Critical Analysis of section 45(4) and 9B of Income-tax Act, 1961

BY

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PART A

Position Before Amendment

Nature of Partnership

Section 4 of the Partnership Act

Partnership‟ is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into 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‟.

Observation of Supreme Court in case of **N. Khadervali Saheb Vs N. Gudu Sahib (Decd) [2003] 261 ITR 1 (SC)**

“A partnership firm is not an independent legal entity, the partners are the real owners of the assets of the partnership firm. Actually the firm name is only a compendious name given to the partnership for the sake of convenience. The assets of the partnership belong to and are owned by the partners of the firm. So long as the partnership continues each partner is interested in all the assets of the partnership firm as each partner is owner of the assets to the extent of his share in the partnership. On dissolution of the partnership firm, accounts are settled amongst the partners and the assets of the partnership are distributed amongst the partners as per their respective shares in the partnership firm. Thus, on dissolution of a partnership firm, the allotment of assets to individual partner is not a case of transfer of any assets of the firm. The assets which hereinbefore belonged to each partner, will after dissolution of the firm stand allotted to the partners individually. There is no transfer or assignment of ownership in any of the assets. This is the legal consequence of distribution of assets on dissolution of a partnership firm. The distribution of assets may be done either by way of an arbitration award or by mutual settlement between the partners themselves. **The document which records the settlement in this case is an award which does not require registration under section 17 of the Registration Act since the document does not transfer or assign interest in any asset.”**

Whether retirement of a partner from the partnership firm would constitute "transfer" under Income Tax Act?

(A) The gist of CIT Vs Mohanbhai Pamabhai [1973] 91 ITR 393 (Guj) is as under:

Section 2(47) defines "transfer" in relation to a capital asset. This definition gives an artificially extended meaning to the term by including within its scope and ambit two kinds of transactions which would not ordinarily constitute "transfer" in the accepted connotation of that word, namely, relinquishment of the capital asset and extinguishment of any rights in it. But, even in this artificially extended sense, there is no transfer of interest in the partnership assets involved when a partner retires from the partnership. The interest of a partner in a partnership is not interest in any specific item of the partnership property. It is a right to obtain his share of profits from time to time during the subsistence of the partnership and on dissolution of the partnership or on his retirement from the partnership to get the value of his share in the net partnership assets which remain after satisfying the debts and liabilities of the partnership. When, therefore, a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts on the footing of notional sale of the partnership assets and given to him, what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. His share in the partnership is worked out by taking accounts in the manner prescribed by the relevant provisions of the partnership law and it is this, namely, his share in the partnership which he receives in terms of money. **There is in this transaction no element of transfer of interest in the partnership assets by the retiring partner to the continuing partners.**

The transfer of a capital asset in order to attract capital gains tax must be one as a result of which consideration is received by the assessee or accrues to the assessee. When a partner retires from a partnership what he receives is his share in the partnership which is worked out and realized and does not represent consideration received by him as a result of the extinguishment of his interest in the partnership assets.

Hence, when an assessee retires from a firm and receives an amount in respect of his share in the partnership there is no transfer of interest of the assessee in the goodwill of the firm and no part of the amount received by him would be assessable to capital gains tax under section 45.

(B) **Addl CIT Vs Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)**

The Department preferred an appeal to the Supreme Court against the aforesaid judgement of the Gujarat High Court.

The Supreme Court, in view of its earlier judgement, in the case of Sunil Siddharthbhai Vs CIT [1985] 156 ITR 509 (SC), dismissed the appeal of the Department and thus, the aforesaid judgement of the Gujarat High court was affirmed by the Supreme Court.

(C) CIT Vs Kunnamkulam Mill Board [2002] 257 ITR 544 (Ker) : 178 CTR 356 (Ker)

(D) Prashant S.Joshi Vs ITO [2010] 324 ITR 154 (Bom)

(E) National Company Vs ACIT [2019] 415 ITR 5 (Mad)

Whether dissolution partnership firm would constitute "transfer" under Income Tax Act?

(A) Supreme Court in case of B.T. Patil and Sons Vs CGT [2001] 247 ITR 588 (SC) : [2000] 163 CTR 363 (SC) has made following observation in para 6

"In our view, when there is a dissolution of partnership or a partner retires and obtains in lieu of his interest in the firm an asset of the firm, no transfer is involved for the reason set out in the passage quoted above."

(B) Supreme Court in case of Jagatram Ahuja Vs CGT [2000] 246 ITR 609 (SC) : 164 CTR 1 (SC) has made following observation:

In Malabar Fisheries Co. vs. Commissioner of Income-tax, Kerala [1979] 120 ITR 49 SC] this Court considered few provisions of Income-tax Act, 1961. Referring to the case of Addanki Narayanappa and other cases expressed the view that a partnership firm under the Indian Partnership Act is not a distinct legal entity apart from the partners constituting it and that in law the firm as such has no separate rights of its own. When one talks of the property or assets of the firm all that is meant is property or assets in which all partners have a joint or common interest. Hence the contention that upon dissolution of the firm rights in the partnership assets are extinguished, cannot be accepted. It is further, held that the partners own jointly or in common the assets of the partnership and, therefore, the consequence of the distribution, division or allotment of assets to the partners which flows upon dissolution after discharge of liabilities is nothing but a mutual adjustment of rights between the partners and there is no question of any extinguishment of the firm's rights in the partnership assets amounting to a transfer of assets within the meaning of Section 2(47) of the Income-tax Act, 1961. Although the case arose under the provisions of Income-tax Act, but as to the nature and character of transaction of mutual adjustment of rights between the partners upon dissolution of a firm, it was clearly held that such a transaction did not amount to transfer.

