

Analysis of Income Tax Provisions relating to taxation of Partnership Firm/LLP

PRESENTATION BY:

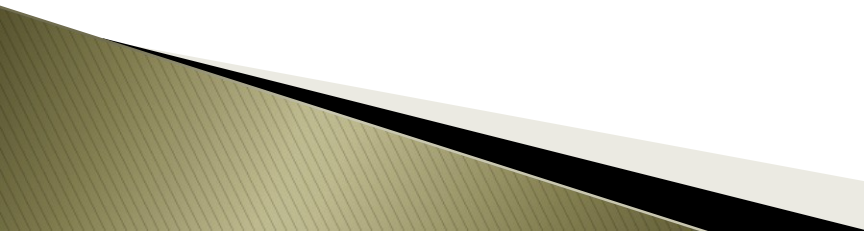
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ANALYSIS OF SECTION 9B (SECTION 8 OF 2025 ACT)

Applicability

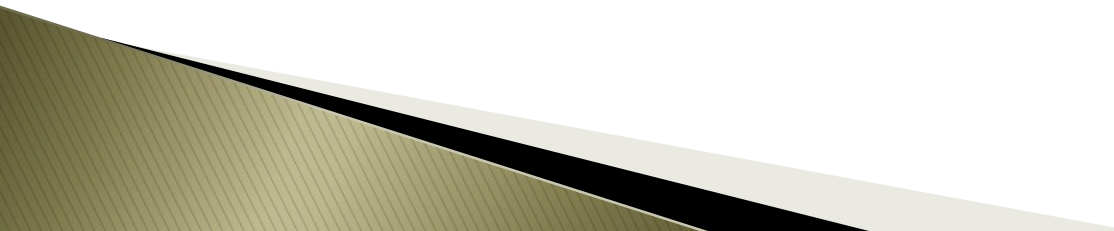
- ❖ Applicable only when Capital Asset or Stock-in-trade(in kind) is given to the specified person / outgoing partner.
 - ❖ No applicability of section 9B if asset in kind is not given or only money is given.
 - ❖ Applicable when Fair Market Value of the asset given is more than its Book Value.
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ANALYSIS OF SECTION 9B (SECTION 8 OF 2025 ACT)

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.

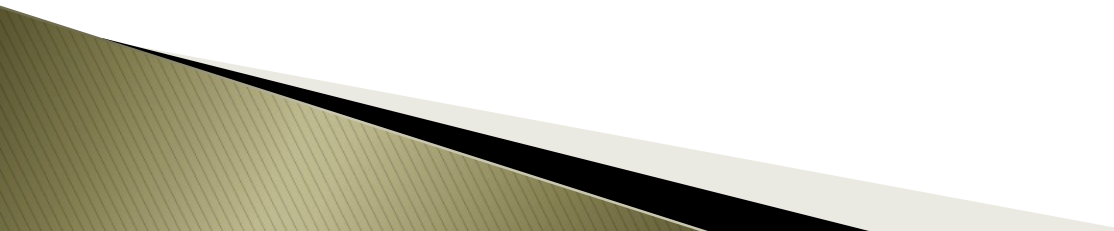
CHARGING AS PER SECTION 9B (SECTION 8 OF 2025 ACT)

- ❖ 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.
 - ❖ Depending upon holding period of asset by the firm, it may LTCG or STCG
 - ❖ Taxable in the year of receipt by the Specified person/Partner. FMV also to be taken relating to the date of receipt (section 9B(3))
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Rationale of Section 9B (SECTION 8 OF 2025 ACT)

