

UDHNA COLLEGE

MCOM SEM 2

FINANCIAL & MANAGEMENT A/C - 6

Computation of total income and tax payable by a partnership firm:

1. Meaning of Partnership Firm

A partnership firm is a business organization formed by two or more persons who agree to share the profits of a business carried on by all or any of them acting for all.

Legal Basis:

- Indian Partnership Act, 1932
- Income Tax Act, 1961

Important Points:

- A firm is not a separate legal entity under the Partnership Act, but
- It is treated as a separate taxable entity under the Income Tax Act.
- A firm may be registered or unregistered; however, tax benefit is allowed only to registered firms.

2. Scheme of Taxation of Firms

Particulars	Treatment
Status	Firm
Taxable Entity	Firm itself
Tax Rate	Flat rate of 30%
Deduction to Partners	Allowed subject to Sec. 40(b)
Share of profit in partners' hands	Exempt u/s 10(2A)

Basic Scheme:

1. Compute Business Income of the firm.
2. Allow remuneration & interest to partners if conditions are fulfilled.
3. Compute Gross Total Income.
4. Deduct Chapter VI-A deductions (if any).
5. Calculate Total Income.
6. Apply tax rate and compute tax payable.

3. Conditions a Firm Should Fulfill under Section 184

A firm can claim deduction of remuneration and interest to partners only if it satisfies Section 184.

Conditions under Section 184:

1. Existence of a Partnership Deed
 - Must be written.
2. Partnership Deed should specify:
 - Individual share of each partner.
3. Certified copy of partnership deed must be submitted:
 - Along with return of income (for first year).
4. Firm must not be assessed as AOP.
5. Change in partnership must be intimated to the Assessing Officer.

If these conditions are not satisfied →

No deduction for remuneration & interest to partners.

4. Conditions for Claiming Deduction of Remuneration & Interest to Partners (Section 40(b))

A. General Conditions:

1. Payment must be:
 - To a working partner
2. Authorized by:
 - Partnership Deed

3. Payment should be:
 - According to deed
 4. Interest rate:
 - Maximum 12% p.a.
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B. Maximum Allowable Remuneration (Section 40(b)(v))

Based on Book Profit:

Book Profit	Maximum Deduction
On first ₹3,00,000	Higher of ₹1,50,000 or 90%
On balance	60%

Meaning of Book Profit:

Net profit as per P&L Account before remuneration to partners but after interest to partners.

C. Interest to Partners:

- Allowed @ maximum 12% p.a.
- Excess interest → disallowed

5. Computation of Income of the Firm

Steps for Computation:

Step 1: Compute Income under various heads:

- Income from Business or Profession
- Income from House Property
- Capital Gains
- Income from Other Sources

Step 2: Business Income:

- Start with Net Profit as per P&L A/c
- Add back:

- Inadmissible expenses
- Excess remuneration/interest
- Deduct:
 - Admissible expenses
 - Allowable remuneration & interest

Step 3: Gross Total Income (GTI)

Step 4: Less:

- Chapter VI-A deductions (if applicable)

Step 5: Total Income

7. Computation of Tax of the Firm

Tax @ 30%

Surcharge if applicable

Health & Education Cess @ 4%

Practical Questions

Q-1	Jay and Veru are working partners in a firm, sharing profit and loss equally. The profit and loss account of the firm for the year ending 31-03-2025 disclosed a net loss of Rs. 60,000 after claiming the following items:
1.	Salary to partners: Jay Rs. 36,000 and Veru Rs. 24,000
2.	Bonus to Jay, Rs. 12,000, and Commission to Veru Rs.10,000.
3.	Interest on capital at 15 %: Jay Rs. 3,000 and Veru Rs. 2,700
4.	Interest paid on the loan of Veru at 16%, Rs. 3,200.
5.	Rent of godown paid to Jay, Rs. 1,000 monthly.
6.	Purchase of machinery Rs. 1,500
7.	Net interest of Rs. 7,200 on a fixed deposit with the bank was credited to the profit and loss account.
8.	The depreciation debited to P & L A/c is Rs. 1,000 more than as per the act.
	Compute the taxable income from the business of the firm for the AY-2025-26.

