

All India Chartered Accountants' Society

-: CASE STUDY BASED DISCUSSION :-

on

Taxability on Reconstitution of Partnership Firms

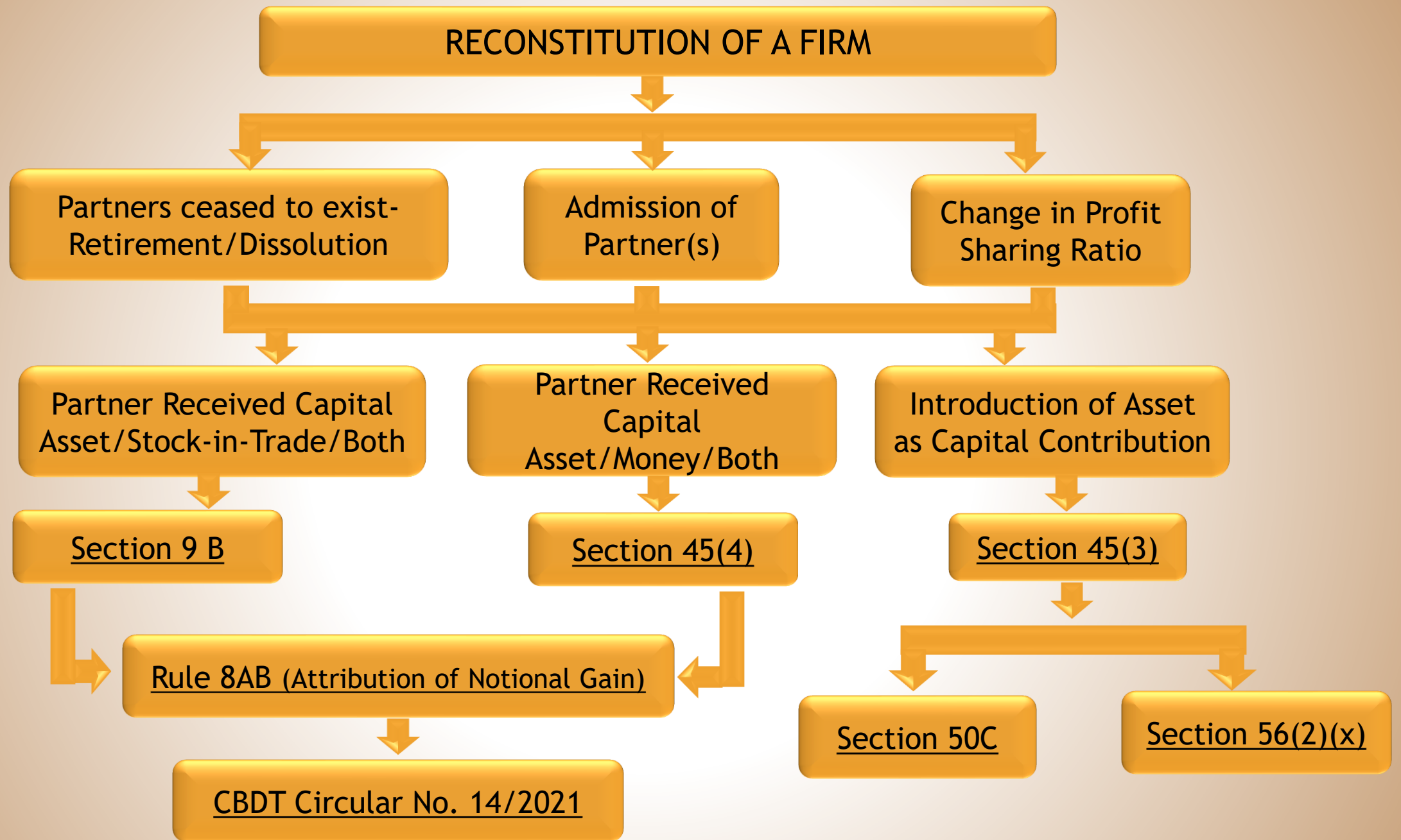
December 13, 2025

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Case Study 1 : (Based on CBDT Circular No. 14/2021)

Facts :

FR & Co.

