

INDORE BRANCH OF CIRC OF ICAI



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TAXATION OF TRANSFER OF CAPITAL ASSET /MONEY/STOCK IN TRADE AT THE TIME OF DISSOLUTION OR RECONSTITUTION OF PARTNERSHIP FIRM



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1. INTRODUCTION

- 1.1.** The income or stock in trade to the partners of the partnership firm at the time of dissolution or reconstitution of the partnership firm have been enormously changed by the Finance Act, 2021. This provided that these changes shall be effective from 01 April 2021. In other words, provisions are made effective retrospective from the assessment year 2021-22 relevant to the previous year 2020-21. The applicability of the same has also been clarified by the circular 14 of 2021. Thus, there is a need of the hour to understand these provisions.
- 1.2.** Erstwhile, the provisions were merely governed by the Section 45(4) of the Income Tax Act (referred as Act). The section inter-alia provided that any profits or gains arising from the transfer of a capital asset shall be chargeable to income-tax under the head 'Capital gains' and shall be deemed to be the income of the previous year in which such transfer takes place. The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or otherwise, shall be chargeable to tax as the income of a firm of the previous year in which the said transfer takes place. Furthermore, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration for the purposes of section 48.
- 1.3.** However, there were uncertainties regarding the applicability of the provisions of aforesaid subsection where assets are revalued or self-generated assets are recorded in the books of accounts, payment is made to partner which is in excess of his capital contribution and payment is made in the event of reconstitution of firm. Adding further, there was ambiguity with regard to word 'otherwise' in the section 45(4).
- 1.4.** Therefore, old provisions of the Section 45(4) has been substituted by the new provisions of Section 45(4) & a new Section 9B has been inserted. In the article, we are going to discuss these provisions along

with relevant rules and guidelines of CBDT.

2. SECTION 9B OF THE INCOME TAX ACT

- 2.1.** There are judgments which held that partnership firm & partners are not the two separate person despite these separate person as per the definition of person in the section 2(31). Thus, in order to tax the transaction, there is a requirement to cover the transfer from partnership firm to a partner under the deeming provision, which has been invoked through section 9B.
- 2.2** The section provides that where a specified person (partner of the firm) receives any capital asset or stock in trade or both from a specified entity (partnership firm) in connection with the dissolution or reconstitution of such specified entity, then the specified entity shall be deemed to have transferred such capital asset or stock in trade or both, as the case may be, to the specified person.
- 2.3** It is pertinent to highlight that the transfer shall be considered in the year in which such capital asset or stock in trade or both are received by the specified person and any profit & gains arising from the deemed transfer shall be income of the specified entity of that previous year. If the capital assets or stock in trade is received by the specified person in more than one previous year, then income shall be offered for taxation in different previous years.
- 2.4** Further, income shall be chargeable under the head 'Profit & gains of Business & Profession' & 'Capital Gains' as the case may be. In order to determine sale consideration for the taxability under these heads of income, the fair market value on the date of receipt of capital asset or stock in trade by the specified person shall be considered.
- 2.5** For the purpose of this section, relevant terms are as follows:
- "specified entity" means a firm or other association of persons or body of individuals (not being a company or a co-operative society);
 - "specified person" means a person, who is a partner of

a firm or member of other association of persons or body of individuals (not being a company or a co-operative society) in any previous year.

- "reconstitution of the specified entity" means, where—
 - (a) one or more of its partners or members, as the case may be, of such specified entity ceases to be partners or members; or
 - (b) one or more new partners or members, as the case may be, are admitted in such specified entity in such circumstances that one or more of the persons who were partners or members, as the case may be, of the specified entity, before the change, continue as partner or partners or member or members after the change; or
 - (c) all the partners or members, as the case may be, of such specified entity continue with a change in their respective share or in the shares of some of them. This is with regard to the change in the profit sharing ratio between the partners.

2.6 To summarize, the limbs of the section are as follows:

- **Event:** Dissolution or reconstitution of specified entity
- **Transfer:** Receipt of capital asset or stock in trade by a specified person from specified entity.
- **Deeming fiction:** Transfer of capital asset or stock in trade in the year of receipt by the specified person.
- **Taxability:** Under the head 'PGPB' or 'capital gains' considering the fair market value on the date of receipt as consideration.
- **Indexation (when capital asset is transferred):** It shall be allowed considering the normal provisions of the capital gains head.
- **Type of capital gains:** Depends on the period of holding capital assets.

