Taxation of Partnership Firms & LLP

CA. PIYUSH S. CHHAJED

FCA., DISA

piyush@cndindia.com

Mob : 9819084820

Relevant Sections in Income-tax Act, 2025 *vis-à-vis* Income-tax Act, 1961

Section in the Income-tax Act		Provision	Difference
1961	**2025**		
2(23)(i)	2(45)	Meaning of Firm	No difference
6(2)	6(9)	Residential Status of Firm	No difference
10(2A)	Schedule III, Table, Sl. No. 2	Any sum received by a partner towards his share in the total income of the firm (as per the profit-sharing ratio provided in the partnership deed)	No difference

Relevant Sections in Income-tax Act, 2025 *vis-à-vis* Income-tax Act, 1961

Section in the Income-tax Act		Provision	Difference
1961	**2025**		
28(v)	26(2)(g)	Any interest, salary, bonus, commission or remuneration due to or received by a partner (to the extent allowed as deduction u/s 35(e) in computing the income of the firm) is taxable under PGBP in the hands of the partner.	No difference
40(b)	35(e)	Disallowance of Remuneration to non-working partner or to a working partner exceeding prescribed limits and disallowance of interest and remuneration not authorized by partnership deed or interest exceeding 12% p.a.	See Note-1

Relevant section in the Income tax Act 2025 *vis-à-vis* Income-tax Act 1961

Section in the Income-tax Act		Provisions	Difference
1961	**2025**		
45(3)	67(9)	Capital Gain on transfer of a capital asset by a person to a firm in which he becomes partner by way of capital contribution or otherwise **chargeable to tax in the year of transfer (Admission of Partner)**	No difference
9B	8	Income on receipt of capital asset or stock-in-trade by specified person (which includes a partner in a firm) from specified entity (which includes a firm) **[Dissolution or Reconstitution of firm]**	See Note-2
45(4)	67(10)	Income on receipt of money or capital asset by partner of firm in connection with **reconstitution of the firm** chargeable to tax in the tax year of such receipt	No difference

Relevant section of Income tax Act 2025 *vis-à-vis* Income-tax Act 1961

Section in the Income-tax Act		Provision	Difference
1961	**2025**		
78(1)	119(1)	Carry forward and set off of losses proportionate to share of retired or deceased partner not permissible in case of **change in constitution of firm**	No difference
47(xiii)	70(1)(zd)	Transfer of a capital asset/intangible asset by a firm to a company on account of **succession of a firm by a company <u>not</u>** a transfer for capital gains	No difference
47(xiiib)	70(1)(ze)	Transfer of a capital asset/intangible asset by a Pvt. Co. or unlisted public company to a LLP on **conversion of the company to a LLP <u>not</u>** a transfer for capital gains.	No difference

Relevant section of Income tax Act 2025 *vis-à-vis* Income-tax Act 1961

Section in the Income-tax Act		Provision	Difference
1961	**2025**		
167A	324	Charge of tax in case of a firm.	See Note-3
184	325	Assessment as a firm – Conditions to be complied with – partnership should be evidenced by an instrument in which individual shares of partners are specified.	No difference
185	326	Assessment when section 325 not compiled with	No difference
187	327	Change in constitution of a firm	No difference
188	328	Succession of one firm by another firm	No difference
188A	329	Joint and several liability of partners for tax payable by firm	No difference

Relevant section of Income tax Act 2025 *vis-à-vis* Income-tax Act 1961

Section of the Income-tax Act		Provisions	Difference
1961	**2025**		
189	330	Firm dissolved or business discontinued.	No difference
167C	331	Liability of partners of LLP in liquidation.	No difference
194T	393(3) Table, Sl No. 7	TDS on any sum in the nature of salary, remuneration, commission, bonus or interest paid to a partner of the firm or credited to his account (including capital account)	See Note 4
283(2)	503(2)	Service of notice when firm is dissolved	No difference
284	504	Service of notice in case of discontinued business.	No difference
140 (cc) & (cd)	265 [Table Sl.No.8 & 9]	Income-tax Return of Firm and LLP by whom to be verified	No difference

Meaning of Firm, Partner and Partnership as per Income-tax Act, 2025

Section	Term	Meaning	Includes
		Same meaning as assigned to it in section 4 of the Indian Partnership Act, 1932	
2(45)	Firm	Persons who have entered into partnership with one another are called individually **"partners"** and collectively "**a firm**", and the name under which their business is carried on is called the "firm name"	"limited liability partnership" as defined in section 2(1)(n) of the Limited Liability Partnership Act, 2008
2(74)	Partner		any person who, **being a minor,** has been admitted to the benefits of partnership; and a partner of a limited liability partnership as defined in section 2(1)(q) of the Limited Liability Partnership Act, 2008;
2(75)	Partnership	the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.	"Limited liability partnership" as defined in section 2(1)(n) of the Limited Liability Partnership Act, 2008

Tax Rate applicable to Partnership Firm

Residential Status of a firm [Section 6(9)] - "firm" shall be resident in India in any tax year unless the control and management of its affairs is situated wholly outside India during such tax year.

Sl. No.	Particulars	Rate
1	Income-tax	30%
2	Surcharge (If income exceeds Rs. 1 crore)	12%
3	Health and Education Cess	4%

Note - There is no special tax regime with concessional rates of tax for partnership firms.

Charge of tax in case of a firm [Section 324 of the 2025 Act corresponding to section 167A of the 1961 Act]

In the case of a firm which is assessable as a firm, tax shall be charged on its total income at the rate as specified in any **Central Act** for relevant tax year.

Note-3

Section 167A of the 1961 Act provides that in the case of a firm which is assessable as a firm, tax shall be charged on its total income at the rate as specified in the **Finance Act** of the relevant year.

Taxability of salary, remuneration received by a partner from a firm

- Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm **shall <u>not</u> be regarded as salary [Section 15(4)]**

- Any interest, salary, bonus, commission or remuneration, by whatever name called, which is due to, or received by, a partner of a firm from such firm to the extent **allowed under section 35(e)** as a deduction in computing the income of the firm will be **<u>chargeable to tax in the hands of the partner under the head "Profits and gains of business or profession</u>" [Section 26(2)(g)]**

Remuneration to partner not deductible in computation of income of firm in certain circumstances [Section 35(e) of the 2025 Act corresponding to section 40(b) of the 1961 Act]

Irrespective of any other provision of Chapter IV-D, the following amounts shall not be allowed as deduction in computing the income chargeable under the head "Profits and gains of business or profession":—

the expenditure incurred by a firm, assessable as such—

(i) in the nature of salary, bonus, commission or remuneration, by whatever name called to a partner, **who is not a working partner;** or

(ii) on the **remuneration to a working partner, and interest to any partner**, if it is–

- **not authorised by the partnership deed** applicable for the period for which such remuneration or interest is paid; or
- authorised by and is as per the terms of partnership deed but **relates to the period prior to the date of such partnership deed**, and which was not authorised by the earlier partnership deed; or

