PARTNERSHIP & HUF :
A PRACTITIONERS' PERSPECTIVE

Committee for Capacity Building of CA Firms and Small & Medium Practitioners' (CCBCAF & SMP)

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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Foreword

It is really heartening that the Committee for Capacity Building of CA Firms and Small & Medium Practitioners (CCBCAF & SMP) is bringing out a publication titled **"Partnership & HUF: A Practitioners' Perspective"** for the benefit of the members.

Hindu Undivided Family (HUF) is a joint family consisting of lineally descended member from a common ancestor. It is a separate tax entity that is automatically constituted when a marriage takes place. Unlike what the name suggests, it is also applicable to Buddhist, Jain or Sikh families, besides Hindus. The senior-most male member of the family is ordinary regarded as the karta of the HUF. The Income of a HUF is subject to tax separately (not in the hands of members) and a HUF is required to obtain a separate Permanent Account Number. It can earn income from all sources, except salary. It may invest in a business and earn profits or earn gains. Rental income can be earned on ancestral or other property held by a HUF.

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

I hope that the said book covering vital information on HUF & Partnership would be able to assist the members while dealing with the related professional assignments and their clients respectively.

I am sure this publication will be useful and serve as a handy reference for all its users.

Date: January 31, 2013
Place: New Delhi

CA. Jaydeep Narendra Shah
President, ICAI

Preface

India is known for its big happy families, we epitomise the large family structure. The Hindu Undivided Family (HUF) is a separate tax entity that is automatically constituted when a marriage takes place. Unlike what the name suggests, it is also applicable to Buddhist, Jain or Sikh families, besides Hindus. The income of an HUF is subject to tax separately (not in the hands of members) and an HUF is required to obtain a separate Permanent Account Number. An HUF can earn income from all sources, except salary. It may invest in a business and earn profits or earn capital gains. Rental income can be earned on ancestral or other property held by an HUF. Under the direct tax laws practiced in India, 'partnership' and 'HUF' are different taxable entities. In other words, these two are 'persons' within the meaning of tax laws for the purpose of levy and assessment of income tax.

This book titled "Partnership & HUF: A Practitioners' Perspective" has been developed with the prime objective of serving as a quick refresher cum knowledge builder for all those, who are involved in formation, management and taxation of these entities in India.This book, though small in size, is a unique publication containing 301 Frequently Asked Questions (FAQs) from Practitioners' Viewpoint. This book has not only covered important taxing issues, related to these taxable entities, but also tried answers to queries and problems pertaining to the Practitioners & HUF.

I take this opportunity to place on record my hearty thanks to CA. V.S. Vadivel for preparing the draft of this publication thereby sharing his relevant experience and expertise amongst members. I appreciate the efforts put in by the Members of the Committee for Capacity Building of CA Firms and Small & Medium Practitioners (CCBCAF & SMP), Working Group on Research & Publications namely CA. Munish Saraogi, CA. Shashi Garg, CA. Harish Gupta, CA. O.P. Mishra & CA. Shailendra Agarwal and Dr. Sambit Kumar Mishra, Secretary, CCBCAF&SMP & other officials of Secretariat who have provided necessary support for publishing the aforesaid book.

With warm regards

CA. Pankaj Tyagee
Chairman
Committee for Capacity Building of CA Firms and
Small & Medium Practitioners (CCBCAF&SMP), ICAI

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Part: 1
Partnership: A Practitioners' Perspective

1. What do you mean by a 'partnership'? Will it include all forms of business organizations?

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

A 'partnership' is basically a contract of two or more competent persons to place their money, effects, labour and skill, or some or all of them, in lawful commerce or business and to divide the profits and bear the loss in certain proportions, as agreed. It is a voluntary contract, entered into between two or more persons with the basic understanding that there shall be a communion of the profits thereof between the persons.

Under the Indian Partnership Act, 1932, the following three elements are very essential to form any firm of partnership in India:

- There must be an agreement between two or more persons;
- The agreement must be to share the profits of the business; and
- All partners together, or any one, on behalf of the others, must carry on the business.

All the above three essentials must co-exist before a firm of partnership can come into existence. Further, a partnership can arise only from a contract and not from a status. In the case of K.D. Kamath & Co. v. CIT [1971] 82 ITR 680 (SC), the Supreme Court has rightly held that the mere nomenclature given to a document is by itself not sufficient to hold that the document in question is one of partnership. In other words, all the above-said three essentials must co-exist before a firm of partnership can come into existence.

2. Is the format of partnership appropriate for all business?

Though partnership is one of the most common forms of business organisations in India, it is more appropriate for medium sized business involving limited capital. This may include the following : (i) small scale industries (SSI), (ii) wholesale trade of goods (iii) retail trade of goods; (iv) small service concerns (transport agencies, real estate brokers etc.) (v) professional firms (CA firms, doctors' clinic, law firms etc.)

3. Can a partnership in India have any number of members?

As regards the maximum and minimum number of persons to form a partnership firm, section 11(2) of the Companies Act, 1956 has prescribed the limit. Accordingly, there must be a minimum of two persons to form any partnership firm in India. Similarly, if the firm is intended to engage in financial or banking transactions, there must be a maximum of ten persons to form such a partnership firm. On the other hand, if the firm is intended for any other (non-banking) purposes, there must be a maximum of twenty persons to form such a partnership firm. In other words, any group of more than 2 persons but not more than 20 persons [10 persons in case of banking business] may join together to carry on a business in partnership.

In this context, any partnership in India, having more than 10 or 20 partners (as the case may be) will be treated as 'illegal'. In case where there is a partnership between two partnership firms, all the partners of each firm will be taken into account for the purpose of this provision.

However, if and when a partnership is between the Karta or any member of HUF on the one hand and another individual or individuals on the other, the members of the joint family will not be taken into account for the purpose of section 11 of the Companies Act.

But in case where two or more HUFs are carrying on business in partnership, the number of the members of those joint Hindu families except minors will be taken into account for the purpose of section 11 of the Companies Act- Agarwal & Co. v. CIT. AIR (1970) SC. 1343.

4. Discuss briefly the partnership law as prevalent in India.

The basic law relating to partnerships and firms in India is contained in the Indian Partnership Act, 1932. This Act 9 of 1932 received the assent of the Governor-General on 8th April 1932 and came into force on 1st October 1932 (except section 69, which came into force on 1st October, 1933).

This Act (which is presently administered through the Ministry of Corporate Affairs, Government of India) has laid down the rules relating to formation of partnership, the rights and duties of partners, management and dissolution of partnership.

Before the enactment of the 1932 Partnership Act, the Indian Contract Act, 1872 contained a separate chapter [Chapter XI] providing for legal requirements on partnerships in India.

The Indian Partnership Act, 1932 applies to the whole of India, except the State of Jammu and Kashmir. Apart from the Partnership Act, the general law of contracts, as contained in the Indian Contract Act, 1872 also applies to partnership firms in India. The 1932 Act is however not applicable to Limited Liability Partnerships, since they are governed by the Limited Liability Partnership Act, 2008.

As per Article 246 of the Constitution of India, which deals with distribution of legislative powers, the Union and State Legislatures have 'concurrent power' with respect to the subjects enumerated in List III. Under Schedule VII, [List III-Concurrent list, entry-7] of the Constitution of India, contracts including partnerships are treated as items falling under 'concurrent list'. Accordingly, the Union and the State Legislatures have concurrent power with respect to the contracts including partnerships in India.

5. "In order to create a partnership, an agreement of partnership is always a must"-Do you agree?

An agreement between the persons constituting the partnership is the sine qua non of the legal relationship of the partners and the very concept of partnership is founded on an agreement between the persons -Mohan Lal Shyam Lal, (1942) 10 ITR 219 (All); Banyan & Berry v. DCIT (1996) 222 ITR 831 (Guj.)

Subject to the provisions of the Indian Partnership Act, 1932, the mutual rights and duties of the partners of a firm may be determined by the contract entered into between the partners. An agreement is sine qua non of every partnership, which may be oral or in writing. It may be expressed or implied by a course of dealings -Jajilsa v. Sarabhai, AIR [1938] Nag 324. In the absence of any evidence to show that there was such an agreement or contract between two or more persons, the parties to the contract cannot be held to be partners or members of a firm of partnership.

6. Can two or more persons join together and establish a firm of partnership for charitable purposes in India?

In order to constitute a valid partnership firm, there must exist a business, which is carried on by the partners for the acquisition of profits or gains. In other words, there can be no partnership where there is no intention among the partners to carry on the business and to share the profit thereof-Chitra Cinema v. CIT (1972) 86 ITR 203 (All).

Under section 2(b) of the Indian Partnership Act, 1932, the term 'business' for this purpose may include every trade, occupation and profession. Legally speaking, a partnership firm cannot be floated for non-economic purposes. In other words, no charitable institution or club may be formed in partnership.

7. Can the partners of a firm share the profits of the firm in whatever manner they like?

The partners of a firm may agree to share the profits of a firm in whatever manner they like. The partners may agree to share them equally or they may agree that one partner is to receive a fixed annual or monthly sum in lieu of a sum varying in accordance with the profits actually earned- CIT v. J.K. Doshi & Co. [1989] 176 ITR 371 (Bom.); Raghunandan Nanu Kothare v. H. B Bamji, AIR (1927) Bom. 187. However, in case where a fixed sum is paid to one person described as a working partner without a right to share in the profits or assets of the firm on dissolution, such person cannot be treated as a partner of the firm.

It is however open to partners of a business to agree not to take whole of profits of partnership for their own personal use and to reserve a part of profits for charitable purposes- Manohar Das Kedar Nath v. CIT [1950] 18 ITR 914 (All.)

8. Discuss the implied authority of a partner to bind the firm under the partnership law in India. Are there any limitations in this regard?

Under section 22 of the Indian Partnership Act, 1932, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm. The authority of a partner to bind the firm conferred by this section is called his "implied authority".

In the absence of any usage or custom of trade to the contrary, the 'implied authority' of a partner does not empower him to—

- submit a dispute relating to the business of the firm to arbitration;
- open a banking account on behalf of the firm in his own name;
- compromise or relinquish any claim or portion of a claim by the firm;
- withdraw a suit or proceeding filed on behalf of the firm;
- admit any liability in a suit or proceeding against the firm;

- acquire immovable property on behalf of the firm;
- transfer immovable property belonging to the firm; or
- enter into partnership on behalf of the firm. (u/s 19)

The partners in a firm may, by contract between the parties, extend or restrict the 'implied authority' of any partner. Notwithstanding any such restriction, any act done by a partner on behalf of the firm, which falls within his implied authority, binds the firm, unless the person with whom he is dealing knows of the restriction or does not know or believes that partner to be a partner.

Further, a partner has authority, in an emergency to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm. In all cases, in order to bind a firm, an act or instrument done or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or in any other manner expressing or implying an intention to bind the firm.

9. Can the duration of a partnership be determined at will?

Under section 7 of the Indian Partnership Act, 1932, a partnership where no provision is made by contract between the partners for the duration or determination of their partnership, the partnership is said to be a 'partnership at will'.

In the case of a partnership at will, each partner of the firm is entitled to dissolution; it is a legal right under the Indian Contract Act, 1872. In other words, the circumstances in which a court of law may order dissolution of partnership during the term have no bearing in connection with a partnership at will.

10. What are the mutual rights of partners in the conduct of the business?

Under section 12 of the Indian Partnership Act, subject to the contract between the partners—

- every partner has a right to take part in the conduct of the business;
- every partner is bound to attend diligently to his duties in the conduct of the business;
- any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners, and every partner shall have the right to express his opinion, before the matter

is decided, but no change may be made in the nature of the business without the consent of all the partners; and

- every partner has a right to have access to and to inspect and copy any of the books of the firm.

Under section 13 of the Act, subject to the contract between the partners:

- a partner is not entitled to receive remuneration for taking part in the conduct of the business of the firm;
- the partners are entitled to share equally in the profits earned;
- the partners shall contribute equally to the losses sustained by the firm;
- where a partner is entitled to interest on the capital subscribed by him, such interest shall be payable only out of profits of the firm;
- a partner making, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six per cent per annum;
- the firm shall indemnify a partner in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business;
- the firm shall indemnify a partner in respect of payments made and liabilities incurred by him in doing such act, in an emergency, for the purpose of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances;
- a partner shall indemnify the firm for any loss caused to it by his willful neglect in the conduct of the business of the firm.

11. Is capital contribution by all partners compulsory?

It is true that partnership is the relation arising out of a contract entered into between two or more persons to share the profits or losses of a joint business or profession. Partnership, being a contract, must be founded on some 'consideration' so that it should be binding on the parties concerned.

The consideration for any contract of partnership need not necessarily be in cash or property. In other words, the consideration may take the form of capital or the shape of labour and skill.

Section 2(d) of the Indian Contract Act, 1872, does not specifically say that the consideration for a contract must take the form of money or property. In this context, it is not necessary that, before a partnership comes into existence, each partner of the firm must contribute capital in the firm. In other words, labour and skill of partners are also valid considerations, as contemplated by the Indian Contract Act, 1872 and the skill and the labour, which a working partner puts in a firm, is sufficient to be the consideration for the partnership contract -CIT v. Gupta Brothers, (1981) 131 ITR 492 (All).

In this context, if and when one person has skill and wants capital to make that skill available and another has capital and wants skill, and the two agree that the one shall provide capital and the other skill, there is a good consideration for the agreement of partnership on both sides. In such a case, it is impossible for the court of law to measure the quantum of value of consideration and the parties must decide that for themselves-Dale v. Hamilton, (1846) 5 Hare 369.

12. "Full time attendance of working partners is a must"-Do you agree?

An individual partner of a firm shall be treated as a 'working partner' if and when (i) such an individual is a partner of the firm; and (ii) such an individual is actively engaged in conducting the affairs of the business or profession of the firm.

As regards attendance of the working partners, it is notable that there is no need for full time attendance of the working partners to any of the functions of the partnership firm. This is mainly because the term 'working partner' does not necessarily signify active and continuous participation in the actual transaction of the day-to-day business of the firm. In other words, the total time devoted by the partners of the firm towards the firm's business is not a relevant criterion in this regard.

13. Who is called a 'sub-partner'? What are his rights in the 'main partnership'?

A sub-partner is a party to an arrangement of sub-partnership, which may be entered into between a partner of a partnership firm and a stranger. A sub partnership may arise out of an agreement between a partner in a firm and a stranger, where the stranger is vested with interest jointly with that partner so far as his share in the firm is concerned.

An agreement of sub partnership will not however render the stranger, a partner of the main partnership firm. Legally speaking, a sub partner can have no right against the main partnership firm to take part in or to interfere with its business. He is also not entitled to examine its account so long as the main partnership continues to function. A sub-partner or a transferee is subject to all equities existing between the firm and the transferor.

In this context, section 29 of the Indian Partnership Act, 1932 deals with the rights of transferee of a partner's interest in a firm. Accordingly, a transfer by a partner of his interest in the firm, either absolute or by mortgage, or by the creation by him of a change on such interest, does not entitle the transferee, during the continuance of the firm, to interfere in the conduct of the business, or to require accounts, or to inspect the books of the firm, but entitles the transferee only to receive the share of profits of the transferring partner, and the transferee shall accept the account of profits agreed to by the partners.

However, if the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled as against the remaining partners to receive the share of the assets of the firm to which the transferring partner is entitled, and for the purpose of ascertaining that share, to an account as from the date of the dissolution. For the purpose of section 29 of the Act, a sub-partner is assumed to be a 'transferee' within the meaning of section 29-Venkatratnam v. Venkatratnam AIR (1944) Mad 394.

14. Who are the owners of a 'partnership property'?

In a firm of partnership, its property is not separate from that of its members or partners. The firm's property is the "joint estate" of all the partners, which is distinct from the 'separate' estate of the partners. In other words, the firm's property does not belong to a body distinct in law from its partners. Even in the event of insolvency of a firm of partnership, the joint estate or the firm's property [after meeting the liability in respect of joint debts] devolves on the partners of the firm.

15. "All the partners can participate in the management of a firm"-Do you agree?

In a firm of partnership, if there is no express agreement to the contrary, all the partners of a firm are entitled to participate in the management of the firm of partnership.

16. Is partnership a distinct legal entity?

Under the Indian law, a partnership firm is not a distinct legal entity and therefore the partnership property belongs to all the partners constituting the firm. In other words, a partnership firm is not a distinct legal entity apart from the partners constituting it- Malabar Fisheries Co. v. CIT [1979] 120 ITR 49 (SC); David Mitchell v. CIT [1956] 30 ITR 701 (Cal.)

A firm of partnership is thus not different from the partners composing it. To be more precise, a partner may be the debtor or the creditor of his co-partners, but he cannot be either debtor or creditor of the firm of which he is himself a member, nor can be employed by his firm, for a man cannot be his own employer- CIT v. R.M. Chidambaram Pillai [1977] 106 ITR 292 (SC); CED v. Kamlavati / Jai Gopal Mehra [1979] 120 ITR 456 (SC)

The word 'firm' is a short collective name for the individual partners who do constitute it. Accordingly, a firm is neither a legal entity nor an artificial person nor a corporation. Even though the common law provides for the firm name being utilised for the purpose of suing and of being sued, a firm of partnership is neither a legal entity nor an artificial person - Iyanar Coffee & Tea Co. v. CIT [1970] 78 ITR 775 (Mad.).

17. Is partnership a 'taxable entity' under the law of income tax?

Under the income-tax law prevalent in India, a partnership firm is treated as an 'assessee'. Section 23(4) of the erstwhile 1922 Act treated the firm as an 'assessee' and provided for the imposition of penalty against the firm in case the firm had committed any of the defaults, as indicated in the sub-section- Y. Narayana Chetty v. ITO [1959] 35 ITR 388 (SC); CIT v. S.V. Angidi Chettiar [1962] 44 ITR 739 (SC); CIT v. Kirkend Coal Co. [1969] 74 ITR 67 (SC). Similarly, section 2(31) of the extant Income-tax Act, 1961, which defines the term 'person', has expressly included a partnership firm. In this context, the decision of the Supreme Court in Dulichand Laxminarayan v. CIT [1956] 29 ITR 535 that firm is not a 'person' does not hold good in view of section 2(31) read with section 2(7) of the 1961 Act.

In this context, section 2(23) of the Income-tax Act, 1961, defines 'firm', 'partner', and 'partnership' as having the meanings respectively assigned to them in the Indian Partnership Act, 1932. Under the general law, 'firm' is different from 'firm's name'. Firm's name is merely an expression whereas the firm is a compendium of the persons who agree to carry on business in partnership and such persons are called partners- CIT v. Jagjit Singh Jaspal Singh [1989] 176 ITR 276 (Punj. &Har.).

Further, for the purposes of income tax law in India, while keeping partnership accounts, the firm is made debtor to each partner for what the partner brings into the common stock. Similarly, a partner is made debtor to the firm for all that he takes out of that stock. Further, the partners are not indebted to each other. In other words, a partner is a debtor or creditor to the firm and the partners are the agents and sureties of the firm. However, the liabilities of a partnership firm are regarded as the liabilities of the partners only in case they cannot be discharged by the firm out of its assets-V.C. Venkata Subbaiah Chetty& Sons v. CIT [1988] 171 ITR 590 (AP).

Under the Indian law of partnership, a partnership firm is neither a distinct legal entity nor an artificial person. In other words, a firm is not a distinct entity apart from the partners constituting it. However, under the Indian income tax law, a firm of partnership can be charged as a distinct assessable entity as distinct from its partners who can also be assessed individually. In this context, a mere change in partners does not affect the entity of the firm as an assessable unit-CIT v. A.W. Figgies & Co. [1953] 24 ITR 405 (SC). The Income-tax Act provides that the technical view of the nature of partnership, under English law or Indian law, cannot be taken in applying the law of income tax. In other words, whatever might be the position of a firm under the general law of partnership, for the purpose of income-tax, it can be said that a firm is an assessable entity, distinct and separate from the partners composing it- Baldevji v. CIT [1985] 156 ITR 776 (Mad.). Thus, for the purposes of income tax law in India, a firm is a body conceptually distinct from partners-V.C. Venkata Subbaiah Chetty & Sons v. CIT [1988] 171 ITR 590 (AP).

18. Can a partnership be created by an oral agreement in India?

Even though an agreement, between two or more persons, is necessary to form a partnership, it is not compulsory for a partnership deed to be in writing. In other words, partnerships may also be started by oral agreements among the partners. Every partnership however presupposes an agreement amongst the partners of firm – Achalsinhji Kesharisinhji & Co. vs. CIT. (1986) 157 ITR 537(Guj).

19. Is registration mandatory for a partnership firm?

Even though registration is not mandatory for partnership firms in India, the partners may get their firm registered under the partnership law, as may be applicable to their relevant State.

20. "Business debts of a firm can always be recovered from the private property of the partners"-Do you agree?

In a firm of partnership, the liability of the partners is 'unlimited'. In other words, each partner of a firm is liable for the debts of the firm incurred in the course of the business of the firm. These business debts of the firm can be recovered from the private property of the partners. This is possible if and when the joint estate of the firm is insufficient to meet the business debts of the firm.

21. Can a HUF become a partner in a firm?

Under section 2(31) of the Income-tax Act, 1961, a Hindu undivided family or HUF is a 'person' for the purpose of the Income-tax Act. However, a HUF is not a juristic person for all purposes (viz., for the purposes of other laws) including the partnership law. Accordingly, under the Indian Partnership Act, 1932, a HUF is not a juristic person and it cannot enter into a valid partnership with any other person- Agarwal & Co. v. CIT [1970] 77 ITR 10 (SC).

Though the HUF cannot as such enter into a contract of partnership with another person or persons, the karta of the HUF, may enter into partnership with outsiders on behalf and for the benefit of his joint family. If he does so the other members of the HUF do not, vis-a-vis the outsiders, become partners in the firm. They cannot interfere in the management of the firm or claim any account of the partnership business or exercise any of the rights of a partner. So far as the outsiders are concerned, it is the karta who alone is, and is in law, recognised as the partner- CIT v. Seth Govindram Sugar Mills [1965] 57 ITR 510 (SC).

The Supreme Court in the case of Rashik Lal & Co. v. CIT [1998] 229 ITR 458 (SC) clarifies the position of a Hindu undivided family in partnerships:

- The HUF (directly or indirectly) cannot become of a partner of a firm because the firm is an association of individuals;
- All the provisions regarding mutual rights and liabilities are only applicable to the partners who are members of the firm;
- The only right of HUF is possibly to call upon the nominee partner to render accounts for the profits that he has made from the partnership business;
- The nominee partner of HUF does not act in a 'representative capacity' in the partnership. The nominee simply functions in his 'personal capacity' like any other partner;
- The HUF or its representative does not have any special status in the Indian Partnership Act, 1932.
- The HUF is not and cannot be a partner in a partnership firm as it is not being a 'person' who can enter into an agreement of partnership;

- If the Karta enters into partnership, upon the death of the Karta, the partnership will stand dissolved. In the absence of a contract to the contrary, another member of the HUF cannot step into the shoes of the Karta.

22. Can a firm of partnership become a partner in another firm?

Under section 4 of the Indian Partnership Act, 1932, one of the basic elements required for a partnership is that there must be an agreement entered into by two or more persons. In this context, the English as well as the Indian law clearly provide that a firm is not a legal entity. Further, the word 'persons', as contemplated in section 4 of the Indian Partnership Act, 1932 means only natural or artificial persons, i.e. legal persons.

Legally speaking, a firm of partnership is not a legal person and therefore a firm cannot become a partner of another firm. A firm is not a person in the eyes of law and as such, it is not entitled to enter into partnership with any firm or individuals or a Hindu undivided family – Dulichand Laxmi Narain vs. CIT [1956] 29 ITR 535 (SC).

Though a firm as such cannot become a partner of another firm, one of the partners of the firm can enter into partnership with other persons. In other words, any partner of a firm may be a partner in another firm of partnership in his 'individual capacity' and he may in turn share the profits derived by him from the said firm with his other co-partners of the parent firm. Such an agreement shall result in constitution of a sub-partnership. Strictly speaking, there is nothing in law to prevent the constituent members of a firm from entering into partnership with another or others-CIT vs. Shantilal Vrajlal (1957) 31 ITR 903 (Bom.); Chhotalal Devchand v CIT [1958] 34 ITR 351 (Bom.).

In such an agreement of sub-partnership, so far as the other firm is concerned, the person representing the parent firm alone is a partner. In other words, in case where a partner of firm becomes a partner in another firm and he agrees to share his profits and losses in the other firm with other partners of his parent firm, neither the parent firm nor its other partners become partner in the other firm – they are strangers to the other firm- CIT v. Chander Bhan Harbhajan Lal [1966] 60 ITR 188 (SC)

23. Can a company become a partner in an Indian firm?

Legally speaking, a company or corporation can become a partner in a partnership firm. This is because a company or corporation is a legal person in the eyes of law. [Under section 11 of the Indian Contract Act, 1872, read with sections 2(e) and 3 of the Indian Partnership Act, 1932 only such persons as are competent to contract, are of sound mind, major and are not disqualified from contracting by any law in force would be entitled to become partner].

Further, there is no general principle of law, which prevents a corporation or company, from being a partner with another corporation or with ordinary individuals, except the principle that a corporation cannot lawfully employ its funds for purposes not authorised by its constitution. Based on this principle, it may be considered as prima facie, ultra vires for an incorporated company to enter into partnership with other persons. –[Lindley on Partnership, 10th Ed.]

This apart, such a partnership (comprising a corporation or company) would however require very special articles since many of the provisions of the Indian Partnership Act, 1932 would be difficult to apply for these artificial entities.

24. Can a partnership firm become a shareholder in a company?

Neither the Indian Partnership Act, 1932 nor the Companies Act, 1956 has answered this question. However, as regards the question whether a partnership firm can be member or shareholder of a company, the DCA Circular [Circular No. 4/72, dated 9-3-1972] is relevant. As per the clarification issued by the Department of Company Affairs, a firm of partnership, (not being a legal person) cannot be registered as a member of a company.

However, as an exception, a firm of partnership can become a member of a charitable company. In other words, in case where the company is licensed under section 25 of the Companies Act, 1956, a firm of partnership can become a member of such a company.

Further, companies which have firms registered as shareholders should be advised to take steps to rectify the position within a specified time. In case the irregularity persists, despite a warning, necessary action can be taken under section 150(2) of the Act [Circular No. 4/72, dated 9-3-1972]. In other words, the department may launch prosecution against the defaulting company under section 150 of the Act for not keeping the register of members in accordance with the law.

25. How to determine the residential status of a partnership firm? Discuss the residential status vis-à-vis taxability.

Under section 6(2) of the Income-tax Act, 1961, a partnership firm is generally treated as resident in India. A firm will however be non-resident in India if the control and management of the partnership firm is situated wholly outside India during that year. Based on the residential status of the partnership firm and the place where the income is earned, the income that is included in the total income of the firm shall be as under:

Sl. No.	Residential status	Taxable income
1.	Resident	All income whether earned in India or outside India
2.	Non-resident	All income earned in India.

A resident firm is thus liable to pay tax in India on its 'total world income' and such a situation may lead to double taxation of the same income in India and again in the country where it is earned. In order to avoid such a situation, the Government of India has however entered into agreements for avoidance of double taxation with different countries.

A partnership firm will be non- resident in India if the control and management of the firm is situated wholly outside India during that year. However, the burden of proving that the firm-taxpayer is not resident in India is on the assessee. In case the assessee-firm has not proved that its case falls under exception, it cannot be treated as non-resident-V. VR.N.M. Subbayya Chettiar v. CIT [1951] 19 ITR 168 (SC).

While deciding the residential status, the words "wholly outside India" suggests that control and management may be at more than one place. If it is proved that the control and management is from India simultaneously with some other place abroad, it would be wholly irrelevant to enquire the extent of control in either place. In other words, any measure of control and management within India will make the assessee resident-B.R. Naik v. CIT, (1946) 14 ITR 334 (Bom). Anyway, a partial control and management in India is sufficient to make the firm resident in India-ITO v. Raza Textiles Ltd., (1977) 106 ITR 408 (All).

26. Can a firm of partnership be treated as a 'citizen' in India for limited purposes?

Article 5 of the Constitution of India has defined the term "citizen". Accordingly, in order to be a citizen of India, a person must have domicile in the territory of India and must satisfy any of the following three conditions:

- he must have been born in India; or
- either of his parents must have been born in India; or
- he must have been ordinarily resident in India for not less than five years before 26-1-1950.

For this purpose, the term 'domicile' shall mean the place where a person's habitation is fixed without any present intention of moving there from-Central Bank of India v. Ram Narain, AIR (1955) SC 36. In other words, mere residence in the territory of India is not enough to have domicile-Abdus Samad v. State of W.B. (1972) SCD 1134; AIR (1973) SC 505.

A partnership firm cannot be treated as a 'citizen' because it has not been included in the definition of 'person' under the Citizenship Act, 1955. In fact, a firm of partnership is neither a legal person nor a citizen so as to claim the fundamental rights granted to citizens by the Constitution of India.

27. Can a person (who is not a citizen of India) become a partner in a partnership in India?

The Indian Partnership Act, 1932 does not prohibit any non-citizen from joining an Indian Partnership firm as partner. In other words, any person who is not a citizen of India may become a partner of a firm of partnership in India, subject to necessary clearances and permissions from appropriate authorities, as may be applicable, in this regard. Further, direct investment in firms in India by NRIs is now permitted. NRIs and OCBs are permitted to make direct investment in partnership / proprietorship concerns in India. Wherever the investments are allowed with repatriation benefits, the funds for the purpose should be received by inward remittances from abroad or from the investor's NRE / FCNR Accounts. However, in respect of investment on non-repatriation basis, funds in NRO Accounts could also be used.

28. When can a partnership be called an 'illegal association'? What are the legal consequences thereunder?

Any association or partnership or company contravening section 11 of the Companies Act, 1956 is called an 'illegal association'. An illegal association under this section is however not an association for illegal purpose. Section

11 only makes the association illegal. In other words, the company law does not recognise the right of more than 10 or 20 (as the case may be) unregistered persons to carry on business as an association in India. But that does not imply that the business of the association is unlawful.

The following are the notable legal consequences of an illegal association under section 11 of the Companies Act, 1956:

- An illegal association cannot sue on a contract made by it. There can be no cause of action on the basis of an illegal association- Kumaraswami Chettiar S.N.T. v. M. S.M. Chinnathambi Chettiar, (1950) 20 Com Cases 286: AIR [1951] Mad 291.
- Members have no remedy against each other for contribution or apportionment in respect of partnership dealings and transactions.
- An illegal association cannot sue to recover any debt or other property- Jennings v. Hammond, (1982) 9 QBD 225.
- Persons making other contracts with an illegal company or association may not be able to enforce them against it.
- Since the rights and liabilities of persons in relation to illegal associations in India have not been clearly settled till date each case will have to be decided on principles of equity.

29. Is the Assessing Officer entitled to enquire into the genuineness of a firm of partnership?

Upto assessment year 1992-93, under the old scheme of taxation of firms, where an application for registration was made under the Act, the Assessing Officer was empowered to enquire into the genuineness of the firm of partnership. The Assessing Officer was also entitled to enquire into the constitution of the firm, as specified in the instrument of partnership. If, on such enquiry, he was not satisfied that a genuine firm with the constitution as specified in the instrument of partnership was in existence during the relevant previous year, he had to reject the application for registration. This was mainly because the registration conferred a substantial benefit upon the partnership firm and its partners and there was no reason why such a benefit should be extended to persons who had entered into a partnership agreement prohibited by law- Bihari Lal Jaiswal v. CIT (1996) 217 ITR 746 (SC).

However, with effect from the assessment year 1993-94, no distinction is made between a 'registered firm' and an 'unregistered firm' for the purposes of taxation. Further, under section 167A of the Income-tax Act, 1961, the income of all firms (irrespective of registration) is chargeable at the flat rate, as prescribed in the relevant Finance Act. Again, the Assessing Officer is not at all required to enquire into the genuineness of the firm of partnership for the purposes of taxation.

30. Does the partnership law in India provide for registration of firms?

Though the English Law of partnership provides for compulsory registration of firms, the Indian law has not made registration of firms mandatory. However, Chapter VII of the Indian Partnership Act, 1932 provides for registration of partnership firms in India.

Accordingly, under section 57 of the Act, the concerned State Government may appoint Registrars of Firms for the purposes of registration of partnership firms under the Partnership Act for different areas.

The application for registration of partnership firm is to be given to the District Registrars of Firms, having relevant jurisdiction. In this context, it is notable that there is no time limit for making such an application for registration of partnership firm in India.

Further, it is also not essential that the firm of partnership should be registered from the very beginning. However, if and when the partners of a firm decide to get their firm registered under section 58 of the Partnership Act, they have to file the statement in the prescribed form.

31. What shall be the legal consequences of any non-registration of a firm in India?

If a partnership firm is not registered, it will not be possible to sue [in the court of law to claim legal rights] one partner of the firm against another partner or against the firm and vice versa. Further, it will not be possible for the firm to sue third party for enforcement of its rights. [Section 69]

32. Please provide some drafting tips for making a partnership deed under the income tax law in India.

While drafting a partnership deed, the practitioners are advised to keep the following points in mind under income tax view point:

- Under the Income-tax Act, 1961, a firm of partnership shall be assessed as a firm only when the partnership is duly evidenced by an instrument. In other words, there should be a partnership deed in writing for any firm to be treated as a firm under tax laws.

- Under section 184(2) of the Act, a certified copy of the instrument of partnership must accompany the first return of income of the firm.
- The deed of partnership should not be dated beyond the accounting year.
- A minor should not be made a partner in the firm. However, a minor child may be admitted to benefits of partnership.
- While a minor child is admitted to the benefits of a partnership, the other partners of the firm should pay extra attention to ensure that the minor child is not saddled with the loss of the firm.
- Under section 184(1)(ii) of the Act, a basic condition as to the eligibility for assessment as a firm is that individual shares of partners of the firm must be specified in the instrument of partnership-CIT v. S. U. Services, (1996) 221 ITR 107 (MP). Accordingly, the individual shares of the partners both in profits and losses should be specified in the partnership deed. As otherwise, the firm will be treated as Association of Persons (AOP).
- In case interest is proposed to be paid to partners on their capital or current account, it should be stipulated in the partnership deed. If not, such interest will not be deductible in the hands of the firm.
- Under section 40(b), any payment of salary, bonus, commission or remuneration by a firm to any partner who is not a working partner is not allowable as deduction in the hands of the firm. Therefore, the partnership deed should not stipulate payment of salary or remuneration to the non-working partners of the firm. As per Explanation 4 to section 40(b), working partner for this purpose means any individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.
- In case salary or remuneration is to be given to the working partners of the firm, it should also be stipulated in the partnership deed. If not, such payment of salary or remuneration to partners will not be deductible in the hands of the firm.
- Under section 40(b)(ii), any payment of salary, bonus, commission or remuneration by whatever name called to a working partner of a partnership firm is allowed as deduction only in the following cases: (a) if and when the payment is authorised by the partnership deed; or

(b) if the payment is made in accordance with the terms of the partnership deed.

