NATIONAL CONFERENCE ON MEMBERS IN PRACTICE

RECENT CONTROVERSIES IN TAXATION OF CAPITAL GAINS, PARTNERSHIPS AND MULTIPLE TAX RATES APPLICABLE TO CORPORATES

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SESSION OVERVIEW:

- RECENT CONTROVERSY IN TAXATION OF PARTNERSHIPS
- TAX RATES APPLICABLE TO CORPORATES
- JUDICIAL DEVELOPMENTS IN CAPITAL GAINS TAXATION

RECENT CONTROVERSY IN TAXATION OF PARTNERSHIPS

Overview:

- Erstwhile scheme of taxation before Finance Act, 2021 amendments
- New scheme of taxation post Finance Act, 2021
- Comparative analysis of erstwhile s.45(4), new s.9B and s.45(4)
- Case studies illustrating operation of provisions
- Some illustrative issues
- Rules governing capital gains chargeable u/s. 45(4) and some illustrative issues relating to rules

ERSTWHILE SCHEME OF TAXATION UP TO AY 2020-21:

- 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
  - Capital gains = FMV* of capital asset on the date of distribution minus cost/WDV

- Besides taxation on dissolution, Firm also exposed taxation on distribution of capital assets on retirement of partner

- Term “or otherwise” in s. 45(4) also includes retirement and triggers s.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] [105 taxmann.com 255] that division of assets on retirement does not trigger s.45(4) However, settlement of Retired partner’s account in cash (even beyond his capital balance) is not hit by s.45(4) in the hands of the firm

- 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 – Sunil Siddharthbhai [156 ITR 509 (SC)] and Mohanbhai Pamabhai [165 ITR 166 (SC)]
  - Dynamic Enterprises (359 ITR 83)(Kar)(FB); Pipelines India (238 Taxman 9)(Mad); Electroplast Engineers (263 Taxman120)(Bom)

NEW SCHEME OF TAXATION VIDE FINANCE ACT 2021

- Finance Minister's speech:
  - *"Taxability of surplus amount received by partners:*
  - *In order to provide certainty, it is proposed to rationalise the provisions relating to taxation of the assets or amount received by partners from the partnership firm in excess of their capital contribution"*

- Explanatory Memorandum to Finance Bill, 2021 introduces amendment as a "rationalisation" measure

- As per Explanatory Memorandum, there is uncertainty regarding applicability of s. 45(4) to a situation where assets are revalued or self-generated assets are recorded in the books of firm, and payment is made to partner in excess of his capital contribution

- Finance Bill, 2021 had proposed existing s.45(4) to be substituted by new s.45(4) and (4A)

- At the enactment stage of Finance Bill, 2021, a revamped version of these provisions was introduced, with introduction of new s.9B and substitution of s.45(4)

SECTION 9B:

- Provides for taxation on firm, by deeming receipt of capital asset or stock in trade or both by specified person (partner) from specified entity (firm) in connection with dissolution or reconstitution as a **deemed transfer**
- Firm is taxable much in the same manner as firm would have transferred such assets in favour of an outsider
- Any profits and gains arising from such deemed transfer is deemed to be the income of firm
- Chargeable as capital gains or business income in accordance with provisions of the Act
- FMV of capital asset or stock in trade or both on date of such receipt by partner is deemed to be full value of consideration received or accruing

SECTION 45(4):

- 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, 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

- 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

COMMON ASPECTS BETWEEN SECTION 9B AND 45(4):

- 'Specified entity' means firm/LLP/AOP/BOI - not being a company or a cooperative society
- 'Specified person' means a person, who is a partner of firm or member of AOP/BOI in any previous year
- When a capital asset is received by a partner from a firm in connection with reconstitution of firm, s.45(4) shall operate in addition to s.9B and taxation u/s. 9B shall be worked out independently
- Reconstitution" of the firm means, where:
  - One or more partners cease to be partners; or
  - 'One or more new partners are admitted in such circumstances that one or more persons who were partners before the change, continue as such after the change; or
  - All the partners continue with a change in their respective shares or in the shares of some of them
- 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

COMPARATIVE ANALYSIS OF ERSTWHILE 45(4) AND NEW SECTION 9B AND 45(4):

Sr. No.	Parameters	Erstwhile s. 45(4)	New s. 9B	New s. 45(4)
1.	Taxable entity	Firm*	Firm*	Firm*
2.	Event of trigger of taxability	Transfer of **capital asset** by way of distribution, on dissolution or otherwise of firm	Receipt of **capital asset** or **stock in trade** or both by partner in connection with dissolution or reconstitution of firm	Receipt of **money** or **capital asset** or both by partner in connection with reconstitution of firm
3.	Year of taxability	Transfer of capital asset	Receipt by partner	Receipt by partner
4.	Head of income	Capital gains	Capital asset – Capital gains Stock in trade – Business income	Capital gains - as per formula A = B + C – D
5.	Quantum of consideration	FMV of capital asset on date of transfer	FMV of capital asset or stock in trade or both on date of receipt by partner	Value of money (B) + FMV of capital asset (C) on date of receipt by partner

** While the above table is based on partnership firm and partner, it will apply equally to AOP/BOI and their members*

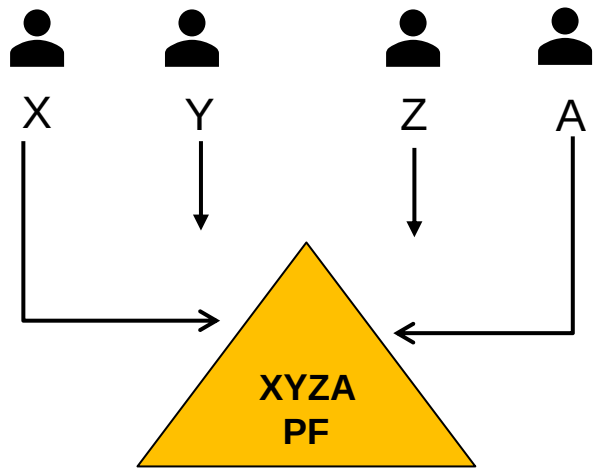
COMPARATIVE ANALYSIS OF ERSTWHILE 45(4) AND NEW SECTION 9B AND 45(4):

Sr. No.	Parameters	Erstwhile s. 45(4)	New s. 9B	New s. 45(4)
6.	Cost of acquisition	As per s.48/49 in respect of capital asset transferred	As per s.48/49 in respect of capital asset transferred	Partner's capital account balance (represented in any manner)** at the time of reconstitution
7.	Treatment of loss	Loss admissible	Loss admissible	Not admissible
8.	Interplay between different provisions	Not applicable	Not specified	S.45(4) shall operate in addition to s.9B and both shall be worked out independently
9.	Reduction from sale consideration due to capital gains taxation in hands of firm	Not applicable as capital asset is no longer with firm	Not applicable	S.48 (iii) contemplates reduction from sale consideration on transfer of remaining capital assets, as per prescribed rules

COMPARATIVE ANALYSIS OF ERSTWHILE 45(4) AND NEW SECTION 9B AND 45(4):

Sr. No.	Parameters	Erstwhile s. 45(4)	New s. 9B	New s. 45(4)
11.	Definition of 'reconstitution', 'specified entity' and 'specified person'	Not applicable – Refer back to judicial conflict on whether 'retirement' falls within scope of s.45(4)	Includes retirement, admission or change in profit sharing ratio	Same as in section 9B
12.	CBDT's power to issue guidelines to remove difficulties	Not applicable	Exists – Binding on both tax authority and taxpayers on placing before both Houses of Parliament	Same as in section 9B

RETIREMENT OF PARTNER SETTLED IN CASH:



Indicative balance sheet			
X Capital	5,000	Assets (FMV 18,000	12,000
Y Capital	5,000	Land (FMV 5000)	1,000
Z Capital	5,000	Cash	7,000
A Capital	5,000		
Total	**20,000**		**20,000**

- XYZA Partnership Firm ("PF") has equal partners X, Y, Z and A with capital of 5,000 each.
- XYZA PF has land acquired at cost of 1,000 whose FMV is 5,000 (obtained through a valuation report)
- Land is held as a long-term capital asset
- X retires from the firm and his account is settled in cash 6000 after considering FMV of land.
- X is paid 6000 against his capital balance of 5000 (ignoring revaluation)
- 6000 is represented by capital of 5000 plus 1/4th share in value appreciation of 4000
- Tax implications on the next slide

RETIREMENT OF PARTNER SETTLED IN CASH:

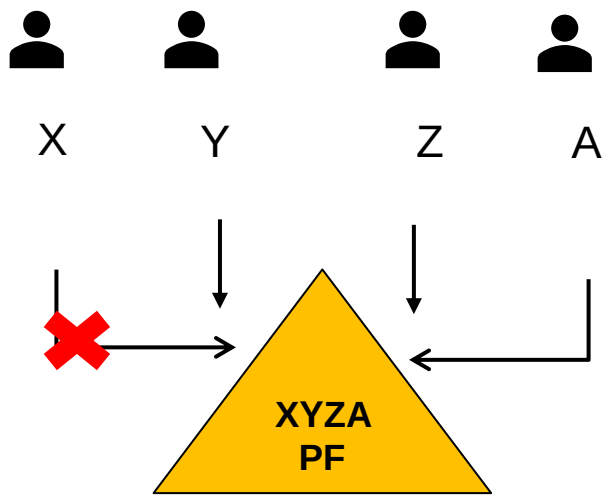
- **Tax Implications:**

Particulars	S.9B	S.45(4)
Money received (B)	N.A	6000
FMV of capital asset received (C)	N.A	N.A.
Capital balance (D)	N.A	(5000)
Capital gains in hands of firm (A)	N.A	1000

- S.9B does not trigger as no capital asset/SIT* is distributed to partner
- Amount of 1000 is attributed to revaluation of land
- S.48(iii) - Reduce 1000 from sale consideration on transfer of land in future by firm
- Say, if firm sells land for 6,000, cost of acquisition (ignoring indexation) is 1,000 and amount attributed is 1000, net CG = 4000

* *SIT = Stock in Trade*

RETIREMENT OF PARTNER SETTLED THROUGH STOCK IN TRADE (SIT):



Indicative balance sheet			
X Capital	5,000	SIT (FMV 18,000)	12,000
Y Capital	5,000	Land (FMV 12,000)	8,000
Z Capital	5,000		
A Capital	5,000		
Total	**20,000**	**Total**	**20,000**

- APF has equal partners X, Y, Z and A with capital of 5,000 each. Many assets are held by the firm including stock at BV of 12000 and FMV of 18000
- X is retiring and his account is settled by giving half SIT (BV*=6000 and FMV=9000)

** BV = Book Value*

RETIREMENT OF PARTNER SETTLED THROUGH STOCK IN TRADE (SIT):

- **Tax Implications u/s. 9B**

Particulars	Amount
FMV of SIT	9000
Cost of SIT	6000
Business income in the hands of firm	3000

- Here 9B applies as asset transferred is SIT
- S.45(4) does not apply as the distribution is not of a capital asset or money
- Consequently, there is no question of attribution as prescribed u/s. 48(iii)
- Cost of acquisition in the hands of the partner will be the FMV

RETIREMENT OF PARTNER SETTLED THROUGH CAPITAL ASSET

- A PF has equal partners A1, A2, A3 and A4 with capital of 5,000 each. Out of many assets held by firm, land is held as a long-term capital asset with Book Value of 7000
- A1 is retiring and his account is settled by giving land of which FMV is 9000. Here 9B and 45(4) both apply. Assumed tax rate for LTCG is 20% and STCG is 15%
- **Capital Gains Tax Liability u/s. 9B**

Particulars	Amount
Deemed FVOC i.e. FMV	9000
Cost of Acquisition (i.e. Book Value) (indexation ignored here)	7000
LTCG	2000
Tax Payable @ 20% u/s. 9B	400

- Now, distribute the following amount to the all the partners including A1 in their PSR

Particulars	Amount
FMV considered u/s. 9B	9000
(-) Book Value of asset	7000
(-) Tax Paid u/s. 9B	400
Amount to be distributed in PSR	1600

- After this distribution the revised capital balances of all the partners stand enhanced at 5400 each. [5000 + (1600/4)]

RETIREMENT OF PARTNER SETTLED THROUGH CAPITAL ASSET

- **Capital Gains Tax Liability u/s. 45(4) using formula A = B + C – D**

Particulars	Amount
FMV of asset received by partner	9000
(+) Value of money received (if any)	NIL
(-) Capital Balance post distribution u/s. 9B	5400
Capital Gain	3600

- Nature of capital gain depends on the nature of the assets to which such gain is attributed to and tax will be paid accordingly i.e. either 15% or 20%
- The firm gets the cost step-up due to attribution as prescribed u/s. 48(iii) r.w.r. 8AA(5) when the assets to which the CG is attributed are sold in future.

DETERMINATION OF NATURE OF CG

- The capital gain calculated u/s. 45(4) shall be charged to tax as either short term or long term in the proportion of increase due to revaluation and nature of remaining assets to which such gain is attributed to of the firm u/s. 48(iii) – Rule 8AA(5)

S.N.	Where s.45(4) CG are attributed, in whole or in part, to	Nature of CG 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/ intangible assets (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

- 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 / depreciable asset

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

DETERMINATION OF NATURE OF CG

- At the time of transfer, amount so attributed to depreciable capital asset is reduced from moneys payable (or sale consideration, if s.50 applies) and only net amount is reduced from WDV (or charged as short-term capital gains, if s.50 applies)

- However, ‘actual cost’ remains intact - no depreciation or indexation benefit is available on amount so attributed (Circular No. 14/ 2021)

MANNER OF ATTRIBUTION OF S.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 on or before the due date of filing ROI

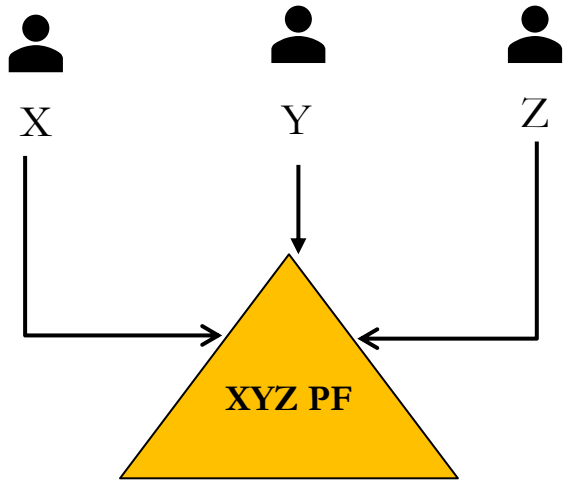
DETERMINATION OF NATURE OF CG – INTANGIBLES / SELF-GENERATED ASSET

- Capital gains u/s. 45(4) attributable to self-generated goodwill/asset are deemed as ST CG, even if such self-generated goodwill/asset is held for > 3 years by firm and qualifies as LTCA in hands of firm

  - If s.45(4) only results in preponing capital gains tax liability to the point of realization by partner as compared to sale of LTCA by firm, whether deeming s.45(4) capital gains as STCG is contrary and ultra vires Act?

  - Rule 8AA(5) states that s.45(4) capital gains attributable to self-generated goodwill/asset or depreciable assets "shall be deemed to be from transfer of short term capital asset" – whether such deeming fiction is limited only to s.45(4), so as to deny indexation benefit? Whether benefit of s.112, s.54EC can still be availed for an asset which is otherwise long term in nature by relying on SC decision of CIT v. Dempo Company Ltd. [2016] 74 taxmann.com 15

CASH PAY OUT ON RETIREMENT INVOLVING GOODWILL IN BOOKS



Indicative balance sheet			
X Capital	500	Land (FMV 2,100)	1,500
Y Capital	500	Goodwill (FMV 3,000)	-
Z Capital	500		
Total	**1,500**	**Total**	**1,500**

- XYZ PF has 3 partners having equal PSR and equal capital contribution
- XYZ PF has land acquired at cost of 1,500 whose FMV is 2,100
- Land is held as a long-term capital asset
- Firm also has self-generated goodwill of 3,000
- 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 1,700 against his capital balance of 500 (ignoring revaluation)
  - 1,700 is represented by capital of 500 plus 1/3rd share in value appreciation of 3,600 (600+3000)
- Refer next slide for tax implications

CASH PAY OUT ON RETIREMENT INVOLVING GOODWILL IN BOOKS

Particulars	S.9B	S.45(4)
Money received	Not applicable as no capital asset or SIT is distributed	1,700 [B]
FMV of capital asset received		- [C]
Partner's capital balance		500* [D]
Capital gains in hands of firm		1,200 [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 / C	1,200 x 600 / 3,600	200 LTCG	400 LTCG (2,100-1,500-200)
Valuation of self-generated goodwill	S.45(4) CG x	B / C	1,200 x 3,000 / 3,600	1,000 STCG	2,000 LTCG (3,000-1,000)

- 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

In case of decline in value of assets, rules do not offer any guidance – however, if assets are impaired in books under accounting standards, no controversy arises

NON DETERMINATION OF NATURE OF CAPITAL GAINS UNDER S. 45(4)- WHETHER CHARGE FAILS?