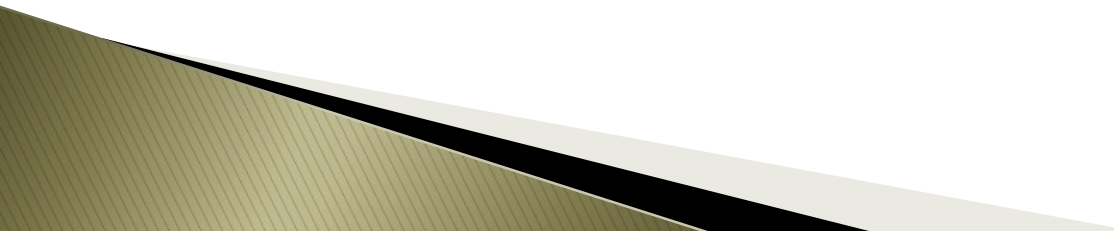
- a) Asset in kind can not be transferred to the partner at book value.
 - b) When Capital Asset or Stock-in-trade is given to outgoing partner the difference of Book Value and Fair Market Value of the asset is profit/ gain to the firm and is taxable in the hands of firm.
 - c) This provision of section 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.
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Cost of acquisition of asset to the partner receiving the asset

- ▶ FMV of the asset to be the Cost of Acquisition in the hands of the partner receiving the asset (CBDT circular 14 of 2021)
 - ▶ Section 49 (section 73 of 2025 Act) regarding Cost of Acquisition not amended.
 - ▶ When FMV is debited to the capital account of the partner , it tantamount to payment of sale consideration by partner.
 - ▶ Asset in kind given is treated as deemed transfer to the partner.
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ANALYSIS OF SECTION 9B (SECTION 8 OF 2025 ACT)

ACCOUNTING TREATMENT

- ▶ To 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 (CBDT circular 14/2021)
 - ▶ FMV of asset to be debited to the capital A/c of the partner outgoing or receiving the asset.
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ANALYSIS OF SECTION 9B (SECTION 8 OF 2025 ACT)

CONTENTIOUS ISSUES

- ▶ Definition of 'Transfer' of Capital Asset u/s 2(47) (section 2(109) of 2025 Act) not amended.
- ▶ As per section 9B (section 8 of 2025 Act) 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---Taxability to the firm shall be in the year of receipt by the partner.

(section 45(4) (section 67(10) of 2025 Act) also on receipt basis, concept of accrual basis diluted. Why???)

- ▶ Whether set off of unabsorbed losses allowed.
- ▶ What about some asset not covered within the definition of capital asset u/s 2(14) (section 2(22) of 2025 Act) e.g. Agricultural land- No Taxability to the firm
- ▶ In case of Capital Gain whether deduction u/s 54EC (section 85 of 2025 Act) can be claimed.
- ▶ Section 28 (section 26 of 2025 Act) 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.

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ANALYSIS OF SECTION 45(4) (SECTION 67(10) OF 2025 ACT)

APPLICABILITY

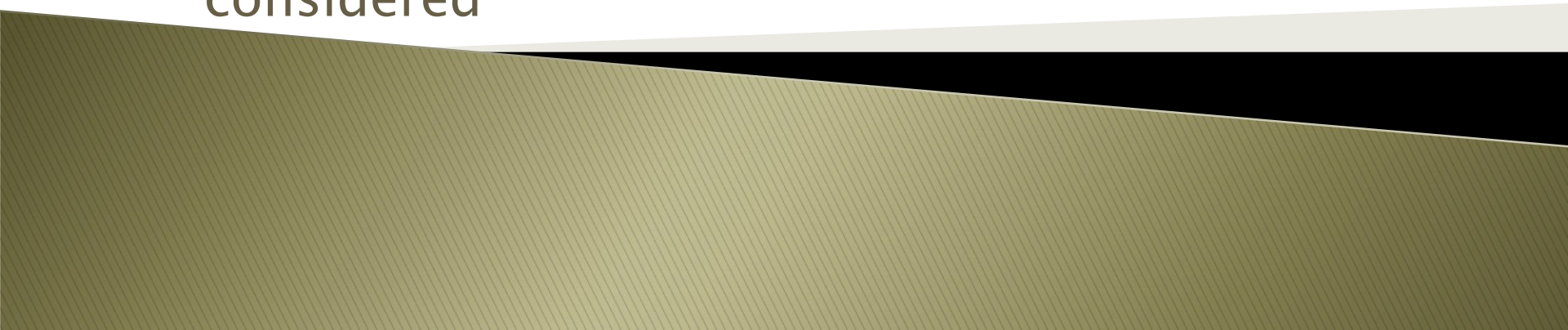
- Applicable when Fair Market Value of asset, if any, and money given to the outgoing partner is in excess of credit balance in his capital account.
- No applicability of section 45(4) if value of money paid to the outgoing partner is up to the extent the amount credited in his capital account.
- Not applicable in case of dissolution of firm.
- Excess amount paid to be attributed to the existing or self generated assets of the firm after revaluation as per rule 8AB.(Rule 50 of 2026 Rules)