(C) CIT Vs Surendra Kumar Gupta [2004] 270 ITR 325 (All) : 191 CTR 538 (All)

Facts

The brief facts before the court were that the assets of the firm were taken over by one of the two partners on payment of an agreed amount to the other partner. Thus, the transaction resulted into a dissolution of the firm.

Substantial question of law

Following Substantial question of law were raised before the Hon'ble High Court

1. "Whether, on the facts and in the circumstances of the case, the finding of the Tribunal that the transaction was not a 'transfer' is legally correct?"

2. Whether, on the facts and in the circumstances of the case, the Tribunal was correct in deleting the income from capital gains added by the Income-tax Officer?"

Held

11. In view of the foregoing discussion we are of the considered opinion that the Tribunal was justified in holding that the transaction was not a transfer and no capital gain accrued. We, therefore, answer both the questions of law in the affirmative, i.e., in favour of the assessee and against the Revenue. However, there shall be no order as to costs.

Whether admission of a partner from the partnership firm would constitute "transfer" under Income Tax Act?

(A) CIT Vs P.N. Panjawani (Decd) [2012] 80 DTR 200 (Karn)

The HC concurred with the view of the lower revenue authorities that, none of the provisions of the Act specifically envisages a situation where capital gains would be chargeable on account of reduction in the share of partnership in a firm by way of introduction of new partners.

In light of the facts of the case, the HC stated that it cannot be said that the old partners transferred their shares in the property of the firm and the amount of drawings represented the consideration received for such transfer, as for the purpose of the Act, the identity of the firm and its partners were separate and distinct, contrary to the treatment as per the Partnership Act.

The contention of the revenue authorities that, the above events represent a colourable device adopted by the partners to avoid payment of taxes is not tenable, as tax planning is legitimate, if done within the frame work of law. This is also owing to the fact that the firm was created in 1962, and land was purchased in 1967. The firm carried on business till FY 1992-93, and the old partners continued to be the partners in the firm, even though with a lower share in profits of the firm. Merely because the business was not conducted post reconstitution, one cannot hold that the firm is not genuine.

(B) CIT Vs Kunnamkulam Mill Board [2002] 257 ITR 544 (Ker)

Held

"13. In the light of what is stated above and in view of the catena of decisions rendered, we are of the view that when a partnership is reconstituted by adding a new partner, there is no transfer of assets within the meaning of Section 45(4) of the Income-tax Act. Therefore, the questions formulated have to be answered against the Revenue and in favour of the assessee."

PART B

Retrospective Amendment by Finance Act, 2021

<u>Section 9B, Section 45(4) and Section 48:-</u> Tax on transfer of money or property by a firm/AOP/BOI to its partners or members

[Assessment Year 2021-22]

Bare Text

Section 9B

(1) Where a specified person receives during the previous year any capital asset or stock in trade or both from a specified entity in connection with the dissolution or reconstitution of such specified entity, then the specified entity shall be deemed to have transferred such capital asset or stock in trade or both, as the case may be, to the specified person in the year in which such capital asset or stock in trade or both are received by the specified person.

(2) Any profits and gains arising from such deemed transfer of capital asset or stock in trade or both, as the case may be, by the specified entity shall be—

(i) deemed to be the income of such specified entity of the previous year in which such capital asset or stock in trade or both were received by the specified person; and

(ii) chargeable to income-tax as income of such specified entity under the head “Profits and gains of business or profession” or under the head "Capital gains", in accordance with the provisions of this Act.

(3) For the purposes of this section, fair market value of the capital asset or stock in trade or both 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 of the capital asset or stock in trade or both by the specified entity.

(4) If any difficulty arises in giving effect to the provisions of this section and sub-section (4) of section 45, the Board may, with the approval of the Central Government, issue guidelines for the purposes of removing the difficulty.

(5) Every guideline issued by the Board under sub-section (4) shall, as soon as may be after it is issued, be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the assessee.

Section 45(4)

Notwithstanding anything contained in sub-section (1), where a specified person receives during the previous year any money or capital asset or both from a specified entity in connection with the reconstitution of such specified entity, then any profits or gains arising from receipt of such money by the specified person shall be chargeable to income-tax as income of such specified entity under the head "Capital gains" and shall be deemed to be the income of such specified entity of the previous year in which such money or capital asset or both were received by the specified person, and notwithstanding anything to the contrary contained in this Act, such profits or gains shall be determined in accordance with the following formula, namely:—

A = B+C-D

Where,

A = income chargeable to income-tax under this sub-section as income 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:

Provided that if the value of “A” in the above formula is negative, its value shall be deemed to be zero:

Provided further that the balance in the capital account of the specified person in the books of account of the specified entity is to be calculated without taking into account the increase in the capital account of the specified person due to revaluation of any asset or due to self-generated goodwill or any other self-generated asset.

Explanation 1.—For the purposes of this sub-section,—

(i) the expressions “reconstitution of the specified entity”, “specified entity” and "specified person" shall have the meanings respectively assigned to them in section 9B;

(ii) “self-generated goodwill” and “self-generated asset” mean

goodwill or asset, as the case may be, which has been acquired without incurring any cost for purchase or which has been generated during the course of the business or profession.

Explanation 2.—For the removal of doubts, it is clarified that when a capital asseet is received by a specified person from a specified entity in connection with the reconstitution of such specified entity, the provisions of this sub-section shall operate in addition to the provisions of section 9B and the taxation under the said provisions thereof shall be worked out independently.’.

