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. The profit and loss account of M/s PQR Co. ,a firm of which P, Q & R are partners which satisfy all the conditions of sections 184 & 40(b)) for the Y.E. 31.03.2014 is given below:

	Rs.		Rs.
Purchases	12,25,000	Sales	19,10,500
Remuneration to partners	P - 2,40,000 Q - 2,40,000 R –2,40,000		
Interest to partners on capital @ 12%	P - 45,000 Q – 45,000 R – 30,000	Interest on Securities	7,500
Municipal Taxes	1,200		
Other expenses	1,99,525	Rent	1,44,000
Depreciation	41,000		

Other Information:

1. Closing stock was valued at Rs.1,55,000/-.
2. Other expenses of Rs. 21,525 is not deductible u/s 36 & 37(1);
3. Expenditure includes Rs. 41,000 by cash.
4. P, Q and R share the profit in 1:1:1 ratio;
5. Eligible depreciation works out to Rs.33,000.

Find out the net taxable income of the firm and that of the partners for the A.Y. 2014-15.

2. The P & L A/c of M/s. ABC Co. is given below:

Particulars	**Rs.**	**Particulars**	**Rs.**
Purchases	30,00,000	Sales	43,41,900
Business expenses	7,50,000	Dividend	8,100
Commission to C	1,50,000		
Remuneration to partners	B-1,50,000 C-1,50,000		
Interest on @ 18% A – 1,00,000 B – 1,00,000 C – 2,00,000	4,00,000	Net loss A: 75,000 B: 75,000 C: 1,50,000	3,00,000
Interest on loan to C	50,000		
	46,50,000		**46,50,000**

Other Information:

C is not a working partner. Business expenses include a brokerage amount of Rs.50,000 paid on sale of capital asset.

Each of the partners have taken LIC policy in their names and the premiums paid by them during the P.Y. are Rs.5,000, Rs. 6,000 and Rs. 11,000 respectively.

Compute the total taxable income of the firm and that of the partners of the firm for the A.Y. 2015-16. Also find the tax payable by the firm and the partners.

3. 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 31.03.2012:

	Rs.		Rs.
Interest on Bank loan	12,200	Gross profit transferred from Tr. A/c	6,92,000
Depreciation	26,000		
Salary to Staff	40,000		
Salary to partners A -1,44,000 B-1,08,000 C- 90,000	3,42,000	Interest from Govt. securities	15,000
Interest on capital @ 12% A -9,900 B-6,600 C-6,600	21,000	Interest from Bank	13,000
Business expenses	25,800		
Donation to NDF	10,000		
Net Profit: A – 1,21,500 B – 81,000 C – 40,500	2,43,000		
	7,20,000		7,20,000

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.30,000.

Compute the taxable business income of the firm for the Assessment Year 2014-15.