- For the assessment years subsequent to the assessment year 1996-97, no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration – Circular No. 739, dated March 25, 1996.
- In cases where neither the amount has been quantified nor even the limit of total remuneration has been specified but the same has been left to be determined by the partners at the end of the accounting period, in such cases, the payment of remuneration to partners cannot be allowed as deduction in the computation of firm's income- Circular No. 739, dated March 25, 1996.
- Section 40(b) of the Income-tax Act, 1961, as amended by Finance Act, 2002 provides for reducing the permissible rate of interest from 18% to 12% with effect from 1.6.2002. In this context, it is not essential to amend the partnership deed to reduce the rate of interest to 12%. As a tax planning exercise, we can simply add back the differential interest in computation of firm's income. By doing so, we can reduce the amount to be taxed in the hands of the partners to the same extent.
- Under section 184(4), if any change in the constitution of the firm assessed as such or in the share of the partners had taken place in any previous year, the firm of partnership must furnish a certified copy of the revised instrument of partnership along with the return of the income for the assessment year relevant to such previous year.
- It is true that any defect in drafting the partnership deed may have an adverse impact on the taxation of the firm. If the deed contains anything in violation of sections 184 or 40(b) of the Act, it will result in the firm being treated as an AOP and the tax liability of the firm may go up. This is because any payment of interest or salary to partners will not be deductible in the hands of the firm while computation of income of the firm.

33. What are the important clauses or matters that can be included in a partnership deed?

While drafting a partnership deed, the draftsman or practitioner should take special care of the following important matters/clauses:

- Name and style of the partnership firm
- Nature of firm's business
- Place of firm's business
- Commencement, duration and determination of partnership business [In case a fixed period is mentioned in the deed, then after the expiry of the specified period, a fresh deed of partnership must be executed. In order to avoid this, it is better to add the term " …….. and thereafter at WILL"]
- Partners' shares in the profits and losses of the firm.
- Names of working partners with their rights and duties.
- Nature and scope of the duties and rights of the partners.
- Restrictions on the rights and powers of the partners.
- Payment of remuneration to working partners [the provision may not be made at a fixed rate since its revision shall require rectification deed entailing expenses on court fee stamps].
- Payment of interest to partners, [subject to maximum of 12% simple interest per annum], on capital contributed or loans advanced or deposits made by the partners.
- Dissolution of the partnership firm.
- Mode of settling disputes among the partners [by arbitration or by any other mode].
- Consent of the guardian if minor is admitted to the benefits of the firm.
- Capital to be subscribed by the partners.
- Drawings by the partners from the capital or asset of the partnership firm.
- Details of partnership funds, banking account and mode of its operation.
- Keeping account and manner of maintaining the books of account.
- Mode and manner of taking annual general accounts.
- Provision for reserve fund.
- Mode, manner and ratio of distribution of profits.

- Management of partnership business. [It is notable that even if the entire control and management vests in one partner, the partnership may be genuine- Vummitti Subramaniam Chetty vs. CIT (1974) 94 ITR 239 (Mad).]
- Minimum guaranteed profits to any one member, [if so agreed] to be specified.
- Option to purchase further share of the partnership business by any one member, if so agreed.
- Increase of capital or additional capital advanced by any one partner.
- Outgoings and expenses of partnership.
- Valuation of goodwill.
- Retirement of any partner
- Death of any partner
- Bankruptcy of any partner
- Expulsion of partners
- Mutual release in respect of previous deed of partnership.
- Option of the heirs of the deceased partner to be sleeping partners.
- Annuity to the widow of deceased partner.
- Power of surviving or continuing partners or partners to purchase partnership business on retirement, death or bankruptcy of any partner.
- Registration of the deed of partnership.
- Custody of the original deed of partnership.
- Provision that in all other matters, not provided for by the deed, the provisions of the Indian Partnership Act shall apply.

34. Who can sign a partnership deed in India?

Under the partnership law in India, the deed of partnership must be signed personally by each partner-CIT vs. Jagannath Pyarelal, (1985) 156 ITR 220 (SC). However, there is no infirmity in two persons signing the deed of partnership as individuals and also as representing their Hindu undivided families-CIT vs. Nataraja Nadar (2000) 243 ITR 844 (Mad).

Similarly, in case where a partnership deed is signed twice by one of partners, once in his 'individual capacity' and then in his 'representative capacity' as executor of will of a deceased partner, it cannot be said that partnership is not genuine-CIT vs. Kondath Motors, (1997) 224 ITR 663 (SC).

35. Who can sign the partnership deed in case a minor is admitted to benefits of the partnership?

In case a minor is admitted to benefits of a partnership, it is necessary to show that the guardian had consented to the admission of the minor to the benefits of the partnership. However, the guardian of the minor need not sign the deed of partnership. In such a case, the fact that the deed had not been signed by such guardian would not invalidate the deed- CIT vs. Shriram Industrial Distribution, (1989) 176 ITR 180 (Cal); CIT vs. Associate Industrial Distributors (1982) 138 ITR 304 (Cal): In such cases, the consent of the guardian can be established either by 'direct evidence' [letter or affidavit of the guardian] or by 'other evidence', viz., the entries in the account books or such other evidence as may be available with the assessee- Safari Wines vs. CIT, (1988) 169 ITR 695 (AP).

36. Can the partners of a firm amend their deed of partnership as they like? How to effectuate such an amendment? Please advise.

Legally speaking, the contracting partners, through a 'rectification deed', can amend any deed of partnership. In other words, the terms of a partnership deed can be altered only by an instrument in writing and not orally- Raj Stores vs. CIT (1988) 170 ITR 119 (All).

In case of amendment of any deed of partnership, the deed of rectification may be appended to the original deed of partnership after all the original partners to the deed have put their signatures and in case of minor admitted to the benefits of partnership, after the guardian has also consented to the amendment.

A deed of rectification after the close of the previous year cannot alter the position of a partnership in the past- N.T. Patel & Co vs. CIT (1961) 42 ITR 224(SC). Therefore, the deed of rectification should be executed in the relevant previous year so as to effectuate the original partnership-Rajendra Trading Co vs. CIT (1976) 104 ITR 39 (Bom.).

However, if and when a partnership did not exist prior to the execution of a valid partnership deed, the subsequent rectification deed cannot bring to life the instrument by merely stating that the partnership should be deemed to have come into existence at the earlier date. Such a subsequent partnership deed cannot create any partnership as from an earlier date. This is because no rectification deed can alter the past-Singh Bros & Co. vs. CIT. (1982) 137 ITR 63 (Gau): Ayrshire Pullman Motor Service vs. IRC. (1929) 14 TC 754:

In case where a partnership firm is re-constituted but the date of retirement of a partner is erroneously mentioned in the new partnership deed, such mistake can be rectified by a deed of rectification even beyond the accounting year. Accordingly, such a deed of rectification cannot be said to be void if the mistake was corrected and the correction was accepted by the authorities-Tue Steel Products v. CIT (1996) 220 ITR 58 (Gau).

37. Is stamp duty payable on a deed of partnership in India?

Under the Indian Stamp Act, 1899, the stamp duty payable on a deed of partnership is a fixed one. Under Article 46 of the Act, the stamp duty on a deed of partnership is divided into two parts, namely if the capital of the firm is not more than Rs.1000/- the duty will be as on a bond otherwise it is a fixed amount.

The stamp duty is also payable on a deed of retirement or a deed of dissolution under the same Article. Accordingly, the deed of dissolution would also attract a fixed duty and not according to the value of the property of the partnership. [However, in the States of Maharashtra, and Gujarat if the deed of retirement or deed of dissolution effects any transfer of an immoveable property, it will attract stamp duty as on a conveyance on the market value of the property].

Though the same division is adopted in various States in India, the amount is different in different States. In this context, the readers may have to refer the rates relevant for their respective States.

38. Is registration compulsory for a partnership deed if an immovable property is brought into the firm? Will your answer be different in case of any division of movable or immovable properties on dissolution of a firm?

Under the Registration Act, 1908, a partnership deed is not required to be registered even if an immovable property is brought into the firm. Similarly, a deed of retirement or a deed of dissolution shall not require any registration under the Registration Act.

In this context, any division of movable or immovable properties on dissolution of a firm shall also not require any registration under this

Registration Act. This is based on the fact that such transactions do not amount to a transfer for the purpose of the Registration Act.

39. Can any individual become a partner of a firm in India?

Legally speaking, an individual, being a natural person, is eligible to become a partner in a firm of partnership. Any adult individual, who is of sound mind and competent to contract, can be a partner in a firm. Under section 11 of the Indian Contract Act, 1872, an individual is competent to contract provided he is a major according to the law, which he is subject to. Further, he should be of sound mind and he should not be disqualified from contracting by any law by which he is governed.

Further, one and the same individual can be a partner in his 'individual capacity' as well as in a 'representative capacity' (viz., as karta of a HUF) in a partnership. This is however possible only in case where there are more than two partners-CIT. vs. Raghavji Anandji and Co. (1975) 100 ITR. 246 (Bom.)

In case where the partnership is between the same individual (viz., in his individual capacity on the one hand and in a representative capacity as karta of a HUF on the other hand) and there are no other partners, such a partnership shall be invalid. This is because it is not permissible under law for a person to enter into an agreement with himself. Further, the plurality of persons is very essential to constitute the relation of partners –Hoosen Kasam Dada vs. CIT (1937) 5 ITR 182.

40. Can a minor become a partner in a firm of partnership in India?

Under the Indian Contract Act, 1872, in terms of section 11, a minor, who is not a person competent to contract in the eye of law as such, would not be entitled to become partner.

A minor can however be admitted to share the profits of a partnership firm. In case where a minor is admitted to the benefits of a partnership, if the minor signs himself the deed, it will become invalid. On the other hand, if the guardian, on behalf of the minor, signs the deed, it will not become invalid-Uttam Singh Khorana & Sons vs. Income-tax Department, (1956) 30 ITR 821 (J& K).

Under section 30 of the Indian Partnership Act, 1932, a minor cannot become a partner, though with the consent of the adult partners, he may be admitted to the benefits of the partnership-A.K.A.C.T.V.C.T. Alagappa Chettiar vs. CIT (1965) 55 ITR 605 (Mad.).

In case where a minor is admitted to the benefits of partnership, the following propositions shall be valid:

- The minors should not be made liable for the losses in the firm.
- The guardian of the minors should sign the deed.
- The minors should not be treated as full partners.
- The partnership deed, if otherwise valid, is not rendered invalid merely because the minors also have signed the deed.
- The deed should specify the share of the partners in the profits and losses in the firm.

41. Can a trust become a partner in a firm of partnership in India? If yes, when?

A trust can become a partner in a firm of partnership through its trustees. It can also enter into valid partnership with an individual-CIT v. Juggilal Kamlapat, (1967) 63 ITR 292 (SC). This is because the trustees may in law enter into a valid partnership on behalf of their trusts. For this purpose, the trust must be valid one and the partnership should not precede the creation of the trust-S. P. Raju v. CIT (1961) 43 ITR 467 (AP); J.K. Hosiery Factory v. CIT (1971) 81 ITR 557(All).

In case where the trustees enter into a partnership on behalf of the trust, their share income could not be included in the computation of their income-Addl. CIT vs. Ram Krishna Gupta (1979) 117 ITR 218 (All.)

42. Can a husband and a wife enter into a valid partnership in India?

An individual, being a natural person, is eligible to become a partner in a firm of partnership. In this context, any adult individual, who is of sound mind and competent to contract, can be a partner in a firm. Such adult individuals may be husband and wife. There is no law, which prohibits a husband and wife to enter into a valid partnership. In this context, a partnership formed by husband and wife and the wife's brother would also be valid-Krishna Flour Mills v. CIT (1962) 44 ITR 501 (SC).

43. Can a lunatic or idiot form a partnership in India? If yes, when?

Under section 11 of the Indian Contract Act, 1872, a partnership is the result of an agreement, whether express or implied, entered into between two or more persons, who are competent to contract. Accordingly, every person, who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject, is competent to contract. In this context, a lunatic or idiot cannot become a partner, as he is also not competent to contract. For this purpose, section 3(5) of the Indian Lunacy Act, 1912 says, "lunatic" means "an idiot or person of unsound mind."

Under section 12 of the Contract Act, a person is said to be of 'sound mind' for the purposes of making a contract if, at the time when he makes it, he is capable of understanding it and forming a rational judgment as to its effect upon his interest. Accordingly, in case of a person, who is usually of unsound mind, but occasionally of sound mind, he may make a valid contract if and when he is of sound mind.

44. Can same persons become partners in different firms?

Legally speaking, a partnership firm has no existence independently of its partners. In this context, if there are two partnership firms, consisting of exactly the same partners, the real position in law is that there is only one firm of partnership in existence.

Such partnership firms, having common partners, may carry on separate businesses or they may carry on those businesses in different names. In all such cases, there is only one firm of partnership in law- Vissonji Sons & Co. vs. CIT (1946) 14 ITR 272 (Bom.).

45. Discuss briefly the rights of female members of a HUF to become partners in a firm of partnership in India.

Legally speaking, female members of a Hindu joint family are also competent to become partners in a firm of partnership. Though a female cannot be karta of a HUF, there is no bar for her to represent the joint Hindu family as its agent. This is mainly because there is a clear difference between "acting as Karta of a HUF" and "acting as agent or representative of a HUF". Accordingly, a female member of HUF can validly represent her HUF in a firm of partnership and the firm so represented would also be legally valid. In fact, there is no law, which prohibits a female from acting in the capacity of a member of the family and entering into a contract of partnership with the permission of the family, for the family -CIT v. Banaik Industries (1979) 119 ITR 282 (Pat).

However, a Hindu widow is not competent to become the manager of a HUF and to enter into an agreement of partnership in her representative capacity- CIT v. Seth Govindram Sugar Mills (1965) 57 ITR 510 (SC). With the coming into force of the Hindu Succession Act, a Hindu widow can now enter into a valid partnership with her adopted son-CIT v. Rupchand Seshmull (1968) 69 ITR 868 (Mys.).

46. Can the practicing advocates and professionals participate in the business of a partnership firm?

In case an advocate in whole time practice participates in the business of a partnership firm, he would be liable for disciplinary action under the Indian Bar Councils Act, 1926. In this context, a partnership deed would not be rendered illegal simply because an advocate is a partner in the firm of partnership.

Under the Indian Bar Councils Act, 1926, an advocate cannot participate in the business of a partnership firm. There is however no bar for an advocate to be a sleeping partner in such business-Malwa Knitting Works vs. CIT (1977) 107 ITR 379 (MP). Similar rule shall be applicable for all professionals (in whole time practice) including chartered accountants in India.

47. Discuss the validity of any partnership, which purports to exist with a wakf as a partner.

Under the Mohammedan law, if and when a wakf is created all rights of the property do pass out of the wakf and vest in the Almighty, which is a non-personal being in nature. In other words, the capital of the wakf simply vests in the Almighty under the Mohammedan law. The mutawalli of a wakf is therefore merely a manager or superintendent, having no vested right in the property of the wakf.

In this circumstance, the Almighty, which is a non-personal being, is not in a position to enter into valid relationship with material persons for the sharing of profits of a business. In other words, any partnership, which purports to exist with a wakf as a partner, can be no partnership in law-Hoosen Kasam Dada vs. CIT (1937) 5 ITR. 182 (Cal).

48. Can two companies join together to form a partnership firm in India?

A company, having a separate legal entity with distinct existence, can become a partner in a partnership firm- CIT v. Gemini Productions (1977) 110 ITR 847 (Mad). Strictly speaking, two or more companies can also form a partnership. In other words, several companies may join together to form a valid partnership-Steel Bros. & Co. v. CIT (1958) 33 ITR 1 (SC).

A corporation or company should however follow the basic principle of corporate law that a corporation cannot lawfully employ its funds for purposes not authorised by its constitution. In this context, any corporation or company, if so authorised by its constitution, can enter into partnership with an individual person or with another corporation, whatever may be its nationality and wherever it may be situated. Such a partnership would however require very special articles since many of the provisions of the Indian Partnership Act, 1932 would be difficult to apply in case of companies.

49. Can a partner of a firm be a benamidar for another?

An agreement of partnership is not concerned with the obligation of the partners to others in respect of their shares of profit in the partnership. The partnership deed merely regulates the rights and liabilities of the partners. In this context, a partner may be a benamidar for another.

In case a person, who is a benamidar, acts as a partner, he shall occupy a dual position. Qua the partnership, he functions in his personal capacity; qua the third parties, he however functions in his representative capacity. In such cases, the third parties, whom one of the partners (as benamidar-partner) represents, cannot enforce their rights against the other partners of the firm. Similarly, the other partners of the firm cannot enforce their rights against the third parties, who are represented by the benamidar-partner. Further, the rights of the third parties are restricted to a share in the profits of their partner-representative in accordance with law or in accordance with the terms of the agreement, as the case may be-CIT vs. Bhagyalakshmi& Co., (1965) 55 ITR 660 (SC).

Further, as in the case of a trustee, a benamidar can also enter into a valid partnership with others. A benamidar is however a mere trustee of the real owner. In other words, the benamidar has no beneficial interest in the property or the business of the real owner.

50. What are the legal rights of a minor partner in a firm?

Under section 30 of the Indian Partnership Act, 1932, the following are the notable rights of a minor partner in a firm:

- The minor partner is entitled to his agreed share of the profits and of the firm-u/s 30(2).
- The minor partner is entitled to have access to the accounts of the firm-u/s 30(2).
- The minor partner is also entitled to inspect and copy the accounts of the firm-u/s 30(2).

- The minor partner can sue the other partners for accounts or for payment of his share but only when severing his connection with the firm and not otherwise-u/s 30(4).
- In case the minor partner severs his connection with the firm, the amount of his share shall be determined as upon dissolution of firm, as prescribed under section 48 of the Act.
- The minor partner is also entitled to get admitted as a full-fledged partner on his attaining majority. On attaining majority the minor partner may, within 6 months, elect to become a partner or not to become a partner-u/s 30(5).
- If the minor partner elects to become a partner, then he is entitled to the share to which he was entitled as a minor.
- On the other hand, if he does not elect to become a partner, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

51. What are the notable liabilities of a minor partner of a partnership firm?

As regards the liabilities of a minor partner of a partnership firm, the following points are notable:

- The minor's share in the property and the profits of the firm is normally liable for the acts of the firm-u/s 30(3).
- The minor partner is however not personally liable for the acts of the firm -u/s 30(3).
- The minor partner becomes fully liable as any other partner, on his attaining majority, if he fails to give public notice of his intention to sever his connection from the firm. For this purpose, the minor partner may give public notice (within 6 months of his attaining majority or on his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later) that he has elected not to become partner and such notice shall determine in the firm u/s 30(5).
- In case the minor partner fails to give such a notice, he shall become a partner in the firm on the expiry of the said six months.

52. What will be the legal position if a minor becomes a partner of his own willingness?

In case the minor becomes a partner of his own willingness or by his failure to give the public notice within specified time, the legal position shall be as follows:

- The rights and liabilities of the minor partner as a minor will continue up to the date on which he becomes a partner.
- The minor partner becomes personally liable to third parties (very similar to those of a full pledged partner) for all acts of the firm done since he was admitted to the benefits of partnership.
- The share of the minor partner in the property and the profits of the firm shall remain the same to which he was entitled as a minor, unless altered by the agreement- u/s 30(7).

53. What will be the legal consequences if a minor decides to sever his connections with a partnership firm?

In case where the minor partner decides to sever his connections with the partnership firm, his rights and liabilities (under section 30) will be as follows:

- The rights and liabilities of the minor partner continue to be those of a minor up to the date of giving public notice.
- The share of the minor partner shall not be liable for any acts of the firm done after the date of the notice.
- The minor partner shall be entitled to sue the partners for his share of the property and profits of the firm- u/s 30(8).
- The minor partner shall have to give notice to the Registrar of Firms that he has or has not become a partner.

54. What are the precautions to be taken while admitting a minor into a partnership firm?

First of all, as a pre-cautionary measure, minor children should not be admitted to the benefits of partnership at all. In case where it is not possible to do so, special attention should be paid in respect of their shares in the firm. The shares of minor partners should be restricted to profits only. In other words, the minors should not be saddled with the burden of losses of the firm.

Further, in case where minors are admitted to the benefits of partnership, the sharing of losses must be provided amongst the major partners. If the major partners have agreed to share the losses, if any, without the actual sharing ratio, they would normally share the losses in the same proportion as they share the profits in respect of which a specific provision has been made, unless otherwise provided. In all cases, provision for sharing of losses should be clearly made in the deed of partnership. This will avoid any legal complications in the event of the minors attaining majority.

55. Do you find any difference between 'registration of a partnership deed' and 'registration of a firm'?

Yes. There is a difference between 'registration of a partnership deed' and 'registration of a firm'. A partnership deed can be written on stamp paper and it can be registered with the office of the Sub-Registrar like any other document. In such a case, only the partnership deed is registered. In other words, such a registration of deed does not mean registration of firm. On the other hand, firms are said to be registered only when registration is made by following the procedure, as prescribed under section 58 of the Indian Partnership Act, 1932.

56. How to register a partnership firm in India?

Chapter VII of the Indian Partnership Act, 1932 provides for registration of partnership firms in India. However, under the Indian law, registration of firms is not compulsory. Further, it is not essential that the firm of partnership should be registered from the very beginning. If and when the partners of the firm decide to get their firm registered under section 58 of the Act, they have to file the statement in the prescribed form. Thus, the registration of a firm may be effected at any time by sending a statement in the prescribed form (as may be prescribed by the relevant State Partnership Rules) to the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated.

For this purpose, the statement shall be signed by all the partners or by their agents specially authorised in this behalf. The prescribed form must be accompanied by the prescribed fee and may be sent either by post or delivered to the Registrar of Firms. The prescribed form must state the following:

- the firm name,
- the place of principal place of business of the firm,
- the names of any other places where the firm carries on business,
- the date when each partner joined the firm,

- the names in full and permanent addresses of the partners, and
- the duration of the firm.

57. What are the documents to be enclosed along with an application for registration of a firm?

The application for registration of a firm should be accompanied with the following documents for registration:

- A certified true copy of the partnership deed. [The partnership deed should be drawn in writing. The deed should incorporate the necessary clauses of terms and conditions under which the business of partnership is to be carried on by the partners]
- Necessary court fee stamp
- Necessary registration charges
- Other documents, if any. [as may be prescribed under the relevant State rules)

58. Can the partners of a firm trade in any name and style as they like?

As a general rule, the partners of a firm may trade in any name and style they choose to adopt. Their choice is however subject to the provisions of the Emblems & Names (Prevention of Improper Use) Act, 1950.

This apart, section 58(3) of the Indian Partnership Act, 1932 provides for certain restrictions. Accordingly, a firm name shall not contain any of the following words, namely, "Crown", "Emperor", "Empress", "Empire", "Imperial", "King", "Queen", "Royal", 'or words expressing or implying the sanction, approval or patronage of Governor, except when the State Government signifies its consent to the use of such words as part of the firm name by order in writing.

59. When shall the process of registration (of a firm) be deemed complete?

When the Registrar of Firms is satisfied that section 58 of the Indian Partnership Act, 1932 has been duly complied with, he shall record an entry of the statement in a register called the Register of Firms, and shall file the statement. The Registrar shall then issue a certificate of registration.

Interestingly, the registration of a firm of partnership under the Act shall be deemed to be complete as soon as an application in the prescribed form with the prescribed fee and necessary details concerning the particulars of the partnership is delivered to the Registrar of Firms for registration. In other words, the recording of an entry in the register of firms is a routine duty of the Registrar of Firms.

60. A partnership firm (registered with Registrar of Firms) wants to make an alteration in its name. What are the formalities involved therefor?

If and when a firm of partnership is registered with the Registrar of Firms, all subsequent alterations such as alterations in the name of the firm, place of business, constitution of firm, etc., which may occur during the continuance of the firm should also be registered with the Registrar of Firms.

Section 60 of the Indian Partnership Act, 1932 deals with recording of alterations in firm name and principal place of business. Accordingly, if and when an alteration is made in the firm name or in the location of the principal place of business of a registered firm, a statement may be sent to the Registrar of Firms accompanied by the prescribed fee, specifying the alteration and signed and verified in the manner required under section 58.

If the Registrar is satisfied that the provisions of sub-section (1) have been duly complied with, he shall amend the entry relating to the firm in the Register of Firms in accordance with the statement, and shall file it along with the statement relating to the firm filed under section 59.

61. How to close or open branches of a partnership firm? Discuss in brief all the registration formalities related thereto.

Under section 61 of the Indian Partnership Act, 1932, when a registered firm discontinued business at any place or begins to carry on business at any place, such place not being its principal place of business, any partner or agent of the firm may send intimation thereof to the Registrar of Firms.

On receipt of such intimation, the Registrar shall make a note of such intimation in the entry relating to the firm in the Register of Firms, and shall file the intimation along with the statement relating to the firm filed under section 59.

62. How to deal with change in name and address of a partner?

Under section 62 of the Indian Partnership Act, 1932, if and when any partner in a registered firm alters his name or permanent address, an intimation of the alteration may be sent by any partner or agent of the firm to the Registrar of Firms.

On receipt of such intimation, the Registrar of Firms shall make a note of such intimation in the entry relating to the firm in the Register of Firms, and shall file the intimation along with the statement relating to the firm filed under section 59.

63. How to register 'changes in constitution' and 'dissolution' of a firm?

Under section 63(1) of the Indian Partnership Act, 1932, when a change occurs in the constitution of a registered firm any incoming, continuing or outgoing partner, and when a registered firm is dissolved any person who was a partner immediately before the dissolution, or the agent of any such partner or person specially authorised in this behalf, may give notice to the Registrar of such change or dissolution, specifying the date thereof;

On receipt of such notice the Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms, and shall file the notice along with the statement relating to the firm filed under section 59.

Notice for dissolution to the Registrar must be given within a reasonable time. Where the delay is reasonable, the application for recording changes in the constitution of the firm cannot be rejected.—Harizan Boot House v. Registrar of Firms AIR (1988) (Guj.) 188.

64. How to register 'withdrawal' of a minor partner?

Under section 63(2) of the Indian Partnership Act, 1932, when a minor who has been admitted to the benefits of partnership in a firm attains majority and elects to become or not to become a partner, and the firm is then a registered firm, he, or his agent specially authorised in this behalf, may give notice to the Registrar that he has or has not become a partner.

On receipt of such notice the Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms, and shall file the notice along with the statement relating to the firm filed under section 59.

65. How to rectify the mistakes in register of firms?

Under section 64 of the Indian Partnership Act, 1932, the Registrar of Firms shall have power at all times to rectify any mistake in order to bring the entry in the Register of Firms relating to any firm into conformity with the documents relating to that firm filed under Chapter VII of the Act.

On application made by all the parties who have signed any document relating to a firm filed under this Chapter, the Registrar may rectify any mistake in such document or in the record or note thereof made in the Register of Firms.

66. Can the register of firms be amended by order of court?

Under section 65 of the Indian Partnership Act, 1932, a court deciding any matter relating to a registered firm may direct that the Registrar of Firms shall make any amendment in the entry in the Register of Firms relating to such firm, which is consequential upon its decision. On receipt of such direction from the court, the Registrar shall amend the entry accordingly.

67. Can anybody inspect the register and filed documents relating to a firm?

Under section 66 of the Indian Partnership Act, 1932, the Register of Firms shall be open to inspection by any person on payment of such fee, as may be prescribed.

All statements, notices and intimations filed under Chapter VII of the Act shall be open to inspection, subject to such conditions and on payment of such fee, as may be prescribed.

Apart from these, the Registrar shall, on application, furnish to any person, on payment of such fee, as may be prescribed, a copy, certified under his hand, of any entry or portion thereof in the Register of Firms-u/s 67.

68. Is registration under income tax law required for firms in India?

Before the enactment of the Finance Act, 1992, which amended section 184 of the Income-tax Act, 1961, so as to remove the difference between registered and unregistered firms, the partnership firms in India were required to apply for registration under the income-tax law. Accordingly, these firms of partnership had to apply to the Assessing Officer, having jurisdiction to assess them. For this purpose, the Income tax Rules, 1962, vide Rules 22 and 24, had prescribed Forms 11, 11A, 12 and 12A. The application, declaration and communication in the prescribed form were required to be made before the end of the previous year relevant to the assessment year in respect of which registration was sought.

However, the Finance Act, 1992 amended section 184 of the Act so as to remove the difference between registered and unregistered firm. These Forms are, therefore, not required to be submitted from the assessment year 1993-94 onwards. With effect from assessment year 1993-94, a certified copy/original of the partnership deed must be filed by the partnership firms along with the return of income.

69. What are the notable disabilities of an 'unregistered firm' in India?

Since the registration of firms is not compulsory under the Indian Partnership Act, 1932, the Act has not prescribed any penalty for non-registration of firms. However, under section 69 of the Act, non-registration of partnership firms may result in a number of disabilities in the hands of firms like the following:

- in case of an unregistered firm, the firm or any other person on its behalf cannot bring an action against the third party for breach of contract entered into by the firm, unless the firm is registered and the persons suing are or have been shown in the register of firms as partners in the firms.
- If an action is brought against the firm by a third party, neither the firm nor the partner can claim any set off, if the suit be valued for more than Rs.100 or pursue other proceedings to enforce the rights arising from any contract.
- Any partner of an unregistered firm (or any other person on his behalf) is precluded from bringing legal action against the firm or any person alleged to be or to have been a partner in the firm. However, such a person may sue for dissolution of the firm or for accounts and realisation of his share in the firm's property where the firm is dissolved.
- Non-registration of a firm of partnership does not affect the right of third parties against the firm or its partners, or the power of an Official Assigns, Receiver of court under Presidency-Towns Insolvency Act, 1909, or the Provincial Insolvency Act, 1920 to realise the property of an insolvent partner.

70. Can an oral partnership be registered in India?

Under the partnership law, if a partnership comes into being by an oral agreement and later on an instrument of partnership is executed, the rights and liabilities of the partners will be governed by that instrument from the very inception of the partnership. In other words, even if partnership comes into existence by oral agreement, it would be entitled to registration, if that agreement is reduced to writing in relevant accounting year-Niadar Mal Jagdish Parshad v. CIT [1959] 37 ITR 349 (Punj.) (FB). Accordingly, partnership firms which were created by word of mouth, but the constitution of which has subsequently been reduced to writing can also be registered-Bharat Prakashan v. CIT [1954] 54 ITR 109 (Guj.).

71. Can an oral partnership be accepted under income tax law?

Under the Income-tax Act, 1961, agreement of partnership must be in writing so that the firm may be assessed as such under income-tax law. However, an agreement of partnership may be by word of mouth initially but it should have been subsequently reduced into writing-R.C. Mitter & Sons v. CIT (1959) 36 ITR 194 (SC). In other words, there is nothing wrong in a partnership deed recording the existence of a partnership, which had already come into existence. However, in such a case, the agreement should record the anterior date on which partnership was constituted-Sulaiman Hassan & Sons v. CIT (1959) 36 ITR 169 (Ker.) In all cases, real intention of the parties to the partnership is one important test under section 6 of the Partnership Act-Addl. CIT v. Rahmat Khan Faizukhan (1985) 152 ITR 676 (Raj)

72. Can a partnership be limited to a 'specific project' or for a 'specific period'?

A partnership may be limited to a 'specific project' or for a 'specific period'. In case where a partnership is formed for a specific period or for a specific project or for a particular venture (e.g. a partnership for producing a particular cinematographic film), such a partnership shall be known as 'particular partnership'.

Section 8 of the Indian Partnership Act, 1932 approves a 'particular adventure' or 'undertaking'. Accordingly, a person may become a partner with another partner in a particular adventure or undertaking. Even though the common law does not recognise the relationship of co-adventurers, the judiciary in India has recognised partnership for an adventure or particular partnership, which is also known, as 'joint venture'.

'Particular partnerships' shall automatically stand dissolved on the expiry of the specified time-period or on the completion of the specific venture or particular project.

73. What is a 'joint venture'? Is it different from partnership?

The term 'joint venture' may mean a group of two or more persons, undertaking to combine their property or labour in context of a particular line of trade or general business for joint profits. In order to constitute a joint venture there must be a community of interest and right to joint control. The relationship of a joint venture thus denotes a special combination of persons, undertaking jointly some specific adventure for profit without any actual partnership.

Though joint adventures are not identical with the ordinary partnerships, the same rules that govern the partnerships, shall also govern the contractual relations between the joint adventurers. Further, a joint venture is a 'limited partnership', in the limited sense that it is limited as to its scope or duration of the venture.

In a joint venture set up, the parties thereto shall undertake no liability beyond the limit of a particular venture or adventure or business or undertaking. The rights and obligations of a member of a joint venture are less extensive than those of the partners in an ordinary partnership-Asia Foundations and Constructions Ltd. v. State of Gujarat AIR (1986) Guj. 185. Further, a joint venture normally relates to a single transaction even though it may comprehend business to be continued over several years. However, a partnership is basically involved in a joint business of a particular trade or profession.

74. Can a firm pay salary to its sleeping partners?

The term 'sleeping partner' under partnership law means a partner, who is not an active partner. The sleeping partner is thus a dormant partner who has become a partner by agreement and who does not actively participate in the conduct of the business of partnership. He is a partner unknown as such to those doing business with the firm.

Under the partnership law, the control and management of the business of a partnership firm can be left [by an agreement between the parties] in the hands of one of the partners to be exercised on behalf of all the partners-K.D. Kamath & Co. v. CIT [1971] 82 ITR 680 (SC). In other words, it is not necessary that all partners of the firm should carry on the firm's business. To illustrate further, all partners of a partnership firm need not be active partners or managing partners or working partners. Legally speaking, the position of a sleeping partner of a firm is very similar to that of an 'undisclosed principal'.

Under section 40(b) of the Income-tax Act, 1961, any payment of salary, bonus, commission or remuneration by a firm to any partner who is not a working partner is not allowable as deduction in the hands of the firm. As per Explanation 4 to section 40(b), 'working partner' for this purpose means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

75. Who can be treated as 'working partners' for the purpose of income tax law?

An individual partner of a firm shall be treated as a 'working partner' if and when:

- such an individual is a partner of the firm; and
- such an individual is actively engaged in conducting the affairs of the business or profession of the firm.

In commercial parlance, 'conducting the affairs of any business or profession' of a firm may normally involve the following functions: (i) establishing and implementing business policies; (ii) effecting business transactions and conducting day-to-day administration; and (iii) attending to other routine jobs. All the above functions, related to any business or profession of a firm, would involve planning, organising, directing, staffing, and controlling of the core area of business, namely: (i) production, (ii) marketing, (iii) finance and (iv) personnel. In this context, the following persons may be treated as working partners in a partnership firm:

- any partner who attends to establishing of business policies of the firm;
- any partner who attends to business decision-making of the firm;
- any partner who is effecting business transactions of the firm;
- any partner who attends to general administration of the firm;
- any partner who attends to routine jobs of the firm;
- any partner carrying out all or most of the above functions.

76. Who cannot be treated as 'working partners' for the purpose of tax law?

Under the income tax law, the following persons may not be treated as working partners in a firm:

- any partner who does not have any knowledge of the business and is a partner on account of mere capital contribution;
- any partner who does not have any knowledge of the business and is a partner on account of mere relationship;
- any partner who does not take partor interest in the business of the firm;

- any partner who temporarily carries out some functions of the firm's business (in the absence of the regular working partner).
- any limited company or any registered trust may be a partner of a firm but not a working partner.

77. Can all partners take part in the conduct of business of a firm?

Partnership business is a business of the partners and their management powers are generally co-extensive and therefore every partner of a firm is entitled to take part in the business of the firm. Even if a partner has mortgaged his interest in the partnership business to other partner, it will not prevent him from participating in the management of the partnership business.