Section 48

The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:—

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto:

(iii) in case of value of any money or capital asset received by a specified person from a specified entity referred to in sub-section (4) of section 45, the amount chargeable to income-tax as income of such specified entity under that sub-section which is attributable to the capital asset being transferred by the specified entity, calculated in the prescribed manner:

1.1. Income on receipt of capital asset or stock in trade by a partner from a firm [Section 9B]

Section 9B(1) provides that where a specified person (say Partner) receives during the previous year any capital asset or stock-in-trade or both from a specified entity (say firm) in connection with the dissolution or reconstitution of such firm, then the firm shall be deemed to have transferred such capital asset or stock-in-trade or both, as the case may be, to the partner in the year in which such capital asset or stock in trade or both are received by that partner.

Section 9B(2) provides that any profits and gains arising from such deemed transfer of capital asset or stock in trade or both, as the case may be, by the firm shall be deemed to be the income of the firm of the previous year in which stock or capital asset were received by the partner and chargeable to income-tax under the head 'business or

profession' or 'capital gain' in accordance with the provisions of the Act.

Section 9B(3) the fair market value of the capital asset or stock on the date of its receipt by the partner shall be deemed to be the full value of consideration while computing profit and gains arising from deemed transfer of such stock or capital asset by the firm.

Section 9B(4) & (5) provides that CBDT is empowered to issue guidelines, with prior approval of the Central Government, for removing difficulties arising in giving effect to the provisions of this section. Every such guidelines shall be laid before each house of Parliament and shall be binding on the Income-tax authorities and assessee.

Explanation.— For the purposes of this section,—

(i) "reconstitution of the specified entity" means, where—

(a) one or more of its partners or members, as the case may be, of such specified entity ceases to be partners or members; or

(b) one or more new partners or members, as the case may be, are admitted in such specified entity in such circumstances that one or more of the persons who were partners or members, as the case may be, of the specified entity, before the change, continue as partner or partners or member or members after the change; or

(c) all the partners or members, as the case may be, of such specified entity continue with a change in their respective share or in the shares of some of them;

(ii) "specified entity" means a firm or other association of persons or body of individuals (not being a company or a co-operative society);

(iii) "specified person" means a person, who is a partner of a firm or member of other association of persons or body of individuals (not being a company or a co-operative society) in any previous year.'.

1.2. Tax on receipt of money or capital asset by partner in connection with reconstitution of firm [Section 45(4)]

The Finance Act, 2021 has substituted sub-section (4).

Section 45(4) provides that where a specified person (say Partner) receives during the previous year any capital asset or money or both from a specified entity (say Firm) in connection with the reconstitution, then any profit and gains arising from such receipt of money by partner shall be deemed to be the income of the firm under the head "Capital Gains' of the previous year in which such capital asset or money or both were received by the partner.

The capital gains shall be computed in accordance with the following formula:

$$A = B + C - D$$

A = Income chargeable to income-tax under this provision as income of the firm under the head 'capital gains';

B = Value of money received by partner on the date of such receipt;

C = Fair market value of the capital asset received by the partner on the date of such receipt; and

D = Balance in the capital account (represented in any manner) of the partner in the books of account of the firm at the time of reconstitution.

The first proviso to section 45(4) provides that if the value of A is negative, it shall be deemed to be *nil*.

Second Proviso to section 45(4) provides that while computing the balance in the capital account of partner in the books of account of firm, increase in capital account due to the following shall not be taken into account:

(*a*) Revaluation of any asset;
(*b*) Self-generated goodwill (goodwill acquired without incurring any cost for purchase or which has been generated during the course of business or profession);
(*c*) Other self-generated assets.

Explanation 2 to Section 45(4) clarifies that when a capital asset is received by the partner from a firm in connection with the reconstitution, the provisions of the said section shall operate in addition to the provisions of section 9B. Thus, the taxation under both the provisions shall be worked out independently.

Comparison between Section 9B and Section 45(4)

Particulars	Section 9B	Section 45(4)
Subject matter of transfer	It would apply upon receipt of capital asset or stock-in-trade or both by a partner	It would apply upon receipt of capital asset or cash or both by a partner
Event triggering applicability	It would apply on the dissolution or reconstitution of a firm	It would apply in connection with reconstitution of the firm
Computation Mechanism and the relevant head of income	For the purpose of computation under Section9B, Fair Market Value is deemed to be the full value of Consideration and computation would be in accordance with the provisions pertaining to 'Profits and gains of business or profession' or 'Capital Gains'	Computation mechanism has been expressly provided under Section45(4) in the form of formula

1.3. Mode of computation of capital gain modified to avoid double taxation [Section 48]

Section 48 has also been amended by the Finance Act, 2021 to mitigate the double taxation arising due to introduction of section 9B and substitution of section 45(4).

A new clause (*iii*) is inserted to provide that capital gains chargeable to tax under section 45(4) which is attributable to capital asset being transferred by the firm shall be reduced while computing capital gain in the hands of the firm. The capital gain attributable to such capital asset shall be computed in a prescribed manner.

PART C

Impact of CBDT Circular 14/2021 & Notification No. 76/2021

Example 1 – CBDT Circular

(A) Firm consists of three partners having equal share

(B) The balance sheet of the firm is as under:-

Liability	Amount (Rs. In Lakhs)	Asset	Amount (Rs. In Lakhs)
Partners Capital	30	Land S	10
A – 10		Land T	10
B – 10		Land U	10
C – 10			
Total	**30**	**Total**	**30**

(C) All the above 3 land parcels are long term capital assets

(D) Partner A wishes to retire from the firm.