ANALYSIS OF SECTION 45(4) (SECTION 67 (10) OF 2025 ACT)

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)) (Rule 6(3) of 2026 Rules)
 - As per Rule 8AA(5) if excess 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.
 - Taxable capital gain to the firm =
Amount paid to the partner in cash or in kind (FMV) – Balance in Capital account
 - Treatment in case ---there is Debit Balance in capital account (due to excess withdrawal/ Losses

BALANCE IN CAPITAL ACCOUNT OF PARTNER

- Balance in capital account or current account
 - Share of partner in free Reserves & Surpluses/ P&L A/c, if kept separately
 - Share of revaluation of assets not to be considered
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Case study on – 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. Capital gain to the firm is Rs. 100 i.e. Amount Paid (200) –Capital A/c balance (100)
4. Tax to firm Rs. 15@ 15% on 100(200-100)

COMPUTATION OF CAPITAL GAIN U/S 45(4) (67(10) of 2025 ACT)

Capital gain by firm = FMV of asset in kind +
amount paid – capital a/c balance

	Situation	A	=	B + C – D	Remarks
i)	Amount paid in excess of capital balance	50	=	30 + 120 – 100	Taxable to firm as capital gain
ii)	Amount paid less than Capital balance	(20)	=	0 + 80 – 100	To ignore, no capital gain or loss
iii)	Debit balance in capital account	20	=	0 + 0 – (–20)	whether to ignore or taxable to firm??

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) (section 67(10) of 2025 Act) revaluation of all existing assets/ self generated assets or goodwill to be got done by the registered valuer.
- ▶ No attribution/ revaluation required, if not to take benefit of COA in future.
- ▶ Depreciation on such amount attributed to the block of 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.
- ▶ No attribution to stock in trade provided.

ANALYSIS OF RULE 8AB (RULE 50 OF 2026 RULES

- ▶ Amount taxed u/s 45(4) (section 67 (10) of 2025 Act) 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 also as per CBDT Circular No. 14 dated 2nd July, 2021.
- ▶ Amount to be attributed in the ratio of –
 - Revaluation of existing assets
 - Valuation of self-generated asset or self-generated Goodwill.
- Such amount is to be attributed on the basis of revaluation of existing asset or self-generated asset/Goodwill on pro-rata 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 assets it shall be ignored for the purpose of section 48(iii) (section 72(5) of 2025 Act)

Attribution – Case Study– as per Rule 8AB (RULE 50 OF 2026 RULES)

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) (67(10) OF 2025 ACT)

- ▶ 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.**
- ▶ Alternatively, such excess amount could have been taxed in the hands of partner. By taxing in the hands of firm, benefit of enhanced cost attributed to the existing assets/self generated assets/goodwill given to the firm
- ▶ Excess amount to be paid to the outgoing partner to be decided mutually which may be decided net off tax effect.

