

Navi Mumbai Branch of WIRC of ICAI

Income Tax Implications on Reconstitution or Dissolution of Partnership Firm & TDS on Partner's Remuneration

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Erstwhile scheme of taxation up to AY2020-21

- Upto AY 1987-88, any distribution of capital assets on dissolution of firm or AOP was exempt from Section 45 by virtue of Section 47(ii) – Nothing but his share in the distributed assets of the firm
 - From AY 1988-89, Section 45(4) provides for capital gains taxation in hands of firm, **on transfer of capital asset to partners, by way of distribution, on dissolution or otherwise**
 - Capital gains = FMV of capital asset on the date of distribution minus cost/WDV
 - Besides taxation on dissolution, Firm also exposed to taxation on distribution of capital asset on retirement of partner
 - Term “or otherwise” in Section 45(4) also includes retirement and triggers Section 45(4) - A.N. Naik Associates [2004] 136 Taxman 107 (Bom HC)
 - However, contrary view expressed by Madras HC in case of National Company v. ACIT [2019] [415 ITR 5] that division of assets on retirement does not trigger Section 45(4)
 - However, settlement of Retired partner's account in cash (even beyond his capital balance) is not hit by Section 45(4) in the hands of the firm
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Erstwhile scheme of taxation up to AY2020-21

- No tax incidence in the hands of retired partner on receipt of cash or capital asset
 - What partner receives is his share in the firm and not any consideration for 'transfer' of his partnership interest
 - Dynamic Enterprises (359 ITR 83)(Kar)(FB); Pipelines India (238 Taxman 9)(Mad); Electroplast Engineers (263 Taxman 120)(Bom)
- No tax on transfer of stock-in-trade to partners at the time of dissolution or otherwise
- No tax on reconstitution of Partnership Firm – CIT v. P. N. Panjawani (356 ITR 676) (Kar)
- No tax on revaluation of fixed assets and then distribution of the surplus amongst partners – CIT v. Hind Construction Ltd. (83 ITR 211)/4 SCC 460(SC)
- Recent Judgement in **CIT v. Mansukh Dyeing & Printing Mills (2022) (449 ITR 439)(SC)** decided against the Assessee

There was uncertainty regarding applicability of Section 45(4) to a situation where assets are revalued or self generated assets are recorded in the books and payment is made to partner or member which is in excess of his capital contribution – Memorandum Explaining the Provisions of the Finance Act, 2021

Section 45(4) of IT Act, 1961 [Section 67(10) of IT Act, 2025]

- Levies capital gains tax on **realization by partner in excess of his capital account balance**, in connection with **reconstitution**
 - Gains are computed from partner's perspective but are taxable in hands of firm
 - If a partner receives **any money or capital asset or both** from a firm **in connection with reconstitution of firm**, firm shall be liable to pay capital gains tax as per following formula:
$$A = B + C - D, \text{ where}$$
 - A = Capital gains chargeable as income of firm
 - B = Value of any money on the date of such receipt
 - C = FMV of capital asset on the date of such receipt
 - D = Partner's capital account balance (represented in any manner) in books of firm at time of its reconstitution (without taking into account increase (a) due to revaluation of any asset or (b) due to self-generated goodwill/asset)
 - Capital gains (A) will be nil if result of formula is negative
 - If negative capital balance, manner of computation [whether negative to be ignored - DCIT v. Summit Securities Ltd. (135 ITD 99)(Mum)(SB)]
 - Self-generated goodwill or asset means that:
 - which has been acquired without incurring any cost for purchase or
 - which has been generated during the course of the business or profession
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Section 9B of IT Act, 1961 [Section 8 of IT Act, 2025]

- **Capital asset or stock in trade in connection with dissolution or reconstitution**
 - **Computation of Income in the case of capital asset**
 - Computation as per Section 48 [deduction includes in case of any money or capital asset is received by the specified person, profits and gains taxed under Section 45(4) (as prescribed), which is attributable to the capital asset]
 - Substitution by FMV as on 01.04.2001 as COA
 - Indexation benefit
 - Set off and carry forward of loss
 - **Computation of Income in the case of stock in trade**
 - Computation as per Sections 28 to 43D
 - Set off and carry forward of loss
 - 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 consideration received or accruing as a result of such deemed transfer of the capital asset or stock on trade or both by the specified entity
 - FMV as defined in Section 2(22B) - Price ordinarily fetchable on sale in the Open market; and in case of unascertainable, such price as may be determined in accordance with the Rules
 - Valuation under Sections 50C/43CA/50CA/56(2)(x)
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Section 9B