Statement of Affairs as at 30-11-2025

Particulars	Amount INR	Particulars	Amount INR
Capital Accounts :		Assets : Land :	
- Partner 'A'	10,00,000	- Land 'S'	10,00,000
- Partner 'B'	10,00,000	(FMV)	(70,00,000)
- Partner 'C'	10,00,000	- Land 'T'	10,00,000
(Sharing P&L equally)		(FMV)	(70,00,000)
		- Land 'U'	10,00,000
		(FMV)	(50,00,000)

All the assets held for more than 24 months. Partner 'A' wishes to retire. The firm decided to pay Rs. 10 Lakhs in cash and land 'U' to partner 'A'

Questions :

1. Applicability of section 9B and tax rate
2. Charge of tax and allocation of post tax gain among the partners
3. Attribution of gain among the partners as per section 48 clause (iii) and Rule 8AB
4. Applicability of section 45(4) and charge of tax

Case Study 2 : (Based on CBDT Circular No. 14/2021)

Facts :

FR & Co.

Statement of Affairs as at 30-11-2025

Particulars	Amount INR	Particulars	Amount INR
Capital Accounts :		Assets :	
- Partner 'A'	1,00,00,000	- Land 'S'	30,00,000
- Partner 'B'	1,00,00,000	(FMV)	(45,00,000)
- Partner 'C'	1,00,00,000	- Patent 'T' (WDV)	45,00,000
(Sharing P&L equally)		(FMV)	60,00,000
		- Cash	2,25,00,000
		- Self Generated	
		Goodwill (FMV)	30,00,000

All the assets held for more than 24 months. Partner 'A' wishes to exit. The firm decided to pay Rs. 75 Lakhs in cash and land 'S' to partner 'A' at FMV.

Questions :

1. Applicability of section 9B and tax rate
2. Charge of tax and allocation of post tax gain among the partners
3. Attribution of gain among the partners as per section 48 clause (iii) and Rule 8AB
4. Applicability of section 45(4) and charge of tax
5. Attribution of gain to remaining assets of the firm i.e. Patent and Goodwill
6. Charge of depreciation on the remaining assets
7. Tax treatment of the attributed gain at the time of sale of these remaining assets

Case Study 3 : Section 45(3): Partner introduces land as capital contribution

Facts : Firm: ABC & Co.

- Partners: A, B, C - equal shares.
- On 01.07.2024, partner A introduces a plot of land into the firm as capital Contribution.
- A's original cost of land: Rs 10,00,000
- Stamp duty value (SDV) on 01.07.2024: Rs 60,00,000
- Value recorded in firm's books as capital contribution: Rs 50,00,000

Questions :

1. Whether there is tax implication in the hand of firm on recording the land value at Rs 50,00,000 in place of FMV of Rs 60,00,000 ?
2. How should Partner A compute capital gain u/s 45(3) when land is transferred to the firm at a book value of ₹50,00,000?
3. Whether provisions of section 50c will be applicable and/or section 50C will override section 45(3) ?
4. Whether provisions of section 56(2)(x) will be applicable in the hands of the firm?
5. Rate of tax on long term capital gain 20% vs 12.5%

Case Study 4 : Pure Money Settlement on Reconstitution

Facts : XYZ & Co. is a partnership firm

- Having three Partners: X, Y, Z
- They have equal shares in profit / loss .
- On 31.03.2025, Partner Z retires.
- Capital balance of Z in the firm books is Rs 25,00,000
- Firm pays Z only cash of Rs 40,00,000 on retirement
- No asset or any right transfer to partner on his retirement

Questions :

1. Which provisions are applicable in this case :
 - a. Section 45(4) and or
 - b. Section 9B of the Act
 - c. Rule 8AB
2. Income and Tax computation in the hand of firm on payment of Rs 40 lakhs to Partner Z.
3. Whether Section 9B applies when only cash is paid to a retiring partner with no transfer of capital asset or stock-in-trade?
4. Is Rule 8AB applicable in a pure cash settlement case, even though no 9B income arises?
5. Should capital balance for Section 45(4) be computed before or after considering accumulated profits, reserves, drawings, or current-year profits/losses?
6. Would the result differ if XYZ & Co. was an LLP instead of partnership?

