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CHAPTER ONE

INTRODUCTION

CHAPTER - I

INTRODUCTION

1.1 Brief Introduction:

The Income-tax Act, 1961, is an outcome of a series of earlier legislations since the British Regime. The Britishers had their own difficulties and they wanted to raise finances for various purposes, including the difficulties arising out of political situation. The last Act passed by the British in this behalf was the Indian Income-tax Act in 1922, which remained in force for a long time. This Act was very complicated and hence, when the country attained Independence, the Government appointed Law Commission with a view to suggest simple and intelligible legislation. Therefore, the Income-tax Act, 1961, was the first legislation during post-Independence period which continues till today. There have been various amendments and modifications to this legislation and hence it has now become very complicated. In addition, various committees were appointed by the Government of India, e.g. Choksi Committee, Wanchoo Committee and finally, Chelliah Committee, all of which were very much concerned with the rationalization and simplification of the tax laws. However, inspite of these efforts, the direct tax legislation still remains very complicated.

The major direct tax legislations in the country include the Income-tax Act, 1961; the Wealth-tax Act, 1957; and the Gift-tax Act, 1958. These laws have common procedural provisions. The Income-tax Act attempts to impose tax on income, whereas other taxes levy taxes on property.

The tax on income is levied on income, which is defined under section 2 of the Income-tax Act, 1961. The tax has to be paid by every person whose taxable income exceeds the limit laid down by the law. The tax has to be paid by persons which include -

- (a) an individual,
- (b) a Hindu undivided family,
- (c) a company,
- (d) a firm
- (e) an association of persons or a body of individuals, whether incorporated or not,
- (f) a local authority, and
- (g) every artificial juridical person not falling within any of the preceding categories.

These are the seven categories of persons chargeable to tax under the Income-tax Act, 1961. The definition is inclusive and not exclusive; therefore, any person not falling in the above mentioned seven categories may still fall in the four corners of the term 'person' and accordingly, may be liable to tax under section 4.

(3)

The charge of tax, according to the provisions of is contained in section 4. On reading this section, the following principles emerge:

- (a) Income-tax is an annual tax on income;
- (b) Income of previous year is charged in the next following assessment year at the rates applicable for the assessment year;
- (c) Tax rates are fixed by the annual Finance Act and not by the Income-tax Act. If, however, on the first day of April of the assessment year, the new Finance Bill had not been placed on the Statute book, the provisions in force in the preceding assessment year or the provisions proposed in the Finance Bill before the Parliament, whichever is more beneficial to the assessee, would apply until the new provisions become effective;
- (d) The tax is charged on every person;
- (e) The tax is levied on the total income of every assessee, computed in accordance with the provisions of the Act;
- (f) The total income is calculated in accordance with the provisions of the Income-tax Act as these provisions stand on the first day of April in any assessment year. Accordingly, for arriving at the total income for the assessment year 1992-93, the income-tax provisions as on April 1 1992 will be applicable.

1.2 Partnership as a Taxable Entity:

The term 'person' includes "firm" as a separate taxable entity. The 'firm' included under the definition of the term "person" means necessarily a partnership firm. In India, there is a separate law relating to the partnership firms, which is known as the Indian Partnership Act, 1932. Under this law, the meaning of the term 'firm' is very specifically provided in section 4. This Act provides the definition of the terms: 'partnership', 'partner', 'firm' and 'firm name'. These provisions are as under.

Definition of 'Partnership', 'Partner', 'Firm' and 'Firm Name':

A Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one 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'.

Essential Ingredients of a Partnership:

The essential ingredients of a partnership are:

1. That there should be an actual or physical overt act on the part of two persons to embark on a business adventure;

2. That if any business is carried on by one or any of the partners, the profits of the business shall be shared by them in the ratio contained in the partnership agreement.

Elements of a Partnership:

Under the Partnership Act, three elements are necessary to be present to constitute a 'partnership'. These are: (1) there must be an agreement entered into by all the persons concerned, (2) the agreement must be to share the profits of business, and (iii) the business must be carried on by all or any one of the persons concerned acting for all. These three elements, though appearing to overlap, are nevertheless distinct. The first element relates to the voluntary contractual nature of the partners, the second relates to the acquisition of gains and the third shows that the persons of the group who conduct the business do so as agents for all the persons in the group and are, therefore, liable to account to all.

