TAX ISSUES IN RELATION TO FIRM

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The Indian Partnership Act do not provide separate legal entity status to the partnership firm, however, for the purpose of the application of the provisions of the Income Tax Act, 1961 ('the Act/ the Income tax act'), a firm and its partner are treated separately. On the other hand, a Limited Liability Partnership (LLP) enjoys separate legal entity status. The LLP integrates the benefits of a company as well as partnership firm, however for the purpose of income tax, LLP is considered as Firm. The Income tax act further provides for special provisions for Firm in relation to payment of interest / remuneration to partners, capital introduction in the form of capital asset by partner, withdrawal from firm at the time of dissolution or reconstitution of firm, etc. In this article, we will understand and analyses some of the issues involved in those provisions.

1. Computation of Book profit - Whether income assessable under the non business head/s which are credited to profit and loss shall form part of 'book profit' u/s 40(b) of Act?

As per the provision of section 40(b) of the Act, while computing the total income of the firm, any remuneration paid/payable to a partner, shall be deductible based on the restrictions prescribed on the computed book profit of the Firm.

Explanation 3 states that the book profit means the net profit as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.

The said chapter nowhere provides that net profit should be the only income from business or profession alone and not from other sources. Thus, for the purpose of section 40(b)(v) read with explanation there cannot be separate method of accounting for ascertaining net profit and/or book profit. Thus, if the income from other sources is included in the PnL A/c, then it cannot be disregarded while ascertaining book profit for computation of the remuneration of the partners.

This ratio was laid down in following case:

- Serajudddin & Bros. vs. CIT [(2012) 24 taxmann.com 46 (Calcutta HC)]
- Suresh A. Shroff & Co. v. JCIT [2012] 27 taxmann.com 291 (Mumbai ITAT)
- Mac Industries v. ITO [2021] 124 taxmann.com 570 (Surat-Trib.)

2. Whether quantum of interest and remuneration etc. to partners is required to be specified in the LLP agreement or a simple recital authorizing partners to mutually decide the quantum of remuneration from time to time will do?

There is no unity of opinions on this question between different High Courts. However, CBDT vide Circular No. 739, dated 25 March 1996 has taken a view that simple authorisation of payment of remuneration etc. in the deed is not sufficient. Remuneration payable to each individual working partner has to be specified in the deed or manner of quantification of such remuneration has to be laid down in such deed and only then the remuneration to a working partner can be allowed as deduction.

3. Whether, for allowance of deduction of interest payments, requirement of section 36(1)(iii) needs to be fulfilled?

The above question is squarely covered by Supreme court in case of Munjal Sales Corp v CIT [2008] 298 ITR 298 (SC), the court held that *"Section 40 starts with the words 'Notwithstanding anything to the contrary in sections 30 to 38' which shows that even if an expenditure or allowance comes within the purview of sections 30 to 38, the assessee could lose the benefit of deduction if the case falls under section 40. In other words, every assessee, including a firm, has to establish, in the first instance, its right to claim deduction under one of the sections between sections 30 to 38 and in the case of the firm, if it claims special deduction, it has also to prove that it is not disentitled to claim deduction by reason of applicability of section 40(b)(iv). It is important to note that section 36(1) refers to other deductions, whereas section 40 comes under the heading 'Amounts not deductible'. Therefore, sections 30 to 38 are other deductions, whereas section 40 is a limitation on those deductions. Therefore, even if an assessee is entitled to deduction under section 36(1)(iii), the assessee-firm will not be entitled to claim deduction for interest payment exceeding 18/12 per cent per se."*

4. Whether despite specific ceiling on allowable quantum of interest and remuneration etc. paid to partners, revenue can invoke the provisions of disallowance of alleged unreasonable or excessive interest and remuneration etc. u/s 40A(2) of Act?

The rulings on the above referred subject has held that section 40(b) and 40A(2) operate in different fields and the provisions of Section 40A have no application in the cases where Section 40(b) has been applied. Further, it was held the AO has no power to go into the question of reasonableness of remuneration paid by the firm to its partners and he can only examine whether the remuneration is not exceeding the prescribed limits as laid down in Section 40(b).

Thus, when remuneration is paid to a working partner as defined in section 40(b) and said payment is authorised by deed, there is no justification for treating any amount of remuneration as excessive under section 40A(2) provided aggregate remuneration to all the partners is also within ceiling prescribed u/s 40(b).