- Specified Entity – PF, AOP, BOI (other than a company or a co-operative society). PF includes LLP.
 - Specified Person – Partner of PF or Member of AOP, BOI
 - Reconstitution of the Specified Entity – (a) one or more partners or members ceases to be partners or members (b) admission of new partners or members and continuation of the existing partners or members (c) all partners or members continue with change in their respective share or in the shares of some of them.
 - Suppose W, X, Y and Z are Partners of a Firm A Co. with equal shares in profit/loss:
 - If X retires
 - If V joins as a partner
 - If U and V join and existing partners retires-
 - If there is a change in profit sharing ratio from equal to 30:20:30:20
 - If there is a change in profit sharing ratio from equal to 30:20:25:25
 - If W retires and new profit sharing ratio is 33:33:34
 - If V admitted and there is a change in profit sharing from equal to 20:20:20:20:20
 - Conversion of firm under Chapter XXI of the Companies Act, 2013 or into LLP – CIT v. Texspin Engg. & Mfg. Works (263 ITR 345)(Bom)
 - Whether mere reconstitution attracts Section 9B or 45(4) ?
 - Additional capital introduced by existing partner or new partner ?
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***Transfer of Capital Asset, Stock in Trade, etc. to a Partner or Member
by Firm, AOP, etc.[Sections 9B, 45(4) and 48(iii)] – AY 2021-22***

Particulars	Old Section 45(4) – Capital Gains	New Section 45(4) – Capital Gains	New Section 9B- Capital Gains or Business Income
Notwithstanding clause	-	Notwithstanding anything contained in Section 45(1)	-
Income	Profits and gains on transfer of capital asset	Profits and gains on <u>receipt of money or capital asset or both</u> by specified person	Profits and gains on <u>receipt of capital asset or stock in trade or both</u> by specified person
Event	on <u>dissolution</u> (or otherwise) of PF, AOP, BOI	In connection with <u>reconstitution</u> of specified entity	In connection with <u>dissolution or reconstitution</u> of specified entity
Taxability in the hands of	chargeable to tax as income of such PF, AOP, BOI	Chargeable to tax as income of such specified entity	Chargeable to tax as income of such specified entity
Year of taxability	In the previous year in which the said transfer takes place	In the previous year in which such money or capital asset or both <u>received</u> by specified person	In the previous year in which such capital asset or stock in trade or both <u>received</u> by specified person
Profits and Gains	FMV of the capital asset on the date of such transfer – deduction u/s. 48	Value of money+FMV of capital asset on the date of receipt- balance in capital account	FMV of capital asset or stock in trade on the date of receipt –Deduction u/s. 28 to 43D and Sec. 48

Sections 9B and 45(4)

- Difficulty in giving effect to the above provisions can be removed by issuance of guidelines by CBDT – to be placed before both Houses of Parliament and binding on both taxpayer and tax authority
 - CBDT issued guidelines via Circular No. 14/2021 dated 2 July 2021
- Explanation 2 to Section 45(4) – When a capital asset is received by a specified person from a specified entity in connection with the reconstitution of the specified entity, Section 45(4) and Section 9 will be operated independently
- COA in the hands of specified person ?? What will be COA in case of dissolution of firm and partner takes over the business ? – Sections 45(4) and 9B are silent; but Circular No. 14/2021 provides guidance
- If only money received by partner on dissolution, excess amount not taxable—short amount received by partner also not taxable—overall neutral on dissolution
- Receipt by legal heirs of deceased partner – whether covered?
- If settlement spread over more than one year – manner of computation
 - Cable & Wireless Ltd v. V H Gangal (90 ITR 84)(Bom) – receipt of monies on liquidation over multiple years – taxable in each year of receipt
 - If settlement in different years, is capital balance to be reduced in subsequent years by earlier years payments/capital assets?

