UNIT 17 ASSESSMENT OF FIRMS

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PART – A

(GENERAL BACKGROUND)

17.1 INTRODUCTION

The traditional form of business organization is sole proprietorship wherein all the business resources are provided by the sole trader himself. This form of business may be suitable to the small-sized business but cannot suit the medium and large sized units. Sole proprietorship suffers from limited means, ability, skill and unlimited liability. In case the business decides to grow in size there will always be need for more capita, more skill, efficient management and fellow partners, to share the risk and liabilities. In such cases, formation of partnership is one of the ways out to meet the expansion requirements of proprietorship.

17.2 OBJECTIVES

After studying this unit, you would be able to:

- study what scheme of taxation is followed while making an assessment of income of the firm as well as its partners;
- learn the rules that are followed in imposing tax on firms and the partners and how to collect it from them; and
- know what tax discipline should be followed by the firm in order to arrive at correct taxable income and the tax payable.

17.3 DEFINITION AND MEANING OF PARTNERSHIP

In India, partnership firm is governed by Indian Partnership Act 1932.

According to Section 4 of Indian Partnership Act, 1932, Partnership means "The relationship between the persons who have agreed to share profit of business carried on by all or any of them acting for all." All persons who have entered into partnership with one another are called individually 'Partners' and collectively a 'Firm' and the name under which business is carried on is called the 'Firm Name'.

17.4 ESSENTIAL FEATURES OF PARTNERSHIP FIRM

- Partnership is an agreement between two or more persons. A verbal agreement is treated as valid as a written agreement.
- Partners must agree to carry on lawful business.
- Sharing the profit or loss of the business should be the objective of the business.

- There is a Mutual Agency among the partners. The business can be carried on by all or any one of them acting for all.
- Minimum 2 persons can constitute a partnership. However, maximum number of partners in case of banking business is 10 and in other business are 20.
- Registration of the Firm is not compulsory as per law; however, registration of the firm is in the interest of firm and the partners.
- Partnership business is governed by the Indian partnership Act, 1932.

17.5 PARTNERSHIP DEED/DEED OF PARTNERSHIP

Partnership arises not from status but from contract. Contract may be verbal or in writing. The written contract between or among the partners is known as Partnership Deed or Partnership Agreement or Articles of Partnership. A partnership deed includes the following points:

- Names and addresses of the firm and partners.
- Duration of partnership.
- Capital contribution of each partner.
- Whether drawings are allowed or not by the partners and if yes then to what extent and in what manner i.e. monthly or six monthly or yearly.
- Interest on capital or interest on loan given by the partners to the firm and interest on drawings (if any) and the rate of such interest.
- Proportion of division of profits and losses. In the absence of agreed ratio of profit or loss, it will be shared equally.
- Right and duties and liabilities of partners.
- Procedure as to admission and retirement of partner.
- Methods of valuation of goodwill to be adopted in case of admission, retirement or death of the partner.
- Methods of keeping accounts and audit.
- Partner's salary (if allowed to any partner).
- Rules as to operation of Bank Account by the Partners (whenever required).
- Methods of evaluating assets and liabilities.
- Circumstances in which firm shall be dissolved.
- In case of dispute, how the settlement is to be made between or among the partners.

Above is not the final list and therefore, some other points may also be included in the partnership deed.

17.6 REGISTRATION OF FIRM

The registration of partnership firm is not compulsory. Following advantages are available to registered firm which are not available to an unregistered firm:

- Registration of a firm empowers it to claim against third parties in the court of law.
- It will enable a partner to enforce his claim against his co-partners or against third parties.
- It also safeguards third parties against fraud or misrepresentation done by a partner of a firm.
- By being registered an incoming partner empowers himself for dues against other fellow partners without relying on their good faith.
- Registration of the firm can be effected at any time.

17.7 NON REGISTRATION OF FIRM

Since the registration of the firm is not compulsory, a non-registered firm is subjected to following disadvantages.

- The firm cannot get enforced a claim against any third party for recovering a debt exceeding Rs. 100.
- A partner loses his right to sue for enforcing his rights against any of his co-partners or against the firm.
- Non registration does not preclude any third party to sue the firm or its partners.

Check Your Progress A

1) Point out whether the following statements are True or False:

   a) Partnership firms are governed by Indian Partnership Act, 1932.

   b) There used to be a Mutual Agency among Partners.

   c) Partnership arises from status and not from contract.

   d) Registration of firm is compulsory.

PART – B

(SCHEME OF TAXATION)

17.8 GENERAL RULES AND PROCEDURE

Assessment of firm involves the following:

1) Computation of total taxable income of the firm.

2) Computation of tax payable by firm.

3) Procedure for making assessee pay tax.

In the process of dealing with the above points, certain rules and regulations are followed which are discussed as under:

A) Residential Status:

Status of the firm may be classified into following two categories.

i) Resident

ii) Non – resident

A firm is said to be resident when its affairs are managed and controlled wholly or partially from India.

A firm is said to be non-resident when its affairs are controlled and managed completely from outside India.

A firm cannot be Not-ordinarily resident. If the partners or the members are resident in India, the general presumption would be that the firm is also resident unless it is proved by the assessee that control and management of the affairs of the firm is situated wholly outside India.

B) Taxability of Income:

To determine taxability of an income, following two rules are important:

i) All revenue receipts are taxable unless specifically exempted.

ii) All capital receipts are exempt unless specifically taxable.

C) Taxability Income under Various Heads of Income:

According to Section 14 of Income Tax Act, there are five heads of income. However, only following four heads of income are applicable in case of firms:

i) Income from House Property.

ii) Profits and Gains of Business or Profession.

iii) Capital Gains.

iv) Income from Other sources.

D) Separate Entity:

A firm has separate entity and therefore, taxed separately.

E) Registration of Firm:

For taxation, there is no distinction between registered and unregistered firm (subject to applicability of rules).

F) Partner's share:

While partner's income is computed for taxation purpose, his share in firm's income is not included in the total income of the partner.

G) Salary, Bonus, Commission or Remuneration Payment:

Any Salary, Bonus, Commission or Remuneration by whatever name called which is due to or received by the partner, is allowed as deduction subject to certain restrictions. A detailed discussion in this regard is made in the ensuing pages of this unit.

H) Payment of Interest:

Any firm if pays interest to any partner, may claim deduction of such interest from its total income but the rate of interest cannot exceed 12 per cent per annum. A detailed discussion regarding interest is made in the ensuing pages of the unit.

I) Tax Rate:

The firm's income is taxed at a flat rate of 30 per cent plus Surcharge (12% if net income exceeds Rs. 1 crore) and plus Health and Education Cess.

J) Alternate Minimum Tax:

Any firm including a limited liability partnership is subject to Alternate Minimum Tax at the rate of 18.5 per cent of adjusted total income.

Note:

With effect from assessment year 2010-11, provisions discussed above are also applicable in case of limited liability partnership (LLP).

Deductibility of Remuneration / Interest:

Remuneration and interest to the partners of the firm are deductible subject to the fulfillment of following conditions:

i) These are otherwise deductible u/s 36 and 37.

ii) Conditions prescribed u/s 184 are satisfied.

iii) Conditions prescribed u/s 40 (b) are satisfied.

It is, therefore, necessary to know the conditions of Section 184 and Section 40 (b).

17.9 PROVISIONS OF SECTION 184 REGARDING ASSESSMENT OF FIRMS

1) Firm's assessment can be made (as a firm) if:

   i) The partnership is evidenced by an instrument. Instrument not only may include partnership deed but also constitute any other formal document.

   ii) The individual shares of partners are specified in that instrument. In other words, individual share of profits in the profit of the partnership must clearly be given in the instrument of partnership.

2) A certified copy of the instrument of partnership deed shall accompany the returns of income of the firm for the previous year relevant to the assessment year in respect of which assessment as a firm is first sought. In other words, the first return of the income of the firm should accompany a certified copy of the instrument of partnership.

3) If once a firm is assessed as a firm for any assessment year, it shall continue to be assessed as a firm for every subsequent year if there is no change in the constitution of the firm.

4) If a change occurs in the constitution of the firm or profit sharing ratio during any previous year, a certified copy of the revised instrument (partnership deed) along with return of income of the relevant assessment year should be furnished/filed.

5) If a firm fails to comply withthe provision mentioned u/s 184, the firm shall be assessed as firm but the following disallowance of deductions will apply:

   a) No deduction by way of payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by the firm to its partners shall be allowed in computing the income chargeable under the head 'Profits and Gains of Business or profession.'

   b) Such interest, salary, bonus, commission or remuneration shall not be chargeable to tax in the hands of partners under the head Profits and gains of business or profession u/s 28 (v).

17.10 ASSESSMENT IN CASE OF NON-COMPLIANCE OF SECTION 184

According to Section 185, following shall be the consequences of non-compliance of the provisions of Section 184:

1) Firm shall be assessed as a firm for the assessment year concerned to non-compliance.

2) No deduction by way of payment of interest, salary, bonus, commission, or remuneration by whatever name called, made by firm to its partners shall be allowed in computing the income chargeable under the head 'Profits and Gains of Business or Profession.'

3) Such interest, salary, bonus, commission or remuneration shall not be chargeable to tax in the hands of partners under the head 'Profits and Gains of Business or Profession [u/s 28 (v)].

17.11 PROVISIONS OF SECTION 40 (b) REGARDING ASSESSMENT OF FIRM

Provisions of Section 40 (b) disallow the following expenses:

i) Any payment of salary, bonus, commission or other remuneration paid or payable to a non-working partner. In brief, these expenses are disallowed.

ii) Any payment of remuneration which is not authorized in the partnership deed and also not in accordance of the partnership deed, terms and conditions to any working partner is disallowed. In brief, these payments are disallowed.

iii) The remuneration to the working partners as per the partnership deed should be payable after the date of deed. In other words, if such payment of remuneration is made from a date prior to the date of partnership deed, it would not be allowed as deduction unless the earlier deed provides for such payment.

iv) Payment of salary, bonus, commission or other remuneration if made to the working partners in accordance with and as authorized by the terms of the partnership deed and in relation to any period falling after the date of partnership deed, it may be allowed as deduction in the hands of the firm. However, W.e.f. assessment year 2010-11, the maximum amount of such payment to all the partners in the previous year should not exceed the specified limit given below; then, any amount exceeding the specified limit would be disallowed.