Case Study 5

Facts : ABC and Co.

- There are three partners 'A', 'B' and 'C' sharing P&L equally
- Partner C retired from Firm on 31.03.2025
- C's capital balance in books: Rs 40,00,000
- Land book value is Rs 50,00,000
- On retirement, C receives:
 - Cash: Rs 20,00,000
 - Land (the same land introduced by A as capital contribution) FMV of that land on 31.03.2025: ₹90,00,000
- There are no self-generated goodwill and no other adjustments.

Questions :

1. How to compute income and tax there on transfer of land to Mr C
2. How to compute income and tax on payment of Rs 20,00,000 and land to Mr C
3. Who is liable to pay tax on the above.
4. Whether any implication of rule 8AB in this Case when the Firm do not have any other Assets and when the firm having the assets.
5. Does transfer of land to Partner C on retirement constitute a deemed transfer under Section 9B?
6. If both 9B and 45(4) apply, should income be computed separately, and how should double taxation be prevented?
7. Whether Rule 8AB applies when the firm either:
 - Has no other asset, or
 - Has other depreciable/non-depreciable assets remaining?
8. Does giving land originally introduced by Partner A mean that Firm A's historical 45(3) cost must be considered for Section 9B computation?
9. If the firm dissolves within the same year after C retires, does 9B apply again?
10. Is the firm required to withhold tax (TDS) under any section (e.g., 194-IA, 194LBA) when land is transferred to a partner?

Case Study 6 :

Change in Profit Sharing Ratio when to retirement/admission of any partner :

Facts : Firm: PQR & Co.

- Partners P, Q, R -
- Initially equal: $\frac{1}{3}$ each.
- On 01.04.2024, deed is amended:
 - a) P's share increases to 50%
 - b) Q's share 30%
 - c) R's share 20%
- There is
 - (i) no change in capital balance is credited/debited due to change in ratio,
 - (ii) no revaluation,
 - (iii) no money or asset distribution.
 - (iv) No flow of money from one partner to another
- Only profit share changes prospectively.

Questions :

1. Any Tax implication in this case
2. Relevant provision of the act and/or rules
3. Does the change in ratio constitute a “reconstitution” under Explanation to Section 9B and 45(4), even though no payout occurs?
4. Can mere change in PSR be construed as transfer of rights under Section 2(47) without consideration? (PSR Profit Sharing Ratio)
5. If capital accounts remain unchanged but PSR changes from 33%
 - 50%, is there indirect shifting of economic interest, which may attract 45(4) or Section 56(2)(x) or Revenue Neutral
6. Does this change create future tax exposure when:
7. profits accumulate, or
8. assets are distributed?

Case Study 7 : Combined 45(3) + later 9B & 45(4) with revaluation

Facts : Firm LMN & Co. formed on 01.04.2025 by L and M

- On 01.04.2025, partner L introduces a building:
 - (i) Cost to L: Rs 20,00,000 (held > 24 months)
 - (ii) FMV / book value in firm: Rs 80,00,000
- On 30.11.2025, the firm revalue the building to Rs1,20,00,000 and credits revaluation reserve of Rs 40,00,000 (L and M: Rs 20,00,000 each) in capital accounts.
- On 01.12.2025, partner N is admitted. N brings in cash of ₹60,00,000 as capital.
- Out of this Rs 60,00,000 the firm pays ₹30,00,000 each to L and M and they withdrawal the money . Partners continue (no one retires), but capital accounts change.

