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PROFESSIONAL EXCELLENCE

C.V.O.CA'S NEWS & VIEWS

FOR MEMBERS / SUBSCRIBERS / VOL. 26 - NO. 1 JULY 2022

From President's Desk...

Dear Professional Colleagues and Readers,

New year, brings new energy and new enthusiasm. Team CVOCA has geared up to take on new tasks and new challenges to ensure all programs are executed with a professional touch. As you all are aware, our association is entering its 50th year – golden jubilee year and it is for me indeed a proud moment to present the first communication of the golden jubilee year. We have planned many programs for society at large, our own members of the association.

We are seeing the Russia-Ukraine war entering its 4th month. No one expected it to last even for more than 4 weeks. With prolonged war, the world is now facing the heat. The ongoing conflict seems to have major ramifications for the global economy, which was just recovering from the stress of the coronavirus pandemic. Russia and Ukraine being major commodity producers such as grain, oil etc, there is a challenge on supply side, resulting in soaring global prices.

Even though Russia and Ukraine combined account for less than 3% of global exports and less than 2% of global imports, the conflict and subsequent sanctions have frayed trade connectivity by disrupting transit routes, particularly for maritime container shipping and air freight traffic. Further, higher fuel prices and insurance premiums have pushed up shipping costs.

The existence of high debt among emerging markets and developing economies also poses a high risk to the world economy. We have seen economic stress being faced by the small countries such as Sri Lanka and Pakistan. We hope we do not see a domino effect and there is least impact on other countries.

Some of the following statistics highlight the seriousness of the crisis:

- The Food Price index is at a historical high. Food prices are nearly three times the pre-pandemic average. Global inflation has reached 5.2 percent, the highest in recent time.
- There is an acute shortage of containers. Freight prices are trending at multiple times their average. Ocean freight from India – US, which used to be in a range of USD 4-5 has increased to USD 18K-20K
- Interest rates are rising across the world creating tight monetary conditions.
- People facing acute food shortages have increased by 46 million in Africa and 47 million in Asia.
- 60 percent of least developing countries are in severe debt distress.

We hope this conflict plays out soon and the liberal, international rules-based order might just have rediscovered what it was for in the first place.

I would like to take this as an opportunity to announce our upcoming events:

Compliances and professional challenges are increasing day by day. Keeping in mind a 2-day RRC on GST is being planned at Karjat on 5th – 6th August. Committee has ensured apt topics, affecting everyone day to day. We have discounts on fees for early bird registration, and in case you have missed the opportunity, please ensure you enroll at the earliest.

Events in retrospect:

With increasing amendments and compliance challenges faced by trust, we have organized a public program on 25th June at Chinchbandar Mahajanwadi. More than 400 participants, mainly trustees of various Sanstha and trusts are expected to attend the program. Abled speakers will cover various issues under Income Tax and Mumbai Trust Act in lucid Gujarati and Hindi language.

We also had a study circle and a program for students on Direct Tax compliances.

Hopefully, we all will have a stress-free compliance calendar this year. This edition of our News and views is a special story on taxation compliances and issues with respect to partnership firm. I am hopeful, this will help all our members to understand nuances of new provisions.

I would like to conclude by remembering what once respected Ratan Tata ji said once

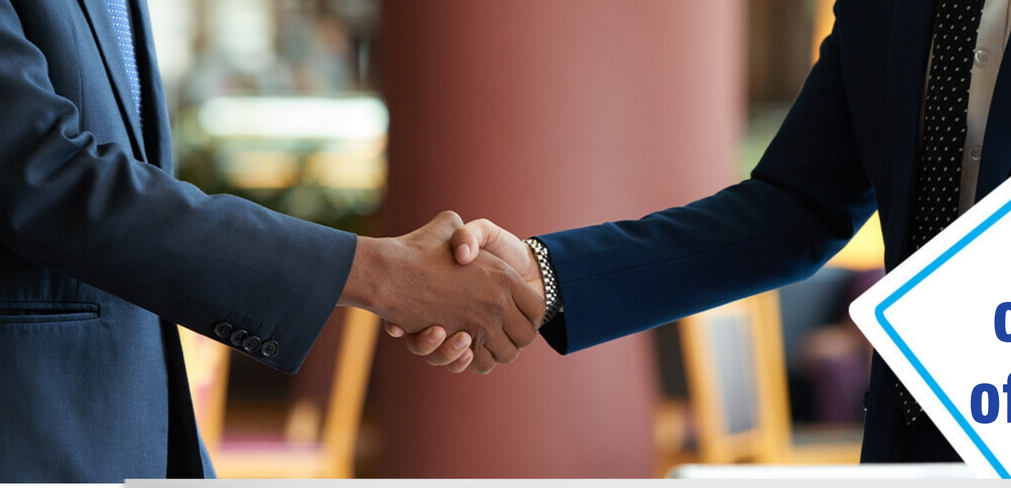
"If you want to walk fast, walk alone, but if you want to walk far, walk together.

I hope to see co-operation and support from each and every member of the association.

Thank you all..... Always in Gratitude

CA Amit Chheda

July 1, 2022



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CHANGE IS CONSTANT

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FROM THE DESK OF CHAIRMAN

All living things keep on evolving with passing of time. Evolution or change is inevitable. Humans are main force on the earth for various unnatural changes that occur and directly or indirectly all species get impacted by such changes, be it environmental, social, economic, scientific, political, etc. With such changes comes struggle to survive, need to adapt to new things or perish with times. Every generation has to pass through this process, there is no exception.

Let us try and put together major events that have taken place which have changed the way we live or changes that have occurred in last couple of decades and impacted us or will impact us in coming times. Probably most important change has come is onset of internet. Internet has impacted our lives in all respects, from children to older people, from education to business to running organizations or governments and what not. It has helped other major inventions such as onset of smart phones, which again has a great impact on lives of people and made possible for even poor people to get included in mainstream benefits of technology. Social media is one such other offshoot of internet technology which is changing things at large scale, having impact on personal lives of people, political arena, social activism and so on. Virtual currency is another change which has made inroads into peoples' investment portfolios but more than that has perplexed governments on how to deal with the issue and keep economies safe. These all major changes are basically technological and impact us faster and in our day to day life. But there are changes which we fail to realize soon and probably be passive to its impact on our lives because they may come over a longer period of time. One such major change is increase in human population. In last couple of decades over 1.6 billion were added to human population. This is definitely going to create a major imbalance in nature and even create conflicts among humans. Further, it has also brought major demographic changes and more and more people want to live in cities, which has its own nuances. Another major change which has come is climate change. In last two decades, the ocean temperature has risen at much faster rate than ever before, and last decade was the hottest in the recorded history of the earth. Other major events that shook the world were the twin tower attack in the USA which gave a new meaning to terrorism, plane with 227 people on board went missing forever with no closure to their families, and lately the covid 19 pandemic which changed many ways we live, to name a few.

It is also true that every major change comes with opportunities and challenges. The challenges with technological advancements are, intrusion of privacy, increase in divide between generations and human relationships, increase in divide between haves and have nots, health hazards, also advanced technologies make world vulnerable to wars and terrorism and in turn adds to miseries of people, destruction of nature, imbalance of nature and its fallouts. Individually we may be weak to deal with challenges, but collectively we can make difference. Opportunities of such changes include governments can bring about positive changes in the lives of people by making inclusive policies and empowering people. Other challenges the world is facing or will face are food scarcity, scarcity of potable water, other pandemics likes of Covid19 or worse and medical facilities to deal with them, human conflicts and conflicts between nature and humans, etc.

What has changed in India in recent years? Probably all will agree that coming to power of Modi led BJP-NDA alliance at the centre was single most important change we witnessed. This changed a lot of things, such as bringing people centric inclusive policies, check on corruption and black money, more and more use of technologies to empower people which brought positive changes in their lives, push to in-house manufacturing, strengthening Indian army, faster infrastructural development, push to space missions, support to medical facilities (like covid vaccinations), push to alternative energy like solar power, dealing strongly with terrorism, working towards making India $5 trillion economy, bringing recognition of India on world map where no country can anymore ignore India or take India for granted, change in internal politics and so on.

Also the changes that impacted world are going to impact India with likes of increase in population and demographic changes, environmental changes, energy etc. India also faces challenges in dealing with terrorism and naxalism, dealing with erring neighbors, illiteracy, education system, pollution, and so on.

If the whole world is changing, how we professionals can be left out. Last decade has seen far greater changes for us chartered accountants in India, e.g. conflict of interest of professional independency vis-a-vis government perspective resulting into formation of NFRA diluting ICAI's role, newer laws to deal with, ever increasing expectations from CAs resulting into introduction of various regulatory requirements by ICAI and / or government and to be followed by professionals, technological advancements resulting in Government asking for lot of compliances ultimately falling on shoulders of professionals, and all these do come with benefits and nuances, challenges and opportunities.

However, changes in last two decades are not important just because they impacted our lives, but more for the reasons that the changes came at much faster pace, and impacted our lives with unprecedented speed, even before we could realize and therefore difficult to cope with. Artificial Intelligence is one thing which is going to generate lot of challenges and at much faster pace in the times to come.

Be that as it may be, the change is constant and it does come with challenges. It is inevitable but to change ourselves with time. Albert Einstein rightly said, "The measure of intelligence is ability to change."

Lastly, on this annual ritual of change taking place at the helms of our Association, I take this opportunity to congratulate our incoming President and his team and wish them a successful term ahead. I also thank them for providing me with opportunity to share my thoughts in the times to come.

With regards.....

Thank you all..... Always in Gratitude

CA Ketan Rambhia

AMENDMENTS PERTAINING TO PARTNERSHIP FIRM VIDE FINANCE ACT, 2021

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A. Background

- Under the Income-tax Act, 1961 ('**IT Act**'), a partnership firm is considered to be a separate taxable entity as compared to its partners. Further, profits and gains of a partnership firm are taxable at the firm level and any distribution to partners is exempt under section 10(2A) of the IT Act.

- However, under the Partnership Act, 1932 ('PA'), partnership has been defined as a relationship between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Further, a partnership firm[1] is not a separate legal entity as compared to a company registered under the Companies Act. Accordingly, any property / asset held by a partnership firm is legally owned by all partners of the firm (jointly and severally).

- On account of the above difference between the IT Act and the PA, provisions under the IT Act pertaining to partnership firm have evolved over time.

B. Legislative History

- Prior to Financial Year ('**FY**') 1987-88, any distribution of capital assets on dissolution of firm was not regarded as a transfer under section 47(ii) of the IT Act and hence such a transaction was exempt from capital gains tax. This exemption was provided since partnership firm was not considered as a separate legal entity and all partners of the partnership firm had a joint or common interest in all properties/ assets of the firm (since partnership firm did not legally own any property/ asset).

- Accordingly, as a tax planning exercise, it was possible to convert partnership assets into individual assets without paying any capital gains tax on such transfers.

- To fix this loophole, the Legislature introduced section 45(4) in the IT Act *vide* Finance Act, 1987. As per the newly introduced section 45(4) of the IT Act, capital gains tax was payable by the partnership firm on distribution of capital assets to its partners either upon dissolution or otherwise. Consequently, exemptions under section 47(ii) of the IT Act were omitted.

- However, the new provision under section 45(4) of the IT Act ended up resulting in long-drawn litigation between the tax payers and the department, especially on the manner in which the term 'otherwise' should be interpreted (whether the term 'otherwise' would include retirement of partner or change in the profit sharing ratio?). Further, the judicial precedents on this issue were inconsistent.

- Further, this section was applicable only on distribution of capital assets and not on distribution of money or any other asset (other than capital asset) to partners even if such distribution was in excess of the balance lying in the capital account of the respective partner.

- On account of the above limitations, it was possible for tax payers to structure their transactions in

[1] *Excluding a Limited Liability Partnership ('**LLP**')*

such a manner that the erstwhile section 45(4) of IT Act would fall short to tax such transaction.

- For better understanding, illustrations covering the below scenarios have been provided in **Annexure 1**.

  i) Transfer of property / assets by using partnership as a holding vehicle

  ii) Retirement of one of the partners basis revaluation of Properties / Assets

  Having discussed the ambiguity / loopholes in the existing provisions, we shall now discuss the amendments introduced vide Finance Act, 2021

C. Amendments introduced vide Finance Act, 2021

- The Finance Act, 2021 has made substantial amendments to the tax laws governing partnership firms by way of insertion of new section 9B, substitution of existing section 45(4) and amendment to section 48 of the IT Act with retrospective effect from FY 2020-21.

- The Finance Act, 2021 proposed to rationalize the provisions of transfer of capital asset to partner on dissolution or reconstitution. The extract from the Memorandum to Finance Bill, 2021 is reproduced below:

  "It has been noticed that there is uncertainty regarding applicability of provisions of aforesaid sub-section [45(4) of the IT Act] to a situation where assets are revalued or self-generated assets are recorded in the books of accounts and payment is made to partner or member which is in excess of his capital contribution."

- Accordingly, section 45(4) of the IT Act was substituted for a new section which is applicable where a partner[2] receives any capital asset or money from a partnership firm[3] which is in excess of his capital balance at the time of reconstitution of the firm.

- Further, section 9B of the IT Act was introduced directly in the Finance Act, 2021passed by the Indian Parliament on 24 March 2022(without any reference in the Finance Bill, 2021) and hence there is no specific explanation provided for introduction of this section in the Memorandum to Finance Act, 2021. Also, there were considerable modifications in language of the revised section 45(4) of the IT Act in the Finance Act, 2021 as compared to the language provided in the Finance Bill, 2021.

- Nonetheless, the explanation provided in the Memorandum to Finance Bill, 2021 i.e. 'Rationalization of provision of transfer of capital asset to partner on dissolution or reconstitution' should act as a guiding principle while interpreting the provisions of newly inserted section 9B, substituted section 45(4) and amended section 48 of the IT Act.

[2] *The amendment defines the term 'specified person' as a person who is a partner in a firm or a member of other Association of Person ('**AOP**') or Body of individuals ('**BOI**'). However, for sake of simplicity, term 'partner' has been referred in the article*

[3] *The amendment defines the term 'specified entity' as a firm or AOP or BOI. However, for sake of simplicity, the term firm has been referred in the article*

<u>Section 9B of the IT Act- Income on receipt of capital asset or stock in trade</u>

- Section 9B of the IT Act is applicable when a <u>partner receives</u> any <u>capital asset</u> or <u>stock in trade</u> or both from a partnership firm in connection with <u>dissolution</u> or <u>reconstitution</u> of the partnership firm.

