

COMPUTATION OF TAXABLE INCOME OF FIRM AND ITS PARTNERS

- As per section 2(23) -
the terms 'FIRM', and 'PARTNERSHIP' have the same meanings respectively, assigned to them in the Indian Partnership Act, 1932 and includes a Limited Liability Partnership as defined in the Limited Liability Partnership Act, 2008;

the term 'PARTNER' has the same meaning assigned to it in the Indian Partnership Act, 1932 and includes a *partner* of a Limited Liability Partnership as defined in the Limited Liability Partnership Act, 2008;

(It shall also include a *minor* who has been admitted to the benefits of Partnership).

- **Partnership** as per section 4 of the Indian Partnership Act, 1932 is defined as relationship among persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
- The persons who have entered into partnership are called *partners* individually and collectively it is a *firm*.
- The business is carried on in the name of the firm and it is taxed as a separate entity.
- The share of profit of the partners is not taxable in the hands of the partners (as the profit from the business is to be taxed in the hands of the firm).
- Any remuneration (salary, bonus or commission) paid / payable to the partners is allowed as a deduction to the firm (subject to conditions) and so the same are taxable in the hands of the partners (not under the head 'salaries').
- The firm can claim deduction towards payment of interest, if any, to any of the partners not exceeding 12% p.a. and this interest amount is taxable in the hands of the partners.
- Payment of remuneration and interest is deductible if the conditions laid down in sections 184 and 40(b) are satisfied.

I. Conditions as per section 184 are as follows:

1. The partnership should be evidenced by an instrument in writing;
2. The shares of each partner should be specified in such instrument;
3. A copy of the partnership instrument as certified by all the partners should be enclosed with a return of income in respect of the first assessment year;

4. If there is a change in the constitution of the firm, certified copy of the revised instrument should be filed alongwith the return of income of the year in which such change has taken place;
5. There should not be any failure in terms of section 144.

Note: If these conditions are not satisfied, payments made by the firm like salary, remuneration, interest, bonus, commission etc will not be allowed.

II. Conditions as per section 40(b) are as follows:

A. Remuneration paid to partners shall be allowed (in the hands of the firm) if the following conditions are satisfied:

- (i). It should be authorized by and in accordance with the partnership deed;
- (ii). It should relate to the period falling after the date of the partnership deed;
- (iii). It should be within the prescribed limits. The limit is given below:

BOOK PROFIT	REMUNERATION ADMISSIBLE
On the first Rs. 3,00,000 or in case of a loss	Rs. 1,50,000 or 90% of book profit whichever is more
On the balance	60% of book profit

- (iv). It should be paid to a working partner. (Working partner means who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner).

B. Interest paid to partners shall be allowed (in the hands of the firm) if the following conditions are satisfied:

- (i). It should be authorized by and in accordance with the partnership deed;
- (ii). It should relate to the period falling after the date of the partnership deed;
- (iii). It should be restricted to 12% p.a. simple interest, if it is more.

How to find out book profit?

- Step 1. Find out the *net profit* of the firm from the P & L A/c
- Step 2. *Exclude* other heads of income
- Step 3. *Make adjustments* as provided in sections 28 to 44D
- Step 4. *Add remuneration* to partners if debited to P & L A/c
- Step 5. Add interest paid to partners *in excess of* 12% p.a.
- Step 6. The resulting figure will be *book profit*.

Exercise

1. P & L A/c of M/s V.S.G Co. (a firm of which V, S & G are partners which satisfy all the conditions of sections 184 & 40(b)) for the Y.E. 31.03.2017 is given below:

	Rs.		Rs.
Purchases	494000	Sales	1175000
Remuneration to partners	V - 240000 S - 240000 G - 180000	Interest on Securities	15000
Interest to partners on capital @ 18%	V - 36000 S - 36000 G - 54000	Dividend	9000
Municipal Taxes	2000	Rent	360000
Other expenses	180000		
Interest paid to G on loan	18000		
Depreciation	30000		
Net Profit	49000		
	1510000		1559000

Other Information:

1. Other expenses of Rs. 36,000 is not deductible u/s 36 & 37(1);
2. Purchases include - Rs.30,000 payments made in cash;
3. V, S and G share the profit in 1:1:1 ratio;
4. G is not a working partner;
5. Eligible depreciation works out to Rs.42,000.

Find out the net taxable income of the firm for the relevant A.Y.

2. M/s ABC Co., a partnership firm, in which A, B and C are partners, furnishes the following P & L A/c for the year ended 31.03.2016:

	Rs.		Rs.
Interest on Bank loan	9,200	Gross profit transferred from Tr. A/c	7,22,000
Depreciation	15,500		
Salary to Staff	53,500		
Long term capital loss	5,000		
Salary to partners A -1,44,000 B-1,08,000 C- 90,000	3,42,000	Short Term capital gain	25,000
Interest on capital @ 12% A -9,900 B-6,600 C-6,600	21,000	Interest from Bank	18,000
Business expenses	25,800		

Donation to charitable trust	50,000		
Net Profit:	A- 1,21,500		
	B - 81,000	2,43,000	
	C - 40,500		
	7,65,000		7,65,000

The partnership deed provides the following:

Profit will be shared in 3:2:1; Interest on capital @ 12%;

A, B & C will receive Rs.12,000, Rs.9,000 & Rs.7,500 p.m. as salary.

Allowable depreciation as per IT Rules works out to Rs.18,000.

Particulars of the partners are as given below:

	A	B	C
Interest on Bank F.D.	Rs.2,75,000	Rs.3,12,000	Rs.1,44,000
Rental Income (H.P.)	-	-	Rs.4,80,000
Investment in PPF	Rs.45,000	30,000	75,000

Compute the taxable income of the firm for the relevant Assessment Year and that of the partners of the firm/

3. The P & L A/c of M/s. XYZ Co. for the year ended 31.03.2018 is given below:

Particulars	Rs.	Particulars	Rs.
Opening Stock	50,000	Sales	5,10,000
Purchases	3,00,000	L.T.C.G.	1,80,000
Property tax for 10-11 & 11-12	3,600	Closing Stock	90,000
Business expenses	75,000		
Commission to X	1,00,000		
Remuneration to partners	Z -96,000 Y-96,000		
Interest on @ 12% X - 30,000 Y - 25,000 Z - 25,000	80,000	Net Loss X: 7725 Y: 6437.5 Z: 6437.5	20,600
	8,00,600		8,00,600

Expenses include donation of Rs. 30,000 to a charitable trust paid by cash. Compute the total taxable income of the firm.

4. A partnership would like to offer its income to tax u/s 44AD. Gross receipts Rs.81,00,000. Partner's remuneration (3 partners - all are working) Rs.2.4 lakhs each as per partnership deed. Interest on capital @ 12% p.a. works out to Rs. 1 lakh each. Compute the total taxable income of the firm for the A.Y. 2017-18.