



Taxation of Firm Tax Implication of Partnership Firm



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A partnership is a common vehicle in India for carrying on business activities on a small or medium scale. Partnership is the relationship between persons who have agreed to share

the profits of a business carried on by all or any of them. Persons who have entered into partnership with one another are called partners individually and a firm collectively. Hence, for Income tax purpose we have a separate status as "firm".

Definition of firm [Section 2(23)]



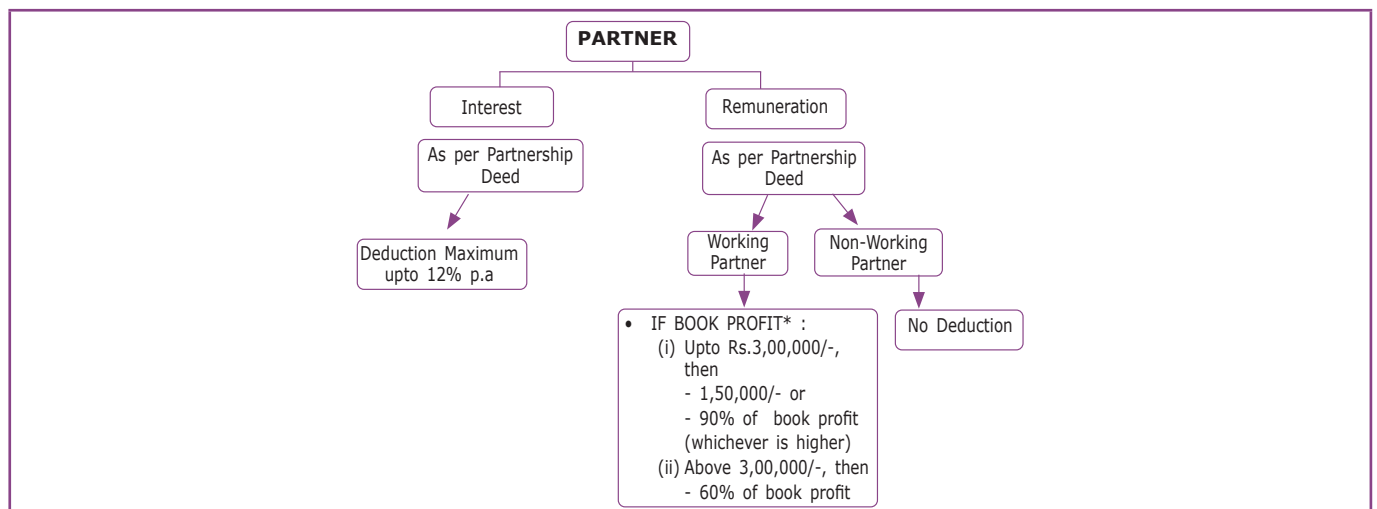
Section 2(23) of the Act states that firm, partner and partnership have the meanings, respectively assigned to them in the Indian Partnership Act, 1932 and shall include a

limited liability partnership (LLP), as a person but the expression 'partner' shall also include any person who being a minor, has been admitted to the benefits of partnership.

Computation of total income of the firm

The total income of the partnership firm will be determined as a separate entity and it will be computed under various heads of income. However, while computing taxable profits under the head 'Profits and gains of business or profession', a deduction is allowable to the firm on account of interest and remuneration payable to the partners subject to provisions of section 40b. Deduction of interest to a partner is allowable under section 36 and remuneration to a working partner will be allowed under section 37.

Condition of interest and Remuneration payable to partner is explained as under:





***Book profit**' means the net profit computed under the head 'Business or Profession' as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit

Payment of remuneration/interest, although authorised by the partnership deed but which relates to a period prior to the date of such partnership deed, shall not be allowed.

Provisions regarding set off and carry forward of losses of firms

There are no special provisions for set off and carry forward of losses of firms. These are the same as applicable in case of other assesseees.

CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM [SECTION 78]

Where a change has occurred in the constitution of a firm, due to retirement of a partner or death of a partner, the firm shall not be entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year. [Section 78(1)]

● **ADJUSTED TOTAL INCOME**

Total income as computed under the normal provisions of Income Tax act	XXX
ADD :- Deduction under chapter VI-A (Heading C except deduction u/s 80P)	XXX
ADD:- Deduction claimed under section 35AD as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under Section 35AD was allowed in respect of the assets on which the deduction under that section is claimed (inserted by the Finance (No 2) Act 2014 w e f A Y 2015-16.	XXX
ADD:- Deduction under section 10AA (Deduction in case of profits of SEZ units)	XXX
Adjusted Total Income	

Treatment of share of profit, interest and remuneration received by a partner from a firm

- Share of profit in the hands of the partner shall be fully exempt under section 10(2A).
- Interest received/receivable by a partner shall be included in the total income of the partner under the head 'Profits and gains of business or profession' to the extent deduction of interest was allowed to the firm as per section 40(b), which cannot exceed 12 per cent per annum.
- Remuneration to a working partner shall also be included in the total income of the partner under the head 'Profits and gains of business or profession' to the extent deduction of remuneration was allowed to the firm as per section 40(b).