- Such receipt of capital asset or stock in trade is considered to be a transfer and any gains on such a transfer is taxable <u>in the year of receipt</u> (by partner)in the hands of partnership firm under the head Profits and Gains from Business or Profession ('**PGBP**') or under the head Capital Gains ('**CG**')as the case may be.

- The section 9B of the IT Act has defined the term reconstitution of partnership firm to include retirement of one or more partners or admission of one or more partners or change in respective share of all partners in the Partnership firm.

- Section 9B of the IT Act levies tax in the hands of partnership firm on profit made by the partnership firm on transfer of capital asset / stock in trade.

- Further, Central Board of Direct Taxes ('**CBDT**') has also issued Circular No 14 of 2021 dated 2 July 2021to provide guidelines for the purpose removing any difficulty in giving effect to provisions of section 9B and section 45(4) of the IT Act. The circular has been discussed at the end with specific illustrations to understand the applicability and computation mechanism of section 9B and section 45(4) of the IT Act.

<u>Section 45(4) of the IT Act – Income on receipt of capital asset</u>

- Section 45(4) of the IT Act is applicable when a <u>partner receives</u> any <u>money or capital asset</u> or both from a partnership firm in connection with <u>reconstitution</u> of a partnership firm. This section is applicable in addition to section 9B of the IT Act and taxation under section 45(4) of the IT Act shall be worked out independently.

  Such receipt of capital asset or stock in trade is considered to be a transfer and any gains on such transfer is taxable <u>in the year of receipt</u> (by partner) in the hands of <u>partnership firm</u> under the head CG.

- Section 45(4) also provides a computation mechanism to calculate profits or gains which is as under:

  A = B + C – D

  A = Profit or gains

  B = Value of money received by partner

  C = Fair market value of capital asset <u>received by partner</u>

  D = The amount of balance in the capital account of partner (without considering any increase on account of revaluation of any asset or self-generated goodwill / asset) in the books of partnership firm

  If the value of 'A' in the above formula is negative, it shall be considered to be zero

- Section 45(4) of the IT Act levies tax in the hands of partnership firm on profits made by the partner on excess distributions received as compared to its balance in the capital account in the books of partnership firm

Amendment in section 48 of the IT Act

- The computation mechanism to calculate capital gains under section 48 of the IT Act was amended to provide a cost step equivalent to the amount taxed under section 45(4) of the IT Act to the remaining capital assets with the partnership firm.

- Rule 8AB has been introduced in the Income-tax Rules, 1962 ('IT Rules') to provide for a methodology to attribute income taxable under section 45(4) of the IT Act to capital assets remaining with the partnership firm.

- As per Rule 8AB of the IT Rules, where the amount chargeable under section 45(4) of the IT Act relates to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, such amount should be attributable to the remaining assets in the ratio of increase in value of respective asset (on account of revaluation) to the aggregate increase in value of all assets (on account of revaluation).

Stage 1: Balance sheet of the firm prior to revaluation of asset

Particulars	Amount	Particulars	Amount
Partner's capital		Property / asset	100
- A	100		
- B	100	Cash	200
- C	100		
Total	**300**	**Total**	**300**

Stage 2: Balance sheet of the firm post revaluation (Property / asset– 300; Self-generated asset 100)

Particulars	Amount	Particulars	Amount
Partner's capital		Property / asset	300
- A	100	Self-generated asset	100
- B	100		
- C	100	Cash	200
Revaluation reserve	300		
Total	**600**	**Total**	**600**

Stage 3: Partner C retires by taking over cash of 200

- As per section 45(4) of the IT Act, **100** [*200 (money received) less 100 (balance in capital account)*] is taxable in the hands of the partnership firm. This profit of 100 is attributed to remaining assets in the following manner:

  i) Property / Assets: [100 * (300-100) / (400 – 100)] = **67**

  - *Revised Cost of acquisition* = **167** (100 + 67);

  ii) Self-generated / Asset: [100 * (100-0) / (400 – 100)] = **33**

  - *Revised Cost of acquisition* = **33** *(0 + 33)*

- Further, it has also been clarified that such cost step-up is only for the purpose of calculation of capital gains on transfer of such assets in future and no depreciation will be available on such cost step-up.

Sr No	Particulars	Prior to amendment introduced vide Finance Act, 2021	Post amendment introduced vide Finance Act, 2021	
		45(4) of the Act	Section 9B of the IT Act	Section 45(4) of the IT Act
1	Introduced	Finance Act, 1987	Directly introduced in the Finance Act, 2021	First introduced in Finance Bill, 2021. Modifications were made in the language inserted in the Finance Act, 2021.
2	Effective date	FY 1987-99	FY 2020-21	FY 2020-21
3	Applicability	Dissolution or otherwise	Dissolution or reconstitution of firm	Reconstitution of firm
4	Receipt by partner	Any capital asset	Any capital asset or stock in trade	Any money or capital asset
5	Head under which income	CG	PGBP or CG	CG
6	Computation mechanics	As per section 48 of the IT Act	Circular No 14 of 2021 dated 14 July 2021	CG = Value of money received + FMV of capital asset - balance in capital account at the time of reconstitution[4]
7	Can loss be set-off against other sources of income	Should be available under general provisions of the IT Act	Should be available under general provisions of the IT Act	No, any loss basis the above formula to be ignored

[4] *Read with Circular No 14 of 2021 dated 14 July 2021*

D. Decoding Circular No 14 of 2021 dated 14 July 2021

For the purpose of removing difficulties in interpretation of section 9B and 45(4) of the IT Act, CBDT issued guidelines to understand the manner in which these sections would apply with the help of examples[5].

Example 1 (all amounts are in lac)

Stage 1: Balance sheet of the firm prior to any reconstitution

Particulars	Amount	Amount	Particulars	Amount	Amount	Valuation report
Partner's capital			Land			
- A	10		- S	10		70
- B	10		- T	10		70
- C	10	30	- U	10	30	50
Total		**30**	**Total**		**30**	**1 9 0**

Stage 2: Partner A to retire (take over Land U at the valuation of 50 and cash consideration of 11)

Discharge of consideration to A on his retirement

Particulars	Amount
Cash consideration	11
Transfer of Land U	50
Total	**61**

Capital gains under section 9B of IT Act (transfer of land)

Particulars	Amount
Sales consideration	50
Less: Indexed COA	(15)
Capital gains	35
Tax @ 20% (tax outflow) (A)	**7**

Capital gains in books of firm

Particulars	Amount
Sales consideration	50
Less: COA	10
Capital gains	40
Tax	7
Net profit (post tax)	33
Credit to each Partner	11

[5] *For the sake of simplicity, examples have been discussed with same numbers as provided in the CBDT circular*

Balance sheet of the firm post transfer of land U (without adjusting capital account of A as if land is sold to external party)

Particulars	Amount	Amount	Particulars	Amount	Amount
Partner's capital			Land		
- A	21		- S	10	
- B	21		- T	10	
- C	21	63	- U	50	70
Provision of tax		7			
Total		**70**	**Total**		**70**

Capital gains under section 45(4) of IT Act (profit of partner)

Particulars	Amount
Sales consideration	61
Less: Partner's capital	(21)
Capital gains	40
Tax @ 20% (tax outflow) (B)	**8**

This transaction would not have been taxable under the erstwhile provisions of section 45(4) of the IT Act

Balance sheet of the firm post retirement of partner A

Particulars	Amount	Amount	Particulars	Amount	Amount
Partner's capital			Land (refer note 1)		
- A	-		- S	30	
- B	21		- T	30	
- C	21	42	- U	0	60
Payable to A		11	DTA (refer note 2)		8
Provision of tax (9B)		**7**			
Provision of tax [45(2)]		**8**			
Total		**68**	**Total**		**68**

Notes:

1. Cost step-up to existing assets is only for computation of capital gains on sale of assets.

   - Cost step up of Land S is **20** [40 * [60 / 120)]
   Revised Cost of acquisition = **30** (10 + 20)

   - Cost step up of Land T is **20** [40 * [60 / 120)
   Revised Cost of acquisition = **30** (10 + 20)

   Alternatively, assets can be recorded as per valuation report + cost step up and creation of a revaluation reserve. However, accounting treatment to be confirmed with auditors.

2. The additional payment of taxes of 8 lacs, would reduce the tax liability on sale of land S & T in future since cost step-up is provided on the capital gains on which tax is paid. However, accounting treatment to be confirmed with auditors.

Example 2 (all amounts are in lac)

Stage 1: Balance sheet of the firm prior to any reconstitution

Particulars	Amount	Amount	Particulars	Amount	Amount	Valuation report
Partner's capital			Land			
- A	10		- S	10		70
- B	10		- T	10		70
- C	10	30	- U	10	30	50
Total		**30**	**Total**		**30**	**190**

Stage 2: Patnership firm sells land U for cash consideration of 50

Capital gains under section 9B of IT Act (transfer of land)

Particulars	Amount
Sales consideration	50
Less: Indexed COA	(15)
Capital gains	35
Tax @ 20% (tax outflow) (A)	**7**

Capital gains in books of firm

Particulars	Amount
Sales consideration	50
Less: COA	(10)
Capital gains	40
Tax	7
Net profit (post tax)	33
Credit to each Partner	11

Balance sheet of the firm post sale of land U

Particulars	Amount	Amount	Particulars	Amount	Amount
Partner's capital			Land		
- A	21		- S	10	
- B	21		- T	10	20
- C	21	63	Cash		50
Provision of tax		7			
Total		**70**	**Total**		**70**

Retirement of A and distribution of cash consideration of 61 by firm to settle his capital account

Capital gains under section 45(4) of IT Act (profit on interest in firm)

Particulars	Amount
Sales consideration	61
Less: Partner's capital	(21)
Capital gains	40
Tax @ 20% (tax outflow) (B)	**8**

This transaction would not have been taxable under the erstwhile provisions of section 45(4) of the IT Act

Particulars	Amount	Amoun	Particulars	Amount	Amount
Partner's capital			Land (refer note 1)		
- A	-		- S	30	60
- B	21		- T	30	
- C	21	42			
Payable to A		11	DTA (refer note 2)		8
Provision of tax (9B)		**7**			
Provision of tax [45(2)]		**8**			
Total		**68**	**Total**		**68**

Notes:

1. Cost step-up to existing asset is only for tax purposes. Accounting treatment to be confirmed with auditors.

2. The additional payment of taxes of 8 lacs, would reduce the tax liability on sale of land S & T in future since cost step-up is provided on the capital gains on which tax is paid. However, accounting treatment to be confirmed with auditors.

Example 3

Stage 1: Balance sheet of the firm prior to any reconstitution

Particulars	**Amount**	**Amount**	**Particulars**	**Amount**	**Valuation report**
Partner's capital			Land	30	45
- A	100		Patent T	45	60
- B	10		Cash	225	225
- C	100	300	Goodwill (self generated)		30
Total		**300**	**Total**	**300**	**360**

Partner A to retire (take over Land at the valuation of 45 and cash consideration of 75

Particulars	**Amount**
Cash consideration	75
Transfer of Land	45
Total	**120**

Capital gains under section 9B of IT Act (transfer of land)

Particulars	**Amount**
Sales consideration	45
Less: Indexed COA	(45)
Capital gains	0
Tax @ 20% (tax outflow) (A)	**0**

Capital gains in books of firm

Particulars	**Amount**
Sales consideration	45
Less: COA	(30)
Capital gains	15
Tax	0
Net profit (post tax)	15
Credit to each Partner	5

Balance sheet of the firm post transfer of land (without adjusting capital account of A – as if land is sold to external party)

Particulars	Amount	Amount	Particulars	Amount
Partner's capital			Land	45
- A	105		Patent T (WDV)	45
- B	105		Cash	225
- C	105	315	Goodwill (self-generated)	
Total		**315**	**Total**	**315**

Capital gains under section 45(4) of IT Act (profit ofpartner)

Particulars	Amount
Payment to settle capital balance	120
Less: Partner's capital	105
Capital gains	15
Tax @ 20% (tax outflow) (B)	**3**

Particulars	Amount	Amount	Particulars	Amount
Partner's capital			Land	-
- A	0		Patent T (refer note 1)	50
- B	105		Cash	150
- C	105	210	Goodwill (self-generated)	10
			(refer note 1)	
Provision of tax (9B)		**0**	DTA (refer note 2)	3
Provision of tax [45(2)]		**3**		
Total		**213**	**Total**	**213**

Notes:

1. Cost step-up to existing assets is only for computation of capital gains on sale of assets and not for claiming depreciation. Accounting treatment to be confirmed with auditors.

- Cost step up of Patent is **5** [15 * [15 / 45)]

  Revised Cost of acquisition = **50** (45 + 5)

- Cost step up of Goodwill (self-generated) is **10** [15 * [30 / 45)]

  Revised Cost of acquisition = **10** (0 + 10)

2. The payment of taxes of 3 lacs, would reduce the tax liability on sale of Patent T and Goodwill since cost step-up is provided on the capital gains on which tax is paid. Accounting treatment to be confirmed with auditors.

E Key observations for future transaction/ Issues on which clarity is awaited

- Tax implications on distribution of any capital asset or stock-in-trade or money in absence of reconstitution or dissolution of the partnership firm
- *Taxability under section 9B and section 45(4) of the IT is applicable only in case of reconstitution or dissolution of firm*
- Taxation on receipt of money by a partner at the time of dissolution
- *Section 45(4) of IT Act covers cases of reconstitution only and not the cases of dissolution*
- Taxation on receipt of capital asset / stock in trade in hands of legal heir in case of death of partner
- *Taxability under section 9B and section 45(4) is applicable on receipt of capital asset / stock in trade by partner of a partnership firm*

Annexure 1

Illustration 1: *Transfer of property / assets by using partnership as a vehicle*

Stage 1: Balance sheet of the firm prior to revaluation of assets

Particulars	Amount	Particulars	Amount
Partner's capital		Property / assets	200
- A	100		
- B	100		
Total	**200**	**Total**	**200**

Stage 2: Property / assets of the firm are revalued

Particulars	Amount	Particulars	Amount
Partner's capital		Property / assets	400
- A	100		
- B	100		
Revaluation reserve			
- A	100		
- B	100		
Total	**400**	**Total**	**400**

Stage 3: New partners are introduced on contribution of cash

Particulars	Amount	Particulars	Amount
Partner's capital		Property / Assets	400
- A	100		
- B	100	Cash	400
- C	200		
- D	200		
Revaluation reserve			
- A	100		
- B	100		
Total	**800**	**Total**	**800**

Stage 4: Erstwhile partners retire by taking out cash equivalent to their capital (Capital + revaluation reserve)

Particulars	Amount	Particulars	Amount
Partner's capital		Property / Assets	400
- C	200		
- D	200	Cash	0
Total	**400**	**Total**	**400**

Important observations

- In this case, there is no tax outflow for the firm or the partners since capital asset is not distributed to any of the partners.
- Commercially A and B have sold Property / asset to C and D without paying any taxes.
- The amendment under section 45(4) of the IT Act levies tax on gains made by A and B on unrealised gains (in the books of firm) on Property / Asset.