Table 17.1: Specified limit for availing deduction

	Particulars	Rs.
(a)	If Book profit is negative i.e. in case of loss	1,50,000
(b)	In case Book profit is positive i.e. in case of profit: i) On the first Rs. 3,00,000 of book profit	1,50,000 or 90% of Book Profit, whichever is more

	ii) On the balance of the book profit	60% of book profit

v) Payment of interest to any partner is disallowed if it is neither authorized nor in accordance with the terms of partnership deed.

vi) Payment of interest should pertain to period after the partnership deed otherwise it will be disallowed. In other words, any payment of interest as per the terms of the earlier partnership deed to any partner for any subsequent period is allowed as deduction subject to the condition that it should be payable after the date of partnership deed.

vii) If the payment of interest to any partner is authorized by and is in accordance with the terms of partnership deed and also it relates to the period falling after the date of partnership deed is allowed as deduction, subject to the condition that the rate of simple interest should not exceed @ 12% per annum. If the rate of interest exceeds @ 12% per annum, the excess of interest amount shall not be allowed as deduction.

viii) Where a firm charges interest on drawings, it means the firm may pay as well as receive interest from the same partner. In such cases, interest received by the firm will be chargeable to tax. For interest paid to the same partner will be allowed according to the provisions of Section 40 (b).

Explanations regarding Section 40 (b)

1) Partners of the firm may be classified as Working partner and Non-working partner. Working partner is an individual who is actively engaged in conducting the affairs of business or profession of the firm of which he is a partner. Non-working partner may be non-acting financing or Sleeping Partner.

2) Partner in representative capacity is an individual who is a partner in a firm on behalf or for the benefit of any other person. Payment of interest by the firm to such individual otherwise than as 'Partner in a Representative Capacity' shall not be taken into account for the purpose of this Section i.e. 40 (b).

3) 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 is taken into account for the purpose of Section 40 (b).

4) Book profit is the Net Profit arrived at as per profit and Loss Account for the relevant previous year after making adjustments as provided by Section 28 to 44D and adding remuneration to partners, if debited to profit and loss account.

5) Merely stating in the partnership deed that the remuneration shall be paid to the working partners does not entitle the firm of the deduction u/s 40 (b).

To be eligible to claim deduction regarding working partners remuneration u/s 40 (b), the partnership deed must specifically state the amount of remuneration payable to each working partner or how the remuneration will be computed, otherwise no deduction will be allowed [u/s 40 (b)] in this regard.

17.12 COMPUTATION OF BOOK PROFIT

Book profit of the firm is the profit before deducting remuneration to partners; it is shown by profit and loss account which has been calculated under provisions under Sections 28 to 44 of income tax act, 1961.This profit is then, increased by the amount of remuneration given or to be given to partners provided this remuneration had already been deducted in ascertaining the net profit.

Steps to calculate Book profit:

1) Profit or loss is calculated by preparing profit and loss account, if profit or loss is given, then, then it is taken as base.
2) The necessary adjustments mentioned in Section 28 to 44D are made in profit and loss account.
3) The remuneration given to the partners is added in net profit.

The final amount so arrived shall be the book profit of the firm.

Note:

a) Following items are not included in book profit of the firm
   i) Capital gains of the firm
   ii) Income from other sources
   iii) Income from house property of firm
b) Following items are not to be deducted from book profit of the firm
   i) Deduction u/s 80Cto 80U from gross total income (while computing total income of the firm the deductions can be deducted)
   ii) Brought forward of business losses (while computing income from business, this loss can be deducted)

As per provisions of Section 40 (b), Book Profit is required to be computed, Book Profit may be computed in the following proforma:

Table 17.2: Proforma for computation of Book Profit

Particulars	Rs.	Rs.
Net profit as per profit and loss account		-
Add:		
1) Expenses disallowed but debited to profit & loss a/c (not covered u/s 28 to 44 D)	-	
2) Incomes which are taxable under the head	-	

Profits and Gains of Business or Profession but not credited to P & L a/c		
3) Remuneration of Partners, if debited to P & L a/c	-	
4) Disallowance of interest in excess of 12% p.a.	-	-
		-
Less:		
i) Incomes not taxable under the head Profits and Gains of Business or Profession but credited to P & L a/c	-	
ii) Expenses / Losses allowed but not debited to P & L a/c	-	-
Book profit		**-**

Note-1:

Brought forward unabsorbed business loss is not deductible in computation of Book Profit.

Note-2:

Non-business incomes and their concerned Non-business expenses are not included to arrive at the Book Profit.

Note-3:

In case of loss, the above rules shall be reversed i.e. in the above proforma items of addition shall be deducted from loss and items of deduction shall be added to the loss.

Note-4:

Incomes chargeable to tax under the heads 'Income from House Property', 'Capital Gains' and 'Income from Other Sources' will not be a part of Book Profit.

Note-5:

Permissible deductions under Section 80-C to 80-U from Gross Total Income shall be ignored while computing 'Book Profit'.

Provision in case of Firm's Losses

When the firm is unable to set off its losses in the same year from the profits of other business etc., the losses which could not be set off in the same year may be carried forward to be set off in subsequent years. Subject to the certain rules of income tax,'Losses' brought forward to be set off in subsequent years shall be dealt as under:

a) Losses of speculative business can be set off against the income of speculative business of the firm in subsequent 4 years from the year in which loss was incurred.

b) Losses of non-speculative business can be set off against any profit of business of the firm in subsequent 8 years from the year in which loss was incurred.

c) Short-terms capital losses can be set off against short-term as well as Long-term capital gains of the firm in subsequent 8 years from the year in which loss was incurred.

d) Long-term capital losses can be set off against long-term capital gains of the firm in subsequent 8 years from the year in which loss was incurred.

e) Unabsorbed depreciation can be set off against business income or any other income of the firm.

17.13 COMPUTATION OF TOTAL INCOME OF THE FIRM

When a Profit &Loss a/c is given to compute the total income of the firm, then profit or loss as revealed by Profit &Loss a/c shall be adjusted in the same manner as is done in the computation of income under the head Profit and Gains of Business or Profession. After arriving at aforesaid profit as under the head 'Profits and Gain of Business or profession' and under the other heads of income (i.e. Income from House property, Capital Gains and Income from Other Sources) is computed and added in the income computed under the head Profits and Gains of Business or Profession and the resultant amount is the Gross Total Income (GTI) of firm.

Incomes exempt under Section 10 to 13-A shall be ignored while computing income under various heads of income as stated above.

From the Gross Total Income of the firm, deductions allowed u/s 80C to 80U shall be deducted and the balance shall be the Total Income of the Firm. It is to be noted that deductions u/s 80 G, 80 GGA, 80 GGC, 80 IA, 80 IAB, 80 IB, 80 IC, 80 ID, 80 IE, 80 JJA and 80 JJAA only are applicable to a firm.

The deductions under the above mentioned Section will not be allowed against short-term capital gains (specified in Section 111-A) and Long-term capital gains (u/s 112).

Table 17.3: Proforma for computation of Total Income of Firm

Particulars		Rs.	Rs.
Book profit (of the firm)			-
Less: Remuneration paid to working partners:			
(a) Actual Remuneration	Whichever is less	-	
(b)Statutory Limit (u/s 40 b)		-	-
Profits and Gains of Business or Profession of the firm			-
Add: Income under other heads of income and sources.			-
Gross Total Income			-
Less:			
Deductions u/s 80 C to 80 U (As applicable on firm)			-
Total income			-

17.14 COMPUTATION OF TAX LIABILITY OF THE FIRM

The following procedure is adopted to find out Tax Liability of the firm:

a) Find out Income Tax on Net Income.

b) Add surcharge @ 12% (If total income exceeds Rs. 1 crore).

c) Add Health and Education Cess @ 4% on the total of above (a) and (b) i.e. (a+b).

d) Tax liability will be total of a, b and c above i.e. (a+b+c).

Table 17.4: Format of Computing Tax Liability on Total Income of a Firm

	Particulars	Rs.
1)	Tax on winning from lotteries, card games, cross word puzzles, horse race etc and other casual income @ 30%	-
2)	Tax on Long-term capital Gains @ 20%	-
3)	Tax on Short-term capital gains @ 15% (Liable for STT or u/s 11A)	-
4)	Tax on other taxable income @ 30%	-
		-
	Add:	

	Surcharge @ 12% (If applicable)	-
		-
	Add:	
	Health and Education Cess @ 4%	-
	Tax payable	-

Note:

i) Surcharge is applicable when total taxable income exceeds Rs. 1 crore.

ii) Tax payable (as shown in the above proforma) is subject to adjustment by way of Marginal relief in surcharge.

Firm having taxable income Rs. 1 crore is liable to pay surcharge @ 12 per cent on the tax. However, the total amount payable as income tax and surcharge on total income exceeding Rs. 1 crore shall not exceed the total amount payable as income tax on the total income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore.

Table 17.5: Format of computing Tax Liability where a Firm is liable for payment of Surcharge is as under

Particulars	Rs.	Rs.
Tax on Total Income	-	
Add: Surcharge	-	
(a)	-	
Or		
Tax on Rs. 1 crore	-	
Add: Amount of taxable income in excess of Rs. 1 Crore	-	
(b)	-	
Amount of (a) or (b) whichever is less		-
Add: Health and Education Cess @ 4%		-
Tax payable		-

17.15 PROVISIONS OF ALTERNATE MINIMUM TAX (AMT) FOR LIMITED LIABILITY PARTNERSHIPS (LLP) OR ANY OTHER NON-CORPORATE ASSESSEE

Alternate Minimum Tax (AMT) is computed on the Adjusted Total Income of Limited Liability Partnership (LLP) and other Non-corporate assessee.