Questions :

1. Tax implication on partner L introduces a building in firm in the hand of firm as well in the hand of L
2. Tax implication when the firm revalue the building to Rs1,20,00,000 and credits revaluation reserve of Rs 40,00,000
3. Tax implication when the partner N is admitted. N brings in cash of ₹60,00,000 as capital.
4. Tax implication when Rs 60,00,000 the firm pays Rs 30,00,000 each to L and M.
5. Whether revaluation reserve (₹20 lakh credited to each L & M) is to be ignored for computing capital balance for Section 45(4)?
6. Whether such revaluation + admission + payout can be treated as indirect distribution of underlying asset, thereby triggering Section 9B?

Case Study 8 : 45(3) Triggered on Introduction of Capital Asset at Artificially Low Value

Facts : Firm Alpha & Co.

- Partner A introduces a commercial shop on 01.06.2025.
- Stamp Duty Value (SDV): Rs1,20,00,000
- Book value recorded by firm: Rs 40,00,000
- Cost to A: Rs 20,00,000 (held > 2 years)

Questions :

1. What would be the tax implications in the hands of the firm as well as 'A', in case after introduction of the capital as asset, 'A'
2. Whether provisions of section 50C as well as section 56(2)(x) will be applicable to the transferor and/or the transferee firm.
3. Whether AO has power to substitute SDV and GAAR may apply

Case Study 9 : 9B Trigger Even When Retirement Payment Is Not “Distribution” but Settlement Through Journal Entry

Facts :

- Firm Delta Trading Co.
- Partner D retires.
- Instead of giving asset physically, the firm transfers the factory building to D via journal entry at FMV.
- Building FMV: Rs 2,00,00,000
- Book value: Rs 70,00,000
- No physical handover and registration

Questions :

1. Whether Section 9B applies even if the transfer is book entry ?
2. Whether section 45(4) also be applicable.
3. Does the AO have the power to challenge FMV adopted for journal-entry distribution?
4. Does the partner acquire the building at FMV for future capital gains computation?

Case Study 10 : Only Stock-in-Trade Distributed on Retirement

Facts : Firm Zen Builders

- Partner Z retires.
- Z receives stock-in-trade (flats) worth Rs 80,00,000 FMV.
- Book value of stock: Rs 50,00,000
- Capital balance of Z: Rs 20,00,000

Questions :

1. Whether Section 9B applies even if the transfer stock in trade instead of capital asset?
2. Whether section 45(4) also be applicable.
3. Under which head of income that will be taxable - Business income or capital gains?
4. What becomes the cost of inventory in the hands of the retiring partner?
5. How it will be reflected in ITR form 5, whether reduction from the sale consideration proceeds of addition in the cost ?

Case Study 11 : When Partner Does Not Retire and reduction in Share and Receipt of Money

Facts : Firm Orion LLP

- Partners P (50%), Q (50%).
- Under New partnership deed share of profit and loss has been reduces and new partner admitted:
 - (i) P : 30%,
 - (ii) Q : 40%,
 - (iii) New partner R gets 30%.
- P receives compensation of ₹25,00,000 for reduction in share.
- P's capital account before change (excluding revaluation): ₹10,00,000.

Questions :

1. Whether Section 9B applies when P receives compensation of Rs 25,00,000 for reduction in share even though no asset is distributed and partner continues?
2. Whether receipt of ₹25 lakh for reduction in share triggers Section 45(4) although P continues as partner? Whether partner will also be subject to any tax ?
3. What will be the income and gain when 'P' sacrifice 20% of the share in the name of 'R' for a consideration of Rs. 25,00,000/-. If yes, what is the cost of acquisition of partnership rights?

Case Study 12 : Rule 8AB Applied Across Multiple Asset Classes

Facts : Firm Sigma Co.

