ASSESSMENT OF PARTNERSHIP FIRMS

1. Hitalji Deshpande is a firm of solicitors sharing profit/loss in equal ratio. Its profits and loss account for the year, 2007-2008 discloses a profit of Rs 5,00,000. Business expenses allowable as per income-tax law amount Rs 2,00,000 but not charged to profit and loss account. Remuneration paid to working partners as per partnership deed and debited to profit and loss account, Rs 6,00,000. Compute the amount of remuneration payable to partners and taxable profit of the firm.

Computation of Book-profits and Taxable Profits for AY 2008-2009

Particulars	Rs.
Net profit as per Profit & Loss Account	5,00,000
Less: Expenses deductible but not charged to profit/loss account	2,00,000
	3,00,000
Add: Remuneration to working partners to be treated separately	6,00,000
Book-profit	**9,00,000**
Less: Remuneration to working partners	(-) 4,30,000
Taxable Business Profits	**4,70,000**
(a) Actual remuneration : Rs 6,00,000, or	
(b) Statutory limit: Rs 4,30,000 (see Note below)	
Whichever is less, is deductible	
Taxable business profits	
Note: for professional firm,	
First 1,00,000 of book-profits 90% =	90,000
Next 1,00,000 of book-profits 60% =	60,000
Balance 7,00,000 of book-profits 40% =	2,80,000
	4,30,000

2. XYZ is a partnership firm, sharing profit/loss in the ratio 3:3:2. Its profit and loss for the previous year 2007-2008 is given below:

Particulars	Rs	Particulars	Rs
Business expenses	8,00,000	Gross profits Net	8,00,000
Remuneration to partners	3,00,000		
Interest on capitals	1,00,000	Net Loss	4,00,000
	12,00,000		12,00,000

Business expenses include payments which are not deductible under Sec. 36 and 37(1): Rs 1,00,000. Compute the remuneration payable to partners on the assumption that X and Z are working partners and Y is a sleeping partner. Remuneration is payable equally. Partnership deed provides for interest payment @ 10% p.a.

Compute the amount of remuneration payable to partners and taxable profits of the firm.

Computation of Book-profits and Taxable profits of the firm for AY 2008-2009

Particulars	Rs	Rs
Net loss as per profit/loss account		(-) 4,00,000
Add: 1. Expenses not deductible	1,00,000	
2. Remuneration to Y(disallowed, being a sleeping partner)	1,00,000	
3. Remuneration to X and Z to be treated separately	2,00,000	+ 4,00,000
Book-profit		**NIL**
Less: Payment of remuneration to working partners		
(a) Actual remuneration: Rs 2,00,000 or		
(b) Statutory limit: Rs 50,000		
whichever is less, is deductible.		(-) 50,000
Business loss		**(-) 50,000**

Note: Interest is allowed if the rate of interest does not exceed 12% p.a. and it is authorised by partnership deed.

3. M/s LKJ, a partnership firm discloses its profit at Rs 4,00,000 for the previous year, 2007-2008. The profit has been arrived at by debiting payments of Rs 2,00,000 which are not allowed under income tax law. Details of remuneration paid to partners, and allowable as per partnership deed are:

Particulars	Remuneration paid to partners	Remuneration allowable as per partnership deed
	Rs	Rs
(i) Commission paid to L (sleeping partner)	50,000	50,000
(ii) Salary paid to K (working partner)	1,50,000	1,00,000
(iii) Bonus paid to J (working partner)	2,00,000	1,50,000

Profit ratio of the partners is 2:2:1

Compute the amount of remuneration deductible and taxable profits.