Remuneration to partner not deductible in computation of income of firm in certain circumstances [Section 35(e) of the 2025 Act corresponding to section 40(b) of the 1961 Act]

The aggregate remuneration to all working partners as authorized by the partnership deed and relating to be a period falling after the partnership deed would be subject to the following limits –

Book Profit	Limit on remuneration
on the first ₹ 6,00,000 of the book profit or in case of **a loss**	₹ **3,00,000** or at the rate of **90% of the book profit**, whichever is higher
on the balance of the book profit	at the **rate of 60%**

Remuneration to partner not deductible in computation of income of firm in certain circumstances [Section 35(e) of the 2025 Act corresponding to section 40(b) of the 1961 Act]

Meaning of book profit and working partner

- **Book Profit** means the net profit, as shown in the profit and loss account for the relevant tax year, computed as per Chapter IV-D as increased by the aggregate amount of the remuneration to all the partners of the firm, if such amount has been deducted while computing the net profit.
- **Working partner** means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

Interest to partner not deductible in certain circumstances in computation of income of firm [Section 35(e) of the 2025 Act corresponding to section 40(b) of the 1961 Act]

Interest to any partner has to be authorised by the **partnership deed**,

It should not exceed 12% simple interest per annum.

If it exceeds 12% simple interest p.a., the excess would be disallowed.

However, where an individual is a partner in a firm as "partner in a representative capacity"

A. interest paid by the firm to such individual **otherwise** than as partner in a representative capacity, shall **not** be taken into account.

B. interest paid by the firm to such individual **as partner in a representative capacity** and interest paid by the firm to the person so represented shall be taken into account.

where an individual is a partner in a firm not in a representative capacity, interest paid by the firm to such individual shall not be taken into account, if such interest is received by him on behalf, or for the benefit, of any other person.

Interest to partner not deductible in certain circumstances in computation of income of firm [Section 35(e) of the 2025 Act corresponding to section 40(b) of the 1961 Act]

- CBDT Circular No. 739, dated March 25, 1996 lays down two conditions. Either the amount of remuneration payable to partners should be specified or the manner of quantifying the remuneration should be specified.
- Where neither the amount has been quantified nor the limit of total remuneration has been specified but the same has been left to be determined by the partners at the end of the accounting period, payment of remuneration to partners cannot be allowed as deduction in the computation of firm's income.
- No deduction under section 35(e)(iii) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

Overriding effect of section 35 of the 2025 Act vis-à-vis section 40 of the 1961 Act

Note 1

- Section 40 of the Income-tax Act, 1961 begins with “Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall **not** be deducted in computing the income chargeable under the head "Profits and gains of business or profession“
- Thus, section 40 of the 1961 Act had an overriding effect only **on sections 30 to 38** but the corresponding section 35 in Income-tax Act 2025 has an overriding effect over all the sections of **Chapter IV-D** i.e. Profit & Gains of business or profession.
- However, inspite of overriding effect over all sections of Chapter IV-D, there appears to be no impact since the other sections of Chapter IV-D [like presumptive provisions, maintenance of books of account, tax audit, deemed profits etc. do not get impacted on account of the overriding provision in section 35, since these sections do not provide for any deduction.

Removal of transition provision introduced by the Finance Act, 1992

The following proviso to section 40(b) of the Income-tax Act, 1961 does not have a corresponding provision in the 2025 Act, since it was a transition provision introduced when the taxation scheme of firms was changed by the Finance Act, 1992 w.e.f. 1.4.1993 -

Provided that in relation to any payment under this clause to the partner during the previous year relevant to the assessment year commencing on the 1st day of April, 1993, the terms of the partnership deed may, at any time during the said previous year, provide for such payment.

Removal of transition provision introduced by the Finance Act, 1992

Position prior to 1.4.1993

- Prior to 1.4.1993, the **partnership firm was taxed at 5% to 18%** (maximum rate of 18% applicable to total income above Rs.1 lakh and
- Thereafter, **the share income of partners distributed to partners was taxable in their hands**.
- Further, the tax liability of a firm and its partners depended upon the question whether the firm was granted registration under the Income-tax Act or not.
- In the case of a **registered firm**, the firm paid tax on its total income according to the rates prescribed in the Schedule for registered firms.
- An **unregistered firm** was taxed at the rates applicable to individuals, with the share income included in the hands of the partners for rate purposes only.

Removal of transition provision introduced in the year 1993

Position of law with effect from 1.4.1993

A firm is taxed as a separate entity and there is no distinction between registered and unregistered firms.

After allowing remuneration and interest to the partners as per the partnership deed, the balance income of the firms is taxed in the hands of the firm.

Share income of partner from a firm is exempt from tax.

Transition provision in the 1961 Act

Accordingly, the proviso was inserted to provide that for the A.Y.1993-94, the partnership deed may at any time during the P.Y.1992-93 provide for payment of remuneration and interest.

Since the proviso is no longer relevant now, there is no corresponding provision in the 2025 Act.

Capital Gain on transfer of a capital asset by a partner to firm [Section 67(9) of the 2025 Act corresponding to section 45(3) of the 1961 Act]

Tax implication at the time of admission of partner

- If any profits or gains arise from the transfer of a capital asset by a person, to a firm **in which he is or becomes a partner**, by way of capital contribution or otherwise, then,–

(a)	such profits and gains shall be chargeable to tax as his income of the tax year of such transfer; and
(b)	for the purposes of computation of capital gains under section 72 the amount recorded in the books of account of the firm, as the value of the capital asset is deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

Capital Gain on transfer of a capital asset by a partner to firm [Section 67(9) of the 2025 Act corresponding to section 45(3) of the 1961 Act]

Issue 1 [Section 45(3) vis-à-vis Sections 50C & 50CA]

Section 45(3) was introduced in the 1961 Act through Finance Act, 1987 as an **anti-avoidance measure** to prevent individuals from converting their assets into assets of a firm to avoid capital gains tax.

Thereafter, section 50C and 50CA were introduced in the Income-tax Act, 1961 by the Finance Act, 2002 and 2017, respectively, to provide for consideration of stamp duty value and fair market value as full value of consideration for transfer of immovable properties and unquoted shares, so as to curb unaccounted money in property and share transactions.

Whether, for the purposes of section 48, the full value of consideration should be the amount as recorded in the books of the firm in accordance with the provisions of section 45(3), or whether it should be the stamp duty value/fair market value in accordance with the provisions of section 50C/50CA? Whether in computing the capital gains, the higher of the two is to be adopted or not?