Q-2	Chhagan, Magan, and Gagan are partners in a firm sharing profits and losses equally. Information is as follows:
1.	Interest on capital:

	<ul style="list-style-type: none"> To Chhagan Rs. 24,000, rate of interest 12% To Magan Rs. 30,000, rate of interest 15% To Gagan Rs. 25,000, rate of interest 12.5%
2.	Interest on drawings Rs. 1000. It is not recorded on Profit and loss account.
3.	Remuneration to partners: <ul style="list-style-type: none"> Chhagan Rs. 2,40,000 Magan Rs. 2,10,000 Gagan Rs. 1,00,000
4.	Net loss after charging partners' remunerations before charging interest on capital as per profit and loss account for the year ending 31-3-2022 is Rs 6,80,000.

Q-3 The following is the profit and loss account of the firm for the year ended March 31, 2025.

Particulars	Amt. Rs.	Particulars	Amt. Rs.
To Business exp.	15,000	By Gross profit	12,60,000
To the insurance premium	18,000	By Interest debited to debtors	7,000
To Traveling exp.	12,000	By Income tax refund (including Rs. 500 interest)	1,500
To Depreciation	24,000	By interest in the Post Office Savings Bank Account (Joint Account)	12,000
To donation to the Prime Minister's relief fund (for corona relief fund)	25,000	By interest on less tax debentures (net) (TDS 20%)	48,000
To Remuneration to partners: Bramha 1,00,000 Vishnu 2,00,000 Mahesh 1,50,000	4,50,000	By Interest on Drawings: Bramha 3,000 Vishnu 4,000 Mahesh 2,000	9,000
To Interest on Capital: Bramha 32,000 Vishnu 48,000 Mahesh 16,000	96,000		

To Interest on Loan taken from a minor son of Bramha (@18%)	27,000		
To Interest on loan taken from the wife of Mrs. Vishnu (@20%)	40,000		
To Salary to staff	84,000		
To Professional tax	2,400		
GST	1,800		
To Bad Debt (old) 2,400 +Bad Debt(new) 1,600 +B.Debt Reserve 3,000	7,000		
To Income tax provision	24,000		
To net profit	5,55,300		
	13,81,500		13,81,500

Additional information:

- (1) Valuation of closing stock is valued 10% less. The value of closing stock shown in books of account is Rs. 90,000.
- (2) Interest on drawing received which is 1% of capital balance as on 1-4-2024.
- (3) Interest on capital is 16%.
- (4) GST included Rs. 500 unpaid GST for 2024-25.
- (5) The written-down value of firm assets as on 1-4-2024 was Rs. 70,000.
On 1-7-2024, an additional asset was purchased at Rs. 1,50,000. Assets used from 1-1-2025. The recognized rate of depreciation is 15%.
- (6) The unabsorbed Depreciation of the previous year ago is Rs. 3,000.
- (7) Salary includes Rs. 15,000 was paid outside of India, on which no tax was deducted at source.
- (8) Long term capital gains Rs. 1,00,000 and short-term capital loss is Rs. 10,000.
- (9) Each partners' remuneration is payable to Rs. 8,000, Rs. 12,000 and Rs. 11,000 p.m. respectively.
- (10) Total sales of the firm are Rs. 9,00,000. The commission will be payable to Mahesh at 1% of the sales.

The ratio of partners' profit and loss is 3:2:1

From the above information, compute the taxable business income of

the firm, the total taxable income of the firm, and the tax liability of the firm for Ay-2025-26.

Q-4 Shyam and Ghanshyam are partners in a firm, sharing profits and losses equally. The following is the profit and loss account of the firm for the year ended March 31, 2025.