The following ruling has laid down the above principle:

- CIT vs. Great City Manufacturing Co. [(2013) 33 taxmann.com 258 (Allahabad HC)]
- Chhajed Steel Corporation v. ACIT 77 ITD 419 (Ahmedabad ITAT)
- N.M. Anniah & Co. v. CIT 101 ITR 348 (Karnataka High Court)

Further, the following cases have held that no disallowance under Section 40A(2) can be made if there no comparable cases available and there is no evasion of tax:

- Indo Enterprises (ITA No. 1221/Pun/2016) dated 19 September 2018;
- Indo Saudi Services (Travel) (P.) Ltd. (2009) (310 ITR 306) (Bom HC)

5. Whether provision of section 50C/50CA are also applicable in case where partner introduces capital asset in the form of land/building/shares by way of capital contribution?

Section 45(3) specifically deals with transfer of capital asset by a person to a firm, in which he is or becomes a partner, by way of capital contribution. The transaction is chargeable to tax as capital gains in the year of transfer and the amount recorded in the books of the firm deemed to be full value of consideration. Thus, issue may arise in a case where amount recorded in books of firm is lower than 50C or 50CA valuation.

The Mumbai tribunal in case of DCIT vs M/s Amartara Pvt. Ltd. (ITA No. 6050/Mum/2016) held that since the Act itself is provided for deeming consideration to be adopted for the purpose of section 48 of the Act, another deeming fiction provided by way of section 50C cannot be extended to compute deemed full value of consideration as a result of transfer of capital asset. Thus section 45(3) prevails over section 50C.

In case of contribution in kind to LLP, section 32(2) of the LLP Act, 2008 read with Rule 23(2) of LLP Rules prescribes that valuation of contribution in kind should be accounted and disclosed in accordance with value approved by valuer.

6. Further, in the hands of Firm, where the capital contribution received is recorded at a lower value, will inadequate consideration be subject to provisions of section 56(2)(x)?

There exist 2 view on the said proposition:

View 1: 56(2)(x) is not applicable

a) The amount credited to partner's account is merely a notional amount. The actual consideration given by the firm on admission of a partner is not ascertainable or indeterminable.

b) The above principles were laid down by the SC in the case of Sunil Siddharthbhai (156 ITR 509) where the SC had to consider the matter from a capital gains angle, in the context of a transfer of assets by a partner to a firm, and contributing shares to the firm as his capital contribution. The SC went to hold that in the absence of the failure of computational mechanisms there would be no capital gains though there was a transfer under the provisions of the Income-tax Act. The Income-tax Act was subsequently amended and section 45(3) was subsequently introduced.

c) Further, deeming provisions as laid down under section 45(3) cannot be used for the purposes of section 56(2)(x).

On the basis of above, it can be said that failure to compute consideration given by the firm leads to inability to calculate inadequacy of consideration, which is indeed the primary requirement for the applicability of section 56(2)(x). Consequently, section 56(2)(x) shall not be applicable in the hands of partnership firm

View 2: 56(2)(x) is applicable

a) It is doubtful that the ratio of Sunil Siddharthbhai's case may be extended to the case of the firm. The contribution would be capital assets in the hands of the firm. The cost of acquisition of the capital asset to the firm may be the same as that recorded in its books of account on contribution. It may be difficult for the firm to urge that the cost is unascertainable and the charge to capital gains on the transfer fails.

In the absence of any other legal precedent, it is difficult to conclude on applicability of 56(2)(x). However, on the basis of above discussion, though arguments in favour of non-applicability of 56(2)(x) exist, View 2 appears to be a better view.

Further, the Finance Act 2021 has amended provisions in relation to withdrawal by partner in the event of reconstitution or dissolution. We hereby understand some of the issues in relation to the same:

7. 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.

8. 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.

9. 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.

10. 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 to clear the ambiguity. There are two views possible w.r.t to 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 **all assets.**

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).

11. 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.

12. 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

13. 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 lumpsum valuation, and the firm does not obtain any valuation report from an approved valuer, it is not possible to apply Rule 8AA(5).

14. 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.50 is 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).

15. 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 2022 and his account is settled in March 2024 by 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 1922 Act 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 FY 2023-24.

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

To illustrate, the partner retires in year 1, and his capital balance at the time of retirement is 3 Lakhs. His share of 10 Lakh is settled in 2 equal installments, 5 Lakh paid in year 1 and the balance 5 Lakh 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 2 cannot 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

17. 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 31 March 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 after 1 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 April 1961, 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 April 2020 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.

18. 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] 19 taxmann.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 taxpayers 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).

19. 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.

In the absence of any guidance from CBDT or legal precedents on many of the issues, it is difficult to form any view with regards to taxability. The issues are litigation prone and department, especially at lower levels, may not take a favourable view on the matter. A comprehensive call including the risk appetite of the client will have to be taken while filing the return of income. A documented approach on the favourable view and steps to mitigate the unfavourable view will be helpful at the assessment and litigation level.