Illustration2: *Retirement of one of the partners basis revaluation of Property / Assets*

Stage 1: Balance sheet of the firm prior to revaluation

Particulars	Amount	Particulars	Amount
Partner's capital		Property / Assets	
- A	100	- X	100
- B	100	- Y	100
- C	100	- Z	100
Total	**300**	**Total**	**300**

Step 2: Assets of the firm are revalued

Particulars	Amount	Particulars	Amount
Partner's capital		Property / Assets	
- A	100	- X	250
- B	100	- Y	250
- C	100	- Z	250
Revaluation reserve			
- A	150		
- B	150		
- C	150		
Total	**750**	**Total**	**750**

Stage 3: Partner C takes over Property / Asset Z and retires

Particulars	Amount	Particulars	Amount
Partner's capital		Property / Assets	
- A	100	- X	250
- B	100	- Y	250
Revaluation reserve			
- A	100		
- B	100		
Profit and loss	100		
Total	**500**	**Total**	**500**

Important observations

- In this case, firm pays taxes on capital gains on distribution of Property/asset to C. How ever, C does not pay any taxes.
- Commercially C's share of 250 includes initial capital of 100 and his share of profit of **150** [1/3 * (750 - 300)] on all three Properties / assets
- The amendment under section 45(4) of the IT Act levies tax on gains made by C on unrealized gains on Property X and Y

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COMPUTATION MECHANISM U/S 9B, 45(4) & 48(iii) AND INTRICACIES THEREOF

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The partnership firm does not enjoy the status of a separate legal entity, hence the partners always had a vested interest in the partnership. Based on this principle, the Supreme Court in the case of Mohanbhai Pammabhai has held that withdrawal at the time of retirement of a partner is not taxable, since withdrawal is nothing but a vested right in the partnership. This principle was used as a tax planning tool thus, the Finance Act 2021 has amended the law by taxing any excess withdrawal by a partner beyond its capital balance.

In this article, we will understand the amended law, the interplay between sections 45(4) and 9B, attribution u/s 48(iii) and the issues arising out of the said amendment while practically applying it.

Section 45(4)

The amended Section 45(4) is applicable when a **specified person** (partner or member) **receives**, any **money or capital asset or both** from a **specified entity** (Firm, AOP or BOI) in connection with the **reconstitution** (admission, retirement or change in profit sharing ratio), then any profits/gains arising from the receipt by the specified person shall be deemed to be the income of the specified entity.

The important point here to note is :

- there is an amendment in the point of taxation, it is changed from the **date of transfer** to the **date of receipt** by the specified person
- the section primarily seeks to tax the transfer of vested right in partnership by a partner and the same is deemed to be the income in the hands of the partnership.

The profits/gains shall be determined in accordance with the following formula:

A = B+C-D, wherein:

A	income chargeable to tax in the hands of the specified entity under the head Capital gains;
B	value of any money received by the specified person from the specified entity on the date of such receipt
C	the amount of fair market value of the capital asset received by the specified person from the specified entity on the date of such receipt; and
D	the amount of balance in the capital account (represented in any manner) of the specified person in the books of account of the specified entity at the time of its reconstitution

It provides that where the value of A is negative, its value shall be deemed to be zero. It further provides the capital balance at D should not include any amount increased on account of revaluation or self-generated goodwill or self-generated asset.

An explanation is further inserted to say that the provision of this sub-section will operate in addition to the provisions of section 9B and the taxation under both the sections will be worked out independently.

Interplay with section 9B

As Section 9B is covered in detail in separate article, we would briefly touch upon the provision of section 9B to understand the interplay between both the sections:

Section 9B is applicable when a specified person receives any capital asset or stock in trade or both from a specified entity in connection with the dissolution or reconstitution of the specified entity. The time of transfer for the specified entity will be deemed to be the day on which the asset is received by the specified person.

The following table gives a summary of the applicability of sections 45(4) and 9B, to understand the differences better:

Particulars	Section 45(4)	Section 9B
Withdrawal of money	Yes, applicable	Not Applicable
Withdrawal of Capital asset	Yes, applicable	Yes, applicable
Withdrawal of Stock in trade	Not Applicable	Yes, applicable
Reconstitution	Yes, applicable	Yes, applicable
Dissolution	Not Applicable	Yes, applicable
Charge created on	Transfer of an interest in a partnership	Transfer of capital asset or stock in trade
Deeming fiction	Deems the gain to be of partnership firm and not the partner	Deems date of transfer to be the date of receipt of the asset by a partner

As it can be seen from above, whenever the partner withdraws any capital asset on reconstitution of the firm, there is a trigger of 9B as well as section 45(4).

Let us understand the computation with the help of an example:

M/s ABC & Co.			
Liabilities	**Amount**	**Asset**	**Amount**
Capital A/c		Capital Asset 1 (FMV is Rs. 150)	90
A	50	Capital Asset 2	50
B	50	Bank	10
C	50		
Total	**150**	**Total**	**150**

M/s ABC & Co. is a partnership firm with A, B & C as its equal partners. Mr. A retires from the partnership and takes over Asset1 (which is a long term asset) whose indexed cost is 120.

Analysis:

Circular 14 of 2021 explains the calculation of 9B & 45(4) as follows:

1. Section 9B

In accordance with provision of Section 9B, it is deemed that the firm has transferred the Capital asset 1 and thus, the computation u/s 9B will be as follows:

Particulars	Amount (in Rs.)
Full value of consideration	150
Less Indexed cost	120
Long term gains on the sale of asset	30
Tax on above @ 20%*	6

(Surcharge and cess are ignored only for ease of calculation)

2. Revised Capital of retiring partner for the purpose of section 45(4) will be:

Particulars	Amount (in Rs.)
A's Capital balance	50
Add: A's share in Book Gain on sale of the asset (150-90) /3	20
Less: Share of Tax	(2)
Revised Capital Balance of Mr. A	**68**

3. Gains u/s 45(4)

Particulars	Amount (in Rs.)
Value of Money received	Nil
FMV of the asset taken over	150
Revised Capital Balance of Mr. A	(68)
Sum chargeable to tax u/s 45(4)	**82**

The amount chargeable to tax in the hands of the firm shall be Rs 30 u/s 9B and Rs 82 u/s 45(4)

Having understood the computation, let us now understand Rule 8AA(5) to evaluate whether the gain u/s 45(4) is a long term gain or short term gain:

Rule 8AA: Method of determination of the period of holding of capital assets in certain cases

Rule 8AA(5) states the amount chargeable to tax u/s 45(4) shall be **deemed to be**:

from the transfer of Short term Capital Asset (STCA), if it is attributed to	A capital asset which is a short term capital asset at the time of its taxation
	Capital asset forming a part of the block of asset
	Self-generated asset or self-generated goodwill
from the transfer of Long Term Capital Asset (LTCA), if it is attributed to	Capital Asset which is not covered in the above clause and is a long term asset at the time of its taxation

The plain reading of the section suggests that the capital gains arising on transfer of Capital asset 1 will be deemed to be from the transfer of long term capital asset.

However, there are issues regarding Rule 8AA(5) :

1. Rule 8AA r. w. Explanation 1(ii) to s. 2(42A) is primarily meant for the determination of the holding period. However, Rule 8AA(5) does not deal with the determination of the holding period and instead seeks to define directly the nature of CG. Further, while s. 2(42A) provides authority to define STCA, Rule 8AA(5) even determines gains arising from the transfer of LTCA

2. Section 45(4) was primarily enacted to tax the transfer of an interest of a partner in the partnership firm. It deems the income to be charged in the hands of the firm but it specifically doesn't describe the nature of the asset. However, Rule 8AA(5) provides to the contrary – and deems a firm to have transferred STCA or LTCA – which conflicts with fiction created by s. 45(4).

3. While the issue involves a legal subject and requires inputs from the legal fraternity, these illustrative features suggest that, as one possible view of the matter, the rule is misconceived and is prescribed without the appropriate backup authority of the law

Having understood the computation under section 9B & section 45(4), we now understand the allowability of the deemed income charged in the hands of the firm as a future cost.

Section 48(iii) r.w. Rule 8AB

S. 45(4) proceeds on basis that any distribution to a partner in excess of his capital account balance represents a share of such partner in value appreciation of capital assets retained by the firm. Such a share is taxable in hands of the firm at the stage of receipt by a partner. Once such value appreciation is taxed at the stage of retirement, s. 48(iii) r. w. Rule 8AB provides for attributing such value of appreciation to remaining capital assets of the firm (viz. other than capital assets distributed to the retiring partner), which is creditable as a reduction from sale consideration, as and when such remaining capital assets are transferred by firm post-retirement. This avoids double taxation of income.

The attribution will be as follows:

Where CG u/s 45(4) relates to	Basis of attribution
Revaluation of any capital asset (taken over by the partner)	No attribution
Revaluation of any capital asset (remaining with the firm)	CG u/s 45(4) x $\frac{\text{increase in value of capital asset}}{\text{Aggregate of increase/recognition of all assets}}$
Valuation of Self-generated assets or Self-generated goodwill	CG u/s 45(4) x $\frac{\text{recognition of value of self-generated goodwill}}{\text{Aggregate of increase/recognition of all assets}}$
Does not relate to any of above	No attribution

The rule has inserted an explanation to state that no depreciation will be allowed on the increased value or self-generated goodwill. Moreover, the attributed amount, won't qualify as cost for the purpose of indexation, thus, no indexation will be available on the said attribution

The rule further specifies the following conditions to claim the aforesaid attribution:

1. Revaluation should be based on a valuation report obtained from a valuer eligible to be appointed as a registered valuer under Wealth-tax Act, 1957
2. Firm to furnish details in Form No. 5C on or before the due date of filing the return of income.

Section 48 r.w Rule 8AA only specifies the attribution to a capital asset not forming a part of the block of asset, however, the guidelines issued by CBDT vide circular 14 of 2021 provides the relief by extending reference to capital asset forming part of the block of assets.

Thus, at the time of transfer by the firm, post-retirement, of such depreciable capital asset forming part of the block of assets, s. 45(4)CG attributed thereto is reduced from money payable (or sale consideration) and only such net amount is reduced from WDV (or charged as STCG).

Guidelines also clarify that 'actual cost' of remaining capital assets remains intact and consequently, no depreciation or indexation benefit is available on the amount so attributed.

To understand the working under Rule 8AA & 8AB we hereby take the following example:

M/s PQR& Co.			
Liabilities	**Amount**	**Asset**	**Amount**
Capital A/c		Asset 1 (FMV 600)	60
P	100	Asset 2 (FMV 900)	240
Q	100		
R	100		
Total	**300**	**Total**	**300**

Firm M/s PQR & co. has 3 equal partners. Both the assets are long term capital assets. The firm has self-generated goodwill of Rs 600. Thus, the net worth of the Firm is Rs 2100 with each partner's intrinsic interest worth Rs 700/-. Mr. P retires from the firm and his account is settled by giving him Asset 1 and cash of Rs 100. The indexed cost of Asset 1 is Rs 90

Analysis:

As already explained the computation u/s 9B will be

Particulars	Amount (in Rs.)
Full value of consideration	600
Less Indexed cost	(90)
Long term gains on the sale of asset	510
Tax on above @ 20%*	102

(Note: Surcharge and cess are ignored only for ease of calculation)

Revised Capital of retiring partner for the purpose of section 45(4) will be:

Particulars	Amount (in Rs.)
P's Capital balance	100
Add: P's share in Book Gain on sale of the asset (600-60) / 3	180
Less: Share of Tax	(34)
Revised Capital Balance of Mr. A	**246**

Gains *u/s 45(4)*

Particulars	Amount (in Rs.)
Value of Money received	100
FMV of the asset taken over	600
Revised Capital Balance of Mr. A	(246)
Sum chargeable to tax u/s 45(4)	**454**

As per s. 48(iii) r. w. Rule 8AB, s. 45(4) CG of Rs 454 is attributed as follows:

Where CG Relates to	Basis of Attribution	Amount
Asset 1 – Taken over by partner	No attribution	Nil
Revaluation of Asset 2 (900-240 = 660)	$454 \quad x \quad \frac{600}{(660+600)}$	216
Valuation of self-generated goodwill	$454 \quad x \quad \frac{600}{(660+600)}$	216

An important point to note is that the Rule states increase/recognition of **<u>all assets</u>** needs to be considered in the denominator. Thus, a question here arises whether the increase in revaluation of Asset 1 also needs to be considered? If the same is considered, the attribution will get further diluted, thus defeating the purpose of avoiding double taxation. Though the reading of rules gives ambiguity, the guidelines issued under the aforementioned circular ignores the revaluation of the asset taken over by the partner as a part of the denominator. Though circular is going beyond section, it is benefiting the tax payers. The said circular will be binding on the department and the benefit of ignoring the increased revaluation of the asset taken over by a partner can be taken.

As per Rule 8AA(5), S 45(4) capital gains of Rs 454 shall be classified as STCG & LTCG as follows:

45(4) Gains attributable to	**Amount attributes as per Rule 8AB**	**Nature of Gain**
Asset 2	238	LTCG
Self-Generated Goodwill	216	STCG

Further, assuming Asset 2 is sold in future years at Rs 1000/- and the indexed cost of Asset (ignoring step-up cost u/s 48(iii)) is Rs.300/- The Capital gains will be computed as follows:

Particulars	**Amount (in Rs.)**
Sale Consideration	1000
Less: Step up cost u/s 48(iii)	(238)
Less: Indexed Cost	(300)
LTCG	462

Having understood the preliminary scope and operation of section 9B, 45(4), 48(iii) and Rule 8AA & 8AB we hereby understand some of the issues:

1. Gains arising on recognition of self-generated Goodwill deemed to be short term

S. 45(4) CG attributable to self-generated goodwill/asset is deemed as STCG, even if such self-generated goodwill/asset is held for more than 3 years by the firm. The rationale for the same is unclear.