Further, a partner who has been wrongfully deprived of the right of participation in the management can approach the court of law for appropriate legal remedies. He has also other remedies such as a suit for dissolution, a suit for accounts without seeking dissolution etc.

However, these legal remedies are available only if there is no contract to the contrary between the partners. In other words, if there is a term in partnership agreement, which gives only limited power of management to a partner or a term that the management of the partnership will remain with one or more of the partners to the exclusion of others, then the court will not interpose with the management with such partner or partners unless it is clearly made out that something was done illegally or in breach of the trust reposed in such partners. Further, a transferee of a partner's interest has no right to interfere in the partnership business. [Section 12(a)]

78. Will 'rule of majority' prevail in all matters affecting a firm of partnership? Can a single dissenting partner restrain all other partners by injunction?

In case any difference arises between the partners of the firm with regard to the business of the firm, then the rule of majority shall prevail and such differences shall be determined by the views of the majority of the partners. In such a case, every partner of the firm shall have the right to express his opinion before the matter is decided.

However, under section 12(c) of the Indian Partnership Act, 1932, no change in the nature of the business of the firm can be made without the consent of all the partners of the firm. In routine matters the opinion of the majority of the partners will prevail whereas in case of special matters of extra-ordinary nature, such matters shall be determined by the consent of all the partners of the firm.

Even when routine matters are decided by rule of majority, it is essential that the majority must act in good faith and every partner must be consulted as far as practicable. The majority rule will not apply where there is a change in the nature of the firm itself. In such a case, the 'unanimous consent' of all the partners is essential. In case any matter affects the nature of the business of the firm, even a single dissenting partner can prevent the change by moving the court of law to interfere into the matter. Thus, even a single dissenting partner of a firm is entitled to restrain other partners by injunction from effecting any change in the nature of the business and transacting any such business in the firm name.

79. Can all partners have valid access to all books of a firm of partnership?

All partners, irrespective of their type, whether active or dormant, are entitled to have access to any of the books of the firm of partnership. Under section 12(d), the partners are also entitled to inspect and take out of copy thereof.

The partners can exercise this power either personally or through their agents provided that the agents are reasonably acceptable to the other partners. Further, the right of inspection of books must be exercised bona fide and the inspection is to be made in such a way as not to curtail the rights or prejudice the position of the other partners of the firm.

80. Can all partners of firm claim remuneration in addition to their share in profits?

Legally speaking, no partner is entitled to receive any remuneration in addition to his share in the profits of the firm for taking part in the business of the firm. However, this rule can be varied by an express agreement among the partners or by a course of dealing in which event the partner will be entitled to remuneration.

Further, in case where it is customary to pay remuneration to a partner of a firm for conducting the business of the firm under the customary usage of the firm, the partner can claim the remuneration even in the absence of a contract for the payment of the same. Likewise, any partner, on whom the whole conduct to the business of the firm has been cast by reason of the other partner's willful neglect of the business to which the latter ought to attend, can claim compensation for the undue labour and trouble being imposed upon him-Krishnamachariar vs. Sankara Saha (1920) 22 Bom. L.R. (1343)

Similarly, the partners may agree that a managing partner will receive over and above his share, salary or commission for the extra-trouble that he will take while conducting the business of the firm. However, this right emanating from agreement shall come to an end on dissolution of the firm.

81. Are all partners entitled to share profits of a firm?

Legally speaking, the amount of a partner's share in a firm must be ascertained by enquiring whether there is any agreement in that behalf between the partners. If there is an agreement, the partners shall be entitled to share the profits or losses in the agreed proportion. Under section 13(b), if there is no agreement, the partners are entitled to share equally in the profits earned by the firm and so contribute equally to the losses sustained by the firm.

Interestingly, there is no direct connection between the proportion in which the partners shall share the profits or losses and the proportion in which they have contributed towards the capital of the firm. In other words, equality in sharing of profits and losses, independent of the share of the original capital contributed by the partners is one of the rules, which applies only when there is no special agreement.

82. All partners of a firm are willing to avail interest on capital brought by them. Can they get such an additive on capital?

Interest on capital subscribed by partners is not allowed unless there is an agreement or usage to that effect. Under section 13(c) of the Indian Partnership Act, 1932, in case interest on capital subscribed by the partner is payable to him under the partnership deed, the interest will be payable only out of profits. Interest on capital account however ceases to run on dissolution of the firm. The following elements are essential for a partner of a firm to avail interest on moneys brought by him in the partnership business:

- an express agreement to that effect or
- practice of the particular partnership (a course of dealings between the parties usually shown from the partnership books) or
- other facts and circumstances from which an agreement may be implied or
- any trade custom to that effect or a statutory provision, which entitles him to such interest.

83. A partner of a firm makes an advance to the firm in addition to the amount of capital to be contributed by him. Can such a partner claim interest on said loan or advance?

Under section 13(d) of the Indian Partnership Act, 1932, in case a partner makes an advance to the partnership firm (in addition to the amount of capital to be contributed by him), the partner shall be entitled to claim interest thereon at the rate of 6 per cent per annum. Unlike the interest on capital account, (which ceases to run on dissolution), the interest on advances keep running even after dissolution and to the day of payment.

Further, the Partnership Act makes a distinction between the 'capital contribution' of a partner and the 'advances' made by him to the firm. While the advances made by a partner are treated as loans, which should bear interest, the capital contributed by the partner shall bear interest only when there is an agreement to this effect.

84. Discuss a partner's legal right to get indemnified by his firm.

Under section 13(e) of the Indian Partnership Act, 1932, every partner has the right to be indemnified by the firm in respect of payment made and liabilities incurred by him in the ordinary and proper conduct of the business of the firm.

Every partner is also entitled to get indemnified by the firm in the performance of an act in an emergency for protecting the firm from any loss if the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstance.

85. Can an existing partner prevent the introduction of a new partner into the partnership firm?

Under section 31(1) of the Indian Partnership Act, 1932, every partner has the right to prevent the introduction of a new partner in the partnership firm without the consent of the existing partners.

86. "Every partner has a right to retire". Do you agree?

Under section 32 of the Indian Partnership Act, 1932, every partner has the right to retire with the consent of all the other partners or in accordance with the terms of the partnership deed. Under section 32(1), in the case of a partnership being at will, every partner shall have the right to retire by giving notice to that effect to all the other partners.

87. Can a partner be expelled from a partnership?

Under section 33 of the Indian Partnership Act, 1932, every partner has the right not to be expelled from the partnership firm by any majority of the partners.

88. Can an outgoing partner carry on business competing with that of the firm?

Under section 36 of the Indian Partnership Act, 1932, an outgoing partner may carry on business competing with that of the firm and he may advertise such business. However, in such a case, the outgoing partner should not use the firm name or represent himself as carrying on the business of the firm. Further, he is not entitled to solicit the custom of persons who were dealing with the firm before he ceased to be a partner.

89. Discuss the legal rights of an outgoing partner to share 'subsequent profits'.

Under section 37 of the Indian Partnership Act, 1932, in case where any partner of a firm has died or ceased to be a partner and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, the outgoing partner or his estate has (at his or his representative's option), the right to such share of the profits made since he ceased to be a partner, as may be attributable to the use of his share of the property of the firm or to interest @ 6% per annum on the amount of his share in the property of the firm.

90. Can a partner of firm dissolve the partnership?

Under section 40 of the Indian Partnership Act, 1932, every partner of a firm has the right to dissolve the partnership with the consent of all partners. Further, under section 43, in case where the partnership is at will, the firm may be dissolved by any partner by giving notice in writing to all the other partners of his intention to dissolve the firm. In such a case, the firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice.

91.What do you mean by a 'change in the constitution' of a firm? What are the rights and duties of a partner after a change in the constitution?

Legally speaking, a change may take place in the constitution of the firm in anyone of the four ways, namely,

(i) where a new partner or partners come in;

(ii) where some partner or partners go out, i.e., by death or retirement;

(iii) where the partnership concerned carries on business other than the business for which it was originally formed; and

(iv) where the partnership business is carried on after the expiry of the term fixed for the purpose.

As regards the change in mutual rights and duties (after the change in constitution), the following points are notable:

- Under section 17 of the Partnership Act, in case where a change occurs in the constitution of the firm in any of the first three ways mentioned above, the mutual rights and duties of the partners in the reconstituted firm shall remain the same, as they were before the change as may be.
- In case where a firm constituted for a fixed term continues to carry on the business after the expiry of the term, the mutual rights and duties of the partners shall remain the same as they were before the expiry, so far as they may be consistent with the incidents of partnership at will.
- In case where the firm of partnership constituted to carry out one or more ventures or undertakings, carries out other ventures or undertakings, the mutual rights and duties of the partners in respect of the other adventures of the undertaking shall be the same as of those in respect of the original adventures.
- All the above-mentioned rules are however subject to contract between the partners.

92. Can a partner earn secret profits?

Under section 16(a) of the Indian Partnership Act, 1932, in case where a partner of a firm derives any profit for himself from any transaction of the firm or from the use of the partnership property or business connection of the firm or firm's name, then he is bound to account for that hidden profit. Such a partner shall also be required to refund all such secret profits, to the partnership firm.

93. Can an existing partner carry on business of the same nature as (and competing with) that of the firm?

Under section 16(b) of the Indian Partnership Act, 1932, if and when a partner carries on business of the same nature as and competing with that of the firm, then he must account for and pay to the firm all profits made by him in the business. However, the mere fact of similarity between the partnership business and the business in which a partner was interested will not be sufficient to justify the profits of that business being brought into accounting.

In the absence of an express restriction by agreement, a partner of a firm may carry on another business in his private capacity, provided he does not compete with and is not connected with the business of the firm and also does not represent the business to be that of the firm. In other words, the partner is under no obligation whatever to account for the profits of a non-competing business, even though his connection with the firm may enable him to push his private trade better.

Section 16(b) does not apply where the business carried on by the partner is not in rivalry with the business of the partnership firm though the same knowledge and information may be useful in both ventures.

Under section 11(2), the partnership deed may however contain a clause that some or all the partners of the firm are not to carry any business other than that of the firm during the continuance of partnership. In such a case, any breach of such a provision may entitle the other partners to recover damages from the defaulting partner.

94. Can every partner of a firm bind the firm by his act? What about an act which is "outside the usual course of the business of the firm"?

Sections 19(1) and 22 of the Indian Partnership Act, 1932 deal with the so-called 'implied authority' of a partner. Accordingly, the act of a partner, which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm, provided that the act is done in the firm name, or in any manner expressing or implying an intention to bind the firm. In this context, the phrase "in the usual way" is significant.

In case an 'usual act' is done by a partner of a firm in an 'unusual way', the third party or the outsider dealing with the firm, may well be put on an enquiry into unusual circumstances under which he is being called upon to act. In case the outsider chooses to neglect what is 'unusual', he must not seek to charge persons other than the one with whom he is actually dealing. In other words, the usual act done in an unusual way by a dealing partner will not bind the partnership firm.

Similarly, if the act is "outside the usual course of the business of the firm" it will not bind the partnership firm even if it is prudent or has benefited the firm unless it is ratified and approved by all partners of the firm. In this context, it is notable that power to do the usual does not include the power to do the unusual. Thus, every partner of a firm has an implied authority to bind the firm by all acts done by him in all matters connected with the partnership business and which are done in the 'usual way' and are not in their nature beyond the scope of partnership.

95. Can the 'implied authority' of a partner be 'restricted' or 'extended'?

Under section 20 of the Indian Partnership Act, 1932 the partners of a firm may, by contract between them, either extend or restrict the implied authority of any partner. In spite of any such restriction if a partner does, on firm's behalf, any act, which falls within his implied authority, the partnership firm will be bound unless the person with whom he is dealing is aware of the restriction or does not know or believe the partner to be a partner.

However, any extension or restriction of the implied authority is only possible with the consent of all the partners. Any one partner, or even a majority of the partners, cannot restrict or extend the implied authority of a partner. Further, a third party or outsider is not affected by a secret limitation of a partner's implied authority unless the third party had actual notice of such limitation or restriction.

96. Can every partner bind the firm by his acts in emergency?

Under section 21 of the Indian Partnership Act, 1932 each partner of a firm can bind the firm by all of his acts done in an emergency, with a view to protecting the firm from any loss, provided he has acted in the same manner, as a man of ordinary prudence would have acted in the like circumstances.

The powers of a partner of a firm to act in emergency are similar to those of an agent, in similar circumstances under section 189 of the Indian Contract Act, 1872. In this context, the right of a partner to be indemnified by his copartners for payments made or any liability incurred in acting for the firm in an emergency is coextensive with his authority.

97.Can a partner of a firm be treated as 'agent of the firm'?

Under section 4 of the Indian Partnership Act, 1932, a partnership is the relationship between the partners, who have agreed to share the profits of the business carried on by all or any of them acting for all. Accordingly, every partner of a firm can be treated as the 'agent' of the other partners. Under section 18, subject to the provisions of the Act, a partner is the agent of the firm for the purpose of the business of the firm.

Legally speaking, a partner of a firm embraces the character of both a principal and an agent. When a partner of a firm acts for himself and in his own interest in the common concern of the partnership, he may properly be deemed as 'principal'. However, when he acts for his partners, he may properly be deemed an 'agent'.

The basic difference between a 'partner-agent' and a mere 'ordinary agent' (under law of agency) is that the partner-agent has a community of interest with other partners in the whole property/business and liabilities of partnership, whereas an ordinary agent as such has no interest. Section 18 of the Partnership Act recognises the doctrine that the law of partnership is a branch of a general law of agency and an implied agency flows from the relationship of partners of a firm.

However, the rule that a partner is the agent of the firm for the purpose of the business of the firm cannot be applied to all transactions and dealings between the partners themselves. In case where two of the partners of a firm executed a promissory note in favour of third partner agreeing to pay him a certain sum due to him on taking partnership accounts, it was held that the remaining partners of the firm were not bound by the promissory note-Hoshiar Singh vs. Udairam AIR (1929) All. 542. In other words, the principle of agency can be applicable only to the act done by partners for the purpose of the business of the firm.

98. "A partner of a firm is both jointly and severally liable to third parties"-Do you agree?

Under the English law, the liability of partners of a firm on contracts is only a joint liability. However, under the Indian law, every partner of a firm shall be liable jointly with other partners also severally for the acts of the firm done while he is a partner. In other words, a partner of a firm is both jointly and severally liable to third parties.

Under section 25 of the Indian Partnership Act, which deals with liability of a partner for acts of the firm, every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner. The expression 'act of firm' for this purpose denotes any act or omission by all the partners or by any partner or agent of the firm, which gives rise to a right enforceable by or against the firm of partnership.

99. Can a firm of partnership own immovable property?

Under the Partnership Act, property brought by the partners or property acquired by the firm in the course of its business is in law considered to be the property of the partnership. Legally speaking, a firm of partnership can own immovable property and income there from is taxable in its hands- Sarvamangala Properties Ltd. v. CIT [1973] 90 ITR 267 (Cal.). In this context, the property of a partnership firm is treated as a 'joint estate' of partners, as distinguished from 'separate estate' of partners.

No partner of a firm has a right to take any specific portion of the partnership property and assert that property is his property exclusively. No such right can be asserted either during the existence of the partnership or after its dissolution. Further, the share of a partner in a partnership is a 'movable property' in nature even if the partnership owns immovable properties- CIT v. Juggilal Kamalapat [1967] 63 ITR 292 (SC).

100. Can a partner assign or transfer his share in the business of a partnership?

A partner of a firm is not entitled to exercise his right of assignment or transfer even to the extent of his share in the business of the partnership. It is true that the partnership business belongs to the partners and each one of them is treated to be an owner thereof. It is equally true that even during subsistence of the partnership a partner of a firm may assign his share to another person. But what is permissible in that regard is the mere right to receive the share of profit of the assignor and to accept the account of profits agreed to by the partners. In other words, what the assignee would get would be only that what is permitted by section 29 of the Partnership Act, that is to say, the right to receive the share of profits of the assignor and accept the account of the profits agreed to by the partners.

101. Can a partner assign his interest in any specific item of partnership property?

During the subsistence of a partnership, no partner of a firm can claim a specific item of the firm's property nor can he assign his interest in any specific item of partnership property. However, if and when all the partners of the firm, by mutual agreement, relinquish or transfer a particular asset of the partnership property in favour of a third party, such a transfer shall be valid. Accordingly, all the partners of a firm may transfer a partnership property to one of themselves and such a transfer is legally valid. It shall also be valid against the firm's creditors if it is done in good faith and if it has been completed. This is because what is done by all the partners of the firm can be treated as "an act of the firm" within the meaning of section 2 (a) of the Partnership Act-Bhaktimala Beedi Factory v. CIT (1996) 219 ITR 6 (AP).

102. How to deal with partnership property at the time of dissolution of a firm?

At the time of dissolution of a firm, the partnership property has to be dealt with on the principles of general accounting between the partners of the firm. Accordingly, the winding up of the partnership involves a determination of the share of each partner of the firm in that partnership property. The individual property of a partner is outside the winding up procedure of a firm and therefore it merely reverts to the owner. The partnership property has to be divided amongst the partners in accordance with the partnership deed. The liabilities of the firm are regarded as the liabilities of the partners only in case they cannot be met by the firm and discharged out of its assets- Bhagwanji Morarji Goculdas v. Alembic Chemical Works Co. Ltd. AIR (1948) PC 100.

103."A change in firm's name may amount to change in constitution of a firm"-Do you agree?

Any change of firm's name does not amount to change in constitution of the partnership firm. Under section 4 of the Indian Partnership Act, 1932, which has defined the expression 'firm name', it is true that firm name is not an essential ingredient of the constitution of a partnership firm. In other words, it is legally permissible for a firm of partnership to carry on its business without assuming a firm name. In this context, a mere change in the name of a firm would not amount to change in the constitution of the firm-Delight Stores v. ITO [1971] 79 ITR 749(All.)

104. How can a partner retire from a firm of partnership? What are the different modes of retirement?

Under section 32(2) of the Indian Partnership Act, 1932, a partner of a firm may retire from a firm of partnership by anyone of the following modes, viz.:

- Retirement with the consent of all the other partners; (the consent may be either express or implied)
- Retirement by virtue of an express agreement between the partners; (the agreement may be either in the form of a clause in the partnership deed or an independent agreement)
- Retirement by giving notice in writing to all other partners of his intention to retire (in the case of a partnership at will)

105."Every partnership firm must execute a retirement deed in case of retirement of its partners"-Discuss briefly.

Legally speaking, it is not compulsory for a firm of partnership to draw a retirement deed. It is however advisable to execute a retirement deed in writing for final settlement of accounts. Such a deed in writing shall be very useful in avoiding all possible future disputes in this regard. From conveyancing point of view, a retirement deed may be executed on a non-judicial stamp paper of appropriate value, as prescribed for a simple agreement.

106. How to publish or issue 'notice of retirement' of a partner?

As regards the issue or publication of notice of retirement, section 32(3) read with section 72 of the Partnership Act is relevant.

In case the firm is not registered, the fact of retirement is to be published in (i) at least one vernacular newspaper circulating in the district where the firm has its principal place of business and (ii) the Official Gazette.

In case of a registered firm, the retiring partner must give notice of his retirement to –(i) the Registrar of Firms in the prescribed form alongwith the prescribed fee; (ii) in the Official Gazette, and (iii) in at least one vernacular newspaper circulating in the district where the firm has its principal place of business.

107. Does retirement of a partner amount to 'dissolution of a firm'?

Legally speaking, retirement of a partner does not amount to dissolution of a firm, [the dissolution of the firm between all the partners of a firm is called the dissolution of the firm] and the effect of this dissolution is the breaking up or extinction of relationship which existed between the partners of the firm- CIT v. H.R. Aslot [1978] 115 ITR 255 (Bom). In other words, continuing business of firm after retirement of one of partners, is a case of change in constitution of firm, even if firm is dissolved-CIT v. Bhagwandas Dwarkadas [1987] 163 ITR 272 (MP)

108. How to expel a partner from a partnership firm? Discuss briefly all the procedures involved therefor.

Under section 33 of the Indian Partnership Act, 1932, a partner of a firm may not be expelled from a partnership firm by a majority of partners except in exercise in good faith of powers conferred by contract between the partners. In order to expel a partner from a firm of partnership, the following pre-conditions are to be fulfilled:

- the contract between the partners must contain a clause for expulsion;
- the power of expulsion must be exercised by a majority of the partners; and

- the power must be exercised in good faith.

In this context, 'exercise in good faith' as prescribed under section 33(1) shall include the following three conditions:

- the expulsion must be in the interest of the partnership;
- the partner to be expelled must be served with a notice; and
- the partner to be expelled must be given an opportunity of being heard.

In case all the above pre-conditions are not satisfied, the expulsion of the partner from a firm shall not be deemed to be in bona fide interest of the business of the partnership firm.

109. Will expulsion of a partner lead to 'dissolution of the firm'?

Under the Indian Partnership Act, 1932, the expulsion of partners does not necessarily result in dissolution of the firm. However, the provisions of section 32(2), (3) and (4) of the Indian Partnership Act, 1932, which are applicable in case of retirement of partners, will be equally applicable to an expelled partner as if he was a retired partner.

110. Can an insolvent partner continue in the firm?

Under section 34 of the Indian Partnership Act, 1932, if and when a partner in a firm of partnership is adjudicated an insolvent, such a person shall cease to be a partner on the date of the order of adjudication. Legally speaking, the estate of the insolvent partner shall, on such adjudication, vest in the official assignee, appointed to wind up the estate of the defaulting partner.

As regards the rights and liabilities, under section 34(2) of the Act, the insolvent partner shall cease to be liable for any act of the partnership firm done after the date of the order of adjudication. Similarly, the partnership firm is also not liable for any act of such an insolvent partner after such date of adjudication. It is irrespective of the fact whether or not [under a contract between the partners] the firm is dissolved by such adjudication.

111. "The insolvency of a partner in a partnership firm shall result in dissolution of the firm"-Do you agree?

As a general rule, the insolvency of a partner in a partnership firm shall result in dissolution of the firm. However, the partners of the firm may agree among themselves that the adjudication of a partner as an insolvent will not give rise to dissolution of the partnership firm. In other words, the adjudication of a partner as an insolvent need not necessarily result in the dissolution of the firm of partnership.

112. "The death of a partner of a firm normally results in the dissolution of the partnership firm"-Is it correct?

As a general rule, the death of a partner of a firm normally results in the dissolution of the partnership firm. However, under section 42(c) of the Indian Partnership Act, 1932, the rule in regard to the dissolution of the partnership by death of partner is subject to a contract between the partners of the firm. Accordingly, the partners of the firm may agree that the death of one partner will not have the effect of dissolving the partnership as regards the surviving partners unless the firm of partnership consists of only two partners- CIT vs. G.S. Mill (AIR) (1966) (SC) 24.

In case where a partner of a firm dies, the following three alternative options are available for the partners:

- the legal representative of the deceased partner may step into the position of the deceased partner by means of a fresh agreement with the surviving partners of the firm; or
- the surviving partners of the firm may continue the firm by purchasing the deceased partner's share; or
- the partnership may be dissolved.

113. Can a partner of a firm transfer his share in a firm? What are the legal rights of the transferee in such a transfer?

Under the partnership law prevalent in India, a share in a partnership firm is transferable like any other property. A partner of a firm can transfer his interest in the business to an outsider, but only with the consent of all other partners. However, as the partnership relationship under the partnership law is based on the mutual confidence among the partners of the firm, the assignee or transferee of a partner's interest by sale, mortgage or otherwise cannot enjoy the same rights and privileges as the original partner of the firm.

Under section 29 of the Indian Partnership Act, 1932 which deals with the rights of transferee of a partner's share, the assignee or transferee will enjoy only the rights to receive the share of the profits of the assignor and account of profits agreed to by other partners- S. Narayanappa vs. Bhaskara Krishnappa (1966) 2 M.L.J (SC) 60.

During the continuance of partnership, such a transferee of a partner's interest is only entitled to receive the share of the profits of the transferring partner and he is bound to accept the profits, as agreed to by the partners. In other words, the assignee cannot challenge the accounts. Such a transferee, during the continuance of partnership, is not entitled:

- to interfere with the conduct of the business of the firm;
- to require accounts of the firm; or
- to inspect books of the firm.

114. What do you mean by 'dissolution of firm'? Is it different from 'dissolution of partnership'?

Chapter VI (consisting of sections 39 to 55) of the Indian Partnership Act, 1932 deals with 'dissolution of a firm'. Under section 39 of the Act, the dissolution of partnership between all the partners of a firm is called the 'dissolution of the firm'. Dissolution of a firm thus means the breaking up or extinction of the relationship, which subsisted between all the partners of the firm under various circumstances, as contemplated by Act. Further, a partnership can be dissolved only in accordance with the manner, as prescribed under the Indian Partnership Act. The expression 'dissolution of a firm' indicates the discontinuation of the jural relation existing between all the partners of the firm.

'Dissolution of a firm' is however different from 'dissolution of a partnership'. In case where one or more partners of a firm retire or become incapacitated from acting as a partner due to death, insolvency or insanity, the partnership, (i.e. the relationship between such a partner and other partners) is dissolved. In such a case, the firm is said to be reconstituted without any dissolution. In other words, in 'dissolution of partnership', the particular partner goes out of the firm, while the remaining partners of the firm carry on the business of the firm.

However, in the case of 'dissolution of the firm', the whole firm is dissolved and therefore the partnership terminates as between each and every partner of the firm. 'Dissolution of the firm' thus involves dissolution of a partnership as well as discontinuance of partnership business.

115. What are the different modes of dissolution of a firm?

Under the partnership law (sections 39-44 of the Indian Partnership Act, 1932) dissolution of a firm may take place by any of the following modes:

(i) Dissolution by agreement (dissolution as a result of any agreement between all the partners);

(ii) Compulsory dissolution (dissolution by the adjudication of all the partners, or of all the partners but one, as insolvent or dissolution by the business of the firm becoming unlawful);

(iii) Contingent dissolution (dissolution subject to agreement between the parties, on the happening of certain contingencies), such as:

- efflux of time;
- completion of the venture for which it was entered into;
- death of a partner;
- insolvency of a partner.

(iv) Dissolution by notice (dissolution by a partner giving notice of his intention to dissolve the firm, in case of partnership at will and the firm being dissolved as from the date mentioned in the notice, or if no date is mentioned, as from the date of the communication of the notice); and

(v) Dissolution by Court (dissolution by intervention of court) in case of;

- a partner becoming of unsound mind;
- permanent incapacity of a partner to perform his duties as such;
- misconduct of a partner effecting the business;
- wilful or persistent breaches of agreement by a partner;
- transfer or sale of the whole interest of a partner;
- improbability of the business being carried on save at a loss;
- the Court being satisfied on other equitable grounds that the firm should be dissolved.

116. When is a firm dissolved compulsorily in India?

Under section 41 of the Indian Partnership Act, 1932, which provides for compulsory dissolution, a firm is dissolved—

- by the adjudication of all the partners or of all the partners but one as insolvent; or

- by the happening of any event, which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership; (e.g., a partnership firm consisting of citizens of two countries, shall become unlawful, on declaration of a war between the said two countries).
- However, where more than one separate adventure or undertaking is carried on by the firm the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures and undertakings.

117. What do you mean by 'contingent dissolution' of a firm?

Section 42 of the Indian Partnership Act, 1932 provides for dissolution of a firm on the happening of certain contingencies. This is known as 'contingent dissolution'. Accordingly, subject to the contract between the partners, a firm is dissolved in the following cases—

- if constituted for a fixed term, by the expiry of that term;
- if constituted to carry out one or more adventures or undertakings, by the completion thereof;
- by the death of a partner; and
- by the adjudication of a partner as an insolvent.

The partners may however provide by a mutual agreement that the firm will not be dissolved on happening of any of the above contingencies.

118. How to dissolve a partnership at will? Discuss in brief all the legal implications involved therein.

Section 43 of the Indian Partnership Act, 1932 provides for 'dissolution by notice' of partnership at will. In this context, the following points are notable-

- In case where a partnership is at will, the firm may be dissolved by any partner [by giving notice in writing] to all the other partners of his intention to dissolve the firm.
- The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice.
- The notice for this purpose must be in writing and unambiguous-Pulin v. Mahendra AIR (1921) Cal 772.

- Notice served to an insane partner is also valid.
- Once served, such a notice of dissolution cannot be withdrawn, without the consent of the partners to whom it was communicated-Jones v. Lloyd (1874) LR 18 Eg. 265.

119. Is the court of law empowered to dissolve a partnership firm in India? Discuss in brief all grounds valid for dissolution by a court.

Under section 44 of the Indian Partnership Act, 1932 courts can dissolve firms. The Court's power is however not subject to the agreement of partnership. Accordingly, at the suit of a partner, the court may dissolve a firm on any of the following grounds, namely—

- that a partner of a firm has become of unsound mind, in which case the suit may be brought by any partner or a next friend of the partner who has become of unsound mind (insanity of a partner does not itself dissolve the firm but is a valid ground for dissolution);
- that a partner, other than partner suing, has become in any way 'permanently' incapable of performing his duties as partner. (In this context, any 'temporary incapacity' of a partner may not enable the other partners to seek dissolution through the court.)
- that a partner, other than the partner suing, is guilty of conduct, which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business; (However, a guilty partner cannot seek dissolution on the ground of his own misconduct. For this purpose, conviction for an offence involving moral turpitude, embezzlement of trust funds belonging to a client by a solicitor, etc., have been held notable valid grounds to seek dissolution through the court.)
- that a partner, other than the partner suing, willfully or persistently commits breach of agreements relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him. (For this purpose, the breach of agreement must be willful, persistent and substantial. In this context, refusal and neglect to perform duties undertaken, keeping of erroneous accounts and not showing all receipts, preparing false balance sheet etc., will be notable valid grounds to seek dissolution through the court.)

- that a partner, other than the partner suing, has in any way transferred(by way of sale, gift or trust) the whole of his interest in the firm to a third party, or has allowed his share to be charged under the provisions of rule 49 of Order XXI of the First Schedule to the Code of Civil procedure, 1908 (5 of 1908) or has allowed it to be sold in the recovery of arrears of land revenue or of any dues recoverable as arrears of land revenue due by the partner. (Transfer of the whole interest of a partner to a third party will not itself dissolve the firm unless the partnership deed so provides. However, it constitutes a valid ground to seek dissolution through the court).
- that the business of the firm cannot be carried on save at a loss; (this ground is available even if the partnership was formed for a particular venture or a fixed term. In such case, it is to be satisfied before the court of law that (i) there is practical impossibility of the firm getting any profit at all in future and (ii) the loss is due to an inherent defect in the business and not due to some special circumstances).
- on any other ground, which renders it just and equitable that the firm should be dissolved. (Under this clause, remedy can be resorted to under the following grounds, viz.,
    - it is no longer practicable to attain the object with which the partnership was started;
    - it is no longer practicable to carry on the partnership business, according to the true intention and meaning of the partnership deed;
    - any partner, if he thinks that he has not been fairly treated by his co-partners;
    - any partner, who has become permanently incapacitated, on the ground of his inability to look after his own interest.

120. How to settle the accounts of a firm after dissolution? Are there any rules to be observed therefor?

Section 48 of the Indian Partnership Act, 1932 provides for the mode of settlement of accounts between partners. If the assets of the firm are not sufficient to pay off the liabilities of the firm including the amount due to each partner on account of capital, each partner of the firm would individually be liable to contribute towards the losses, including deficiencies of capital, in the proportion in which he is entitled to share profits. While settling the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed—

- losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.
- the assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order—
  - a) in paying the debts of the firm to third parties;
  - b) in paying to each partner ratably what is due to him from the firm for advances as distinguished from capital;
  - c) in paying to each partner ratably what is due to him on account of capital; and
  - d) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

121. How to make payment of firm's debts and of separate debts after dissolution?

Under section 49 of the Indian Partnership Act, 1932, in case where there are joint debts due from the firm and also separate debts due from any partner:

- (i) the property of the firm shall be applied in the first instance in payment of the debts of the firm, and if there is any surplus, then the share of each partner shall be applied to the payment of his separate debts or paid to him;
- (ii) the separate property of any partner shall be applied first in the payment of his separate debts and surplus, if any, in the payment of debts of the firm.

Section 49 of the Act has to be read along with section 25 of the Partnership Act and if so read it would indicate that even while applying the provisions of section 49, the debt by the third party can be recovered by proceeding against the partners—N.B. Mawagane Shop, a Registered Firm, vs. M/s Rej & Co. AIR (1982) Bom. 388.

122. How to deal with sale of goodwill after dissolution?

Under section 55 of the Indian Partnership Act, 1932 which deals with sale of goodwill after dissolution, while settling the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets, and it may be sold either separately or along with other property of the firm.

In case where the goodwill of a firm is sold after dissolution, a partner may carry on a business competing with that of the buyer and he may advertise such business, but, subject to agreement between him and the buyer, he may not—

1) use the firm name,
2) represent himself as carrying on the business of the firm, or
3) solicit the customers or persons, who were dealing with the firm before its dissolution.

Any partner may, upon the sale of the goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits and, notwithstanding anything contained in section 27 of the Indian Contract Act, 1872 (9 of 1872), such agreement shall be valid if the restrictions imposed are reasonable.

123. How to give 'public notice' in respect of dissolution of a firm?

Section 72 of the Indian Partnership Act, 1932 provides for giving public notice in respect of dissolution of a firm in India. In every case where the public notice of any matter in respect of partnership firm is required to be given under this Act, it must be given by publication in the Official Gazette and in at least one vernacular newspaper circulating in the district where the firm to which it relates, has its place or principal place of business.

In the case of registered firms, apart from the aforesaid notification, a notice is also required to be served on the Registrar of Firms under section 63 where the matters relate to (a) the retirement or expulsion of a partner, or (b) dissolution of the firm, or (c) the election, on attaining majority, to be or not to be a partner, by a person who as a minor, was admitted to the benefit of partnership.

124. Can an existing business of a partnership firm be converted into a company?

Legally speaking, conversion of an existing business of a partnership firm into a company can be done by any of the following ways:

- Conversion by sale of existing business to a limited company.
- Admission of a limited company as partner to the partnership and allowing it to acquire the shares of other partners.
- Conversion by registration under Part IX of the Companies Act, 1956.

125. How to convert a partnership firm into a company under Part IX of the Companies Act, 1956?

Under the Companies Act, 1956, Part IX of the Act (viz., sections 565 to 581) lays down the law as well as the procedure to be followed for registration of an existing business organisation into a company under the Act. Accordingly, a partnership firm may be converted into a company by following the provisions of Part IX of the Companies Act, 1956. As a matter of procedure, the due compliance with the following conditions may facilitate speedy registration under Part IX of the Companies Act, 1956.

1. Ensure that there must be at least 7 partners in the partnership firm. Draft a deed of admission of partners to assure that there are at least seven partners in the partnership firm.
2. Ensure that the Deed of Partnership should elaborate the business activities that the firm would like to carry out.
3. Draft the object of the business, by classifying them into (i) main objects, (ii) incidental or ancillary objects and (iii) other objects.
4. Ensure that the firm must be registered with the Registrar of Firms.
5. Ensure that in the Capital Clause of the Partnership Deed, the capital should be bifurcated into (i) fixed capital and (ii) current capital indicating the amount of the fixed capital against the name of each partner. There must be a fixed capital of at least Rs. 1 lakh. Note that all the other clauses of the Partnership Deed can be in the normal format.
6. There must be an agreement by the partners to convert the partnership to a company. This can be done by a contract in writing to this effect to which the partner's resolution for conversion can be attached as annexure.