- S. 45(4) provides for taxation of money or capital asset received by partner from firm in connect with reconstitution as 'capital gains'.
  - Section does not provide any guidance on nature of CG whether short term or long term
  - ITA provides for different tax treatment for STCG and LTCG.
  - Rule 8AA(5) seeks to provide manner of determination of nature of capital gains basis underlying capital asset retained by the firm-subject to valuation report.
- If charge is inadequate or there is ambiguity in determination of components of tax, charge may fail– Govindsaran Gangasaran v CST [1985] 155 ITR 144 (SC)
  - Where the rate is not stipulated or it cannot be applied with precision, it would be difficult to tax a person - CIT v. Vatika Township (P.) Ltd. [2014] 227 Taxman 121 (SC)
- Under following circumstances, it may be difficult or not possible to ascertain nature of capital gains under s. 45(4):
  - No specific mandate on firm to obtain a valuation report - If no valuation report is obtained, nature of capital gains (whether short-term or long-term) u/s. 45(4) remains undetermined?
  - In case where retired partner receives cash from firm which is wholly attributable to value appreciation in SIT retained by the firm, capital gains taxed under s.45(4) is not attributed to any capital asset of firm. Consequently, Rule 8AA(5) fails.

WHETHER RULE 8AA(5) IS APPLICABLE TO RECEIPT IN CONNECTION WITH RECONSTITUTION IN A.Y. 2021-22?

- Rules are silent on the effective date
- Website of Income-tax Department suggests that the rules are effective from 2 July 2021
- Principles of law relevant for ascertaining effective date :
  - In absence of any effective date specified in notification, notification shall apply from date of publication in Official Gazette*
  - Law to be applied for determining tax liability is the law in force as on the first day of relevant assessment year, unless otherwise stated or implied**
- Ambiguity survives on applicability of rules for receipts in A.Y. 2021-22 (previous year 2020-21)
- **View 1: Rules are applicable even to receipts in A.Y. 2021-22**
  - Rules which effectuate the purposes for which the statute was enacted, are effective from the date on which the statute has become operative***
- **View 2: Charge fails?**
  - CBDT could have notified rules retrospectively, but chose not to do so
- **View 3: Charge survives, but compute capital gains by reference to life of partnership interest?**

**UOI v. Ganesh Das Bhojraj (2000) 244 ITR 691 (SC), UOI v. Param Industries Ltd. [2015] 321 ELT 192 (SC)*
*** CIT v. Isthmian Steamship Lines [1951] 20 ITR 572 (SC)*
**** S.A.L. Narayan Row v. Ishwarlal Bhagwandas [1965] 57 ITR 149 (SC)*

OTHER ILLUSTRATIVE ISSUES

ISSUE 1: IS TAX U/S. 45(4) TRIGGERED UPON PARTNER RETIRING FROM THE FIRM, OR UPON ACTUAL RECEIPT FROM FIRM?

- A partner retires in March 2021 whose account is settled in March 2022 by cash payment. Whether s.45(4) triggers in FY 2020-21 or FY 2021-22?

- **View 1:- Once a partner retires and entitlement is determinate as a creditor, charge u/s. 45(4) is triggered**

- **View 2:- Word 'receives' refers to actual receipt by the partner from the firm; acknowledgement of debt in favour of retiring partner is insufficient**

ISSUE 2: WHETHER S.45(4) IS PROSPECTIVE OR RETROSPECTIVE?

- Partner retires in March 2020, but his account is settled in April 2020 by cash payment* – Is s.45(4) triggered, which is effective from AY 2021-22?
- **View 1:- S.45(4) applies**
  - It is deeming fiction of receipt-based taxation, like ss.45(1A) and 46(2) – Since receipt by partner from firm is post 1 April 2020, s.45(4) applies

- **View 2:- S.45(4) does not apply**
  - 'Reconstitution' is defined as where a person "ceases" to be a partner of firm – where such cessation took place before introduction of law, it is not 'reconstitution'
  - S.45(4) only shifts timing of taxation to actual receipt – basis of taxation continues to be accrual – which, in the present case, happened in March 2020

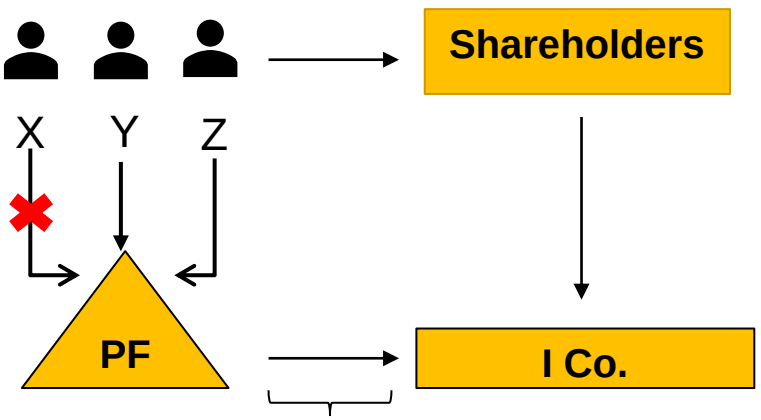
** Controversy applies equally to settlement by distribution of capital asset in April 2020*

ISSUE 3: WHETHER S.9B IS PROSPECTIVE OR RETROSPECTIVE?

- Partner retires in March 2020, but his account is settled in April 2020 by distribution of capital asset – Is s.9B triggered, which is effective from AY 2021-22?
- **View 1:- S.9B applies**
  - S.9B concerns taxability on the part of the firm w. r. t. parting of CA or SIT

- **View 2:- S.9B does not apply**
  - Retirement in March 2020 could not have resulted into creation of a debt against firm – legally, a partner can never be creditor of the firm; he is creditor of other partners
  - In absence of saving clause for past reconstitution, lacuna in legislation cannot justify the trigger of charge

ISSUE 4: IMPACT OF CORPORATISATION OF FIRM U/S. 47(XIII) OR CHAPTER XXI POST RETIREMENT



Indicative balance sheet			
X Capital	1,000	Land (FMV 9,000)	3,000
Y Capital	1,000		
Z Capital	1,000		
Total	**3,000**	**Total**	**3,000**

- XYZ LLP has 3 partners having equal PSR and equal capital contribution
- Partner X retires w. e. f. 1 January 2021
- Value of X's interest is determined at 3,000, which is payable in cash by LLP to X at the end of three years, i.e. on 31 December 2023
- X is recognized in books of LLP as a creditor
- Post retirement, remaining partners decide to carry on business in the form of a corporate structure
- On 31 March 2021, Y and Z form a company 'I Co.', infuse capital therein, and I Co. purchases business from LLP for a lump sum consideration – such conversion is exempt u/s. 47(xiii)
- On 31 December 2023, I Co. discharges the debt in favor of X by payment of cash
- Assuming charge u/s. 45(4) is triggered on actual receipt, can such charge trigger even where debt is repaid by I Co. and not by LLP?

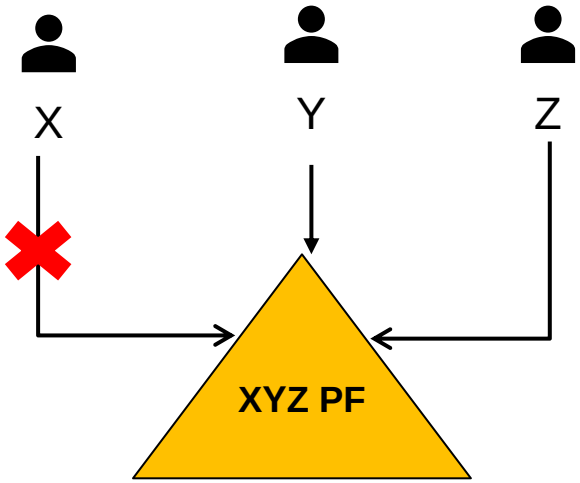
ISSUE 4: IMPACT OF CORPORATISATION OF FIRM U/S. 47(XIII) OR CHAPTER XXI POST RETIREMENT

- S, 45(4) triggers charge "where specified person receives money ……from a specified entity….."
- At the stage of conversion in year 1, retired partner receives debt owed by I Co. in lieu of debt owed by firm/LLP – retired partner does not receive any money from the firm/LLP
- At the stage of discharge of debt by I Co. in year 3, retired partner receives money from I Co. which is not a 'specified entity'
- Charging provisions require strict construction – absence of receipt by partner from 'specified person' may frustrate the charge?