Computation of Book-profits and Taxable profits for AY 2008-2009

Particulars	Rs	Rs
Business profit		4,00,000
Add: Inadmissible items:		
i) Expenses not deductible	2,00,000	
ii)Commission to sleeping partner not be allowed	50,000	
iii)Remuneration not in accordance with partnership deed		
(a) Salary to K	50,000	
(b) Bonus to J	50,000	
(iv) Remuneration to working partners as per partnership deed to be treated separately	250,000	
	6,00,000	6,00,000
Book-profits		**10,00,000**
Less: Remuneration allowable to working partners:		
(a) Actual remuneration as per partnership deed:		
Salary to K + bonus to J =	2,50,000	
(b) Statutory limit: (see Note below)		
Whichever is less, is deductible	4,52,500	(-) 2,50,000
Business profit		**7,50,000**
Note:		
(1) Statutory limit:		
First 75,000 of book-profit 90% =		67,500
Next 75,000 of book-profit 60% =		45,000
Balance 8,50,000 of book-profit 40% =		3,40,000
		4,52,500
(2) Commission to N, a non-working partner cannot be allowed even if it is authorised by partnership deed.		

4. K, B and C are partners in a firm. They share profits in the ratio 2:2:1.

Profit & Loss A/c of the firm for the year ended 2007-2008

Particulars	Rs	*Particulars*	Rs
Establishment expenses	5,00,000	Gross profit	22,00,000
Depreciation	3,00,000	Income from other sources:	
Remuneration to partners	7,00,000	Interest on securities (gross)	50,000
Interest to partners @16%	2,00,000		
Income tax	1,50,000		
Sundry expenses	50,000		
Net profit	3,50,000		
	22,50,000		22,50,000

You are further informed that:

(i) Remuneration allowable as per partnership deed is given as below:

(a) K :Rs 2,00,000 (b) B: Rs 1,50,000 (c) C: Rs 1,50,000

(ii) Carried forward losses and allowance are given as below:

Particulars	Assessment year	Rs
Depreciation	2004-2005	5,00,000
Business loss	2005-2006	8,00,000

Compute the admissible amount of remuneration and the total income. Would you change your answer in the following cases:

(i) there is no carried forward business loss;

(ii) there is no carry forward depreciation;

(iii) there is carried forward business loss of Rs 14,00,000 instead of Rs 8,00,000.

Computation of amount of remuneration payable to partners and total income of the partnership firm

Particulars	Case I Rs	Case II Rs	Case III Rs	Case IV Rs
Net profit	3,50,000	3,50,000	3,50,000	3,50,000
Add: (i) Income tax	1,50,000	1,50,000	1,50,000	1,50,000
(ii) Interest to partners 2,00,000 x 4 % / 16 %	50,000	50,000	50,000	50,000
(iii) Remuneration in excess of partnership deed	2,00,000	2,00,000	2,00,000	2,00,000
(iv) Remuneration to working partners to be treated separately	5,00,000	5,00,000	5,00,000	5,00,000
	12,50,000	12,50,000	12,50,000	12,50,000
Less : Interest on securities	50,000	50,000	50,000	50,000
Book profits before adjusting carried forward depreciation	**12,00,000**	**12,00,000**	**12,00,000**	**12,00,000**
Less : Unabsorbed depreciation : However, carried forward business loss, first should be reduced notionally [Sec. 32(2) r.w.Sec (2)]	(-) 4,00,000	(-)5,00,000	Nil	Nil
Book-profit	**8,00,000**	**7,00,000**	**12,00,000**	**12,00,000**
Remuneration allowable to partners (see Note below)	3,72,500	3,32,500	5,00,000	5,00,000
Computation of Total Income				
Book-profit before carried forward depreciation	12,00,000	12,00,000	12,00,000	12,00,000
Less: Remuneration to partners	(-) 3,72,500	(-) 3,32,500	(-) 5,00,000	(-) 5,00,000
Business profit	**8,27,500**	**8,67,500**	**7,00,000**	**7,00,000**
Add: Interest on securities	50,000	50,000	50,000	50,000
Aggregate income	**8,77,500**	**9,17,500**	**7,50,000**	**7,50,000**
Less: 1. Carried forward business loss	(-) 8,00,000	Nil	(-) 7,00,000	(-) 7,00,000
2. Carried forward depreciation	(-) 77,500	(-) 5,00,000	Nil	(-) 50,000
Total income	**Nil**	**4,17,500**	**50,000**	**Nil**
Note: Remuneration allowable				
(i) Remuneration as per partnership deed	5,00,000	5,00,000	5,00,000	5,00,000
(ii) Statutory limit: Computed with reference to book-profits at prescribed rates	3,72,500	3,32,500	5,32,500	5,32,500
Whichever is less, is allowed	3,72,500	3,32,500	5,00,000	5,00,000