7. A memorandum of association and articles of association may be made for the company, which will be similar in all respects to a normal Memorandum and Articles of Association except that it will be in agreement form. The Company may alter the form of it by substituting the memorandum and articles of association in place of the deed of partnership, by special resolution.

8. Form 1 (Declaration of Compliance with the provisions of the Companies Act, 1956), Form 18 (Address of Registered Office) and Form 32 (Particulars of the Directors, Secretary and Manager) must also be filed.

9. Make an application for availability of name in Form 1A to the ROC. For this purpose, one of the partners of the firm should be the applicant. Give the name of all the partners as the directors or promoters of the company.

10. Enclose the following documents (duly certified by the partners) with Form 1A:

    - A letter stating that the name application is for conversion of a partnership firm as a Private Limited Company as per section 569 of the Companies Act and the Application for Name is being made in pursuance of Section 565 of the Companies Act.
    - Copy of Partnership Deed.
    - Copy of the last Balance Sheet.
    - Copy of Income-tax Assessment Order.
    - No Objection Certificate signed by all the partners that they have no objection in getting the firm registered under the Companies Act and allowing the name as per the name application.
    - A copy of true extract of Register of Firm from the Registrar of Firms.

11. After obtaining the name approval, the following documents should be filed for incorporation of the Company.

    - Form No. 37 being Application for Registration under Part IX with the following Annexures:

        a) Copy of Deed of partnership.

        b) Form No. 39.

c) Form No. 40 giving statement of particulars.

d) Form No.41 giving copy of Resolution.

- Original name approval letter.
- Form No. 1 giving Declaration of Compliance with the requirements of the Companies Act duly stamped.
- Form No.18 giving Notice of Situation of Registered Office of the Company on Incorporation.
- Form No. 32 (in duplicate) giving Particulars of Directors as named in the memorandum and Articles of Association.
- Letter of Authority executed on the requisite stamp paper.
- Details of other Directorships of the Directors of the Company.
- A copy of the true extract from the Registrar of Firms giving the details of the partners of the firm. (In case copy of the true extract from the Registrar of Firms is not available, an affidavit may be given by any two of the directors of the company. Such an affidavit must clearly state that (i) the firm has been registered with the Registrar of Firms and that there are no other documents regarding the formation of the Joint Stock Company and (ii) at a meeting of the members, it was unanimously resolved that the said partnership is to be registered as a Joint Stock Company under Part IX of the Companies Act, 1956.)
- Three copies of the printed Memorandum and Articles of Association of which one copy is duly stamped as per the applicable rates depending upon the authorised share capital of the Company.
- Pay order towards Filing Fees for Registration of the above documents viz., Memorandum of Association, Articles of Association Form Nos. 1, 18, 32.
- It may be noted that no filing fees are payable for Form Nos. 37, 39, 40, and 41.

12. Note that debts and liabilities are not automatically transferred to the new company and therefore a novation agreement will have to be entered into by the company with its debtors and creditors.

13. It is advisable to obtain an indemnity from the company to the partnership firm for all acts, deeds and things done after the registration under Part IX and vice versa.

14. Further, it is advisable not to execute dissolution deed. Instead of dissolution deed, a declaration must be made stating (i) the existence of the partnership firm, (ii) its conversion to a company under Part IX and henceforth applicability of the Companies Act and (iii) non-existence of the partnership firm's business. However, joint and several liabilities of the partners of acts, deeds and things done prior to its conversion shall continue until the firm is dissolved.

15. From accounting point of view, please make note of the following:

    - Prior to registration under Part IX of the Act, all assets may be revalued and transferred either to revaluation reserve account or to capital account.
    - Proper disclosure must be made in the books of the company, regarding shares issued for cash and those issued for other consideration.
    - Proper disclosure must be made on the method of accounting, adopted for the assets and liabilities of the firm (in the books of the company) in the annual accounts of the company each year.
    - Disclosure of details of share capital in the books of the company must be made, giving details of revaluation.
    - Prior period items of the partnership firm must be reflected as prior period items in the books of the company or adequate disclosure to that effect must be made.
    - Compliance with the provisions of section 209 of the Companies Act. 1956 must be done i.e., accrual system of accounting on double entry basis.

126. Discuss the taxation aspects arising in case of conversion of a partnership firm into a joint stock company.

From tax angle, with the insertion of section 47(xiii) in the Income-tax Act, 1961, vide the Finance Act, 1998, the capital gains on any transfer of assets resulting due to the succession of the firm by a company is now exempt. Accordingly, with effect from assessment year 1999-2000, no capital gain shall arise in case of conversion of a partnership firm into a joint stock company. However, this exemption is available only if the following conditions as prescribed under section 47 (xiii) are fulfilled:

- all assets and liabilities of the firm relating to the business immediately before the succession shall become the assets and liabilities of the company;
- all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession;
- the partners of the firm do not receive any consideration or benefit, directly or indirectly in any form or manner, other than by way of allotment of shares in the company;
- the aggregate of the shareholding in the company of the partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of 5 years from the date of succession.
- the corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation, which is approved by the SEBI.

No capital gain will therefore arise under income tax law in case where a partnership firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any building, machinery, plant, furniture, or intangible asset to the company, provided all the conditions, as prescribed are duly fulfilled.

Further, on such conversion of firm into company, the brought forward business loss and unabsorbed depreciation in the hands of the partnership firm shall also be allowed to be set off by the company. The exemption of capital gains on conversion of a partnership firm into a joint stock company is a welcome step, which has provided the much-needed boost to trade and industry in the country. However, there are still certain deterrents like the stamp duty levied by certain State governments.

127. Can a firm be converted into a company by sale of firm's business?

- Under conversion by sale of firm's business, the entire business of an existing firm along with all its assets and liabilities are sold to a newly formed limited company. The company may issue shares or other securities to the partners of the partnership firm in proportion of their interest in the firm. The partnership firm itself is not dissolved but may become a shell entity with no activities and the company can carry on the business of the partnership firm.

- This method of conversion is relatively simple since only a sale deed is required for transfer of the business of the firm. Further, the transfer or sale may be made at book values or it may be at market values or at any other revalued figure.
- In case where any immovable property is involved, a separate conveyance deed may be required. Subsequent to the sale or transfer, new shareholders may be admitted to the company on subscribing to the shares in the company at negotiated values, considering the value of the entire business.
- In case where the partners are desirous to have the existing business name of their partnership firm for the proposed company, they have to clearly mention the fact in the application form [Form 1A] for availability of name of the new company. As an additional requirement, the promoters should also enclose a letter of no objection from the partners of the existing concern in this regard.
- After the incorporation of the new company, the partners of the existing firm may enter into an agreement for sale of the running partnership business to the new company on mutually agreed terms and conditions.
- In this context, the partners of the firm may be paid their consideration by way of shares in the capital of the newly promoted company. For this purpose, the partners of the existing business may get their existing business along with all the assets, duly valued by an approved and experienced valuer. Such an independent valuation of existing business and all assets shall enable the promoters of the company to have a rational base for approving the proposal on behalf of the new limited company.
- In this context, the partners of the existing business as well as the new company must ensure that the transfer of existing partnership business and all the assets and liabilities is completed in favour of the new company at the earliest.

- All such transfers shall be made in accordance with the terms and conditions of the agreement, as may be entered into by both the parties.

128. How to treat sale of business as a going concern by a firm to a company under income tax law?

From the taxation point of view, the sale of the business as a going concern by the firm to the company may be treated as a 'slump sale'. Under section 2(42C) of the Income-tax Act, 1961, 'slump sale' means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

Under section 50B of the Income-tax Act, 1961, any profits or gains arising from the slump sale shall be chargeable to income tax as capital gains in the year of such sale. In this context, in case where the business has been carried on for more than 36 months, it will be taxable as long-term capital gains: otherwise it will be taxable as short-term capital gains. For this purpose, the net worth of the business transferred will be treated, as the cost of acquisition and cost of improvement of the business and capital gains will be calculated accordingly without any indexation.

However, in case where the sale or transfer is structured in such a manner thatvalues are assigned to individual assets and liabilities, it will not be treated as a slump sale. In such a case, capital gains will be computable on each capital asset separately and the profit on sale of stock in hand will be taxable as business income.

Further, with the insertion of section 47(xiii) in the Income-tax Act, 1961, vide the Finance Act, 1998, the capital gains on any transfer of assets resulting due to the succession of the firm by a company is now exempt.

129. Can a firm be converted into a company by admission of a limited company as partner?

One of the most common methods of converting a partnership business into a company is to admit a limited company to the partnership as a partner of the firm and then let the company-partner to acquire the shares of the other partners.

Under this method of conversion, a company on which the partners of the firm hold shares proportionately may be admitted as a partner to the firm of partnership. The partnership firm may then be dissolved and all the assets and liabilities of the firm be taken over by the company on dissolution.

From taxation viewpoint, section 45(4) of the Income-tax Act, 1961is relevant. Under section 45(4), the profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.

Accordingly, under section 45(4), the profits or gains arising from the transfer of a capital asset on dissolution of a firm, shall be chargeable to tax as the income of the firm in the year in which the sale takes place. In this context, the fair market value (FMV) of the assets on the date of transfer will be treated as the sale price of the assets for the purpose of computing capital gains under section 45(4).

130. Can a HUF enter into an agreement of partnership with another HUF?

The concept of a HUF joining a partnership firm is legally impossible. A HUF, being a fleeting body (subject to birth, death, marriage, divorce etc. of members), cannot as such enter into a contract of partnership with another person or persons-Agarwal & Co. v. CIT (1970) 77 ITR 10(SC); CIT v. Kalu Babu Lal Chand, (1959) 37 ITR 123 (SC); Thus, a HUF cannot enter into an agreement of partnership with another HUF or individual-Ram Laxman Sugar Mills v. CIT, (1967) 66 ITR 613 (SC). Further, a HUF and a firm cannot constitute a partnership-Prabhu Lal Peary Lal v. CIT (1935) 3 ITR 197 (All).

The law governing partnership does not recognise any HUF becoming a partner. However, there is no bar on an individual member of HUF entering into partnership with another but in reality acting on behalf of HUF. Accordingly, the karta or manager of the HUF can become a partner of a firm in his individual capacity. In such a case, the karta will be treated as the representative of the HUF by the partnership firm.

131. Can a HUF's business be converted into a partnership?

As regards conversion of HUF's business into partnership, there are two different lines of judicial thinking. The first line of judicial thinking is that the

HUF business should be partitioned among the members of the family and thereafter partnership may be formed-Lachiram Baldeodas v. CIT (1936) 4 ITR 279 (Pat); Bisseswarlal Brijlal v. CIT, 4 ITC 365 (Cal); CIT v. Gestha Behari Sadhukhan, (1946) 14 ITR 219 (Cal); CIT v. Kishori Lal Sunder Lal, (1968) 69 ITR 229 (P&H); Hotchand Chattaram v. CIT, (1974) 96 ITR 586 (Mad); Daya Shanker Vijay Kumar v. CIT, (1980) 124 ITR 691 (All).

The second line of judicial thinking is that a karta of the HUF can enter into a partnership with other members of the joint family who do not bring in any individual or separate property of their own as capital contribution but only contribute their labour and skill as working partners-Ramchand Nawalrai v. CIT, (1981) 130 ITR 826 (MP); I. P. Munavalli v. CIT, (1969) 74 ITR 529 (Mys); CIT v. Gaeikwade Vasappa & Sons, (1983) 143 ITR 1 (AP); CIT v. Gupta Bros., (1981) 131 ITR 492 (All).

In this context, another question may arise as to what would be the correct line of approach to the problem of conversion of a HUF into a firm. If it is possible that the karta of a HUF can enter into a partnership with the other members of his family who do not make any capital contribution of their individual and separate property but only contribute their labour and skill as working partners – a concept based on new economic trends commensurate with technological developments- and the members of a HUF can enter into partnership inter se without disrupting the family status, there can be no valid reason why an existing HUF business cannot be converted into a partnership, without disrupting its status, either with or without capital contribution by other members of the family- Ratanchand Darbarilal v. CIT (1985) 155 ITR 720 (SC); CIT v. Maskara Tea Estate (1977) 108 ITR 70 (Gau); Chandrakant Manilal Shah v. CIT, (1992) 193 ITR 1 (SC). Further, with the coming into force of the Hindu Succession Act, 1956, the old concepts of the Mitakshara coparcenary have already undergone a radical change. In this context, to insist on the partition of HUF before the joint family can convert its business into a partnership would be an indirect attempt to frustrate the radical changes, introduced by the so-called Hindu Succession Act, 1956.

132. Can a partnership be started for non-business purposes?

There can be a partnership only if there is some business to be carried on by the firm. If there is no business to be done, there can be no question of partnership. This is because the existence of a business is a sine qua non of partnership-K. Viswanathan v. Namakchand Gupta, AIR [1955] Mad 536; R.C. Mitter & Sons v. CIT. (1959) 36 ITR 194 (SC). For this purpose, section

2(b) of the Indian Partnership Act, 1932 has defined the word "business". Accordingly, business of a partnership includes "every trade, occupation and profession." This definition under section 2(b) of the Act is an inclusive definition-CIT v. Phabiomal & Sons, (1986) 158 ITR 773 (AP).

133. Can the business of a firm be carried on through agents or employees?

Strictly speaking, there is no legal requirement that the business should in fact be carried on by all the partners and that all of them should participate in carrying on the business of a firm. In this context, the partnership business may be carried on through agents, sub-agents, servants or employees-CIT v. Hind Commission Agents, (1963) 48 ITR 615 (Bom.).

134. Can a CA issue a certificate as proof of a partnership business?

Many banks (especially the foreign banks and the so-called new generation private banks) in India do call for a CA certificate as a basic requisite (as proof of partnership business) while opening a bank account in the name of any partnership firm. For this purpose, the CA certificate can be issued in the following format:

Chartered Accountant's Certificate for Partnership Concern

(To be printed on the CA's letterhead)

Date:

To

The Branch Manager,

…………….Bank Ltd.,

______________ Branch

(Address of the Branch)

Dear Sir,

This is to certify that Mr. /Mrs. /Miss. __________________________, __________________________________ is / are the Partner/s / of M/s. _____________________________, having its office at ________________________________.

The firm/ concern is engaged in the business of ______________________________ (Please specify nature of business)

This certificate is being issued to enable the aforesaid firm / concern to submit the same to _____________Bank Ltd., _______________ Branch and the aforesaid facts have been verified by me/us.

FOR __________ & Co.,

Chartered Accountants

(_____________)

Partner/ Proprietor

Membership Number: ___________

135. Can a partner of a firm carry on separate business?

Under section 11(2) of the Indian Partnership Act, 1932, the contract of partnership, entered into by the partners, may provide that a partner of a firm shall not carry on any business other than that of the firm while he is a partner. In this context, it is a well-settled law that subject to the contract between the partners, the members of a firm of partnership are entitled to carry on a business in their individual capacity.

In case where there is a restrictive clause in the partnership deed of a firm that a partner of the firm shall not carry on any business other than that of the firm while he is a partner, then the partner cannot carry on any business other than that of the firm while he is a partner in such a firm.

In case where there is no such restrictive clause in the partnership deed, then the partners may carry on any business other than that of the firm even while they are partners. If the members of a firm of partnership carry on a business in their individual capacity, the income from such a separate business, would be their own, and not that of the partnership.

136. Can a professional partnership be formed between a husband and a wife? Is it advantageous?

Practising professionals such as management consultants, architects, advocates, chartered accountants, doctors and other professionals can validly form partnerships to carry on their profession. Formation of professional partnership between husband and wife, when they belong to the same profession, shall permit pooling of resources and thereby diversion of income from the more affluent partner to his spouse.

Though the system of taxation of firm at flat rate offers lesser scope for immediate tax benefit professional partnerships (between husband and wife) may enable better allocation of income as between the spouses, so as to benefit the spouse with lesser earning capacity to build up better assets than otherwise.

137. Do you find any difference between a 'trading firm' and a 'professional firm'?

The basic difference between a 'trading firm' and a 'professional firm' lies in the requirement of capital. Accordingly, a partnership business always needs capital and almost the first and foremost thing required for starting any trading partnership is the contribution by the partners to the capital of the firm.

However, in case of professional partnerships, such as law firm or an accountants' firm, the foremost thing is not the capital base but the existence of suitable partners who could draw clientele or the specialised professional talent of its members. In other words, a professional partnership can be started with little or no capital contribution from the partners.

Unlike the ancient definition of partnership, which requires the contribution of capital or labour by those who become partners, the present day definition of partnership has eschewed all reference to capital contribution. It is enough that a business (which includes, under the partnership law a profession) is carried on by all the contracting parties or any one of them acting for all-CIT v. M. Uttama Reddy, (1984) 148 ITR 580 (Mad).

138.Four Chartered Accountants propose to start a partnership firm to carry on the profession, which shall be that of chartered accountancy and all services permitted under the Chartered Accountants Act 1949 and Rules and Regulations made thereunder. Can you draft a partnership deed to be executed amongst these four partners?

PARTNERSHIP DEED

THIS DEED OF PARTNERSHIP MADE AND EXECUTED AT ……….ON THIS ……… DAY OF ……….20… AMONGST:

1. Shri ………, son of Shri. …………, aged about………years residing at No………………(hereinafter called the PARTY OF THE FIRST PART):

2. Shri ……………, son of Shri …………aged about ……..years resident of ……………..(hereinafter called the PARTY OF THE SECOND PART):

3. Shri ……………., son of Shri………….aged about ……..years, residing at ……………..(hereinafter called the PARTY OF THE THIRD PART):

4. Shri ……………., son of Shri………….aged about ……..years, residing at ……………..(hereinafter called the PARTY OF THE FOURTH PART): shall include and mean their representatives, nominees, heirs, agents, assigns, etc.

WHEREAS ALL THE PARTIES HERETO HAVE MUTUALLY DECIDED AND AGREED TO carry on the PROFESSION OF CHARTERED ACCOUNTANCY under the name and style of Messrs ………….& ASSOCIATES.

WHEREAS TO AVOID ANY FUTURE EVENTUALITY THE PARTIES HERETO have agreed to reduce in writing all the terms and conditions governing their mutual interest in the said profession as follows:

1. That the partnership shall be deemed to have commenced w.e.f. …………….

2. That the name and style of the firm shall be Messrs ………..& ASSOCIATES.

3. That the partnership shall carry on the profession of chartered accountancy and all services permitted under the Chartered Accountants Act 1949 and Rules and Regulations made thereunder.

4. That the partnership shall be carried on at ………………..and/ or at such other place or places as the partners shall determine from time to time.

5. That profits or losses of the profession shall be divided among the partners and liabilities and assets, if any, shall be borne by them in proportion to their respective shares in the profession, which shall be as below:

Shri ………..	PARTY OF THE FIRST PART	30%
Shri ………..	PARTY OF THE SECOND PART	30%
Shri ………..	PARTY OF THE THIRD PART	20%
Shri ………..	PARTY OF THE FOURTH PART	20%

6. That each partner shall be entitled to a monthly salary of Rs……… subject to the limits prescribed under the Income-tax Act, 1961. In the event of the surplus of income falling below such salary, the same shall be reduced proportionately, to ensure that no disallowance is made by the assessing /appellate authorities.

7. That each partner shall be entitled to interest on his capital investment @ 12% p.a., or at such rate as may be prescribed, from time to time, under the provisions of Income-tax Act, 1961.

8. That the partnership shall be AT WILL and terminable by any of the partners with six months' notice in writing to the other partners.

9. That no partner shall be entitled or empowered to raise any loan for and on behalf of the firm except with consent of the other partners. Any partner doing so in contravention of this clause shall be personally liable and responsible for its repayment.

10. That none of the partners shall carry on professional practice on any name or form, except as a partner of the above mentioned firm.

11. That none of the partners shall disclose /publish any material /information coming to his knowledge, except where the same is required by / under any law.

12. That any work accepted and handled by any of the partners as on the date of commencement of this partnership, shall not be affected by any of the clauses of this deed and the partner(s) shall be entitled to complete the same and also collect the fees therefor in their individual capacities.

13. That in respect of empanelments applied for by the partners in their individual names, prior to the date of commencement of this partnership, shall not be considered as a violation of this deed of partnership, if such work is allotted at a later date. In the event of such work being allotted the respective partner(s) shall be entitled to carry out such work and to collect the fees applicable, in respect of the financial year …….. only.

14. That each of the partners shall be entitled to sign the agreements, contracts or any other documents for and on behalf of the firm and shall also be authorized to draw the payments either in cash or by cheques/ demand drafts, etc. from the government departments, local

authorities, business houses or any other person or persons connected with any concerned with the business of the firm.

15. That all the acts and deeds of each partner shall be deemed to have been done for and on behalf of the firm, which shall be binding upon the other partners.

16. That none of the partners shall be entitled to dispose off, transfer or in any other way alienate or part with his share or interest in the firm to any other person except with the written consent of the other partners.

17. That the firm shall have its bank account(s) in any bank as per mutual consent of the partners, as may be decided by them, from time to time, and shall be operated by the partners jointly or severally by any one of them. However, the partners can change the mode of bank operation by mutual consent without the necessity of writing a fresh partnership deed.

18. That the partners shall maintain or cause to be maintained the books of accounts, record, vouchers, etc. which shall be kept at the place of profession and the same shall be open for inspection by any of the partners or his authorized agents at all reasonable times, with power to take copies and extracts thereof.

19. That the annual accounts shall be taken on 31st March each year of all the assets and liabilities of the firm, after defraying all the chargeable expenses and accounting for the income of the profession. Any surplus or deficit resulting therefrom shall be credited or debited, as the case may be, to the personal accounts of the partners.

20. That each partner shall be entitled to draw for his personal use against the expected surplus and shall pay interest on such drawings as per Income-tax Act, 1961, if the personal account gets overdrawn.

21. That in the event of the retirement or death of any of the partners, the firm shall not be dissolved but shall be carried on by the remaining partners on such terms and conditions as shall be agreed upon by them mutually. However, the share of the retired/deceased partner upto that date shall be determined and paid to such retiring partner or the legal heir(s) of the deceased partner, as the case may be within 6 months of such happening.

22. That on dissolution of the firm, the profession shall be wound up and the assets and liabilities dealt with in accordance with the provisions of the Indian Partnership Act, 1932.

23. That all the provisions of the Indian Partnership Act, 1932 shall apply unless otherwise mentioned herein above.

IN WITNESS WHEREOF the parties hereto have set their hands on this Instrument on the day, month and year aforementioned.

Signed and delivered by the PARTY OF THE FIRST PART Shri…….. in the presence of Shri…………..

Signed and delivered by the PARTY OF THE SECOND PART Shri…….. in the presence of Shri…………..

Signed and delivered by the PARTY OF THE THIRD PART Shri…….. in the presence of Shri…………..

Signed and delivered by the PARTY OF THE FOURTH PART Shri…….. in the presence of Shri…………..

139. Three CA partners (who had joined together as a firm) have now agreed by mutual consent to dissolve their partnership. Each partner agrees to release and discharge the other from all actions, proceedings, claims and demands on account of the said partnership. Please draft a 'deed of dissolution' for this purpose.

DEED OF DISSOLUTION

THIS DEED OF DISSOLUTION EXECUTED ON THIS ……… DAY OF ……..20… BETWEEN:

1. Shri …………., son of Shri. ……………, aged about ……….years residing at No……………………………………………..(hereinafter called the PARTY OF THE FIRST PART):

2. Shri ………………….., son of Shri ……………..aged about …………years resident of ………………….(hereinafter called the PARTY OF THE SECOND PART):

3. Shri …………….., s/o ……………. aged about ………years residing at No…………………..(hereinafter called the PARTY OF THE THIRD PART) shall include and mean their representatives, nominees, heirs, agents, assigns, etc.

WITNESSETH AS FOLLOWS:

WHEREAS ALL THE AFORESAID PARTIES of the FIRST, SECOND AND THIRD PARTS constituted themselves into a partnership to carry on the PROFESSION OF CHARTERED ACCOUNTANCY at …………………under the name and style of Messrs ………..& ASSOCIATES, the same having been constituted under an instrument of Partnership dated ……, 20……, and whereas the PARTY OF FIRST PART is desirous of leaving the partnership, and the parties have agreed to dissolve the said partnership.

NOW, THEREFORE, it is agreed by and between the PARTIES OF THE FIRST, SECOND AND THIRD PARTS that:

1. The partnership of M/s ……….& ASSOCIATES, shall stand dissolved from …………..20…….
2. The parties have by mutual consent agreed to dissolve the partnership and to release and discharge the other from all actions, proceedings, claims and demands on account of the said partnership.
3. The partners release each other from all obligation arising from the deed dated …………20…. save that all statutory liabilities like income tax shall be proportionately borne by the parties and paid for even after the dissolution and the partners agree to notify the discontinuance of profession to the income tax authorities under section 176 and all other concerned authorities.

IN WITNESS WHEREOF the parties hereto have set their hands on this Instrument out of mutual goodwill and consent, on the day, month and year aforementioned.

Signed and delivered by the PARTY OF THE FIRST PART Shri…….. in the presence of Shri…………..

Signed and delivered by the PARTY OF THE SECOND PART Shri…….. in the presence of Shri…………..

Signed and delivered by the PARTY OF THE THIRD PART Shri…….. in the presence of Shri…………..

140. Is it compulsory for all partnership firms carrying on 'specified professions' to maintain books of account?

According to section 44AA of the Income-tax Act, 1961 read with Rule 6F, the persons carrying on any of the 'specified professions' mentioned hereinafter are required to maintain compulsory books of account and other documents if yearly gross receipts of the profession exceed Rs.1,50,000 vide *Notification No. S.O. 352 (E) dated 6.4.2000* (Earlier it was Rs.60,000 and in the case of medical practitioners dispensing drugs and medicines it was Rs.80,000). The new monetary limit of Rs.1,50,000 shall be applicable to all the following professions-

- legal,
- medical,
- architectural,
- engineering,
- accountancy,
- technical consultancy,
- interior decoration,
- acting as authorized representative before any tribunal or other authority,
- film artists who include actor, cameraman, director, music director, art director, dance director, editor, singer, lyricist, storywriter, screenplay writer, dialogue writer, dress designer.
- company secretary and
- information technology (w. e. f. A.Y. 2002-03)

141. What are the compulsory books of account to be maintained by 'specified professional firms' in India?

The following table clarifies the mandatory requirements [as to maintenance of books of account by specified professional firms] in a nutshell:

Sl. No.	Type of professional firm	Requirement of maintenance
1.	Specified professionals whose gross receipts in their profession exceed the prescribed limit of Rs.1,50,000 in all the three years immediately preceding the previous year.	Compulsory to maintain the books of account as prescribed under Rule 6F[CBDT has prescribed books of account]
2.	Specified professionals whose gross receipts in their profession	Compulsory to maintain the books of account as prescribed

	is likely to exceed the prescribed limit of Rs.1,50,000 [If the profession has been newly set up in the previous year]	under Rule 6F [CBDT has prescribed books of account]
3.	Specified professionals whose gross receipts in their profession do not exceed the prescribed limit of Rs.1,50,000 in any [one or more] of the three years immediately preceding the previous year.	Compulsory to maintain such books of account and other documents as may enable the assessing officer to compute their taxable income under the Income-tax Act, 1961. [CBDT has not prescribed any books of account]
4.	Specified professionals whose gross receipts in their profession is not likely to exceed the prescribed limit of Rs.1,50,000 [If the profession has been newly set up in the previous year]	Compulsory to maintain such books of account and other documents as may enable the assessing officer to compute their taxable income under the Income-tax Act, 1961. [CBDT has not prescribed any books of account]

142. Is it compulsory for all partnership firms (engaged in non-specified profession or business) to maintain books of account?

In case of persons engaged in any other profession (non-specified) or carrying on any business, the requirement of compulsory maintenance of books of account arise under section 44AA(2) of the Act. Accordingly, such non-specified professionals or businessmen must maintain books of accounts compulsorily with effect from assessment year 1999-2000 if and when-

- the income from business or profession exceeds Rs.1,20,000 (earlier Rs.40,000 from A.Y. 1993-94 to 1998-99) or the turnover or gross receipts exceed Rs.10 lakhs (earlier Rs.5 lakhs) in any [one or more] of the three years immediately preceding the previous year.
- However, in case of a new business or profession, if the turnover or income is likely to exceed the above limits, the books of account are to be maintained.

143. What are the books of account required to be maintained by partnership firms who are 'specified professionals'?

As per rule 6(F)(2), the books of account and documents required to be maintained by the specified professionals are the following-

- cash book recording all cash receipts and payments, kept and maintained from day to day and giving the cash balance in hand at the end of each day or at the end of a specified period not exceeding a month-[Rule 6F(2)(b)].
- journal (if the accounts are maintained as per mercantile system of accounting)
- ledger,
- carbon copies of bills, serially numbered and carbon copies or counterfoil of receipts issued in respect of sums exceeding Rs.25; and
- original bills for expenses exceeding Rs.50 and payment vouchers for petty expenses. However, in a case where the cashbook maintained by the person contains adequate particulars in respect of the expenditure incurred, then vouchers are not necessary in respect of expenses up to Rs.50.

However, persons engaged in medical profession are, in addition, required to maintain daily case register in the prescribed pro forma (Form No.3C) and inventory, as at the beginning and end of the year, of stock of drugs, medicines and other consumable accessories used for the purpose of his profession. [Rule 6F(3)]

Further, under section 2(12A) "books or books of account" include ledgers, day books, cash books, account books and other books, whether kept in the written form or as printouts of data stored in a floppy disc, tape or any other form of electro –magnetic data storage device (w. e. f. 1.6.2001). This apart, section 2(22AA) also defines 'documents' to include data, record or data generated, image or sound stored, received or sent in an electronic form or microfilm or computer generated microfiche (w. e. f. 1.6.2001)

144. What are the books of account to be maintained by partnership firms engaged in non-specified profession or business?

All partnership firms engaged in non-specified profession or business are required to maintain such books of account and other documents as may enable the assessing officer to compute their taxable income under the

Income-tax Act, 1961. [CBDT has not prescribed any specific books of account]

145. For how many years should a firm of partnership keep its books of account and other documents?

- Under Rule 6F(5), as amended by the IT (First Amendment) Rules, 2002, the books of account and other documents are to be kept for at least 6 years (w. e. f. 4.2.2002) from the end of the relevant assessment year after the amendment vide *Notification No.21/2002 – F. No.-142/3/2002 – TPL*. Prior to this the books of accounts and other documents were to be kept for at least 8 years from the end of the relevant assessment year.
- Earlier, the cashbook and ledger were required to be preserved for a period of 16 years. However, with effect from 4.2.2002 these are also required to be kept only for 6 years from the end of the relevant assessment year.
- In a case where the assessment in relation to any assessment year has been reopened u/s 147 within the time limit u/s 149, in such case all the books of account and other documents shall continue to be kept till the assessment so reopened has been completed.
- It is also advisable for the assessees to retain books of account and relevant documents for those years also, for which any appeal or other proceeding is pending.

146. Can a firm of partnership keep its books of account anywhere?

- As per Rule 6F(4), the current year's books of account should be maintained and kept at the place where he is carrying on the profession or where the person carries on the profession in more than one place at the 'principal place of business'.
- In case a person carries on the profession in more than one place and he keeps and maintains separate books of account for each place, then he may keep the same at the respective places.
- However, there is no specific rule as to where the books of account of earlier years should be kept.

147. What are the legal provisions with regard to 'method of accounting' to be followed by a partnership firm in India?

- Income chargeable under the head "Profits and gains of business of profession" or "Income from other sources" shall be computed only in accordance with either the cash or the mercantile system of accounting regularly employed by an assessee. That means, the hybrid system, even if regularly followed in earlier years, will not be permitted with effect from assessment year 1997-98.

- The Central Government is empowered to specify, by notification in the Official Gazette, the accounting standards which every assessee will have to follow in computing his income under the head "Profits and gains of business or profession" or "income from other sources".
- Under section 145(1) of the Income-tax Act, 1961, (as substituted by the Finance Act, 1995, w. e. f. 1-4-1997) income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with the method of accounting regularly employed by the assessee.
- In any case where the accounts are correct and complete to the satisfaction of the Assessing Officer but the method employed is such that, in the opinion of the Assessing Officer, the income cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Assessing Officer may determine.
- If no method of accounting is regularly employed by the assessee, any income by way of interest on securities shall be chargeable to tax as the income of the previous year in which such interest is due to the assessee. Further, nothing contained in this sub-section shall preclude an assessee from being charged to income tax in respect of any interest on securities received by him in a previous year if such interest had not been charged to income tax for any earlier previous year.
- Under section 145(2), where the Assessing Officer is not satisfied about the correctness or the completeness of the accounts of the assessee, or where no method of accounting has been regularly employed by the assessee, the Assessing Officer may make an assessment in the manner provided in Section 144.
- Under section 145A, [as amended by Finance (No.2) Act, 2009 w.e.f.1.4.2010] notwithstanding anything to the contrary contained in section 145, the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be—

- in accordance with the method of accounting regularly employed by the assessee; and
- further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and conditions as on the date of valuation. For the purposes of this section, any tax duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment.]

148. What will be the legal consequence if a partnership firm fails to maintain or retain books of account and other documents as required u/s 44AA of the Income tax Act, 1961?

- Any failure on the part of a partnership firm to maintain or retain books of account and other documents as required under section 44AA attracts penalty. With effect from 1.6.2001, a penalty of Rs.25,000/- has been prescribed under section 271A of the Act, which can be imposed by the A.O or CIT (A).
- Further, under section 144 of the Act, if the Assessing Officer is not satisfied about the correctness or completeness of the accounts, or finds that the method of accounting is neither cash nor mercantile, or the accounting standards have not been followed, then he can make what is popularly called the 'Best Judgment Assessment'.
- If and when the Assessing Officer makes a Best Judgment Assessment, he is entitled to reject the income as per the books of account maintained by the assessee firm and to make an estimate on the basis of the records available with him using his best judgment.

149. Is audit of partnership firms compulsory in India?

Legally speaking, audit of accounts of a partnership firm is not compulsory in India. However, the audit of a firm's accounts shall ensure not only proper maintenance of books of account but also proper disclosure of the actual profit or loss for the year. Further, bankers and other financial institutions including government authorities in the country readily accept the audited accounts. The tax authorities including the income tax and sales tax also prefer the audited accounts.

However, under section 44AB of the Income-tax Act, 1961, a compulsory audit is required in respect of accounts of taxpayers including partnership firms in the following cases:

- Where the taxpayer is carrying on business and his total sales, turnover or gross receipts in the business exceeds Rs.60 lakh (Rs.1 crore from assessment year 2013-14) in any previous year; or
- Where a taxpayer is carrying on profession and his gross receipts in profession exceeds Rs.15 lakh (Rs 25 lakh from assessment year 2013-14) in any previous year; or
- Where the profits and gains from a business are deemed to be the profits and gains of a person u/s 44AD or 44AE or 44AF or 44BB or 44BBB, as the case may be, and he has claimed his income to be lower than the profits or gains as deemed to be the profits and gains of his business. In such cases, the assessee will be required to get a tax audit done even if the total sales, turnover or gross receipts do not exceed Rs.60 lakh (Rs.1 crore from assessment year 2013-14).