Section 115JC of the Act

- Partnership firm is liable to pay Alternate Minimum Tax (AMT) if the tax payable under the normal provisions of income tax is lower than AMT.
- **Rate of AMT : 18.5% of Adjusted total income*** (as increased by surcharge, if applicable and Cess)



TAX CREDIT

- If **AMT > Income tax** as per normal provisions of income tax act, then the excess amount shall be available as credit against future tax liability.
- The AMT Credit will be allowed to be **carried forward and set off for a period of 10 years** succeeding the year in which that credit is available.
- However, The MAT Credit of company is not allowed to carry forward in hands of LLP in case of conversion of company in LLP.

- o Transfer of Capital Assets/Stock in Trade by Firm to Partner (in case of dissolution or reconstitution) [New Section 9B]
- o Receipt of capital asset by Partner from Firm (in case of dissolution or otherwise) [Old Section 45(4) which is substituted]
- o Receipt of money or capital asset by Partner from Firm (in case of reconstitution) [New Section 45(4)]

Amendment by the Finance Act, 2021 (Applicable from AY 2021-22)

Tax on transfer of money or asset by Firm/AOP/BOI to its Partners/Members

Section 9B, 45(4), 48(iii)

- o Asset introduced by Partner to a Firm [Section 45(3)- no change]

Section 9B, Section 45(4) are simplified in the below table:

Situation	Taxable in hands of	Computation
In case of Reconstitution		
Receipt of Money or Capital Asset by Partner from Firm [New Section 45(4)]	Firm <i>(Though the income arises to a partner but it is deemed as income of the firm)</i>	Value of Money + FMV of Capital Asset Less: Balance in Capital account at the time of reconstitution = Capital Gain <i>(if gain is negative then it will be considered as NIL)</i>
Stock in Trade transferred by Firm to Partner Section 9B (money is not covered)	Firm	FMV of Stock is taxable under the head Business or Profession



Situation	Taxable in hands of	Computation
Capital Asset transferred by Firm to Partner Section 9B (money is not covered)	Firm	FMV of asset is considered as Full Value of Consideration under the head Capital Gain, and while calculating Capital gain, amount taxable u/s 45(4) will be reduced proportionately [Ref Section 48(iii)-]
In case of Dissolution		
Capital asset/stock in trade transferred by Firm to Partner Section 9B (money is not covered)	Firm	FMV of stock/asset is taxable under the head Business / Capital Gain respectively

Balance in Capital account of partner to be calculated without considering the increase due to revaluation of assets or due to self-generated goodwill/assets. Please note that reduction if any in the capital account due to revaluation is not to be add back. [Section 45(4)]

Section 9B covers both situation of 'reconstitution' and 'dissolution'. However, section 45(4) covers only 'reconstitution'.

'Reconstitution' means:

- One or more of its partners or members ceases to be partners or members;
- One or more new partners or members are admitted. However, at least one existing partner or member should continue to be partner or member of the specified entity after admission of the new partner(s) or member(s); or
- All the partners or members continue with change in their respective share or in share of some of them.

- Erstwhile section 45(4) was covering situation of transfer of capital asset during Dissolution or Otherwise. However, in the new section 45(4), it is applicable only in case of reconstitution. Further, term 'otherwise' is being deleted. Accordingly, new provision will not cover any other situation where the capital asset is being transferred by Firm to a Partner. It will be interesting to analyse the implication of section 56 on such situations if any.
- Fair Market Value is being used for the purpose of taxability. Accordingly, if the Net Realisable Value is very less as compared to Fair Value, then it will result in higher taxability. We are awaiting the guidelines about the calculation of FMV. On a safer side, if the NRV is lesser than, its beneficial to first liquidate the asset and then transfer the amount to a partner.
- CBDT has issued guidelines u/s 9B and 45(4) vide circular no. 14 of 2021



clarifying certain issues by way of giving example

- Asset introduced by Partner to a Firm [Section 45(3)]:
 - o When a Partner introduces capital asset in the Firm, it is regarded as a taxable transaction in the hands of Partner in the year

of such transfer. The amount recorded in the books of accounts of the Firm is considered as Full value of consideration.

This does not deal with any specific situation of 'Reconstitution' or otherwise under which the asset is introduced by a Partner.

