

# **DIRECT TAX**

## **Circular No. 12 /2019**

**Date – 19.06.2019**

### **Assessment of Firms'-some of the important issues to be kept under consideration by the Assessing Officers while framing assessment-reg.**

C&AG had carried out a Performance Audit regarding 'Assessment of Firms' under the Income tax Act, 1961 ('Act') and in its Report NO.7 of 2014, has made certain suggestions so that in future, assessments in these cases are handled in a more effective manner by the Assessing Officers (AOs).

In order to improve the quality of assessments being framed in these cases and also to reduce the scope for committing errors, the Board desires that Assessing Officers should duly take into consideration the following issues while making assessments in case of firms.

- Expenses in the hands of the firm such as interest on capital paid to the partners, remuneration payable to the working partners etc. are taxable in the hands of respective partners. Therefore, while framing assessment in case of firms, a cross-verification of such amounts with income-tax return of firm's partner will be desirable and any discrepancy between the tax return of a firm and its partners should be dealt with as per provisions of the Act.
- AOs should invariably call for a copy of the partnership deed during the course of assessment proceedings and examine it carefully so that instances of payment of remuneration to any non-working partner or remuneration payment for period prior to the date of partnership deed but claimed as deductible are identified and cognizance of these are duly taken in assessment.
- Where the interest in the partnership deed was stated to be below twelve percent, yet, the same was allowed at the rate of twelve percent by the AO. Such mistakes should be avoided.
- In case the rate prescribed in the partnership deed is in excess of twelve percent, the excess should be disallowed in assessment. The AO is also required to ascertain whether payment of interest is duly authorized by the partnership deed or not.
- While calculating interest payable to the partners for purposes of section 40(b)(iv) of the Act, ADs are taking different yardsticks for calculating interest viz. opening balance of capital, closing balance of capital, fixed capital or current capital etc. In this regard, section 40(b)(iv) of the Act prescribes that payment of interest to partners should be authorized by and be in accordance with the partnership deed. Therefore, while framing assessment, ADs should refer to the terms of the partnership deed for purpose of computation of interest on capital payable to a partner.
- In some assessments, ADs had allowed expenditure on remuneration to the working partners though the same was either not authorized by the partnership deed or was in excess of the amount specified therein. In order to prevent recurrence of mistakes and allowing the expenditure strictly as per provisions of the Act, the ADs should ensure that claim under section 40(b)(v) of the Act is allowed only after a thorough verification of the partnership deed.
- While computing remuneration which is allowable to a working partner under section 40(b)(v) of the Act, the term 'in accordance with the terms of the partnership deed' in clauses (ii) and (v) of section 40(b) of the Act implies that remuneration should not be undetermined or undecided.

- In situations where the remuneration either so specified in the partnership deed or computed as per the method indicated therein falls short of the amount allowable under section 40(b)(v) of the Act, it would be restricted to the figure computed on the basis of the partnership deed.
- At the time of computing 'book profit' for purposes of section 40(b)(v) of the Act, all incomes such as capital gain, interest, rental income, income from other sources etc. which do not fall under the head 'profit or gain of business or profession', should be excluded.
- ADs are advised to apply the provisions of Chapter XVI of the Act in assessment of firms whenever required. It should be taken into consideration that under section 185 of the Act, any noncompliance by the firm or its partners with provisions of section 184 of the Act may result in denial of expenses such as remuneration, interest etc. payable to the partners which are otherwise allowable under the provisions of the Act.
- Some firms try to inflate the profits eligible for deduction under section 80IA of the Act by not claiming expenditure towards remuneration, salary, interest etc. which are payable to the partners. In such situations, Assessing Officers may examine these transactions in light of provisions of sub-section (10) of section 80IA of the Act which empower Assessing Officer to re-compute profit of the eligible business after excluding the profits of the related activity/business which produced the excessive profit.
- While framing assessments in case of firms claiming carry forward and set off of losses, Assessing Officers are requested to verify such claims taking into consideration provisions of section 78 of the Act which disallow such a carry forward and set off in case of change in constitution of the firm or on succession.
- **Regarding the issue concerning possible action against the tax auditor for furnishing incomplete information in the Tax-Audit Report and effective utilization of information in the Tax Audit Report by the Assessing Officers, it is reiterated that directions given earlier viz. Instruction No. 09/2008 dated 31.07.2008 of CSDT should be followed scrupulously by the field authorities.**