3. SECTION 45(4) OF THE INCOME TAX ACT

3.1 The section deals with the situation where the amount paid to the specified person (partner of the firm) exceeds the balance of the specified person (from the partnership firm) in the books of the specified entity.

3.2 The section starts with the notwithstanding clause and provides that where a specified person receives during the previous year any money or capital asset or both from a specified entity in connection with the reconstitution of such specified entity, then any profits or gains arising from such receipt by the specified person shall be chargeable to income-tax as income of such specified entity under

the head "Capital gains" and shall be deemed to be the income of such specified entity of the previous year in which such money or capital asset or both are received by the specified person.

3.3 The sub section has provided the method of computation of the capital gains which is as follows:

$$A = B + C - D$$

Where,

A = income chargeable to income-tax under this sub section as income of the specified entity under the head "Capital gains";

B = value of any money received by the specified person from the specified entity on the date of such receipt;

C = the amount of fair market value of the capital asset received by the specified person from the specified entity on the date of such receipt; and

D = the amount of balance in the capital account (represented in any manner) of the specified person in the books of account of the specified entity at the time of its reconstitution.

Provided that if the value of "A" in the above formula is negative, its value shall be deemed to be zero.

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

3.5 The definitions of the specified person & the specified entity in the section have been borrowed from this section 9B. It is pertinent to highlight the definition of specified person does not include the legal heirs of the partnership. Therefore, when the money or capital asset or stock in trade is given to the legal heir, then the provisions of Section 9B & 45(4) shall not have any implications.

3.6 Further, the section 48(iii) reiterates that in case of value of any money or capital asset received by a specified person from a specified entity referred to in section 45(4), the amount chargeable to income-tax as income of such specified entity under that sub-section which is attributable to the capital asset being transferred by the specified entity, calculated in the prescribed manner.

3.7 The manner has been prescribed in the Rule 8AB of the Income Tax Rules, 1962. It is provided that

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

Amount attributable to the remaining assets Amount chargeable in the section 45(4) * Amount of revaluation of a particular assets Amount of revaluation of all assets.

- 3.8** However, if it does not relate to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, of the specified entity, the amount charged to tax section 45(4) shall not be attributed to any capital asset for the purposes of clause (iii) of section 48.
- 3.9** For such attribution, specified entity shall furnish the details of amount attributed to capital asset

4. INTERPLAY OF SECTION 9B & SECTION 45(4) OF THE INCOME TAX ACT

4.1 Considering both the section, here are the points of distinction:

Particulars	Section 9B	Section 45(4)
Event	Dissolution or reconstitution	Reconstitution
Transfer of	Capital asset or stock in trade or both	Money or capital asset or both
Chargeability	Capital gains or Profit & gains of Business & Profession or both	Capital gains
Indexation	Available	Not Available
Loss	Loss shall be carry forward	Every loss shall be deemed to be zero.

4.2 It is evident that both sections have covered the transfer of capital asset in the event of reconstitution under its scope of taxation. Therefore, in this concern, it is clarified under explanation 2 of the section 45(4) that when a capital asset is received by a specified person from a specified entity in connection with the reconstitution of such specified entity, the provisions of section 45(4) shall operate in addition to the provisions of section 9B and the taxation under the said provisions thereof shall be worked out

remaining with the specified entity in Form No. 5C. The form shall be furnished electronically either under digital signature or through electronic verification code and shall be verified by the person who is authorized to verify the return of income of the specified entity under section 140. Further, it shall be furnished on or before the due date under section 139 of the assessment year in which amount is chargeable under section 45(4).

- 3.10** It is pertinent to note that revaluation of an asset or valuation of self-generated asset or self-generated goodwill does not entitle the specified entity for the depreciation on the increase in value of that asset on account of its revaluation or recognition of the value of self-generated asset or self-generated goodwill due to its valuation.
- 3.11.** Further, the amount attributed to such capital assets gets reduced from the full value of the consideration at the time of sale of that capital asset to the extent the specified entity shall not pay tax again on the same amount.
- 3.12.** Furthermore, it is further noticed that this attribution is given in the Act only for purpose of section 48 of the Act. It may be seen that section 48 of the Act only applies to capital assets not forming part of block of assets. Thus, in this regards, it is clarified vide circular 14 of 2021, that the rule 8AB also applies to capital assets forming part of block of assets.

independently. Refer the illustration for better understanding.