Sections 45(4) and 48(iii) and Rules 8AB

- Section 45(4) taxes realisation in excess of partner's capital account balance, which represents such partner's share in value appreciation of remaining capital assets of firm
 - Since such value appreciation is already taxed under Section 45(4) at the time of reconstitution, Section 48(iii) provides for attributing Section 45(4) capital gains to remaining capital assets of firm
 - Amount so attributed is reduced from sale consideration as and when such remaining capital assets are transferred by firm
 - Aforesaid principle is equally applicable to capital asset forming part of block of assets
 - At the time of transfer, amount so attributed to depreciable capital asset is reduced from moneys payable (or sale consideration, if Section 50 applies) and only net amount is reduced from WDV (or charged as short-term capital gains, if Section 50 applies)
 - However, 'actual cost' remains intact - no depreciation or indexation benefit is available on amount so attributed
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Manner of Attribution of Section 45(4) capital gains – Rule 8AB

Where s.45(4) capital gains relates to	Basis of attribution:	
Capital asset received by partner from firm	No attribution	
Revaluation of any capital asset of firm (other than above)	S.45(4) capital gains x	A
		C
Valuation of self-generated goodwill/asset of firm	S.45(4) capital gains x	B
		C
Does not relate to any of the above	No attribution	

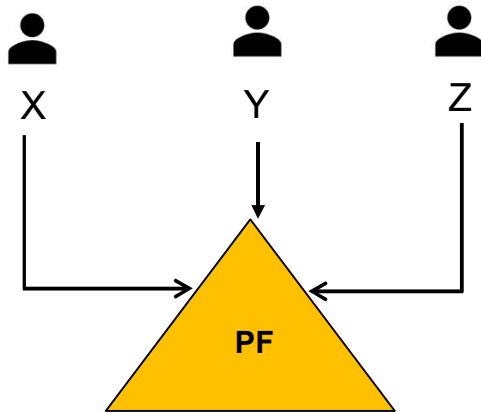
- A = Increase in value of such remaining capital asset because of revaluation
 - B = Recognition of value of such self-generated goodwill/asset because of valuation
 - C = Aggregate of increase in value of all capital assets because of revaluation, or recognition of value of all self-generated goodwill/assets because of valuation
 - ▶ **Conditions:**
 - Revaluation should be based on a valuation report obtained from a valuer who is eligible to be appointed as a registered valuer under Wealth Tax Act, 1957
 - Firm to furnish details in prescribed form (Form 5C) on or before the due date of filing ROI
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Whether Section 45(4) capital gains are short-term or long-term – Rule 8AA (5)

S.N.	Where section 45(4) Capital Gains are attributed, in whole or in part, to	Nature of Capital Gains chargeable u/s. 45(4)
1	Capital asset which is short-term under ITL, at the time of taxation of s.45(4) capital gains (identify asset by tenure)	STCG*
2	Capital asset forming a part of block of assets (by class of asset)	
3	Self-generated goodwill/asset (by class of asset)	
4	Any other capital asset not covered above and, which is long- term capital asset under ITL, at the time of taxation of s.45(4) capital gains (identify asset by tenure)	LTCG

**shall be deemed to be from transfer of short term capital asset*

Example 1 – Retirement - Section 48(iii) and Rule 8AB – Cash pay out



Indicative balance sheet			
X	5,00,000	Land	15,00,000
Y	5,00,000	Goodwill	-
Z	5,00,000		
Total	15,00,000	Total	15,00,000

- ▶ PF has 3 partners having equal PSR and equal capital contribution
- ▶ PF has land acquired at cost of 15,00,000 whose FMV is 21,00,000
- ▶ Land is held as a long-term capital asset
- ▶ Firm also has self-generated goodwill of 30,00,000
- ▶ X retires from the firm and his account is settled in cash after taking into account FMV of land and self-generated goodwill
- ▶ In order to settle X's share, continuing partners Y and Z bring in cash
- ▶ X is paid 17,00,000 against his capital balance of 5,00,000 (ignoring revaluation)
 - ▶ 17,00,000 is represented by capital of 5,00,000 plus 1/3rd share in value appreciation of 36,00,000 (6,00,000+30,00,000)