- Distributes land on retirement of partner S.
- 9B capital gain on land: Rs 30,00,000
- Remaining capital assets & FMV:
 - a) Building - Rs 3 Cr
 - b) Machinery - Rs 1 Cr
 - c) Trademark - Rs 1 Cr
- Total FMV = Rs 5 Cr

Questions :

1. How to allocate Rs 30,00,00 as per Rule 8AB and its proportion.
2. How to considered these amounts in the tax computation of the firm in the future when these assets sold
3. Whether Attribution of profit will be part of block of the asset and the firm is eligible to claim depreciation/amortization?
4. Whether intangible assets (like trademark) require separate attribution compared to tangible assets?

Case Study 13 : Exiting Partner received amount after Revaluation

Facts : Firm Nimbus & Co.

- Five (5) partners
- Share in profit and loss : equal that is $1/5$ or 20%
- Partner capital : balance Rs 5,00,000
- Revaluation reserve and surplus amount Rs 50,00,000 credited to partners account Rs 10,00,000 in each partner account
- Capital account after revaluation reserve transfer Rs 15,00,000
- One partner exit and he receiving Rs 15,00,000.

Questions :

1. Does crediting revaluation reserve trigger any tax event under the law?
2. How to compute tax on Rs 15,00,000 received by the partner and who will pay the tax ?

Case Study 14 : Only Change in Ratio but Hidden Distribution Through Capital Adjustment

Facts : Firm : Binary Tech LLP

- Partners two A and B
- Profit / loss sharing ratio = equal
- Reconstituted firm only Profit / loss ratio change new ratio will be A= 80%, B = 20%.
- For compensated to B : Rs 2,00,000 credited to B's capital account and debit to A capital account.
- However, no revaluation done.

Questions :

1. Tax implication when there is change in the Profit and loss ratio
2. Tax implication when Rs 2,00,000 credited to the B capital account section applicable and computation.
3. Section 45(4) applicable ?
4. Whether amount credit in capital account is constructed payment to B ?
5. How to compute taxable capital gain in the light of the fact when partner is continued and getting some amount ?

Case Study 15 : When partner introduced plot / land in the firm

Facts : Firm ABC LLP

- Three partners ABC
- Share in profit and loss : equal ($1/3$)
- Partner A introduces plot in ABC LLP
 - (i) Cost of plot to A is Rs 10,00,000
 - (ii) Firm records the plot in books of account for Rs 20,00,000 and credited the amount to A capital account.
 - (iii) Stamp duty value of that plot is Rs. 50,00,000

Questions :

1. Taxability in the hand of A when he transfers plot to firm. - whether deemed consideration is book value (₹20 lakh)?
2. Applicability and Taxability in the hand of Firm
3. If Firm Recorded Value of plot Lower than SDV.
4. Whether Section 50C overrides Section 45(3) in computing partner's capital gain?
5. What becomes the cost of land to the firm for future sale?

Case Study 16 : Partial Distribution of a Composite Asset (e.g., subdivision of land)

Facts : Firm ABC LLP

- Firm having three partner ABC
- Profit and loss : equal share of each partner
- The Firm owns a big land
- On retirement of partner C from the firm he gets 1/3rd undivided share in the land
- That land status is :
 - (i) FMV of whole land: Rs 3 Cr and FMV of 1/3rd portion: Rs 1 Cr
 - (ii) Book value of entire land: RS 90,00,000

Questions :

1. Taxability in the hand of firm
2. Taxability in the hand of partner C if any
3. Cost of land in his hand of partner C
4. Relevant sections
5. Does distribution of 1/3rd undivided share in land to Partner C constitute a deemed transfer under Section 9B?
6. Does Section 45(4) also apply since partner receives property exceeding capital balance?
7. What is the cost of acquisition of the 1/3rd land in C's hands?
8. How should firm compute income under 9B when part of a composite asset is transferred?
9. Does Rule 8AB apply when only one asset remains or attribution is not possible?

THANK you