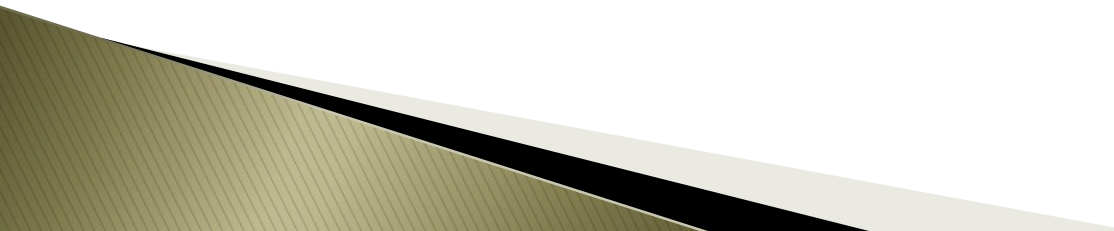
ACCOUNTING TREATMENT

- ▶ Excess amount paid to the outgoing partner to be attributed to the existing assets/ self generated Goodwill or assets as per Rule 8AB (Rule 50 of 2026 Rules).
- ▶ In the books such excess amount paid to the outgoing partner may be accounted as---addition to the value of existing assets to which such amount is attributed.

RE-ADJUSTING SHARING RATIO OF PARTNERS

- ▶ Reconstitution may comprise of change or re-adjustment of sharing ratio of partner inter se due to admission or retirement of some partner or otherwise.
- ▶ No applicability of section 45(4) in case of reconstitution of firm by re-adjusting sharing ratio of partners , when no payment is made to the partner foregoing part of his share.
- ▶ Whether in such case provision of section 56(2)(x) (section 92(2)(m) of 2025 Act) can be attracted. No concept of valuation of share of partner in firm.
- ▶ Disproportionate investment in capital A/c by partners permitted.
- ▶ In case due to reconstitution, a partner foregoing his part of share is paid some amount, whether it may be taxable to the firm if it is in excess of capital account balance.--- whether revaluation of assets required to apply section 45(4).
- ▶ Taxability in case amount is paid to the partner foregoing his share by incoming partner
 - in the books through firm
 - out of firm outside mutually

ANALYSIS OF PROVISION OF SECTION 48(iii)(SECTION 72(5) OF 2025 ACT)

- ▶ Excess amount paid to outgoing partner is attributed to the existing assets/Goodwill of the firm as per Rule 8AB (Rule 50 of 2026 Rules)
 - ▶ Such amount attributed to be allowed as deduction on transfer of such asset while calculating capital gain u/s 48 (section 72 of 2025 Act) at any later stage.
 - ▶ However, depreciation on such amount attributed shall not be allowed.
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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.
- ▶ What would include credit balance of partner's capital account—Reserves & Surplus—only free reserves to be included and P& L A/c debit balance, if any, to be reduced.
- ▶ Set off and carry forward of losses in case of taxability u/s 9B and section 45(4) (section 8 and 67(10) of 2025 Act)
- ▶ 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) (section 8 and 67(10) of 2025 Act) 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.

CONVERSION OF PRIVATE COMPANY OR UNLISTED PUBLIC COMPANY INTO LLP

► Conditions under Section 47(xiiib)

- a) All assets and liabilities of the company become those of the LLP.
- b) All shareholders become partners of the LLP.
- c) Shareholders should not receive any consideration other than capital contribution and profit share in the LLP.
- d) Capital contribution and profit-sharing ratio in the LLP must be in the **same proportion as shareholding** in the company.
- e) Aggregate profit-sharing ratio of the erstwhile shareholders must remain at least **50% for 5 years** from conversion
- f) Turnover/gross receipts of the company in any of the preceding 3 years should not exceed **₹60 lakh**
- g) Book value of total assets in any of the preceding 3 years should not exceed **₹5 crore**.
- h) No amount can be paid, directly or indirectly, out of the company's accumulated profits to partners for **3 years** from the date of conversion

Condition (h) specifically states that **no amount should be paid to partners out of the accumulated profits standing in the company's books on the date of conversion for 3 years**. Therefore, if reserves and surplus are credited to partners' capital/current accounts and withdrawn within 3 years, there is a risk of violating Section 47(xiiib), resulting in withdrawal of the tax exemption.

THANK YOU