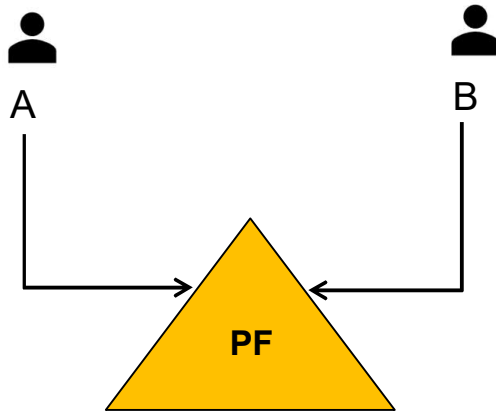
Example 1 – Retirement - Section 48(iii) and Rule 8AB – Cash pay out

Particulars	Section 9B	Section 45(4)
Money received	Not applicable as no capital asset or SIT is distributed	17,00,000 [B]
FMV of capital asset received		- [C]
Partner's capital balance		5,00,000* [D]
Capital gains in hands of firm		12,00,000 [A = B + C – D]

Where s.45(4) capital gains relates to	Basis of attribution		Calculation	Nature of s.45(4) CG	CG on future transfer
Revaluation of land	S.45(4) CG x	A	12,00,000 x $\frac{6,00,000}{36,00,000}$	2,00,000 LTCG	4,00,000 LTCG (21,00,000 - 15,00,000 - 2,00,000)
		C			
Valuation of self-generated goodwill	S.45(4) CG x	B	12,00,000 x $\frac{30,00,000}{36,00,000}$	10,00,000 STCG	20,00,000 LTCG (30,00,000 - 10,00,000)
		C			

- ▶ A = Increase in value of such remaining capital asset because of revaluation
 - ▶ B = Recognition of value of such self-generated goodwill/asset because of valuation
 - ▶ C = Aggregate of increase in value of all capital assets because of revaluation, or recognition of value of all self-generated goodwill/assets because of valuation
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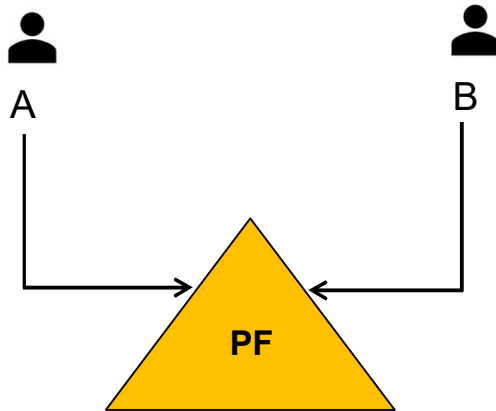
Example 2 – Dissolution



Indicative balance sheet			
Capital		Land	1,00,000
A	50,000		
B	50,000		
Total	1,00,000	Total	1,00,000

- ▶ PF has two equal partners A and B
- ▶ Capital of A and B is 50,000 each and is represented by land acquired by firm in past by investing capital of 1,00,000 contributed by partners
- ▶ Land is held as a long-term capital asset
- ▶ Firm is to be dissolved and on dissolution, land is distributed equally between A and B
- ▶ FMV of land as on the date of receipt is 10 Lac
- ▶ Tax implications u/s. 45(4) (under old regime)
 - ▶ FMV as on date of transfer adopted for taxation u/s. 45(4) in hands of firm
 - ▶ Capital gains is 9,00,000 [FMV of 10 Lac (-) cost of acquisition of 1.00,000 (ignoring indexation)]

Example 2 – Dissolution



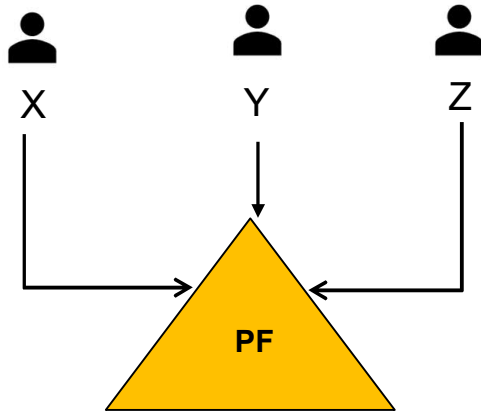
Indicative balance sheet			
Capital		Land	1,00,000
A	50,000		
B	50,000		
Total	1,00,000	Total	1,00,000