5. ABC & Associates,Profit and loss account for the year ended 31.3.2008

Particulars	Rs	Particulars	Rs
Purchases	15,45,000	Sales	40,00,000
Direct and indirect expenses	8,00,000	Interest on securities (tax deducted at	
Depreciation	2,00,000	Rs 5,000)	45,000
Interest to partners	2,00,000		
Salaries to partners	6,60,000		
Net profit	6,40,000		
	40,45,000		40,45,000

You are further informed:
(i) Depreciation allowable as per Sec. 32 is Rs 1,50,000.
(ii) Purchases include cash purchase of Rs 1,50,000
(iii) A, B, C, share profits in the ratio of 2:1:1. C is a sleeping partner,
(iv) Interest is paid to partners @ 20% p.a. Interest is authorised by partnership deed.
(v) Salaries, authorised by partnership deed, are paid to all the partners equally.
Compute (i) book-profit and (ii) total income of the firm in the following cases:
(I) It is a professional firm.(II) It is business firm.
(III) It does not file the return of its income, leading to best judgement assessment.

Computation of Book-profits and Total Income for the PY 2007-2008/AY 2008-2009

Particulars	**Case I (Rs)**	**Case II (Rs)**	**Case III (Rs)**
Net profit	6,40,000	6,40,000	6,40,000
Add: Inadmissible items:			
(i) Cash purchases- of Rs. 1,50,000 [Sec. 40A(3)]	1,50,000	1,50,000	1,50,000
(ii) Interest paid to partners	80,000	80,000	2,00,000
(iii) Salary paid to C - sleeping partner (disallowed)	2,20,000	2,20,000	2,20,000
(iv) Salary paid to A&B- working partners(to be treated separately)	4,40,000	4,40,000	4,40,000
(v) Depreciation	50,000	50,000	50,000
	15,80,000	15,80,000	17,00,000
Less: Income not related to business or profession: Interest on	(-) 45,000	(-) 45,000	(-) 45,000
Book-profit	**15,35,000**	**15,35,000**	**16,55,000**
Less: Remuneration allowable to working partners [Note 1]	(-) 4,40,000	(-) 4,40,00	Nil
Income from business or profession	10,95,000	10,95,000	16,55,000
Add: Income from other sources— interest on securities	50,000	50,000	50,000
Taxable income	**11,45,000**	**11,45,000**	**17,05,000**

Note 1:

Professional firms Remuneration allowable to working partners		Business firms Remuneration allowable to working partners	
Particulars	Rs.	Particulars	Rs.
(a) Actual remuneration	4,40,000	(a)Actual remuneration	4,40,000
(b) Statutory limit:		(b)Statutory limit:	
First 1,00,000 90%	90,000	First 75,000 90%	67,500
Next 1,00,000 60%	60,000	Next 75,000 60%	45,000
Balance13,15,000 40%	5,34,000	Balance 13,85,000 40%	5,54,000
	6,84,000		6,66,500
Whichever is lower is allowed	4,40,000	Whichever is lower is allowed	4,40,000

Note 2: In case III, no deduction has been allowed in respect of interest and remuneration paid to partners because the firm is assessed by way of best judgement assessment.

Note 3: In cases I & II, interest is allowed @ 12% p.a. Excess interest @ 8% p.a. has been disallowed.

6. M/s JP & Co. discloses net profit of Rs.1,70,000 for the PY 2007-2008 after debiting and crediting the following:

Particulars	Rs.
(a) Debits:	
(i) Installation of computers in September 2007	1,00,000
(ii) Advance tax	25,000
(iii) Interest to partners—J&P @ 16% p.a., duly authorised by partnership deed	1,60,000
(iv) Business expenses	5,00,000
(v) Commission to J, authorised by partnership deed	1,00,000
(vi) Salary to P, authorised by partnership deed	1,00,000
(vii) Donation to National Defence Fund	50,000
(b) Credits:	
(i) Dividend received from Indian companies	75,000
(ii) Refund of sales tax allowed as deduction	60,000

Compute (i) book-profits and total income of the firm in the following cases: (I) M/s JP & Co. is a business firm. (II) M/s JP & Co. is a professional firm.