Additionally, corporatisation u/s. 47(xiii) involves novation of debt as inter-vivos transfer

- Novation involves discharge of original debt due by LLP and substitution by fresh debt due by I Co.
- Such discharge is not by way of repayment but by way of a mutual agreement

ISSUE 5: IMPACT OF PARTNER'S CAPITAL ACCOUNT TURNING NEGATIVE BY IGNORING REVALUATION



Indicative balance sheet			
X Capital	1,000	Land (FMV 9,000)	3,000
Y Capital	1,000		
Z Capital	1,000		
Total	**3,000**	**Total**	**3,000**

- XYZ LLP has 3 partners having equal PSR and equal capital contribution
- In year 1, partner X desires to withdraw cash from his capital account for personal purposes
  - In year 1, land is revalued by firm and revaluation profit of 6,000 is credited in equal proportion to capital account of all three partners
  - Out of total credit balance in partner's capital account of 3,000 (viz. 1,000 capital contribution and 2,000 revaluation), partner X withdraws cash of 2,500 in year 1
- In year 2, partner X retires from LLP
- Amount payable to X on retirement is determined at 500, which is payable in cash in year 2
- Since retiring partner's account is settled in cash, s.9B does not trigger
- Refer next slide for s.45(4) implications

Issue 5: Impact of partner's capital account turning negative by ignoring revaluation

Particulars	If no withdrawal in year 1	Post withdrawal in year 1
Money received in connection with reconstitution	3,000 [B]	500 [B]
FMV of capital asset received	- [C]	- [C]
Partner's capital balance at the time of reconstitution	(1,000) [D]	(- 1,500*) [D]
Capital gains u/s. 45(4) in hands of firm	2,000 [A = B + C – D]	2,000 [A = B + C – D]

**Compute without taking into account increase due to revaluation of any asset*

X's capital account per books (post revaluation)			
Particulars	**Debit**	**Particulars**	**Credit**
Year 1			
To Withdrawal in year 1	2,500	By Opening b/f	1,000
To Closing c/f	500	By X's share on revaluation of land	2,000
Total	**3,000**	**Total**	**3,000**
Year 2			
		By Opening b/f	500

Memorandum capital a/c (ignoring revaluation)			
Particulars	**Debit**	**Particulars**	**Credit**
Year 1			
To Withdrawal in year 1	2,500	By Opening b/f	1,000
		By X's share on revaluation of land	Ignored *
		By Closing c/f	1,500
Total	**2,500**	**Total**	**2,500**
Year 2			
To Opening b/f	1,500		

ISSUE 6: WAIVER OF DEBIT BALANCE IN PARTNER'S CAPITAL ACCOUNT ON RETIREMENT

- In earlier case study, assume that partner X withdraws cash of 3,500 in year 1 for personal purposes, against his capital balance of 3,000 (post revaluation)
- Firm waives of 500 due from partner X and also, nothing further is paid to partner
  - CIT v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC): "waiver of loan by the creditor results in the debtor having extra cash in his hand. It is receipt in the hands of the debtor."
- Hence, waiver of 500 by firm results in receipt of extra cash in hands of partner from firm

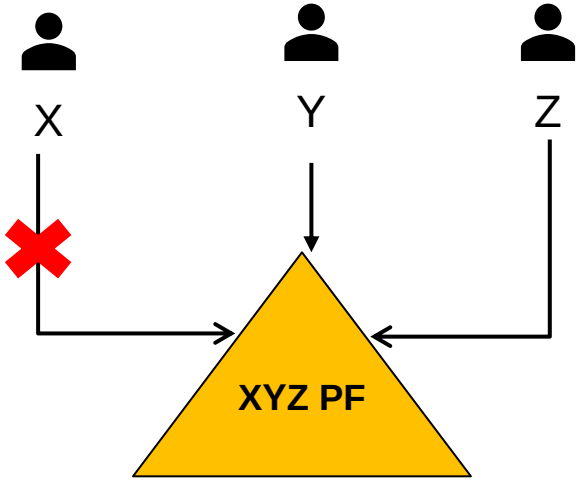
Particulars	Amount
Money received in connection with reconstitution	500 [B]
Partner's capital balance at the time of reconstitution	(2,000) [D]
Capital gains u/s. 45(4) in hands of firm	2,500 [A = B + C – D]

ISSUE 6: WAIVER OF DEBIT BALANCE IN PARTNER'S CAPITAL ACCOUNT ON RETIREMENT

- In earlier Memorandum Capital Account of Partner X (ignoring revaluation) is as under:-

Memorandum Capital Account of Partner X			
Particulars	**Debit**	**Particulars**	**Credit**
Year 1			
To Withdrawal in year 1	3,500	By Opening b/f	1,000
		By X's share on revaluation of land	Ignored*
		By Closing c/f	2,500
Total	**3,500**	**Total**	**3,500**
Year 2			
To Opening b/f	2,500	By P&L account (waiver in year 2)	500
		By Closing c/f	2,000

issue 7: is s.45(4) applicable on receipt by legal representative of deceased partner?



Indicative balance sheet			
X Capital	1,000	Land (FMV 9,000)	3,000
Y Capital	1,000		
Z Capital	1,000		
Total	**3,000**	**Total**	**3,000**

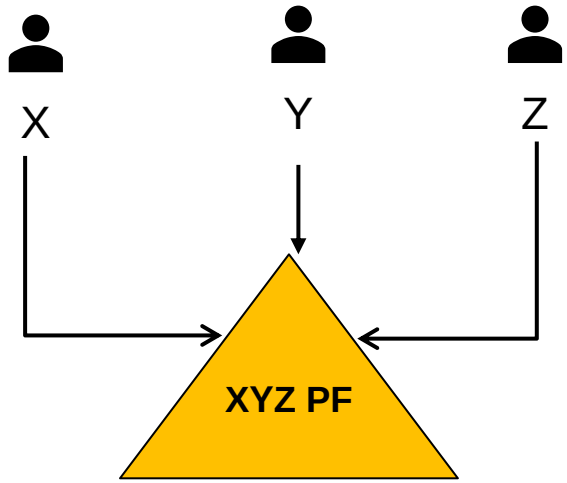
- XYZ PF has 3 partners having equal PSR and equal capital contribution
- Partner X expires
- As per partnership deed, account of deceased partner X is to be settled at fair value in favour of his legal heir without admitting him as partner
- Continuing partners Y and Z bring in cash for payment to legal heir of X
- While there is no dispute that death of partner gives rise to reconstitution of the firm; limited issue is whether s.45(4) gets triggered when the legal heir receives settlement of deceased partner's capital account.
- S, 45(4) states 'where **a specified person receives** money……from specified entity…'
- 'Specified person' is defined to mean **a person who is partner of a firm**…..

ISSUE 7: IS S.45(4) APPLICABLE ON RECEIPT BY LEGAL REPRESENTATIVE OF DECEASED PARTNER?

- **View 1:- S.45(4) applies**
  - Legal heir steps into shoes of deceased partner - payment is made to legal heir pursuant to right conferred on deceased partner in terms of partnership deed
  - Concept of 'substituted assessee' enshrined in s.49(1) of ITL – to also be read into s.45(4)
  - C.V. Ramanathan v. CIT [1980] 125 ITR 191 (Madras) – exemption u/s. 54 allowed to deceased taxpayer even where the investment in new house was made by son of deceased taxpayer
- **View 2:- S.45(4) does not apply**
  - Legal heir was never admitted into partnership – hence, is not a 'specified person' – charge fails in absence of receipt by a 'specified person' –
  - Being a charging provision, strict interpretation required
  - S.159/168 provide taxing deceased person's income in hands of legal representatives/executor – such provisions are inapplicable to present case as taxation u/s. 45(4) is in hands of firm
  - A specific provision along the lines of Explanation (iii) to s.45(5) is needed for taxing receipt by legal heir
  - Interest paid by firm to estate of deceased partner administered by trustee, is not hit by s.40(b) as such trustee was never admitted as a partner in firm [Colombo Stores (1984)(17 Taxman 183)(Madras HC)]

Where firm having 2 partners is dissolved due to death of one partner, and business is continued by legal heir with surviving partner, there may be emergence of AOP/BOI

ISSUE 8: WITHDRAWAL OF FIRM'S PROPERTY BY PARTNERS IN THEIR PSR



Indicative balance sheet			
X Capital	1,000	Business (FMV 6,000)	2,000
Y Capital	1,000	Land (FMV 3,000)	1,000
Z Capital	1,000		
Total	**3,000**	**Total**	**3,000**

- XYZ PF has 3 partners having equal PSR
- XYZ PF has two assets, one being business with book value of 2,000 (whose FMV is 6,000) and another being land with book value of 1,000 (whose FMV is 3,000)
- For diverse commercial and social considerations and for bona fide reasons of long-term sustenance of partnership relations, a decision is taken to distribute certain firm's properties
- Accordingly, Land B (having FMV of 3,000) is distributed to X against his entitlement of 3,000
- Firm debits book value of Land B against X's capital account balance
- In absence of any dissolution/reconstitution, s.45(4)/s.9B may not trigger in hands of PF
- Whether s.45(1) triggers in hands of firm? If yes, whether consideration is debit to partner's capital account? Whether s.50C applies?