- Tax implications u/s. 45(4) (under new regime)

Particulars	Section 9B	Section 45(4)
FMV of land	10,00,000	N.A
Less:- Cost of acquisition (ignoring indexation)	1,00,000	N.A
LTCG in hands of firm	9,00,000	N.A

- Section 45(4) not applicable to dissolution
- Effectively, no difference between old regime and new regime

Example 3 – Retirement – Cash Payout



Indicative balance sheet			
X	5,00,000	Land	15,00,000
Y	5,00,000		
Z	5,00,000		
Total	15,00,000	Total	15,00,000

- ▶ PF has 3 partners having equal PSR and equal capital contribution
- ▶ PF has land acquired at cost of 15,00,000 whose FMV is 21,00,000
- ▶ Land is held as a long-term capital asset
- ▶ X retires from the firm and his account is settled in cash after taking into account FMV of land
- ▶ In order to settle X's share, continuing partners Y and Z bring in cash
- ▶ X is paid 7,00,000 against his capital balance of 5,00,000 (ignoring revaluation)
- ▶ 7,00,000 is represented by capital of 5,00,000 plus 1/3rd share in value appreciation of 6,00,000

Example 3 – Retirement – Cash Payout

Tax implications under old regime

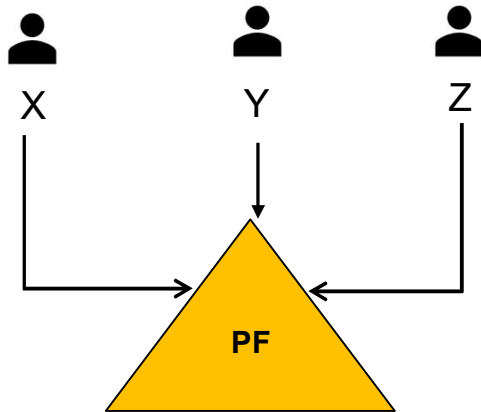
- ▶ Erstwhile s.45(4) provided for capital gains taxation in hands of firm, on transfer of capital asset to partners, by way of distribution, on dissolution or otherwise
- ▶ Cash payment to settle account of retiring partner does not result in transfer of capital asset by firm
- ▶ Cost of land continues to be historical cost of 15,00,000
- ▶ No taxation also in the hands of retiring partner as what he receives is always belonging to him

Tax implications under new regime

Particulars	Section 9B	Section 45(4)
Money received (B)	N.A	7,00,000
FMV of capital asset received (C)	N.A	N.A.
Capital balance (D)	N.A	(5,00,000)
Capital gains in hands of firm (A)	N.A	2,00,000

- ▶ Section 9B does not trigger as no capital asset/Stock in trade is distributed to partner
- ▶ Amount of 2,00,000 is attributed to revaluation of land
- ▶ Section 48(iii) - Reduce 2,00,000 from sale consideration on transfer of land in future by firm
- ▶ Say, if firm sells land for 21,00,000, cost of acquisition (ignoring indexation) is 15,00,000 and amount attributed is 2,00,000, net Capital Gain = 4,00,000

Example 4 – Retirement – Distribution of Capital Asset



Indicative balance sheet			
X	5,00,000	Land	15,00,000
Y	5,00,000		
Z	5,00,000		
Total	15,00,000	Total	15,00,000

- ▶ Facts are similar to Example 3, however, X's account is settled by distribution of 1/3rd land against his capital balance of 5,00,000
- ▶ FMV of 1/3rd land is 7,00,000 ($21,00,000 \times 1/3$), which is represented by capital of 5,00,000 plus 1/3rd share in value appreciation of 6,00,000
- ▶ **Tax implications under old regime**
 - ▶ Judicial conflict whether distribution of capital asset on retirement is covered by old Section 45(4)
 - ▶ If old section 45(4) applies, firm pays tax on capital gains of 2,00,000 (ignoring indexation)
 - ▶ Cost of remaining 2/3rd land continues to be historical cost of 10,00,000
- ▶ No separate taxation in the hands of retiring partner.