Computation of book-profits and total income of M/s JP & Co. AY 2008-2009

Particulars	**Case I (Rs)**	**Case II (Rs)**
Net profit	1,70,000	1,70,000
Add: Inadmissible items:		
(i) Purchase of computers	1,00,000	1,00,000
(ii) Advance tax	25,000	25,000
(iii) Interest to partners in excess of 12%	40,000	40,000
(iv) Commission and Salary to J and P to be treated separately	2,00,000	2,00,000
(v) Donation to National Defence Fund	50,000	50,000
	5,85,000	5,85,000
Less: Dividend from Indian companies	(-) 75,000	(-) 75,000
	5,10,000	5,10,000
Less: Depreciation on computers not included in debits:		
60% of Rs 1,00,000	(-) 60,000	(-) 60,000
Book-profits	**4,50,000**	**4,50,000**
Less: Remuneration to J&P [see Note below]	(-) 2,00,000	(-) 2,00,000
Taxable business income	**2,50,000**	**2,50,000**
Add: Income from other sources: dividends from Indian companies: Exempt	—	—
Gross total income	**2,50,000**	**2,50,000**
Less: Deductions from GTI		
Donation to National Defence Fund @ 100% of Rs 50,000	(-) 50,000	(-) 50,000
Total income	**2,00,000**	**2,00,000**

Note :1

Remuneration to partners : Business firms				Remuneration allowable to partners : Professional firms			
(a) Actual remuneration			2,00,000 or	Actual remuneration			2,00,000 or
(b) Statutory limit based on book-profit:				Statutory limit based on book-profit:			
First	75,000	90%	67,500	First	1,00,000	90%	90,000
Next	75,000	60%	45,000	Next	1,00,000	60%	60,000
Balance	3,00,000	40%	120,000	Balance	2,50,000	40%	1,00,000
			232,500				2,50,500
Whichever is less is allowed			2,00,000	Whichever is less is allowed			2,00,000

7. J, K & P are partners in a firm sharing profit and losses in the ratio of 2:1:1.

'K' retires w.e.f. 31 October 2007. The firm income for the PY 2007-2008, before setting-off carried forward losses and allowances, includes the following:

		Rs
(i)	Business profits	8,00,000
(ii)	Long-term capital gains accruing from land on 1 January 2008	4,00,000
(iii)	Income from other sources	1,00,000
	Carried forward losses and allowances are given as below:	
(i)	Business loss C.F. from the AY 2006-2007	5,00,000
(ii)	Short-term capital loss C.F. from the AY 2007-2008	2,00,000
(iii)	Depreciation C.F. from the AY 2005-2006	1,75,000

Compute the total income and tax liability of the firm for the AY 2008-2009

Computation of remuneration allowable to partners and total income of the firm for the AY 2007-2008

Income form Business		8,00,000
Long term Capital gain		4,00,000
Income from other Sources		1,00,000
	Aggregate Income	**13,00,000**
Less: Carried forward Losses / allowances :		
i) Business los to be set-off against business profits		5,00,000
ii) Short term capital loss to be set off against long term capital gains		2,00,000
iii) Depreciation to be set of against business profits		1,75,000
	Total Income	**4,25,000**
Computation of Tax Liability		
LTCG @ 20% on 2,00,000 (4,00,000 – 2,00,000)		40,000
Other Income @ 30% on 2,25,000		67,500
		1,07,500
(+) Surcharge @ 10%		10,750
		1,18,250
(+) Education Cess @ 2%		2,365
(+) SHEC @ 1%		1,183
		1,21,798
Tax payable Rounded off u/s 288 B		**1,21,800**