AMT is applicable to individual HUF, AOP, BOI, Artificial Judicial person only when they satisfy following two conditions:

i) They have claimed deductions u/s 10-AA, 35 AD and Chapter VI heading C.

ii) The adjusted total income exceeds Rs. 20 Lakhs.

In all other cases (LLP, partnership firms and Non-corporate assessees), the limit of Rs. 20 Lakh does not apply.

Thus, where the regular income tax payable by a Limited Liability Partnership (LLP) is less than the Alternate Minimum Tax (AMT) payable for such previous year, the Adjusted Total Income shall be deemed to be the total income of LLP. In other words, the tax liability of LLP shall be tax on Total Taxable Income or AMT whichever is higher.

LPP shall be liable to pay tax on the adjusted total income @ 18.5% + Health and Education Cess @ 4%

Table 17.6: The Adjusted Total Income of LLP can be computed as under:

Particulars	Rs.
Total taxable income of LLP	-
Add:	
(i) Deduction claimed under chapter VI-A from 80 H to 80-RRB (not being Section 80-P)	-
(ii) Deduction claimed if any under Section 10-AA	-
(iii) Deduction claimed if any under Section 35 AD reduced by regular depreciation allowed.	-
Adjusted Total Income	-

Table 17.7: Alternate Minimum Tax can be calculated as under:

Particulars	Rs.
Tax on adjusted total income @ 18.5%	-
Add: Surcharge @ 12% (if adjusted total income exceeds Rs. 1 crore)	-
	-
Add: Health and Education Cess @ 4%	-
Alternate Minimum Tax (AMT)	-

Provisions of Tax credit in respect of Tax paid on Adjusted Total Income of LLP

i) Tax credit shall be the excess of the AMT paid over the tax payable on the total income computed under the provisions of the Act.

ii) The tax credit is allowed to be carried forward for a maximum 15 assessment years immediately succeeding the assessment year in which the credit becomes allowable.

iii) Tax credit = Total income- Tax payable under AMT.

iv) Set off the tax credit shall be allowed for the assessment year in which the regular income tax exceeds AMT to the extent of the excess of regular income tax over the AMT.

v) No interest shall be paid on tax credit.

vi) Where as a result of assessment, reassessment, rectification of mistake, appeal or revision, settlement, there is reduction or increase in the amount of tax payable, the tax credit amount will also be reduced or increased accordingly.

vii) If provisions of AMT are applicable, the LLP will have to obtain a report in prescribed format from a chartered accountant.

17.16 COMPUTATION OF PARTNER'S INCOME FROM THE FIRM

1) **Share of profit**

Partner's share of profit in the firm is exempt u/s 10 (2A). Therefore, it will not be included in his income.

2) **Remuneration**

Any remuneration such as salary, bonus, commission or other remuneration received by a partner as per the provisions of partnership deed but not violating the provisions of Section 40 (b) shall not be taxable under the head 'Salaries' because a partner is not an employee of the firm. However, if remuneration as stated above is paid to the partner in excess of the amount admissible u/s 40 (b), the excess amount shall not be included in the taxable income of the partner as it must have already been included in the firms total income. Therefore, double taxation cannot be implemented on tax payer.

3) **Interest**

If a partner receives interest as per provisions of partnership deed not exceeding 12% p.a. then, such interest is treated as business income and included under head 'Profits and Gains of Business or Profession'.

4) **Rent**

If a building of a partner is let out to the firm, the rent received by the partner will be taxable under the head 'Income from House Property.' Otherwise, the problem of double taxation would be generated.

5) **Rent Free Accommodation**

If the partner of a firm is provided rent free accommodation with free electricity, such expenses are not allowed in the hands of the firm. Hence, this amount is not assessable in the hands of the partner.

6) **Deductions**

Following deductions may be claimed by the partner in computation of income under the head 'Profits and Gains of Business or Profession.'

a) The partner is entitled to deduction of interest on the borrowed capital which is to be invested in the firm. This does not make any impact on this provision whether the firm has utilized such money for what purpose and the partner shall be entitled for such deduction in all circumstances including the situation when he receives or not receives income from the firm.

b) Sometimes, partners are required to maintain a minimum balance of their capital in the firm. In case the minimum balance of the partner's capital goes down for any reason, firm may charge interest on his deficit capital. Such interest on deficit capital of the partner is allowed as deduction. However, interest paid to the firm on the amount withdrawn for the payment of personal advance tax and personal expenses, is not deductible from the interest income of the firm.

c) To earn the remuneration from the firm, if the partner incur any other expenses such as travelling expenses, expenses on maintenance of car and depreciation of car etc., such expenses are allowed as deduction under the head 'Profits and Gains of Business or Profession.'

17.17 ASSESSMENT OF RECONSTITUTED FIRM

A firm is said to be a reconstituted firm when following changes take place in its constitution: -

i) When one or more partners cease to be the partners but remaining partners continue to be partners (Due to Death or retirement).

ii) When one or more new partners are admitted in a firm but at least one old partner continues to be a partner.

iii) When there used to be a change in the respective share or change in the share of some of the partners.

In case of a reconstituted firm, the assessment shall be made on the firm as constituted at the time of making the assessment where a firm has two partners only, on the death of one partner the firm will cease to exist and assessment shall be made separately for the period before and after death of the partner.

17.18 ASSESSMENT IN CASE OF SUCCESSION OF ONE FIRM BY ANOTHER FIRM

When all the partners of the firm are replaced by other partners and the firm is dissolved and reconstituted, it is said succession of one firm by another firm has taken place. In reconstituted Firm, there may be all the new partners or some of them may be old ones. Thus, while substantially identity and continuity of the business is preserved and whole of the business is transferred with the change of ownership.

In case of succession of one firm by another (carrying on business or profession) separate assessment shall be made on the predecessor and the successor firm. Predecessor firm shall be assessed for its income related with the period of pre-transfer of ownership and the successor firm shall be assessed on its income related with after the transfer of ownership.

17.19 JOINT AND SEVERAL LIABILITIES OF PARTNERS FOR TAX PAYABLE BY THE FIRM

According to Section 188 A, Every person who was during the previous year, a partner of the firm 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 the tax, penalty, or some other amount payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of the Act shall apply to the assessment of such tax or imposition or every of such penalty or other sum.

17.20 DISSOLUTION OF A FIRM OR DISCONTINUANCE OF BUSINESS

Complete cessation of business is known as discontinuance of business. Change in constitution of the Firm or change of ownership is not discontinuance of business. However, where the business of the firm is split up on dissolution and portions or branches of the business are divided among the partners, there is a discontinuance of the old business and it does not make any impact even if such portions or branches carry their business by the partners. Provisions regarding the assessment of such business are as under:

i) Where the business or profession carried on by the firm is discontinued or where a firm is dissolved, the assessment shall be made of the total income of the firm as if no such discontinuance or dissolution had taken place.

ii) Every person who was a partner and the legal representative of a deceased partner in the firm shall be jointly and severally liable for the amount of the tax, penalty or other sum payable by the firm.

iii) Inspite of the fact that discontinuance or dissolution of firm has taken place, and the proceedings in respect of an assessment year have commenced, the proceedings may be continued against persons mentioned in (ii) above.

Check Your Progress B

1) Choose the correct answer in each of the following:

   i) In case of Book Loss, the maximum allowable remuneration to working partner shall be:

      (a) NIL (b) Rs. 1,50,000(c) Rs. 3,00,000 (d) Rs. 1,20,000

   ii) Interest paid to any partner of a firm is disallowed u/s 40(b) in excess of:

      (a) 6% (b) Rs. 12% (c) 15% (d) Rs. 20%

   iii) A firm has Book profit of Rs. 9,36,000, the admissible remuneration to working partner for income tax purpose shall be:

      (a) Rs. 6,51,600 (b) Rs. 6,81,600

      (c) Rs. 2,70,000 (d) None of (a), (b), (c)

   iv) According to Income Tax Act, 1961, interest on capital received by a partner from a partnership firm is chargeable under the head:

      a) Profits and gains of business or profession

      b) Income from house property

      c) Capital gains

      d) Income from other sources

   v) Provision of Alternate Minimum Tax (AMT) u/s 115 JC are not applicable to:

      (a) Company (b) Individual

      (c) Partnership firm (d) Association of persons (AOP)

2) Fill in the blanks:

   a) Total income of a firm is chargeable to tax at …………

   b) From tax point of view, a Limited Liability Partnership (LLP) is treated as ………………..

   c) Surcharge is levied on the income of a partnership firm when its income exceeds Rs. …………

   d) Interest on capital contributed by partners is admissible at ……

   e) Surcharge (if applicable) shall be paid on firm's income @.........

3) State whether the following statements are True or False:

   a) A partner is liable to pay tax on his share of profit from the firm.

   b) Partner can set off losses of the firm from their income.

   c) AMT is calculated on adjusted total income of firm.

   d) No interest shall be payable to LLP on tax credit.

17.21 PROCEDURE OF TAX PAYMENT AND FILING OF RETURN OF INCOME BY FIRMS

1. Mode of Payment of Tax

Tax can be paid in any of the following modes:

a) **Physical Mode:** Payment can be made by furnishing the hard copy of the challan at the designated bank.

b) **Electronic Mode:** Payment can be made by using electronic mode. It is also called E-payment mode. Payment by E- payment mode is mandatory for a firm which is liable to get its accounts audited u/s 44AB of the Income Tax Act.