Example 4 – Retirement – Distribution of Capital Asset

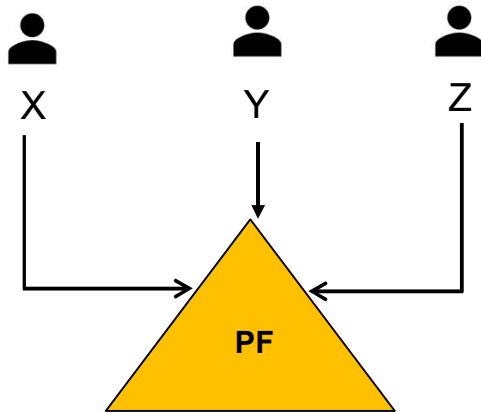
► Tax implications under new regime

Particulars	Section 9B	Section 45(4)
Money received	-	- [B]
FMV of capital asset received	7,00,000	7,00,000 [C]
Cost of 1/3rd land (ignoring indexation)	5,00,000	-
Partner's capital balance	-	5,53,000* [D]
Capital gains in hands of firm	2,00,000	1,47,000 [A = B + C – D]

X's capital account			
Particulars	Debit	Particulars	Credit
Distribution of 1/3rd land to X	7,00,000	Opening balance	5,00,000
Closing balance	-	X's share on profit realized on transfer of 1/3 land (7,00,000-5,00,000)=2,00,000- Tax @ 20% (40,000) = 1,60,000 x 1/3 share	53,000
Total	7,00,000	Total	5,53,000

- As per CBDT's guidelines, retiring partner's share of value appreciation in capital asset distributed to him (viz. 53,000) is includible in his capital account balance [D]
- Section 48(iii) - Reduce 1,47,000 from sale consideration on transfer of 2/3rd land in future by firm
- Say, if firm sells 2/3rd land for 14,00,000, cost of acquisition (ignoring indexation) is 10,00,000 and amount attributed is 1,47,000, then net Capital Gain = 2,53,000
- Thus, there is no double taxation; taxation under Section 45(4) merely represents timing difference.

Example 5 – Retirement – Distribution of Stock-in-trade



Indicative balance sheet			
X	5,00,000	Land	15,00,000
Y	5,00,000		
Z	5,00,000		
Total	15,00,000	Total	15,00,000

- ▶ PF has 3 partners having equal PSR and equal capital contribution
- ▶ PF has land acquired at cost of 15,00,000 whose FMV is 21,00,000
- ▶ Land is held as a stock-in-trade
- ▶ X retires from the firm and his account is settled by distribution of 1/3rd land as against his capital balance of 5,00,000
- ▶ FMV of 1/3rd land is 7,00,000 ($21,00,000 \times \frac{1}{3}$), which is represented by capital of 5,00,000 plus 1/3rd share (2,00,000) in value appreciation of 6,00,000

Example 5 – Retirement – Distribution of Stock-in-trade

Tax implications under old regime

- ▶ In absence of provision along the lines of section 45(4), transfer of Stock-in-trade on retirement does not amount to “transfer” from firm to partner. Arguably, firm not liable to business taxation
- ▶ Partner also not liable. It is realisation of pre-existing right
- ▶ ACIT v. Agrawal Timber and Bans Co. [1983] 144 ITR 46 (MP); and CIT v. Anant Narhar Nimkar (HUF) [1997] 224 ITR 221 (Gujarat)

Tax implications under new regime

Particulars	Section 9B
FMV of Stock-in-trade	7,00,000
Cost of land	(5,00,000)
Business income in hands of PF	2,00,000

- ▶ Section 45(4) is inapplicable to case of distribution of Stock-in-trade as its applicability is restricted to distribution of any money or capital asset.
- ▶ Consequently, section 48(iii) will also not apply

Mansukh Dyeing and Printing Mills (449 ITR 439)(SC)

- The assessee-partnership firm reconstituted the partnership firm and new partners were admitted. Later, the assets of the firm were revalued and revaluation amounts were credited to accounts of the partners in their profit sharing ratio.
- Furthermore, two of the existing partners withdrew part of their capital and new partners were immediately benefitted by the credit to their capital accounts of the revaluation amount which was greater than their contribution amount.
- Reopening of assessment on grounds that the assessee enhanced the value of assets by revaluing the land and building, and subsequent crediting of the enhanced revalued amount to the respective partners' capital accounts would constitute transfer and therefore, revaluation amount was liable to u/s. 45(4) as short-term capital gains.