ISSUE 8: WITHDRAWAL OF FIRM'S PROPERTY BY PARTNERS IN THEIR PSR

- **View 1:- S.45(1) may not trigger in hands of firm:-**
  - Despite s.14 and s.15 of Indian Partnership Act, firm is not a separate legal entity but a compendium of partners, firm cannot function without partners, and as a result, real owners of firm's property are partners who are effective co-owners in their profit sharing ratio

- **View 2:- Capital gains u/s. 45(1) r. w. s. 50C are attracted:-**
  - S.14 and s.15 of Indian Partnership Act provides that firm can acquire and own assets*

In case of withdrawal from LLP, View 2 becomes stronger as LLP Act regards LLP as a body corporate, capable of acquiring, owning, holding disposing of property

CERTAIN ADDITIONAL POINTS

- S.9B and s.45(4) are independent charging provisions; absence of back up amendment to definition of 'transfer' u/s. 2(47) or 'income' u/s. 2(24) may not frustrate the charge
- S.9B(3) deems FMV of capital asset or SIT as full value of consideration received or accruing as a result of deemed transfer - where stamp duty value is > FMV, whether the same substitutes FMV?
  - Arguably, no - S.9B(3) begins with the words "for the purposes of this section" – such a specific provision for ascertaining sale consideration shall prevail over all other general provisions such as s.43CA or s.50C
- As per s.45(4), partner's capital account can be "represented in any manner" in the books of the firm
  - In the context, both fixed capital and fluctuating capital account will be considered for s.45(4)
    - However, an account created due to loan is, strictly speaking, not a "capital account"
- S.56(2)(x) implications in each case in the hands of the partner need to be evaluated separately as the partner either receives cash, movable property (SIT) or immovable property (land) for a consideration which is lower than the FMV of the asset
- If retiring partner is from a jurisdiction that has favourable capital gains article in tax treaty with India, can firm suggest that s.45(4) charge is not attracted as firm and partners are alternative taxpayers and if partner is treaty protected, there can be no taxation on firm?
- For example, Article 13(5) of India-Netherlands treaty provides that "Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4 shall be taxable only in the State of which the alienator is a resident"

CERTAIN ADDITIONAL POINTS

- Firm may convert capital asset into stock in trade before distribution to partner upon reconstitution – such conversion may avoid duplicated taxation u/s. s.45(4) subject to GAAR
  - Upon distribution to partner, firm attracts taxation u/s. 45(2) w. r. t. FMV on date of conversion
  - S.9B impact is confined to appreciation beyond aforesaid FMV
  - Since receipt by partner is SIT which is neither money nor capital asset, s. 45(4) will not trigger.

CIT VS. MANSUKH DYEING AND PRINTING MILLS (145 TAXMANN.COM 151)

- Facts of the case:

  In the present case (AY 1992-93), the Respondent admitted four new partners who contributed small amounts of capital to the Respondent. Shortly thereafter, the Respondent revalued land and building (held as capital assets) and credited huge gains on revaluation to capital accounts of all the partners in their PSR and two of the existing partners withdrew small amounts from their capital balance. The tax authority invoked the erstwhile section 45(4) of the Act on the basis that huge gains on revaluation of capital assets credited to partners' capital accounts was "in effect" a distribution of those capital assets by the Taxpayer to the partners, as the enhanced capital balance immediately became available to all the partners for withdrawal.

- Respondent's arguments:

  The Taxpayer contended that old section 45(4) was inapplicable as there was neither a transfer by way of distribution of capital assets by the Taxpayer to the partners, nor any transfer on account of dissolution of the Taxpayer or otherwise. The Taxpayer contended that there can be no income just due to revaluation of capital assets in the books of the Taxpayer, unless the capital assets themselves are also transferred.

- Decision of the Hon'ble Supreme Court:

  SC held that, credit of revaluation gain to partners' capital accounts can be said to be in effect distribution of the capital assets valued at their fair market value (FMV). Further, the partners' capital accounts stood enhanced upon revaluation, which became available for withdrawal and in fact some of the partners had withdrawn such amounts subsequently from their capital accounts. Therefore, such revaluation could be said to be a "transfer", falling in the category of "or otherwise", in terms of old section 45(4).

  The Hon'ble Supreme Court also affirmed a Bombay High Court ruling in case of A.N. Naik Associates [(2004) 265 ITR 346 (Bombay HC), which held that the word "or otherwise" covers not only distribution of capital assets on dissolution but also subsisting partners transferring the firm's capital assets in favor of a retiring partner.

  The Hon'ble Supreme Court also distinguished its earlier ruling in case of Hind Construction [(1972) 83 ITR 211 (SC)] which regarded revaluation of goods to be non-taxable as inapplicable to the present case, as its earlier ruling dealt with pre-amended provisions where the term "or otherwise" was absent.

TAX RATES APPLICABLE TO CORPORATES

TAX RATES (GENERAL):

Particulars	Section 115BAA @ 22% (Surcharge @10%)	Finance Act 2022 [25%*/30%]
Applicable from	AY 2020-21	-
Condition as to commencement	-	-
Deduction, losses, depreciation not allowed	➢ 10AA, 32(1)(iia), 32AC, 32AD, 33AB, 33ABA, 35, 35(i), 35(1)(ii),(iia), (iii), 35(2AA), 35(2AB), 35AD, 35CCC, 35CCD, Chapter VI-A deductions [other than 80JJAA or 80M] ➢ In case of amalgamation, loss or allowance of unabsorbed depreciation (relating to additional depreciation) would not deemed so under section 72A of the amalgamating company if such loss or allowance is in relation to the above ➢ Depreciation [other than 32(1)(iia)]	NA
MAT Applicability	MAT Not Applicable	MAT applicable
Voluntary applicability	Once opted cannot opt out except for 115BAB	-

* 25% in case of domestic company whose total turnover for previous year 2019-20 is at the most Rs. 400 Cr.

SECTION 115BAA - CARRY FORWARD OF LOSS AND UNABSORBED DEPRECIATION:

Nature of Item	Provisions
Business loss	Allowed
Loss in relation to incentives mentioned above	Not Allowed
Loss in relation to R&D expenses (S. 35(1)(i) & (iv)	Allowed
Loss/ unabsorbed depreciation in relation to normal depreciation	Allowed
Loss / unabsorbed depreciation in relation to additional depreciation	Not Allowed (Circular 29/2019 has clarified that loss in relation to additional depreciation cannot be carried forward)

Proviso to section 115BAA(3) of the Act states that if there is any unabsorbed depreciation in respect of the block of asset for which no effect is given, corresponding adjustment (i.e. to be added) should be made to the value of block as on 1 April 2019. This is to benefit the companies to the extent that depreciation that has not been given full effect to would not put them to disadvantage vis a vis companies who did not claim these higher depreciation.

SECTION 115BAA – OTER KEY POINTS:

- In case of domestic companies who have exercised option under section 115BAB of the Act (15% scheme) and this 15% option has been rendered invalid due to violation of some of conditions contained herein, such companies can exercise option under section 115BAA of the Act (22% scheme) subject to satisfaction of conditions of this section.

- Thereby it is clarified that if company fails 15% scheme it would not directly fall in the 30% bracket but would have the option to avail benefit of 22% scheme (subject to fulfilment of certain conditions).

TAX RATES (FOR DOMESTIC COMPANIES ENGAGED IN MANUFACTURING/ PRODUCTION):

Particulars	Section 115BA @ 25%	Section 115BAB @ 15% (Surcharge @10%)
Applicable from	AY 2017-18	AY 2020-21
Condition as to commencement	Company set up & registered on or after 01 March 2016	Company set up & registered on or after 01 October 2019 and commence manufacturing on or before 31 March 2024. Option to be exercised in first return filed under section 139(1) of the Act.

Condition as to nature of business	Engaged in manufacture/ production of articles/ things and research of articles or things	➢ Engaged in manufacture/production of articles or things as well as research and distribution of articles or things
		➢ Business not formed by splitting up or reconstruction
		➢ Does not use any machinery or plant previously used for any purpose except:
		  ➢ Imported assets subject to certain conditions
		  ➢ Use of previously used plant & machinery to the extent of 20% of total value of machinery or plant is permissible
		➢ Does not use building previously used as a hotel or convention centre in respect of which 80-ID deduction has been claimed and allowed

TAX RATES (FOR DOMESTIC COMPANIES ENGAGED IN MANUFACTURING/ PRODUCTION):

Particulars	Section 115BA @ 25%	Section 115BAB @ 15% (Surcharge @10%)
Deductions, losses and depreciation not allowed	10AA, 32(1)(iia), 323(AD), 33AB, 33ABA, 35, 35(i), 35(1)(ii),(iia), (iii), 35(2AA), 35(2AB), 35AD, 35CCC, 35CCD, Chapter VI- A deductions [other than 80JJAA (for 115BA)/ 80JJAA and 80M (for 115BAB)]	
	➢ 32AC and 32AC ➢ Carried forward loss attributable to aforementioned deductions ➢ Depreciation [other than 32(1)(iia)]	➢ No set-off of loss carried forward from earlier AYs shall be allowed if such loss is attributable to any deductions stated above. Such losses are deemed to have been given effect to and no further deduction shall be allowed. ➢ In case of amalgamation, loss or allowance of unabsorbed depreciation (relating to additional depreciation) would not deemed so under section 72A of the amalgamating company if such loss or allowance is in relation to the above ➢ Loss in relation to R&D expenses and unabsorbed normal depreciation shall be allowed to be carry forward
Voluntary applicability	Once opted, cannot opt out except for 115BAA	Once opted (Form 10-ID), cannot opt out

TAX RATES (FOR DOMESTIC COMPANIES ENGAGED IN MANUFACTURING/ PRODUCTION):

Particulars	Section 115BA @ 25%	Section 115BAB @ 15% (Surcharge @10%)
Miscellaneous	MAT provisions are not applicable	➢ No sunset date as long as set up on or after 1 October 2019 and commences manufacturing on or before 31 March 2024 ➢ Any business transacted by company with any persons owing to close connection shall be subject matter of transfer pricing provisions ➢ Tax rates for other incomes: ➢ Income neither incidental to nor derived from manufacturing or production and for which no specific rate is provided – 22% on gross basis ➢ STCG on non-depreciable assets – 22% ➢ Profits in excess of ALP from parties close to taxpayer – 30% ➢ Income other than the above – 15% ➢ MAT provisions are not applicable ➢ From GAAR perspective, it is imperative to maintain documentation providing commercial justification for a change in a business model and / or expansion of business in a separate company.