2. Payment of Advance Tax

Firms should also pay Advance Tax on the basis of expected tax liability of the year on due dates. Also called 'Pay as you earn Scheme', advance tax is payable if tax liability exceeds Rs. 10,000/- in a year. It is paid in the year of receipt of income.

3. Filing of Return of Income

- Every firm should file its return of income mandatorily irrespective of the amount of its income or loss.
- E-filing of return of income can be made with or without digital signatures.
- A partnership firm may also file its return of income under electronic verification code (EVC).
- If the accounts of the firm are liable to be audited u/s 44 AB it shall furnish return electronically under digital signature.
- Designated partner should normally sign the return of income of the firm, however, if for any unavoidable reason designated partner is unable to sign or in case where there is no designated partner, then, any partner may sign the return.
- Return of Income should be signed by managing partner in case of LLP.

- Return of income should be filed in the prescribed form by the income tax authorities.
- The return of income should be filed on or before the prescribed due date for this purpose.

Check Your Progress C

1) State whether the following statements are True or False:

   a) Payment of tax by E-payment mode is mandatory for a firm if Section 44 AB is applicable on it (firm).

   b) A firm should pay advance tax if its tax liability exceeds Rs. 10,000 in a year.

   c) It is not mandatory for a firm which incurs loss to file its return of income.

   d) A firm on which Section 44AB is applicable shall furnish return of income electronically under digital signature.

2) Short answer questions

   a) What is the rate of tax of a firm?

   ……………………………………………………………………………………

   ……………………………………………………………………………………

   ……………………………………………………………………………………

   ……………………………………………………………………………………

   b) State the two conditions to be fulfilled for the partnership firm to be assessed as firm.

   ……………………………………………………………………………………

   ……………………………………………………………………………………

   ……………………………………………………………………………………

   ……………………………………………………………………………………

17.22 ILLUSTRATIONS

Illustration- 1

The following is the Profit and Loss Account of partnership firm of x y z assessed firm, for the year ended 31st March 2023. Compute 'Book Profits' for Assessment Year 2023-24.

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
General Expenses	7,00,000	Gross Profit	28,75,000
Entertainment Expenses	2,75,000	Interest on Bank Deposits	1,45,000
Advertising	4,45,000	Excise Duty Refund	1,80,000
Rent, Rates and Taxes	2,90,000		
Salary to Partners			
X – Rs. 1,00,000 Y- Rs. 1,50,000 Z- Rs. 1,75,000	4,25,000		
Interest on Capital			
X – @ 20% - Rs. 40,000 Y- @ 10% - Rs. 20,000 Z- @ 15% - Rs. 30,000	90,000		
Donations	4,36,000		
Income Tax	49,000		
Net Profits	4,90,000		
	32,00,000		**32,00,000**

Other Information:

1) General expenses include Rs. 1,25,000 which is inadmissible.

2) Advertising includes Rs. 1,45,000 for advertising in a souvenir of a Political Party.

3) Payment of interest on capital and salary to partners is provided for in the Partnership Deed.

Solution:

Computation of Book Profitsfor Assessment Year2023-24

Particulars	Rs.	Rs.
Net Profits as per Profit and Loss Account		4,90,000
Add:		
General expenses to the extent inadmissible	1,25,000	
Expenditure on advertising in a publication of Political Party	1,45,000	
Salary to Partners	4,25,000	
Interest on Capital in excess of 12%		
X: (Rs. 40,000×8/20) = Rs. 16,000		
Z: (Rs. 30,000×3/15) = Rs. 6,000	22,000	
Donations	4,36,000	

Income Tax	49,000	12,02,000
		16,92,000
Less:		
Interest on Bank Deposits		1,45,000
Book Profits		**15,47,000**

Note:

i) In computation of Book Profit, Remuneration to Partners is fully inadmissible.

ii) If partnership deed permits, interest on capital is admissible upto 12% only.

Illustration- 2

Compute the amount of admissible remuneration of a partnership firm in the following cases, if the Book Profits are as under:

Case (1): (-) Rs. 3, 00,000

Case (2): Rs. 1, 25,000

Case (3): Rs. 2, 75,000

Case (4): Rs. 5, 00,000

Case (5): Rs. 8, 00,000

Partnership deed provides for the following salary to the partners:

A. Being working partner Rs. 2,40,000

B. Non-working partner Rs. 1,40,000

C. Being working partner Rs. 1,20,000

Also calculate amount of salary taxable in the hands of partners.

Calculation of admissible maximum limit

Case	**Book Profit** Rs.	**Calculation: [(a) 90% of Rs. 3,00,000 of Book Profit + 60% of balance of book profit or Rs. 1,50,000, whichever is higher]**	**Higher Amount** Rs.	**Admissible Maximum Limit** Rs.
1.	-3,00,000	Book Profit is negative	1,50,000	1,50,000
2.	1,25,000	90% of Rs. 1,25,000 or Rs. 1,50,000 whichever is higher	1,50,000	1,50,000
3.	2,75,000	90% of Rs. 2,75,000 or Rs. 1,50,000 whichever is higher	2, 47,500 (90%)	2,47,500
4.	5,00,000	90% of Rs. 3,00,000 = 2,70,000 +60% of Bal. Rs. 2,00,000 = 1,20,000 = Rs. 2,70,000 or Rs. 1,50,000 whichever is higher	3,90,000	3,90,000

5.	8,00,000	90% of Rs. 3,00,000 + 60% of Bal. Rs. 5,00,000 (Rs. 2,70,000 + Rs. 3,00,000) =Rs. 2,70,000 or Rs. 1,50,000 whichever is higher	5,70,000	5,70,000

Note:

In case of Loss (Negative Book Profit) Rs. 1, 50,000 is allowed as admissible maximum limit.

Calculation of Admissible Remuneration

Rs.

	Case 1	Case 2	Case 3	Case 4	Case 5
Eligible admissible actual remuneration i.e. remuneration of working partners as per deed (A+C)	3,60,000	3,60,000	3,60,000	3,60,000	3,60,000
Maximum Limit	1,50,000	1,50,000	2,47,500	3,90,000	5,70,000
Admissible remuneration (Least of the Above Two)	1,50,000	1,50,000	2,47,500	3,60,000	3,60,000

Calculation of Amount Taxable in the Hands of Partners

Rs.

	Case 1	Case 2	Case 3	Case 4	Case 5
Admissible Remuneration for the Firm	1,50,000	1,50,000	2,47,500	3,60,000	3,60,000
Remuneration Taxable in the hands of A [Admissible Remuneration $\times \frac{2,40,000}{3,60,000}$]	1,00,000	1,00,000	1,65,000	2,40,000	2,40,000
Remuneration Taxable in the hands of Non-working partner-B	NIL	NIL	NIL	NIL	NIL
Remuneration Taxable in the hands of C [Admissible Remuneration$\times \frac{1,20,000}{3,60,000}$]	50,000	50,000	82,500	1,20,000	1,20,000

Illustration- 3

From the information given below, compute the total income of the firm and tax payable by it for the Assessment Year 2023-24

Particulars	Rs.
Profit from small scale industrial undertaking	6,50,000
Profit from the animal breeding business	2,20,000
Short term capital loss	2,50,000
Long term capital gain	4,50,000
Interest from bank (Gross)	80,000
Donation to charitable institution (approved) by cheque	1,30,000

Solution:

Computation of Total Income for Assessment Year 2023-24

Income from Business:	Rs.	Rs.
Industrial undertaking	6,50,000	
Animal breeding	2,20,000	8,70,000
Capital Gains:		
LTCG	4,50,000	
Less: STCL	2,50,000	2,00,000
Income from other sources:		
Interest		80,000
Gross Total Income		11,50,000
Less: Deduction u/s 80G		47,500
Total income		**11,02,500**

Computation of Tax Payable for the Assessment Year 2023-24

	Rs.
Total Income Rs. 11,02,500	
Tax on LTCG Rs. 2,00,000 @ 20%	40,000
Tax on Rs. 9,02,500 @ 30%	2,70,750
	3,10,750
Add: Health and Education cess @ 4%	12,430
Tax Payable	**3,23,180**

Note:

Deduction u/s 80G has been computed as under:

Qualifying amount: 10% of Rs. 11, 50,000 – (LTCG) Rs. 2, 00,000) = Rs. 95,000

Deduction 50% of Rs. 95,000 = Rs. 47,500

Illustration- 4

P and Q are two partners having profit sharing ratio (1: 2) of P Q Co. [a limited liability partnership (LLP)]. The Profit & Loss Account of the LLP for the year ending March 31, 2023 is as follows:

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
Cost of Goods sold	12,00,000	Sales	23,25,000
Salary to Staff	3,00,000	Long term Capital Gains (according to Section 48)	40,000
Depreciation	80,000		
Remuneration to Partners:		Other Business Receipts	31,000
P	2,00,000		
Q	1,60,000		
Interest on Capital @ 14%:			
P	28,000		
Q	14,000		
Other Expenses	3,93,000		
Net Profit	21,000		
	23,96,000		**23,96,000**

Other Information:

i) The LLP completed all legal formalities to get the status of 'firm'.

ii) The LLP is not eligible for deduction under Section 80-IB.

iii) The LLP has given donation of Rs. 80,000 to a Notified Public Charitable Trust by cheque which is included in other expenses.

iv) Salary and interest is paid to partners as per the Partnership Deed.

v) Depreciation allowable u/s 32 is Rs. 78,000.

vi) Income and investment of P and Q are as follows:

Particulars	P Rs.	Q Rs.
Interest on Company Deposits	30,000	15,000
Dividend from companies registered outside India	7,000	11,000
Long-term Capital Gains	2,80,000	30,000
Short term Capital Gains	3,000	(-) 6,000
Winning from lottery	4,000	-
Contribution towards Home Loan Account of the National Housing Bank	-	60,000

Find out net income and tax liability on total income of the LLP and partners for the Assessment Year 2023-24.