2. Subsequent transfer of goodwill

If s. 45(4) Capital Gains pertains to self-generated goodwill/asset, the firm gets relief only at the time of sale of such goodwill/asset in the future as a standalone capital asset, which, in most cases, is an unlikely event. In event of the sale of such goodwill/ asset as a part of a slump sale, then the subject matter of transfer is an undertaking and not goodwill as a standalone capital asset, there is no clarity whether s. 45(4) CG attributed to self-generated goodwill/asset can be reduced while computing CG from slump sale.

3. Subsequent transfer of the remaining asset in the firm being a tax-neutral transfer

For all practical purposes, the amount attributed u/s. 48(iii) to remaining capital assets of the firm remains in abeyance and can be activated only upon transfer thereof by the firm in the future. If the firm transfers such remaining capital assets as tax-neutral transfer (say, by way of gift or conversion under Chapter XXI of Companies Act, 2013), difficulty may arise in claiming the benefit of s. 48(iii):

- Since the transaction is tax neutral transfer in the hands of the firm, the firm may not be able to claim the benefit
- The successor of the firm (who acquires such assets through tax-neutral transfer) may need to cross the hurdle of the restrictive scope of s. 48(iii), which apparently grants benefit only where the transfer is "by the specified entity" itself i.e. firm, and not by the successor.

4. When Stock in trade and capital asset both are taken over by the retiring partner

To understand the issue, let us take an example as follows:

M/s XYZ& Co.			
Liabilities	**Amount**	**Asset**	**Amount**
Capital A/c		Asset 1 (FMV 600)	300
X	500	Asset 2 (FMV 1200)	900
Y	500	Stock in trade (FMV 600)	300
Z	500		
Total	**1500**	**Total**	**1500**

Firm M/s XYZ& co. has 3 equal partners. Both the assets are long term capital assets. Thus, the net worth of the Firm is Rs 2400 with each partner's intrinsic interest worth Rs 800/-. Mr. X retires from the firm and his account is settled by giving him Asset 1 and 1/3rd of stock in trade. The indexed cost of Asset 1 is Rs 450

Analysis:

As already explained the computation u/s 9B will be

Particulars	Amount (in Rs.)
Full value of consideration	600
Less: Indexed cost	450
Long term gains on the sale of asset – I	**150**
Tax on above @ 20%*	30
#FMV of Transfer of Stock in trade	200
#Less: Cost	100
#Business profits on above – II	**100**
#Tax on above @ 30%*	30

(*Note: Surcharge and cess are ignored only for ease of calculation)

#The guidelines issued are silent on the treatment, in cases where stock in trade is taken over. Explicit guidelines with regard to the treatment of stock in transfer are expected from CBDT. There are two views possible w.r.t to it consideration while calculating the revised capital:

One can say that double taxation is only with respect to the capital asset being transferred since the same is taxable u/s 9B and 45(4). Thus, the gains only with respect to the transfer of capital asset ought to be adjusted in the partner capital balance.

On the contrary, one can state that the section clearly mentions 'amount standing to the credit of the partner capital' means after considering all the profits/gains/losses till the date of retirement. Moreover, the analogy prescribed in the circular states that '*This exercise is required to be carried out since section 9B of the Act mandates that it is to be deemed that the firm has transferred the asset to partner"*. Thus, the distribution of share business profit should be allowed to avoid double taxation without any dilution.

Thus, Rs 150 will be taxable under the head capital gains and Rs 100 will be taxable under the head business and profession.

Based on the above analogy, the Revised Capital of retiring partner for the purpose of section 45(4) will be:

Particulars	**Considering credit of profit on transfer of stock in trade**	**Not considering credit of profit on transfer of stock in trade**
X's Capital balance	500	500
Add: X's share in Book Gain on sale of the asset (600-300) /3	100	100
Less: Share of tax on LTCG	(10)	(10)
Add: Share of Profit & loss on the transfer of stock in trade (200-100)/3	33	-
Less: Share of tax on business profits	(10)	-
Revised Capital Balance of Mr. A	**613**	**590**

Gains u/s 45(4)

Particulars	**Considering credit of profit on transfer of stock in trade**	**Not considering credit of profit on transfer of stock in trade**
Value of Money received	Nil	Nil
FMV of the asset taken over	600	600
Revised Capital Balance of Mr. A	(613)	(590)
Sum chargeable to tax u/s 45(4)	**(13)**	**10**

In the first scenario, the capital gains u/s 45(4) will be deemed to be nil. Hence no further attribution is required u/s 48(iii).

In second scenario, as per s. 48(iii) r. w. Rule 8AB, s. 45(4) CG of Rs 10 is attributed as follows:

Where CG Relates to	Basis of Attribution	Amount
Asset 1 – Taken over by partner	No attribution	Nil
Revaluation of Asset 2 (1200-900 = 300)	$10 \times \frac{300}{(300+300^{**})}$	5
Revaluation of Stock in Trade (600-300 = 300)	Not Applicable	???

Note: Rule 8AB states that the **numerator will be an increase in or recognition of the **capital asset,** however, the **denominator** will be an increase in or recognition of the value of **<u>all assets.</u>**

The term 'all assets' is not clearly defined, it can have 2 interpretations:

- Literal interpretation: It includes all assets including current assets
- Other view is that the rule speaks of only capital asset, self-generated goodwill, or any self-generated asset, thus the denominator should also be an aggregate of only those assets.

However, the rule further states that if the CG u/s 45 is not on account of revaluation of a capital asset or self-generated asset/goodwill, no amount shall be attributable to any capital asset. In our example the CG u/s 45 is also on account of the revaluation of stock in trade, hence its attribution cannot be made to Asset 1.

Since the provision of section48(iii) is not applicable in the case of stock in trade, as seen from the above, the tax paid on the transfer of stock in trade is not allowed as a step-up cost.

Further, as per Rule 8AA(5), S 45(4) capital gains of Rs 10, in the second scenario, shall be classified as STCG & LTCG as follows:

45(4) Gains attributable to	Amount attributes as per Rule 8AB	Nature of Gain
Asset 2	5	LTCG
Stock in trade	???	???

Since stock in trade is not a capital asset, it is not possible to decide the nature of capital gain. Can it be said that the computation mechanism fails, by applying the law laid down by the Honourable Supreme Court in case of B. C. Srinivasa Setty 128 ITR 294?

A similar situation will arise when there is a takeover of agricultural land by a partner on his retirement since agricultural land is not a capital asset as per section 2(14).

5. What if there is a decrease on account of revaluation?

Rule 8AB only mentions "increase in or recognition of capital asset' hereby implying that only upward revaluation ought to be considered while the downward revaluations are to be ignored. Thus, in cases where there is an increase in the revaluation of only 1 asset and that asset is taken over by the partner, no attribution will be allowed.

6. What about the revaluation of liabilities?

Section 45(4) only states to compute capital balance without considering the amount of **increase** in any asset or recognition of self-generated goodwill. Thus, following the analogy as stated in the point before, the capital balance can include a decrease in the revaluation of liabilities.

For the purpose of attribution under rule 8AB, in case the CG u/s 45(4) is on account of decrease in revaluation of liabilities, a similar situation will arise as stated in **Issue 4.**Further, the nature of capital gains is also not ascertainable as envisaged in Issue 4

7. What if the partner is retired based on the DCF method of valuation?

Where the retiring partner is paid cash on basis of the DCF method or an ad-hoc valuation, and the firm does not obtain any valuation report from an approved valuer, it is not possible to apply Rule 8AA(5).

8. Whether one can claim deduction u/s 54EC in case the asset transferred is a long term capital asset?

The Supreme court in the case of Dempo Company Ltd. [2016] 74 taxmann.com 15, approved Bombay HC's decision in the case of ACE Builders (P.)Ltd. [2006] 281 ITR 210 which granted deduction u/s. 54E on CG computed u/s.50 from the sale of LTCA being a depreciable asset, for the following reasons

- Deeming fiction in s.50is confined only to s.48 and 49 – and does not apply to other provisions of the act such as s.54E, which makes no distinction between depreciable and non-depreciable assets.
- Fiction in s.50 deems CG as STCG and does not convert depreciable asset which is LTCA into STCA.

Rule 8AA(5) employs phrase which is similar to s. 50, and states that s.45(4) CG attributable to depreciable assets "shall be deemed to be from the transfer of STCA". Is such deeming fiction limited only to the characterisation of CG for purpose of s. 45(4), which has the impact of denial of indexation benefit?

The fiction of STCG in relation to CG u/s. 45(4) is created via Rule 8AA(5). The legal validity of Rule 8AA(5) is in question since it is going beyond the scope of section 2(42A). However, assuming the said rule is valid, such rule is notified under the authority of s. 2(42A) which defines STCA for the entire act. Unlike in the case of s.50- which merely overrides s.48/49, the fiction of Rule 8AA(5) r. w. s. 2(42A) is created at the very root of the definition of STCA. Capital gains so computed will therefore be STCG for all provisions of the Act. There is no requirement thereafter, to examine the nature of capital asset every time while examining different provisions of the Act such as s. 74, 112, etc. Consequently, the ratio of SC decision will have no applicability to capital gains computed under s. 45(4) r.w. Rule 8AA(5).

9. Is tax u/s. 45(4) triggered in the event of a partner retiring from the firm, or upon actual receipt from the firm?

Assume, a partner retires in March 2022and his account is settled in March 2024by cash payment from the firm. Whether s. 45(4) is triggered in hands of the firm in FY 2021-22 (viz. year of retirement) or FY 2023-24 (viz. year of actual receipt)?

As per one view, s. 45(4) is triggered in FY 2021-22. As per the Indian Partnership Act as also u/s. 24(5) of the LLP Act, immediately upon retirement, a debt (viz. right to receive) is determined in favour of the retiring partner, representing the value of his share in the firm's assets. Determination of such a debt due to the partner in lieu of extinguishment of his partnership interest is a constructive receipt, which triggers s. 45(4) in hands of the firm immediately.

Another view is that s. 45(4) is triggered in FY 2023-24 viz. on actual receipt; S. 45(4) refers to 'received' which is different than 'receivable'. Wherever Legislature desired to capture receipt on the accrual basis, it has consciously employed 'receivable' or 'due to' or 'repayable' (Example: Refer TDS provisions). The Hon'ble Supreme Court in the case of **Moon Mills Ltd.(1966) (59 ITR 574)** dealt with the balancing charge provision in the 1922Act which provided for taxation of insurance money "received". The Hon'ble Supreme Court held that the balancing charge was fictional in the business chapter, and such fiction cannot be extended beyond what was clearly contemplated therein. SC did not attribute the word 'received' as an equivalent to 'receivable', and SC upheld taxation in the year of actual receipt, despite the taxpayer having adopted the mercantile method of accounting and insurance compensation shown as receivable in books. Also, fact that other aspects of the business chapter were computed as per the mercantile method was regarded as irrelevant by SC while dealing with the fictional provision relating to balancing charge which was based on actual receipt.

The issue is fact-specific. The Honourable supreme court in the case of Standard Triumph Motor Co. Ltd. [1993] 67 Taxman 160 held that the time of receipt depends upon when funds are made available by the firm at disposal of the retiring partner. In the present case, if the retiring partner had an unfettered right to withdraw funds in FY 2021-22 itself, the mere fact that he chose to withdraw funds only in FY 2023-24 may not arguably defer taxability u/s. 45(4). On other hand, where terms of the partnership deed suggest that partner could have withdrawn funds only in FY 2023-24, arguably, s. 45(4) may trigger only in FY2023-24.

10. Where retiring partner's account is settled by the firm over a period, in instalments

To illustrate, the partner retires in year 1, and his capital balance at the time of retirement is 3 Lakhs. His share of 10 Lakhs is settled in 2 equal instalments, 5 Lakhs paid in year 1 and the balance 5 Lakhs paid in a year. As per the partnership deed, such a partner could not have withdrawn funds at any point of time prior to actual receipt from the firm in years 1 and 2.

An open issue could be, whether s.45(4)can be defended in year 2 on the ground that the person is not at all a 'specified person' in year 2 since he ceased to be a partner in year 1 itself? Definition of 'specified person' in s. 9B refers to a person who 'is' a partner of a firm in 'any previous year'.

Another issue could be, whether component D of the formula in s. 45(4)(representing partner's capital account balance) can be deducted twice over years 1 and 2? A better view appears to be that, the aggregate deduction of component D across years 1 and 2cannot exceed the partner's capital balance at the time of retirement. Permitting deductions at every instalment would result in duplicated deduction, which is not permitted in law unless specifically provided. In the above facts, component D of 3 Lakh once reckoned while computing CG u/s. 45(4) in year 1, cannot be reckoned again in year 2

11. Whether s. 45(4) is prospective or retroactive?

S. 45(4) is applicable from AY 2021-22. Assume, the partner retired prior to the introduction of s. 45(4) - say, on 31March 2020 and cash payable to him on retirement from the firm got crystallised prior to 31 March 2020, but such cash is actually received by him only after1 April 2020 - is charge u/s. 45(4) triggered?

In one view, s. 45(4) should be given a retroactive effect and applies to every receipt post 1 April 2020 even where reconstitution or part receipt would have happened before 1 April 2020. S. 45(4) is a deeming fiction linked to receipt-based taxation, along the lines of s. 45(1A) and 46(2). Fact that reconstitution may have occurred prior to 1 April 2020 does not dilute deemed taxability linked to the event of receipt. Also, s. 45(4) does not grandfather past reconstitution; unlike other amendments in Act. Also, s. 46(2) has been applied in respect of distributions by liquidator post 1 April1961, while earlier distributions were exempt.