Mansukh Dyeing and Printing Mills (449 ITR 439)(SC)

- On appeal, CIT(A) upheld the additions on grounds that value of the assets of the firm which commonly belonged to all the partners of the partnership have been irrevocably transferred in their profit-sharing ratio to each partner and to that extent, the partnership had effectively relinquished its interest in the assets and such relinquishment could only be termed as transfer by relinquishment therefore, according, conditions of section 45(4) were satisfied and therefore the assets to the extent of their value distributed would be deemed as income by capital gains in the hands of the assessee firm. ■
- On second appeal, the Tribunal set aside additions made by the Assessing Officer on ground that revaluation of the assets and crediting to partner's account would not involve any transfer relying the decision of SC in Hind Construction [1972] 4 SCC 460.
- On revenue's appeal, the High Court affirmed the order of the Tribunal.

Mansukh Dyeing and Printing Mills (449 ITR 439)(SC)

- Before SC, it was argued that there can be no income just due to revaluation of the capital assets unless capital assets is also transferred. The amount credited on revaluation to the capital accounts of the partners is only notional or book entry, which is not represented by any additional tangible assets or income. Therefore, unless there is a dissolution of the partnership firm, and there is only transfer of the amount on revaluation to the capital accounts of the respective partners, Section 45(4) shall not be applicable
- However, in view of the amended section 45(4) inserted vide Finance Act, 1987, by which, "OR OTHERWISE" is specifically added, the aforesaid submission on behalf of the assessee has no substance. The Bombay High Court in the case of CIT v. A.N. Naik Associates [2004] 265 ITR 346 had an occasion to elaborately consider the word "OTHERWISE" used in section 45(4). After detailed analysis of section 45(4), it is observed and held that the word "OTHERWISE" used in section 45(4) takes into its sweep not only the cases of dissolution but also cases of subsisting partners of a partnership, transferring the assets in favour of a retiring partner.

Mansukh Dyeing and Printing Mills (449 ITR 439)(SC)

- SC Held that - the assets of the partnership firm were revalued to increase the value on 1-1-1993 (relevant to assessment year 1993-94) and the revalued amount was credited to the accounts of the partners in their profit-sharing ratio and the credit of the assets' revaluation amount to the capital accounts of the partners **can be said to be in effect distribution of the assets to the partners** and that during the years, some new partners came to be inducted by introduction of small amounts of capital and the said newly inducted partners had huge credits to their capital accounts immediately after joining the partnership, which amount was available to the partners for withdrawal and in fact some of the partners withdrew the amount credited in their capital accounts. Therefore, **the assets so revalued and the credit into the capital accounts of the respective partners can be said to be "transfer" and which fall in the category of "OTHERWISE" and therefore, the provision of section 45(4) inserted by Finance Act, 1987 with effect from 1-4-1988 shall be applicable**

**Recently, Review Petition Dismissed by the Supreme Court
Saying No Reconsideration is Required**

Mansukh Dyeing and Printing Mills (449 ITR 439)(SC) – Effect of this Ruling Under New Law

- Sections 45(4) and 9B - transfer of capital asset/money/stock in trade is taxable in the hands of firm only if there is any dissolution or reconstitution of the firm
- It is only revaluation of capital assets, no income is arising out of self transaction
- No dissolution or constitution of the Firm
- No distribution of capital asset to partner
- Even if it is distribution of money, it is not in connection with reconstitution of Firm
- The word “otherwise” is missing in new Section 45(4)
- New Law in favour of the Assessee
- Chances of re-opening of old assessments
- Orders can be rectified under Section 154