Concept of Partnership:

The concept of partnership law is that a firm is not an entity or a person in law but only a compendious mode of designating persons who have agreed to carry on the business in partnership. It is clear that a partnership firm under the Indian Partnership Act, 1932, is not a distinct legal entity apart from the partners constituting it and equally in

law the firm as such has no separate rights of its own in the partnership assets and when one talks of the firms' property or firms' assets, all that is meant is the property or the assets in which all partners have a joint or common interests. If that be the position, it is difficult to accept the contention that upon dissolution, the firm's rights in the partnership are extinguished.

1.3 Title of the Study:

The present study is intended to examine the statutory provisions as well as the assessment of partnership firms under the Income-tax Act. The Dissertation, therefore, is titled as: "A Critical Evaluation of Provisions Relating to the Assessment of Partnership Firms".

1.4 Objectives of the Study:

With respect to the statement of the problem expressed above, the following have been framed as the specific objectives of the present study:

1. To critically examine the statutory provisions under the direct tax laws relating to the partnership firm;
2. To examine the new scheme for taxation of firms and partners;
3. To examine the relevant caselaw in respect of the tax assessment of the partnership firm.

Statistical Information:

In the following three Tables, certain important statistical information about the overall direct tax collections is being presented.

Table 1.1:

The Table shows the number of returns filed by different taxable entities during the period from 1984-85 to 1987-88. It is seen that in the year 1984-85, out of the total, 17.0 per cent returns were filed by the registered firms, which percentage has come down to 16.30 in the year 1987-88. Also, there has also not been a significant increase in the number of returns filed by the assessee in all status.

Table 1.2:

This Table records the statistics about the returned income of different taxable entities for the same period. It is revealed that while the companies have registered a substantial increase (+8.50%) in the returned income, the same has increased by +1.1% in case of registered firms. Also, the returned income by the assesseees of all status has registered substantial increase.

Table 1.1

Number of tax returns filed by different taxable entities during the period from 1984-85 to 1987-88 (Rs.in '000)

| Assessment year | Registered Firm | Individuals | Individually undivided families | Others | Companies | All status |
|-----------------|--------------------|----------------------|---------------------------------|------------------|------------------|------------|
| 1984-85 | 601,724 (17.00) | 2,650,396 (76.00) | 178,563 (5.17) | 7,553 (0.21) | 25,109 (0.72) | 3,463,345 |
| 1985-86 | 538,593 (21.09) | 1,741,444 (72.00) | 105,137 (4.29) | 43,433 (1.77) | 20,858 (0.85) | 2,449,465 |
| 1985-86 | 571,143 (19.66) | 2,307,568 (74.00) | 164,845 (5.38) | 28,747 (0.95) | 17,055 (0.61) | 3,089,358 |
| 1987-88 | 585,475 (16.30) | 2,659,676 (76.80) | 172,742 (4.97) | 21,614 (0.63) | 38,590 (1.30) | 3,478,097 |

(8)

Note: Figures in brackets indicate percentages

Source: Compiled from 'Statistical Abstracts', Central Statistical Organization, Department of Statistics, Ministry of Planning, Government of India, 1990 Edition, Table 185.

Table 1.2

Returned income of different entities during the period from
1984-85 to 1987-88 (Amount in Rs.'000)

| Assessment year | Registered firm | Individuals | Indu- undivided families | Others | Companies | All status |
|--------------------|-----------------------|------------------------|--------------------------------|---------------------|-----------------------|---------------|
| 1984-85 | 25,508,097 (17.40) | 69,047,866 (47.80) | 6,013,741 (4.16) | 237,205 (0.16) | 43,821,833 (30.84) | 144,628,742 |
| 1985-86 | 29,543,601 (20.87) | 50,723,296 (35.87) | 3,202,091 (2.26) | 1,655,877 (1.27) | 55,955,931 (39.80) | 141,120,797 |
| 1986-87 | 36,869,624 (19.32) | 82,672,213 (41.50) | 7,038,871 (3.57) | 1,605,381 (0.81) | 68,941,358 (34.80) | 197,128,447 |
| 1987-88 | 40,617,295 (16.30) | 101,745,438 (40.70) | 8,177,999 (3.25) | 1,096,759 (0.45) | 99,597,724 (39.30) | 251,235,215 |

Notes: Figures in brackets indicate percentage.

