Partnership Firms, AOP & BOI : Secs. 9B & 45(4) – Overview, Examples, Issues

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Taxation of Partnership Firm:

Section 2(31)	-'person' includes 'firm', 'AOP', 'BOI'.
Section 2(23)	-'firm' - as per Partnership Act, 1932 - as per LLP Act, 2008 -'partnership firm' - as per Partnership - as per LLP Act, 2008.

Taxation of Partnership Firm:

Section 40(b)	- Deduction of interest and remuneration to partners
Section 45(4) – new	- Profits and gains on “reconstitution” of firm
Section 9B – new	- Capital gains on ‘reconstitution’ and ‘dissolution’ of firm
Board Circular No. 14 dt. 2-7-2022	- Guidelines u/s 9B and 45(4)
Sec. 48(iii)	- Capital gain charged u/s 45(4) to be deducted from consideration of asset sold later as per rule 8AB

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<u>**Why Secs. 9B & 45(4)?:**</u>

- Ambiguity in taxation on distribution of assets to partners
- Ambiguity in computation of income on such events
- To bring to tax fair values of assets given to partners
- To make money paid in excess of capital as income chargeable to tax

Section 9B r. w. r. 8AB:

Applies from	:	• 01-04-2021 (A.Y. 2021-22; F.Y. 2020-21) i.e. as good as from dt. 1-4-2020 • By Finance Act, 2021 (passed in April 2021 - retractive effect) • Rule 8AB inserted from 2-7-2021
Applies to	:	Partnership Firm, AOP, BOI ("specified entity") (not to partners/members)
Applies when (taxing event)	:	- Dissolution of firm and/or - Reconstitution of firm (as defined)

<u>Section 9B :</u>

Applies only if : If a partner/ member ("specified person") receives any "capital asset" or "stock-in-trade" or both from firm on dissolution or reconstitution of firm

Treated as "deemed transfer"

: Section 9B <u>does not</u> apply if only money, no assets are received by partner

<u>'Reconstitution' means</u>:

(a) Retirement/Cessation as partner/member
(b) Admission of partner
(c) Change in share of partner

Effect of Section 9B:

Amount of taxable income of firm	:	Profits and gains on such deemed transfer chargeable to firm as: - Business income (if stock-in-trade given) - Capital gains (if capital asset is given)
Computation of profit and gains of firm	:	Deemed consideration = F.M.V. of asset Less: Actual cost/Indexed cost/ WDV of asset/stock
Time of Taxation/Transfer		Year in which asset/money is received by partner (may not be same as the year of the taxing event)

<u>Sec. 45(4):</u>

Amount of capital gain of firm	:	Deemed transfer chargeable as capital gains of firm: - if capital asset or money is given to partner on reconstitution of firm
Computation of capital gains	:	FMV of capital asset + money given – capital account balance of partner
Time of Taxation/Transfer		Year in which asset/money is <u>received</u> by partner (may not be same as the year of the taxing event)

Sec. 45(4) : old vs. new

OLD : A.Y. 1988-89 to A.Y. 2020-21	NEW : A.Y. 2021-22 onwards
Distribution of capital asset by firm to partner	Receipt of capital asset or money by partner from firm
Capital asset	Capital asset & money
On dissolution of firm or otherwise	On reconstitution of firm
Gain chargeable to firm in year of event	Gain chargeable to firm when asset received by partner
Deemed consideration is FMV of asset	Deemed consideration is FMV of asset
Refund of excess money over capital : NOT	CHARGEABLE AS CAPITAL GAIN

Sec. 9B vs. Sec. 45(4) - Comparison

	Sec. 9B	Sec. 45(4)
• Event	- Dissolution - Reconstitution	- Reconstitution
• Asset given to partner	- Capital asset - Stock-in-trade	- Capital asset - Money
• Chargeable as income of	- Firm	- Firm
• Year of chargeability	• Year of receipt by partner	• Year of receipt by partner
• Computation formula	• FMV of asset minus cost of asset	• Money amt (+) FMV of asset (-) balance in Capital account