5. NATURE OF CAPITAL GAINS

- 5.1** The nature of the capital assets taxed in accordance with the provision of section 9B of the Act depends upon the period of holding of that capital assets.
- 5.2** However, the nature of gains taxable under the head capital gains in accordance with the section 45(4) of



the Act depends upon the attribution of such capital gains as per rule 8AB on the capitals assets remained or left with the specified entity.

5.3 It is provided that the amount or a part of it shall be deemed to be from transfer of short term capital asset, if it is attributed to,- Capital assets which is short term capital asset at the time of taxation of amount under sub-section (4) of section 45 capital asset forming part of block of asset; capital asset being self-generated asset and self-generated goodwill Meaning thereby, the nature of capital gain of the asset transfer depend on the remaining assets with the specified entity considering the attribution as per the rule 8AB. The amount of capital gains under section 45(4) attributed to short term capital assets or capital asset forming part of block of asset or capital asset being self-generated asset and self-generated goodwill shall be considered as short term capital gains.

5.4 The amount or a part of it shall be deemed to be from transfer of long term capital asset or assets, if it is attributed to capital asset which is not covered in above mentioned cases and is long term capital asset at the time of taxation of amount under section 45(4).

6. ILLUSTRATION

The Balance Sheets of Firm ABC as on 31.03.2021:

Particulars	Amount	Particulars	Amount
Capital A	10,00,000	Land S	10,00,000
Capital B	10,00,000	Land T	10,00,000
Capital C	10,00,000	Land U	10,00,000
Total	30,00,000	Total	30,00,000

There are three partners in the firm A, B & C sharing profits equally. All the three assets were acquired by the firm 2 year ago. Now, Partner A wishes to retire and the firm revalues its assets. FMV of the Land S, T and U are 70 lakhs, 70 lakhs & 50 lakhs respectively. Mr. A is to be given cash of INR 10 lakhs & land U.

Taxability is as follows:

- It is the case of reconstitution of the firm where partner A is going to retire. Further, a capital asset is also given to the partner. Thus the provisions of section 9B as well as 45(4) have the applicability in accordance with explanation 2 of the section 45(4) (refer 4.1 & 4.2).
- Capital gains in the hands of firm in accordance with section 9B which deals with the transfer of capital asset by the partnership firm to a partner:

Particulars	Amount (INR)
Sales consideration (FMV on the date of transfer)	50,00,000
Indexed cost (let the indexed cost of land U is INR 15 lakhs)	15,00,000
Long term capital gains	35,00,000
Tax @ 20% as per section 112	7,00,000
Capital gains in the hands of firm in accordance with section 45(4) which deals with the excess amount paid to the partner of the firm as compared to the balance of the partner in the books of firm.	

Particulars	Amount
Amount paid to A (land of INR 50 lakhs + cash of 11 lakhs)	61,00,000
Capital balance of A (refer working note 1)	21,00,000
Taxable under section 45(4)	40,00,000

Working note 1:

Determination of capital account balance of A as per books

Particulars	Amount
Sale consideration of land U	50,00,000
Book value of land U	10,00,000
Profit in the books of accounts	40,00,000
Less: Tax payment under section 9B	7,00,000
Remaining profit for the firm	33,00,000
Share of partner A in the sale of land U	11,00,000
Capital balance of A already exists in the books	10,00,000
Total capital account balance of A	21,00,000

- On account of clause (iii) of section 48 of the Act, read with rule 8AB of the rules, this INR 40 lakhs taxed under section 45(4) is to be attributed to the remaining assets of the firm on the basis of increase in their value due to revaluation based on the valuation report of the registered valuer. In this case, as per reevaluation there are only two remaining assets: land S & T. In both the cases the value has increased by 60 lakhs each. Thus, out of INR 40 lakhs, INR 20 lakhs shall be attributed to land S & INR 20 lakhs to the land T. When either of these lands get sold, this amount attributed to them would be reduced from sale consideration under section 48(iii) of the Act.
- The amount of INR 40 lakhs which is charged to tax under section 45(4) shall be charged as long term capital gains in view of rule 8AA(5), since the amount is attributed to land S & T which are both long term capital assets at the time of taxation of INR 40 lakhs under section 45(4) of the Act.