As another view (which appears to be defensible), s. 45(4) should NOT be given a retroactive effect and is inapplicable to receipts post 1 April2020 where reconstitution happened before 1 April 2020. Reconstitution is defined as where a person "ceases" to be a partner of a firm - emphasis on 'ceases' supports that cessation needs to occur only after new provisions are introduced on statute – where cessation is before 1 April 2020, there is no 'reconstitution', and hence, s. 45(4) is inapplicable. Further, terms such as 'specified person' and 'specified entity' are coined by statute for the first time post 1 April 2020.It would be incorrect to attribute such terminologies to past transactions carried out when such concepts never existed on statute. Also, to attract charge u/s. 45(4), there has to be 'profits or gains' from receipt in hands of a partner is necessary. In the present case, the retiring partner's entitlement stood determined prior to 1 April 2020, receipt post 1 April 2020 does not yield any 'profits or gains' – rather, it is the realisation of pre-existing right or debt. In the commercial sense, no 'profits or gains' were made by the partner post 1 April 2020. To attract tax u/s. 45(4), receipt post 1 April 2020 should lead to income or enrichment of partner. Also, a specific provision along the lines of Explanation to s. 45(5) is needed to cover past reconstitutions into the ambit of s. 45(4). Also, a comparison with s. 46(2) under the alternative view is inappropriate since the liquidation of the company is a continuing event while retirement/ reconstitution is a snapshot event. Further, in liquidation, there is unlikely to be any prior debt realised by a shareholder from the company.

12. Impact of partner's capital account having a negative balance

The formula as prescribed u/s 45(4) of A=B+C-D, where D represents the balance in the capital account of the partner (represented in any manner). The issue is whether component D, being a negative figure, can be assumed as zero, or, should be considered as a negative figure to effectively increase CG?

Mumbai Tribunal (SB) decision of Summit Securities Ltd. [2012] 19taxmann.com 102 held that, though negative net worth of the undertaking, if 'deducted' as cost of acquisition in terms of s. 50B, effectively leads to an addition to the full value of sale consideration, the same needs consideration and cannot be assumed as nil. Considering the ratio of such a decision, it is possible to argue in the context of component D that negative capital balance may effectively lead to an increase in component A thus same needs to be considered.

In defence, an argument that tax payers may like to raise is that component D can only mean a positive figure since the language of s.45(4) defines component D as "balance in the capital account", and "balance" always refers to a positive figure and cannot envisage a negative figure. As a counter to such argument, the tax authority may suggest that as per the SC decision in the case of J. K. Industries vs. UOI [2007] 165 Taxman 323, words of accounting language used in a statute should be interpreted as understood in accounting practice – and hence, expression "balance" should be interpreted in an accounting sense, to mean either a positive figure (in case of credit balance) or a negative figure (in case of debit balance).

13. Impact of retirement at book value

Assume, the retiring partner's account is settled at book value which is equivalent to his capital balance, and such settlement is as per long-standing terms of the partnership deed.

Arguably, such a settlement may not have any adverse implications u/s. 45(4) as there is no excess over capital balance and such settlement merely reflects working out of pre-existing rights.

In a different scenario, assume, there is retirement where the partner retires by receiving only his capital balance and nothing in excess thereof – despite there being a higher entitlement basis partnership deed.

Arguably, actual receipt by a partner from the firm is relevant - s. 45(4) does not have any deeming fiction for taxation w. r. t. the fair value of partnership interest.

However, s. 56(2)(x) implications in hands of continuing partners (which are enriched on account of lower payment to retiring partner) may require evaluation.

Conclusion:

There can be ample conditions and situations based on which the computation mechanism can be affected. The new proposition has created ambiguity in many aspects if practically applied like constitutional validity, failure of computation mechanism, etc. thereby opening doors for litigation. Proper guidelines and amendment in current law is required to clear the ambiguity.

TAX ISSUES IN CASE OF PATNERSHIP FIRM / LLP

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Introduction

In India, the partnership firms are dealt with under the Partnership Act, 1932. Unlike the Companies Act, 2013 (or, its earlier versions) which has a specific provision declaring a company to be a separate legal person independent of its shareholders / members, there is no such provision in the Partnership Act to declare a partnership firm to be a separate legal entity or a juristic person.

It is also declared that persons who have entered into a partnership with one another are called **individually "partners"** and **collectively "a firm"** and the name under which their business is carried on is called the **"firm name".** A firm is conglomeration of its partners. Firm name is only a compendious name given to the partnership and the partners are the real owners of its assets. There is no legal provision to declare the partnership firm to be a separate legal entity apart from its partners.

However, for the purpose of the application of the provisions of the Income Tax Act, 1961, a firm and its partner must be treated differently as a partner of a firm may have income other than his share of profits from the firm.For the purposes of assessment to tax, the income of the partnership firm shall be assessed in the hands ofthe firm as a single unit, the firm itself being treated as an assessable entity separate and distinct from the partners constituting it. The firm is an assessable unit separate and distinct from the individual partners whoas individuals constitute assessable units separate and distinct from the firm.

The same is held by various Supreme Court decisions:

Tanna& Modi v. CIT, (2007) 7 SCC 434

DCIT v. K. Kelukutty(1985) 22 Taxman 25

N. Khadervali Saheb v. N. Gudu Sahib, (2003) 3 SCC 229

V. Subramaniam v. Rajesh Raghuvandra Rao, (2009) 5 SCC 608

In this article, I have tried to analyse the tax issues prevailing over Partnership firms / LLP.

❖ **Taxation of Partnership Firm/LLP**

The partnership firm is taxed as a separate entity, with no distinction as registered and unregistered firms whereas an LLP is mandatorily to be registered with Registrar of Companies to have a legal status in the eyes of law. In the eyes of Income Tax vide Sec 2(23), there is no distinction between a partnership firm and an LLP. In computing the total income of the firm, any salary, bonus, commission or remuneration, to a partner, shall be deductible subject to certain restrictions as provided under Sec 40(b) of the Income Tax Act, 1961.In general, partnership firms enjoy a single layer of taxation (@30% + SC + EC/SHEC or HEC), i.e., once a firm pays tax on its profits; distribution of such profits to Partners is exempt.

❖ **Computation of Book Profit**

As per Sec 40(b) of the Act, the book profits for the partnership firm is to be calculated as follows:

Book Profit = Net Profit as Per Profit & Loss A/c – b/f Depreciation + Remuneration to partners if debited + Interest in excess of 12% if debited

A. *What is included in the income? – Capital Gains, FD Interest, Sec 50 Income, Business Income not credited to P&L A/c*

The provisions of section 40focuses on the calculation of book profits to derive at an income chargeable under "Profits and Gains of Business or Profession". Hence income chargeable under the heads **other than** "Profits and Gains of Business or Profession" shall be excluded from the calculation of Book Profits.

Accordingly, Business Income not credited to P&L A/c shall be included in the Book Profits.

Capital gains arising from the sale of any asset by the partnership firm are taxable under section 112 or 112A, if it is short-term capital gain - tax rate as per normal tax slab, if it is long-term capital gain - tax rate is 20%, in case of sale of listed shares and mutual funds the tax rate for short-term gain is 15%, for long-term income is 10% over Rs. 1,00,000.

B. *Are brought forward losses and unabsorbed depreciation required to be reduced from the net profit?*

Unabsorbed loss including depreciation of the firm will not be apportioned amongst the partners and will be carried forward by the firm only. Hence, firm can carry forward the loss excluding the loss proportionate to the retiring partners as per the provisions of Sec 78 of the Act.

❖ **Remuneration to Partners**

The allowance of remuneration expenses is based on following conditions:

- It shall be given to Working Partner only
- It shall be authorised by the Partnership deed

No deduction u/s. 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration — *Circular No. 739 dt. 25-3-1996*

Remuneration to partners, even if authorised by the partnership deed but relating to prior period, shall not be allowed as a deduction. Hence, the deduction of remuneration to partners cannot be claimed with a retrospective date.

A. *Allowability of Remuneration in case of Cash System of Accounting*

As per Sec 145 of the Act, cash system of accounting is allowed to be opted by any person having Income under "Profits and Gains under Business or Profession" or "Income from Other Sources". Hence, the method of accounting followed by the assessee has no relevance while computing income charged to tax under the heads "Salaries", "House property" and "Capital gains". In this method of accounting, revenue and expenses are recorded at the time of its realisation and payment respectively. Accordingly, remuneration paid to partners shall be allowed as an expense in the year of actual payment.

B. *Excessive or Unreasonable remuneration - Sec 40(b)(v) v/s Sec 40A(2)*

Sec 40(b)(v) states conditions for the allowability of remuneration paid to partners being authorised by the partnership deed, paid to working partners and within the limits of the said provisions. If remuneration paid is within the ceiling limit provided under Section 40(b)(v), then provisions of Section 40A(2)(a) cannot be invoked. Section 40A has no application to the matters contained in Section 40(b) and the overriding effect given to Section 40A is only in respect of matters not covered by Section 40(b). The same was also held by High Court of Allahabad in the case of *CIT Vs. Great City Manufacturing Co.(2013) 351 ITR156*.

Applicability of Sec 40A(3) – Cash Payment in excess of Rs. 10,000

The provisions of the section states disallowance of the "expenditure" if the payment of the same is done in cash beyond the threshold limits prescribed. In normal parlance, the remuneration paid to the partners is an expenditure claimed by the partnership firm and hence provisions of Sec 40 are applicable. Accordingly, remuneration expense paid by way of cash shall be disallowed, if made in excess of Rs. 10,000, in a day.

A contrary view to be taken is that remuneration paid to partner is the share of profit of firm and it retains same character in hands of partner and therefore taxable in the books of firm. It is not in the nature of salary paid by the employer to an employee, deduction of which can be claimed as an expenditure by the employer.

Thus, remuneration paid to partner will not fall within the category of 'expenditure' as normally considered and accordingly even if paid in cash above the threshold under section 40A(3) of the Act, provided the conditions of section 40(b) of the Act are not applicable, shall be allowed as deduction while computing the income under the head 'Profits and gains of business or profession'. This is held by Supreme Court in case of *CIT vs. R.M. Chidambaram Pillai [1977] 106 ITR 292* and Mum. Tribunal in case of *Ratilal& Sons vs. ITO [2019] 105 taxmann.com 366* states

C. *Sec 28(v) w.r.t Sec 40(b)*

Sec 28(v) states income to be chargeable under Profits and Gains of Business or Profession only to the extent allowable u/s 40(b)(v). The remuneration allowable u/s 40(b)(v) shall only be taxed in the hands of the partner.

❖ **Interest to Partners**

The allowance of interest expenses is based on following conditions:

- It shall be authorised by the Partnership deed
- It shall be given at the rate of not exceeding 12%

A. *Charge of Interest on Partner's debit balance*

Interest on capital by the firm to its partner shall be authorised by the deed and hence if the deed specifies the clause to charge interest on the partner's debit balance of capital, then the same shall be credited to firm's account and borne by the partner.

B. ***Interest received in a representative or individual capacity***

A partner in a representative capacity is an individual who is a partner in a firm on behalf of, or for the benefit of, any other person.

E.g. A partner representing his HUF shall be called a partner in a representative capacity. The taxability of interest received by them shall depend on whether it is received in a representative capacity or their individual capacity. The tax positions are summarised as under:

<table>
<tr><td>Partner in a representative capacity</td><td>Interest received in an individual capacity</td><td rowspan="2">The limit of section 40(b) is not applicable, i.e. interest more than 12% is allowed, but it should be reasonable.</td></tr>
<tr><td>Partner in an individual capacity</td><td>Interest received in a representative capacity</td></tr>
</table>

❖ **Assessment of Firm – Sec 184 & Sec 185**

Prior to introduction of the provisions of Sec 184 which came into force w.e.f. 1.4.1993, a firm could be assessed either as a registered firm on complying with the formalities or otherwise only as AOP. However, w.e.f. AY 1993-94 onwards, the firm has to fulfil the conditions in order to get assessed as a firm:

The firm should have a partnership deed containing terms of partnership

Share of each partner shall be specified in the deed

Certified copy of the deed should be attached with the first return of income of firm

Other cases where certified copy of deed is required

If the partnership firm has not complied with the requirements of forming a partnership deed and specifying the relevant clauses of share of partners, then deduction u/s 40(b) shall not be allowed to the firm on its assessment and the same not be chargeable to tax u/s 28(v).

The said provisions seems not be applicable to the LLP since an LLP shall not be incorporated without a registered instrument and hence the LLP shall be deemed to be assessed as firm as per Sec 184.

❖ **Set off of losses of the firm**

A. ***Sec 78(1) - Reduction of brought forwarded losses to the extent retiring/deceased partners***

The change due to retirement or demise of a partner will affect the carry forward loss of the firm since the loss to the extent of the retired or deceased partner has to be reduced for carrying forward to the subsequent year.

Eg. A partnership firm, having 3 partners in equal profit-sharing ratio, earns a profit of Rs. 3,30,000/- in FY 2021-22. It has C/F loss of Rs. 3,00,000/- (PSR =1:1:1), one of them retired in the current year on 31/12/2021, his share of profit for the current year becomes Rs. 82,500/-. Now, loss of the retired partner can't be carried forward but can the excess loss of retired partner of Rs. 17,500/- (1,00,000 – 82,500) be set off against profit of other remaining partners in the current year??

Opinion

Where a change in constitution of firm takes place on account of retirement of partner or death of the partner then, the firm shall not carry forward and set off the following brought forward losses:

Share of the retired/ deceased partner in the brought forward losses of the firm	XXX
Less: Share of the retired/ deceased partner in the current year profit	(XX)

Accordingly, the share loss of the retired partner comes to Rs. 1,00,000/- of which only Rs. 82,500/- will be allowed to be set off and remaining loss of Rs. 17,500 will go lapse.

The provisions of section deal with Change in constitution due to retirement or death of partner. <u>Change in constitution due to admission of partner or change in PSR are not covered by Sec 78.</u>

B. *Applicability of Sec 78(1) to unabsorbed depreciation*

Provisions of Sec 78(1) deals with the unabsorbed business losses. The same excludes unabsorbed depreciation from its purview and hence carry forward of unabsorbed depreciation is allowed even in case of retirement or death of a partner.

C. *Carry forward of Loss of firm on succession – Sec 78(2)*

Where any person carrying on any business or profession has been succeeded in such capacity by:

- Any person other than by way of inheritance – loss of predecessor cannot be carried forward
- Any person by way of Inheritance - loss of predecessor can be carried forward

Eg. Mr. M, sole proprietor carrying on the business of garments earned losses in FY 21-22. On his death, his legal heirs viz. wife, son and daughter started a partnership carrying on the same business of the deceased person under the same trade name.