Source: Same as Table 1.1

Table 1.3

Tax payable by different taxable entities during the period from 1984-85 to 1987-88 (Amounts in Rs.'000)

| Assessment year | Registered firms | Individuals | Partly undivided families | Others | Companies | All status |
|-----------------|---------------------|-----------------------|---------------------------|-------------------|-----------------------|------------|
| 1984-85 | 2,519,087 (6.10) | 11,509,340 (28.50) | 1,915,332 (4.78) | 49,997 (0.12) | 24,004,766 (60.50) | 39,998,517 |
| 1985-86 | 3,163,207 (7.30) | 8,909,229 (19.64) | 8,22,247 (1.81) | 521,440 (1.15) | 31,915,212 (70.70) | 43,331,335 |
| 1986-87 | 3,65,660 (7.50) | 13,547,515 (27.80) | 1,618,833 (3.34) | 488,250 (1.36) | 29,142,552 (60.00) | 48,447,510 |
| 1987-88 | 4,206,112 (6.50) | 18,119,400 (27.50) | 1,928,615 (2.97) | 339,654 (0.52) | 40,153,716 (62.50) | 64,747,505 |

Note: Figures in brackets indicate percentage.

Source: Same as Table 1.1

Table 1.3:

Table 1.3 reveals the tax payable by different taxable entities during the period under consideration. It is seen that while the amount of the tax payable by the registered firm has remained approximately the same, its percentage in the total tax payable by the assessee of all status has decreased; while in the case of companies, though their percentage of contribution to the total tax payable has not varied much, the amount they have contributed has increased substantially.

Taken collectively, these Tables reveal that the registered firms contribute a very significant volume of revenue to the total tax collections. At the same time, the number of returns filed by the company assesses is least (about 1% of the total returns filed) but their contribution to the tax revenue is the highest (above 60% of the total collection).

1.5 Methodology Adopted:

The present study relies exclusively on the secondary data from published sources, particularly the analysis of the statutory provisions. The study also draws exclusively from the interpretation and analyses offered by tax experts, legal luminaries and also from the caselaw as delivered by the highest judicial forum in the country.

1.6 Scope of the Study:

The study is confined to the evaluation of the assessment of the partnership firm. Under the Income-tax Law the entire legislation covering about 298 sections is not extensively examined in this dissertation. Some of the provisions of the Act having direct bearing on the subjects have been examined.

1.7 Limitations of the Study:

The present study deals with the assessment of the partnership firms under the Income-tax Act. The references utilized in this work have to be, therefore, necessarily taken from relevant statute. The use of journals, magazines and periodicals have also been made. Thus, the study primarily rests on the secondary data concerned with library sources.

1.8 Chapter Scheme:

The Dissertation has been divided into Five Chapters. Chapter-I deals with the framework aspects such as brief introduction, partnership as a taxable entity, title of the study, objectives of the study, methodology adopted, scope of the study and limitations of the study. Chapter-II comprises of the statutory provisions, procedure for assessment of firms, new procedure laid down and the amendments made in the Act. Chapter-III contains new scheme for taxation of firms and partners and presents the distinctions between the existing scheme and the new scheme, computation of income, procedure of assessment, computation of loss, assessment of partners, deduction of tax at source, clubbing provisions, conclusions and illustrations. Chapter-IV contains a review of the recommendations of various tax reform committees as also relevant caselaw; and Chapter-V records the conclusions drawn at the end of the study and the suggestions emerging therefrom. The Dissertation concludes with a comprehensive Bibliography.

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