Particulars	Rs.	Particulars	Rs.
To Salary and Bonus	1,80,000	By Gross profit	16,30,000
To General Expenses	2,60,000	By Bank Interest (Gross)	52,000
To Rent, tax, and insurance	1,20,000	By Bad debts recovered (disallowed in earlier years' assessment)	8,400
To GST	15,000	By Dividend	36,000
To Income Tax Reserve	72,000	By long-term capital gains	78,000
To Bad debts written off	18,000	By interest on drawing	12,000
To Bad debts reserve	48,000		
To Advertising	90,000		
To Subscriptions	6,000		
To Donation to Hospitals	42,000		
To Depreciation on old plant and machinery	60,000		
To Loss on sale of motor car	70,000		
To Interest on capital: Shyam 72,000 Ghanshyam 90,000	1,62,000		
To Partners Salary: Shyam 60,000 Ghanshyam 80,000	1,40,000		
To Commission to Ghanshyam	50,000		
To Net Profit	4,83,400		
	18,16,400		18,16,400

Additional information:

1. Rent, taxes and insurance include Rs. 60,000 being rent paid to Shyam for premises for business.
2. Rs. 20,000 outstanding bonus is included in bonus.

3. Interest on capital payable at 18%.
 4. A long-term loan of Rs. 30,000 was taken during the year. This sum has been debited to the account. Interest on loan Rs. 5,000 is outstanding and not considered in the books.
 5. Advertising expenses were paid by cash.
 6. The motor car is entirely used for the private purpose of the partners.
 7. The written-down value of old plant and machinery as 1-4-2024 was Rs. 2,50,000. On 1-7-2024, a new plant and machinery was purchased of Rs. 3,00,000. Depreciation at 15% is available on all plants and machinery.
- From the above information of the partnership firm, compute the taxable income of the business firm, total taxable income of the firm and tax liability of the firm for the assessment year 2025-26.

Q-5 Radha and Krishna are partners of the firm 'M/s Vrindavan'. The Profit and Loss Account of the firm for the year ending on 31-03-2025.

Particulars		Particulars	Amt. Rs.
Cost of goods sold	14,00,000	By Sales	22,22,000
Staff Salary	60,000	By Long-Term Capital Gain	45,000
Interest on loan from partner Radha at 15 % p.a.	45,000	By Short-Term Capital Gain	25,000
Interest on loan from partner Krishna at 15% p.a.	30,000	By House Rent	90,000
Interest on term loan at 16 % p.a.	70,000	By Interest on Inv. (Net) (TDS 10%)	18,000
Salary to Partners: Radha 60,000 Krishna 72,000	1,32,000	By Interest on Drawings Radha 4,000 Krishna 2000	6,000
Office Rent	60,000		
Interest on capital at 13.5 % Radha 40,500 Krishna 27,000	67,500		
Commission to the working partner Radha	50,000		
Donation to PM Relief Fund	51,000		
Income tax paid	17,000		
Entertainment expenses	11,000		
Bad debts	2,500		
To provision for Bad debts	12,000		

Insurance premium	12,000		
To net profit	3,86,000		
	24,06,000		24,06,000

Additional Information:

- (1) Entertainment expense was 10% paid in cash.
- (2) Machinery has purchased on 1-4-2024 for Rs. 3,00,000 but put on use from 1-8-2024. Another machinery of Rs. 45,000 purchased on 23-11- 2024. Approved rate of depreciation is 15 %.
- (3) 2/3 insurance premium is for the shop and the rest is for the life Insurance.
- (4) GST of Rs 15,000 payable on 31-3-2025, from which Rs. 10,000 was paid on 31-07-2025 and Rs. 5,000 was paid on 30-09-2025, although the due date of payment under the GST was 30-06-2025.
- (5) In staff salary Rs. 3,000 include the bonus paid to partners.
- (6) Approved bad debt is 40 %.
- (7) Advertisement expense has been paid Rs. 10,000 which is not mentioned in above P & L Account.

From the above information, calculate the taxable business income of the firm, total taxable income of the firm and tax liability of the firm for the AY 2025-26.