Can the loss of the Mr. M be carried forward by the partnership firm?

Opinion

The nature of business carried on by the partnership firm was same as that of the deceased person under the same trade name. The constituents of the assessee's business were the same as those of the business of the deceased. The intention of the partners / legal heirs of the deceased person were to continue and carry on the business. Hence, succession by way of inheritance within the meaning of Sec 78(2) was occurred. Therefore, the loss incurred by Mr. M before his death shall be carried forward by the partnership firm held by his legal heirs.

** <u>Where there are only two partners, dissolution of Firm by death of one partner, cannot involve succession by inheritance.</u>

❖ **<u>Presumptive Income</u>**

As per Income tax Act, a firm includes LLP whereas as per explanation to Sec 44AD, defines eligible assessee as an individual, Hindu undivided family or a firm who is a resident <u>but not a limited liability partnership firm.</u>

A. ***Deduction of Interest & Remuneration***

Resident Partnership Firms are eligible to opt for presumptive taxation u/s 44AD or 44ADA or 44AE. Sec 44AD and 44AE were amended in 1997 w.e.f 01/04/1994 to allow remuneration and interest to partners (subject to conditions and limits specified in section 40(b)) after determination of profits as per sec 44AD or 44AE. However, by Finance Act, 2016, second proviso to Section 44AD(2) has been omitted which provided for deduction under section 40(b) with regard to the salary and interest to partners. However, sec 44AE has not been amended.

Hence, remuneration and interest to partners will not be allowed in sec 44AD and 44ADA.

B. ***Issue of disallowance u/s 40***

Section 40 is clothed in a negative language and it says that certain amounts shall not be deducted while computing income under thehead "Profits & Gains of Business or Profession". Whereas section 44AD begins with— Not with standing anything to the contrary contained in sec 28 to 43C. On analysis ofboth the sections, the amplitude of non-obstante clause of section 44AD is higher than the non-obstante clause of section 40. Section 40 relates to disallowance of certain expenses due to non-deduction of TDS or non-deduction/non-payment of equalisation levy, remuneration/interest by firm to partners in excess of allowed etc.

Therefore, these expenses would not be disallowed even if TDS has not been deducted. However, the assessee may be deemed as assessee in default as persection 201 as sec 44AD override provisions of section 28 to 43C but not the provisions of TDS.

C. ***Applicability of Section 44ADA to a partner of firm receiving remuneration and/or interest from the firm***

The eligible remuneration is deductible in the hands of firm and taxable in hands of partners, the remainder (profit) is taxable in hands of the firm and exempted in the hands of partners u/s 10(2A). Hence, in the hands of the partner, the following will be the impact:

1. Remuneration which was allowed as deduction in firm will be taxable
2. Profit which was taxed in the hands of the firm will be exempt.

I am of the opinion that the provisions of Section 44ADA is applicable either for an individual or partner in a professional firm. This is also supported by certain judicial pronouncements (though not directly on the said issue) in the case of *Sagar Dutta vs DCIT (ITAT Kolkata)* and *Usha A Narayanan vs DCIT (ITAT Kolkata).* The following is evident from the above judgments:

In both the judgments,

1. The tax payers were chartered accountants in partner capacity in a firm and contended they were not carrying any profession in individual capacity but they were acting as partner and hence tax audit requirements do not attract.
2. Both of them have received remuneration, salary, interest on capital and others more than the threshold limit specified under Section 44AB.
3. The department is of the view that since the gross receipts (remuneration, salary, interest on capital and others) were in excess of threshold limits specified under Section 44AB, the tax payers would have got their books of accounts and audited.

Based on the above judgements, the salary, remuneration, profit, interest on capital and others received by partner from a partnership firm are treated as gross receipts falling under the ambit of Sec 44AB and hence, the benefit of 50% of gross receipts offering to income tax is possible.

D. Set off of Brought Forward Loss against Presumptive Income

The income calculated under Presumptive Scheme shall be aggregated with income from any other business under the provisions of the Income-tax Act. Hence, the brought forward business losses shall be set off against the Presumptive Income.

❖ **Corporatisation & Part IX Conversion**

A. Succession of firm by company – Section 47 (xiii)

Conversion of a Firm to a Company shall not be regarded as a transfer, if all the conditions u/s 47(xiii) are complied with. The provisions of section states capital gains on transfer of capital asset on violation of any of the conditions given. What if there are no capital assets in the firm?

In absence of any capital assets in the firm, the conversion into a Company shall not be bound to the conditions prevailed in sec 47(xiii) of the Act.

At the outset, the High Court of Bombay in the case of *CIT v. Texspin Engg. & Mfg. Works [2003] 129 Taxman 1 (Bombay)* in context of conversion of a firm into a company held that transfer of assets, etc. was pursuance to the statutory vesting under the Companies Act, 1956 and that same did not tantamount to transfer under the IT Act. Further, while coming to the said conclusion, the High Court stated that for a transfer to take place there shall be a transfer or as well as a transferee, both existing at the same point in time simultaneously.

However, in the case of conversion, the transferor and the transferee do not exist together and at the same point in time. It is a case of conversion of the transferor into transferee. In other words, only when the transferor ceases to exist that the transferee comes into existence. Thus, the fundamental test of having the transferor and transferee for the purposes of transfer is not achieved under the conversion framework. Thus, it was held that the statutory vesting of assets on conversion was not to be regarded as transfer and consequently no capital gain arose on such conversion.

Note: Views expressed in this article can be subjective and that of the readers on the same topic may differ.

CASE STUDIES ON RECONSTITUTION/ DISSOLUTION OF PARTNERSHIP FIRMS – SECTION 9B, 45(4) AND 48(III) OF THE INCOME-TAX ACT, 1961

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Introduction

The Finance Act, 2021 (FA 2021) has overhauled the tax implications in the hands of firm/ Association of Persons(AOP)/ Body of Individuals (BOI) (specified entity) where a partner/ member (specified person) receives cash or property on dissolution or reconstitution of the specified entity. The amendments by way of introduction of section 9B and section 48(iii) to the Income-tax Act, 1961 (Act) and substitution of section 45(4) of the Act have come into effect from 1 April 2021 viz. Assessment Year (AY) 2021-22.

The said provisions introduced by the FA 2021 have been well-explained at length in the previous articles of this publication. The same have been briefly summarised hereunder for the benefit of readers before we delve into the case studies:

- **Section 9B** of the Act provides that where a 'specified person' (partner of firm/ member of AOP/ BOI) receives any <u>capital asset or stock-in-trade or both</u> from a specified entity in connection with the <u>dissolution or reconstitution</u>(as defined) of such specified entity, it shall be considered as a deemed transfer of such capital asset or stock-in-trade by the specified entity. Any profits and gains arising from such deemed transfer of capital asset or stock-in-trade shall be chargeable to tax as income of the specified entity under the head 'profits and gains of business and profession' or 'capital gains', as the case may be, in the year in which such capital asset or stock-in-trade were received by the specified person. Tax is triggered in the year of receipt of capital asset/ stock-in-trade by the specified person and not in the year of transfer by the specified entity.

  The fair market value of such capital asset or stock-in-trade as on the date of its receipt by the specified person shall be deemed to be the full value of the consideration received or accruing as a result of such deemed transfer by the specified entity.

- **Section 45(4)** of the Act provides that notwithstanding anything contained in section 45(1) of the Act, where a specified person receives any <u>money or capital asset or both</u> from a specified entity in connection with <u>reconstitution</u> (as defined) of such specified entity, then any profits and gains (as computed in the specified manner) arising from such receipt by the specified person shall be chargeable to tax as income of the specified entity under the head 'capital gains'. Such income shall be deemed to be the income of the previous year in which such money or capital asset or both were received by the specified person.

  Where a capital asset is received by the specified person from the specified entity in connection with reconstitution of the specified entity, the provisions of section 45(4) shall operate in addition to the provisions of section 9B and the taxation under the said provisions shall be worked out independently.

  With respect to capital gains chargeable to tax under section 45(4) of the Act, **Rule 8AA(5)**of the Income-tax Rules, 1962 (Rules) provides that the capital gains taxable under section 45(4) of the Act shall be deemed to be from transfer of short-term capital asset if it is attributed to:

- o Capital asset which is short term capital asset at the time of taxation under section 45(4)
- o Capital asset forming part of block of assets
- o Self-generated asset or self-generated goodwill

and shall be deemed to be from transfer of long-term capital asset if it is attributed to capital asset (other than those covered above) which is long term capital asset at the time of taxation under section 45(4) of the Act.

- As per the provisions of **section 48(iii) of the Act read with Rule 8AB**, the amount chargeable to tax under section 45(4) of the Act (which represents specified person's share in value appreciation of the remaining capital assets of the specified entity) shall be attributed to remaining capital assets of the specified entity (as per Rule 8AB) and the same shall be deducted from the full value of the consideration as and when such remaining capital assets are transferred by the specified entity in future. This is intended to avoid double taxation of the income.

  By virtue of the guidelines issued by the Central Board of Direct Taxes (CBDT) in **Circular No. 14/ 2021 dated 2 July 2021**(CBDT Guidelines), the aforesaid principle of attribution contained in section 48(iii) is equally made applicable to the capital assets forming part of the block of assets and hence, amount so attributed shall be reduced from the moneys payable or sales consideration, as the case may be, for the purposes of section 43(6)(c) or section 50 of the Act. However, the actual cost of the capital asset remains intact and thus, no depreciation or indexation benefit is available on the amount so attributed.

  For the purposes of the present article, I have assumed that some of the fundamental issues/ controversies such as (a) applicability of the above amendments introduced by FA 2021 in a scenario where dissolution/ reconstitution has taken place prior to 1 April 2020 and date of receipt by specified person is on or after 1 April 2020, (b) constitutional validity of the amendments, (c) where money/ property is received from the specified entity by legal heirs of deceased specified person in connection with dissolution/ reconstitution of the firm, (d) where money/ property is received in instalments by the specified person, strictly, not from the specified entity (say, post dissolution of specified entity, specified entity is converted into company, by continuing partners) etc. would have been dealt in the respective previous articles in this publication. Case studies on practical application of these amendments have been discussed hereunder.

Case study 1: Distribution of capital asset on dissolution of firm

Facts

- A partnership firm, AB & Associates, consists of two partners, A and B, having equal share in profits and capital.

  Indicative balance sheet of the firm is as under:

Liabilities	INR	Assets	INR
Partner's Capital		Land (FMV = 10 lakh)	2,00,000
A	1,00,000		
B	1,00,000		
Total	**2,00,000**	**Total**	**2,00,000**

- Land is held as a long-term capital asset
- The firm is to be dissolved and on dissolution, land is distributed equally amongst the partners
- Fair market value (FMV) of the land as on the date of distribution to partners is INR 10 lakh
- Indexed cost of acquisition assumed to be INR 3 lakh

Tax implications

- Distribution of land to the partners on dissolution of the firm shall be deemed to be a transfer of capital asset by the firm and taxable in the hands of firm under section 9B of the Act as under:

Full value of consideration as per section 9B(3) of the Act (FMV of land as on the date of receipt)	10,00,000
Less: Indexed cost of acquisition	(3,00,000)
Long-term capital gains in the hands of firm as per section 9B of the Act	7,00,000

- Section 45(4) of the Act has no applicability in the given case since capital asset is received by the partner on dissolution of the firm.

Case study 2: Distribution of stock-in-trade on retirement of partner from firm

Facts

- A partnership firm, ABC & Associates, consists of three partners, A, B and C, having equal share in profits and capital.
- Indicative balance sheet of the firm is as under:

Liabilities	INR	Assets	INR
Partner's Capital		Land (FMV = 12 lakh)	3,00,000
A	1,00,000		
B	1,00,000		
C	1,00,000		
Total	**3,00,000**	**Total**	**3,00,000**

- Land is held as stock-in-trade by the firm
- Mr. C retires from the firm and his account is to be settled by distribution of 1/3rd of the land held as stock-in-trade
- FMV of the land as on the date of retirement is INR 12 lakh

Tax implications

- Receipt of land by Mr. C on his retirement shall be deemed to be a transfer of stock-in-trade by the firm and taxable in the hands of firm under section 9B of the Act as under:

Full value of consideration as per section 9B(3) of the Act (FMV of one-third share of the land as on the date of receipt)	4,00,000
Less: Cost of acquisition	(1,00,000)
Profits and gains from business and profession in the hands of firm as per section 9B of the Act	3,00,000

- Section 45(4) of the Act has no applicability in the given case since stock-in-trade is received by the partner on retirement from the firm.

Case study 3: Settlement in cash on retirement of partner from firm

Facts

- A partnership firm, ABC & Associates, consists of three partners, A, B and C, having equal share in profits and capital.
- Indicative balance sheet of the firm is as under:

Liabilities	INR	Assets	INR
Partner's Capital		Land (FMV = 12lakh)	3,00,000
A	1,00,000		
B	1,00,000		
C	1,00,000		
Total	**3,00,000**	**Total**	**3,00,000**

- Land is held as a long-term capital asset by the firm. Indexed cost assumed to be same as the cost of acquisition.
- FMV of the land as on the date of retirement is INR 12 lakh
- Mr. C retires from the firm and his account is settled by paying him cash of INR 4 lakh.

Tax implications

Receipt of money by Mr. C on his retirement from the firm shall be chargeable to tax as income of the firm under the head 'capital gains' under section 45(4) of the Act.

- Such capital gains shall be computed as under in accordance with the provisions of section 45(4) of the Act:

Money received by Mr. C (B)	4,00,000
FMV of capital asset received by Mr. C (C)	NA
Balance in the capital account of Mr. C at the time of retirement(D)	(1,00,000)
Capital gains in the hands of firm under section 45(4) of the Act (A = / B + C – D)	3,00,000

- Section 9B of the Act has no applicability in the given case since only <u>cash is received</u> by the partner on retirement from the firm.
- Capital gains taxable under section 45(4) of the Act amounting to INR 3 lakh is attributable to the revaluation of land. As per the provisions of section 48(iii) read with Rule 8AB(2) of the Rules, INR 3 lakh shall be reduced from the sale consideration on transfer of land in future by the firm.
- For instance, if firm sells land for INR 15 lakh in future and the cost of acquisition is INR 3 lakh, INR 3 lakh attributable under section 48(iii) of the Act shall be reduced from the sales consideration and net capital gains will be computed as INR 9 lakh [15L (sales consideration) – 3L (cost) – 3L (attribution as per section 48(iii) of the Act)].
- As per the Explanation 1 to Rule 8AB, for the purposes of attribution of capital gains taxed under section 45(4) of the Act, the revaluation should be based on a valuation report obtained from a registered valuer.