(E) Fair Market Value of Land S and T at the time of retirement is Rs. 70 lakh each while that of Land U is Rs.50 Lakh

(F) Partner A's account is proposed to be settled as under:-

- Cash payment – Rs. 11 Lakh
- Distribution of land U – FMV 50 Lakh

(G) Indexed cost of acquisition for land U is Rs. 15 Lakhs

Various Implications

Implications under section 9B of the Act – Capital Gains shall be chargeable to tax in the hands of firm

Particulars	Amount
Sale consideration (FMV of Land U)	50
Less:- Indexed cost of Acquisition	15
Long term capital gains chargeable u/s 9B in hands of firm	**35**
Capital gains tax payable by the firm @ 20% (without surcharge and education cess, for simplicity as per CBDT Circular)	7

Capital Account of each of the partners- post transaction would be:-

Particulars	Amount
Sale consideration (FMV of Land U)	50
Less:- Cost of land for the firm (as per books)	10
Pre-tax Profit of the firm as per books	**40**
Capital gains tax paid by the firm	7
Post-tax profit of the firm **(this amount will be equally distributed to all 3 partners)**	**33**
Capital Balance of each of the partners (Old Bal 10 + Profit 11)	21

Implications under section 45(4) of the Act – Capital Gains shall be chargeable to tax in the hands of firm

Particulars	Description	Amount (Rs. in Lakhs)
(A)	Value of any money received by partner from firm on the date of such receipt	11
(B)	FMV of the capital asset received by partner from firm on the date of such receipt	50
(C)	Balance in the capital account of partner in the books of account of the firm at the time of reconstitution	(21)
	Capital Gain (A + B – C)	**40**

Attribution of capital gains under section 45(4) to remaining capital assets of firm:

Particulars	Cost	FMV	Increase in value	Proportion	Attribution of capital gains charged u/s 45(4) [Rs. in lakhs]
Land S	10	70	60	50%	20
Land T	10	70	60	50%	20
Total			**120**		**40**

Implication when Land S and/or T would be sold out in future: As it can be seen that Rs. 20 Lakh each shall be attributed to land S and land T. When either of such land gets sold by the firm in the future, Rs. 20 Lakh as attributed above, shall be reduced from sale consideration of respective land in view of the amendment carried out under section 48 of the Act while computing capital gains on sale of such land.

Nature of capital gains under section 45(4): Since, capital gains of Rs.40 Lakh gets attributed to the long-term capital assets retained by the firm, such capital gains of Rs. 40 Lakh shall be chargeable as long-term capital gains.

Example 2 – CBDT Circular

(A) Example 2 in the guidelines contemplates situation where, instead of allotment of land U to the retiring partner, the firm sells land U to an outsider (third Party) at FMV and settles retiring partner's capital account by paying only cash of Rs. 61 Lakhs.

(B) In Example 2, section 9B is not applicable but the normal capital gains taxation provisions would be applicable at the time of sale of capital asset by the firm in favor of an outsider (third Party).

(C) Circular thus emphasized that the net result of capital gains tax incidence in Example 2 is the same as reached in Example 1.

Example 3 – CBDT Circular

(A) Firm consists of three partners having equal share

(B) The balance sheet of the firm is as under:-

Liability	Amount (Rs. In Lakhs)	Asset	Amount (Rs. in Lakhs)
Partners Capital	300	Land S	30
A – 100		Patent T	45
B – 100		Cash	225
C – 100			
Total	300	Total	300

(C) Partner A wishes to retire from the firm.

(D) Land S is a long term capital assets and Patent T is a short term capital asset

(E) Fair Market Value of the various assets at the time of retirement is as under

Land S- Rs. 45 Lakhs

Patent T- Rs. 60 lkhs

Goodwill – Rs. 30 Lakhs

(F) Partner A's account is proposed to be settled as under

- Cash Payment – Rs. 75 Lakhs
- Distribution of land S – FMV Rs. 45 Lakhs

(G) Indexed cost of acquisition for land S is Rs. 45 Lakhs

Various Implications

Implications under section 9B of the Act – Capital Gains shall be chargeable to tax in the hands of firm

Particulars	**Amount (Rs. in Lakhs)**
Sale consideration (FMV of Land S)	45
Less:- Indexed Cost of Acquisition	45
Long term capital gains chargeable u/s 9B in hands of firm	**0**
Capital gains tax payable by the firm @ 20% (without surcharge and education cess, for simplicity as per CBDT Circular)	0

Capital Account of each of the partners- post transaction would be:-

Particulars	**Amount (Rs. in Lakhs)**
Sale consideration (FMV of Land S)	45
Less:- Cost of land for the firm (as per books)	30
Pre-tax Profit of the firm	15
Tax paid by the firm	0
Post-tax profit of the firm (this amount will be equally distributed to all 3 partners)	15
Capital Balance of each of the partners (Old Bal 100 + Profit 5)	**105**

Implications under section 45(4) of the Act – Capital Gains shall be chargeable to tax in the hands of firm

Particulars	Description	Amount (Rs. in Lakhs)
(A)	Value of any money received by partner from firm on the date of such receipt	75
	FMV of the capital asset received by partner from firm on the date of such receipt	45
(B)	Balance in the capital account of partner in the books of account of the firm at the time of reconstitution	(105)
(C)	Capital Gains (A + B – C)	15

Attribution of capital gains under section 45(4) to remaining capital assets of firm:

Particulars	Cost	FMV	Increase in value	Proportion	Attribution of capital gains charged u/s 45(4) [Rs. in lakhs]
Patent T	45	60	15	33.33%	5
Self Generated Goodwill	0	30	30	66.66%	10
Total			45		15

Implication when paten T and/or Goodwill would be sold out in future When Patent T gets sold subsequently, Rs. 5 lakhs shall be reduced from the sale consideration for the purpose of computing capital gain under section 50 of the Act. Similarly, when goodwill gets sold subsequently, Rs.10 lakhs shall be reduced from sale consideration and only such reduced consideration shall be taken into consideration for computation of capital gain under section 50 of the Act.