BOTH S. 9B AND 45(4) TO BE APPLIED TOGETHER AND INDEPENDENTLY

Sec. 48(iii)

Gain computed u/s 45(4) can be deducted from sale consideration value when the remaining capital asset of the firm is transferred later; as per method given in Rule 8AB (called attribution)

Attribution of gains in proportion of difference between increase in value of remaining capital assets

No attribution if there is no revaluation

No attribution if there are no remaining capital assets

Illustration – as per Board Cir, No.14 dt. 2-7-21:

Partners' Capital Bal.	Amount	Assets	Book Value	FMV revalued
A	10.00	Land – S	10.00	70.00
B	10.00	Land – T	10.00	70.00
C	10.00	Land – U	10.00	50.00
Total	**30.00**		**30.00**	

- Partner A retires; with Land – U & Rs. 11L money
- Indexed cost of Land – U : Rs. 15L (> 2 years)

Computation of Capital Gains u/s 9B:

	₹
Fair Market Value of Land - U	**50,00,000**
Less: Indexed Cost of Acquisition [assumed]	**(15,00,000)**
Long term Capital Gains	**35,00,000**
Tax on Long Term Capital Gains at 20%	**7,00,000**

Working of Book profit of firm up to retirement date:

Calculation of Share of Profit of retiring partner

	₹
Fair Market Value of Land – U	**50,00,000**
Less: Book Cost of Acquisition of Land – U (w/o indexation)	**(10,00,000)**
Book Profit Before Tax	**40,00,000**
Less: Long Term Capital Gains (calculated as above)	**(7,00,000)**
Book Profit After Tax	**33,00,000**
Share of profit of retired partner – 1/3rd	**11,00,000**

Computation of capital gains u/s 45(4):

		₹
I. Capital Balance of Partner-A:		
Opening Bal.	10,00,000	**21,00,000**
Share of profit up to Rt. Dt.	11,00,000	
II. Deemed Consideration:		
		61,00,000
FMV of Land- U	50,00,000	
Settled money	11,00,000	
III. Long Term Capital Gain to firm (II – I)		**40,00,000**
(to be attributed to value of remaining assets)		

Calculation of attribution to remaining capital assets as per Rule 8AB(2):

Land	FMV	Cost	Increase in Value	Proportion of Increase in Value	Attribution of CG charged u/s 45(4)
S	70,00,000	10,00,000	60,00,000	50%	20,00,000
T	70,00,000	10,00,000	60,00,000	50%	20,00,000
			120,00,000		**40,00,000**

Some more Illustrations:

(Only Methods are shown; figures are indicative; not conclusive)

Case - 1 : LAND GIVEN TO PARTNER ON DISSOLUTION:

B/S of Firm

Amt. Rs.

Capital Balance		**Assets**	
Partner-1	10,00,000	Land (FMV 80,00,000)	22,00,000
Partner-2	12,00,000		
	22,00,000		**22,00,000**

<u>Computation of profits and gains of firm:</u>

		u/s 9B	**u/s 45(4)**
FMV of Land		80,00,000	
Less: Actual Cost 22,00,000			
Indexed Cost	40,00,000	40,00,000	Not attracted on dissolution
Long term capital gain to firm (would have been same as per old sec. 45(4)		**40,00,000**	

Case – 2 : Retirement of partner- money only paid:

B/S of Firm:

Capital Balance		**Assets**	
P-1 (retires)	10,00,000	Land (FMV 80,00,000)	22,00,000
P-2	12,00,000	Bank Balance	10,00,000
P-3	10,00,000		
	32,00,000		**32,00,000**