In such cases, the assessee-firm shall have to get its accounts of such previous year audited by an accountant (Chartered Accountant) before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars, as may be prescribed. For this purpose, "specified date", in relation to the accounts of the assessee of the previous year relevant to an assessment year, means the 30thday of September of the assessment year. Rule 6G of the Income-tax Rules, 1962, has prescribed the audit reports, as applicable for partnership firms. Since partnership firm is a person who carries on business or profession and who is not required to get its accounts audited under any other law (including the partnership law), the audit report in case of a firm shall be in Form 3CB. Further, the prescribed particulars shall be given in Form 3CD.

150. What are the circumstances under which the need for compulsory audit arises in case of a firm?

Under section 44AB of the Income-tax Act, 1961, the following firms are required to get their accounts compulsorily audited by a chartered accountant.

Sl. No	Type of firm	When covered by the provisions of compulsory audit under section 44AB
1.	Any firm carrying on business	If the total sales, turnover or gross receipt in business for the previous year(s) relevant to the assessment year exceed Rs. 60 lakh for the assessment years 2011-12 and 2012-13 (Rs. 40 lakh up to the assessment year 2010-11 and Rs. 1 crore from the assessment year 2013-14)
2.	Any firm carrying on profession	If the gross receipts in profession for the previous year(s) relevant to the assessment year exceed Rs 15 lakh for the assessment years 2011-12 and 2012-13 (Rs. 10 lakh up to the assessment year 2010-11 and Rs. 25 lakh from the assessment year 2013-14)
3.	Any firm covered under section 44AD, 44AF (omitted from the assessment year 2011-12).	If the firm claims that the profits and gains from the business are lower than the profits and gains computed under these sections (irrespective of the turnover)
4.	Any firm covered under section 44AE, 44BB or 44BBB	If the firm claims that the profits and gains from the business are lower than the profits and gains computed under these sections (irrespective of the turnover)
5.	Any firm covered under section 44AD (applicable from the assessment year 2011-12).	If the firm claims that the profits and gains from the business are lower than the profits and gains computed in accordance with provisions of section 44AD(1) and if the income exceeds the maximum amount which is not chargeable to tax.
6.	Any firm covered under section 44B or 44BBA	Section 44AB is not applicable in the case of assessees who come within the purview of section 44B or 44BBA.

151. What are the 'due dates' for getting books of account audited and submission of audit report by a firm?

Though a firm of partnership carries on business or profession under the partnership law, it is not required by or under the partnership law to get its accounts audited. In this context, a firm has to get its accounts audited under section 44AB of the Income-tax Act, 1961. For this purpose, the following details are relevant:

Audit Form No.	Statement particulars	Due date for getting books audited	Due date for submission of audit report
Form No. 3CB	Form No. 3CD	Due date of furnishing return of income under section 139(1) [October 31 up to the assessment year 2007-08, September 30 from assessment year 2008-09]. If the firm is covered u/s 92E, November 30[from assessment year 2012-13]	Due date of furnishing return of income under section 139(1) [October 31 up to the assessment year 2007-08, September 30 from assessment year 2008-09]. If the firm is covered u/s 92E, November 30 [from assessment year 2012-13]

152. Is it compulsory for a firm to attach report of audit under section 44AB with income tax returns?

- Under e-filing, the report of audit under section 44AB is not to be attached with new returns. It should not be furnished separately also before or after the due date.
- The firm should however get the report of audit before the due date of the furnishing of the return and should fill out the relevant columns of return forms on the basis of such report.
- The firm should retain the audit report with itself. The audit report may be furnished in original during the assessment proceedings.

- In this context, no penalty under section 271B shall be initiated or levied for not furnishing the tax audit report on or before the due date.

153. Is it compulsory for a partnership firm to get its accounts audited under section 44AB in respect of all income?

In case of an assessee carrying on a business or profession, it is necessary to comply with the provisions of section 44AB only in respect of his income from business or profession. In other words, it would not be necessary to comply with the provisions of section 44AB in respect of his other income – Ghai Constructions v. State of Maharashtra (2009) 184 Taxman 52 (Bom.).

154. Can a partnership firm avail the benefit of 'presumptive taxation' under section 44AD?

Section 44AD of the Income-tax Act, 1961 [as substituted by the Finance (No.2) Act, 2009 w.e.f.1.4.2011] provides special provisions for computing business profit on 'presumptive basis' from assessment year 2011-12.

Section 44AD shall be applicable only to an 'eligible assessee'. An eligible assessee for this purpose may include a partnership resident in India. The following persons are however not eligible to avail any benefit under section 44AD-

- An LLP;
- any person carrying on 'specified profession' as referred to in section 44AA(1);
- any person earning income in the nature of 'commission' or 'brokerage'; or
- any person carrying on any 'agency business'.

In order to avail benefit u/s 44AD, the assessee-firm should not claimany deduction under sections 10A, 10AA, 10B, 10BA, 80HH to 80RRB in the relevant assessment year.

The assessee should not be engaged in the business of plying, hiring or leasing goods carriages referred to in section 44AE.

The total turnover/ gross receipt in the previous year of the business should not exceed Rs. 60 lakh(Rs. 1 crore from the assessment year 2013-14).

If the above conditions are satisfied, the income from the 'eligible business' is estimated at 8 percent of the gross receipt or total turnover. However, the assessee can voluntarily declare a higher income in the return.

All deductions under sections 30 to 38, including depreciation and unabsorbed depreciation, are deemed to have been already allowed and no further deduction is allowed under these sections.

However, in the case of a firm, the normal deduction in respect of salary and interest to partners under section 40(b) shall be allowed. The written down value is calculated, where necessary, as if depreciation as applicable has been allowed. Moreover, it will be assumed that disallowance, if any, under sections 40, 40A and 43B has been considered while calculating the estimated income @8percent.

An assessee opting for the above scheme shall be exempted from payment of advance tax related to such business. He shall also be exempted from maintenance of books of account related to such business as required under section 44AA.

When income is taxable at the rate of 8 percent as stated above, the concerned assessee is not under any obligation to explain individual entry of cash deposit in his bank, unless such entry has no nexus with the gross receipts- CIT v Surinder Pal Anand (2010)192 Taxman 264 (Punj. & Har.).

However, if the assessee-firm declares its income which is lower than the deemed profits and gains as stated above, the following consequences are applicable:

- The firm will have to maintain the books of account as per section 44AA (irrespective of income or turnover) if its total income exceeds the exemption limit.
- The firm will have to get its books of account audited under section 44AB (irrespective of turnover) if its total income exceeds the exemption limit.

155. How to approach audit of a partnership firm?

- Before commencement of audit, the auditor of a partnership firm should know the scope of his audit work. The appointment letter should give clear and definite instructions in writing. This will help in fixing his liabilities and the extent thereof.
- While auditing books of a partnership firm, there are no statutory requirements or directives expected from the auditor. In this context, the auditor should take an engagement letter, which should describe the scope of his work.

- The auditor of a firm should examine the original copy of the partnership deed and obtain one certified copy for his file.
- He should carefully study all the important provisions of the partnership deed. He should be extra-vigilant on those clauses, affecting the accounts in particular.
- He should see that the activities of the firm and the actions of the partners are in the interest of all and the firm, are not detrimental to the interest of any of them.
- He should verify the following:
  - Names of the partners;
  - The profit-sharing ratios of partners;
  - Capitals of the partners.
  - Drawings allowed to each partner.
  - Remuneration of all or any of the partners.
  - Interest on capital;
  - Interest on drawings;
  - Provision for accounts and audit, if any.
  - Provision regarding retirement;
  - Provision regarding dissolution, and
  - Provision regarding goodwill.
- The auditor should verify the existence and the extent of the internal control in operation in the firm.
- He should obtain a list of all the books of account and the names of the persons in charge of these accounts.
- He should in particular verify the drawings of each of the partners.
- The auditee, being a partnership concern, the auditor has to be careful while checking the firm's expenses. The auditor has to see that the personal expenses of the partners are not entered as the expenses of the business.
- The auditor should also see whether any goods have been taken by the partners for their personal use and see that the accounting entries are passed properly in the books of accounts.

- As a notable feature, the problems of internal check are sometimes tricky in a partnership concern. This is because in a firm of partnership, the partners themselves supervise or perform all the managerial functions.

156. How to prepare the balance sheet of a firm?

It is true that neither the Indian Partnership Act, 1932 nor the Income tax Act, 1961 has prescribed any specific format for the financial statements meant for a partnership firm. In this context, here are certain guidelines, which may be useful while preparing a balance sheet for this unique non-corporate entity.

CAPITAL & LIABILITIES:

Sl.No.	Item to be disclosed	How to disclose?-Guidelines
1.	Capital	In the case of partnership, particulars of capital are to be given separately for each partner and if possible the fixed capital accounts may be segregated from the current accounts) as at the beginning of the year. ❑ Add /Deduct Net Profit /Net Loss during the year; ❑ Interest on capital; ❑ Drawings; ❑ Any other items (give details).
2.	Reserves	Give details under each head: ❑ Capital reserves (if any); ❑ Other Reserves; ❑ Sinking Funds (if any).
3.	Loans & borrowings	Under "Loans & borrowings", ❑ Interest accrued and due on each category to be shown separately; ❑ In the case of secured loans the nature of security to be specified; ❑ Amounts due for repayments within one year from the balance sheet date to be shown separately;

		❑ Loans from partners, relatives of the partners to be shown separately; ❑ Loans from financial institutions; ❑ Loans and borrowings from banks (Specify the name of the bank, the relevant amount and the nature of the borrowing e.g. cash credit, term-loans, overdraft, packing credit etc. (separately); ❑ Fixed deposits (from public and others); ❑ Others (give details).
4.	Current Liabilities & Provisions	(Amounts due for payment beyond one year from the date of the balance sheet (to be shown separately) Under Current Liabilities, give details: ❑ Sundry creditors for goods supplied. ❑ Sundry creditors (Others) ❑ Advances/Progress Payments from Customers/deposits from dealers, selling agents etc. ❑ Interest and other charges accrued but not due for payment. ❑ Bills Payable. ❑ Statutory liabilities (Overdue amounts to be shown separately) ❑ Other current liabilities and provisions (Major items to be shown separately) Under Provisions, give details: ❑ For taxation Less advance tax paid ❑ For Provident Fund ❑ For contingencies ❑ Other provisions.(A foot note to the balance sheet may be added to show separately) ❑ Claims against the entity not acknowledged as debts. ❑ Uncalled liability on shares partly paid ❑ Estimated amount of contracts

		remaining to be executed to capital account and not provided for. ❑ Contingent liability for bills discounted. ❑ Other money for which the entity is contingently liable. (give details) ❑ Aggregate amount of arrears of depreciation, if any.

PROPERTIES & ASSETS:

Sl. No.	Item to be disclosed	How to disclose?-Guidelines
1.	Fixed Assets	❑ Under each head the original cost, the additions thereto, the deductions there from during the year and the total depreciation written off or provided upto the end of the year to be stated. ❑ Where the assets have been revalued, the revalued figures to be shown. Each balance sheet for the first five years subsequent to the date of revaluation to state the amount of revaluation. Distinguishing as far as possible between expenditure upon: ❑ Goodwill ❑ Land ❑ Buildings ❑ Leaseholds ❑ Railway sidings ❑ Plant and Machinery ❑ Furniture & Fittings ❑ Development of property ❑ Patents, Trademarks and designs ❑ Livestock ❑ Vehicles etc. Cost Less: depreciation
2.	Advances and Deposits on Capital Account	

3.	Investments	(Attach details of investment showing in each case nature of investment and mode of valuation e.g., cost or market value) ❑ Investment in shares, debentures or bonds (Investments in concern wherein proprietor, partner or their relative are interested to be shown separately) ❑ Immovable properties ❑ Investments in the capital of partnership firms ❑ Other investments.
4.	Loans	❑ The nature of security (if any) and amount of each type of loan to be specified. ❑ Amounts due within one year to be shown separately. ❑ Loans to proprietors, partners or associated concern (to be shown separately) ❑ Loans considered bad or doubtful to be shown separately. ❑ Less: provision for bad and Doubtful loans.
5.	Current Assets	Under Inventories: (The mode of valuation to be shown separately) ❑ Raw materials (including stores and other items used in the process of manufacture) ❑ Work in process. ❑ Finished goods. ❑ Consumable stores and spare parts. ❑ Loose tools. ❑ Others Under Receivables: ❑ Debts due and outstanding for a period exceeding six months (to be shown separately). ❑ Instalments of deferred receivables due

		within one year to be shown separately. ❑ Debts considered bad or doubtful to be shown separately. ❑ Amount due from proprietors, partners or associated concerns to be shown separately. (i) On account of sales on deferred payment basis. (ii) On account of exports (iii) Others (iv) Total receivables (v) Less: provision for bad and doubtful debts. Under Bills of Exchange: (Same information to be given as for "Receivables') Under Advance on Current Account: (Same information to be given as for loans). ❑ Advance to suppliers of merchandise supplies and sundries etc. and stores/spares/ consumables. ❑ Advance payment of taxes (in excess of tax payable) ❑ Pre-paid expenses. ❑ Others Under Cash & Bank Balances: ❑ Fixed deposit account ❑ Current and savings account ❑ Cash on hand
6.	Miscellaneous Expenditure	To the extent not written off or adjusted (specify the nature and amount of each item).
7.	Accumulated Losses, if any	❑ before depreciation ❑ depreciation
Notes on Balance Sheet: 1. In case of partnership firms, state whether it is registered with Registrar of Firms, registration number, date of registration and the State in which it is registered.		

2.	Unless otherwise indicated, the terms used herein have the same meaning as they have in Schedule VI to the Companies Act, 1956.

157. How to prepare the profit and loss account of a partnership firm?

It is true that neither the Indian Partnership Act, 1932 nor the Income tax Act, 1961 has prescribed any specific format for the financial statements meant for a partnership firm. In this context, herein below is a specimen of the profit and loss account of a partnership firm.

Pro forma of profit and loss account of a partnership firm

Name of the entity:

____

Profit and Loss Account for the year ending:

____

		(000's omitted)	Previous Year	This Year (actuals)
1.	Sales			
	(Income from services may be shown separately)			
2.	Less: Excise Duty			
3.	Net Sales			
	(Item No.1 minus Item No.2)			
4.	Add/Deduct/Increase /Decrease in Finished Goods			
	Closing Stock			
	Less: Opening Stock			
5.	Cost of Production			
	(a) Raw material consumption.			
	Add: Purchases			
	Less: Closing Stock			
	(b) Stores and spare consumption			
	(c) Salaries and wages			
	(d) Other manufacturing expenses, excluding depreciation			
	Sub-total			

Add: Opening stocks-in-process

Deduct: Closing stock-in-process

Cost of production

Gross profit/loss (Item No.3 minus Item No.4)

6. Sales and administrative expenses
7. Interest and other overheads
8. Other income/expenses net (+)
9. Profit /loss before depreciation and tax

   (Item No.5 minus item No. (6+7)
10. Depreciation
11. Profit after depreciation
12. Taxation
13. Profit after tax

Notes:

1. Any item of expenditure, which forms a significant proportion, say 5% or more of the total sales or has special significance or otherwise, should be shown separately under appropriate heads. For example (i) salary (ii) commission (iii) perquisites and money value thereof.
2. If audited accounts for the previous year are not available, the fact should be stated.

158. Can a foreigner set up a partnership or proprietorship concern in India?

No. Only NRIs/PIOs are allowed to set up partnership or proprietorship concerns in India on non-repatriation basis.

Part II of Master Circular on Foreign Investment in India (RBI/2012-13/15) dated July 02, 2012 deal with Investment in Partnership Firm by NRI and PIO.

For this purpose, 'Non-Resident Indian (NRI)' means a person resident outside India who is a citizen of India or is a person of Indian origin;

'Person of Indian Origin' means a citizen of any country other than Bangladesh or Pakistan or Sri Lanka, if

(a) he at any time held Indian passport; or

(b) he or either of his parents or any of his grand - parents was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or

(c) the person is a spouse of an Indian citizen or a person referred to in sub-clause (a) or (b);

The readers may also refer the Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations, 2000 (Notification No. FEMA 24 /2000-RB dated 3rd May 2000).

159. Can any NRI or PIO make investment in Indian Partnership Firms on non-repatriation basis?

Part II of Master Circular on Foreign Investment in India (RBI/2012-13/15) dated July 02, 2012 deal with Investment in Partnership Firm by any NRI or PIO. Accordingly, a Non-Resident Indian (NRI) or a Person of Indian Origin (PIO) resident outside India can invest by way of contribution to the capital of a firm in India on non-repatriation basis provided:

(i) Amount is invested by inward remittance or out of NRE / FCNR(B) / NRO account maintained with Authorised Dealers / Authorised banks.

(ii) The firm is not engaged in any agricultural / plantation or real estate business (i.e. dealing in land and immovable property with a view to earning profit or earning income there from) or print media sector.

(iii) Amount invested shall not be eligible for repatriation outside India.

160. Can NRI or PIO make investments in Indian Partnerships with repatriation benefits?

Part II of Master Circular on Foreign Investment in India (RBI/2012-13/15) dated July 02, 2012 deal with Investment in Partnership Firm by NRI and PIO. Accordingly, NRIs / PIO may seek prior permission of Reserve Bank for investment in partnership firms with repatriation benefits. The application will be decided in consultation with the Government of India.

For this purpose, the application should be addressed to the Chief General Manager-in-Charge, Reserve Bank of India, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai.

161. Can non-residents [other than NRIs / PIO] make investments in Indian Partnerships?

A person resident outside India other than NRIs / PIO may make an application and seek prior approval of Reserve Bank, for making investment by way of contribution to the capital of a firm in India. The application will be decided in consultation with the Government of India.

For this purpose, the application should be addressed to the Chief General Manager-in-Charge, Reserve Bank of India, Foreign Exchange Department, Foreign Investment Division, Central Office, Mumbai.

162. Can NRIs or PIOs invest in Indian firms of partnership engaged in all sectors?

An NRI or PIO is not allowed to invest in a firm of partnership engaged in any agricultural/plantation activity or real estate business (i.e. dealing in land and immovable property with a view to earning profit or earning income therefrom) or engaged in Print Media.

163. Can a partnership firm in India make payment to NRI or PIO who has made investment?

A partnership firm in India may make payment to or for the credit of a non-resident Indian or a person of Indian origin the sum invested by such person in that firm or the income accruing to such person by way of profit on such investment. The readers may please refer the Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations, 2000 (Notification No. FEMA 24 /2000-RB dated 3rd May 2000).

164. "Issue of notice to any partner may be considered as issue of notice to a firm"-Do you agree?

Section 24 of the Indian Partnership Act, 1932 deals with the effect of notice made to an acting partner of a firm. Accordingly, the notice issued to a partner, who habitually acts in business of the firm, on matters relating to the affairs of the firm, operates as a notice to the firm of partnership except in the case of a fraud on the firm committed by or with the connivance of that partner.

In other words, the notice to one partner (as prescribed under section 24) is equivalent to the notice to the rest of the partners of the firm, just as a notice to an agent is notice to his principal.

For this purpose, this notice must be actual and not constructive. Again, the notice must be received by a working partner and not by a dormant sleeping partner. The notice must further relate to the firm's business. Only then it would constitute a notice to the firm.

165. Is a power of attorney required for a partner to act on behalf of a firm?

Under section 19 of the Indian Partnership Act, 1932 if there is no usage or custom of trade to the contrary, the implied authority of the partner does not empower him to:

(a) submit a dispute relating to the business of the firm to arbitration;

(b) open a banking account on behalf of the firm in his own name;

(c) compromise or relinquish any claim or portion of a claim by the firm;

(d) withdraw a suit or proceeding filed on behalf of the firm;

(e) admit any liability in a suit or proceeding against the firm;

(f) transfer immovable property belonging to the firm; or

(g) enter into partnership on behalf of the firm.

Accordingly, unless all the partners of the firm join in conferring an authority under a power-of-attorney in respect of the matters mentioned in clauses (a) to (g) above a power-of-attorney executed by only one or less than all the partners will not constitute the attorney or agent competent to do any of the acts comprised under clauses (a) to (g) above mentioned. In all other cases, a partner should be deemed to have an implied authority to appoint an agent and to execute a power-of-attorney on behalf of the firm to do such act for the purpose of business of the firm.

166. What are the salient features of the scheme of taxation of partnership firms in India?

- Under section 2(31) of the Income-tax Act, 1961, the term 'person' includes a partnership firm and therefore a firm of partnership is taxed as a 'separate entity'.
- With effect from assessment year 1993-94, there is no distinction between 'registered' and 'unregistered' firms.
- Under section 184(1) of the Act, [for and from the assessment year 1993-94], a firm of partnership will be assessed as such if the following conditions are fulfilled:
  - (i) the partnership is evidenced by an instrument; and
  - (ii) the individual shares of the partners are specified in that instrument.

167. What will happen if a partnership firm does not comply with the provisions of section 184 of the Income-tax Act, 1961 for any assessment year?

If and when a partnership firm does not comply with the provisions of section 184 for any assessment year, it will be so assessed for that assessment year that no deduction by way of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such firm to any partner of such firm shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession" and such interest, salary, bonus, commission or remuneration shall not be chargeable to income-tax under section 28(v) in the hands of the partner.

168. When will a firm attract 'best judgment assessment' under income tax law?

In case a partnership firm commits any of the defaults as prescribed under section 144 of the Act, in any assessment year, it shall be sufficient to attract best judgment assessment under income tax law. In such case, the partnership firm will be assessed under section 184(5) without allowing any deduction of interest, salary, etc. paid to partners for that assessment year. Under the income tax law, the following defaults shall attract best judgment assessment:

- Failure to make the return of income as required under section 139(1) and non-submission of a belated return under section 139(4) or a revised return under section 139(5). (Clause (a) of section 144(1).
- Failure to comply with all the terms of a notice issued by the Assessing Officer under section 142(1) for furnishing return of income or to produce accounts or documents or to furnish information called for. (Clause (b) of section 144(1))
- Failure to comply with the directions issued under section 142(2A) for getting the accounts audited. (Clause (b) of section 144(1))
- Failure to comply with all the terms of a notice issued by the Assessing Officer under section 143(2) for production of evidence in support of return. (Section 144(1)(c).

169. "Payment of interest to partners is always deductible in the hands of a partnership firm". Do you agree?

Under the Income-tax Act, 1961, payment of interest to partners is deductible in the hands of a partnership firm if and when the following conditions are satisfied:

- the firm of partnership should be evidenced by an instrument [section 184(1)(i)]
- The individual shares of the partners must be specified in the instrument. [section 184(1)(ii)]
- Certified copy of the instrument of partnership must accompany the return of income.[Section 184(2)]
- Revised instrument of partnership should be submitted if there is any change in the constitution of firm / profit-sharing ratio [Section 184(4)]
- There should not be any failure as is mentioned in section 144.[Section 184(5)]
- Payment of interest should be authorised by the partnership deed[Section 40(b)(ii)]
- Payment of interest should pertain to the period after the partnership deed[Section 40(b)(iv)]
- Rate of interest should not exceed 12 per cent (18 per cent up to the assessment year 2002-03)[Section 40(b)(iv)]

170. What are the conditions to be fulfilled for claiming payment of remuneration to partners?

The new scheme of taxation of firms [introduced from 1.4.1993] provides for payment of interest to partners and remuneration to working partners subject to a ceiling, as prescribed therein. As for salary or remuneration paid to partners of a firm, it is deductible only if it is paid to the working partner/s of the firm. Further, the allowance is subject to a ceiling of aggregate payments of salaries or remuneration to partners, which depends on the 'book profits' of the firm of partnership. Under the Income-tax Act, 1961, payment of remuneration to partners is deductible in the hands of a partnership firm if and when the following conditions are satisfied:

- The firm of partnership must be evidenced by an instrument in writing. [Section 184(1)(i)]]

- The individual shares of the partners must be specified in the instrument. [Section 184(1)(ii)]]
- Certified copy of the instrument of partnership must accompany the return of income. [Section 184(2)]
- Revised instrument of partnership should be submitted if there is any change in the constitution of firm / profit-sharing ratio[Section 184(4)]
- There should not be any failure as is mentioned in section 144. [Section 184(5)]
- Remuneration should be paid only to a working partner. [Section 40(b)(i)]
- Remuneration must be authorised by the partnership deed. [Section 40(b)(ii)]
- Remuneration should not pertain to period prior to partnership deed. [Section 40(b)(iii)]
- Remuneration should not exceed the permissible limit. [Section 40(b)(v)]

171. Can a partnership claim deductions under Chapter VIA of the Income-tax Act, 1961?

Under section 80A of the Income-tax Act, 1961, in computing the total income of an assessee, there shall be allowed from his gross total income, certain deductions in accordance with and subject to the provisions of Chapter VIA (viz., the deductions specified in sections 80C to 80U). The aggregate amount of the deductions under Chapter VIA shall not, in any case, exceed the gross total income of the assessee. As for as a partnership firm is concerned, only two deductions (viz., under sections 80G and 80GGC) shall be available (in respect of payments made by the assessee) under Chapter VIA.

172. Can a partnership firm make political donations?

Under section 80GGC of the Income-tax Act, 1961, deduction is available in respect of donations made to political parties. Deduction under this section is allowable to any person except local authority and an artificial juridical person wholly or partly funded by the Government. Amount of deduction available under section 80GGC shall be 100% of sum contributed by the assessee during a previous year to any political party.

For this purpose, 'political party' means any political party, registered under section 29A of the Representation of the People Act, 1951.

173. How will you treat any payment made to a retiring partner?

Any lump sum paid to the retiring partners for transfer of all their rights to the reconstituted firm would be revenue expenditure where the firm makes profits from stock and right so transferred-Sukhbir Prashad v. CIT, (1983) 144 ITR 437 (P&H).

Payment of certain sums to two outgoing partners and a minor admitted to the benefits of the partnership on the dissolution of the partnership as consideration for goodwill and relinquishment of all the rights in the firm by the reconstituted firm would be a capital expenditure. This is because the payment was not incidental to the carrying on of business but to the reconstitution of the business by remaining partners in the new partnership-CIT v. Purandas Ranchoddas & Sons, (1988) 169 ITR 480 (AP).

174. Can a firm claim the expenditure in connection with the closure or transfer of a business?

In order to claim deductions/allowances under the Income tax Act, 1961, the assessee-firm should carry on the business or profession during the year. In this context, the expenditure in connection with the closure or transfer of a business may not be available as deduction, notwithstanding the fact that such expenditure has been incurred genuinely, and in connection with the business. Accordingly, retrenchment compensation in connection with the closure is inadmissible-CIT v. Gemini Cashew Sales Corporation (1958) 34 ITR 10 (SC).

However, certain receipts (even if received after the closure of the business or profession) are specifically made taxable under the following sections, viz.,

- recovery or excess recovery against a deduction u/s 41(1);
- sale of an asset used for scientific research u/s 41(3);
- recovery or excess recovery against bad debts u/s 41(4);
- sum received after discontinuance of a business u/s 176(3A);
- sum received after discontinuance of profession u/s 176(4) etc.

175. How will you treat payment of penalties and fines in case of a partnership firm?

Penalties, which are incurred by an assessee-firm for an infraction of the law, cannot be called commercial losses incurred by the assessee in carrying on the business. This is because infraction of the law is not a normal incident of the business and therefore only such disbursements can be allowed as are really incidental to the business itself-Haji Aziz & Abdul Shakoor Bros. v. CIT (1961) 41 ITR 350 (SC).

So long as any payment is to be made by the assessee for infraction of law, it cannot be said that it is being made in the course of carrying out of the trade or business- Maddi Venkataraman & Co. (P.) Ltd. v. CIT (1998) 229 ITR 534 (SC). However, if a payment made by the assessee-firm is really in the nature of a compensatory payment, it may qualify for deduction. Sales tax penalty was allowed on the reasoning that it is compensatory-CIT v. Sutlej Cotton Mills Ltd. (1992) 194 ITR 66 (Cal.).

176. How will you treat higher education expenses of a partner?

In case where a partner of a firm incurs expenditure for higher education, the admissibility of the expenditure as a business deduction shall depend upon the purpose for which the higher education is undertaken.

Where a partner of a firm incurs expenditure for higher education, the expenditure cannot be treated as for his personal benefit, if the course of study is such as to help expansion of the business, so that such nexus would entitle deduction for the firm-CIT v. Kohinoor Paper Products, (1997) 226 ITR 220 (MP).

In case expenditure is incurred for acquiring education, enrichment of knowledge and getting technical know-how etc. in a foreign country by partner, director or their relatives, the allowability of the above expenditure as business expenditure shall depend upon the facts of each case. If the expenditure is for the purpose of business and not personal or capital in nature the same is allowable u/s 37- Sakal Papers (P) Ltd. v. CIT (1978) 114 ITR 256 (Bom).

Where the partners of the assessee-firm undertook foreign tours for attending the international Trade Fair with intent to advance the business, the expenditure on their tour has been held as revenue expenditure- Addl. CIT v. Southern Leather Industries (1986) 164 ITR 194 (Mad).

The expenditure incurred on a partner's education abroad was not in the nature of capital expenditure or for personal purposes. It was spent wholly and exclusively for the purpose of the business of the assessee-firm and was allowable- CIT v. Kohinoor Paper Products (1997) 226 ITR 220 (MP).

Where an assessee-firm took a person as a partner in the firm and immediately thereafter sent the new partner to USA for higher studies, it was held that it was not possible to accept the submission of the assessee as the expenditure in question was not incurred in relation to the business of the assessee firm and the expenditure incurred had no nexus to the existing business of manufacturing stocks and underwear- CIT v. Hindustan Hosiery Industries (1994) 209 ITR 383 (Bom).

177. What are the ceilings prescribed for remuneration to partners of a firm upto assessment year 2009-10?

While computing the income of the firm, any payment of salary, bonus, commission or remuneration by whatever name called (hereinafter referred to as 'remuneration') to any partner who is not a 'working partner' will be disallowed under section 40(b). "Working partner" for this purpose means an individual, who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner [Explanation 4 to section 40(b). Following are the ceilings as applicable in respect of working partners [upto assessment year 2009-10].

UP TO THE ASSESSMENT YEAR 2009-10:

Nature of firm	Book profit	Ceilings for 'remuneration'
I. Professional firms referred to in section 44AA.	on the first Rs.1,00,000 of the book-profit or in case of a loss	Rs.50,000 or at the rate of 90% of the book-profit, whichever is more.
	on the next Rs.1,00,000 of the book-profit	at the rate of 60%
	on the balance of the book-profit	at the rate of 40%.
II. For firms other than professional firms	on the first Rs.75,000 of the book-profit or in case of a loss	Rs.50,000 or at the rate of 90% of the book-profit, whichever is more.
	on the next Rs.75,000 of the book-profit	at the rate of 60%

	on the balance of the book-profit	at the rate of 40%.

Any payment in excess of the above ceilings will be disallowed in the hands of the firm. Further, "Book-profit" for this purpose means the net profit, as per the profit and loss account, computed under section 28 to 44DA of the Income-tax Act, 1961. The remuneration paid or payable to partners, if debited to the profit and loss account, will have to be added back to the net profit. [Expl. 3 to section 40(b)].

178. What are the ceilings prescribed for remuneration to partners of a firm from assessment year 2010-11?

With effect from assessment year 2010-11 uniform limits have been provided for both professional firms and non-professional firms. Further, these limits will be applicable whether the firm is a limited liability partnership firm or otherwise. The revised limits are as follows-

Book profit	Amount deductible in respect of remuneration to partners under section 40(b) with effect from the assessment year 2010-11
If book profit is negative	Rs. 1,50,000
In case book profit is positive- On first Rs. 3 lakh of book profit	Rs. 1, 50,000 or 90 per cent of book profit, whichever is more.
On the balance of the book profit	60 per cent of book profit

179. How to compute 'book profit' for the purpose of remuneration to partners?

'Book profit' of a partnership firm can be determined as under:

1. Find out the net profit of the firm as per the Profit and Loss Account.
2. Make adjustments as provided by sections 28 to 44D.
3. Add remuneration to partners if debited to the Profit and Loss Account.
4. The resulting amount is "book profit".

As far as adjustments to be made, only adjustments as specified under sections 28 to 44D will be made and, consequently,-

- income 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";
- brought forward business losses will not be deducted from " book profit"; and
- permissible deductions from gross total income under sections 80C to 80U shall be ignored from computing " book profit".

180. How to assess 'share income' of partners of a firm?

- Under the income tax law, the partners of a firm are assessable as individuals but their share income from the firm is totally exempt from tax, for and from the assessment year 1993-94 and it cannot be included in their total income even for rate purposes. (section 10(2A).
- Explanation to this caluse states that share of a partner in a firm shall be computed by dividing the assessed income of the firm in the same proportion as the profit sharing ratio mentioned in the partnership deed. In this context, it may be noted that assessed income and not the net profit as per books of account of the firm has to be taken into account for the purpose of exemption.

181. How to assess salary or interest income of partners of a firm?

- Any salary or interest received by the partners of a firm will be taxable in their hands and, the firm will be entitled to the deduction of interest and salary paid to the partners subject to the limits prescribed-Section 40(b).
- Any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner from firm, will be assessed in the hands of the partner. These have been treated as 'income' under section 2(24)(ve) of the Act.
- The salary or remuneration received by the partners from the firm will be taxed in their hands under the head "Profits and gains of business or profession". (Clause (v) of section 28). In this context, the partners of the firm will be entitled to the deduction of revenue expenditure in earning their salary from the firm. (Section 37(1).)
- Under Explanation 2 to section 15, the salary received by partner will not be treated as 'salary income' and hence deduction u/s. 16 cannot be availed of. Instead, both remuneration and interest will be

assessed as business/professional income in the hands of partner under section 28(v).

- Further, the remuneration and/or interest to partners in excess of the prescribed ceiling limit will be disallowed in the hands of the firm u/s. 40(b) and taxed there at the maximum mariginal rate. In such a case, the amount of salary, remuneration, etc. and/or interest so disallowed will be reduced from the salary, remuneration, etc. and/or interest assessable in the hands of the partner [Proviso to section 28(v)].

182. How will you treat losses of firm against the partners?

Under section 75 of the Income-tax Act, 1961, any unabsorbed loss (apportioned to a partner) of the firm relating to assessment year 1992-93 and earlier years which could not be fully set off in the hands of partner upto assessment year 1992-93, will be set off against the income of the firm in assessment year 1993-94 and subsequent years.

This is, however, subject to additional conditions that the said partner continues in the said firm and that such set off is in accordance with sections 70,71,72,73,74 & 74A.

However, the loss of firm relating to assessment year 1993-94 and subsequent years, will be set off only in the hands of the firm. However, the share relatable to an outgoing partner, either by retirement or death, will be excluded for the purposes of such setting off [section 78(1)]

183. Can a firm's business be run at a partner's premises?

As an accepted rule under partnership law, a business carried on by a partnership firm is a business carried on by its partners. Therefore, a partner of firm, making available to it a house property, of which he is the owner, for carrying on business, would not be assessable in respect of the annual value of such property- (CIT v. K.N. Jagannathan, (1989) 180 ITR 191 (Mad): Addl. CIT v. N. Vidyanathan, (1989) 180 ITR 198 (Mad): CIT v. Rasiklal Balabhai, (1979) 119 ITR 303 (Guj). Therefore, a partnership firm may take advantage of this legal position.