Capital Gain on transfer of a capital asset by a partner to Firm [Section 67(9) of the 2025 Act corresponding to section 45(3) of the 1961 Act]

- If a special provision is made on a certain matter, the matter is excluded from the general provisions – '*generalia specialibus non derogant*'.
- Section 45(3) is a **special provision** insofar as computation of capital gains resulting from capital contribution made by a partner to the firm is concerned, and **section 50C and 50CA are general provisions** insofar as transfer of immovable property and unquoted shares by a partner to a firm is concerned.
- Section 45(3) being a specific provision which comes into play only when a capital contribution is made by partners to a firm. This provision provides a deeming fiction whereby the amount recorded in the books is considered to be the full value of consideration. Therefore, another deeming fiction provided u/s 50C cannot be extended to compute the full value of consideration when an immovable property is contributed by a partner to the firm.
- This view was taken by the Mumbai, Ahmedabad and the Chennai Tribunal.

  DCIT v. Amartara Pvt. Ltd. IT Appeal No. 6050 (Mum.) of 2016, dated December 29, 2017.
  Nareshbhai Ishwardas Patel v. The ITO[2023] 155 taxmann.com 141 (Ahmedabad – Trib.).
  Shri Sarrangan Ashok v. The ITO IT Appeal No. 544 (Chennai) of 2019, dated August 19, 2019.

Capital Gain on transfer of a capital asset by a partner to Firm [Section 67(9) of the 2025 Act corresponding to section 45(3) of the 1961 Act]

- The Allahabad High Court in the case of *CIT v. Carlton Hotel (P.) Ltd. [2017] 88 taxmann.com 257/399 ITR 611 (All.)* held that where value of land contributed by the assessee in stock of firm was much higher as against its negligible profit sharing in the firm, entire transaction of contribution to partnership was a sham, and it was an attempt to device a method to avoid capital gain tax on transfer of land to the firm
- The High Court observed at para.71 of its judgment that "when one goes through the object of insertion of section 50C, it is found that it was inserted to tackle unaccounted income by practice of under-statement of consideration in acquisition of a property. Whether stamp duty is payable or not, is not a factor relevant for attracting section 50C and this is clear from the circular of CBDT Circular No. 8/2002, dated 27-8-2002."
- The decision of the Allahabad High Court was, therefore, on account of the transaction being established as a colorable device to evade tax.
- Thus, the interplay between 45(3) and sections 50C/50CA would depend on the facts of the case i.e., whether it is a genuine transfer, in which case section 45(3) would apply. However, if it is established as a strategy to circumvent tax, then, the provisions of sections 50C/50CA would also come into play.

Capital Gain on transfer of a capital asset by a partner to firm [Section 67(9) of the 2025 Act corresponding to section 45(3) of the 1961 Act]

Issue 2

Would the provisions of section 56(2)(x) of the 1961 Act apply if the immovable property transferred is recorded in the books at less than stamp duty value?

Where the partner transfers a capital asset to the firm at value which is less than the stamp duty value, then, he will be charged u/s 45(3) for capital gains on the difference between its cost of acquisition and value recorded in the books of the firm being value less than the stamp duty value. The firm will also be charged u/s 56(2)(x) on the deemed income being difference between the value recorded in the books and stamp duty value of that asset. However, provisions of section 56(2)(x) will not be applicable in case of transfer of an asset by the partner to the firm, if it is stock-in-trade.

Note - It is possible to take a view that since the amount recorded in books of account is the full value of consideration for section 45(3) for determining capital gains in the hands of the partner, then, the stamp duty value cannot be considered for the purpose of invoking section 56(2)(x) in the hands of the firm.

Income on receipt of capital asset or stock-in-trade or both by a partner on dissolution or reconstitution of firm [Section 8 of the 2025 Act to corresponding section 9B of 1961 Act]

- **Deemed transfer** - Where a specified person (partner, in this case) receives during the tax year any **capital asset or stock-in-trade**, or both, from a specified entity (firm, in this case) in connection with the dissolution or reconstitution of the firm, then, the firm shall be deemed to have transferred such capital asset or stock-in-trade, or both, to the partner **in the year in which such capital asset or stock-in-trade, or both, are received by the partner**.

- **Year of taxability in the hands of the firm** – Profits and gains from deemed transfer would be deemed to be income of the firm of the **tax year in which such capital asset or stock in trade was received by the partner**.

Income on receipt of capital asset or stock-in-trade or both by a partner on dissolution or reconstitution of firm [Section 8 of the 2025 Act to corresponding section 9B of 1961 Act]

- **Head of income** – The profits would be chargeable as income of firm under the head "**PGBP**" (in case the asset transferred is stock-in-trade) and "**Capital gains**" (in case the asset transferred is a capital asset)
- **Full value of consideration – The fair market value** of the capital asset or stock-in-trade, on the date of its receipt by the partner shall be deemed to be the full value of the consideration received or accruing as a result of such deemed transfer.
- **Issuance of guidelines for removal of difficulty** - If any difficulty arises in giving effect to the provisions of this section and section 67(10), the Board may, with the previous approval of the Central Government, issue guidelines for removing the difficulty.

Income on receipt of capital asset or stock-in-trade or both by a partner on dissolution or reconstitution of firm [Section 8 of the 2025 Act to corresponding section 9B of 1961 Act].

- **Guideline to be laid before each House of Parliament**
  - Every **guideline** issued by the Board shall be laid before **each** House of Parliament while it is in session for a **total period of 30** days (comprised in one session or in two or more successive sessions).
  - If, before the expiry of the session immediately following the session or the successive sessions aforesaid, both houses agree –
    - in making any modification in such guideline, then, the guideline shall have effect in such modified form or
    - that the guideline, should not be issued, the guideline shall thereafter be of no effect
  - However, any such modification or annulment would be without prejudice to the validity of anything previously done under that guideline.

Note 2

As per section 9B of the 1961 Act, every guideline issued by the Board shall, as soon as may be after it is issued, be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the assessee. The binding provision is not present in section 8 of the 2025 Act. However, section 8 contains the provision for modification or annulment by both houses of Parliament, which section 9B of the 1961 Act did not provide for expressly.

Scope of Section 8 and 67(10) of the 2025 Act corresponding to section 9B and 45(4) of the 1961 Act

	Particulars	Section 8	Section 67(10)
(i)	**Dissolution of firm**	🌍	x
(ii)	**Reconstitution of firm**		
A.	Receipt of stock-in-trade by a partner of a firm on reconstitution	🌍	x
B.	Receipt of money by a partner of a firm on reconstitution of firm	x	🌍
C.	Receipt of capital asset by a partner of a firm on reconstitution of the firm	🌍	🌍
Thus, when capital asset is received by a partner from a firm on reconstitution, then, the provisions of section 67(10) will apply in addition to the provisions of section 8.			