SCOPE OF THE TERM 'MANUFACTURING AND PRODUCTION OF ARTICLE OR THING':

- The first test which needs to be satisfied is whether the activities carried out by the entity leads to dealing in 'article or thing' and thereafter, it needs to be tested whether such article or thing is outcome of manufacturing or production process.

- The term manufacturing has been defined under section 2(29BA) of the Income Tax Act, as under:

  "Manufacture", with its grammatical variations, means a change in a non-living physical object or article or thing,—
  (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
  (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure;"

- It is evident from the above, that the definition of 'manufacture' emphasises on change of composition of an article or thing which results in a new and a distinct object or thing, either with a different name, character and use or with a different chemical composition or integral structure.

USE OF PLANT & MACHINERY:

- Unlike other incentive provisions, which linked second hand P&M to “transfer”, S. 115BAB uses the expression “use”. This has expanded scope of restrictive conditions substantially and will apply to P&M taken on hire also. However, lease of machinery newly purchased and not used earlier should not disqualify the new Co. from claiming the benefit.

- Further, in the other incentive provisions, condition of transfer of second hand machinery was at the stage of formation of undertaking. However, no such terminology has been used in s.115BAB. Therefore, literal reading of the condition relating to use of second-hand machinery under S. 115BAB(2)(a)(ii) suggests that test if to be applied on year on year basis.

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SPLIT UP/ RECONSTRUCTION

Scope of the relevant terms	Splitting up of the business ➢ The integrity of a business in existence is broken up and different sections of the activities previously conducted are carried on independently Reconstruction of business ➢ The existing unit is merely altered (i.e. made into a new form) and the business is continued in such altered form. The identity of the business is not lost. Necessarily involves a substantial transfer of the assets from existing unit.
Key factors to be established	➢ Set-up with an intent to expand the capacity ➢ Significant investment in plant and machinery ➢ Operational independence ➢ Concurrent running of old and new unit ➢ Significant technological improvement ➢ Different Product ➢ Recruiting of new employees ➢ Sale of products of new customers

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SPLIT UP/ RECONSTRUCTION

Inconsequential aspects	➢ Use old premises/ building (not subject to deduction under section 80-ID) ➢ Common management as commercially expedient and without compromising the distinct identity ➢ Purchase or sale of goods to related party (subject to satisfaction of arms' length price
Instances	➢ Expansion of the capacity ➢ Backward/ forward integration
Formative or year on year condition	➢ Literal interpretation supports the view that the same should be tested only in the year of set-up. Thus, if the Tax Authorities is satisfied about compliance of the condition in the year of formation, the same should continue to govern subsequent years ➢ However, the Court has affirmed the above claim under specific facts and it can be argued that the condition needs to be satisfied at each stage of expansion in future

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SOLELY ENGAGED IN THE MANUFACTURRE AND PRODUCTION OF ARTICLE OR THINGS

Scope of the terms	➢ The term ‘manufacturing’ has been defined under section 2(29B) of the Act – change of composition of an article or thing which results in a new and a distinct object or thing, either with a different name, character and use
	➢ The term ‘production’ has not been defined – having regard to judicial precedents, it can be said that:
	  ➢ The word 'produce' is something which is brought forth or yielded either naturally or as a result of effort and work
	  ➢ Even if characteristic of article or thing remains that of underlying material, it may still be production if it results into commercially different saleable product – hence, as in case of manufacturing, production need not result into a distinct/ new article
	  ➢ Manufacturing is limited to non-living objects – however, production is not limited to non-living object [e.g. agriculture]
	  ➢ Thus, the word 'production' has a wider connotation than the word 'manufacture’

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SOLELY ENGAGED IN THE MANUFACTURRE AND PRODUCTION OF ARTICLE OR THINGS

Activities not regarded as manufacture or production of articles or things	Legislature inserted a clarificatory explanation restricting the scope and specifically excluding: ➢ Development of computer software in any form or in any media; ➢ Mining; ➢ Conversion of marble blocks or similar items into slabs; ➢ Bottling of gas into cylinder; ➢ Printing of books; ➢ Production of cinematograph films; or ➢ Any other business as may be notified by Central Govt in this behalf.

With aforesaid explanation the legislature has overruled various settled favourable judicial precedents including the decisions of SC, thereby compromising the intent of incentivizing investment and Make in India

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SOLELY ENGAGED IN THE MANUFACTURRE AND PRODUCTION OF ARTICLE OR THINGS

Industry which may still scope In	➢ Power Generation ➢ Food processing ➢ Fishing ➢ Jewellery ➢ Conversion ➢ Film Production
Sub-contractor/ Job worker – who can claim the benefit	Depends on the following important aspects as upheld by judiciary from time to time: ➢ Contract of work or contract for sale ➢ Control over the manufacturing process ➢ Undertaking the associated risk ➢ Manner of discharging consideration and accounting treatment – Sale of goods v. processing fees ➢ The volume of sub-contracting ➢ Significance of the process sub-contracted ➢ Investment made in the facility including plant & machinery ➢ Label on product – Manufactured by sub-contractor, while the product is marketed by the New Co. ➢ Industry practice

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SECOND HAND MACHINERY / BULIDING

Key distinction vis-à-vis other provisions of the Act	Conventionally, restriction applied to eligible undertaking not "formed by transfer" of second hand plant and machinery ➢ Section 115BAB mandates that the company "does not use" any plant and machinery previously used for any purpose ➢ Thus, on two counts the restriction under section 115BAB is distinct: a) It is not a formative conditions and hence, needs to be satisfied on year on year basis b) It applies to even the plant or machinery which is hired ➢ This condition requires stricter adherence on the part of taxpayer – also, if the goods are being manufactured through a job worker, the condition may extend to use of plant or machinery by such job worker ➢ It is perceived to be most controversial considering the broader language of the provision

ISSUES IN RELATION TO KEY CONDITIONS UNDER SECTION 115BAB

- SECOND HAND MACHINERY / BULIDING

Other issues	➢ How to determine 80:20 condition – in comparison with Gross value, Book WDV, Tax WDV or Fair Market Value('FMV') - FMV could be a better view ➢ Leads to subjective and possible reference to a valuation officer ➢ Whether the above condition is applicable only in relation to manufacturing process or extended to all functions at entity level – Basis language, applies to all functions

CONSEQUENCES, IN CASE THE BENEFIT OF SECTION IS DENIED:

- The 4th proviso to section 115BAB(1), provides that in case of violation of the conditions mentioned in sub-section (2) in any previous year, then the benefit under the provision of section 115BAB shall not be available for the AY relevant to the PY in which condition is breached and all the subsequent AYs. In such a case, the other provisions of the Act shall apply and the same shall be treated as option never been exercised.

- The issue arises whether in such a case, the Assessee shall be entitled to claim the benefit of lower corporate tax rate of 22% under the provisions of section 115BAA of the Act. Proviso to section 115BAA(5) provides certainty on this issue, wherein it has been provided that in case of breach of conditions under section 115BAB(2)(a)(ii) (P&M condition) or (iii) (use of building condition) or section 115BAB(2)(b) (solely engaged in manufacturing business condition), the Assessee shall be entitled to exercise option under section 115BAA of the Act.

- If the Assessee does not satisfy the condition of split-up or reconstruction which is governed by the provisions of section 115BAB(2)(a)(i) of the Act, as per the 4th proviso to section 115BAB(1) and considering that such clause is not covered under proviso to section 115BAA(5) as discussed above, it is likely that the Assessee shall be liable to tax under normal provisions. To mitigate the risk of taxability under normal provisions @ 30%, it can be explored if the declaration can be filed before filing the return of income with the Assessing Officer under both the provisions – section 115BAB and on a without prejudice basis under section 115BAA.