Nature of capital gains under section 45(4):

Since capital gains of Rs. 15 lakhs gets attributed as Rs. 5 Lakh to asset forming part of block of assets (Patent T) and Rs. 10 Lakh to self-generated goodwill, such capital gains of Rs. 15 Lakh shall be chargeable as short- term capital gains.

MINISTRY OF FINANCE

(Department of Revenue)

(CENTRAL BOARD OF DIRECT TAXES)

NOTIFICATION

New Delhi, the 2nd July, 2021

G.S.R. 470(E).—In exercise of the powers conferred by section 48 read with section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct taxes hereby makes the following rules further to amend the Income-tax Rules,1962, namely:—

1. Short title:- (1)These rules may be called the Income tax Amendment (18th Amendment), Rules, 2021.

2. In the Income-tax Rules, 1962, (hereinafter referred to as the principal rules) in rule 8AA, after sub-rule (4), the following sub-rule shall be inserted, namely:-

"(5). In case of the amount which is chargeable to income-tax as income of specified entity under sub-section (4) of section 45 under the head "Capital gains",-

(i) the amount or a part of it shall be deemed to be from transfer of short term capital asset, if it is attributed to,-

(a) capital asset which is short term capital asset at the time of taxation of amount under sub-section (4) of section 45; or

(b) capital asset forming part of block of asset; or

(c) capital asset being self-generated asset and self-generated goodwill as defined in clause (ii) of *Explanation* 1 to sub-section (4) of section 45; and

(ii) the amount or a part of it shall be deemed to be from transfer of long term capital asset or assets, if it is attributed to capital asset which is not covered by clause (i) and is long term capital asset at the time of taxation of amount under sub-section (4) of section 45.".

3. In the principal rules, after rule 8AA, the following rule shall be inserted, namely:—

"8AB. Attribution of income taxable under sub-section (4) of section 45 to the capital assets remaining with the specified entity, under section 48.-

(1) For the purposes of clause (iii) of section 48, where the amount is chargeable to income-tax as income of specified entity under sub-section (4) of section 45, the specified entity shall attribute such amount to capital asset remaining with the specified entity in a manner provided in this rule.

(2) Where the aggregate of the value of money and the fair market value of the capital asset received by the specified person from the specified entity, in excess of the balance in his capital account, chargeable to tax under sub-section (4) of section 45,relates to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, of the specified entity, the amount attributable to the capital asset remaining with the specified entity for purpose of clause (iii) of section 48 shall be the amount which bears to the amount charged under sub-section (4) of section 45 the same proportion as the increase in, or recognition of, value of that asset because of revaluation or valuation bears to the aggregate of increase in, or recognition of, value of all assets because of the revaluation or valuation.

(3) Where the aggregate of the value of money and the fair market value of the capital asset received by the specified person from the specified entity, in excess of the balance in his capital account, charged to tax under sub-section (4) of section 45 does not relate to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, of the specified entity, the amount charged to tax under sub-section (4) of section 45 shall not be attributed to any capital asset for the purposes of clause (iii) of section 48.

(4) Notwithstanding anything contained in sub-rules (2) or (3), where the aggregate of the value of money and the fair market value of the capital asset received by the specified person from the specified entity, in excess of the balance in his capital account, charged to tax under sub-section (4) of section 45 relate only to the capital asset received by the specified person from the specified entity, the amount charged to tax under sub-section (4) of section 45 shall not be attributed to any capital asset for the purposes of clause (iii) of section 48.

(5) The specified entity shall furnish the details of amount attributed to capital asset remaining with the specified entity in Form No. 5C.

(6) Form No. 5C shall be furnished electronically either under digital signature or through electronic verification code and shall be verified by the person who is authorised to verify the return of income of the specified entity under section 140.

(7) Form No. 5C shall be furnished on or before the due date referred to in the *Explanation* 2 below sub-section (1) of section 139 for the assessment year in which the amount is chargeable to tax under sub-section (4) of section 45.

(8) The Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, shall -

(i) specify the procedure for filing of Form No. 5C;

(ii) specify the procedure, format, data structure, standards and manner of generation of electronic verification code, referred to in sub-rule (6), for verification of the person furnishing the said Form; and

(iii) be responsible for formulating and implementing appropriate security, archival and retrieval policies in relation to the Form No 5C so furnished.

***Explanation* 1:** For the purposes of this rule, the amount chargeable to tax under sub-section (4) of section 45 shall relate to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, of the specified entity, if the revaluation is based on a valuation report obtained from a registered valuer as defined in clause (g) of rule 11U.

***Explanation* 2:** For the removal of doubt it is clarified that revaluation of an asset or valuation of self-generated asset or self-generated goodwill does not entitle the specified entity for the depreciation on the increase in value of that asset on account of its revaluation or recognition of the value of self-generated asset or self-generated goodwill due to its valuation.

***Explanation* 3:** For the purposes of this rule, the expressions "self-generated asset" and "self-generated goodwill" shall have the same meaning as assigned to them in clause (ii) of *Explanation* 1 to sub-section (4) of section 45.".

4. In the principal rules, in Appendix II, after Form No. 5B, the following Form shall be inserted, namely:—

"Form No. 5C

(See rule 8AB)

Details of amount attributed to capital asset remaining with the specified entity

1. Name of the specified entity

2. Permanent Account number

3. Assessment Year

4. Amount taxable under sub-section (4) of section 45

5. Attribution of amount taxable under sub-section (4) of section 45 to capital assets remaining

Sr.No.	Capital Asset		Book Value	Revalued amount/valued amount for self-generated asset	Amount attributed	Short term/ long term
	name	Whether self generated yes/no				
	Total					

6. Name and registration number of the valuer based on whose valuation report information at serial no 5 is provided.

VERIFICATION

I, _____son/ daughter of _____ solemnly declare that to the best of my knowledge and belief, the information given in the form is correct and complete and is in accordance with the provisions of the Income-tax Act, 1961. I further declare that I am furnishing the form in my capacity as _____ (drop down to be provided in e-filing utility) and I am also competent to furnish this form and verify it. I am holding permanent account number _____.