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Tax impact at the time of reconstitution of firm

Meaning of reconstitution [Section 8(6)(c) of the 2025 Act]

"Reconstitution of the firm" means, where

(a) one or more of its partners ceases to be partners; or

(b) one or more new partners are admitted in such firm in such circumstances that one or more of the persons who were partners of the firm, before the change, continue as partner or partners after the change; or

(c) all the partners of such firm continue with a change in their respective share or in the shares of some of them

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Tax impact at the time of reconstitution of firm

- **Deemed income in the hands of firm [Section 67(10) –** Where a partner receives during the tax year **any money or capital asset or both** from a firm in connection with the **reconstitution of such firm**, then, any profits or gains arising from such receipt by the partner shall be chargeable to income-tax as income of such firm under the head "**Capital Gains**".
- **Year of taxability [Section 67(10)] –** Such profits and gains shall be deemed to be the **income of firm of the tax year in which such money or capital asset or both were received by the partner.**

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Computation of Capital Gains u/s 67(10)

A=B+C-D

A= income chargeable u/s 67(10) as income of the firm under the head “Capital gains”

B= value of any **money** received by the partner from the firm on the date of such receipt

C= amount of **fair market value** of the **capital asset** received by the partner from the firm on the date of such receipt

D=amount of **balance in the capital account** (represented in any manner) of the partner in the books of account of the firm at the time of its reconstitution

Note - If the value of “A” as computed is **negative,** such value shall be deemed to be **zero**

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

- The balance in the capital a/c of the partner in the books of account of the firm (D in the formula) has to be calculated **without considering any increase in the capital account of the partner** due to **revaluation** of any asset or due to **self-generated goodwill** or any other self-generated asset;

- "Self-generated goodwill" and "self generated assets" means goodwill or asset –
  - which has been acquired without incurring any cost for purchase or
  - which has been generated during the course of the business or profession

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

In case of the amount which is chargeable to tax as income of firm u/s 67(10) under the head - "Capital gains", the same shall be deemed to be from transfer of STCA or LTCA, as the case may be, mentioned in column (1), if it is attributed to capital asset mentioned in the corresponding row in column (2) -

Rule 6(3) of the Draft Income-tax Rules, 2026	
Deemed capital gains from transfer of capital asset	**Type of capital asset of firm**
Capital gains from transfer of a short-term capital asset (STCA)	a) capital asset which is short term capital asset at the time of taxation of amount under section 67(10); or b) capital asset forming part of block of asset; or c) capital asset being self-generated asset and self-generated goodwill as defined in section 67(10)
Capital gains from transfer of a long-term capital asset (LTCA)	Capital asset which is not covered in above and is long term capital asset at the time of taxation of amount u/s 67(10).

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Attribution of income taxable u/s 67(10) to the capital assets remaining with the firm u/s 72.

For the purpose of section 72(5), where the amount is chargeable to income-tax as income of the firm u/s 67(10), the firm shall attribute such amount to capital asset remaining with the firm in the prescribed manner:-

S. No.	Particulars	Attribution to the capital assets remaining with the firm
Where the aggregate of the value of money and the FMV of the capital asset received by the partner from the firm, in excess of the balance in his capital account, chargeable to tax u/s 67(10) -		
(i)	relates to revaluation of any capital asset or valuation of self-generated asset or self-generated goodwill, of the firm. The revaluation should be based on a valuation report obtained from a registered valuer	the amount charged u/s 67(10) x (increase in, or recognition of, value of that asset because of revaluation or valuation) / (aggregate of increase in, or recognition of, value of all assets because of the revaluation or valuation)

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

S. No.	Particulars	Attribution to the capital assets remaining with the firm
(ii)	does not relate to revaluation of any capital asset or valuation of self generated asset or self-generated goodwill, of the firm	the amount charged to tax u/s 67(10) shall not be attributed to any capital asset
(iii)	relate only to the capital asset received by the partner from the firm	the amount charged to tax u/s 67(10) shall not be attributed to any capital asset

- The firm has to furnish the details of amount attributed to capital asset remaining with it in Form No. 27.
- Form No. 27 shall be verified by the person who is authorized to verify the return of income of the firm u/s 265.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Example 1

There are three partners A, B and C in a firm ABC, having **1/3 rd share** each. Each partner has a capital balance of Rs 10 lakh in the firm. There are **three pieces of land, I, II & III** in that firm and there is no other capital asset in that firm. Book value of each of the land is Rs 10 lakh. All these three lands were acquired by the firm more than two years ago.

Partner A wishes to exit. The firm revalues its lands based on valuation report from a registered valuer, and as per that valuation report fair market value of lands I and II is **Rs 70 lakh** each, while fair market value of land III is **Rs 50 lakh.** On the exit of partner A, the firm decides **to give him Rs. 11** lakh of money and land “III" to settle his capital balance.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 1:

Computation of Capital Gain u/s 8

Deemed Transfer of Asset to Partner "A"	Fair Market Value	Cost	Capital Gain u/s 8	Capital Gain Tax 13%(12.5% Plus 4% Cess)	Net Book Profit After Tax
A	B	C	D = B-C	E =13% x D	F = D-E
Land III	Rs. 50 Lakhs	Rs. 10 Lakhs	Rs. 40 Lakhs	Rs. 5.20 Lakhs	Rs. 34.80 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 1 (Contd…)

Sl. No.	Partner	Profit Sharing Ratio	Opening Capital	Book Profit Rs. 34.80 Lakhs distributed to each partner as per profit sharing ratio	Increased Capital
1.	A	1/3	Rs. 10 Lakhs	Rs. 11.60 Lakhs	Rs. 21.60 Lakhs
2.	B	1/3	Rs. 10 Lakhs	Rs. 11.60 Lakhs	Rs. 21.60 Lakhs
3.	C	1/3	Rs. 10 Lakhs	Rs. 11.60 Lakhs	Rs. 21.60 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 1 (Contd…)

Computation of Capital Gain u/s 67(10)

Outgoing Partner	Asset Distributed to A	FMV of Assets Distributed to A	Money distributed to A	Total Distribution to A	Increased Capital of Mr. A	Capital Gain chargeable u/s 67(10)
(1)	(2)	(3)	(4)	(5) = (3) + (4)	(6)	(7) = (5) – (6)
A	Land III	Rs. 50 Lakhs	Rs. 11 Lakhs	Rs. 61 Lakhs	Rs. 21.60 Lakhs	Rs. 39.40 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 1 (Contd…)

Attributable gains as per rule 6(3) of Draft Income-tax Rules, 2026

The type of gains will depend on whether the remaining capital assets to which the gains have to be attributed are long-term or short-term. In this case, both Land I & II are LTCA. Hence, capital gains is long-term.

Sl. No.	Attributed Assets	Ratio	Type of gain	Distributed amount
1	Land I (LTCA)	50% (60/120)	LTCG	39.40*1/2= 19.70 Lakhs
2.	Land II (LTCA)	50% (60/120)	LTCG	39.40*1/2= 19.70 Lakhs

When either of these lands gets sold, this amount attributed to them would be reduced from sales consideration under section 72(5).

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Example 2 on application of sections 8 and 67(10)

There are three partners A, B and C in a firm ABC, having one third share each. Each partner has a capital balance of Rs.10 lakh in the firm.

There are three pieces of lands I, II and III in that firm and there is no other capital asset in that firm. All these three lands were acquired by the firm more than two years ago. Book value of each of the land is Rs.10 lakh. Partner A wishes to exit.