Computation of firm:

	u/s 9B	u/s 45(4)
Deemed consideration – amt. paid	Not attracted as no asset/stock given	30,00,000
Asset given	-	-
Less: Capital account credit balance of P-1 on dt. of retirement	N/A	(10,00,000)
Capital Gain to firm as per formula of sec. 45(4) – to be attributed to Land as per sec. 48(iii)	N/A	20,00,000

Case III : Only Asset given on Retirement :

B/S of firm

Capital Balance		**Assets**	
P-1 (retires)	10,00,000	Land (FMV 75,00,000)	22,00,000
P-2	12,00,000	Bank Balance	10,00,000
P-3	10,00,000		
	32,00,000		**32,00,000**

1/3rd Land to P-1 → FMV =75,00,000 / 3 = 25,00,000 to P-1

Case – III contd..

Capital account balance of P-1	10,00,000
Add: 1/3rd profit share due to land revaluation entry [(75,00,000-22,00,000)/3]	18,00,000 (r/off)
Total balance pre-retirement	**28,00,000**

c/f to next slide

Computation of firm:

	u/s 9B	u/s 45(4)
1/3rd Land value given to P-1	25,00,000	25,00,000
Less : indexed cost of 1/3rd Land, say,	13,00,000	Not deductible here
P-1 Capital Balance (see working on previous slide)	-	(28,00,000)
Capital Gain chargeable to firm	12,00,000	Nil, as capital is more than FMV hence no income as per formula

Case 4 : Distribution of money, capital asset & stock-in-trade on retirement:

B/S of firm

Capital Balance		Assets	
P-1 (retires)	10,00,000	Land-1 (FMV 15,00,000)	9,00,000
P-2	12,00,000	Land-2 (FMV 25,00,000)	12,00,000
P-3	8,00,000	Motor Car (FMV 2,00,000)	3,00,000
		Bank Balance	4,00,000
		Stock-in-trade	2,00,000
	30,00,000		**30,00,000**

- P-1 retires
  - Paid money 4,00,000
  - Paid Stock-in-trade FMV 3,00,000
  - Paid Land-1 FMV 15,00,000

Computation of firm :

	u/s 9B	u/s 45(4)
Land-1 given: FMV as deemed consideration	15,00,000	See next slide
Less : Indexed Cost of land (assumed)	9,00,000	
LTCG	**6,00,000**	
Stock-in-trade given: FMV	3,00,000	
Less: Cost (assumed)	1,00,000	
Business income	**2,00,000**	

Computation of firm :

		u/s 9B	u/s 45(4)
B = Money Paid		Not taxable here	4,00,000
C = FMV of Land-1 given to partner		Considered in earlier slide	15,00,000
Value of Stock-in-trade given		-- do –	Not taxable here
			19,00,000
Less: D = Capital Balance of partner	(10,00,000)		
Profit Share up-to retirement	(2,66,667)		
(see working on next slide)			(12,66,667)
LTCG as per formula : A = B + C – D *(also available*			6,33,333

Working of Profit share of P-1:

Land-1 :	FMV	(15,00,000)
	Cost	(9,00,000)
Profit		6,00,000
(a) 1/3rd share of P-1		2,00,000

Stock-in-trade:

	FMV	3,00,000
	Cost	1,00,000
	Profit	2,00,000
(b) 1/3rd Share of P-2		66,667
(a + b)		**2,66,667**

Some issues:

- Year of chargeability to firm : if year of event and delivery are different
- Meaning of ‘capital asset’ – sec. 2(14) : property of every kind other than …………….
- Meaning of ‘stock-in-trade’ – sec. 2(14) : distinguishes it with raw materials and stores – how much relevant : (AS-2 uses the phrase “Inventories”)
- When there is no payment of value in excess of book balance in capital account

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Some issues:

- How to compute effect of past revaluation of assets and inclusion in capital bal.
- Attribution would continue in cases of succession/conversion/slump sale of firm?
- What is FMV? Same as stamp duty value u/s 50C/43CA?
- What is better now? To sell property to partner or to distribute?