CONSEQUENCES, IN CASE THE BENEFIT OF SECTION IS DENIED:

- In case of denial, the risk of penalty provisions under section 270A getting invoked are less likely, since, the said section imposes penalty on under reporting of income or mis reporting of income and denial of the said section does not carry any impact on the income of the Assessee since the income remains the same and it's the tax rate which gets changed.

- However, the risk of prosecution provisions of section 276C – wilful attempt to evade payment of tax or section 277 - false statements in verification, cannot be ruled out. But one may still argue that in a case where penalty is not leviable, the same should be kept outside the scope of prosecution.

JUDICIAL DEVELOPMENTS IN CAPITAL GAINS TAXATION

RELEVANT TO THE REAL ESTATE SECTOR

Sr. No.	Particulars	Decision
1	Jogani and Dialani Land Developers and Builders [272 Taxman 111 (SC) (9 January 2020)]	Where High Court upheld Tribunal's order holding that in case of assessee, a builder, profit earned on sale of land kept as investment was to be taxed as long-term capital gain, SLP filed against said order was to be dismissed.
2	Lalitaben Govindbahi Patel [261 Taxman 453 (SC) (28 January 2019)]	SLP dismissed against High Court ruling that in case of sale of property, assessee was required to offer capital gain only in respect of amount actually received by him as per sale deed even though a part of sale consideration was also received by confirming party.
3	J.S. & M.F. Builders [426 ITR 460 (Bombay HC) (12 June 2020)]	Upon purchase of flat from builder, purchaser certainly acquires right or interest in proportionate share of land but its realisation is deferred till formation of co-operative society by flat owners and transfer of entire property to co-operative society; cost of land is to be considered while computing capital gains in hands of builder.

Sr. No.	Particulars	Decision
RELATING TO DEVELOPMENT AGREEMENT:		
4	Charanjit Singh [85 taxmann.com 144 (Punjab & Haryana HC) (24 March 2017)]	Where development agreement entered into between developer and housing society for development of land owned by society was not registered, pro-rata transfer of part of land would not fall within meaning of section 2(4)(v) of Income-tax Act, 1961 read with section 53A Transfer of Property Act
5	Balbir Singh Maini [251 Taxman 202 (SC) (4 October 2017)]	Where for want of permissions, entire transaction of development of land envisaged in Joint Development Agreement (JDA) fell through, there would be no profit or gain which arose from transfer of capital asset, which could be brought to tax under section 45, read with section 48
6	Ind Sing Developers (P.) Ltd. [239 Taxman 350 (Karnataka HC) (2 March 2016)]	Settlement amount received by assessee for foregoing its rights upon termination of AOP entered into by assessee for jointly developing property, whereby assessee agreed to provide land as capital contribution, was not taxable as settlement deed practically put an end to AOP and transfer of title in land was distribution of capital assets of AOP on its dissolution

Sr. No.	Particulars	Decision
7	P. Madhusudhan [419 ITR 194 (Madras HC) (11 June 2019)]	Where assessee, co-owner of a land, entered into a development agreement wherein assessee transferred certain area of land to developer and in return developer agreed to develop certain area of said land, since No Objection Certificate for transfer of property was issued by Appropriate Authority under section 269-UL and approval clearly stated extent of land which was agreed to be transferred, impugned transaction was said to be qualified as transfer under section 2(47)(v) Where assessee, owner of a land, entered into a development agreement with a developer to develop certain area of land, damages paid by developer on account of non-fulfilment of condition in agreement with regard to time limit of handling possession of constructed area to assessee would not be added as income in hands of assessee as long term capital gains Where assessee, owner of a land, entered into a development agreement for developing certain area of land and developer provided rent free accommodation to assessee till construction got over, since development agreement did not provide for any adjustment of payment on account of rent free accommodation against consideration payable under development agreement, same could not be included to income of assessee as long term capital gains Where development agreement entered into by assessee with builder clearly contemplated transfer of land along with building constructed thereon and this document of transfer was accepted and no objection certificate was also issued by Appropriate Authority, exemption under section 54 could not be denied to assessee

RELEVANT TO DEDUCTIONS UNDER SECTION 54 AND 54F OF THE ACT

Sr. No.	Particulars	Decision
1	Smt. Umayal Annamalai [273 Taxman 146 (Madras HC) (22 July 2020)]	Where assessee invested sale proceeds of old asset in new property before due date of filing belated return and took possession within three years, she was entitled to exemption under section 54F though she had not invested sale proceeds in Capital Gain Account Scheme before due date of filing of return under section 139(1)
2	Antony Parakal Kurian [442 ITR 38 (Karnataka HC) (9 December 2021)]	While considering exemption under section 54F, residential house purchased in spouse's name cannot be considered as property owned by assessee, thus, it cannot be construed as owned by assessee for determining eligibility for exemption under section 54F however investment in property registered in spouse's name is eligible for exemption under section 54
3	Arun K. Thiagarajan [272 Taxman 235 (Karnataka HC) (18 June 2020)]	For purpose of allowing benefit of deduction under section 54(1), expression 'a residential house' includes within its ambit plural numbers as well and, thus, it cannot be construed as one residential house only.
4	Ms. Moturi Lakshmi [274 Taxman 286 (Madras HC) (17 August 2020)]	Where advance was paid by assessee to purchase residential flat prior to sale of capital asset, such advance was to be considered as part of purchase for purpose of section 54

Sr. No.	Particulars	Decision
5	Venkata Dilip Kumar [268 Taxman 111 (Madras HC) (5 November 2019)]	Where assessee was in a position to satisfy that amount for which deduction was sought for under section 54 was utilised either for purchasing or constructing residential house in India within time prescribed under section 54(1), assessee could not be denied benefit of section 54 for mere non-compliance of a procedural requirement under section 54(2)
6	Vaidya Panalalmanilal (HUF) [259 Taxman 19 (Gujarat HC) (24 September 2018)]	Where consideration that arose in hands of HUF on sale of capital asset had been invested for purchase of new residential house in name of some of its members instead of assessee (HUF), deduction under section 54F in hands of HUF would still be permissible
7	C. Aryama Sundaram [258 Taxman 10 (Madras HC) (6 August 2018)]	Not only cost of construction of new property incurred after sale of old property would be eligible for exemption under section 54(1), but also cost of land on which new property was constructed, even if such land had been purchased three years prior to sale of old property.
8	Mrs. Hilla J.B. Wadia [216 ITR 376 (Bombay HC) (2 March 1993)] Mrs. Shakuntala Devi [389 ITR 366 (Karnataka HC) (28 September 2016)]	Utilization of capital gains in construction of residential house within a period of two years would suffice to claim exemption under section 54 irrespective of fact that neither sale transaction was concluded, nor registration had taken place within 2 years.

Sr. No.	Particulars	Decision
9	G. Chinnadurai [74 taxmann.com 227 (Madras HC) (29 August 2016)]	Where assessee sold land to developer and for making investment assessee was offered a part of built up area, even if assessee was given five different flats, assessee would be entitled to claim section 54F exemption in respect of investment made for all five flats
10	Ram Gopal [230 Taxman 205 (Delhi HC) (9 February 2015)]	Even where assessee acquired property by provisional booking, he was eligible for section 54 deduction for cost of improvement along with cost of investment
11	Devdas Naik [227 Taxman 157 (Bombay HC) (10 June 2014)]	Where acquisition of two flats had been done independently but eventually they were a single unit and house for purpose of residence, claim under section 54 could not be denied.
12	Khoobchand M. Makhija [223 Taxman 189 (Karnataka HC) (18 December 2013)] [Contra: Pawan Arya [2011] 200 Taxman 66 (Punjab & Haryana HC) (13 October 2010)]	Acquisition of more than one residential house by assessee out of capital gains would not disentitle assessee from availing benefit conferred under section 54
13	Gita Duggal [214 Taxman 51 (Delhi HC) (21 February 2013)]	Merely because a residential house consists of several independent residential unit it would not take away deduction under section 54/54F

Sr. No.	Particulars	Decision
14	Ved Prakash Rakhra [210 Taxman 605 (Karnataka HC) (28 August 2012)]	Where before entering into development agreement and handing over residential property, assessee himself demolished same, he could not claim benefit of deduction under section 54
15	Ashok Syal [209 Taxman 376 (Punjab & Haryana HC) (4 May 2012)]	Where on a plot of land only one room had been constructed with bricks and mud and there were no amenities like boundary wall, kitchen, toilet, etc., house in question could not be considered a residential house
16	Rasiklal M Parikh [393 ITR 536 (Bombay HC) (10 March 2017)]	Where assessee invested consideration received on surrender of tenancy rights towards construction cost of new flats but construction of said flats having not been completed, he could not obtain allotment letter from developer within period of three years, he was not entitled to exemption under section 54F
17	Humayun Suleman Merchant [387 ITR 421 (Bombay HC) (18 August 2016)]	Where assessee had filed return of income and entire amount which was subjected to capital gain tax had not been utilized for purpose of construction of new house, nor were unutilized amounts deposited in notified Bank Accounts before filing return of income, Assessing Officer rightly restricted exemption under section 54F proportionately to amount invested

CIRCULAR : NO. 471 [F. NO. 207/27/85-IT(A-II)], DATED 15-10-1986:

1. Sections 54 and 54F provide that capital gains arising on transfer of a long-term capital asset shall not be charged to tax to the extent specified therein, where the amount of capital gain is invested in a residential house. In the case of purchase of a house, the benefit is available if the investment is made within a period of one year before or after the date on which the transfer took place and in case of construction of a house, the benefit is available if the investment is made within three years from the date of the transfer.