Solution:

Computation of Total Income and Tax Liability of P. Q. Co (LLP) for Assessment Year 2023-24

Particulars	Rs.
Net Profit	21,000
Adjustments:	
Depreciation	2,000
Remuneration to Partners	3,60,000
Interest to Partners	6,000
Other Expenses (Donation)	80,000
Long-term Capital Gains	(-) 40,000
Book Profit	4,29,000
Less: Remuneration to Partners:	
90% of Rs. 3,00,000+60% of Rs. 1,29,000 = 3,47,400 or Remuneration as per deed Rs, 3,60,000, whichever is less	3,47,400
Business Income	81,600
Long-term Capital Gain	40,000
Gross Total Income	1,21,600
Less: Deduction under Section 80G (50% of 10% of Business Income, Rs 81,600)	4,080
Net Income	**1,17,520**
Tax Computation of P Q Co.	Rs.

Tax on LTCG of Rs. 40,000 @ 20%	8,000
Tax on Rs. 77,520 @ 30%	23,256
	31,256
Add: Health and Education cess @ 4%	1,250
Tax Liability	**32,506**
Rounded off	**32,510**

Computation of Income and Tax of P and Q for Assessment Year 2023-24

Rs.

Business Income:	**(P)**	**(Q)**
Remuneration from P. Q. Co. (Rs. 3,47,400 divided in the ratio of 20:16)	1,93,000	1,54,400
Interest	24,000	12,000
Business Income	2,17,000	1,66,400
Capital Gains (Long term + S.T.C.G.)	2,83,000	24,000
Income from Other Sources:		
P: Rs. 30,000 + Rs. 7,000+Rs. 4,000	41,000	
Q: Rs. 15,000 + Rs. 11,000		26,000
Gross Total Income	5,41,000	2,16,400
Less: Deduction under Section 80C	-	60,000
Net Income	5,41,000	1,56,400
Tax on Long-term Capital Gains (20% of Rs. 2,80,000)	56,000	-
On winning from lottery (30% of Rs. 4,000)	1,200	-
On Balance	350	-
Total	57,550	-
Add: Health and Education cess @ 4%	2,302	-
Tax Liability	**59,852**	-
Rounded off	**59,850**	

Note:

Total Income of does not exceed Rs. 2,50,000, hence tax is not payable.

Illustration- 5

A firm with P, Q and R as equal partners, furnished following information for the Previous Year 2022-23

Particulars		Rs.
Profit from business (after deducting the following amounts)		1,81,000
(i) Salary to P		7,000
(ii) Interest paid for non-payment of GST		5,000
(iii) Interest on capital @ 12% :		
P	5,000	
Q	4,000	
R	3,000	12,000
(iv) Donation to approved institution by cheque		4,000
(v) Donation to a Research Association for scientific research (Not debited to P & L A/c)		20,000
Other Incomes:		
(a) Long-term capital gains (LTCG)		20,000
(b) Interest on securities (gross)		39,000
(c) Income from house property (computed)		24,000

Compute the Taxable Income of the firm and allocate it amongst the partners. The firm fulfills the conditions of Section 184.

Solution:

Computation of Total Income for Assessment Year2023-24

Particulars	Rs.
Profit from Business	1,81,000
Add: Disallowed expenses:	
Salary to P	7,000
Donation	4000
	1,92,000
Less: Donation to Scientific Research Association:	
100% of amount donated	20,000
Book Profits	**2,32,000**
Less: Remuneration (Salary) to Partner (Amount is less than the prescribed limit)	7,000
Business Income	**2,25,000**

Statement showing Taxable Incomefor Assessment Year2023-24

Particulars	Rs.
Income from House Property	24,000
Business Income	2,25,000
Capital Gains – LTCG	20,000
Income from Other Sources:	
Interest on Securities	39,000
Gross Taxable Income	3,08,000
Less: Donation: 50% of Rs. 4,000	2,000
Taxable Income	**3,06,000**

Statement of Income of Partners for Assessment Year2023-24

Particulars	P Rs.	Q Rs.	R Rs.
Salary	7,000	-	-
Interest	5,000	4,000	3,000
Share in profit	Exempt	Exempt	Exempt
	12,000	**4,000**	**3,000**

Illustration- 6

X, Y and Z are partners in a firm which fulfills the conditions of Section 184. Z is non-working partner. They share profits and losses in the ratio of 3:2:1. The following is the profit and loss account for the year ended 31.03.2023.

Dr. Cr.

Particular	Rs.	Particular	Rs.
Establishment Expenses	51,000	Gross profit	1,30,000
Rent to partner	10,000	Interest from Bank	4,000
Salary to partners: Rs.		Interest on Government Securities	6,000
X 35,000			
Y 25,000	60,000	Net Loss	60,000
Interest on Capital (14%):			
X 7,000			
Y 5,600			
Z	14,000		

1,400			
Bonus to partners:			
X 15,000			
Y 10,000			
Z 5,000	30,000		
Profession tax	2,000		
Income tax	12,000		
Income tax provisions	8,000		
Loss on sale of machinery	8,000		
Depreciation	5,000		
	2,00,000		**2,00,000**

a) Establishment expenses include commission paid to Z Rs. 10,000 and for furniture purchased Rs. 2,000.

b) Machinery which is sold during the previous year for Rs. 10,000 is of the W.D.V. Rs. 18,000 as on 01.04.2020.

c) Depreciation allowable as per rules is Rs. 2,000.

Compute the Total Income of the firm for the Assessment Year 2023-24.

Solution:

Computation of Total Income of the Firm for Assessment Year 2023-24

		Rs.
Net Loss		(-) 60,000
Add: Disallowed expenses:	Rs.	
Salary to partners	60,000	
Bonus to partners	30,000	
Commission to Z	10,000	
	1,00,000	
Interest to partners in excess of 12% (1,000+800+200)	2,000	
Income tax	12,000	
Income tax provision	8,000	
Loss on sale of machinery	8,000	
Excess depreciation (5,000 – 2,000)	3,000	
Furniture purchased	2,000	(+) 1,35,000
		75,000
Less:Incomes not taxable under the head Business:		

	Interest from bank	4,000	
	Interest on Govt. Securities	6,000	10,000
Book-profit			65,000
Less:	Remuneration to working partners:		
(i)	Rs. 85,000 to X and Y as per deed or		
(ii)	90% of Rs. 65,000 = Rs. 58,500 or Rs. 1,50,000, whichever is more Deductible (i) or (ii), whichever is less		85,000
	Business Income (Loss)		(a) 20,000
Income from Other Sources:			
	Interest from bank		4,000
	Interest on Govt. Securities		6,000
			(b) 10,000
Gross Total Income being Total Income – Loss (b-a)			**10,000**

Note:

1) Loss on sale of machine is STCL. It is assumed that there is no other machine in this block of asset. There is no capital gain, hence, the loss will be c/f and set-off against capital gains in the following eight years.

2) Remuneration to working partners (X and Y) = Salary of X and Y + Bonus to X and Y

   = 35,000+25,000+15,000+ 10,000= Rs 85,000

Illustration -7

A, B and C share profits of a firm equally as partners. For the Assessment Year 2023-24,following details are available:

		Rs.	Rs.
i)	Loss as per profit and loss account(After debiting Partners Remunerationand interest on capital)		4,84,000
ii)	Remuneration to Partners:A	1,68,000	
	B	1,68,000	
	C	84,000	4,20,000
iii)	Interest on capital: *Capital as on 1.4.2022 Interest*		
	A	1,00,000	12,000
	B	2,00,000	24,000
	C	1,00,000	12,000

You are required to work out the income of the firm and its partners for the Assessment Year 2023-24, if the partners have no other income.

Solution:

Computation of Total Income of Firmfor Assessment Year 2023-24

Particulars	Rs.
Loss as per P & L A/c	(-) 4,84,000
Add: Remuneration to partners	(+) 4,20,000
Book Profit (Loss)	(-) 64,000
Add: Remuneration to partners Rs. 1,50,000 or 90% of book profit, whichever is more or Actual remuneration Rs. 4,20,000, whichever is less	(-) 1,50,000
Loss of the Firm c/f	(-) 2,14,000

Computation of Income of the Partnersfor Assessment Year 2023-24

	A	B	C
	Rs.	Rs.	Rs.
Interest	12,000	24,000	12,000
Remuneration 2 : 2 : 1	60,000	60,000	30,000
	72,000	84,000	42,000

Illustration- 8

P, Q and R partners in a firm sharing Profit and Loss in the ratio of 2 : 2: 1. For the assessment year 2021-22, the firm incurred a loss of Rs. 2, 25,000 from business, which has not been set off. P died on 30.11.2022 and Q and R continued the business. The profits of the business for the year 2022-23 were Rs. 1,35,000, find out the income and unabsorbed loss of the firm for the Assessment Year 2023-24.

Solution:

Computation of Income and Unabsorbed Loss for Assessment Year 2023-24

	P	Q	R
	Rs.	Rs.	Rs.
Profit from 1.4.2022 to 30.11.2022	36,000	36,000	18,000
Profit from 1.12.2022 to 31.03.2023	-	30,000	15,000
	36,000	66,000	33,000
Less: B/f loss	90,000	90,000	45,000
Loss c/f	**Nil**	**(-) 24,000**	**(-) 12,000**

Note: Deceased partner's (P) loss cannot be carried forward. Hence it is NIL.

Illustration- 9

Shri Ivin, Shri Uvin and Shri Hivin are partners in a firm sharing profits in the ratio 5: 3: 2. The net profit of the firm as per its P & L account for the year ending 31st March, 2023 was Rs. 3, 00,000.