The firm sells land III for its fair market value of Rs.50 lakh to pay Partner A. Thus, an amount of Rs.40 lakhs i.e., Rs.50 lakh less Rs.10 lakh would be charged to tax in the hands of firm ABC under the head “Capital gains".

Hence, the amount of Rs.40 lakh is charged to long term capital gains and tax on the same is Rs.5.20 lakh (Rs. 5 lakh, being 12.5% on Rs.40 lakh + cess@2% on Rs.5 lakh)

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 2:

Computation of Capital Gain u/s 197

Sale of Asset	Sale proceeds	Cost	Capital Gain	Capital Gain Tax 13%(12.5% Plus 4% Cess)	Net Book Profit After Tax
(a)	(b)	(c)	(d) = (b) –(b)	(e) = 13% x (d)	(f)
Land III	Rs. 50 Lakhs	Rs. 10 Lakhs	Rs. 40 Lakhs	Rs. 5.20 Lakhs	Rs. 34.80 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 2 (Contd…)

Partner	Profit Sharing Ratio	Opening Capital	Book Profit Rs. 34.80 Lakhs distributed to each partner	Increased Capital
A	1/3	Rs. 10 Lakhs	Rs. 11.60 Lakhs	Rs. 21.60 Lakhs
B	1/3	Rs. 10 Lakhs	Rs. 11.60 Lakhs	Rs. 21.60 Lakhs
C	1/3	Rs. 10 Lakhs	Rs. 11.60 Lakhs	Rs. 21.60 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 2 (Contd…)

Computation of Capital Gain u/s 67(10)

Outgoing Partner	Money distributed to Partner A	Increased Capital	Capital Gain chargeable u/s 67(10)
(1)	(2)	(3)	(4) = (2) – (3)
A	Rs. 61 lakhs	Rs. 21.60 lakhs	Rs. 39.40 lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 2 (Contd…)

Attributable gains as per rule 6(3) of Draft Income-tax Rules, 2026

The type of gains will depend on whether the remaining capital assets to which the gains have to be attributed are long-term or short-term. In this case, both Land I & II are LTCA. Hence, the capital gains is long-term. Since both lands have been revalued at Rs.70 lakhs, the increase in value is Rs.60 lakhs in both cases.

Sl. No.	Attributed Assets	Ratio	Type of gain	Distributed amount
1	Land I (LTCA)	50% (60/120)	LTCG	39.40*1/2= 19.70 Lakhs
2.	Land II (LTCA)	50% (60/120)	LTCG	39.40*1/2= 19.70 Lakhs

When either of these lands gets sold, this amount attributed to them would be reduced from sales consideration under section 72(5).

Note: The final result in both example 1 and 2 is same due to the operation of section 8.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Example 3 on application of sections 8 and 67(10)

There are three partners X, Y and Z in a firm XYZ, having one third share each. **Each partner** has a capital balance of **Rs 100 lakh** in the firm. There is a piece of land L of book value of Rs 30 lakh (which is also its cost). There is patent P of written down value of Rs 45 lakh . And there is cash of Rs 225 lakh. The land was acquired by the firm more than two years ago. The patent was acquired/developed/registered **one** year back.

Partner X wishes to **exit**. The firm **revalues** its land and patent based on valuation report from a registered valuer and as per that valuation report, FMV of land L is Rs 45 lakh and fair market value of patent P is Rs. 60 lakh. As per the valuation report, there is also self-generated asset of Rs 30 lakh. On the exit of partner X, the firm decides to give him Rs 75 lakh in money and land L to settle his capital balance.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 3

Sl. No.	Type of Asset	Type of Capital Asset	Book Value / WDV of Assets	Fair Market Value of Assets
1.	Land L	LTCA, since held for more than 2 years	Rs. 30 Lakhs	Rs. 45 Lakhs
2.	Patent	STCA, since it is a depreciable asset	Rs. 45 Lakhs	Rs. 60 Lakhs
3.	Self Generated Asset	STCA	-	Rs. 30 Lakhs
4	Cash	-	Rs. 225 Lakhs	

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 3:

Computation of Capital Gain u/s 8

Transfer Asset to Partner "X"	Fair Market Value of Assets	Cost	Capital Gain u/s 8	Capital Gain Tax 13%(12.5% Plus 4% Cess)	Net Book Profit After Tax
A	B	C	D = B - C	E = 13% x D	F = D -E
Land L	Rs. 45 Lakhs	Rs. 30 Lakhs	Rs. 15 Lakhs	Rs. 1.95 Lakhs	Rs. 13.05 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 2 (Contd…)

Partner	Profit Sharing Ratio	Opening Capital	Book Profit Rs. 13.05 Lakhs distributed to each partner	Increased Capital
X	1/3	Rs. 100 Lakhs	Rs. 4.35 Lakhs	Rs. 104.35 Lakhs
Y	1/3	Rs. 100 Lakhs	Rs. 4.35 Lakhs	Rs. 104.35 Lakhs
Z	1/3	Rs. 100 Lakhs	Rs. 4.35 Lakhs	Rs. 104.35 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 2 (Contd…)

Computation of Capital Gain u/s 67(10)

Out-going Partner	Assets Distributed to Partner X	FMV of Assets Distributed to Partner X	Money distributed to Partner X	Total Amount Distributed to partner X	Increased Capital	Capital Gain chargeable u/s 67(10)
(1)	(2)	(3)	(4)	(5) = (3) + (4)	(6)	(5) – (6)
X	Land L	Rs. 45 Lakhs	Rs. 75 Lakhs	Rs. 120 Lakhs	Rs. 104.35 Lakhs	Rs. 15.65 Lakhs

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Solution to Example 3 (Contd…)

Attributable gains as per rule 6(3) of the draft Income-tax Rule, 2026. In this case, the capital gains is to be attributed to self-generated assets and Patent P, both of which are short-term capital assets. Hence, the resultant capital gains is short-term.

Sl. No.	Asset	Ratio	Type of gain	Distributed Amount
1	Self Generated Assets	2/3 (30/45)	STCG	15.65 Lakhs x 2/3= 10.433 Lakhs
2	Patent P	1/3 (15/45)	STCG	15.65 Lakhs x 1/3= 5.217 Lakhs

only **net amount of Rs 19.783 lakh** shall be considered for reduction from the WDV of the block of intangible assets u/s 41 or for calculation of capital gains, as the case may be, u/s 74.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Attribution would **not** be required if –

- The capital gain chargeable u/s 67(10) does not relate to revaluation of any asset or creation of a self-generated asset.
- The capital gain chargeable u/s 67(10) relates to only the capital asset received by the retiring partner.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

- The above examples have been taken from CBDT Circular No.14/2021 dated 2.7.2021.
- The Circular mentions "Similarly when goodwill gets sold subsequently, 10.433 lakh would be reduced from its sales consideration under section 72(5)".
- As per para 35 of AS 26 internally generated goodwill should not be recognized as an asset.
- Therefore, when it is not recognized as an asset, there is no possibility of sale.
- Accordingly, self-generated goodwill has been replaced with "Self-generated asset" in the above example.
- It may be assumed that the self-generated asset is arising in development phase meeting all the conditions in para 4 of AS 26.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

In case of slump sale of the undertaking, whether the amount attributed to individual assets, including self-generated asset can be adjusted?