184. How will you consider occupation of firm's property by its partners?

- The partners of a firm may occupy the property of the firm for residential purposes and annual value of such property will not be chargeable to tax because the occupation by the partners is the occupation the firm and the partners occupy such property only for the better carrying on of the business of the firm.

- In this context, the occupation of the firm's property by the partners for their residential purposes will be regarded as one for the purposes of firm's business when the partners supervise and attend to the firm's business-Saligram & Co. v. CIT. (1990) 185 ITR 82 (Gau).

185. Who are liable to pay income tax on behalf of a firm?

- Under section 188A of the Income-tax Act, 1961, the liability of a partnership firm to pay tax, penalty or any other sum for an assessment year can be recovered from any or all the persons, who were, during the previous year relevant to the assessment year, partners and the legal representive of any such partner who is deceased.
- This apart, under section 189(3) of the Act, in case where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, every person who was at the time of such discontinuance or dissolution a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable.

186. Can a partner bring in capital assets towards his capital contribution in a firm?

Legally speaking, capital contribution by each and every partner of a firm is not necessary. However, if a partner contributes capital, it should be in the form of cash or in form of stock-in-trade of business and not any capital asset because the contribution of capital asset by the partner would attract tax on capital gains under section 45(3) of the Income-tax Act, 1961 and the amount recorded in the books of account of firm as the value of capital asset will be deemed to be the full value of consideration for such capital asset- CIT v. Prakash Chand Dhadda, (1996) 221 ITR 102 (Raj).

However, if and when it becomes unavoidable to contribute a capital asset, a long-term capital asset may be contributed as capital to attract lower incidence of tax under section 112(1).

In the case of CIT v. J. M. Mehta & Bros., (1995) 214 ITR 716 (Bom.), where the firm transferred immovable property to its partners by mere book entries, without registration, capital gain arising on sale of said property was held assessable in the hands of the firm. Despite the liability of a firm to tax on capital gains arising on the transfer of capital assets, a firm is also liable to this tax, where there is a distribution of capital assets on the dissolution of a firm. In such a case, the fair market value of the asset on the date of such distribution is deemed to be the full value of consideration received or accruing to the firm. Such distribution is regarded as a transfer under section 45(4).

187. Is it compulsory for a firm to file its return of its income?

Under the Income-tax Act, 1961, all partnership firms are required to file return of their income, irrespective of their income.

Under section 139(1) of the Income-tax Act, 1961, filing of return by partnership firms is mandatory (as amended by Finance Act, 2005, w.e.f.1.4.2006). Accordingly, every partnership firm shall, on or before the due date, furnish a return of its income or the income of such other person during the previous year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.

188. What are the 'due dates' for filing return of income by partnership firms?

As per explanation 2 to section 139(1) of the Income-tax Act, 1961, the return is to be filed by a partnership firm within the due dates, viz.,

- Where the assessee is required to furnish a report in Form No.3CEB under section 92E pertaining to international transactions (from assessment year 2012-13), the 30th day of November of the assessment year;
- where the assessee is a partnership firm whose accounts are required to be audited under this Act or under any other law for the time being in force, the 30th day of September of the assessment year;
- where the assessee is a working partner of a firm whose accounts are required to be audited under this Act or under any other law for the time being in force, the 30th day of September of the assessment year; and
- in the case of any other firm, the 31st day of July of the assessment year.

In case the last day for filing return of income is a day on which the office is closed, the assessee can file the return on the next day afterwards on which the office is opened. In such cases, the return of income filed by the assessee will be considered to have been filed within the specified time limit- CBDT's Circular No. 639, dated 13.11.1992.

189. Is filing return of income by a firm within due date mandatory?

Any return of income, which claims carry forward of any business loss or capital loss must be furnished under section 139(3) before the due date. If not, the carry forward facility shall not be allowed to the partnership firm.

190. What are the details to be kept ready (at the time of filing return) by a firm in case regular books of account are maintained?

In case regular books of account are maintained by the partnership firm, the return is required to be accompanied by copies of the following:

- manufacturing account;
- trading account;
- profit and loss account; or, as the case may be, income and expenditure account; or any other similar account; and
- balance sheet;
- personal accounts of the partners.

In case the accounts of the partnership firm have been audited, the return is required to be accompanied by copies of the audited profit and loss account and balance sheet and the auditor's report. The following details should also be kept ready by a partnership firm at the time of filing its return:

- a statement showing the computation of the tax payable on the basis of the return;
- the report of the audit under section 44AB and where the audit report has been furnished prior to the furnishing of the return, by a copy of such report together with proof of furnishing the report;
- proof of the tax, if any, claimed to have been deducted at source;
- proof of advance tax and tax on self-assessment, if any, claimed to have been paid;
- the amount of compulsory deposit, if any, claimed to have been made under the Compulsory Deposit Scheme (Income-tax Payers) Act, 1974.

191. What are the details to be kept ready (at the time of filing return) by a firm in case regular books of account are not maintained?

In case regular books of account are not maintained by the partnership firm, the return is accompanied by a statement indicating the amounts of turnover or, as the case may be, gross receipts, gross profit, expenses and net profit of the business or profession and the basis on which such amounts have been computed, and also disclosing the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

192. What are the penalties prescribed for filing delayed return by a partnership firm?

In case of delayed return or no-return, simple interest is payable on the amount of tax assessed as reduced by the amount of advance tax paid and TDS (or TCS). For this purpose, the interest under section 234A shall be charged @ 1% for every month or part of month of delay in filing the return, i.e. from the due date to the date of filing the return, or where no return has been filed, upto the date of completion of assessment u/s 144. Interest for this purpose shall be calculated on the amount of tax payable on returned income as reduced by advance tax, TDS, and tax paid along with self-assessment tax.

However, interest may not be levied for late filing of return, if tax payable on total assessed income has been paid in full (or is in excess) by way of advance tax or as T.D.S except self-assessment tax u/s 140A. Further, the CBDT is empowered to relax the provisions in case of default in filing the income-tax return under section 139 and the mandatory interest under section 234A in suitable cases.

Under section 271F, (as substituted by the Finance Act, 2002, w.e.f.1.6.2002), if a person required to file return u/s 139(1) or its proviso, fails to file the return of income before the end of the relevant assessment year, a penalty of Rs. 5,000 shall be leviable.

This apart, under section 276CC, (as amended by Finance Act, 2012) if any assessee, including a partnership firm willfully fails to file his return of income u/s 139(1) or 142(1) or 148, and the amount of tax payable by him after deducting advance tax and TDS exceeds Rs. 3,000, he shall be punishable as follows:

- in a case where the amount of tax, which would have been evaded if the failure had not been discovered, exceeds twenty five hundred thousand rupees, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;

- in any other case, with imprisonment for a term which shall not be less than three months but which may extend to two years and with fine.

193. Who can sign return of income in case of a firm?

Under section 140(cc) of the Income-tax Act, 1961, in the case of a partnership firm, the return under section 139 shall be signed and verified by any of the following persons —

- by the managing partner of the partnership firm if there is a managing partner; or
- where for any unavoidable reason such managing partner is not able to sign and verify the return, by any partner thereof, not being a minor; or
- where there is no managing partner as such, by any partner thereof, not being a minor.

194. How to serve any notice or requisition on a firm?

Under section 282 (1) of the Income-tax Act, 1961, any notice or requisition under this Act may be served on the person therein named either by post or as if it were a summons issued by a court under the Code of Civil Procedure, 1908 (5 of 1908). The above two modes of service of notice are alternative in nature. In other words, it is optional for the tax department to adopt either the postal mode or any of the ways in which a court under the Code of Civil Procedure, 1908 issues a summons- Venkat Naicken Trust v. ITO [2000] 242 ITR 141[Mad.].

Under section 282 (2) (a) of the Income-tax Act, 1961, any notice or requisition in the case of a partnership firm may be addressed to any member of the assessee- firm- M. Vedachala Mudaliar v. S. Rangaraju Naidu, (1960) 39 ITR 308 (Mad). However, if and when an assessee argues that he has not been properly served with any notice under this section, the burden lies on the tax department to substantiate, with relevant materials, that the said notice had been properly served on the assessee-Keshab Narayan Banerjee v. CIT [1998] 238 ITR 694 [Cal.].

If the department fails to prove, with relevant materials, that the notice had been properly served on the assessee, any assessment/reassessment order passed by the Assessing Officer shall be treated as bad in law- Saha v. CIT 27 ITR 231, 240. In this context, any service of notice by registered post on a firm or its partner at the firm's principal place of business is proper- Bal Chandanben Jivanlal v. L.D. Joshi, (1969) 74 ITR 448 (Guj).

195. How to serve notice on a dissolved firm?

Section 283(2) of the Income-tax Act, 1961 deals with service of notice on dissolved partnership firms. Accordingly, where a partnership firm is dissolved, notices under this Act in respect of the income of the firm may be served on any person who was a partner not being a minor, immediately before its dissolution.

Any notice under section 283(2) need not be addressed to all the erstwhile partners of a dissolved firm. Further, the notices need not be served on all of those who were partners at the time of dissolution-K.L. Parvathamma v. ITO (1974) 93 ITR 138 (Mys.). However, such a notice under section 283(2) cannot be served on a partner who had retired before the dissolution of the partnership firm.

In case notice of penalty proceedings is served only on one of the partners of the dissolved firm, it is a valid and proper service. The order, imposing penalty would also be valid and proper-CIT v. Mehanga Ram Baldeo Singh, (1989) 179 ITR 624 (P & H); Indira Chemical Agency v. CIT, (1979) 119 ITR 569 (Mad.).

196. How will you treat any interest due to (or received by) a partner?

Any interest which is due to (or received by) a partner of a firm from the firm is taxable in his hands under section 28(v), under the head "Profits and gains of business or profession".

However, any expenditure incurred in order to earn such income can be claimed as a deduction from such income under sections 32 to 37. For instance, if a partner borrows money to make his capital contribution to the firm and he is paid interest on his capital contribution, the amount of such interest will be taxed under the head "Profits and gains of business or profession", but the interest paid by him on the borrowed money is allowed as a deduction.

197. How will you treat the disallowed remuneration/interest [disallowed in firm's hands]?

Under proviso to section 28(v) of the Income-tax Act, 1961, where any interest, salary, bonus, commission or remuneration, by whatever name called, or any part thereof has not been allowed to be deducted under clause (*b*) of section 40, the income under this clause shall be adjusted to the extent of the amount not so allowed to be deducted.

Accordingly, if and when any remuneration/interest (or part thereof) has not been allowed as deductible by virtue of section 40(b) [read with section 184], in the hands of the firm, it shall not be chargeable to tax in the hands of partners.

198. How will you treat the amount received by a partner on his retirement from a firm?

The amount received by a partner on his retirement from a firm, does not constitute capital gains, nor is it assessable under section 28(iv)- CIT v. Balvantrai Vithaldas Shah [1992] 196 ITR 379 (Guj.)

199. A partner of a firm contributes land as capital and the land is revalued in the books of firm. Can the difference be treated as income?

In case where a partner of firm contributes land as capital and land is revalued in the books of firm, it cannot be said that difference amount has to be assessed as 'income from business' or 'income from other sources'- CIT v. Smt. Mamta Narottamdas [1986] 162 ITR 365 (Guj.)

200. How will you treat profits from sale of assets received by a partner on dissolution of a firm?

Profits from sale of assets received by a partner on dissolution of a firm do not necessarily constitute business income of that partner-K.T. Appanna v. CIT [1967] 64 ITR 310 (Mys.). However, the distribution of the buildings in specie amongst the partners by the assessee-firm (the assessee-firm's business consisted of purchase of land and construction of buildings thereon and sale of the buildings) amounted to a business transaction by the assessee-firm and the surplus was taxable.

However, the taxing authorities had no right to substitute the market price in place of the price or value agreed to between the parties to a transaction, unless the transaction had been shown to be a sham one or unless the price paid or the value shown was not value in the books of account- CIT v. Keshavlal Chandulal [1966] 59 ITR 120 (Guj.).

201. A change has occurred in the constitution of a partnership firm during a previous year. Is a separate assessment required before and after the said change?

In case where at the time of assessment, it is found that a change has occurred in the constitution of a firm, only one assessment shall be made in respect of the entire previous year in which change in the constitution has occurred. For this purpose, a change in the constitution of a firm is said to take place in the following cases:

- if one or more of the partners cease to be partners or one or more new partners are admitted, provided that at least one of the partners of the firm before the change continues as partners after the change [it does not cover a case where a firm is dissolved on the death of any of its partners];
- where all the partners continue with a change in their respective shares or change in the shares of some of them.

However, if a firm carrying on a business or profession is succeeded by another firm, such a case shall be different. In such a case, a separate assessment shall be made on the predecessor firm and the successor firm.

202. How will you treat remuneration received by a karta/manager of a HUF from a firm in which the HUF is a partner? Is it taxable income of HUF or karta?

If a karta or a member of a HUF is a partner in a firm and where the share of that partner, including remuneration if any, received by him is due to the investments of the family funds, both the share of profits and the remuneration will be assessed as income of the HUF.

However, the remuneration paid to the karta or a coparcener of a family by a firm in which the family is a partner cannot be assessed as the income of the family unless there is a direct nexus between the investment of the funds of the family in the firm and the payment of the salary-CIT v. N. Deenadayalan [2000] 241 ITR 133 (Mad.).

On the other hand, if the remuneration paid to such Karta/member partner is linked to some professional expertise that he may possess and specifically rendered by him to the firm without any detriment to the funds invested by the HUF in the firm, then the remuneration will be assessed in his individual hands as his individual income. However, even in such cases, the share of profits in their firm will continue to be assessed as income of the HUF.

203. Can the assessing officers disallow remuneration paid to partners under section 40A(2)?

Even though remuneration to partners is deductible under section 37(1), read with section 40(b), the assessing officer may disallow under section 40A(2). In this context, the Finance Minister, while moving the Finance Bill, 1992, in

Lok Sabha on April 30, 1992, has given the following assurance: "There seems to be some apprehension that the provisions of section 40A(2) of the Income-tax Act may be indiscriminately resorted to by the Assessing Officers to make disallowance out of salary paid to the partners as being excessive. The CBDT will be asked to issue instructions to the Assessing Officers so as to ensure that this power is not used in the case of small firms and even otherwise, it should be used sparingly." – [1992] 195 ITR (St.) 128.

In the context, based on the FM's assurance, we may conclude that only in the case of big sized firms section 40A(2) may be invoked. Further, section 40A does not have overriding effect over the provisions of section 40(b)- Syntholab Chemicals & Research v. CIT [2008] 172 Taxman 38 (ITAT).

204. Can the assessing officer disallow interest paid to a partner under section 40A(2)?

Though interest paid to a partner is deductible under section 36(1)(iii), read with section 40(a)(i) and 40(b), it may be disallowed under section 40A(2). The Bombay Tribunal in the case of ITO v. M.M Textiles [2010] 122 ITD 435 (Mum.) has however held that interest payments to partners as per section 40(b) could not be disallowed under section 40A(2) as excessive or unreasonable.

205. Can a firm carry forward and set off of loss in the case of change in the constitution? Is it mandatory to deduct the share of outgoing partner in such a case?

Section 78 of the Income-tax Act, 1961 provides that where there is a change in the constitution of the firm on account of death/ retirement, the firm shall not be entitled to carry forward so much of the loss as is attributable to such partner.

This section applies only in the case when a partner goes out of the firm (i.e., the case of retirement or death). In other words, it is not applicable in case of change in profit sharing ratio or the case of admission of a partner.

In other words, a firm can set off and carry forward its lossess (viz., house property loss, business loss, capital loss and loss from the activity of owning and maintaining race horses) in the case of a change in the constitution of the firm as per the modified provisions of section 78 of the Act.

- Firstly ascertain the share of the outgoing partner in the profit/ loss of the firm in the year of change in the constitution of the firm.

- Compute the share of loss of outgoing partner in the brought forward loss.
- The difference between the two (in the case of profit in the year of change) or the aggregate of the two (if there is loss in the year of change in the constitution of the firm) cannot be allowed to be set off and carried forward.

206. Can a firm of partnership carry forward its unabsorbed depreciation?

Section 78 of the Income-tax Act, 1961 is not applicable in the case of unabsorbed depreciation. Therefore, the entire unabsorbed depreciation (without deducting share of outgoing partner) will be carried forward by the reconstituted firm.

207. Can a partnership firm receive cash gifts from anybody?

Under section 56(2)(vi) or the erstwhile section 56(2)(v) of the Income-tax Act, 1961, it is very clear that any cash receipt without consideration, implying in the nature of gift, save exclusions, whether capital or otherwise, may be considered as taxable income. However, such cash receipts shall be taxable only in the hands of an individual or a Hindu undivided family. In other words, similar receipts by any person (such as a partnership firm, a limited company or an association of persons etc.), other than an individual or a Hindu undivided family, would not constitute taxable income.

208. How to value the stock-in-trade or other assets of a firm on dissolution? Is it proper to value such stock at cost?

Legally speaking, the stock-in-trade or other assets of the firm on dissolution have to be valued on the basis of the market value as on the date of dissolution of the firm- A. L. A. Firm vs. CIT (1991) 189 ITR 285 (SC). The principle of valuing the closing stock of a business at cost or market price at the option of the assessee is an accepted principle that would hold good only so long as there is a continuing business and that where a business is discontinued, (whether on account of dissolution or closure otherwise by the assessee), then the profits of the firm cannot be ascertained except by taking the closing stock at market value- G.R. Ramachari& Co. v. CIT [1961] 41 ITR 142 (Mad).

In this context, the only possible tax-planning device, available to the assessee-firm, is to make dissolution of the firm on a date when the market value of the stock-in-trade and the assets is lower than the cost so that there may be no profits chargeable to tax.

209. Is a partnership firm a taxable entity under the Wealth-tax Act, 1957?

A partnership firm as such is not a taxable entity under the Wealth-tax Act, 1957. Further, a partnership firm has no separate legal existence and the partnership property will vest in all the partners of the firm and every partner has an interest in the property of the partnership- Addanki Narayanappa v. Bhaskara Krishnappa, AIR [1966] (SC) 1300.

In this context, for the purpose of wealth tax and for computing the net wealth of a partner in a firm, the partner has to be treated as an individual. Accordingly, the determination of net assets of a partner has to be worked out in his individual capacity-Juggilal Kamlapat Bankers v. WTO (1979) 116 ITR 646 (All).

210. How to value 'interest of a partner' in a partnership?

Rule 16 of Schedule III to the Wealth-tax Act, 1957 deals with computation of net wealth of the firm and its allocation amongst the partners. As regards the valuation of interest of a partner in a partnership, the following points are to be kept in mind:

- Firstly, determine the net wealth of the firm on the relevant valuation date. Then allocate that portion of the net wealth of the firm as is equal to the amount of its capital among the partners in the proportion of their capital contribution.
- Allocate the residue of the net wealth of the firm amongst the partners in accordance with the agreement of partnership for the distribution of assets in the event of dissolution of the firm.
- If there is no such agreement, then allocate the residue of the net wealth in the proportion in which the partners are entitled to share the profits of the firm.
- Arrive at the sum total of the amounts, so allocated to a partner. The amount so arrived at shall be the value of the interest of that partner in the firm of partnership-Rule 16 of Schedule III to the Wealth-tax Act, 1957.
- Unexplained credits, if any, assessed in income-tax assessment of a partnership firm are includible in the net wealth of the assessee-partner-CWT v. Harish Chandra Agarwal, (1991) 189 ITR 604 (All).

- Value of interest in assets of partnership is not to be made on the basis of any asset to be taken individually. While computing value of interest, the net wealth of the firm has to be computed as on valuation date and then the notional share of a partner as on relevant valuation date has to be ascertained as per the terms of partnership and share so ascertained alone forms part of the assessment of the net wealth of such person as per his status as taxable entity under Wealth tax Act-CWT v. Smt. Sita Devi [2002] 257 ITR 258 [Raj.].
- In determining the net wealth of the partnership firm for the purposes of this rule, no account shall be taken of the exemptions in sub-sections (1) and (1A) of section 5.
- In case an amount written off as bad debt has been disallowed in the income-tax assessment of a partnership firm, the partner of such a firm cannot exclude such a bad debt from the assets of the firm in computing his interest in the partnership firm-Achamma Sebastion v. CWT (1988) 173 ITR 296 (Ker).
- In case the net wealth of the partnership firm computed in accordance with this rule includes the value of any assets located outside India, the value of the interest of any partner in the assets located in India shall be determined having regard to the proportion which the value of assets located in India diminished by the debts relating to those assets bears to the net wealth of the firm;
- Where the net wealth of the firm computed in accordance with this rule includes the value of any assets which are exempt from inclusion in the net wealth under sub-sections (1) and (1A) of section 5, the value of the interest of a partner shall be deemed to include the value of his proportionate share in the said assets and the provisions of section 5(1) and 5(1A) shall apply to him accordingly;
- Where the net wealth of the firm computed in accordance with this rule includes the value of any assets referred to in sub-section (2) of section 5,the value of the interest of a partner shall be deemed to include the value of his proportionate share in the said assets, and the provisions of sub-section (2) of section 5 shall apply to him accordingly.
- In case an assessee, being a minor, who is a legal heir of a deceased partner, is bequeathed interest right and title of deceased partner in a partnership firm under a will, the value of such devolved property

shall be his asset. In such a case, the subsequent arrangements made by the natural guardian of the minor-assessee under an agreement, entered into with the partnership firm cannot be the basis for computing the value of such asset-CWT v. Rajiv I. Modi (Minor), (1999) 238 ITR 689 (Guj).]

211. How to value the net assets of the business, where the assessee maintains regular accounts?

Under Rule 14(1) of Schedule III to the Wealth-tax Act, where the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the balance-sheet of such business on the valuation date after adjustments specified in rule 14(2) of Schedule III to the Wealth-tax Act shall be taken as the value of such assets-CWT v. Rama Shankar Gupta, (1991) 190 ITR 157 (All).

212. How to compute taxable income of a partnership firm?

Computation of a firm's income normally involves the following steps:

- Compute income under the different heads (viz. "Income from house property", "Profits and gains of business or profession", "Capital gains" and "Income from other sources") ignoring incomes exempt under sections 10 to 13A.
- Make adjustment on account of brought forward losses/ disallowances. The total income under the aforesaid heads is 'gross total income'.
- From the "gross total income" make deduction under sections 80G, 80GGA, 80GGC, 80-IA, 80-IB, 80-IC, 80JJA and 80-O.

213. Is wealth tax payable by partnership firms in India?

With effect from assessment year 2010-11, only the net wealth in excess of the value of Rs.30 lakhs (Rs.15 lakhs for assessment years 1993-94 to 2009-10) is chargeable to wealth-tax in India. Accordingly, the excess over Rs.30 lakhs is taxable at the rate of 1%.

Sl. No.	Net wealth	Tax payable
1.	On net wealth upto Rs.30,00,000	Nil
2.	On net wealth exceeding Rs.30,00,000	1%

Notes:

1. The wealth tax rates, given above, are as specified in Schedule I to the Wealth-tax Act, 1957. The rates are applicable for every individual, HUF and company.
2. A partnership firm as such is not a taxable entity under the Wealth-tax Act, 1957.
3. However, under section 4(1)(b) of the Wealth-tax Act, where an individual is a partner in a firm of partnership, the value of his interest in the partnership firm shall be determined in the manner as laid down in Schedule III of the Act and such a value shall be included in computing his net wealth.
4. Education cess is not applicable on wealth tax payable.

214. Is gift tax payable by partnership firms in India?

It is notable that no gift tax is payable under the Gift –tax Act, 1958 by any assessee (including partnership firms) on gifts made on or after 1.10.1998. In case the gift was made prior to 1.10.1998, the gifts were taxed at the rate of 30% of the taxable amount of gifts. [viz., after allowing exemption under section 5(2)]

The exemption limit under the Gift– tax Act, 1958, for gift tax [basic exemption under section 5(2)], is Rs. 30,000. However, the gifts received from non-related persons by individuals and HUFs on or after 1.9.2004 will be taxed in the hands of the recipient as income subject to certain exceptions.

215. How to compute tax liability of a partnership firm?

Income tax is payable by a firm for the assessment years 2012-13 and 2013-14 at the following rates:

	Tax rate
Short-term capital gain under section 111A	15%
Long-term capital gain	20%
Winnings from lottery	30%
Other income (not being income which is subject to special tax rate)	30%

Notes:

1. Education Cess is payable @ 2% of income tax;

2. Secondary and Higher Education Cess is payable @ 1% of income tax.

216. Is Alternate Minimum Tax applicable to a firm of partnership?

Under sections 115JC to 115JF of the Income tax Act, 1961, Alternate Minimum Tax provisions are applicable for a firm of partnership (other than LLP) from assessment year 2013-14. For LLPs, minimum alternate tax provisions are applicable from assessment year 2012-13.

From the assessment year 2013-14, alternate minimum tax provisions are applicable in the case of a partnership firm only if the assessee has claimed any deduction under section 10AA or 80H to 80 RRB (except section 80P).

217. How to compute alternate minimum tax in respect of a partnership firm?

From the assessment year 2013-14, a partnership firm in India is subject to alternate minimum tax. For this purpose, the alternate minimum tax shall be computed as follows:

Step involved	Computation process/notable points
1	Compute the regular income-tax liability of the firm ignoring the provisions of sections 115JC to 115JF.
2	Find out adjusted total income of the firm. Adjusted total income is net income or total income of the firm as increased by: ❑ amount claimed as deduction by the firm under sections 80H to 80RRB , (not being section 80P) and ❑ amount claimed as deduction by the firm under section 10AA.
3	Find out 19.055% (i.e., 18.5% +EC +SHEC) of adjusted total income computed under Step 2.
4	If amount computed under Step 1 is equal to or more than amount determined under Step 3, then the provisions of alternate minimum tax will not be applicable. If, however, amount computed under Step 3 is more than the regular tax liability determined under Step 1, then- ❑ adjusted total income determined under Step 2 will be deemed as total income of the firm for such previous year; and

	❑ 19.055% of adjusted total income will be deemed as tax liability of the firm for such previous year.
5	❑ The excess of the amount computed under Step 3 over the amount computed under Step 1 will be available as credit for alternate minimum tax. ❑ It can be carried forward and can be set off against regular tax liability of the firm of the next year or subsequent year (but not beyond the 10th assessment year). ❑ No interest is payable on such credit. ❑ Tax credit shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the alternate minimum tax to the extent of the excess of the regular income-tax over the alternate minimum tax.
6	Where the provisions of alternate minimum tax are applicable, the assessee will have to obtain a report in Form No. 29C from a chartered accountant.

Part: 2
HUF: A Practitioners' Perspective

218. Is the concept of HUF applicable to all?

Under section 2(31) of the Income-tax Act, 1961 a Hindu undivided family or HUF is treated as an entity distinct and different from an individual and it would be wrong not to keep that difference in view - C. Krishna Prasad v. CIT [1974] 97 ITR 493 (SC).

However, the concept of HUF is applicable to all those who have been brought up as Hindus. In other words, all those persons who have been brought up as Hindus can claim the status of a Hindu joint family under the tax laws.

The Jain families are also regarded as Hindu families for the purpose of levy of income-tax and wealth tax In India- CWT v. Smt. Champa Kumari Singhi [1972] 83 ITR 720 (SC) / Nathu Sao v. CIT (1934) 2 ITR 463(Nag.)

219. How to create a HUF? Who can be a member of a HUF?

A Hindu undivided family or HUF is neither the creation of law nor of contract. The membership of a Hindu undivided family normally arises from birth. A Hindu is verily born into a Hindu undivided family. In a Hindu undivided family, an 'adopted son' is however exactly on the same footing as a 'natural son'.

Membership to a HUF is possible only by birth. Traditionally speaking, a Hindu undivided family or a joint Hindu family thus consists of all males lineally descended from a common ancestor, their wives and unmarried daughters and daughters-in-law. Generally, the father or senior most male member of the family manages the property of the family as 'karta'.

However, with the enactment of the Hindu Succession (Amendment) Act, 2005 (w.e.f. 9th September, 2005), a daughter of a coparcener shall also by birth become a coparcener in her own right in the same manner as the son.

Unlike an AOP or a firm or a company, which are created by acts of parties, the HUF is purely a creature of Hindu law and cannot be created by act of parties. However, a HUF can be divided and put to an end by the parties under the Hindu law.

220. Can non-Hindus claim the status of a HUF?

In *Perumal v. Ponnuswamy (AIR 1971 SC 235.)* the Supreme Court has held that any person can become a Hindu after expressing his intention that he lives as a Hindu and that the community or caste into the fold of which he is ushered has accepted him as a member of that community or caste. Thus, any non-Hindu in India can become a Hindu by undergoing the formality of conversion, as prescribed by a caste or community to which he converts.

Further, it is legally possible in India for certain non-Hindus like *Khojhas*, *CutchiMemons*, the *Bohras*, *Moplas* and the *HolaiMemons*, who are Muslims, to follow the Hindu law of inheritance and succession subject to the provisions of the Shariat Act, 1937. Similarly, some Christian communities can also follow the Hindu law of succession. However, in all these cases, the Muslims/Christians cannot claim the status of a HUF even if they do follow Hindu law of succession.

221. Who are 'Hindus' for the purpose of Hindu laws?

Under the codified law relating to the Hindus, (viz., Hindu Marriage Act, 1955, the Hindu Succession Act, 1956, the Hindu Minority and Guardianship Act, 1956, and the Hindu Adoptions and Maintenance Act, 1956), the meaning and the concept of the term "Hindu" and "Hinduism" have undergone radical changes over the years. In this context, it is notable that the aforesaid Hindu Acts are not only applicable to Hindus by birth or religion but also to a large number of other persons who are 'deemed' to be Hindus in the eyes of law.

In case where one of the parents is a Hindu and the son is brought up as a Hindu, the son will be a Hindu. Son born of a family married under Special Marriage Act, 1972 even where one of the parents is a Christian, can be a Hindu, if brought up as a Hindu- *CWT v. Late R. Sridharan. (1976) 104 ITR 436 (SC)*. Similarly, even a Hindu who declares for the purposes of Special Marriage Act, 1972 that he is not a Hindu does not cease to be a Hindu for purpose of succession - *CIT v. Partap Chand (1959) 36 ITR 262 (Punj.).* Broadly speaking, the following are some of the persons to whom the Hindu law applies:

- Hindus by birth;
- Hindus by religion, i.e., converts to Hinduism;
- Illegitimate children where both parents are Hindus;

- Illegitimate children where the father is a Christian and the mother is a Hindu, and the children are brought up as Hindus. [However, the Hindu law of coparcenary, which contemplates the father as the head of the family and the sons as coparceners by birth with rights of survivorship, cannot, from the very nature of the case, apply to such children]
- Jains;
- Buddhists;
- Sikhs;
- Nambudiri Brahmins except so far as such law is varied by custom;
- Lingayats who are considered Sudras;
- Hindus by birth who, having renounced Hinduism, have reverted to it after performing the religious rites of explanation and repentance. [Or even without a formal ritual of reconversion when they were recognised as Hindus by their community]
- Sons of Hindu dancing girls of the Naik caste converted to Mahomedanism, where the sons are taken into the family of the Hindu grand-parents and are brought up as Hindus;
- Brahmos;
- AryaSamajists;
- Santhals of Chota Nagpur;
- Santhals of Manbhum except so far as it is not varied by custom;
- Hindus who made a declaration that they were not Hindus for the purpose of the Special Marriage Act, 1872.
- Radhaswamis;
- Swayamariyathais (self-respecters) opposed to Purohit cult.
- Satsangis etc.

222. Distinguish between 'specified HUFs' and 'Non-specified HUFs'.

Upto assessment year 1996-1997, there was a distinction between specified HUFs and Non-specified HUFs. Specified HUFs were those HUFs one or more of whose members earn an individual income equivalent to the taxable minimum for an individual (Rs.40,000 for the assessment year 1996-97). On the other hand, non- specified HUFs were those HUFs none of whose members earn an individual income equivalent to the taxable minimum for an individual.

As regards taxation, there was a lower taxable minimum income – Rs.18,000 up to 1996-97 assessment year for the specified HUF and such specified HUF's were taxed a higher rate. The non-specified HUFs were treated on par with the individual for the purpose of determining the taxable minimum and for rates of tax. However, this distinction and discrimination of HUFs now stands abolished (for and from the assessment year 1997-98).

223. Is it compulsory for a HUF to carry on any business?

A Hindu undivided family is basically a unit of society and therefore it need not necessarily be an economic or commercial unit. Practically speaking, there could be a HUF, which does not own any property or carry on any business. Such a joint family can also acquire property, which has all the characteristics of an HUF property.

224. Is HUF a distinct taxable entity? Are there any benefits in treating a HUF as a separate taxable entity?

Under the income-tax law, the income of a Hindu undivided family can be assessed in the hands of the HUF alone and not in the hands of any of its members, unless specifically so provided by law. This is because the HUF is a separate and distinct tax entity under the law. The following are some of the notable tax benefits in treating a HUF as a separate taxable entity:

- In case of an individual assessee, who is also a member of HUF, the share of his income, which is derived from the HUF property, is not considered for deriving at the total income of that person as an individual [Section 10(2)]
- HUF itself is a separate tax entity and therefore there is no question of double taxation.
- In the assessment of HUF, expenses like remuneration, interest, commission etc. paid to the members thereof for services rendered are deductible.
- Total partition of HUF is one of the best ways to avoid income tax, capital gain tax, gift tax, wealth tax, stamp duty etc. because the property divided amongst the members of a HUF through partition is not considered as transfer or disposition of the property under section 47.

225. When can a HUF be a resident in India?

Under section 6(2)] of the Income-tax Act, 1961, a Hindu undivided family is said to be resident in India if the control and management of its affairs is "wholly or partly" situated in India. "Control and management" of affairs for this purpose means controlling and directive power. It means de facto control and management and not merely the right to control or manage- CIT v. Nandlal Gandalal [1960] 40 ITR 1(SC).

For the purpose of residential status of a HUF, the situation of control and management of the HUF in relevant year only is material. What the income-tax law requires is the control and management of the affairs in the accounting period and not in any subsequent or earlier accounting period- *Sri Raja K.V. Narasimha Rao Bahadur v. CIT [1950] 18 ITR 181 (Mad.)*

A resident Hindu undivided family is said to be "ordinarily resident" in India if the karta or manager of the family (including successive kartas) is resident in India in at least 2 years (9 years upto the assessment year 2003-2004) out of 10 years immediately preceding the relevant previous year and is in India for 730 days or more during 7 years immediately preceding the relevant previous year.

If the karta or manager of a resident family is not resident in India in at least 2 out of 10 immediately preceding previous years or is not present in India for at least 730 days in 7 immediately preceding previous years, the joint family will be regarded as "resident but not ordinarily resident" in India.

226. When will a HUF be a non-resident? Who has to prove the non-residential status?

A Hindu undivided family or HUF will be non- resident in India if the control and management of the family is situated wholly outside India during that year.

The onus of proving that the HUF taxpayer is not resident in India is on the assessee. In case the assessee-HUF has not proved that its case falls under exception, it cannot be treated as non-resident-V. VR.N.M. Sybbayya Chettiar v. CIT [1951] 19 ITR 168 (SC).