FAQ's on Cancellation of GST Registration

Q.1 What are the circumstances in which GST registration can be cancelled?

Subsection 1 Any registration granted under this Act may be cancelled by the Proper Officer. The various circumstances and the provisions of the law on this subject have been outlined under Sec. 29

A registration granted can be cancelled by the proper officer, either on his own or on application by the registered person when –

- the business is discontinued, transferred fully for any reason including death of proprietor, amalgamated with other legal entity, demerged or otherwise disposed of; or
- there is any change in the constitution of the business; (For example- Private limited company has changed to a public limited company) or
- the taxable person is no longer liable to be registered under sections 22 or section 24 or intends to opt out of the registration voluntarily made under subsection (3) of section 25.

Provided that during pendency of the proceedings relating to cancellation of registration filed by the registered person, the registration may be suspended for such period and in such manner as may be prescribed. Inserted vide The Central Goods & Services Tax Amendment Act, 2018 w.e.f 01.02.2019

Q.2 When the proper office may cancel the registration?

Subsection 2 The proper officer may cancel the registration of a person from such date, including any retrospective date, as he may deem fit, where, —

- (a) a registered person has contravened such provisions of the Act or the rules made thereunder as may be prescribed; or
- (b) a person paying tax under section 10 has not furnished returns for three consecutive tax periods; or
- (c) any registered person, other than a person specified in clause (b), has not furnished returns for a continuous period of six months; or
- (d) any person who has taken voluntary registration under

sub-section (3) of section 25 has not commenced business within six months from the date of registration;

or

- (e) registration has been obtained by means of fraud, wilful misstatement or suppression of facts:

Provided that the proper officer shall not cancel the registration without giving the person an opportunity of being heard:

[Provided further that during pendency of the proceedings relating to cancellation of registration, the proper officer may suspend the registration for such period and in such manner as may be prescribed].

Inserted vide The Central Goods & Services Tax Amendment Act, 2018 w.e.f 01.02.2019

Q.3 Is the cancellation of Reg. affect the liability?

Subsection 3 No, The cancellation of registration under this section shall not affect the liability of the person to pay tax and other dues under this Act or to discharge any obligation under this Act or the rules made thereunder for any period prior to the date of cancellation whether or not such tax and other dues are determined before or after the date of cancellation.

Q.4 Is the cancellation deemed to be affect in all act of GST?

Subsection 4 Yes, The cancellation of registration under the State Goods and Services Tax Act or the Union Territory Goods and Services Tax Act, as the case may be, shall be deemed to be a cancellation of registration under this Act.

Q.5 What will be liability of GST reversal in case of GST Registration cancellation?

Subsection 5 Every registered person whose registration is cancelled shall pay an amount, by way of debit in the electronic credit ledger or electronic cash ledger, equivalent to the credit of input tax in respect of inputs held in stock and inputs contained in semi-finished or finished goods held in stock or capital

goods or plant and machinery on the day immediately preceding the date of such cancellation or the output tax payable on such goods, whichever is higher, calculated in such manner as may be prescribed:

Provided that in case of capital goods or plant and machinery, the taxable person shall pay an amount equal to the input tax credit taken on the said capital goods or plant and machinery, reduced by such percentage points as may be prescribed or the tax on the transaction value of such capital goods or plant and machinery under section 15, whichever is higher.

Q.6 What will be the manner of calculation of amount payable u/s 5 ?

Subsection 6 The amount payable under sub-section (5) shall be calculated in such manner as may be prescribed.

Q.7 What is the Process for Application for cancellation of GST Registration cancellation?

Rule 20

A registered person, other than a person to whom a registration has been granted under rule 12 or a person to whom a Unique Identity Number has been granted under rule 17, seeking cancellation of his registration under sub-section (1) of section 29 shall electronically submit an application in FORM GST REG-16, including therein the details of inputs held in stock or inputs contained in semi-finished or finished goods held in stock and of capital goods held in stock on the date from which the cancellation of registration is sought, liability thereon, the details of the payment, if any, made against such liability and may furnish, along with the application, relevant documents in support thereof, at the common portal within a period of thirty days of the occurrence of the event warranting the cancellation, either directly or through a Facilitation Centre notified by the Commissioner.