There is no restriction in Rule 50 of the Draft Income-tax Rules, 2026. In fact, the rule does not deal with the manner in which the amount attributed to individual assets is to adjusted. The same is dealt with by way of examples in Circular No. 14/2021, dated 02.07.2021.

Though there is no example in respect of slump sale, in the absence of express restriction, the amount attributed to individual assets can be adjusted from the consideration for slump sale.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

What would be the tax treatment of transfer of stock in trade to retiring partner vis-à-vis sale of stock-in-trade and using the proceeds to settle the account of retiring partner?

- In case of transfer of stock in trade to retiring partner, section 8 would apply
- In case of sale of stock in trade to outsider and using the proceeds to settle the account of retiring partner, -
  - Sale of stock in trade would give rise to regular business income
  - Section 67(10) would apply in respect of money paid to settle the dues of the outgoing partner.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

Would the provisions of section 8 or 67(10) be attracted, if rural agricultural land is given to the outgoing partner on retirement?

- Since rural agricultural land is not a capital asset or stock in trade, neither section 8 nor section 67(10) would be attracted.
- If rural agricultural land is sold to a third party and the proceeds therefrom are used to settle the dues of the retiring partner, then, though there would be no capital gains on transfer of rural agricultural land, the provisions of section 67(10) would be attracted on the money paid to the outgoing partner.

Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

Would the provisions of section 67(10) apply where the receipt is by legal heirs of deceased partner?

Since both section 8 and 67(10) deal with taxability of receipt by a specified person.

As per section 8(6)(b), “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 co-operative society) in any tax year.

Since receipt by legal heirs of deceased partner is not receipt by “specified person”, we can take a view that the provisions of section 67(10) would not apply.

7. Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

Would capital balance include balances in current account and loan of partners?

7. Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

Is proportionate share of reserves to be considered as part of capital?

Credit balance in the profit and loss account or balances in the reserves should be credited to partners' accounts before reconstitution. Accordingly, the capital balance of the partners would increase. It would be further increased by the partner's share of book profit on transfer of capital asset (after reduction of tax).

The money and fair market value of capital asset given to the retiring partner would be reduced by the capital balance of the Partner and the difference would be the capital gain under section 67(10).

7. Tax implications on receipt of money or capital asset or both by a partner on reconstitution of firm [Section 67(10) of the 2025 Act [corresponding to section 45(4) of the 1961 Act]

Issue

How to compute capital gains if there is negative capital balance?

A negative balance in the capital account represents money due by the partner to the firm. If such balance is not made good by him on reconstitution, it amounts to a waiver which may in turn amount to payment of cash applying the rationale in Mahindra and Mahindra 404 ITR 1 SC.

Section 119(1) Carry forward and set off losses not permissible [corresponding to section 78(1) of Income-tax Act, 1961]

In case of change in constitution of a firm during a tax year, firm cannot carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the tax year.

Transfer of capital asset or intangible asset on succession of firm by a company not to be treated as a transfer [Section 70(1)(zd) of the 2025 Act corresponding to section 47(xiii) of the 1961 Act]

Transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm would **not** be treated as a transfer for levy of capital gains tax, if —

- **all the assets and liabilities of the firm** relating to the business immediately before the succession **become the assets and liabilities of the company**;
- all the partners of the firm, immediately before the succession, become the shareholders of the company **in the same proportion in which their capital accounts** stood in the books of the firm on the date of the succession;
- the partners of the firm **do not receive any consideration or benefit**, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and
- the aggregate of the shareholding of the partners in the company **is not less than 50% of the total voting power** and such shareholding **continues to be not less than 50% for five years** from the date of succession;

Transfer of capital asset or intangible asset on succession of firm by a company not to be treated as a transfer [Section 70(1)(zd) of the 2025 Act corresponding to section 47(xiii) of the 1961 Act]

- **Withdrawal of exemption on failure to fulfill the conditions [Section 71(2)]**
  - If any of the conditions are not complied with at the time of succession, then, this exemption would not be available and the transfer of capital asset/intangible asset would attract capital gains tax liability.
  - If any of the conditions are not complied with subsequently, like if the aggregate shareholding of the partners falls below 50% in the five years from the date of succession, the profits and gains arising from transfer of such capital asset or intangible asset not charged under section 67 would be deemed to be the profit and gains chargeable to tax under the head “Capital Gains” of the successor company for the tax year in which such conditions are not complied with.

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

Transfer of a **capital asset or intangible asset by a private company or unlisted public company to a LLP** or transfer of a share or shares held in the company by a shareholder as a result of **conversion of the company into an LLP** under the provisions of sections 56 and 57 of the LLP Act, 2008, would **not** be treated as a transfer for levy of capital gains tax, if ─

- all the assets and liabilities of the company, immediately before the conversion, become the assets and liabilities of the LLP;
- all the shareholders of the company, immediately before the conversion, become the partners of the LLP and their capital contribution and profit-sharing ratio in the LLP are in the same proportion as their shareholding in the company on the date of conversion;
- the shareholders of the company do not receive any consideration or benefit, directly or indirectly, other than by way of share in profit and capital contribution in the LLP;

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

- the aggregate of the profit-sharing ratio of the shareholders of the company in the limited liability partnership **shall not be less than 50%** at any time during five years from the date of conversion;
- the total sales, turnover or gross receipts in the business of the company in any of the three tax years preceding the tax year in which the conversion takes place **does not exceed Rs.60 lakh;**
- the total value of the assets, as appearing in the books of account of the company in any of the three tax years preceding the tax year in which the conversion takes place does not exceed **Rs.5 crore**; and
- no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for three years from the date of conversion;

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

Withdrawal of exemption on failure to fulfil the conditions [Section 71(3)]

- If any of the conditions are not complied with at the time of conversion, then, this exemption would not be available and the transfer of capital asset/intangible asset would attract capital gains tax liability.
- If any of the conditions are not complied with subsequently, like if the aggregate of the profit-sharing ratio of the shareholders of the company falls below 50% at any time in the five years from the date of conversion, the profits and gains arising from transfer of such capital asset or intangible asset or share or shares not charged under section 67 would be deemed to be the profit and gains chargeable to tax under the head “Capital Gains” of the successor LLP or the shareholder of the processor company, for the tax year in which such conditions are not complied with.

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

Decision in *CIT v. Texspin Engg. And Mfg. Words (2003) 129 Taxmann 1(Bombay High Court)* - Conversion of a firm into a company does **not** constitute transfer and is not subject to tax.

Issue - The ratio of this ruling is sought to be applied in the reverse conversion i.e., conversion of company into LLP considering that only the form of business is changing on account of the conversion.