227. Discuss in brief the evolution of Hindu laws in India.

Till the 19th century, A.D, the ancient Hindu-law, as laid down in the so-called Srutis, the Smritis and other Hindu law scriptures and texts, followed its customary course without any interference of the lawmakers. However, during the first half of the 20th century, some attempts were made by the lawmakers in India for legislative reforms in respect of the time-old Hindu laws, which were badly in need of amendments and reforms. The dire need to give a better status to Hindu women through a limited estate was felt for the first time by the lawmakers. These amendments helped a lot in making the Hindu law, more relevant for the changing time and conditions of the Hindu society.

The first phase of the Hindu law reforms started with the enactment of the following Acts:

- The Hindu Law of Inheritance Act, 1929;
- The Hindu Gains of Learning Act, 1930;
- The Hindu Women's Right to Property Act, 1937 and
- The Hindu Married Women's Right to Separate Residence and Maintenance Act, 1946.

After the dawn of independence on 15th August, 1947, the legislative movement on codification of Hindu laws in India gained further momentum. Accordingly, the Indian Parliament proceeded to enact the following Acts:

- The Hindu Marriage Act, 1955
- The Hindu Succession Act, 1956
- The Hindu Minority and Guardianship Act, 1956.
- The Hindu Adoptions and Maintenance Act, 1956.

These Hindu Acts, enacted by our Parliament are now the supreme authority as regards Hindu laws in India. These enactments, (which have overriding effect in case of inconsistency with the respective branch of law) hold good in the respective branch of Hindu law covered by them. In this context, it is also true that these enactments have not touched many areas, where the ancient customary usages and exceptional provisions still hold sway.

228. Will the children of mixed marriages be treated as Hindus?

The decision of the Supreme Court in the case of *CWT v. Late R. Sridharan (1976) 104 ITR 436 (SC)* is relevant here. In this case where a son, born to a Hindu father and Christian mother and who has been brought up as a Hindu, had formed a HUF with his father. The Court held that legitimate children born to such a mixed marriage couple who are brought up as Hindus would be governed by the Hindu law. According to the apex Court, if a Hindu married a Christian lady under Special Marriage Act, son born to them if brought up as a Hindu, would be a Hindu, and such a son can validly form a

HUF with his father. However, a Hindu who has converted to Christianity is not entitled to claim the status of a Hindu undivided family. *[P. F. Pinto 65 ITR 123 (Mys)].*

Where a Hindu marries a Christian lady and their daughter is brought up as a Christian, the individual, his wife and daughter would not constitute a HUF for assessments to tax under income tax law. For claiming the status of a HUF, it is necessary that the child must be brought up as member of the family to which the Hindu parent belongs, namely, the family of the Hindu parents and brothers, etc., - *Addl. CIT v. G. Venkataraman (1977) 109 ITR 247 (Mad).* However if a Hindu marrying a Christian lady brought up his son/daughter as a Hindu by taking the child into the fold of Hindu family, the child would be regarded as Hindu- *Lingappa Goundan v. Esudasan (1903) ILR 27 13 (Mad).*/ *Late R. Sridharan v. CWT 73 ITR 360 (Mad).*

229. What will be the effect of marriage on a member of a HUF under the Special Marriage Act?

Section 19 of the Special Marriage Act, 1954 deals with the effect of marriage on a member of an undivided family. Accordingly, the marriage solemnized under this Act of any member of an undivided family who professes the Hindu, Buddhist, Sikh or Jain religion shall be deemed to effect his severance from such family. In other words, if a Hindu gets married under the Special Marriage Act with a non-Hindu by declaring that he is not a Hindu, he will cease to be a member of the HUF of which he was a coparcener before his marriage.

However, section 20 of the Special Marriage Act, 1954 provides for the rights and disabilities not affected by Act. Accordingly, subject to the provisions of section 19, any person whose marriage is solemnized under this Act, shall have the same rights and shall be subject to the same disabilities in regard to the right of succession to any property as a person to whom the Caste Disabilities Removal Act, 1850 (21 of 1850), applies. A male member of a HUF on marriage with a non-Hindu does not relinquish his interest in joint HUF property. However such a member ceases to be a coparcener. Section 19 read with section 21A of the Special Marriage Act, 1954 enables a person who solemnises a marriage with a non-Hindu lady to realise his interest in HUF but he will cease to be a coparcener.

230. What do you mean by 'HUF property'?

The term 'joint family property' or 'HUF property' under the Hindu law may also include self-acquired property. Hindu coparcenary property means the property, which consists of ancestral property, or of joint acquisitions, or of property thrown into the common stock, an accretion to such property- *Kapur Kaur v. Kishan Singh, AIR, 1970 (P&H) 270.* Following are the properties, which are recognized as 'coparcenary property' under the Hindu law:

- Ancestral property;
- Property allotted at a partition;
- Property jointly acquired by coparceners;
- Property acquired with the aid of coparcenary property;
- Separate property of a coparcener thrown into family hotchpot and treated as coparcenary property; and
- Separate property of a coparcener blended with coparcenary property. (CIT v. Dr. (Mrs.) Sita Bhateja, (1973) 91 ITR 193, 195-6 (Mys.).

For this purpose, 'ancestral property' means all property inherited by a Hindu male from his father, father's father or father's father's father. If the property came from the father as gift to a son, such gifted property cannot be treated as ancestral property. Ancestral property in the ordinary sense means property of the father or forefathers, which is inherited- *Khalill Ullah Shah v. Ewaz Ali, 741 IC AIR (1923).*

231. What do you mean by an 'ancestral property'? What are the properties which cannot be treated as ancestral in nature?

All property, which a man inherits from a direct male ancestor, not exceeding three degree higher than himself, is ancestral property and it is at once held by himself, in coparcenary with his own issue. However, where he has inherited from a collateral relation, as for instance, from a brother, nephew, cousin or uncle, it is not ancestral property; consequently, his own descendents are not coparceners in it with him –Gurumurthi Reddi v. Gurammal and another 1 IC 750. In this context, the following properties would not be an ancestral property for this purpose of HUF:

- any property inherited from maternal grandfather (Muhammad Husai Khan v. Babu Kishya Nandan Sahai, (1937) 64 IA 250.) or
- any property inherited from collaterals, (Baboo Nund Coomar v. Razeeooddeen, (1973) 10 Beng LR 183.) or

- any self-acquired or separate property obtained from paternal ancestor under express terms of gifts or will *(Arunachala Mudaliar v. Murugantha Mudaliar, 1954 SCR 243.)*

232. What are the two different types of ancestral property?

Under the Mitakshara law, ancestral property is of two types, namely: (1) Apratibandhadaya or unobstructed heritage, and (2) Sapratibandhadaya or obstructed heritage.

An unobstructed heritage or apratibandhadaya is an ancestral property in which a person acquires an interest by birth. An apratibandhadaya is not obstructed by the existence of the owner. Unobstructed heritage is not recognised by the Dayabhaga law whereas the Mitakshara law recognises an unobstructed heritage. Further, the obstructed heritage devolves by succession, whereas the unobstructed heritage devolves by survivorship.

233. What are the rights of a member of a HUF? Are these rights different from that of a coparcener?

As regards the rights of members, a coparcener under the Hindu law is superior over other members of the HUF who are not coparceners. An adult coparcener has not only the right of maintenance but also has the right to claim partition. On partition, his branch of the family secures a specific share of the HUF property. However, what a coparcener gets on partition of the HUF is not his own individual share but the share of family of which he is the Karta.

On the other hand, the members of the family, other than coparceners, (especially the females) do have only the right of maintenance. They do not have the right to claim partition.

234. Who are coparceners?

Under the Hindu law, a coparcenary consists of a male ancestor and his lineal descendants in the male line within four degrees including himself. The coparceners of a Hindu undivided family qua inherited property are as follows:

- The person who inherited the HUF property; (viz., the one in whose time the Hindu family acquired property by inheritance for the first time);
- His sons;
- His grandsons; and

- His great grandsons.

However, with the enactment of the Hindu Succession (Amendment) Act, 2005 (w.e.f. 9th September, 2005), a daughter of a coparcener shall also by birth become a coparcener in her own right in the same manner as the son.

235. Can females be coparceners in a HUF?

With the enactment of the Hindu Succession (Amendment) Act, 2005 (w.e.f. 9th September, 2005), a daughter of a coparcener shall also by birth become a coparcener in her own right in the same manner as the son.

236. "No female can be a member of a HUF"-Is it legally correct?

Under the Hindu law, it is not correct to say that no female can be a member of HUF and a HUF does not necessarily consist of only male members [Kalyanji Vithaldas v. CIT 5 ITR 90 (PC)]. In a HUF, a daughter is also a member of the family till her marriage. On her marriage, the daughter ceases to be a member of her father's family and she becomes a member of the family of her husband as a daughter-in-law.

Even though a Hindu undivided family may consist of its members, males and females, adults and minors, only some of the members of the joint family of Hindus are known as "coparceners". Before the enactment of the Hindu Succession (Amendment) Act, 2005, the coparceners were always from the male members of the Hindu undivided family.

However, with the enactment of the Hindu Succession (Amendment) Act, 2005 (w.e.f. 9th September, 2005), a daughter of a coparcener shall also by birth become a coparcener in her own right in the same manner as the son.

237. Distinguish between a Hindu coparcenary and a Hindu undivided family.

A Hindu coparcenary is always smaller than the membership of a Hindu undivided family. In this context, it is true that there can be a Hindu undivided family all of whose members are coparceners. However, there cannot normally be a Hindu undivided family without a coparcener.

A Hindu undivided family or HUF is a body, which is wider than a Hindu coparcenary. The direct tax laws in India (both the Income-tax Act, 1961 and Wealth-tax Act, 1957) also deal with the Hindu undivided families (HUF) and not with the Hindu coparcenary.

238. Who is called 'karta' of HUF?

Under the Hindu law prevalent in India, the manager of a Hindu undivided family or a Hindu joint family is called the 'Karta'. In legal parlance, the word 'Karta' as used in Wills and other legal documents always means heir or person entitled.

As an accepted general rule, the right to managership of a Hindu undivided family under the Hindu law is conferred on the father as the head of a joint Hindu family. Where the father of the family is dead, the right to managership of the Hindu undivided family simply devolves upon the senior-most adult member of the Hindu joint family.

As regards the basic qualification to become a karta of a Hindu undivided family, the person on whom the right of managership devolved must be a coparcener of the joint family. In other words, if the person is not a member of the coparcenary, he has no right to claim the managership of the joint Hindu family.

The Karta has extensive powers in respect of the day-to-day management of the joint Hindu family. He is the controller of the income and expenditure of the joint family and he is the custodian of its surplus finances.

239. What are the salient features of the Hindu Succession (Amendment) Act, 2005?

The Hindu Succession (Amendment) Act, 2005 (39 of 2005) has come into force from 9th September, 2005. The Hindu Succession (Amendment) Act is to remove gender discriminatory provisions in the Hindu Succession Act, 1956 and gives the following rights to daughters under Section 6:

- The daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son;
- The daughter has the same rights in the coparcenary property as she would have had if she had been a son;
- The daughter shall be subject to the same liability in the said coparcenary property as that of a son; and any reference to a Hindu Mitakshara coparceners shall be deemed to include a reference to a daughter of a coparcener;
- The daughter is allotted the same share as is allotted to a son;

- The share of the pre-deceased son or a pre-deceased daughter shall be allotted to the surviving child of such pre-deceased son or of such pre-deceased daughter;
- The share of the pre-deceased child of a pre-deceased son or of a pre-deceased daughter shall be allotted to the child of such pre-deceased child of the pre-deceased son or a pre-deceased daughter.

240. Can a female be the karta of a HUF?

Under the Hindu law prevalent in India, the right to managership of a Hindu undivided family is generally conferred on the father as the head of a joint Hindu family. In case the father of the family is no more, the right to managership of the HUF simply devolves upon the senior-most adult member of the Hindu joint family.

As regards the basic qualification to become a karta of a Hindu undivided family, the person on whom the right of managership devolved must be a coparcener of the Hindu joint family. In other words, if the person is not a member of the coparcenary, he has no right to claim the managership of the joint Hindu family.

Coparcenership is an essential qualification for the managership of a Hindu joint family. With the enactment of the Hindu Succession (Amendment) Act, 2005 (w.e.f. 9th September, 2005), a daughter of a coparcener shall also by birth become a coparcener in her own right in the same manner as the son. In this context, a female may also be a karta of a HUF.

241. Can a Hindu widow have interest in coparcenary property?

Though a Hindu widow cannot be a coparcener, she has coparcenary interest and she is also a member of the coparcenary by virtue of the rights conferred on her under section 3(2) of the Hindu Women's Right to Property Act, 1937- CED v. Alladi Kuppuswamy, (1977) 108 ITR 439, 450 (SC).

Under the Hindu Women's Right to Property Act, 1937, the interest of the widow of member of a Hindu coparcenary arises not by inheritance, nor by survivorship, but by statutory substitution The widow does not become a coparcener, though invested with the same interest, which her husband had in the property; she does not acquire the right, which her husband could have exercised over the interest of other coparceners. If however she died before partition, the interest acquired by her would merge in the coparcenary property and will devolve upon the heir of her husband. -SatrughanIsser v. Smt. Sabujpari, AIR (1967) SC 272.).

A Hindu widow is the surviving half of her husband and so long as she is alive, the husband continues to live in her. In that case the Hindu widow does not become a coparcener but she is entitled to claim partition in the same position in which her deceased husband would have been in the matter of exercise of the right. The quantum of interest of such a Hindu widow is to be determined as on the date on which she seek to enforce a partition under section 3(3) - Potti Lakshmi Perumallu v. Potti Krishnavenamma, AIR (1965) SC 825.

However, with the passing of the Hindu Succession Act, 1956, widow has been designated as class I heir to male Hindu dying intestate. In this context, if a Hindu widow remarries, then on her remarriage, she does not have a right in the erstwhile joint family estate. This is because she ceases to be the surviving part of her husband's body on her remarriage- Pandurag Narayana Salunke v. Sindhu AIR (1971) (Bom.) 413.

242. What will happen to the HUF if a Hindu widow adopts a son?

When a Hindu widow adopts a male heir, the adopted son would be a member of the family from the date of death of adoptive father and therefore the widow cannot be considered to be the sole member of the HUF. The Hindu undivided family would be constituted by the Hindu widow along with the adopted son- C. Krishna Prasad v. CIT [1974] 97 ITR 493 (SC). An adoption by a Hindu widow amounts to adoption by her late husband and the adopted son would be a child of the husband also. In this view, the Hindu undivided family did not cease to exist and on adoption of a son by assessee widow, the status of assessee is to be taken as that of a HUF - Savitri Devi v. CIT [1976] 104 ITR 385 (Pat).

243. Can a sole surviving coparcener obtain the status of a joint Hindu family when he is single?

Under the Hindu system of law, prevalent in India, a sole surviving coparcener cannot obtain the status of a joint Hindu family when he is single. However, if he gets married, he can obtain the status of a joint family. An individual may acquire joint family property by survivorship or on partition. In such cases, he has to be assessed only as an individual till his marriage, since a joint family implies plurality of membership. Plurality of persons is an essential attribute of a family. In other words, a single person, male or female, does not constitute a family. A family consisting of a single individual is a contradiction in terms. Section 2 (31) of the Income-tax Act, 1961 treats a HUF as an entity distinct and different from an individual and it would be wrong not to keep that difference in view-C. Krishna Prasad v. CIT, (1974) 97

ITR 493 (SC). The sole surviving coparcener on marriage holds the property as potential joint family, which comes into existence on marriage - Prem Kumar v. CIT. (1980) 121 ITR 347 (All.)/ S. Periannan v. CIT (1991) 191 ITR 278 (Mad.)/ CIT v. Arun Kumar Jhunjhunwala & Sons. (1997) 223 ITR 45 (Gau.)

244. Can a single male member with females constitute a HUF? Can a brother (along with his unmarried sisters) be a HUF?

Under the Hindu system of law, a joint family may consist of single male member and widows of deceased members-Kalyanji Vithal Das v. CIT 5 ITR 90 (PC). Similarly, a joint family may consist of single male member with wife and daughters- N.V. Narendra Nath 74 ITR 190 (SC). Likewise, a joint Hindu family may consist of single male member with his unmarried daughter-CIT v. Harshwardhan Mangaldas (1992) 194 ITR 136 (Guj.) Interestingly, a joint Hindu family may also consist of a brother and his unmarried sisters-Bharatkumar Chinubhai v. CIT (1969) 74 ITR 1 (Guj.).

245. A HUF did not have any ancestral property and the HUF property was created by the sole coparcener throwing his separate property in the common hotchpot. How to assess the income from the property?

In case the HUF did not have any ancestral property and the HUF property was created by the sole coparcener throwing his separate property in the common hotchpot, the income from the property would be assessed in his hands as an individual. This is because none other than him had any coparcenary interest in the property. In this case, the property did not come to him either by devolution or by partition but by his own act of throwing the same into the family hotchpot. Therefore though the property assumes the character of HUF property, it could not be held assessable in the hands of the HUF- Surjit Lal Chhabda v. CIT (1975) 101 ITR 776 (SC).

In other words, in cases of single coparceners for determining their status, the distinction regarding the source of acquisition of the nucleus property is to be seen. In case the single coparcener of the HUF got the property by devolution on the death of the other coparcener, the ancestral property was subsisting and there was continuity of ownership of property in the Hindu family. On the other hand, in case where the property did not come to the single coparcener either by devolution or by partition but by his own act of throwing the same into the family hotchpot, the property could not be held assessable in the hands of the HUF.

246. Can a single member without females constitute a HUF?

A single person, male or female, does not constitute a family and a family consisting of a single individual is a contradiction in terms. 'Family' connotes a group of people related by blood or marriage- CIT v. Ved Prakash [1982] 136 ITR 238 (Punj. & Har.) Further, an individual by himself cannot constitute a Hindu undivided family. In other words, there must be more than one person in the family before a HUF can come into existence. However, it is not necessary that the two members should both be males. The HUF can validly consist of a male and a female, like a husband and wife, or a father and his unmarried daughter.

Thus where a Hindu family is reduced to a single male coparcener without any female member, such a family has to be treated as an individual and not as a HUF. This is because the single male member is entitled to dispose of the coparcenary property as if it were his separate property. He may sell or mortgage the property without legal necessity or he may make a gift of it. The sole surviving coparcener is entitled to dispose of the coparcenary property as if it was his separate property- Surendra Nath Malhotra (HUF) v. GTO [1985] 13 ITD 499 (Cal.)

In this context, the only way by which the single coparcener can constitute a HUF is to marry a woman. In that case he and his wife would constitute a Hindu undivided family. Once the sole surviving coparcener marries, a HUF comes into existence, for the wife along with her husband constitutes a joint Hindu family-Prem Kumar v. CIT (1980) 121 ITR 347 (All.)

247. Can a HUF consist of only female members?

Legally speaking, a female can be a member of a Hindu undivided family- Kalyanji Vithaldas v. CIT [1937] 5 ITR 90 (PC). Similarly, there can be a HUF consisting of female members only. Females are and can be component parts of an undivided Hindu family. That being so, there can be an undivided Hindu family consisting of females only- CIT v. Sarwan Kumar [1945] 13 ITR 361 (All).

The Hindu coparcenary shall come to an end with the disappearance of the last male member in the family. However, the existence of coparcenary is not essential for the existence of a joint Hindu family- CIT v. Sarwan Kumar 13 ITR 361 (All).

248. Do you find any difference in adoption of a child by an unmarried Hindu female and a Hindu widow? Will such an adoption bring into existence a HUF?

Under the Hindu Adoptions and Maintenance Act, 1956, even an unmarried female can adopt. In such a case, the adoption made by an unmarried female would be to her only. However, a Hindu widow does not cease to be the wife of her deceased husband merely by death. In this context, the adopted child becomes the child of the husband also and such adoption brings into existence a joint Hindu family-Savitri Devi v. CIT, (1976) 104 ITR 385 (Pat).

249. Can a coparcener blend his individual property with the main HUF? Can he do so with the smaller HUF?

Under the Hindu system of law, blending of individual property in the hotchpot of the family may be done with the main or smaller HUF. Accordingly, a Hindu coparcener has the discretion to blend the individual property with the property of the main family consisting of his father, himself and his brothers and their progeny or the smaller family consisting of himself, his sons and their progeny. Blending of his separate property in the hotchpot of the smaller family can be done even while he is a coparcener in the bigger HUF, comprising his father, himself and his sons.

250. Discuss the doctrine of throwing into common stock. Can the family reject such blending?

Under the doctrine of throwing into common stock, the separate property of a member of a joint Hindu family may be impressed with the character of joint family property if he voluntarily throws it into the common stock with the intention of abandoning his separate claim therein. On such blending, the separate property of a Hindu ceases to be separate property, and acquires the characteristics of joint family or ancestral property. This result is achieved not by any physical mixing of separate property with the ancestral property but by a unilateral act of his own volition waiving and surrendering his separate property. In such a case, there is no question of the joint family rejecting or accepting and therefore there is no donor or donee – Goli Eswariah v. CGT [1970] 76 ITR 675 (SC).

251. What are the basic principles involved in throwing into the common hotchpot?

The following are notable principles with regard to the throwing into the common hotchpot of the separate self-acquired property of a Hindu, as laid down in the case of Mallesappa Bandappa Desai v. Desai Mallappa (1961) 3 SCR 779:

- The owner of the separate and self-acquired property desirous of throwing it into the common hotchpot should himself be a coparcener, having coparcenary interest in the joint property of the family.
- The existence of a coparcenary is, therefore, a condition precedent for throwing separate and self-acquired property into the common hotchpot.
- Such a coparcenary may or may not own a joint property but should be capable of owning joint property.
- The intention of abandoning his exclusive ownership over the separate and self-acquired property and blending it with the property of the HUF should be clear and unequivocal.
- There need not be a physical mixing of the separate property thrown into the common hotchpot with the existing property of the HUF, if any.
- The action of throwing his separate and self-acquired property into the common hotchpot is a unilateral action on the part of the coparcener.
- The action of throwing his separate and self-acquired property into the common hotchpot by a coparcener does not require the consent of other members of the family, coparceners or otherwise.
- There is no question of acceptance of this blending of individual property of a coparcener into HUF property.
- Once the intention to vest the property with the character of joint family property is made clear and unequivocal by the concerned coparcener, voluntarily and on his own (in specific and unambiguous terms), the blending will take effect.
- No sooner does a coparcener declare his intention to treat his self-acquired property as ancestral property, the property assumes the character of joint family property.
- The doctrine of throwing into the common stock is a doctrine peculiar to the Mitakshara school of Hindu law.

- In the case of blending of individual property of a coparcener into HUF property, there is no donor and no donee and the vesting coparcener does not make any gift.

252. How to create a HUF property?

Since the HUF is a creature of Hindu law, it can exist even without any nucleus or ancestral joint family property-CIT v. K. Satyendra Kumar (1998) 232 ITR 360 (SC)]. However, a HUF property can be created in the following ways:

- partition of a larger Hindu Undivided family;
- devolution of interest in coparcenary property of a coparcener who dies intestate;
- inheritance through a specific bequest under a will;
- reunion of separated coparceners;
- receipt of gifts;
- blending of individual property with the family hotchpotch;
- doing joint labour for the benefit of HUF.

Even though there may be many modes of creation of HUF property available, the methods of gift and will are the most common ways for creating a HUF.

253. Can a newly created HUF receive gifts from outsiders?

As a matter of tax planning, a newly created HUF as a unit may receive gifts from outsiders or from father or brothers of the karta who are not members of the donee HUF. In such cases, such gifts will result in accretion to the family fund without attracting the provisions of section 64(2) of the Income-tax Act, 1961. It is noted that none of the donors should be coparceners or members of the donee HUF.

254. Is registration required for partition?

A partition of a HUF may be effected either orally or in written form. In case the parties reduce the transaction to a formal document, which is intended to be the evidence of the partition, it has the effect of declaring the exclusive title of the coparcener to whom a particular property is allotted by partition, and is thus, within the mischief of section 17(1)(b) of the Registration Act, 1908- Nanni Bai v. Gita Bai AIR 1958 (SC) 706/ Hans Raj Agarwal v. CCIT (2003) 259 ITR 265 (SC).

Under Hindu Law it is not necessary that the partition should be effected by a registered partition deed. Even a family arrangement is enough to effectuate the partition between coparceners and to confer right to a separate share and enjoyment thereof- Digambar Adhar Patil v. Devram Girdhar Patil 1995 (4) JT (SC). Further, an oral partition recorded later by Memorandum of Partition does not need registration under any law.

255. What do you mean by 'partition'?

Under section 171 (Explanation (a)) of the Income-tax Act, 1961, the expression 'partition' means:

- where the property admits of a physical division, a physical division of the property, but a physical division of the income without a physical division of the property producing the income shall not be deemed to be a partition; or
- where the property does not admit of a physical division, then such division as the property admits of, but a mere severance of status shall not be deemed to be a partition.

Under the Dayabhaga School of Hindu law, the shares of members are already defined and therefore no physical division is required. On the other hand, under the Mitakshara School, mere intention to divide and specification of interest of various members may [without even actual division] constitute a partition.

However, under the tax laws, only a physical division by metes and bounds does constitute a partition. In case a property is incapable of such division, specification of shares may however be sufficient. To be more specific, there is said to be a partition under tax laws only when the Assessing officer passes an order under section 171 of the Income-tax Act, 1961 or under section 20A of the Wealth-tax Act, 1957.

256. How to effect partition in a joint family consisting of only brothers?

In case the joint Hindu family consists of only brothers, they take equal shares on a partition.

257. How to effect partition in a joint family consisting of father, mother and sons?

In a partition of a HUF, which includes father, mother and sons, the mother has no right to claim partition. However, when a partition is actually effected, the mother in the family takes a share equal to the sons.

258. How to effect partition in a joint family consisting of unmarried daughters?

Earlier, under the Hindu law, the unmarried daughters had generally no right to share on partition. However, with the passing of the Hindu Succession (Amendment) Act, 2005 (w.e.f. 9th September, 2005), a daughter of a coparcener shall also by birth become a coparcener in her own right in the same manner as the son.

259. How to make a partition to get recognized under the Income-tax Act, 1961?

Under the Income-tax Act, 1961 it is essential to have a partition by metes and bounds and only then it can be recognised as a partition. In other words, if it is not possible to have a physical division, then an adjustment will have to be made amongst coparceners to comply with the definition of partition under section 171. The most important aspect of partition for recognition under the Income-tax Act, 1961 is that there must be a physical division of the property and there must be a partition in definite portions or by metes and bounds. It is not sufficient for coparceners to divide the ownership, and become co-owners or tenants-in-common.

The expression "physical division in definite portion" for this purpose means a division in which a member takes a particular house which he can occupy and live or a piece of land which he can cultivate or which he can sell or mortgage, or takes a particular ornament which he can wear or dispose of. In other words, such a division is not one in which he can only claim as a proportion of the income and a division of the corpus but where he cannot claim any definite portion of property. However, a business cannot be divided into parts in the same manner as a piece of land and division may only be possible in the books-Joint Family of Udayan Chinubhai v. CIT [1967] 63 ITR 416 (Guj)

260. Is registration of partition deed mandatory?

As regards registration and attestation requirements in respect of deed of partition, the law is now well settled that if a partition is made by a formal document and the property affected is above Rs.100 in value, such a document requires mandatory registration. In other words, a partition, which is effected by writing, requires registration under the Registration Act, 1908 if the property involved is worth Rs.100 or more. Section 17 (1) of the Registration Act does not refer to a deed of partition but provides in clause (b) that a non-testamentary instrument which purports or operates to create, declare, assign, limit or extinguish whether in present or in future, any right, title or interest whether vested or contingent, of the value of one hundred rupees and upward to or in immoveable property requires registration.

In this context, a deed of partition, even assuming that it is not a transfer of property, still declares or limits or extinguishes a right, title or interest in property and, therefore, if the property is immovable and of the value of Rs. 100 or more, it would require registration-Siromani v. Hemkumar & Dinmani, AIR 1968 SC 1299; Nanibai v. Gitabai, AIR 1958 SC 706; Muthyalareddy v. Venkata Reddi, AIR 1969 A. P. 242.]

However, if the document is not a formal document effecting a partition, but is only one which merely acknowledges a former partition orally made or is merely a memorandum of what was decided at the oral partition, it does not require registration-Sunder Singh Majithia, (1938) 5 I.T.R. 336; Kalwa Devadattam v. Union of India, (1983) 33 I.T.R. 56. However, the deeds of partition made by Revenue Officer do not require registration under the law.

261. What is partial partition? Is partial partition valid under Hindu law?

Legally speaking, partition of a HUF can be partial as regards property or persons or both. In a partition of HUF, there can be a division/partition where only some of the property is divided while the balance of the property remaining joint. Similarly, there may be a partition where some of the coparceners leave the family, with their share of property, while others remaining joint.

Under Hindu law, partial partition in HUF is valid and there is nothing in Hindu law to stop members from effecting a division of one of the assets and remaining joint in respect of the other property but the partition must take place legally and the property actually divided in definite portions- Sir Sunder Singh Majithia v. CIT [1942] 10 ITR 457 (PC). Accordingly, the property partially partitioned would thereafter belong to the members and that income from the property would not belong to the HUF- Charan Dass Haridas v. CIT [1960] 39 ITR 202 (SC).

262. Is partial partition valid under income tax law?

All partial partitions made on or before 31st December 1978 could have been recognised under section 171 of the Income-tax Act, 1961. However, though Hindu law recognises division of property among family members through partial partition, from assessment year 1980-1981, the Income-tax Act, 1961 and Wealth-tax Act, 1957 do not recognise such partial partition, made after 31st December, 1978.

Section 171(9)(c) provides for recovery of tax in such cases and accordingly each member shall be jointly and severally liable for tax. Under section 171(9)(d) the separate liability of any member shall be computed according to the portion of the family property allotted to him on such a partial partition. The effect of section 171(9) in a case of partial partition which takes place after 31.12.1978 is that:

- the amendment takes effect from the assessment year 1980-81.
- the partial partition cannot be claimed; [even if a claim is made by any member of the HUF, the same will be ignored by the Assessing Officer who will not make any inquiry and will not record any finding]
- the partial partition cannot be recorded;
- the partial partition cannot be recognised under section 171;
- the HUF will continue to be assessed as joint family in future as if no such partial partition has taken place;
- the income apportioned to members will continue to be included in the hands of HUF for assessment purposes;
- the wealth apportioned to members will continue to be included in the hands of HUF for assessment purposes;
- the tax liability for the income or wealth will be borne jointly and severally;
- the taxes will be apportioned according to the ratio of assets and incomes so allotted;

263. How to assess a HUF after partition?

- Legally speaking, unless and until there is a finding of partition of HUF, as recorded by an assessing officer, a Hindu undivided family assessed as such is deemed to be a Hindu undivided family.
- In case at the time of making an assessment under Section 143 or 144 it is claimed by or on behalf of any member of a Hindu Undivided Family that a partition of the HUF, [whether total or partial] before 1 January 1979 has taken place among the members of such family, the Assessing Officer shall make an enquiry therein after giving notice of the enquiry to all the members of the family.
- On the completion of such enquiry, the Assessing Officer shall record a finding as to whether there has been a total or partial partition of the joint family property.

- If there has been such a partition of Hindu undivided family, the Assessing Officer shall record the date on which it has taken place.
- For this purpose, a partition of a Hindu undivided family can be either total or partial. The term "partition" means:
- where the property admits of a physical division, a physical division of the property (but a physical division of the income without a physical division of the property producing the income shall not be deemed to be a partition), or
- where the property does not admit of a physical division, then such division as the property admits of (but a mere severance of status shall not be deemed to be a partition)
- The term "partial partition" means a partition, which is partial as regards the persons constituting the Hindu Undivided Family or the properties belonging to the HUF, or both.
- After 31.12.1978, any partial partition of Hindu undivided families will not be recognised as per amendment by the Finance (No.2) Act, 1980, effective from assessment year 1980-81.
- In case the Assessing Officer has recorded a finding of total or partial partition under this section and the partition has taken place during the previous year the total income of the joint family in respect of the period upto the date of partition shall be assessed as if no partition had taken place.
- In such cases, each member or group of members shall, in addition to any tax for which he or it may be separately liable be jointly and severally liable for the tax on the income so assessed.
- Further, if the partition of HUF has taken place after the expiry of the previous year, the income of the family shall be assessed as if no partition has taken place.
- After the completion of the assessment of the HUF if the Assessing Officer finds that the family has already affected a partition, whether total or partial, the Assessing Officer shall proceed to recover the tax from every person who was a member of the family before the partition.
- In such cases, every such person [every person who was a member of the family before the partition] shall be jointly and severally liable for the tax on the income so assessed.

- For this purpose, the 'several liability' of any member or group of members thereunder shall be computed according to the portion of the joint family property allotted to him or it at the time of partition, whether total or partial.

264. What are the pre-requisites for a valid reunion under Hindu law?

The following are the conditions precedent [as decided in CIT v. A.M. Vijyapuri Chettiar & Ors. (1995) 215 ITR 836 (Mad)] for a valid reunion under Hindu law:

- there must have been a previous state of reunion. Re-union is possible only among the persons who were, on an earlier date, members of an HUF;
- there must have been a partition in fact;
- the reunion must be effected by the parties or some of them who had made the partition;
- there must be a junction of the estate and the reunion of property because reunion is not merely an agreement to live together as tenants-in-common;
- Reunion is intended to bring about a fusion in the interest and in the estate among the divided members of an erstwhile HUF so as to restore to them the status of an HUF once again.

265. Discuss in brief the taxability of conversion of a self-acquired property into a HUF property.

- Under section 64(2) of the Income-tax Act, 1961, in case an individual being a member of a Hindu undivided family, converts, at any time after the 31st of December 1969, his separate property into property belonging to the family through the act of impressing such separate property with the character of property belonging to the family or throwing it into the common stock of the family otherwise than for adequate consideration, the individual shall be deemed to have transferred the converted property, through the family, to the members of the family for being held by them jointly.
- The income derived from the converted property or any part thereof shall be 'deemed to arise to the individual' and not to the family.
- Where the converted property has been the subject matter of a partition (whether partial or total) amongst the members of the family,

the income derived from such converted property as is received by the spouse on partition shall be deemed to arise to the spouse from assets transferred indirectly by the individual to the spouse and the provisions of section 64(1) shall apply accordingly.

- For this purpose, "income" includes loss and "property" includes any interest in property, movable or immovable, the proceeds of sale thereof and any money or investment for the time representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

- Under section 64(2) the income generated by the blended or impressed assets has to be clubbed in the individual income of the member who has blended his asset with the HUF character. But the interesting point to be noticed is that such income remains with the HUF and may be invested by the HUF. Any income generated from this income will be assessed in the hands of HUF. In other words, clubbing provision will attract only in respect of income generated from the amount originally blended by the individual with HUF character.

- To illustrate the clubbing provisions, if Mr. X, a member of a HUF, transfers or blends his individual cash amount of RS.500,000 with the HUF character and the HUF in turn invests this money in fixed deposit with bank. In such a case, assuming the interest rate at 12% p.a., a sum of RS.60,000 being the income on the amount blended by Mr. X will be clubbed in his individual income. However, if the amount of interest of RS.60,000 is invested further and the HUF gets an interest of RS.6,000 on the same, it will be assessed as income of HUF. In this context, it may also be pointed out that a female member is not eligible to blend her personal property into HUF but she can make a gift to HUF – *Pushpa Devi v. C.I.T. 109 ITR 730 (SC).*

- Under section 4(2) of the erstwhile Gift Tax Act, the gift tax was also attracted in respect of the amounts blended to the extent of the share of coparceners other than the transferor himself. For example, if a father has four sons and blends his personal property valued at RS.500,000 with the HUF character, making a declaration to that effect. In such case four fifth of the blended amount i.e. RS.400,000 will be treated as gift to the HUF. Therefore while deciding the amount to be blended, the gift tax exemption limit should be kept in mind. However gift made on or after 1.10.1998 are not subject to gift tax [as gift tax in India has been abolished w.e.f. 1.10.1998].