[Provided that no application for the cancellation of registration shall be considered in case of a taxable person, who has registered voluntarily, before the expiry of a period of one year from the effective date of registration.] Omitted vide Notf no. 03/2018-CT dt. 23.01.2018

Q.8 In what cases GST Registration to be cancelled by Proper officer?

Rule 21

Registration to be cancelled in certain cases

The registration granted to a person is liable to be

cancelled, if the said person,-

- (a) does not conduct any business from the declared place of business; or
- (b) issues invoice or bill without supply of goods or services in violation of the provisions of this Act, or the rules made thereunder; or

[(c) violates the provisions of section 171 of the Act or the rules made thereunder. i.e Violates the anti-profiteering provisions (for example, not passing on benefit of ITC to customers)]- Inserted vide Notf no. 07/2017-CT dt. 27.06.2017 ; or

[(d) violates the provision of rule 10A. i.e requirement of furnishing of the bank account details under GST]- Inserted vide Notf no. 31/2019 – CT dt. 28.06.2019 With effect from 1st January 2021-

(e) Utilisation of ITC from electronic credit ledger to discharge more than 99% of the tax liability for specified taxpayers violating Rule 86B – with the total taxable value of supplies exceeding Rs.50 lakh in the month, with some exceptions. OR

(f) A taxpayer who cannot file GSTR-1 due to GSTR-3B not being filed for more than two consecutive months (one quarter for those who opt into the QRMP scheme) OR

(g) Avails input tax credit in violation of the provisions of section 16 of the Act or the rules.

Q.9 What is Suspension of GST Registration and when this Rule inserted ?

Inserted vide Notf no. 03/2019-CT dt. 29.01.2019 wef 01.02.2019

Rule 21A (1) Where a registered person has applied for cancellation of registration under rule 20, the registration shall be deemed to be suspended from the date of submission of the application or the date from which the cancellation is sought, whichever is later, pending the completion of proceedings for cancellation of registration under rule 22.

(2) Where the proper officer has reasons to believe that the registration of a person is liable to be cancelled under section 29 or under rule 21, he may, after affording the said person a reasonable opportunity of being heard, suspend the registration of such person with effect from a date to be determined by him, pending the completion of the proceedings for cancellation of registration under rule 22.

(3) A registered person, whose registration has been suspended under sub-rule (1) or sub-rule (2), shall not make any taxable supply during the period of

suspension and shall not be required to furnish any return under section 39.

[Explanation.-For the purposes of this sub-rule, the expression "shall not make any taxable supply" shall mean that the registered person shall not issue a tax invoice suspension].-Inserted vide Notf no. 49/2019-CT dt.09.10.2019

(4) The suspension of registration under sub-rule (1) or sub-rule (2) shall be deemed to be revoked upon completion of the proceedings by the proper officer under rule 22 and such revocation shall be effective from the date on which the suspension had come into effect.]

[(5) Where any order having the effect of revocation of suspension of registration has been passed, the provisions of clause (a) of sub-section (3) of section 31 and section 40 in respect of the supplies made during the period of suspension and the procedure specified therein shall apply].-Inserted vide Notf no. 49/2019-CT dt.09.10.2019

Q.10 What is the Process of cancelling of GST Registration by Proper officer ?

Rule 22

(1) Where the proper officer has reasons to believe that the registration of a person is liable to be cancelled under section 29, he shall issue a notice to such person in FORM GST REG-17, requiring him to show cause, within a period of seven working days from the date of the service of such notice, as to why his registration shall not be cancelled.

(2) The reply to the show cause notice issued under sub-rule (1) shall be furnished in FORM GST REG-18 within the period specified in the said sub-rule.

(3) Where a person who has submitted an application for cancellation of his registration is no longer liable to be registered or his registration is liable to be cancelled, the proper officer shall issue an order in FORM GST REG-19, within a period of thirty days from the date of application submitted under rule 20 ([sub-rule (1) of] rule 20 Omitted vide Notf no. 7/2017-CT dt. 27.06.2017) or, as the case may be, the date of the reply to the show cause issued under sub-rule (1), cancel the registration, with effect from a date to be determined by him and notify the taxable person, directing him to pay arrears of any tax, interest or penalty including the amount liable to be paid under sub-section (5) of section 29.