Case Study 4: Distribution of capital asset on retirement of partner from firm

<u>Facts</u>

- A partnership firm, ABC & Associates, consists of three partners, A, B and C, having equal share in profits and capital.
- Indicative balance sheet of the firm is as under:

Liabilities	INR	Assets	INR
Partner's Capital		Land (FMV = 12lakh)	3,00,000
A	1,00,000		
B	1,00,000		
C	1,00,000		
Total	**3,00,000**	**Total**	**3,00,000**

- Land is held as a long-term capital asset by the firm. Indexed cost is assumed same as the cost of acquisition.
- FMV of the land as on the date of retirement is INR 12 lakh
- Mr. C retires from the firm and his account is settled by distribution of one-third portion of the land valuing INR 4 lakh (comprising of capital balance of 1 lakh and 1/3rd share in value appreciation of land (of 9 lakh) amounting to 3 lakh).

Tax implications

- Distribution of one-third land to Mr. C on his retirement from the firm shall be deemed to be a transfer of capital asset by the firm and taxable in the hands of firm under section 9B of the Act as under:

Full value of consideration as per section 9B(3) of the Act (FMV of land as on the date of receipt)	4,00,000
Less: Indexed cost of acquisition	(1,00,000)
Long-term capital gains in the hands of firm as per section 9B of the Act	3,00,000

- Distribution of one-third land to Mr. C on his retirement from the firm shall also be chargeable to tax as income of the firm under the head 'capital gains' under section 45(4) of the Act. Such capital gains shall be computed as under in accordance with the provisions of section 45(4) of the Act:

Money received by Mr. C (B)	NA
FMV of capital asset received by Mr. C (C)	4,00,000
Balance in the capital account of Mr. C at the time of retirement (Original balance in capital account of Mr. C of 1 lakh + 1/3rd share in value appreciation of land distributed to Mr. C amounting to 1 lakh (1/3 * 3L) (D)	(2,00,000)
Capital gains in the hands of firm under section 45(4) of the Act (A = B + C – D)	2,00,000

- As per the CBDT Guidelines, value appreciation (net of tax) in the capital asset transferred to the retiring partner is to be credited to the capital account of each of the partners, including the retiring partner and such revised capital account balance is to be considered for the purposes of computing capital gains under section 45(4) of the Act. Accordingly, Mr. C's share in the appreciation of land value allotted to him (viz. 3L * 1/3) is added to his capital account balance.
- Capital gains taxable under section 45(4) of the Act amounting to INR 2 lakh shall be attributable to the remaining assets of the firm i.e. balance 2/3rd portion of land remaining with the firm. As per the provisions of section 48(iii) read with Rule 8AB(2) of the Rules, INR 2 lakh shall be reduced from the sale consideration on transfer of balance land in future by the firm.
- For instance, if firm sells land for INR 10 lakh in future and the cost of acquisition is INR 2 lakh (ignoring indexation), INR 2 lakh attributable under section 48(iii) of the Act shall be reduced from the sales consideration and net capital gains will be computed as INR 6 lakh [10L (sales consideration) – 2L (cost) – 2L (attribution as per section 48(iii) of the Act)].

- As per the Explanation 1 to Rule 8AB, for the purposes of attribution of capital gains taxed under section 45(4) of the Act, the revaluation should be based on a valuation report obtained from a registered valuer.

Case Study 5: Settlement in cash on retirement of partner from firm and attribution of capital gains as per section 48(iii) of the Act

Facts

- A partnership firm, ABC & Associates, consists of three partners, A, B and C, having equal share in profits and capital.
- Indicative balance sheet of the firm is as under:

Liabilities	INR	Assets	INR
Partner's Capital		Land (FMV = 12lakh)	3,00,000
A	1,00,000	Goodwill (FMV = 6lakh)	
B	1,00,000		
C	1,00,000		
Total	**3,00,000**	**Total**	**3,00,000**

- Land is held as a long-term capital asset by the firm. Indexed cost is assumed same as the cost of acquisition
- FMV of the land as on the date of retirement is INR 12 lakh
- Firm also has self-generated goodwill worth INR 6 lakh
- Mr. C retires from the firm and his account is settled in cash after taking into account FMV of land and self-generated goodwill. Thus, as against his capital balance of 1 lakh, he is paid INR 6 lakh (comprising of capital balance of 1 lakh + 1/3rd share in value appreciation of land and self-generated goodwill (9 lakh + 6 lakh) amounting to 5 lakh).

Tax implications

- Section 9B of the Act has no applicability in the given case since only cash is received by the partner on retirement from the firm.

  Distribution of cash to Mr. C (in excess of his capital balance) on his retirement from the firm shall be chargeable to tax as income of the firm under the head 'capital gains' under section 45(4) of the Act. Such capital gains shall be computed as under in accordance with the provisions of section 45(4) of the Act:

Money received by Mr. C (B)	6,00,000
FMV of capital asset received by Mr. C (C)	-
Balance in the capital account of Mr. C at the time of retirement (D)	(1,00,000)
Capital gains in the hands of firm under section 45(4) of the Act (A = B + C – D)	5,00,000

- Capital gains taxable under section 45(4) of the Act amounting to INR 5 lakh shall be attributable to the remaining assets of the firm i.e. land and self-generated goodwill and shall be reduced from the sale consideration on future transfer of such remaining assets of the firm.
- As per the provisions of section 48(iii) of the Act read with Rule 8AB(2) and Rule 8AA(5)of the Rules, the tax implications shall be as under:

Where capital gains under section 45(4) relates to	Basis of attribution as per Rule 8AB	Calculation	Nature of capital gains	Capital gains on future transfer[1]
Revaluation of land	Capital gains u/s 45(4) * A / C	5L * 9L / 15L = 3L	Long-term capital gains	6L (12L – 3L – 3L)
Valuation of self-generated goodwill	Capital gains u/s 45(4) * B / C	5L * 6L / 15L = 2L	Short-term capital gains	4L (6L – 2L).

A = Revaluation of land

B = Valuation of self-generated goodwill

C = Increase in value of all assets because of revaluation or valuation

- As per the Explanation 1 to Rule 8AB, for the purposes of attribution of capital gains taxed under section 45(4) of the Act, the revaluation should be based on a valuation report obtained from a registered valuer.

Case Study 6: Distribution of capital asset on retirement of partner from firm and attribution of capital gains as per section 48(iii) of the Act

Facts

- A partnership firm, ABC & Associates, consists of three partners, A, B and C, having equal share in profits and capital.
- Indicative balance sheet of the firm is as under:

[1] *Assuming the same is transferred at the revalued amount*

Liabilities	INR	Assets	INR
Partner's Capital		Land (FMV = 18lakh)	6,00,000
A	5,00,000	Depreciable assets	9,00,000
B	5,00,000	Goodwill (FMV = 3lakh)	
C	5,00,000		
Total	**15,00,000**	**Total**	**15,00,000**

- Land is held as a long-term capital asset by the firm. Indexed cost is assumed same as the cost of acquisition
- FMV of the land as on the date of retirement is INR 18 lakh
- Firm also has self-generated goodwill worth INR 3 lakh and depreciable assets worth INR 9 lakh
- Mr. C retires from the firm and his account is settled by giving him one-third portion of the land (valuing to INR 6 lakh) and cash of INR 4 lakh. Thus, as against his capital balance of INR 5 lakh, he is paid INR 10 lakh (comprising of capital balance of 5 lakh + 1/3rd share in value appreciation of land and self-generated goodwill (12 lakh + 3 lakh) amounting to 5 lakh).

Tax implications

- Distribution of one-third land to Mr. C on his retirement from the firm shall be deemed to be a transfer of capital asset by the firm and taxable in the hands of firm under section 9B of the Act as under:

Full value of consideration as per section 9B(3) of the Act (FMV of land as on the date of receipt)	6,00,000
Less: Indexed cost of acquisition	(2,00,000)
Long-term capital gains in the hands of firm as per section 9B of the Act	4,00,000

- Long term capital gains tax rate is assumed to be 25%. Accordingly, profit after tax on deemed transfer of land amounts to INR 3 lakh (4 lakh – 25% tax on it) which is credited to each partner's capital account in equal ratio.
- Thus, as per the CBDT Guidelines, revised capital account balance of Mr. C amounts to INR 6 lakh (original balance of 5L + share in profit after tax pertaining to appreciation in value of land allotted to Mr. C) for the purposes of computing capital gains under section 45(4) of the Act.
- Distribution of cash and land to Mr. C (in excess of his capital balance) on his retirement from the firm also shall be chargeable to tax as income of the firm under the head 'capital gains' under section 45(4) of the Act. Such capital gains shall be computed as under in accordance with the provisions of section 45(4) of the Act:

Money received by Mr. C (B)	4,00,000
FMV of capital asset received by Mr. C (C)	6,00,000
Balance in the capital account of Mr. C at the time of retirement (D)	(6,00,000)
Capital gains in the hands of firm under section 45(4) of the Act (A = B + C – D)	4,00,000

- Capital gains taxable under section 45(4) of the Act amounting to INR 4 lakh shall be attributable to the remaining assets of the firm and shall be reduced from the sale consideration on future transfer of such remaining assets of the firm.
- As per the provisions of section 48(iii) of the Act read with Rule 8AB(2) and Rule 8AA(5)of the Rules, the tax implications shall be as under:

Where capital gains under section 45(4) relates to	Basis of attribution as per Rule 8AB	Calculation	Nature of capital gains	Capital gains on future transfer[2]
Revaluation of land	Capital gains u/s 45(4) * A / C	4L * 12L / 15L = 3.2L	Long-term capital gains	4.8L (12L – 4L – 3.2L)
Valuation of self-generated goodwill	Capital gains u/s 45(4) * B / C	4L * 3L / 15L = 0.8L	Short-term capital gains	2.2L (3L – 0.8L).

A = Revaluation of land

B = Valuation of self-generated goodwill

C = Increase in value of all assets because of revaluation or valuation

- As per the CBDT Guidelines, capital gains chargeable to tax under section 45(4) of the Act can also be attributed to depreciable assets and can be reduced from the moneys payable/ sales consideration for the purposes of section 43(6)(c) and section 50 of the Act. However, in the present case, there is no revaluation in depreciable assets and accordingly, no amount of capital gains under section 45(4) is attributed to such depreciable assets.
- As per the Explanation 1 to Rule 8AB, for the purposes of attribution of capital gains taxed under section 45(4) of the Act, the revaluation should be based on a valuation report obtained from a registered valuer.

Case Study 7: Distribution of capital asset on retirement of partner from firm and attribution of capital gains as per section 48(iii) of the Act

Facts

- A partnership firm, ABC & Associates, consists of three partners, A, B and C, having profit sharing ratio and capital as under:

[2] *Assuming the same is transferred at the revalued amount*

Partners	Profit sharing ratio	INR
A	25%	5,00,000
B	25%	5,00,000
C	50%	10,00,000
Total	**100%**	**20,00,000**

- Mr. C retires from the firm and his account is settled by giving him self-generated patent (worth INR 60 lakh) and cash of INR 15 lakh.
- On retirement, all the assets of the firm including stock-in-trade are revalued at FMV and taken into account for settlement purposes.
- The details of the assets of the firm and revaluation as on the date of retirement are given as under:

Assets	Book	FMV	Appreciation in value
Depreciable assets	10,00,000	25,00,000	15,00,000
Self-generated patent	-	60,00,000	60,00,000
Land	30,00,000	75,00,000	45,00,000
Stock-in-trade	20,00,000	30,00,000	10,00,000

- Land and patent are held as long-term capital asset by the firm. Indexed cost is assumed same as the cost of acquisition.

Tax implications

- Distribution of self-generated patent to Mr. C on his retirement from the firm shall be deemed to be a transfer of capital asset by the firm and taxable in the hands of firm under section 9B of the Act as under:

Full value of consideration as per section 9B(3) of the Act (FMV of patent as on the date of receipt)	60,00,000
Less: Indexed cost of acquisition	-
Long-term capital gains in the hands of firm as per section 9B of the Act	60,00,000

- Long term capital gains tax rate is assumed to be 20%. Accordingly, profit after tax on transfer of self-generated patent by firm amounts to INR 48 lakh (60 lakh – 20% tax on it) which is credited to each partner's capital account in their profit-sharing ratio.
- Thus, as per the CBDT Guidelines, revised capital account balance of Mr. C amounts to INR 34 lakh (original balance of 10L + share in profit after tax (50% * 48L) pertaining to appreciation in value of patent allotted to Mr. C) for the purposes of computing capital gains under section 45(4) of the Act.

- Distribution of cash and patent to Mr. C (in excess of his capital balance) on his retirement from the firm shall be chargeable to tax as income of the firm under the head 'capital gains' under section 45(4) of the Act. Such capital gains shall be computed as under in accordance with the provisions of section 45(4) of the Act:

Money received by Mr. C (B)	15,00,000
FMV of capital asset received by Mr. C (C)	60,00,000
Balance in the capital account of Mr. C at the time of retirement (D)	(34,00,000)
Capital gains in the hands of firm under section 45(4) of the Act (A = B + C – D)	41,00,000

- Capital gains taxable under section 45(4) of the Act amounting to INR 41 lakh shall be attributable to the remaining capital assets of the firm and shall be reduced from the sale consideration on future transfer of such remaining assets of the firm.