Issues for consideration and Way Forward

- Sections 45(4) and 9B are prospective or retrospective? – In case the reconstitution or dissolution happened prior to 31 March 2020 and effect is given or distribution done post 1 April 2020 - Taxable on reconstitution or receipt of money/capital asset/stock-in-trade
 - Distribution of capital assets/stock-in-trade/money without reconstitution or dissolution – Whether Sections 45(4) or 9B trigger? In connection – Direct connection
 - Applicability of Section 45(4) and 9B on conversion of partnership firm or LLP into Company
 - Retirement of Partner at book value
 - Liquidation of capital asset or stock in trade before the dissolution and then Transfer of money to partner on dissolution of Firm –Whether Section 9B trigger?
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Issues for consideration and Way Forward

- Whether Section 56(2)(x) would be applicable to retiring partner
 - Where stamp duty value exceeds FMV of asset, can stamp duty value be substituted for the FMV for determining gains under Section 9B and whether Section 194IA would trigger
 - In case of value appreciation of self-generated goodwill, the specified entity would get benefit of attributed amount at the time of sale of such goodwill in future – Practically an unlikely event. Tax paid by specified entity on such value appreciation may practically become cost for the specified entity
 - In case of slump sale, since the subject matter of transfer is an undertaking and not a particular asset, it is unclear as to whether the benefit of amount attributed to the assets forming part of the undertaking would be allowed or not.
 - Partnership deed/LLP agreement to be revisited for ascertaining the terms regarding retirement, settlement and commercial understanding on sharing of tax liability under Section 45(4) r.w. Section 48(iii) etc.
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Section 194T of IT Act, 1961 [Section 393(3) & Table of IT Act, 2025]

Following section 194T shall be inserted after section 194S by the Finance (No. 2) Act, 2024, w.e.f. 1-4-2025:

Payments to partners of firms.

- 194T.** *(1) Any person, being a firm, responsible for paying any sum in the nature of salary, remuneration, commission, bonus or interest to a partner of the firm, shall, at the time of credit of such sum to the account of the partner (including the capital account) or at the time of payment thereof, whichever is earlier shall, deduct income-tax thereon at the rate of ten per cent.*
- *(2) No deduction shall be made under sub-section (1) where such sum or the aggregate of such sums credited or paid or likely to be credited or paid to the partner of the firm does not exceed twenty thousand rupees during the financial year.*

Section 194T - Applicability

Section	Applicability
Payer	Partnership Firm or LLP
Payee	Partner of Firm or LLP
Nature of Payment	any sum in the nature of salary, remuneration, commission, bonus or interest
Obligation to deduct when	time of credit of such sum to the account of the partner (including the capital account) or at the time of payment thereof, whichever is earlier
Tax Rate	10%
Threshold Limit	such sum or the aggregate of such sums credited or paid or likely to be credited or paid to the partner of the firm does not exceed INR 20,000 during FY
Applicable from	Any payment from 1 April 2025

Section 194T - Issues

- No TDS is applicable on the drawings or capital repayment or on share of profit or reimbursement of expenses to the partner of the firm
- Deduction on entire amount paid or credited & not on allowable amount under Section 40(b):

(a)	on the first Rs. 6,00,000 of the book-profit or in case of a loss	Rs. 3,00,000 or @ 90% of the book- profit, whichever is more;
(b)	on the balance of the book-profit	@ 60%

- Obligation to deduct - If the partnership deed specifies monthly remuneration and same is followed, TDS must be deducted monthly. Remuneration allowable as per Section 40(b) or Interest on capital – Usually calculated at year-end, so TDS is to deducted in March.

Section 194T - Issues

- Payer - Unlike proviso to S. 194A, no relaxation based on T/O or gross receipts, Applicable to firms where audit not required u/s 44AB as well – Hardship to small firms
- Compliance Burden - Additional TDS obligation, payment and filing of TDS returns
- Penal Action against firms under Income tax Act, for delay in compliance/non-compliance (especially where remuneration is decided at the end of FY/ at the time of books - closure based on profitability) & Additional financial burden
- Cash flow issue
- Section 40(a)(ia)- Applicability for Disallowance

Section 194T - Issues

- Applicability of Section 206 AA (No PAN) and Section 206AB ITR non-filers)
- Payee partner cannot obtain certificate (Section 197) for no TDS or TDS at a lower rate
- Self-declaration in Form 15G/Form 15H also not applicable
- Adjustment of excess/deficiency in TDS deduction from subsequent deduction in same FY

Questions?





Thank You !

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