, or
  - To keep in separate account pending allocation.

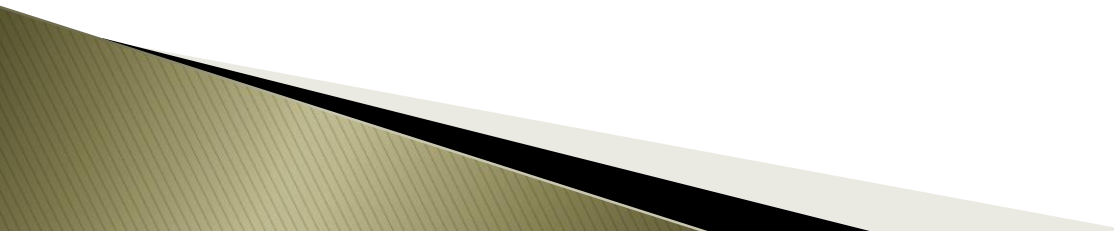
# Case study on – No commercial prudence of tax u/s 45(4) being paid by firm.

Liabilities	Amount	Assets	Amount
Capital Account	300	Land	100
Partner—A 100 B 100 C 100		Bank	200
Total	300	Total	300

1. Land revalued at Rs. 400
2. Partner “A” paid Rs. 200
3. Tax to firm Rs. 30@ 30% on 100(200-100)
4. Existing partners asset value after payment of taxes (400-30=370)



# RE-ADJUSTING SHARING RATIO OF PARTNERS

- ▶ No applicability of section 45(4) if amount in excess of credit balance in capital account of the partner is not paid.
  - ▶ No applicability of section 45(4) in case of admission of new partner.
  - ▶ In case there is reconstitution of firm by re-adjusting sharing ratio of partners whether it may attract provision of section 45(4)???
  - ▶ Whether in such case provision of section 56(2)(x) can be attracted.
  - ▶ Disproportionate investment in capital A/c by partners.
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# ISSUES TO BE ADDRESSED

- ▶ Taxable on receipt basis---If receipt by partner in several different years in future, whether taxable in different years, attribution to assets in which year.
- ▶ Computation of Capital Gains u/s 45(4) in case of negative capital balance of partner. Debit balance due to losses or due to excess withdrawals earlier made.
- ▶ Whether forgoing debit balance tantamounts to payment.
- ▶ What would include credit balance of partner's capital account—Reserves & Surplus—only free reserves to be included.
- ▶ Set off and carry forward of losses in case of taxability u/s 9B and section 45(4)
- ▶ What would be the treatment of the excess amount paid not attributed to any assets of the firm. Whether it may be allowable expense.
- ▶ Whether provisions of section 9B and 45(4) tantamount to double taxation in the hands of firm.
- ▶ Treatment of the amount received by outgoing partner, if any, outside the firm from incoming partner to relinquish his share in the firm. Whether there can be any cost of acquisition to be reduced.
- ▶ Whether it would be LTCG or STCG

# ANALYSIS OF PROVISION OF SECTION 48(iii)

- ▶ Excess amount paid to outgoing partner is attributed to the existing assets/Goodwill of the firm as per Rule 8AB.
- ▶ Such amount attributed to be allowed as deduction on transfer of such asset while calculating capital gain u/s 48 at any later stage.
- ▶ However, depreciation on such amount attributed shall not be allowed.

# ANALYSIS OF RULE 8AB

- ▶ Amount taxed u/s 45(4) is required to be attributed to the remaining capital assets of the firm.
- ▶ Such attribution may be to the capital asset forming part of Block of asset as per CBDT Circular No. 14 dated 2<sup>nd</sup> July, 2021.
- ▶ Amount to be attributed to---
  - Revaluation of existing assets
  - Valuation of self-generated asset or self-generated Goodwill.
- Such amount is to be attributed on the existing asset or self-generated asset/Goodwill on prorata basis.
- Revaluation of asset has to be based on a valuation report obtained from a registered valuer.
- If excess amount paid doesn't attribute to any of the existing assets it shall be ignored for the purpose of section 48(iii)
- No attribution to the asset in kind, if any, given to the outgoing partner, taxable u/s 9B of the Act.

THANK YOU