Place:

Date : Signature…….".

[Notification No. 76/2021/F. No. 370142/22/2021-TPL]

ANKIT JAIN, Under Secy.

Note: The principal rules were published in the Gazette of India, Extraordinary, Part-II, Section-3, Sub-section (ii) *vide* number S.O. 969 (E), dated the 26th March, 1962 and last amended *vide* notification number G.S.R. 395 (E), dated 8th June, 2021.

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Circular No. 14 of 2021

F. No.370142/22/2021-TPL
Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes (TPL Division)

Dated: 02nd July, 2021

Sub.: Guidelines under section 9B and sub-section (4) of section 45 of the Income-tax Act, 1961 - reg.

Finance Act, 2021 inserted a new section 9B in the Income-tax Act 1961 (hereinafter referred to as "the Act"). This section mandates that whenever a specified person receives any capital asset or stock in trade or both from a specified entity, during the previous year, in connection with the dissolution or reconstitution of such specified entity, then it shall be deemed that the specified entity have transferred such capital asset or stock in trade or both, as the case may be, to the specified person (hereinafter referred to as "deemed transfer"). This deemed transfer would be in the year in which such capital asset or stock in trade or both are received by the specified person. Any profits and gains arising from such deemed transfer is deemed to be the income of such specified entity of the previous year in which such capital asset or stock in trade or both were received by the specified person. Further, it is chargeable to income-tax as income of such specified entity under the head "Profits and gains of business or profession" or under the head "Capital gains", in accordance with the provisions of this Act. It has also been provided that the fair market value of the capital asset or stock in trade or both, 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. The definitions of terms "reconstitution of the specified entity", "specified entity" and "specified person" are provided in section 9B of the Act.

2. Similarly the Finance Act 2021 substituted sub-section (4) of section 45 of the Act. This newly substituted sub-section (4) now provides that where a specified person receives any money or capital asset or both from a specified entity, during the previous year, in connection with the reconstitution of such specified entity, then any profits or gains arising from receipt of such receipt by the specified person shall be chargeable to income-tax as income of the specified entity under the head "Capital gains". It has been further deemed that this income shall be the income of the specified entity of the previous year in which such money or capital asset or both were received by the

specified person. A formula to calculate such profits and gains has also been provided in this sub-section. The definitions of terms "reconstitution of the specified entity", "specified entity" and "specified person" shall be as provided in section 9B of the Act while the terms "self-generated goodwill" and "self-generated asset" have been defined in this sub-section. It has been further clarified that when a capital asset is received by a specified person from a specified entity in connection with the reconstitution of such specified entity, the provisions of sub-section (4) of section 45 of the Act shall operate in addition to the provisions of section 9B of the Act and the taxation under the said provisions thereof shall be worked out independently. Both, the new section 9B and substituted sub-section (4) of section 45 are applicable for the assessment year 2021-22 and subsequent assessment years.

3. Sub-section (4) of section 9B of the Act provides that if any difficulty arises in giving effect to the provisions of this section and sub-section (4) of section 45 of the Act, the Board may, with the approval of the Central Government, issue guidelines for the purposes of removing the difficulty. For this purpose, the Central Board of Direct Taxes, with the approval of the Central Government, hereby issues the following guidelines.

Guidelines

4. It is noticed that the amount taxed under sub-section (4) of section 45 of the Act is required to be attributed to the remaining capital assets of the specified entity, so that when such capital assets get transferred in the future, the amount attributed to such capital assets gets reduced from the full value of the consideration and to that extent the specified entity does not pay tax again on the same amount. It is further noticed that this attribution is given in the Act only for the purposes of section 48 of the Act. It may be seen that section 48 of the Act only applies to capital assets which are not forming block of assets. For capital assets forming block of assets there is sub-clause (c) of clause (6) of section 43 of the Act to determine written down value of the block of asset and section 50 of the Act to determine the capital gains arising on transfer of such assets. However, the Act has not yet provided that amount taxed under sub-section (4) of section 45 of the Act can also be attributed to capital assets forming part of block of assets and which are covered by these two provisions. To remove difficulty, it is clarified that rule 8AB of the Income Tax Rules, 1962 (hereinafter referred to as "the Rules") notified vide notification no. 76 dated 02.07.2021 also applies to capital assets forming part of block of assets. Wherever the terms capital asset is appearing in the rule 8AB of the Rules, it refers to capital asset whose capital gains is computed under section 48 of the Act as well as capital asset forming part of block of assets. Further, wherever reference is made for the purposes of

section 48 of the Act, such reference may be deemed to include reference for the purposes of sub-clause (c) of clause (6) of section 43 of the Act and section 50 of the Act.

5. For the removal of doubt it is further clarified that in case the capital asset remaining with the specified entity is forming part of a block of asset, the amount attributed to such capital asset under rule 8AB of the Rules shall be reduced from the full value of the consideration received or accruing as a result of subsequent transfer of such asset by the specified entity, and the net value of such consideration shall be considered for reduction from the written down value of such block under sub-clause (c) of clause (6) of section 43 of the Act or for calculation of capital gains, as the case may be, under section 50 of the Act.

6. For the purposes of understanding and for removing difficulties, if any, the application of section 9B of the Act and sub-section (4) of section 45 of the Act is explained with the help of the following examples:

Example 1: There are three partners "A", "B" and "C" in a firm "FR", having one third share each. Each partner has a capital balance of ₹10 lakh in the firm. There are three pieces of lands "S", "T" and "U" in that firm and there is no other capital asset in that firm. Book value of each of the land is ₹10 lakh. All these three lands were acquired by the firm more than two years ago.