Section 47(xiiib) was introduced in the Income-tax Act, 1961 by the Finance Act, 2010 w.e.f. A.Y.2011-12, under which transfer of a capital asset or intangible asset by private company or unlisted public company to an LLP would not be considered as transfer subject to fulfillment of stipulated conditions.

Companies which could not satisfy these conditions relied upon the Bombay High Court ruling to claim that the conversion would not be taxable even if the conditions were not fulfilled.

This issue was dealt with by the Mumbai ITAT in *Celerity Power LLP v. ACIT ITAT No.3637/Mum/2015*. The taxpayer relied on the Bombay High Court decision and claimed that conversion of company into LLP was not transfer even though the conditions in section 47(xiiib) were not satisfied.

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

ITAT Observations:

Since conversion of company into LLP is a transaction listed in section 47 as exempt subject to fulfillment of specific conditions, accordingly, the same would amount to a transfer, if not for the specific exemption which depends on the fulfilment of such conditions.

In Texspin Eng and Mfg., the issue was in relation to conversion of firm into company under Part IX of the Companies Act, 1956, as per which conversion of firm into a company would result in vesting of property of the firm into a company.

If the constitution of the partnership firm is changed into that of a company by registering it under Part IX of the Companies Act, 1956, there shall be statutory vesting of the title of all the property of the previous firm in the newly incorporated company without any need for a separate conveyance - *Vali Pattabhirama Rao v. Sri Ramanuja Ginning & Rice Factory (P) Ltd. (1986) 60 Comp. Cas. 568 (AP).*

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

However, as per Chapter X of the LLP Act, 2008, on and from the date of registration specified in the certificate of registration issued, all tangible (movable or immovable) and intangible property vested in the firm or the company, as the case may be, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, as the case may be, and the whole of the undertaking of the firm or the company, as the case may be, **shall be transferred to and shall vest** in the limited liability partnership without further assurance, act or deed.

Thus, conversion of the company into LLP is a transfer and the gains arising therefrom is taxable as capital gains. By virtue of section 170, the successor-LLP is liable for capital gains tax on the transferor company.

In this case, however, while on the actual tax liability, the Tribunal observed that the assets of the company were transferred to the LLP at book value and no consideration was paid for the same. Thus, the book value is the full value of consideration. Since there is no difference between the consideration received and the cost of acquisition of assets (being book value), no tax would be leviable.

Transfer of a capital asset on conversion of private limited and unlisted public company to Limited Liability Partnership [Section 70(1)(ze) of the 2025 Act corresponding to section 47(xiiib) of the 1961 Act]

Though the ITAT holds that such conversion is a transfer, there would be no tax liability if the conversion is at book value.

The impact of this judgement is on taxpayers who transfer assets at a value higher than book value pursuant to such conversion.

The ITAT also held that carry forward and set-off of losses by the LLP was not possible since there has been failure to comply with all the stipulated conditions for exemption of transfer.

Note – The issue of taxability of shareholders was not before the ITAT. Since such conversion is being considered as a taxable transfer, capital gains arising in the hands of the shareholders upon alienation of shares in return for interest in LLP may also be sought to be taxed. However, if the shareholder gets the same amount of interest in the LLP as held in the company, then, the logic that there would be no capital gains would hold good here also.

Assessment as a firm [Section 325 of the 2025 Act corresponding to section 184 of 1961 Act]

- A firm shall be assessed as a firm for the purpose of this Act, if–

  (a) the partnership is evidenced by an instrument; and

  (b) the individual shares of the partners are specified in that instrument

- A certified copy of the instrument of partnership shall accompany the return of income of the firm of the tax year in respect of which assessment as a firm is first sought.
- For this purpose, copy of the instrument of partnership shall be certified in writing by –
  - all the partners (not being minors) or,
  - where the return is made after the dissolution of the firm, by all persons (not being minors), who were partners in the firm immediately before its dissolution and
  - by the legal representative of any such partner who is deceased.
- Where a firm is assessed as such for any tax year, it shall be assessed in the same capacity for every subsequent year, if there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the assessment as a firm was first sought.

Assessment as a firm [Section 325 of the 2025 Act corresponding to section 184 of 1961 Act]

- Where any such change had taken place in the tax year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for such tax year, and all the provisions of this section shall apply accordingly.
- Irrespective of anything contained in any other provision of this Act, where, in respect of any tax year, there is on the part of a firm any such failure as is mentioned in section 271 (relating to best judgement assessment) [failure to furnish a return u/s 263(1)/(4)/(5), failure to comply with a notice issued u/s 268(1)/fails to comply with the terms of notice issued u/s 270(8)],—

  (a) the firm shall be so assessed that **no deduction by way of any payment of interest, salary, bonus, commission or remuneration**, by whatever name called, made by such firm to any partner of such firm **shall be allowed** in computing the income chargeable under the head “Profits and gains of business or profession”; and

  (b) such payment shall not be chargeable to income-tax under section 26(2)(g) in the hands of the partner

Assessment as a firm [Section 325 of the 2025 Act corresponding to section 184 of 1961 Act]

- There should not be any failure as is mentioned in section 271 [corresponding section 144 of the 1961 Act]. If there is any failure as is mentioned in section 271, then by virtue of section 325(6) the firm shall not be allowed deduction on account of remuneration and interest.
- What is important is type of failure in section 271 and not assessment under section 271. In other words, section 325(6) does not come into operation automatically when assessment is made under section 271. It come into play only when there is a complete failure as mentioned in section 271.

Ref:- Surendra Prasad Misra v. ITO [2006] 7 SOT 457/104 TTJ 292 (Luck.)

Assessment as a firm [Section 325 of the 2025 Act corresponding to section 184 of 1961 Act]

- For instance, assessment is completed in manner as prescribed in section 271 but such a course of action has been adopted because the Assessing Officer is not satisfied about the correctness or completeness of accounts of assessee as per section 276 dealing with Method of Accounting. No disallowance can be made under section 325(6) for payment of remuneration/interest to partners.

  [Vijay Veer Singh v ITO[2014] [2015] 153 ITD (Agra)]

- Filing of a return against notice (issued under section 280) itself is not the same as filing a return under section 263 and failures referred to in section 271(1) which attract disallowance of deductions under section 325(6) are absolute failures which cannot be remedied by filing returns based on notice under section 280 [corresponding section 148 of the 1961 Act]

  [Radha Picture Palace v CIT [2011] 9 taxmann.com 16 (Ker)]

Assessment when section 325 not complied with [Section 326 of the 2025 Act corresponding to section 185 of 1961 Act]

Irrespective of anything contained in any other provision of said Act, where a firm does not comply with the provisions of section 325 for any tax year,—

- **no deduction by way of any payment of interest, salary, bonus, commission or remuneration,** by whatever name called, made by such firm to any partner of such firm **shall be allowed** in computing its income chargeable under the head “Profits and gains of business or profession”; and
- such interest, salary, bonus, commission or remuneration shall **not** be chargeable to income-tax under section 26(2)(g) in the hands of partners of such firm.