- From the viewpoint of tax planning, in certain cases it may be useful for a member of the HUF to blend or transfer his own shares of any company with the HUF character. If, later on, bonus shares are issued in respect of the shares so blended with the HUF property, such bonus shares will be treated as the property of the HUF. Consequently, the dividend in respect of original shares will only be clubbed with the income of the transferor member of HUF and the dividend on bonus shares will be assessed in the hands of HUF. In this context, the decision of Madras High Court in *CIT v. T. Saraswathi Achi 133 ITR 315.*Is relevant. It becomes more useful as the dividends from Indian companies referred to in section 115-o, is now totally exempt u/s 10(34) w.e.f. 1.4.2004 (as amended by Finance Act, 2003). So consideration of dividend in the hands of individual will have no tax impact.

266. Can a HUF be created out of gifts from others?

- The Supreme Court in *Pushpa Devi v. CIT 109 ITR 730 (SC)* has heldthat a HUF can accept gift from a person who is not a coparcener. The decision of the Madras High Court in *Satyendra Kumar v. CIT 140 ITR 840 (Mad.)* is also relevant. In this case the donor provided gifts to the donee with the clear intention to benefiting the family. The donee kept the gifted amount as nucleus of the HUF and there was no evidence that the donee intended at any point of time to hold the said property as his individual property. The Court held that once the intention of the donor to donate the funds for the joint family was conceded, the presence of the basic nucleus of the joint family was established.

- In *C.N. Arunachala Mudaliar v. C.A. Muruganatha Mudaliar [1954] SCR 243,* it was *held* that the court would have to collect the intention of the donor from the language of the document taken along with surrounding circumstances in accordance with the well-known canons of construction. The point that the gift is being made to the HUF and not to the Karta in his individual capacity should be clearly indicated by the donor by way of an affidavit.

- In order to avoid various complications it is advised that gifts to HUF should be preferred from the uncles, brother-in-law, grandparents and other relatives who are not the members of the HUF. In such a case the transfer by way of gift will not attract the clubbing provisions of section 64.

267. Can a HUF be created through will?

- The creation of HUF through Will has been upheld by various High Courts following the Supreme Court decision in the case of *SurjitLal Chhabda v. C.I.T. [1975] 101 ITR 776.*
- A Will can be made in favour of a HUF, which is not in existence at the time of the execution of the Will or which does not have HUF nucleus, as decided by Punjab & Haryana High Court in *C.I.T. v. Ghanshamdass Mukim 118 ITR 930.* In the said case a Will was left by the mother of Ghanshamdass providing therein for passing of certain properties to the HUF of his son who had only wife and a daughter at that time. The Will in favour of HUF was held valid and the contention of revenue that no HUF could be created by Will was rejected.
- It was observed that joint family is the normal condition of Hindu Society and there is no restriction to bequeathing property to a joint Hindu family, therefore the Court held that the pre-existence of HUF was not necessary for bequeathing property to HUF through a Will.

268. Can a HUF be created by joint labour?

- Under the Hindu law a property is treated as joint family property if it has been acquired in business by persons constituting a joint Hindu family by the joint labour unless the acquirer's intention is to hold the property as co-owners individually. 'Ancestral nucleus' is not necessary for creation of HUF by joint labour of coparceners.
- However, the coparceners should be engaged in carrying on work together and they should belong to the same line of ancestors.
- For the purpose of income tax it would be advisable that such coparceners should declare the intention in writing stating that the income earned through their joint labour will be the income of the joint family and such income or any assets acquired out of it will neither belong to them nor their legal heirs or successors in individual capacity.
- The income of joint family through joint labour is not subjected to clubbing provisions of section 64(2) of the Income-tax Act, 1961.

269. Can partial partition be made for tax benefits?

- A HUF can be partitioned and as such smaller HUFs can be created, each enjoying the benefit of threshold limit under the income tax act as well as Wealth tax Act. It may however be noted that the partial partition is no more useful after 31.12.1978 due to insertion of section 171(9).
- Accordingly, even in case of partial partition taking place, such Hindu family shall continue to be liable to be assessed under the Income-tax Act as if no such partial partition had taken place.

270. Discuss in brief the tax implications of a HUF property received and held by a husband &a wife having no son.

- In *Pannalal Rastogi v. CIT 65 ITR 592 (Pat.)* the High Court held that 'A' and his wife constituted a HUF in respect of the assets and the property they got on partition. They stated that safer test would be, as pointed out in the case of *Attorney General of Ceylon v. Arunachalam Chettiar [1957] A.C. 540* whether there is a potentiality of a coparcener being brought into existence either by law (i.e. adoption) or by nature (birth by wife). So long as the potentiality is there, the property must be held to be that of a HUF. Such a potentiality exists in the case of a sole surviving coparcener because he may be getting a son or adopting a son.
- In *Bharat Kumar Chinubhai v. CIT 71 ITR 1*, (Guj.), it was held "where an assessee has only a wife or unmarried daughter and no son, the property received by him in respect of his share in the joint family properties on partition belongs to the HUF consisting of himself and his wife or unmarried daughter and is liable to be assessed as property of the HUF and not his individual property". Similar decision was also made in *CIT v. Beni Prasad Tandon 71 ITR 322 (All.)*
- In *Pratap Narain v. CIT 63 ITR 505 (All.)* 'P' received certain properties on partition of a HUF. He had a wife but no children. It was held that he constituted a HUF with his wife and was assessable as such. The Court observed, "It is not correct to say that the share of the property upon partition constitutes the separate property of the coparcener and that it is only subsequently when a son is born that the property becomes ancestral property or HUF property. The birth of a son does not alter the nature of the property. Property all along continues to be coparcenary property".

271. Can the coparcenary property be gifted?

The coparcenary property belonging to a HUF is joint property and the same can be transferred or alienated or gifted away only under certain specific circumstances, like the following-

- A Hindu father, being the Karta, has a right to make a gift of ancestral movable property, within reasonable limits, without the consent of his sons, for the purpose of support of the family, relief from distress, affection and other indispensable acts of duty. Such a gift may be made to a wife, to a daughter and even to a son, within reasonable limits. However, gift of whole of such property would not be within reasonable limits.
- For pious purposes a Hindu father has power to make a gift of ancestral immovable property also but it should be within reasonable limit.
- Gifts of reasonable amount can be made from the HUF property at the time of marriage of any family member apart from incurring normal expenses on marriage.

However, what amount should be termed reasonable, will depend upon the circumstances of each case depending upon the quantum of HUF properties, the number of family members, responsibilities of maintaining the family, expenses required to be incurred by the HUF on marriage, education and other purposes etc.

272. Discuss in brief some of the tax planning options available with regard to a HUF?

The following are some notable tax-planning options with regard to a HUF, namely,

- Ensure that gifts or inheritances meant for the benefit of all the members of a family are gifted specifically to the HUF, instead of separately to individual members of the family. Since there is no gift tax and estate duty, neither the benefactor nor the recipient will attract tax on such a transfer.
- The capital of a HUF can also be enhanced by borrowing funds from people who are not members. If the borrowings are specifically in the HUF's name, and it is thereafter invested in the HUF's name, the income arising on the investment will be regarded as the income of the HUF.

- It is advisable to transfer individual funds to the HUF and then invest the money in tax-free instruments. Since the income from such investments will be tax-free, it will not be clubbed with the individual's income. The income arising on the reinvestment of the tax-free income (which may be in taxable income-yielding assets) will also not be clubbed, since only the income arising on transferred amounts is clubbed.
- Legally speaking, it is possible for a member of a HUF to transfer his or her individual assets to the HUF. However such a transfer is not beneficial from the income tax point of view. This is because there is no transfer of the tax liability on the income from such assets, due to the tax provisions governing the clubbing of such income with the income of the transferor.

273. What is a family settlement? What are its salient features?

- A family settlement is an arrangement between family members for sharing the family property. It is resorted to for the benefit of the family members, to sort out doubtful or disputed rights and to avoid future litigation.
- The term family settlement is popular in connection with property settlements, whether by partition or otherwise. Family settlement is the best way to settle disputes of family property and ensure amity and goodwill amongst the family members.
- The concept of family settlement is not necessarily confined to Hindu families in India. In fact family settlement is a familiar concept under the English Law as well. The Halsbury's Laws of England has defined the term 'family arrangement' as under: "A family arrangement is an agreement between members of the same family, intended to be generally and reasonably for the benefit of the family, either by compromising doubtful or disputed rights or by preserving the family property or the peace and security of the family by avoiding litigation or by saving its honour."
- The following are the salient features of a family settlement:
  - There must be mutual understanding among the various family members regarding the terms of the family settlement.
  - The family settlement should benefit the family as a whole and promote goodwill between the members.

- The family settlement should be just and fair.
- The settlement should not be induced by fraud, coercion or undue influence
- The settlement must be completely voluntary.
- Family settlement can be both oral and written.
- The members who are parties to the family arrangement must have some title, claim or interest or even a possible claim in the property, dealt with in the family settlement.
- A family member can give up all his claims to a family property in favour of another who does not have any claim or title in the family property.
- Family disputes can be settled by a genuine family arrangement, which is fair and equitable. It is irrelevant whether they do involve legal claims or not.
- In a family arrangement it is not essential that every participating party should be shown to have a legal claim to share in family property-Rangaswami Gounder v. Nachiappa Gounder, AIR [1918] PC 196.
- The family settlement is final and binding on the parties.

274. Can a minor be a party to a family settlement?

- Legally speaking, a minor can be a party to a family settlement if a guardian represents him. [Generally, only adults of sound mind are eligible to contract].
- Further, any family settlement made for the minor member must be beneficial to him. In other words, no family liability should be imposed on the minor member of the family.

275. How does a 'family settlement' differ from a 'gift' or 'will'?

A family settlement is different from a gift which can be made to anybody, whether family member, institution or government. Legally speaking, gift involves the transfer of property, whereas there is no immediate transfer of property in a family settlement.

A family settlement is also different from a will. A will normally confers rights on anyone, even if he is not a family member. However, family settlement involves only members of the very same family. Further, a will comes into effect after the lifetime of the person who makes it unlike a family settlement, which comes into effect from the date of the settlement itself.

276. Is registration required for any deed of family arrangement?

- Registration is not required in the case of a memorandum of partition or family arrangement. Generally, a family arrangement would not require registration but if the title vested in one person is transferred to another in an immovable property, it would require registration-Shambhu Prashad Singh v. Phool Kumari, AIR [1971] SC 337; Maruri Pullaiah v. Maturi Narasimham, AIR [1966] SC 1836;
- Further, any family settlement which merely recognises the rights of all the persons mentioned therein and makes no transfer of any title does not require registration.
- However, any settlement deed dealing with immovable property must be stamped. Accordingly, the duty to be paid is calculated on the market value of the property. Further, two competent persons must attest the settlement deed. For this purpose, persons who are of sound mind and above the age of eighteen are eligible to attest.

277. Who are owners of a HUF business?

- The owner of a HUF business is the joint Hindu family and in Mitakshara family the coparceners have coparcenary interest in joint business asset of the family in the same way as in the other assets of the family. The relationship between the Hindu coparceners arises not out of contract but by the operation of Hindu law.
- Based on the above, if and when disputes arise amongst the coparceners of a family in respect of the joint business of the Hindu family, these disputes should be resolved under the relevant provisions of the Hindu law and not under the Indian Partnership Act, 1932.

278. What are the salient features of a 'trading family' under the Hindu law?

Under the Hindu law, the following are the notable features of a trading family:

- A trading Hindu undivided family is not a firm.
- A joint Hindu family is the creature of personal law and not of contract.

- No member of Mitakshara family can predicate any definite shares in the business assets until division/partition.
- A joint family business is not dissolved by the death of a coparcener.
- A coparcener is not entitled, on severance of his connection with the family business, to ask for accounts of past profits and losses.
- In the joint Hindu family business, the shares of the individual members in the profits and losses are not worked out.
- In the case of family business, the manager alone has the implied authority to contract debts in the ordinary course of business.
- In the case of family business, the debts, as contracted by the karta, would be binding on the family property including the interest of the minor coparceners therein.
- In the case of a family business, the manager or karta is liable to the debts, contracted by him (in pursuance of his implied authority in ordinary course of the family business) to the extent of his share in the joint family property. Further, the karta, being a party to the contract, is also liable personally (viz., his separate property is also liable).
- In case of coparceners (who are not minors) the liability is normally limited to the extent of their interest in the family property. However, they are personally liable in the case of a contract sued upon, (though purporting to have been entered into by the karta alone), is in reality (i) one to which the coparceners are actual contracting parties, or (ii) one to which the coparceners can be treated as being contracting parties by reason of their conduct, or (iii) one which the coparceners have subsequently ratified;
- In the case of minor coparceners, unless they have ratified the contract on attaining majority, the liability is normally limited to the extent of their interest in the family property.

279. Can a HUF be a shareholder in a company?

Under section 2(31), a Hindu undivided family is a 'person' for the purpose of the Income-tax Act, 1961. However, a Hindu undivided family or HUF is not a juristic person for all purposes (viz., for the purposes of other laws) including the company law. However, there is no legal bar on a Hindu undivided family to invest its money in shares and securities of companies and the Companies Act, 1956 does not prohibit membership of HUF.

Under the company law, the shares cannot be directly allotted to a Hindu undivided family. However, they can be allotted to any member of the joint family as a representative. In other words, the HUF can purchase the shares in a company in the name of the individual members or coparceners of the family. In such a case, these persons (individual members or coparceners of the family) may hold the shares in a representative capacity and the beneficial interest in the shares is held by the HUF.

280. Can a HUF create a trust?

- Under section 7 of the Indian Trusts Act, 1882, any person competent to contract and competent to deal with property can create a trust. Accordingly, not only individuals but also a body of individuals or any artificial person such as an association of persons, an institution, limited company or a Hindu undivided family can also form a trust.
- Legally speaking, a Hindu undivided family is entitled to create a trust through its karta or manager. A karta or manager of a joint Hindu family can create a charitable trust in relation to the joint family property, for the benefit of the family- Sri Thakurji v. Nand Ahir ILR 43 All. 560.
- Further, the karta of the HUF can also form a charitable trust if it is necessary to fulfil the religious or charitable obligations of the Hindu joint family- Gangi Reddi v. Tami Reddi. AIR 1927 PC 80: S. Devraj v. CWT (1973) ITR 400 (Mad); Narasimhaswami v. Venkatalingam. AIR 1927 Mad. 636(FB).
- However, a Hindu coparcener, governed by the Mitakshara Hindu law, cannot transfer or alienate his coparcenary interest in the joint family property to a charitable trust- Sahu Ram Chandra v. Bhup Singh AIR 1917 PC 61.

281. Can a HUF be a partner in a firm? Can all members of the family become partners?

- Under section 2(31), a Hindu undivided family is a 'person' for the purpose of the Income-tax Act, 1961. However, a Hindu undivided family or HUF is not a juristic person for all purposes (viz., for the purposes of other laws) including the partnership law.
- Under the Indian Partnership Act, 1932, a Hindu undivided family is not a juristic person and it cannot enter into a valid partnership with any other person.

- The HUF cannot as such enter into a contract of partnership with another person or persons-Agarwal & Co. v. CIT [1970] 77 ITR 10 (SC).
- However, the karta of the HUF may enter into partnership with outsiders on behalf and for the benefit of his joint family. But when he does so the other members of the family do not, vis-a-vis the outsiders, become partners in the firm. They cannot interfere in the management of the firm or claim any account of the partnership business or exercise any of the rights of a partner. So far as the outsiders are concerned, it is the karta who alone is, and is in law, recognised as the partner- CIT v. Seth Govindram Sugar Mills [1965] 57 ITR 510 (SC).

282. Can a HUF control a partnership in India? Discuss in brief the legal rights of the joint family vis-à-vis its nominee partner.

The Supreme Court of India in the case of Rashik Lal & Co. v. CIT [1998] 229 ITR 458 (SC) clarifies the position of a Hindu undivided family in partnerships:

- The HUF (directly or indirectly) cannot become of a partner of a firm because the firm is an association of individuals;
- All the provisions regarding mutual rights and liabilities are only applicable to the partners who are members of the firm;
- The only right of HUF is possibly to call upon the nominee partner to render accounts for the profits that he has made from the partnership business;
- The nominee partner of HUF does not act in a representative capacity in the partnership. The nominee simply functions in his personal capacity like any other partner;
- The HUF or its representative does not have any special status in the Indian Partnership Act, 1932.
- The HUF is not and cannot be a partner in a partnership firm as it is not being a 'person' who can enter into an agreement of partnership;
- If the Karta enters into partnership, upon the death of the Karta, the partnership will stand dissolved. In the absence of a contract to the contrary, another member of the HUF cannot step into the shoes of the Karta;

283. What are the income tax rates (applicable for HUF) for assessment year 2013-14?

Sl. No.	Total Income	Tax payable
1.	Upto Rs.2,00,000	Nil
2.	Rs.2,00,000 – Rs.5,00,000	10 per cent of the amount by which the total income exceeds Rs.2,00,000
3.	Rs.5,00,000-10,00,000	Rs.30,000 plus 20 per cent of the amount by which the total income exceeds Rs.5,00,000
4.	Above Rs.10,00,000	Rs.130,000 plus 30 per cent of the amount by which the total income exceeds Rs.10,00,000
5.	Surcharge	Nil
6.	Education Cess	2 per cent on the amount of income tax
7.	Secondary and Higher Education Cess	1 per cent on the amount of income tax

Note: For the assessment year 2013-14, tax payable by a HUF cannot be less than 18.5% (+EC+SHEC, effective rate 19.055 % of 'adjusted total income' as per section 115JC. [as amended by Finance Act, 2012, w.e.f.1.4.2013].

284. What are the income tax rates (applicable for HUF) for assessment year 2012-13?

Sl. No.	Total Income	Tax payable
1.	Upto Rs.1,80,000	Nil
2.	Rs.1,80,000 – Rs.5,00,000	10 per cent of the amount by which the total income exceeds Rs.1,80,000
3.	Rs.5,00,000-8,00,000	Rs.32,000 plus 20 per cent of the amount by which the total income exceeds Rs.5,00,000
4.	Above Rs.8,00,000	Rs.92,000 plus 30 per cent of the amount by which the total income exceeds Rs.8,00,000
5.	Surcharge	Nil

6.	Education Cess	2 per cent on the amount of income tax
7.	Secondary and Higher Education Cess	1 per cent on the amount of income tax

285. How to compute income tax in case of a HUF? Discuss briefly all the steps involved.

As regards the computation of income tax in case of HUF, the following steps/points are noteworthy:

- First of all, the HUF must compute the gross total income, like any other person. [The gross total income for this purpose shall be computed under four heads of income, on the basis of their residential status. There can be no income under the head income from salaries in the case of HUF].
- Sections 60 to 63 [viz., provisions relating to income of other person included in the assessee's total income] are applicable in case of HUF.
- However, section 64 is not applicable to HUF as it is applicable in case of individual assessee only.
- Set off of losses is permissible in case of HUFs while aggregating the income under different heads of income.
- Carry forward and set off of losses of past years, if permissible, is allowed.
- The income computed as above is known as gross total income from which the following deductions under sections 80C to 80U will be allowed. [A HUF is eligible for deductions under sections 80C, 80D, 80DD, 80DDB, 80G, 80GGA, 80HH, 80HHA, 80HHB, 80HHBA, 80HHC, 80HHD, 80HHE, 80HHF, 80-I, 80IA, 80-IB, 80JJA, 80L (omitted w.e.f. 1.4.2006) and 80-O].
- Find out the balance of income after allowing the deductions, which is known as total income. Round off the total income to the nearest Rs.10.
- Compute the tax on such total income at the prescribed rates of tax.
- Find out the balance, which is the total tax payable.
- Add the tax payable by surcharge at applicable rates.

- Add education cess at the rate of 2 per cent on the amount of income tax and surcharge [The Finance Act, 2007 has, with effect from 1st April, 2007, provided for levying an additional cess of 1% on all taxes to fund the secondary and higher education, thus effectively increasing the rate of education cess from 2% to 3%.].
- Deduct the TDS and advance tax paid for the relevant assessment year.
- Find out the balance, which is the net payable.
- Pay the net tax payable as self-assessment tax before submitting the return of income.
- While computing the income under the head 'capital gains', the HUF is entitled to the following exemptions:
  - (i) Capital gain on sale of property used for residence (section 54)
  - (ii) Capital gain on compulsory acquisition of lands and buildings (Section 54D)
  - (iii) Capital gain on transfer of long-term capital assets (section 54EC)
  - (iv) Capital gain on transfer of certain capital assets where investment is made in a residential house (section 54F)
  - (v) Capital gain on transfer of assets on shifting of an industrial undertaking from urban area (section 54G).
  - (vi) However, exemption in respect of capital gains of agricultural land covered u/s 54B is not allowed to HUF.

286. Who are 'sapinda relations' under Hindu law?

- Clause (f) of section 3 of the Hindu Marriage Act, 1955 deals with sapinda relations of Hindus. Accordingly, "sapinda relationship" with reference to any person extends as far as the third generation (inclusive) in the line of ascent through the mother, and the fifth (inclusive) in the line of ascent through the father, the line being traced upwards in each case from the person concerned, who is to be counted as the first generation.

- In this context, two persons are said to be "sapindas" of each other if one is a lineal ascendant of the other within the limits of sapinda relationship, or if they have a common lineal ascendant, who is within the limits of sapinda relationship with reference to each of them.
- Under section 5 of the Hindu Marriage Act, 1955, which contains certain conditions for a Hindu marriage, a marriage may be solemnized between any two Hindus, if the parties are not sapindas of each other, unless the custom or usage governing each of them permits of a marriage between the two [Clause (v) of section 5].

287. What are the powers of a karta of a HUF?

- The Karta has extensive powers in respect of the day-to-day management of the joint Hindu family. He is the controller of the income and expenditure of the joint family and he is the custodian of its surplus finances. The Karta may well spend on a son whose family is large or who has special aptitude or necessity- CIT v. Dewan Krishna Kishore 9 ITR 695 (PC)
- The Karta is always expected to utilise the income of the joint family for the purpose of the family, viz., for the maintenance, education, marriage, shradh and other religious ceremonies of the coparceners and members of the joint family. Where the karta spends more than the other members approve, their remedy is to demand a partition of HUF.
- The Karta as manager of the affairs of HUF has power to contract debts on behalf of the joint family and discharge claims against the family. Interestingly, the Karta of HUF is not liable to submit account to anyone, even in the contingency of partition of the HUF.
- The Karta has a right to partition the family with or without the consent of his sons or other coparceners, if any. The Karta father is also entitled to effect a division (in the overall interest of the family) between the sons inter se.
- The Karta is also empowered to alienate for value the joint family property, so as to bind the interests of both adult and minor coparceners. However, such alienation is to be made for a legal necessity, or for the benefit of the estate.

- The Karta can enter into partnership on behalf of the Hindu undivided family. In such a case, the Karta is the only person recognised as a partner by others- CIT v. Kalubabu Lal Chand 37 ITR 123 (SC).

288. Can two HUFs enter into a partnership agreement?

In case two Kartas of two HUFs enter into a partnership agreement, the partnership is popularly described as between the two HUFs. However, in the eyes of law it is a partnership between the two Kartas. In such a case, the other members of the families do not ipso facto become partners-K. Mohan Sanyasi Charan Sadhukkan v. CEPT 24 ITR 488 (SC)

289. Can a minor member of a HUF be its karta?

Legally speaking, a minor member can also act as the karta of the joint Hindu family. The minor member can act through his natural guardian, his mother, where father's whereabouts are not known at the time- Jogendra Singh v. Narayan, AIR (1965) Punj. 300.

290. Can a person other than the senior most coparcener be the Karta of a HUF?

- A person other than senior most coparcener may also be Karta. It is generally presumed that the senior most member of the family would be regarded as Karta of the joint Hindu family.
- However, in case the senior member gives up his right of management, a junior member may be appointed manager. A junior member of a family can act as Karta with the consent of the other members- Narendra Kumar S. Modi v. CIT 105 ITR 109 (SC).

291. Can a person be the karta in more than one HUF?

- Under the Indian income tax law, just like every other person, a HUF or Hindu Undivided Family is also given a specific name for its identification. Accordingly, a Hindu Undivided Family is normally referred to as "Name of the Karta (HUF)".
- Practically speaking, it is possible that a person can be a Karta or manager in more than one HUF at a time. For instance, Mr. X, a Hindu male member, may constitute a HUF along with his five younger brothers, his spouse, the spouses of his five brothers and the children of all the brothers. In this big HUF, Mr. X will be the Karta or manager. This is simply because he is the oldest surviving male member of the said HUF. Under the income tax law, this HUF will be referred to as "X (HUF)". At the same time, Mr. X may also constitute

another HUF along with his wife and children. Interestingly, the same Mr. X can be the karta of the newly constituted HUF consisting of himself, his wife and children.

- In such circumstances, in order to avoid any difficulty in identification, the first HUF is identified as 'X' (BHUF) and the second as 'X' (SHUF). The expressions "BHUF" and "SHUF" here denote 'bigger HUF' and 'smaller HUF' respectively.

292. Can smaller HUF be created from an existing HUF?

- Under the Hindu law, a smaller HUF may also be created by partial partition of an existing HUF. However, any such creation or partial partition is derecognised under section 171(9) of the Income-tax Act, 1961. In case where a smaller HUF is created as a taxable entity, many tax advantages such as the basic exemption, the lower slab rates of tax and other deductions will be available.
- In this context, in case where the HUF consists of fairly large members, it may be beneficial to form multiple HUFs. In such process one member of HUF releases his right in one property and brings another HUF into existence in which other members of HUF other than the member who relinquishes his right will be the members of that HUF. Similarly other member in other properties would do relinquishment of rights one by one. This will bring the new HUF entity into existence.
- In other words, a number of HUFs can be brought into existence by process of relinquishment of right in the properties. As a result, considerable tax gains can be achieved by dividing the existing income among a number of different taxable entities. Legally speaking, this concept of multiple HUFs/ relinquishment of right in the properties has been upheld by the Gujarat High Court in the case of CIT vs. Shantikumar Jagabhai [1976] 105 ITR 795 (Guj.).

293. Can a HUF be assessed as a distinct tax entity? Discuss notable features of taxation of a HUF.

- Under section 2(31) of the Income-tax Act, 1961, a HUF is a separate and a distinct tax entity. Accordingly, the income of a Hindu undivided family can be assessed in the hands of the HUF alone and not in the hands of any of its members, unless specifically provided by law.

- However, any sum received by an individual as a member of a HUF, where such sum has been paid out of the family or income of the impartible estate belonging to the family shall be exempt in the hands of the member of the HUF as per section 10(2).
- As per section 64(2), income from the transfer of a self-acquired asset, without adequate consideration or conversion of the same into joint family property, shall not be treated as the income of the HUF. Such income [viz., income from the transfer of a self-acquired asset, without adequate consideration or conversion of the same into joint family property] shall continue to be taxed in the hands of the transferor who is the member of the HUF.
- Any fee or remuneration received by a member of the HUF as a director or a partner in a company or firm, which is a result of the investment made in such concern out of the funds of the HUF, shall be treated as income of the HUF. However, if such fee or remuneration is earned by the member of the HUF as a director or partner for services rendered purely in his personal capacity, it shall be treated as the income of the individual and not the HUF.
- Remuneration and commission received by the karta/manager of HUF on account of his personal qualifications and exertions and not on account of investment of the family funds in the company cannot be treated as income of HUF-K.S. Subbiah Pillai v. CIT (1999) 103 Taxman 400 (SC).

294. Can a HUF pay remuneration to its karta/manager?

If remuneration is paid to the karta/manager of a HUF under a valid agreement which is bona fide and in the interest of, and expedient for, the business of the family and the payment is genuine and not excessive, such remuneration paid wholly and exclusively for the business of the family, shall be allowable as an expenditure while computing the income of the HUF-Jugal Kishore Baldeo Sahai v CIT (1967) 63 ITR 238 (SC).

295. Is Alternate Minimum Tax applicable for a HUF?

Under sections 115JC to 115JF of the Income tax Act, 1961, Alternate Minimum Tax provisions are applicable for a HUF from assessment year 2013-14.

From the assessment year 2013-14, alternate minimum tax provisions are applicable in the case of a HUF only in the following cases:

- if the assessee has claimed any deduction under section 10AA or 80H to 80 RRB (except section 80P).
- if adjusted total income exceeds Rs. 20 lakh.

296. How to compute alternate minimum tax in respect of a HUF?

From the assessment year 2013-14, a HUF in India shall be subject to alternate minimum tax. For this purpose, the alternate minimum tax shall be computed as follows:

Step involved	Computation process/notable points
1	Compute the regular income-tax liability of the HUF ignoring the provisions of sections 115JC to 115JF.
2	Find out adjusted total income of the HUF. Adjusted total income is net income or total income of the HUF as increased by: ❑ amount claimed as deduction by the HUF under sections 80H to 80RRB , (not being section 80P) and ❑ amount claimed as deduction by the HUF under section 10AA. If the assessee is a HUF and the adjusted total income is Rs 20 lakh (or less), then the provisions of alternate minimum tax are not applicable.
3	Find out 19.055% (i.e., 18.5% +EC +SHEC) of adjusted total income computed under Step 2.
4	If amount computed under Step 1 is equal to or more than amount determined under Step 3, then the provisions of alternate minimum tax will not be applicable. If, however, amount computed under Step 3 is more than the regular tax liability determined under Step 1, then- ❑ adjusted total income determined under Step 2 will be deemed as total income of the HUF for such previous year; and ❑ 19.055% of adjusted total income will be deemed as tax liability of the HUF for such previous year.
5	❑ The excess of the amount computed under Step 3 over the amount computed under Step 1 will be available as credit for alternate minimum tax.

	❑ It can be carried forward and can be set off against regular tax liability of the HUF of the next year or subsequent year (but not beyond the 10th assessment year). ❑ No interest is payable on such credit. ❑ Tax credit shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the alternate minimum tax to the extent of the excess of the regular income-tax over the alternate minimum tax
6	Where the provisions of alternate minimum tax are applicable, the assessee will have to obtain a report in Form No. 29C from a chartered accountant.

297. How to serve notice on a HUF?

- Under section 282(2) of the Income-tax Act, 1961, any notice or requisition under the income tax law in respect of a Hindu undivided family may be addressed to the manager or any adult member of the family. For this purpose, the adult member of the family need not be a coparcener or male member. In other words, the service of a notice on any adult member would amount to service on the HUF.
- However, the term 'adult' for this purpose does not mean 'major' and accordingly a notice may be served on a 'minor' member of the family provided he has attained the age of discretion-Sridhar Udai Narain v. CIT, (1962) 45 ITR 577 (All). Legally speaking, there is no legal bar to a female member acting as a manager representing a HUF for purposes of assessment of income tax. In such a case, any notice may be validly served on her-Champa Kumari v. Addl. Member, Board of Revenue, (1962) 46 ITR 81 (Cal);
- Any notice issued to any adult member of a Hindu undivided family for submitting a return of income of the family is a valid notice-Sarupchand & Hukumchand v. UOI, (1953) 23 ITR 282 (MP-FB). Though a notice in respect of a HUF can be served on any adult member of the family, it should clearly indicate that it is meant for the family and not for that particular adult member of the family.

298. Who can sign return of income in case of a HUF?

Under section 140(b) of the income-tax Act, 1961 in the case of a Hindu undivided family, the return shall be signed and verified by any of the following persons:

- by the karta of the Hindu undivided family or
- where the karta is absent from India, by any other adult member of such family or
- where the karta is mentally incapacitated from attending to his affairs, by any other adult member of such family.

Before signing the verification, the signatory in the return of income should satisfy himself that this return is correct and complete in every respect. This verification assumes greater importance because any person making a false statement in this return shall be liable to prosecution under section 277 of the Income-tax Act, 1961.

299. Can a karta of a HUF be punished for making false statements before income tax authorities?

Under section 277 of the Income tax Act, 1961, [as amended by Finance Act, 2012] any person, making a false statement in any verification (under the Income-tax Act, 1961 or any rules made there under) in return of income shall be punishable with imprisonment/fine as follows:

- In a case where the tax sought to be evaded exceeds twenty five lakhs rupees, he may be punished with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;
- In any other case, with rigorous imprisonment for a term, which shall not be, less than three months but which may extend to two years and with fine.

Under section 278A, if any person convicted of an offence under section 277 is again convicted of an offence under any of the aforesaid provisions, he shall be punishable for the second and for every subsequent offence with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine.

300. Is return of wealth to be filed by every HUF in India?

- Under section 14 of the Wealth-tax Act, 1957, every HUF, if its net wealth or the net wealth of any other person in respect of which it is assessable under this Act on the valuation date exceeded the maximum amount which is not chargeable to wealth-tax, shall, on or before the due date, furnish a return of its net wealth or the net wealth of such other person as on that valuation date.

- Such return of wealth must be filed in the prescribed form [Form BA from Assessment year 1993-94] and verified in the prescribed manner setting forth particulars of such net wealth and such other particulars, as may be prescribed.
- Where the HUF is carrying on a business, a copy of the balance sheet or trial balance as on the valuation date or on the date of the closing of accounts immediately preceding the valuation date, and a copy of the auditor's report, if any, shall also be furnished along with the return of net wealth.
- For this purpose, "due date" in relation to an assessee under the Wealth-tax Act shall be the same date as that applicable to the HUF under the Income-tax Act under the Explanation to sub-section (1) of section 139 of the Income-tax Act, 1961.

301. Who should sign and verify the return of net wealth of a HUF?

Under section 15A of the Wealth-tax Act, 1957, the return of net wealth made under section 14 or section 15 of the Act shall be duly signed and verified by the assessee concerned. In the case of a Hindu undivided family, the return shall be signed and verified by any of the following persons:

- by the karta of the Hindu undivided family; or
- where the karta is absent from India, by any other adult member of such family; or
- where the karta is mentally incapacitated from attending to his affairs, by any other adult member of such family.

While signing the verification, the signatory in Form BA should satisfy himself that this return is correct and complete in every respect. This verification assumes greater importance because any person making a false statement in this return shall be liable to prosecution under section 35D of the Wealth-tax Act, 1957.

Under section 35D of the Wealth tax Act, 1957, any person, making a false statement in Form BA shall be punishable with imprisonment/fine as follows:

- In a case where the tax sought to be evaded exceeds one lakh rupees, he may be punished with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;
- In any other case, with rigorous imprisonment for a term, which shall not be, less than three months but which may extend to three years and with fine

Feedback Page

This is the first edition of the book on Partnership & HUF by the Committee, and, obviously, therefore there is scope for improvement. We intend to make it as useful as possible in its present format. The committee, therefore, hopes to keep updating this Referential Book on a regular basis in order to make it more functional.

We solicit comments and suggestions from practitioners and others to improve the usefulness of the Book on Partnership & HUF. In particular, we will welcome practitioners, and further areas for inclusion.

Your valuable inputs may be sent to ccbcaf@icai.org.

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