2. The Board had occasion to examine as to *whether the acquisition of a flat by an allottee under the Self-Financing Scheme (SFS) of the D.D.A. amounts to purchase or is construction by the D.D.A. on behalf of the allottee.* Under the SFS of the D.D.A., the allotment letter is issued on payment of the first instalment of the cost of construction. The allotment is final unless it is cancelled or the allottee withdraws from the scheme. The allotment is cancelled only under exceptional circumstances. The allottee gets title to the property on the issuance of the allotment letter and the payment of instalments is only a follow-up action and taking the delivery of possession is only a formality. If there is a failure on the part of the D.D.A. to deliver the possession of the flat after completing the construction, the remedy for the allottee is to file a suit for recovery of possession.

CIRCULAR : NO. 471 [F. NO. 207/27/85-IT(A-II)], DATED 15-10-1986 (CONTD.):

3. The Board have been advised that under the above circumstances, the inference that can be drawn is that the, D.D.A. takes up the construction work on behalf of the allottee and that the transaction involved is not a sale. Under the scheme the tentative cost of construction is already determined and the D.D.A. facilitates the payment of the cost of construction in instalments subject to the condition that the allottee has to bear the increase, if any, in the cost of construction. Therefore, *for the purpose of capital gains tax the cost of the new asset is the tentative cost of construction and the fact that the amount was allowed to be paid in instalments does not affect the legal position stated above. In view of these facts, it has been decided that cases of allotment of flats under the Self-Financing Scheme of the D.D.A. shall be treated as cases of construction for the purpose of capital gains.*

CIRCULAR NO.672, DATED 16-12-1993:

1. Attention is invited to Board's Circular No. 471, dated 15-10-1986. It was clarified therein that cases of allotment of flats under the Self-Financing Scheme of the DelhiDevelopment Authority (DDA) should be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act. The Board has since received representations that even in respect of allotment of flats/houses by co-operative societies and other institutions, whose schemes of allotment and construction are similar to those of DelhiDevelopment Authority, a similar view should be taken.

2. The Board has considered the matter and has decided that if the terms of the schemes of allotment and construction of flats/houses by the co-operative societies or other institutions are similar to those mentioned in para 2 of Board's Circular No. 471, dated 15-10-1986, such cases may also be treated as cases of construction for the purposes of sections 54 and 54F of the Income-tax Act.

JUDICIAL PRONOUNCEMENTS ON OTHER ISSUES RELATING TO TAXATION OF CAPITAL GAINS

Sr. No.	Particulars	Decision
	AGRICULTURAL LAND	
1	M.R. Anandaram (HUF) [289 Taxman 121 (Karnataka HC) (22 July 2022)]	Where assessee got their agricultural lands converted for non-agricultural purpose and sold same and Tribunal had recorded that, though land was converted, assessee had continued agricultural operations and as per Notification issued by Central Government, lands did not fall within 8 kms from Municipality of Bangalore, finding of Tribunal that lands sold by assessees were agricultural land as defined under section 2(14)(iii) being based on evidence on record, did not call for any interference
	INDEXATION	
2	Best Trading and Agencies Ltd. [428 ITR 52 (Karnataka HC) (26 August 2020)] [Contra: Dharmayug Investments Ltd. [58 taxmann.com 116 (Mumbai ITAT) (10 June 2015)]	Benefit of indexed cost of acquisition is available to assessees while computing capital gain for purpose of computation of book profit under section 115JB

Sr. No.	Particulars	Decision
LOSSES		
3	Reliance Natural Resources Ltd. [286 Taxman 435 (SC) (25 February 2022)]	Department SLP dismissed against order of the Bombay High Court that loss arising out of assignment of loan is short-term capital loss
4	Alcon Developers [432 ITR 277 (Bombay HC) (22 January 2021)]	Assessee was entitled to claim set off of its business losses of earlier years against income from capital gains earned by assessee from selling its business undertaking
COMPULSARY ACQUISATION		
5	Raj Pal Singh [427 ITR 1 (SC) (25 August 2020)]	Capital gains arising out of land acquisition compensation accrue on arrival of relevant stage of taking possession i.e. on date of award of compensation and not on date of notification for acquisition
6	Mahender Pal Narang [423 ITR 13 (Punjab & Haryana HC) (19 February 2020)]	Interest received on compensation or enhanced compensation under Land Acquisition Act, 1894 is to be treated as 'income from other sources' and not under head 'capital gains'

Sr. No.	Particulars	Decision
COMPULSARY ACQUISATION		
7	Seema Jagdish Patil vs National Hi-Speed Rail Corporation Ltd. [139 taxmann.com 249 (Bombay HC) (9 June 2022) Viswanathan M. [116 taxmann.com 894 (Kerala HC) (18 February 2020)]	Applying section 96 of Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 read with CBDT circular 36/2016, no income tax shall be levied on compensation/ award or agreement made under the said Act.;
8	Ganga Developers [145 taxmann.com 515 (Mumbai - Trib.) (12 October 2022)]	Where assessee received compensation for compulsory acquisition of its non-agricultural land under Land Acquisition Act, 1894 which stood repealed w.e.f 1-1-2014 and replaced by RFCTLARR Act, 2013, provisions of RFCTLARR Act would apply and in view of provisions of section 96 of said Act, said compensation would not be taxable under provisions of Income-tax Act

Sr. No.	Particulars	Decision
COMPULSARY ACQUISATION		
9	Jagdish Arora [93 ITR(T) 233 (Agra - Trib.) (14 June 2021)]	Land of assessee was compulsorily acquired by Government and the assessee claimed exemption from long-term capital gains being received as per RFCTLARR Act. AO taxed amount received against acquisition of land, under head long-term capital gain as no document in support of exemption claimed by assessee had been filed. On appeal, the Tribunal held that provisions of section 105(3) read with fourth schedule make it abundantly clear that provisions of RFCTLARR Act shall be applicable to enactments mentioned in fourth schedule, if, Central Government, within one year of passing of Act, issues notification in that regard mentioning therein that RFCTLARR Act shall apply with such exceptions or modifications. Since, no notification has been issued in respect of National Highways Act, 1956 (which forms part of the fourth schedule), benefit under section 96 of RFCTLARR Act could not have been extended>

Sr. No.	Particulars	Decision
TOLERANCE BAND		
10	Maria Fernandes Cheryl [187 ITD 738 (Mumbai ITAT) (15 January 2021)]	Amendment made in scheme of section 50C(1), by inserting third proviso thereto and by enhancing tolerance band for variations between stated sale consideration vis-à-vis stamp duty valuation from 5 per cent to 10 per cent are effective from date on which section 50C, itself was introduced, i.e 1-4-2003
TENANCY RIGHTS		
11	Amol C. Shah (HUF) [423 ITR 408 (Bombay HC) (27 January 2020)]	Where Tribunal in case of seller of property returned a finding that property in question was under occupation of assessee as a tenant, amount received by assessee from seller of property for surrendering his tenancy right was chargeable under head 'capital gains' and not under head 'income from other sources'

Sr. No.	Particulars	Decision
MISCELLANEOUS		
12	P. P. Mahatme [279 Taxman 325 (SC) (9 March 2021)]	SLP dismissed against impugned order of Bombay High Court, Goa Bench holding that consideration received on settlement of case of property usurped by relatives was taxable as capital gain
13	Smt. Shail Moti Lal [218 Taxman 298 (Punjab & Haryana HC) (29 January 2013)]	Date of agreement to sell cannot be treated as date of transfer of immovable property, it should be date on which delivery of possession is given and entire sale consideration is received
14	ABB Ltd. [439 ITR 554 (Karnataka HC) (4 October 2021)]	Technical know-how would be comprised of assets of business and not goodwill; profits on sale of technical know-how would be taxable as 'capital gain' under section 45
15	Vembu Vaidyanathan [265 Taxman 535 (SC) (19 July 2019)]	For computing capital gain tax, date of allotment of flat by DDA would be date on which purchaser of flat can be stated to have acquired property
16	Saroja Naidu [281 Taxman 305 (Madras HC) (22 June 2021)]	(Property outside India - Position prior to 1-4-2015) Assessee would be entitled to exemption under section 54 where investment in purchase of flat outside India was prior to 1-4-2015

Q&A

THANK YOU!!