Partner "A" wishes to exit. The firm revalues its lands based on valuation report from a registered valuer, as defined in rule 11U of the Rules, and as per that valuation report fair market value of lands "S" and "T" is Rs 70 lakh each, while fair market value of land "U" is ₹50 lakh. On the exit of partner "A", the firm decides to give him ₹11 lakh of money and land "U" to settle his capital balance.

In accordance with the provisions of section 9B of the Act, it would be deemed that the firm "FR" has transferred land "U" to the partner "A" at its fair market value of ₹50 lakh. Let us assume that the indexed cost of acquisition of land "U" is ₹15 lakh.

Now on account of the deeming provisions of section 9B of the Act, it is deemed that the firm "FR" has transferred land "U" to partner "A". Thus, an amount of ₹50 lakh less ₹15 lakh would be charged to tax in the hands of firm "FR" under the head "Capital gains". For partner "A", the cost of acquisition of this land would be ₹50 lakh. Hence, the amount of ₹ 35 lakh is charged to long term

capital gains and let us assume that the tax is ₹7 lakh(assume no surcharge or cess just for ease of calculation and illustration purposes).

This, net book profit after tax of ₹33 lakh (capital gains of ₹40 lakh without indexation less tax of ₹7 lakh) is to be credited in the capital account of each of the three partners, i.e. ₹11 lakh each. Thus partner "A" capital account would increase to ₹21 lakh. This exercise is required to be carried out since section 9B of the Act mandates that it is to be deemed that the firm "FR" has transferred the land "U" to partner "A" and the long term capital gains of ₹35 lakh is chargeable to tax in the hands of the firm "FR".

As against capital balance of ₹21 lakh, partner "A" has received ₹61 lakh (₹11 lakh of money plus land "U" of fair market value of ₹50 lakh). Thus ₹40 lakh is required to be charged to tax under sub-section (4) of section 45 of the Act. This shall be in addition to an amount of ₹35 lakh charged to tax under section 9B of the Act.

On account of clause (iii) of section 48 of the Act, read with rule 8AB of the Rules, this ₹40 lakh is to be attributed to the remaining assets of the firm "FR" on the basis of increase in their value due to revaluation based on the valuation report of registered valuer. In this case as per revaluation there are only two capital assets remaining; lands "S" and "T". In both cases the value has increased by ₹60 lakh each. Thus, out of ₹40 lakh, ₹20 lakh shall be attributed to land "S" and ₹20 lakh to land "T". When either of these lands gets sold, this amount attributed to them would be reduced from sales consideration under clause (iii) of section 48 of the Act.

The amount of ₹40 lakh which is charged to tax under sub-section (4) of section 45 of the Act shall be charged as long term capital gains in view of sub-rule (5) of rule 8AA of the Rules, since the amount of ₹40 lakh is attributed to land "S" and land "T" which are both long term capital assets at the time of taxation of ₹40 lakh under sub-section (4) of section 45 of the Act.

Example 2: There are three partners "A", "B" and "C" in a firm "FR", having one third share each. Each partner has a capital balance of ₹10 lakh in the firm. There are three pieces of lands "S", "T" and "U" in that firm and there is no other capital asset in that firm. All these three lands were acquired by the firm more than two years ago.

Book value of each of the land is ₹10 lakh. Partner "A" wishes to exit. The firm sells land "U" for its fair market value of ₹ 50 lakh. Let us assume that the indexed cost of acquisition of land "U" is ₹15 lakh. Thus, an amount of ₹50 lakh less ₹15 lakh would be charged to tax in the hands of firm "FR" under the head "Capital gains". Hence, the amount of ₹ 35 lakh is charged to long term capital gains and let us assume that the tax is ₹7 lakh(assume no surcharge or cess just for ease of calculation and illustration purposes).

This, net book profit after tax of ₹33 lakh (capital gains of ₹40 lakh without indexation less tax of ₹7 lakh) is to be credited in the capital account of each of the three partners, i.e. ₹11 lakh each. Thus partner "A" capital account would increase to ₹21 lakh.

Partner "A" decides to exit the firm "FR". The firm revalue its lands "S" and "T" based on valuation report from a registered valuer, as defined in rule 11U of the Rules, and as per that valuation report fair market value of lands "S" and "T" is ₹70 lakh each On the exit of partner "A", the firm decides to give him ₹ 61 lakh of money to settle his capital balance. Thus, as against capital balance of ₹21 lakh, partner "A" has received ₹61 lakh of money. Thus ₹40 lakh is required to be charged to tax under sub-section (4) of section 45 of the Act. This will be in addition to ₹35 lakh already charged to capital gains.

On account of clause (iii) of section 48 of the Act, read with rule 8AB of the Rules, this ₹40 lakh is to be attributed to the remaining assets of the firm "FR" on the basis of increase in their value due to revaluation based on the valuation report of registered valuer. In this case as per revaluation there are only two capital assets remaining; lands "S" and "T". In both cases the value has increased by ₹60 lakh each. Thus, out of ₹40 lakh, ₹20 lakh shall be attributed to land "S" and ₹20 Lakh to land "T". When either of these lands gets sold, this amount attributed to them would be reduced from sales consideration under clause (iii) of section 48 of the Act.

The amount of ₹40 lakh which is charged to tax under sub-section (4) of section 45 of the Act shall be charged as long term capital gains in view of sub-rule (5) of rule 8AA of the Rules, since the amount of ₹40 lakh is attributed to land "S" and land "T" which are both long term capital assets at the time of taxation of ₹40 lakh under sub-section (4) of section 45 of the Act.

