Lalit Vanjani & Co.

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Tax and Regulatory Alert | India | 21 June 2019 | DT/002/19-20

Central Board of Direct Taxes issues guidelines for Assessing Officers in relation to assessment of partnership firms	Guidelines issued in view of Report No. 7 of 2014 issued by Comptroller and Auditor General after conducting a Performance Audit regarding 'assessment of firms' - *Circular 12 of 2019 dated 19 June 2019*

A. Background

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

Considering the recommendations and in order to improve the quality of assessments being framed in these cases and also to reduce the scope for committing errors, Central Board of Direct Taxes ('CBDT') has issued Circular no. 12 of 2019 dated 19 June 2019 which prescribes the guidelines for AOs to conduct the assessments of partnership firms.

B. Highlights of guidelines

(a) Remuneration and interest paid to Partners needs to be cross verified from the tax returns of Partners.

(b) AOs should invariably call the copy of Partnership Deed and the payment of remuneration/interest to Partners should be verified.

(c) *Specific guidelines related to interest payable to Partner*

i) If the rate of interest payable to Partners as per Partnership Deed is below 12%, then the deduction of **interest paid must be restricted to the rate specified in the Deed**.
ii) If the rate of interest as per the Deed exceeds 12%, then the deduction should be restricted to 12% [section 40(b)(iv) of the Act].
iii) AOs should **refrain from using different yardsticks for calculating interest** such as opening balance of capital, closing balance of capital, fixed capital or current capital, etc. AOs should refer to the terms of Partnership Deed for purpose of computation of interest payable to Partner.

(d) *Specific guidelines related to remuneration payable to Partner*

i) Remuneration payable to Partners should be strictly as per the Partnership Deed.
ii) Clauses (ii) and (v) of section 40(b) of the Act implies that remuneration should n**ot be undetermined or undecided.**
iii) Where the remuneration, either so specified in Partnership Deed or computed as per the method indicated therein, is less than the amount allowable under section 40(b)(v) of the Act, it would be restricted to the figure computed as per Partnership Deed.
iv) While computing **'book profit'** for purposes of section 40(b)(v) of the Act, all income which do not fall under the head 'profit or gain of business or profession', **should be excluded**, such as capital gains, interest, rental income, income from other sources, etc.

(e) *Compliance with section 184*

Compliance by the Firm or its Partners with provisions of section 184 of the Act must be examined. Any non-compliance may result in denial of expenses such as remuneration, interest etc. payable to the Partners [section 185 of the Act].

(f) *Examination of inflated profits while claiming section 80-IA deduction*

i) AOs should ensure that the profits of the Firm are not inflated for claiming deduction under section 80-IA of the Act by not claiming expenditure towards remuneration, salary, interest, etc. which are payable to the Partners.
ii) AOs may invoke provisions of sub-section 10 of section 80-IA to recompute the profits if the same are excessive.

(g) *Carry forward and set-off of losses*

i) Claim of carry forward and set-off of losses should be verified and allowed only after considering provisions of section 78 of the Act.
ii) Section 78 provides for disallowance of carry forward and set-off in case of change in constitution of the firm or on succession.

(h) *Action against Tax Auditors*

i) Directions given earlier vide Instruction No. 09/2008 dated 31 July 2008 of CBDT, regarding possible **action against the Tax Auditor** for furnishing incomplete information in the Tax-Audit Report and effective utilization of information in the Tax Audit Report by the AOs, should be followed scrupulously by the field authorities.

(i) The guidelines in the Circular apply to complete as well as limited scrutiny.

C. Key takeaways

The Circular has reiterated and summarized the provisions of law in respect of taxability of Partnership Firms. The most important basis of assessment is the Partnership Deed and it is very important that Deed is properly drafted, and the provisions of the Act are duly considered while drafting.

Further, the guideline regarding computation of 'book profit' to only include profits and gains from business or profession, there have been some judicial precedents which have held that all incomes credited to Profit & Loss account have to be considered while computing book profits [*Md. Serajuddin & Brothers vs. CIT (Calcutta HC) ITA no. 201 of 2003*]. This guideline may lead to enhanced litigation between taxpayers and the revenue authorities.

Another important aspect of the Circular is that it instructs the AOs to take possible actions against the Tax Auditors, if it is found that incomplete information has been furnished in the Tax Audit report. In recent times the reporting by Tax Auditors has come under scrutiny, hence reinforcing the importance of appropriate reporting in the audit reports.

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About Lalit Vanjani & Co.

Lalit Vanjani & Co. (LVC) is a firm of Chartered Accountants in India. Established in year 1993, LVC has been serving clients for more than 25 years and is a multi-disciplinary firm with extensive experience in Audit & Assurance, Tax & Regulatory, Financial Process Outsourcing and Secretarial Services.

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