The debits to the Profit and Loss Account included the following:

i) Rs. 3,600 for depreciation of Motor cycle purchased by Ivn for Rs. 18,000 on 1st April, 2022 which is used wholly for the business of the firm and Rs. 3,600 p.a. for petrol and repairs etc. of this Motor cycle, is paid to Ivin as Motor cycle allowance.

ii) Smt. Shivim wife of Uvin, was paid Rs. 25,000 as commission for acting as the Sole Selling Agent of the firm.

iii) Smt. Hervin wife of Hivin was paid Rs. 3,000 for appearing as an advocate in an appeal filed by the firm in the High Court.

iv) Rs. 80,000 spent on scientific research which includes Rs. 30,000 for the construction of research laboratory completed on 30th September, 2022.

v) Firm spent Rs. 10,000 for promoting family planning amongst its employees including Rs. 5,000 capital expenditure.

vi) Rs. 8,000 paid in proportion of 5:3:2 to the Life Insurance Corporation for getting each partner's life insured for Rs. 25,000.

Prepare the statement of Total Income of the firm and compute the income-tax payable by the firm on its total income.

Solution:

Computation of Firm's Total Income for Assessment Year 2023-24

Particulars		Rs.
Profit as per Profit & Loss Account		3,00,000
Add: Items disallowed:	Rs.	
(i) Depreciation on Motor Cycle	3,600	
(ii) Capital Expenditure on Family Planning	5,000	
(iii) Life Insurance Premium	8,000	16,600
Total Income		3,16,600
Income tax on Rs. 3,16,600 @ 30%		94,980
Add: Health and Education cess @ 4%		3,799
Total Tax payable		**98,779**
Rounded off		**98,780**

Note:

1) U/s 32, depreciation will not be allowed as Motor Cycle is not owned by the firm.

2) Motor cycle allowance to partner is not covered by Section 40(b), therefore, it is correctly charged to Profit and Loss Account of the firm.

3) Amounts paid as commission and fee to the wives of the partners of the firm are allowed as deduction in computing the profits and gains of business or profession, as the payment to the wives of the partners is not a payment to the partners; but is should be a reasonable amount in the opinion of the assessing officer.

4) The whole of the capital expenditure incurred in any previous year on scientific research related to the business is allowed as a deduction in computing the profit and gains of the business for that previous year.

5) Under Section 37 (1), revenue expenditure incurred for promoting family planning amongst its employees is allowed as a deduction.

6) Life insurance premium paid by the firm for getting each partner's life insured is disallowed.

7) In computing the total income of Ivin, Motor cycle allowance will not be included in his total income as it is for meeting the running cost wholly for business.

Illustration- 10

The Profit & Loss Account of a firm of professionals XYZ & Co. (having three partners X, Y and Z), covered by Section 44AA, for the previous year relevant to the Assessment Year 2023-24 is given below:

Dr. Cr.

Particulars	Rs.	**Particulars**	Rs.
Expenses (Office)	70,000	Fees & Professional receipts	2,50,000
Remuneration to working partners	1,60,000	Income from other sources	80,000
Interest on Capital to Partners @ 10%	50,000	Net Loss	25,000
Depreciation	75,000		
	3,55,000		3,55,000

Additional Information:

1) Out of office expenses of Rs. 70,000, Rs. 8,500 is not deductible u/s 36 and 37. Depreciation allowable u/s 32 is Rs. 65,000.

2) Work out the net income of the firm and partners for the Assessment Year 2023-24. You may make the following assumptions:

   i) Payment of remuneration and interest has been made according to the partnership deed.

   ii) Profit sharing ratio is 1: 3: 2.

   iii) Other income of the partners:

		X	Y	Z
		Rs.	Rs.	Rs.
a)	Income from share of H.U.F.	50,000	10,000	70,000
b)	Interest on securities (gross)	40,000	20,000	18,000
c)	Half share of profit from an A.O.P.	13,000	-	-

   (A.O.P. has not paid tax on its income)

Solution:

Computation of book profitfor Assessment Year 2023-24

Particulars		Rs.
Net Loss as per Profit & Loss Account		(-) 25,000
Add: Amounts inadmissible:	Rs.	
(i) Expenses	8,500	
(ii) Depreciation	10,000	
(iii) Remuneration of Partners	1,60,000	(+) 1,78,500
Total Income		1,53,500
Less: Income from Other Sources being not Professional Income		80,000
Book Profit		**73,500**

Computation of Firm's Total Incomefor Assessment Year 2023-24

Particulars	Rs.
Book Profit	(+) 73,500
Less: Admissible Remuneration to Partners: 90% of Book Profit of Rs. 73,500 or Rs. 1,50,000, whichever is more Or Actual remuneration Rs. 1,60,000, whichever is less	(-) 1,50,000
Income from Profession – Loss	(-) 76,500
Income from Other Sources	(+) 80,000
Firm's Total Income/Loss	**3,500**

Computation of income of partners based on assumption that remuneration and interest have been distributed equally among the partners:

	X	Y	Z
Particulars	Rs.	Rs.	Rs.
Remuneration from firm	53,333	53,333	53,334
Interest from firm	16,666	16,667	16,666
Interest on securities	40,000	20,000	18,000
Share of Profit from an A.O.P.	13,001	-	-
Gross Total Income	**1,23,000**	**90,000**	**88,000**
Less: Deduction	Nil	Nil	Nil
Total Income	**1,23,000**	**90,000**	**88,000**

Illustration- 11

'X' and 'Y' are partners in a firm assessed as such. They share profits and losses in the ratio of 60% and 40% respectively. The firm runs a small-scale industrial undertaking. The Profit & Loss Account for the Financial Year 2022-23 is as under:

Dr. Cr.

Particulars	Rs.	**Particulars**	Rs.
Salaries & Wages	5,00,000	Gross Profit	14,50,000
Advertisement	2,00,000	Long-term Capital Gains	4,00,000
Travelling Expenses	1,50,000	Recovery of Bad Debts	50,000
Depreciation as per I.T. record	80,000		
Approved Donation by cheque	70,000		
Interest payable	2,00,000		
General Expenses	4,00,000		
Net Profit	3,00,000		
	19,00,000		**19,00,000**

Additional Information:

i) 25% plant and machinery of the industrial undertaking is old.

ii) Salaries and wages include the sum of Rs. 90,000 and Rs. 60,000 paid to 'X' and 'Y' respectively.

iii) Interest payable includes:

a) Interest to 'X' on a deposit made by his minor son 'A' amounting to Rs. 30,000 @ 15%. Rs. 30,000 is the amount of interest.

b) Interest to 'Y' amounting to Rs. 30,000 @ 12%.

c) Interest of Rs. 10,000 payable to Industrial Development Bank of India on loan taken for the industrial undertaking.

iv) Travelling expenses include visit of 'X' to Mumbai for business purposes for 15 days where his hotel bill was Rs. 5,000 per day.

v) Salary and interest payments have been authorized by partnership deed.

vi) 'B', a minor son of 'Y' has been admitted to the benefits of partnership in another firm. He has received salary and interest amounting to Rs. 40,000 and Rs. 15,000 from that firm out of which salary of Rs. 10,000 and interest of Rs. 5,000 has been disallowed to the firm.

vii) Income from Mutual Fund (Gross): 'X' Rs. 30,000, 'Y' Rs. 50,000.

viii) 'X' has purchased NSC VIII Issue on 31.03.2023 for Rs. 40,000 and 'Y' has deposited Rs. 60,000 in Public Provident Fund during the Financial Year 2022-23.

Compute for the Assessment Year 2022-23, (a) total income of the firm (b) tax liability of the firm on its total income, (c) total income of the partners.

Solution:

Computation of Total Income of Firmfor Assessment Year 2023-24

Particulars	Rs.
Net Profit	3,00,000
Add: Disallowed Expenses:	
(i) Travelling Expenses of X Fully allowed	-
(ii) Donation	70,000
(iii) Interest to IDBI – Not paid (disallowed u/s 43 B)	10,000
(iv) Remuneration to Partners (Rs. 90,000+60,000)	1,50,000
	6,30,000
Less: Long-term Capital Gains	4,00,000
Book Profit	2,30,000
Less: Remuneration to Partners:	
90% of Rs. 2,30,000 or Actual remuneration Rs. 1,50,000,	
whichever is less	1,50,000
Business Income	80,000
Add: Long-term Capital Gains	4,00,000
Gross Total Income	4,80,000
Less: Donations u/s 80G:	
Qualifying Amount 10% of Rs. 70,000	
Deduction 50% of Rs. 7,000	3,500
Total Income	**4,76,500**

Computation of Tax Liability of the Firm for Assessment Year 2023-24

Particulars	Rs.
Tax on Business Income Rs. 76,500 @ 30%	22,950
Tax on LTCG Rs. 4,00,000 @ 20%	80,000
	1,02,950
Add: Health and Education cess @ 4%	4,118
Tax Liability	1,07,068
Rounded off	**1,07,070**

Computation of Total Income of Partners for Assessment year 2023-24

Particulars	Rs.	Rs.
Share in the income of firm – Exempt u/s 10(2A)	-	-
Remuneration	90,000	60,000
Interest to Y allowed to the firm	-	30,000
Income from M.F. (Exempt)	-	-
Interest Income of Minor Son	30,000	10,000
	1,20,000	1,00,000
Less: Exempt u/s 10 (32)- Minor Son's Income	1,500	1,500
	1,18,500	98,500
Less: Deduction u/s 80C	40,000	60,000
	78,500	38,500

Note: Salary income of B, minor son is not includible in the income of Y since it is from manual work.

Illustration- 12

The Profit & Loss Account of the firm of M/s A and B, sharing profits and losses in the ratio of 3: 2 for the previous year ending on 31st March, 2023 are as follows:

Dr. Cr.