Note: The final result in both example 1 and 2 is same due to the operation of section 9B of the Act.

Example 3:

There are three partners "A", "B" and "C" in a firm "FR", having one third share each. Each partner has a capital balance of ₹100 lakh in the firm. There is a piece of land "S" of book value of ₹30 lakh. There is patent "T" of written down value of ₹45 lakh. And there is cash of ₹225 lakh. The land was acquired by the firm more than two years ago. The patent was acquired/developed/registered one year back.

Partner "A" wishes to exit. The firm revalue its land and patent based on valuation report from a registered valuer, as defined in rule 11U of the Rules, and as per that valuation report fair market value of land "S" is ₹45 lakh and fair market value of patent "T" is ₹60 lakh. As per the valuation report there is also self-generated goodwill of ₹30 lakh. On the exit of partner "A", the firm decides to give him ₹75 lakh in money and land "S" to settle his capital balance.

In accordance with the provisions of section 9B of the Act, it would be deemed that the firm "FR" has transferred land "S" to the partner "A" at its fair market value of ₹45 lakh. Let us assume that the indexed cost of acquisition of land "S" is ₹45 lakh.

Now on account of the deeming provisions of section 9B of the Act, it is deemed that the firm "FR" has transferred land "S" to partner "A". However, since the sale consideration is equal to indexed cost of acquisition, there will not be any capital gains tax. For partner "A", the cost of acquisition of this land would be ₹45 lakh.

The net book profit of ₹15 lakh (capital gains of ₹15 lakh without indexation) is to be credited in the capital account of each of the three partners, i.e. ₹5 lakh each. Thus partner "A" capital account would increase to ₹105 lakh. This exercise is required to be carried out since section 9B of the Act mandates that it is to be deemed that the firm "FR" has transferred the land "S" to partner "A". Thus, any gain in the books is to be apportioned to partners' capital accounts.

As against capital balance of ₹105 lakh, partner "A" has received ₹120 lakh (money of ₹75 Lakh plus land "S" of fair market value of ₹45 lakh). Thus ₹15 Lakh is required to be charged to tax under sub-section (4) of section 45 of the Act.

On account of clause (iii) of section 48 of the Act, read with rule 8AB of the Rules and this guidance note, this ₹15 lakh is to be attributed to the remaining capital assets of the firm "FR" on the basis of

increase in the value due to revaluation of existing capital assets, or due to recognition of the value of self-generated goodwill, based on the valuation report of registered valuer. In this case as per this report the value of patent "T" has increased by ₹15 lakh and the self-generated goodwill value has been recognised at ₹30 lakh. Thus one third of ₹15 lakh (i.e. ₹5 lakh) would be attributed to patent "T", while two third of ₹15 lakh (i.e. ₹10 lakh) would be attributed to self-generated goodwill. ₹5 lakh attributed to patent "T" shall not be added to the block of the assets and no depreciation shall be available on the same. When patent "T" gets transferred subsequently, this ₹5 Lakh attributed shall be reduced from the full value of the consideration received or accruing as a result of transfer of patent "T" by the firm "FR", and the net value shall be considered for reduction from the written down value of the intangible block under sub-clause (c) of clause (6) of section 43 of the Act or for calculation of capital gains, as the case may be, under section 50 of the Act.(Refer guidance in paragraph 5 of this circular). Let us say that Patent T is sold for ₹25 lakh. ₹5 lakh shall be reduced from ₹25 lakh and only net amount of ₹20 lakh shall be considered for reduction from the written down value of the intangible block under sub-clause (c) of clause (6) of section 43 of the Act or for calculation of capital gains, as the case may be, under section 50 of the Act. Similarly when goodwill gets sold subsequently, ₹10 lakh would be reduced from its sales consideration under clause (iii) of section 48.

The amount of ₹15 lakh which is charged to tax under sub-section (4) of section 45 of the Act shall be charged as short term capital gains, as ₹5 lakh is attributed to the Patent "T" which is part of block of assets and ₹10 lakh is attributed to self-generated goodwill. In accordance with sub-rule (5) of Rule 8AA of the Rules, both of these are to be characterised as short term capital gains.

Note: For the purpose of calculation of depreciation under section 32 of the Act, the written down value of the block of asset "intangible" of which Patent "T" is part, would remain ₹45 lakh and would not be increased to ₹60 lakh due to revaluation during the year. In this regard it may be highlighted that the following provisions are relevant in determining the amount on which depreciation is allowable under the Act:

- Explanation 2 of sub-section (1) of section 32 of the Act provides that the term "written down value of the block of assets" shall have the same meaning as in clause (c) of sub-section (6) of section 43 of the Act.

- Clause (c) of sub-section (6) of section 43 of the Act, with respect to block of assets, inter-alia, provides that the aggregate of the written down values of all the assets falling within that block of assets at the beginning of the previous year is to be increased by the actual cost of any asset falling within that block, acquired during the previous year. This clause does not allow any increase on account of revaluation.
- Sub-section (1) of section 43 of the Act which defines "Actual cost" as actual cost of the assets to the assessee. In revaluation, there is no actual cost to the assessee

Further, section 32 of the Act does not allow depreciation on goodwill. If in the given example "self-generated goodwill" is replaced by "self-generated asset", even then the depreciation will not be admissible on the amount of ₹30 lakh recognised in valuation. In this regard it may be highlighted that the above mentioned provisions, in the immediate preceding paragraph, are also applicable to "self-generated asset" and since there is no actual cost to assessee in case of "self-generated asset", depreciation is not allowable under section 32 of the Act on an asset whose actual cost is nil.

02.07.2021

(Ankit Jain)

Under Secretary to the Govt. of India

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