Change in constitution of a firm [Section 327 of the 2025 Act corresponding to section 187 of 1961 Act]

- Where at the time of making an assessment under section 270 or 271, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment.
- For the purposes of this section, there is a change in the constitution of the firm—

(a) if one or more of the partners cease to be partners or one or more new partners are admitted, subject to the condition that at least one person who was partner of the firm before the change continues as partner after such change; or

(Note - This is not applicable where the firm is dissolved on the death of any of its partners);

(b) where all the partners continue with a change in their respective shares or in the shares of some of them.

Succession of one firm by another firm [Section 328 of the 2025 Act corresponding to section 188 of 1961 Act]

Where a firm carrying on a business or profession is succeeded by another firm, except in a case covered by section 327, separate assessments shall be made on the predecessor firm and the successor firm as per the provisions of section 313 (Succession to business or profession otherwise than on death].

Joint and several liability of partners for tax payable by firm [Section 329 of the 2025 Act corresponding to section 188A of 1961 Act]

- Every person who was a partner of a firm during the tax year, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the tax year, and
- All the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm dissolved or business discontinued [Section 330 of the 2025 Act corresponding to section 189 of 1961 Act]

- Where a firm is dissolved or any business or profession carried on by it has been discontinued, the Assessing Officer shall make an assessment of the total income of the firm, as if no such dissolution or discontinuance had taken place, and
- All the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act, shall apply, so far as may be, to such assessment.
- If the Assessing Officer or Joint Commissioner (Appeals) or Commissioner (Appeals), in the course of any proceeding under this Act in respect of any such firm which is dissolved or business or profession carried on by it has been discontinued, is satisfied that the firm was guilty of any of the acts specified in Chapter XXI, he may impose or direct the imposition of a penalty as per the provisions of that Chapter.

Firm dissolved or business discontinued [Section 330 of the 2025 Act corresponding to section 189 of 1961 Act]

- Every person who was at the time of such dissolution or discontinuance a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.
- Where such dissolution or discontinuance takes place after any proceedings in respect of a tax year have commenced, the proceedings may be continued against the persons referred to above from the stage at which the proceedings stood at the time of such dissolution or discontinuance, and all the provisions of this Act shall, so far as may be, apply accordingly.
- The provisions of section 330 shall not affect the provisions of section 302(4), which limits the liability of legal representative to the extent to which the estate of the deceased is capable of meeting the liability.

Liability of partners of LLP in liquidation [Section 331 of the 2025 Act corresponding to 167C of the 1961 Act]

Irrespective of anything contained in LLP Act, 2008, where any tax including penalty, interest, fee or any other sum payable under the Act is due and cannot be recovered from—

- the LLP in respect of any income of any tax year; or
- any other person in respect of any income of any tax year during which such other person was a LLP,

then, in such case, every such person who was a partner of such LLP at any time during the relevant tax year, shall be jointly and severally liable for the payment of such tax due unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP.

TDS on payment to partner of firm [Section 393(3) [Table Sl. No.7] of the 2025 Act corresponding to section 194T of the 1961 Act]

Any person being a firm is liable to deduct tax on any sum in the nature of salary, remuneration, commission, bonus or interest paid to a partner of the firm or credited to his account (including capital account) at the rate of 10% if amount exceeds Rs. 20,000.

Note 4 - It may, however, be noted that clause (c) of section 393(3) requires tax deduction at the time of payment thereof in cash or by way of cheque or a draft or by any other mode, or as specified therein.

It is not clear whether tax has to be deducted only at the time of payment or at the time of credit or payment, whichever is earlier.

TDS on payment to partner of firm [Section 393(3) [Table Sl. No.7] of the 2025 Act corresponding to section 194T of the 1961 Act]

Issue

Remuneration payable to partners is allowable as deduction only to the extent of limits based on the book profit of the firm, which can be ascertained only on finalization of accounts and completion of audit.

Whereas as per the agreement of partnership, a fixed sum is payable as remuneration every month, only the remuneration upto the limits permitted u/s 35(e) based on book profit would be deductible in the hands of the firm and chargeable to tax in the hands of the partner.

While the TDS statement for the last quarter has to be filed on 31st May, the “book profit” and the allowable remuneration based thereon can be determined only on finalisation of accounts and completion of audit i.e., by 30th September.

The balance remuneration would be disallowed in the hands of the firm. Hence, it would not be chargeable in the hands of the partners.

TDS on payment to partner of firm [Section 393(3) [Table Sl. No.7] of the 2025 Act corresponding to section 194T of the 1961 Act]

Issue

However, TDS@10% is deductible on the entire remuneration and not only on the amount which is actually subject to tax in the hands of the partners.

It has been noted that in other TDS provisions, in cases where the deductor deducts tax at a rate higher than that provided in the provisions of the Act or on a higher amount than the amount liable for deduction of tax, and remits the tax so deducted, credit of such excess tax deducted by the deductor is denied by the CPC.

Consequently, credit for excess tax deducted and paid may be denied.

TDS on payment to partner of firm [Section 393(3) [Table Sl. No.7] of the 2025 Act corresponding to section 194T of the 1961 Act]

Also, there should be a separate column in Form 168 (corresponding to Form 26AS) showing the amount of excess tax deducted.

Otherwise, there may be a chance of opening/reopening of scrutiny assessments stating short declaration of income since the amount of Income would not match with the amount of TDS by applying the rate of TDS.

A separate column in Form 168 (Form 26AS) to reflect the excess tax deducted will enable the deductee to get credit of the entire tax deducted at source without giving rise to mismatch of amount of income applying the correct rate of TDS.

Service of notice when firm is dissolved [Section 503(2) of the 2025 Act corresponding to section 283(2) of the 1961 Act]

Where a firm is dissolved, notices under this Act for the income of such firm may be served on any person, who was a partner (not being a minor) or immediately before its dissolution.

Service of notice in case of discontinued business [Section 504 of the 2025 Act corresponding to section 284 of the 1961 Act]

Where an assessment is to be made under section 320 (in case of discontinued business), the Assessing Officer may serve on the person who was a partner of firm at the time of discontinuance.

- a notice containing all or any of the requirements which may be included in a notice containing all or any of the requirements which may be included in a notice u/s 268(1) (corresponding to section 142(1) of the 1961 Act); and
- the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that section.

In case of Firm and LLP, return by whom to verified [Section 265 [Table Sl. No. 8 & 9] of the 2025 Act corresponding to section 140 of the 1961 Act]

In case of firm, return has to be verified by—

- By the managing partner of the firm;
- where the managing partner is not able to verify the return due to any unavoidable reason, or there is no managing partner as such, by any partner of the firm, not being a minor.

In case of LLP, return has to be verified by—

- By the designated partner of the LLP;
- where the designated partner of the LLP is not able to verify the return due to any unavoidable reason, or where there is no designated partner, by any partner of the LLP or any other person as may be prescribed for verifying the return.

THANK YOU

CA PIYUSH .S. CHHAJED

Lets Gets Connected