Particulars	Rs.	**Particulars**	Rs.
Cost of Goods sold	6,45,000	Sales	10,50,000
Remuneration of Partners	3,00,000	Dividends	30,000
Remuneration to Employees	1,50,000	Long-term capital gains	1,80,000
Interest to Partners	15,000		
Other Expenses	1,20,000		
GST outstanding	10,000		
Net Profit	20,000		
	12,60,000		**12,60,000**

Additional information is given below:

1) Other expenses include the following:
   i) Entertainment expenses Rs. 40,000
   ii) Mobiles, costing of Rs. 2,500 each given to ten dealers who exceeded the sales target fixed under sales promotion scheme.
   iii) Rs. 35,500 paid in cash to an advertising agency.
2) Outstanding GST was paid on 14^{th} July, 2023.
3) The firm is not evidenced by instrument.
4) Other incomes of A Rs. 1,00,000 and B Rs. 81,000.

You are required to compute for the assessment year 2023-24

i) Total income of the firm and (ii) Tax liability of the firm on its total income.

Solution:

(a) Computation of Income from Business for Assessment Year 2023-24

Particulars		Rs.
Net Profit as per Profit and Loss Account		20,000
Add: Inadmissible Payments:		
Interest to Partners		15,000
Entertainment: Fully allowed		-
Sales Promotion Expenses: Fully allowed (Mobiles)		-
100% of Rs. 35,500 cash payment to advertising agency		35,500
Remuneration to Partners		3,00,000
		3,70,500
Less: (i) Dividend	30,000	
(ii) Long-term Capital Gain	1,80,000	2,10,000
Income of business		**1,60,500**

(b) Computation of Income of the Firm for Assessment Year 2023-24

Particulars		Rs.
Profits and Gains of Business		1,60,500
Long-term capital gain		1,80,000
Income from other sources: Dividend		Exempt
Total Income		**3,40,500**

(c) Computation of Tax Liability of the Firm for Assessment Year 20223-24

Particulars		Rs.
(i) Long-term Capital Gain: Rs. 1,80,000 @20%		36,000
(ii) Business Incomes: Rs. 1,60,500 @ 30%		48,150
		84,150
Add: Health and Education cess @ 4%		1,926
Tax liability		**86,076**
Rounded off		**86,080**

Note: Though firm does not fulfill conditions of sec. 184 still it will be assessed as firm hence, interest and remuneration to partners will not be allowed as a deduction in computing the income of the firm and these payment shall not be included in the income of the partners under the head Profits and Gains of Business or Profession.

Illustration-13

L, P and J are partners of a firm sharing profits/losses in the ratio of 7:5:3. In the Previous Year 2020-21 the firm incurred a loss of Rs. 2,10,000.

On 30th November, 2022, P retired from the firm though L and J continued the business agreeing to share profits/losses in the ratio of 7:3. In previous year 2022-23, the firm made a profit of Rs. 3,15,000. Determine the taxable profit of the firm for Assessment Year 2023-24.

Solution:

Computation of Taxable Profits of the Firmfor Assessment Year 2023-24

Profit of the firm = Rs. 3,15,000

Profits from 1.4.2022 to 30.11.2022= Rs. 2,10,000

Profits from 1.12.2022 to 31.3.2023= Rs. 1,05,000

Share of profit of partners

Particulars	L	P	J
	Rs.	Rs.	Rs.
Profit up to retirement date			
Rs. 2,10,000 in 7 : 5: 3	98,000	70,000	42,000
Profit for post-retirement period Rs. 1,05,000 in 7 : 3	73,500	-	31,500
	1,71,500	70,000	73,500
Loss: 7 : 5 : 3 (Rs. 2,10,000)	98,000	70,000	42,000
	73,500	**NIL**	**31,500**

	Rs.
Max. deduction allowable regarding share of loss of P	NIL
Profit of business	3,15,000
Less: Loss (98,000+NIL+42,000)	1,40,000
Business income being Total Income	**1,75,000**

Illustration-14

Profit and Loss Account of A Co. (Partnership firm assessed as such of A, B and C) for the year ending March 31, 2023 is as follows:

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
Cost of Goods sold	17,70,000	Sales	30,00,000
Remuneration of Partners		Rent of the house property (half portion)	1,00,000
A	2,00,000	Interest on debentures (Gross)	1,20,000
B	2,00,000		
C	2,00,000		
Interest to Partners			
A	80,000		
B	80,000		
C	90,000		
Municipal tax of the house property (Entire property)	10,000		
Other expenses	5,00,000		
Net Profit	90,000		
	32,20,000		**32,20,000**

Other Information:

i) On scrutiny, it was found that the firm purchased raw material on credit from D-brother of partner A. The amount of bill is Rs. 62,000 (market value is Rs. 48,000). The bill is paid in cash on August 5, 2022.

ii) On December 1, 2022, firm pays an outstanding custom duty liability of Rs. 50,000 of the Previous Year 2021-22. As this amount pertains to the Previous Year 2021-22, it has not been debited to the aforesaid profit and loss account.

iii) C is not a working partner. Salary has been given as per the partnership deed.

iv) Interest on capital to partners not deductible under Section 40(b) is Rs. 35,000.

v) The firm owns a house, the ground floor is used for business purposes, and the first floor is given on rent. The municipal taxes were due on 31.03.2023and were paid on July 1, 2023.

vi) The firm donated by chequeRs. 20,000 to Prime Minister's National Relief Fund. This amount of Rs. 20,000 is included in other expenses duly debited to Profit and Loss A/c.

Find out the net income of the firm (and also the tax treatment of the payments to partners in their hands) for the Assessment Year 2023-24, assuming that three concerned partners are to share profits and losses equally.

Solution:

Computation of Book-profit for Assessment Year 2023-24

Particulars			Rs.
Net Profit			90,000
Add: Disallowed items:			
Remuneration to Partners			6,00,000
Excess interest to partners			35,000
Municipal tax 1/2 let out portion			5,000
Excess payment to brother			14,000
Amount paid in cash			
100% disallowed of Rs. 48,000			48,000
Donation			20,000
		(a)	8,12,000
Less: Custom Duty			50,000
Rent			1,00,000
Interest on debentures			1,20,000
		(b)	2,70,000

Book profit (a - b)			5,42,000
Less: Remuneration to partners:			
On Rs. 3,00,000 @ 90% or Rs. 1,50,000 whichever is higher	2,70,000		
On Rs. 2,42,000 @ 60%	1,45,200		
	4,15,200		
Or			
Rs. 5,00,000 as per deed, whichever is less			4,15,200
Business Income		**(A)**	1,26,800

Income from House Property:			
G.A.V. (Rent)			1,00,000
Less: Municipal Tax (unpaid)			-
Annual Value			1,00,000
Less: 30% of A.V.			30,000
		(B)	70,000
Income from other sources :			
Interest on debentures		**(C)**	**1,20,000**
Gross Total Income (A+B+C)			3,16,800
Less: Deduction u/s 80G: Donation			20,000
Total Income		**(D)**	**2,96,800**

Computation of Income of Partners for Assessment Year 2022-23

	A	**B**	**C**
Particulars	Rs.	Rs.	Rs.
1. Interest (14% disallowed)	68,800	68,800	77,400
2. Remuneration A and B (2:2)	2,07,600	2,07,600	-
3. Share in profit – Exempt	-	-	-
Amount taxable in the hands of partners	**2,76,400**	**2,76,400**	**77,400**

Note:

1) Amount of municipal tax has been paid before the due date of furnishing the return, tax for building used for business purposes is allowable.

2) C is not a working partner. Hence, he is not entitled to remuneration.

3) Remuneration allowed Rs. 4, 15,200 divided in the ratio of 2: 2.

4) Interest disallowed = $\frac{35,000 \times 100}{2,50,000} = 14\%$

17.23 LETUS SUM UP

For assessment of a firm as a firm, it is necessary that partnership is evidenced by an instrument in which partner's individual share should also be specified. The return on income of the firm should accompany a certified copy of the instrument (partnership deed) when it (Return) is filed for the previous year relevant to the assessment year in respect of which assessment as a firm is first sought. The remuneration and interest to be paid to the partners should be duly authorized by and accordance with the partnership deed. A limit is prescribed beyond which payment of remuneration to the partner's shall not be allowed even if is authorized by partnership deed. Following are such limits:

Upto first Rs. 3,00,000 of Book Profit/Loss- Rs. 1,50,000/- or 90% of Book Profit, whichever is more , on the balance of Book Profit over Rs. 3,00,000/- 60%.

Provisions of Section 184 and Section 40(b) are to be compiled by the firm. If the firm fails to fulfill the conditions of Section 184, the firm shall be assessed as firm but interest and remuneration to partners shall not be allowed as deduction. Similarly, deductions can be claimed within the four corners of Section 40 (b).

Computation of firm's income is based on its Book Profit and Adjustment of profit and lossaccount. In case of change in the constitution of the firm, the assessment shall be made on the firm as re-constituted.

In case of dissolution of firm or discontinuance of business, the assessment of the firm's total income shall be made as if no such dissolution or discontinuance has taken place and every partner at the time of such dissolution or discontinuance shall jointly and severally be liable for tax, penalty or interest due from the firm.

As provided in partnership deed [but not exceeding as provided in Section 40 (b)], if Salary, Bonus, Commission or other remuneration is paid to the partners while computing the income of partners from the firm, such payments will be taxable as business income in the hands of partners and not under the head 'Salaries'. Interest on capital and loan to the partners, if authorized by the partnership deed, is allowable as deduction from the firm's profit but it cannot exceed @ 12% per annum. Similarly, if a firm pays rent to any partner for using his building for firm's business, such rent paid is an allowable expenditure in the firm.

Firm's losses can be carried forward to be set off in future under the income tax rules. However, the share of loss of a partner in the firm cannot be set off by the partner from his income.

Tax can be paid by either physical mode or electronic mode (E- payment mode), however, payment of tax by E- payment mode is mandatory for the firm which is liable to get its accounts audited u/s 44 AB of Income Tax Act. A firm is also liable to pay advance tax as per Income Tax Law.

It is mandatory for every firm to file its return of income no matter it has profit or loss. It is not mandatory for all firms to have digital signature in E-filing of Return of Income. However, digital signatures are required in the return of firms falling under the provision of Section 44 AB.