- As per the provisions of section 48(iii) of the Act read with Rule 8AB(2) and Rule 8AA(5)of the Rules, the tax implications shall be as under:

Where capital gains under section 45(4) relates to	Basis of attribution as per Rule 8AB	Calculation	Nature of capital gains	Capital gains on future transfer[3]
Revaluation of depreciable assets	Capital gains u/s 45(4) * A / D	41L * 15L / 120L = 5.12L	Short-term capital gains	9.88L (25L – 10L – 5.12L)
Valuation of self-generated patent	Capital gains u/s 45(4) * B / D	41L * 60L / 120L = 20.5L	Short-term capital gains	NA
Revaluation of land	Capital gains u/s 45(4) * C / D	41L * 45L / 120L = 15.38L	Long-term capital gains	29.62L (75L – 30L – 15.38L)

A = Revaluation of depreciable assets

B = Valuation of self-generated patent

C = Revaluation of land

D = Increase in value of all assets because of revaluation or valuation

- As per the CBDT Guidelines, capital gains chargeable to tax under section 45(4) of the Act is to be also attributed to depreciable assets and reduced from the moneys payable/ sales consideration for the purposes of section 43(6)(c) and section 50 of the Act.

- Since patent is allotted to the retiring partner, there is no question of attribution of capital gains chargeable to tax under section 45(4) for the purposes of section 48(iii) of the Act read with Rule 8AB.

[3] *Assuming the same is transferred at the revalued amount*

- As per the Explanation 1 to Rule 8AB, for the purposes of attribution of capital gains taxed under section 45(4) of the Act, the revaluation should be based on a valuation report obtained from a registered valuer.

The revaluation of stock-in-trade is not considered for the purposes of attribution of capital gains chargeable to tax under section 45(4) of the Act.

Conclusion:

Without an iota of doubt, the taxation of specified entities on their dissolution/ reconstitution has become more complex and controversial. For instance, partner's capital balance (fixed + current) could be built-up over various years and could comprise of various adjustments such share in profits, withdrawal from firm, share in revaluation of assets etc. and to determine partner's capital balance without taking into account revaluation of assets/ self-generated goodwill for the purposes of section 45(4) of the Act would be a challenging task. Further, where there is revaluation/ devaluation of various assets including stock-in-trade, attribution of capital gains taxable under section 45(4) of the Act for the purposes of section 48(iii) of the Act could also become tricky.

Accordingly, it is better to have clear commercial understanding between the firm and the partners on tax implications arising on dissolution/ reconstitution of the firm as also maintain proper documentation to substantiate the tax position adopted by the firm.

"DREAMZZ UNLIMITED": STORIES THAT INSPIRE

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Firstly, I would like to sincerely thank CVOCA for giving me this tremendous opportunity to share my journey so far. It's a privilege for me to go back in time and experience the important life events and fruitful lessons learnt which in turn has helped me re-live my olden days. These moments of life in flashback till present day is making me feel nostalgic about the how far I have reached and will even give me more clear insights on the road ahead to future. Let's rewind a bit and take you through my life in a movie called "Lakshaya" solely written, directed and produced by me but sportingly acted and promoted by my crew members. Let's start the movie from beginning and take you thru my experiences.

Flashback: 30 sal pehle from where it all began!

I have always grown up admiring my dad and I vaguely remember somewhere when I was in my 8thgrade, he used to consult our CA for many things which involved investments, returns, etc and somehow, I gave a thought that a Chartered Accountant has all the knowledge and can address to any financial requirements. My inquisitive mind pushed me to visit a CA every time my dad went to meet him. By the time I reached my 10th boards, I was very sure that I want to get into the commerce stream and pursue CA and as time passed by, I started noticing my inclination and interest growing towards numbers. Maybe playing with numbers runs in my DNA hence I listened to my inner voice and opted to pursue CA.

I can't thank my parents enough who have raised me, showed me the right path, corrected me when I was wrong and supported me in whatever I wanted to do. They have paved my way to self-learning by teaching me to do things on my own starting with something as simple as tying shoelaces to achieving bigger educational and career goals. Everything I am is because of them and I heart fully thank them for being my daily inspiration. However, despite being always surrounded by people in the medical field, there was much pressure on me from the society to pursue medicine, I still choose to opt for commerce stream moving towards achieving my dream of being a CA.

My entry into commerce was not that great, from being a school topper in maths to just passing marks in my junior college exams, totally broke me down in standard 11th.

Main Story: Some months later, started my CA Journey!

Unfortunately, the series of poor performance continued till F.Y.B.Com and CA Foundation (which I failed to clear). This was probably the lowest stage of my educational journey. It was an eye opener and a turning point for me. Hence in S.Y.B.Com, I gathered myself-up, reignited faith in my abilities and started studying from the basics. While studying all the subjects from 11th standard onwards, I focused towards Accounts and Economics. This in turn helped me gain confidence and ace these subjects. Surprisingly even my parents were totally amazed seeing my exponential progress and performance. This made me bounce back with extreme dedication, commitment and planning.

Few Stunts: Stints and achievements in my professional journey!

Everyone agrees with the fact that, as an art to perform, stunts goes hand in hand with many risks, but in order to accomplish this act, one must dare to take risks. Same is with life, in order to execute and grow, one must have the ability and willingness to take risks. So let me put some light on the few stints / stunts that I performed during my journey:

- I joined back CA course in June 2000. In the first year of my articleship I was lucky enough as the other two existing articles who were working at the same firm as me were on study leave. Fortunately, I was lone article trainee for the entire filing season and this gave me immense practical experience and exposure. The workload that normally every article gets in their third year; I was lucky enough to get the same in my first year of my articleship. And I am really thankful to my then boss CA Hemraj Chheda for the same.
- Finally, I cleared CA final in Nov 2003 attempt, this was achieved by very hard work & dedication towards my goal.
- With a good study plan, progressive mindset and faith in myself, I successfully passed my CA inter in first attempt and CA final in second attempt.
- My first job as a CA was with a CA firm in Khar. I remember this was the first year of E-TDS returns and we struggled at the time of filing. However, since I had penchant for technology, helped me to guide the firm in filing returns. My boss was extremely delighted and satisfied with my performance and within a short stint of 2 months, I was then shifted to another firm called Gala Haria & Associates. Here I was working as the Audit-Manager, this gave me hands on experience in handling team and getting the work done.
- Post this, I joined Shah Group Builders Limited located in Vashi as a Manager-Accounts & Finance. Here I got immense experience in setting systems, taxation and raising finance, as I was heading entire accounts and finance team there and was reporting directly to directors
- In August 2007, I joined my present company Shemaroo Entertainment Limited. Initially entrusted with handling Corporate Finance as a one-man team.
- My first year into my job was very eventful, as at home my family expanded and I also got my first major project in the company. I was able to get the same completed in the record time. Also, at the same time one of my colleagues, who was handling PE fund raising quit the company and I was given this additional responsibility. On the other hand, I also got experience in the new fund raising medium.
- Somewhere in 2010, our company decided to go Public. In the process for IPO my team expanded. I drew the entire IPO filing process with my juniors and we filed IPO application with SEBI in 2011.
- However, the company was finally listed in 2014. This was one of the landmarks I am proud of. By now I had the entire Corporate Finance and Company Secretarial team reporting to me.
- My team started getting bigger and in 2018, my responsibilities expanded to handling of accounts team as well.
- And, finally in May 2022, all my hard work paid off, my efforts were recognised and I was promoted to CFO.

As its appropriately said that the road to success is not always easy, one has to pass through various rough patches and similarly there have been ups and downs in my CA journey as well but I have sailed through smoothly with support from family, friends and above all almighty. The whole journey of studying late nights, to writing exams, to getting the results, to achieving targets, implementing ideas, handling a team, taking decisions etc has been with its share of ups and downs, but these are the memories which I will cherish forever. All in all, I must say this entire journey has been quite eventful.

Background music of my life:

What is a movie without music? And my journey has also been harmonious with many selfless human beings who have melodiously tuned my journey. By helping me, staying with me and supporting me to reach where I am today. Firstly, I thank my wife who has been there with me through thick and thin. A professional life is like a wife whose demands are never ending. Both need equal amount of time and attention to make things work. I don't know whether I did justice to balance both my professional and personal life, but I feel I am lucky enough to have a life partner who understands my goals in life. Secondly, I am grateful for the flawless support from my team members and my colleagues. Without them, I would not have been able implement my ideas smoothly. And lastly, I am obliged to have met such inspiring bosses and mentors in my life who have not only believed in me but have also inspired me and guided meat each and every turning point in my professional life. I am fortunate enough to have lived my life with such understanding crew members who have knowingly or unknowingly given a soothing background music to my movie and without them my journey would not have been a blockbuster.

Climax: Lessons learnt during this journey

As its rightly said that "Build your life on your own dreams because dreams never have bad endings". And some of my simple life mantra to achieve a successful and fruitful climax are:

- One of the greatest Japanese proverb is, "Fall Seven times, stand up Eight!" Never get discouraged when the things do not go as per expectations. Always remember that the greatest glory in life is not winning, but rising every time we fall.
- Never give up! If you have a dream, pursue it, no matter how big or small your dream is.
- One should always have willingness to learn. Always keep in mind that an investment in knowledge pays the best interest.

In a nutshell our life is like a movie, it looks meaningless without action, humour, stunts, thrill, emotions, drama, climax and of course music. Similarly in order to live a meaningful life and make your career a Box Office Hit, one must stay strong, do proper planning and strategizing, do not compare yourself with others and have a positive mindset whenever you have a doubt creeping in. Lastly if you are pursuing a CA course or in finance background, you are already running a marathon, therefore consider yourself worthy enough to face any challenges that come your way.

Congratulate, Celebrate and Motivate yourself and don't forget to Keep Going. At every step keep reminding yourself, "picture abhi baaki hai mere dost….! "

(PS: Special thanks to my Sister-in-law Khyati for helping me penning this article)

Events In Retrospect

1 Event

Day & Date	Committee	Program Name	Moderator / Speaker	Attendance / Views
2 nd June to 3 rd June 2022	Students Committee	Student RRC	CA Atul Bheda CA Viral Satra CA Gautam Mota CA Nihar Dharod	45 Students

2 Event

Day & Date	Committee	Program Name	Moderator / Speaker	Attendance / Views
15th June 2022	Students Committee	Webinar on Revised Schedule III and Amendment in CARO	CA Parin Gala	50+ Students

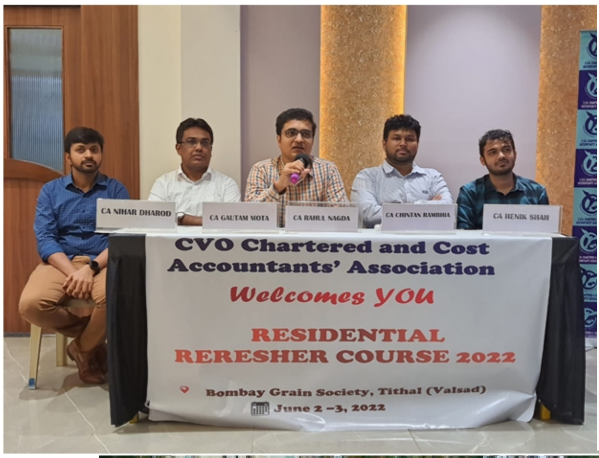
3 Event

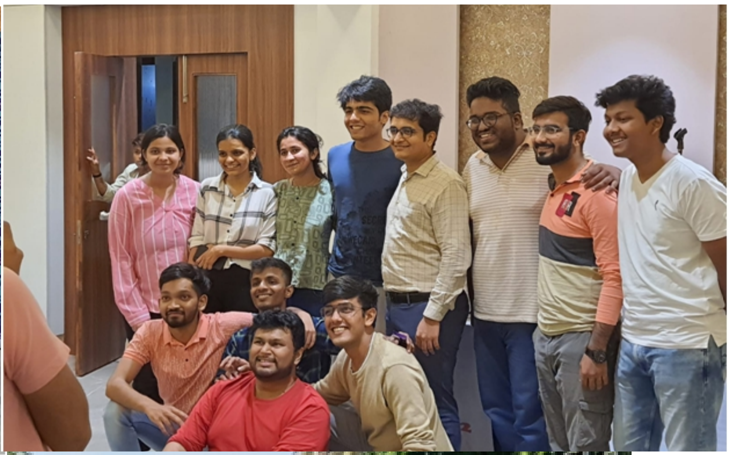
Day & Date	Committee	Program Name	Moderator / Speaker	Attendance / Views
19th June 2022	Students Committee	Career Guidance Session who wished to purse CA after Board Exam of 10th/12th	CA Gautam Mota	250+ Students

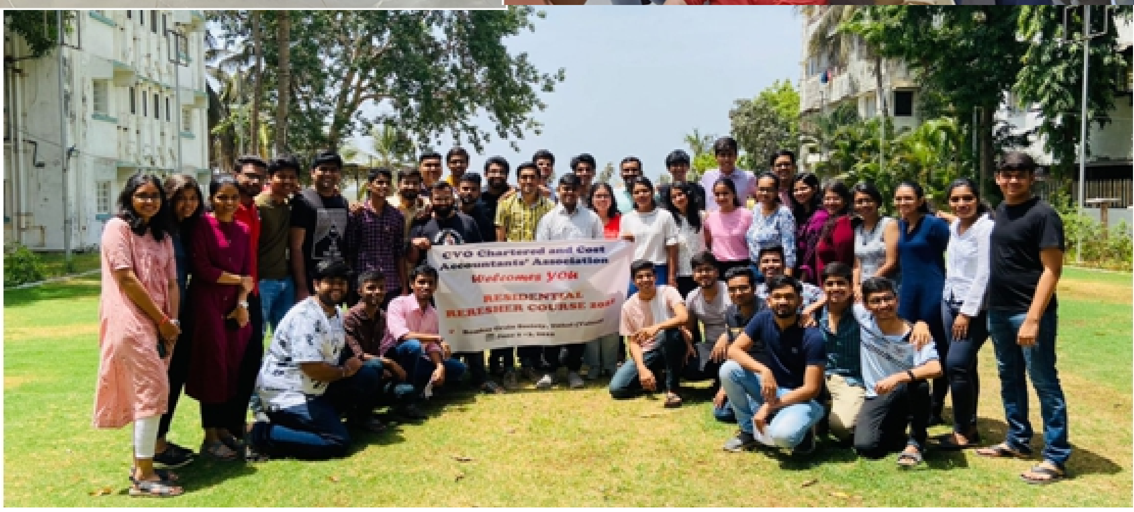
4 Event

Day & Date	Committee	Program Name	Moderator / Speaker	Attendance / Views
19th June 2022	Program Committee	Prevention of Cyber Frauds	Sachin Dedhia (CISA, CEH, ISO 27001 LA)	2500 views on youtube

Events 1 : Student Residential Refresher Course 2022







Events 3 Career Guidance Session