(4) Where the reply furnished under sub-rule (2) is found to be satisfactory, the proper officer shall drop the proceedings and pass an order in FORM GST REG-20:

[Provided that where the person instead of replying to the notice served under sub-rule (1) for contravention of the provisions contained in clause (b) or clause (c) of subsection (2) of section 29, furnishes all the pending returns and makes full payment of the tax dues along with applicable interest and late fee, the proper officer shall drop the proceedings and pass an order in FORM GST-REG-20].-Inserted vide

(5) The provisions of sub-rule (3) shall, mutatis mutandis, apply to the legal heirs of a deceased proprietor, as if the application had been submitted by the proprietor himself

Q. 11 What is final return and when it to be filed after cancellation?

As per section 45 i.e Final return, "every registered person who is required to furnish a return under sub-section(1) of section 39 and whose registration has been cancelled shall furnish online on the GST Portal, a final return"within three months" of the date of cancellation or date of order of cancellation, whichever is later, in GST FORM GSTR-10 as specified in Rule 81"

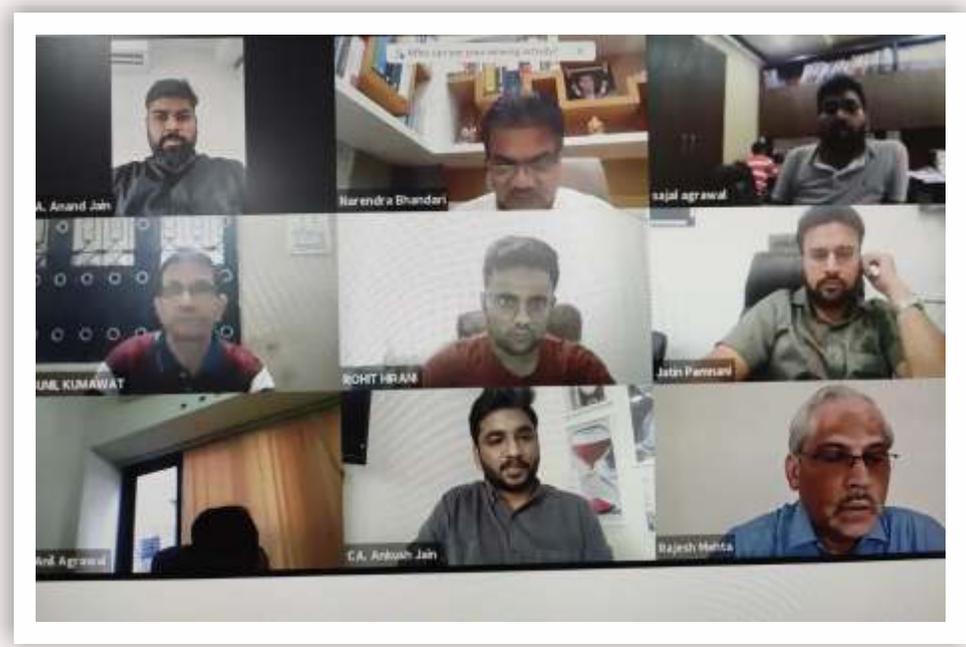
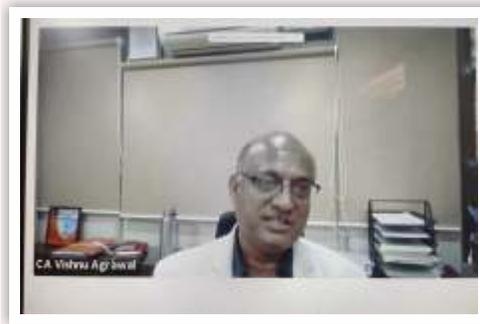
Q.12 What are the relevant form for GST Registration cancellation?

Form No	Filed By	Description
REG-16	For Taxpayer	Application for Cancellation of Registration
REG -17	For Tax Official	Show Cause Notice for Cancellation of Registration
REG -18	For Taxpayer	Reply to the Show Cause Notice issued for cancellation for registration
REG-19	For Tax Official	Order for Cancellation of Registration
REG-20	For Tax Official	Order for dropping the proceedings for cancellation of registration

Q.13 In case a person whose turnover not exceed threshold limit but taken GST Registration can apply for cancellation?

Yes, can apply after Notf no. 03/2018-CT dt. 23.01.2018, Earlier, such person could not apply for cancellation before expiry of one year from the effective date of registration.





Various Virtual CPE Meetings organized by Indore Branch of CIRC of ICAI