17.24 KEY WORDS

Partnership: According to Indian Partnership Act 1932, Section 4, partnership is "the relationship between persons who have agreed to share profits of a business carried on by all or any of them, acting for all."

Partners: Any persons who have entered into partnership with one another as per provisions of Section 4 Partnership Act, 1932, are called individually 'Partners',

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.

Working Partner: A person engaged actively in conducting the affairs of the business or profession of the firm of which he is a partner. A non-working partner does not take part in the activities of the firm.

Book Profit: Net profit as calculated by profit & loss account for the relevant previous year computed in accordance with Section 30 to 44D as increased by the aggregate amount of remuneration paid to all the partners, if the firm of such amount has been deducted while computing the net profit.

Limited Liability Partnership (LLP): According to the Limited Liability Partnership Act, 2008 [Section 2], Limited Liability Partnership is a partnership formed and registered under the Act. A Limited Liability Partnership (LLP) is a body corporate formed and incorporated under the Limited Partnership Act, 2008. The entity of LLP is legally separate from that of its partners.

A LLP is liable to the full extent of its assets but liability of the partners is limited to their agreed contribution in the LLP. Since, liability of partners in LLP is restricted to their agreed contribution; the LLP contains elements of both a corporate structure as well as a partnership firm structure.

Alternate Minimum Tax (AMT): The provisions of AMT are applicable to all the partnership firms. Tax payable by the firm cannot be less than 18.5% (+ Surcharge + Health and Education Cess) of adjusted total income as per Section 115 JC. The deduction under Section 80 HH to 80 RRB can be claimed only by paying minimum tax @ 18.5% on Adjusted Total Income of partnership firms including LLP's.

Adjusted Total Income: Adjusted Total Income = Taxable Income + Deduction claimed under Chapter VI A (if any) from Section 80 H to 80 RRB except 80 P. + Deduction claimed if any u/s 10 AA + deduction claimed if any u/s 35 AD as reduced by regular depreciation allowed.

E-filing of Return of Income: When return of income is filed by electronic mode, it is called E- filling of Return of Income.

17.25 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress A

1) (a) True (b) True (c) False (d) False

Check Your Progress B

1) (i) b (ii) b (iii) a (iv) a (v) a

2) (a) 30% (b) General partnership firm (c) one crore (d) 12% p.a. (e) 12% p.a.

3) (a) False (b) False (c) True (d) True.

Check Your Progress C

1) (a) True (b) True (c) False (d) True

17.26 TERMINAL QUESTIONS/EXERCISES

1) Who can be a Partner of a firm? Distinguish between a Working Partner and a Non-working Partner.
2) Explain with example the term Book Profit in relation to the assessment of firms.
3) Explain the procedure of computation of total income of the firm. Give a proforma and such computation.
4) What items are disallowed as deduction in computation of firm's income from business or profession under Section 40(b).
5) Explain in detail provisions of Section 184 in relation to the assessment of the firm.
6) Explain fully, the rules related with the filing of return of income by the firm.
7) From the following information compute the total income of the firm and tax payable by it for the Assessment Year 2023-24.

		Rs.	Rs.
i)	Profit from an industrial undertaking	35,000	
ii)	Profit from business of glass work		25,000
iii)	Short-term capital gains		20,000
iv)	Long term capital gains		40,000
v)	Interest from bank		6,000
vi)	Loss from house property Rs. 10,000 (on account of interest on loan taken to construct the property).		
vii)	Donation to approved Charitable institution by cheque		15,000

[Answer: (a) Total Income Rs. 1,12,200 (b) Tax Liability Rs. 30,850]

8) Profit and Loss Account of Kamal & Co. (a partnership firm of Chartered Accountants) for the year ending 31st March, 2023 is as follows:

Particulars	Rs.	Particulars	Rs.
Expenses	85,000	Audit fee	80,000
Depreciation	40,000	Receipt from Clients for tax advice	62,000
Interest on capital to partners	8,000	Net Loss	58,000
Remuneration to partners	67,000		
	2,00,000		**2,00,000**

Addition information:

i) Out of expenses of Rs. 85,000, Rs. 16,000 is not deductible u/s 36, 37 (i) and 43 (b).

ii) Allowable depreciation u/s 32 is Rs. 42,000.

iii) Interest to the extent of Rs. 800 is not allowed to be deducted u/s 40(b).

Compute the deductible remuneration in relation to partner' remuneration and Book Profit u/s 40(b).

[Answer: Book Profit Rs. 23,800, Allowable Remuneration Rs. 67,000]

9) X, Y and Z are equal partners in a firm. For the previous year, the particulars of income of the firm are given below:

	Particulars	Rs.
a)	Profit from business (after debiting remuneration to partners)	3,00,000
b)	Long-term capital gains	1,20,000
c)	Interest on Bank deposit	50,000
d)	Remuneration to partners	1,80,000
e)	Unabsorbed depreciation	30,000
f)	Brought forward business loss	3,00,000
g)	Capital gain invested in specified assets	35,000
h)	Amount deposited in Capital Gain A/c Scheme, 1988	45,000

Compute total income and tax liability of the firm.

[Answer: (a) Book Profit Rs. 4,50,000 (b) Total Income Rs. 60,000
(c) Tax liabilities Rs. 14,560]

10) Partnershipfirm X, Y and Co. furnishes the following particulars for the Assessment Year 2023-24.

Particulars	Rs.	Rs.
Loss as per Profit and Loss A/c after debiting the following	1,50,000	
a) Remuneration to partners:		
X	90,000	
Y	60,000	
Z	30,000	1,80,000
b) Interest on Capital @ 16%		
X	20,000	
Y	24,000	
Z	18,000	62,000
c) Patent rights acquired		1,00,000
d) Donation to National Defence Fund by cheque		20,000
e) Preliminary Expenses paid		20,000
Remuneration to Partners is as per Partnership deed.		
Calculate total income of the firm.		

[Answer: Book Profit Rs. 1,56,500, Total Income – Nil]

11) Bose & Co., dealers in hardware, show sales of Rs. 40,00,000. Their purchases amounted to Rs. 42,50,000. The value of the closing stock was (a) according to cost price Rs. 10,00,000 and (b) according to market rate Rs. 9,00,000

Their establishment and other expenses amounted to Rs. 2,50,000. The expenses included the following:

Particulars	Rs.
Bad Debts	12,000
Bad Debts Reserve	6,000
Donation to a Political Party by cheque	3,000
Entertainment Expenses	6,000
Professional Tax	1,000
Loss of Stock in trade by theft	5,000
Legal costs incurred to defend their title on their business premises owned by them	7,250
Loss on sale of motor. The written-down value was Rs. 47,000. It was sold for Rs. 40,000	7,000

They owned another motor and the W.D.V. of it is Rs. 77,000. Provision has to be made for its depreciation at 15%. Work out the firm's taxable income.

[Answer: Taxable Income Rs. 4,00,400]

12) A, B and C are partners of a firm with equal shares. The profit and loss accounts for the year ended 31.3.2023 shows a net profit of Rs. 99,750 after debiting the following as per deed.

i) Salaries of Rs. 17,000 and 18,000 to A and B respectively.

ii) Bonus to C Rs. 15,000.

iii) Rs. 5,000 for interest on capital to 'A' calculated @ 20%.

iv) Rs. 15,000 for rent of the business premises paid to 'B'.

v) Commission of Rs. 5,000 to 'C'.

Compute Book Profit and the total income of the firm for the Assessment Year 2023-24, assuming that it is a professional firm and all are working partners.

[Answer: (a) Book Profit Rs. 1,56,750

(b) Total Income Rs. 1,01,750]

13) The Profit & Loss Account of M/s XY pottery Works for the year ending on 31st March, 2023 is:

Particulars	Rs.	**Particulars**	Rs.
Stock	1,50,000	Sales	4,50,000
Purchases	1,30,000	Stock	25,000
Penalties and Fines	59,000	Rent from House Property	12,000
Office Expenses	4,000		
Selling Expenses	10,000		
Interest to Partners	6,000		
Net Profit	1,28,000		
	4,87,000		**4,87,000**

i) Interest of Rs. 6,000 @ 8% has been paid to X on capital.

ii) Penalties and fines have been levied because of illegal sale and purchase of raw materials.

iii) Remuneration payable to partners: X Rs. 2,00,000 and Y Rs. 1,00,000 has not been debited to Profit & Loss Account.

iv) X and Y are equal partners in the firm.

Compute the tax payable by the firm and the total income of the partners.

[Answer: (a) Book Profit Rs. 1,75,000

(b) G.T.I. Rs. 25,900

(c) Tax payable 8,081 or 8,080 (Rounded off)

(d) Income of partners X Rs. 1,11,000 , Y Rs. 52,500]

14) X, Y and Z are partners in a firm, sharing profits and losses in the proportions of 2/5th, 2/5th and 1/5th respectively. The Profit and Loss Account for the year ended 31st March, 2023 is as follows:

Particulars	Rs.	Particulars	Rs.
To Sundry Trade Expenses	1,22,000	By Gross Profit b/d	4,88,200
Interest on Capital @ 13%		Interest on Securities Gross	10,000
X 13,000			
Y 6,500			
Z 6,500	26,000		
Rent to Y	20,000		
Salary to Y	72,000		
Commission to Z	36,000		
Net Profit	2,22,200		
	4,98,200		**4,98,200**

Compute the total income of the firm and taxable income of the three partners in the firm, Y and Z are working partners.

[Answer: a) Book profit Rs. 3,22,200

b) Business income Rs. 2,14,200.

c) Total income Rs. 2,24,200.

d) Taxable income of partners

(X Rs. 12,000, Y Rs. 78,000, ZRs. 42,000)]

Note: These questions and illustrations are helpful to understand this unit. Do efforts for writing answers to these questions but do not send your answers to university. It is only for your practice.