

Introduction	2.1
Special Provisions Applicable to Firms	2.2
Assessment of Firms' New Procedure	2.3
Amendments made in the Act	2.4

CHAPTER TWO

STATUTORY PROVISIONS

CHAPTER - II
STATUTORY PROVISIONS

2.1 Introduction:

The partnership as a unit of taxation stands on different footing as compared to other taxable entities. The 'firm' is a separate unit of assessment. The Indian Partnership Act governs the formation and dissolution of firms and it is based on the English law. Under the law of partnership, a firm has no legal existence apart from its partners and it is merely a collective name to describe its partners.

Under the income-tax law, the assessment of partnership is provided under a separate Chapter, 'Chapter XVI : Special Provisions Applicable to Firms'. The whole scheme of this Chapter is summarized as under.

Chapter XVI of the Income-tax Act is subdivided into three parts. Part-A, entitled 'Assessment of Firms', consists of two sections, viz.

section 182, dealing with assessment of registered firms; and
section 183, dealing with assessment of unregistered firms;

Part-B, entitled 'Registration of Firms', consists of:

section 184, providing for application for registration;
section 185, prescribing the procedure on receipt of
application; and

section 186, laying down circumstances for cancellation of registration;

Part-C, entitled 'Changes in Constitution, Succession and Dissolution of Firms', consists of:

section 187, laying down the procedure for assessment on and defining change in the constitution of firm;

section 188, laying down the procedure for assessment when a firm has been succeeded by another firm; and

section 189, laying down the procedure for assessment when a firm is dissolved or the business carried on by it is discontinued.

Under the above provisions, the detailed procedure is laid down under the old Act. The statutory provisions under the law are as under:

2.2 Statutory Provisions:

CHAPTER XVI

SPECIAL PROVISIONS APPLICABLE TO FIRMS

¹[A.-Assessment of Firms]

²¹[Assessment of registered firms.

³**182.** (1) Notwithstanding anything contained in sections 143 and 144 and subject to the provisions of sub-section (3), in the case of a registered firm, after assessing the total income of the firm,-

(i) the income-tax payable by the firm itself shall be

determined; and

(ii) the share of each partner in the income of the firm shall be included in his total income and assessed to tax accordingly.

(2) If such share of any partner is a loss it shall be set off against his other income or carried forward and set off in accordance with the provisions of sections 70 to 75.

(3) When any of the partners of a registered firm is non-resident, the tax on his share in the income of the firm at the rate or rates which would be applicable if it were assessed on him personally, and the tax so assessed shall be paid by the firm.

(4) A registered firm may retain out of the share of each partner in the income of the firm a sum not exceeding thirty per cent thereof until such time as the tax which may be levied on the partner in respect of that share is paid by him; and where the tax so levied cannot be recovered from the partner, whether wholly or in part, the firm shall be liable to pay the tax, to the extent of the amount retained or could have been so retained.]

⁴⁵[Assessment of unregistered firms.

183. In the case of an unregistered firm, the ⁶[Assessing] Officer-

(a) may determine the tax payable by the firm itself on the basis of the total income of the firm; or

⁷[(b) if, in his opinion, the aggregate amount of the tax payable by the firm if it were assessed as a registered firm and

the tax payable by the partners individually if the firm were so assessed would be greater than the aggregate amount of the tax payable by the firm under clause (a) and the tax which would be payable by the partners individually, may proceed to make the assessment under sub-section (1) of section 182 as if the firm were a registered firm; and, where the procedure specified in this clause is applied to any unregistered firm, the provisions of sub-sections (2), (3) and (4) of section 182 shall apply thereto as they apply in relation to a registered firm.]]]

⁸[B.-Registration of firms⁹

Application for registration.

¹⁰184. (1) An application for registration of a firm for the purposes of this Act may be made to the ⁶[Assessing] Officer on behalf of any firm if-

- (i) the partnership is evidenced by an instrument; and
- (ii) the individual shares of the partners are specified in that instrument.

(2) Such application may, subject to the provisions of this section, be made either during the existence of the firm or after its dissolution.

(3) The application shall be made to the ¹¹[Assessing] Officer having jurisdiction to assess the firm, and shall be signed-

- (a) by all the partners (not being minors) personally; or

- (b) in the case of a dissolved firm, by all persons (not being minors) who were partners in the firm immediately before its dissolution and by the legal representative of any such partner who is deceased.

Explanation: In the case of any partner who is absent from India or is a lunatic or an idiot, the application may be signed by any person duly authorized by him in this behalf, or, as the case may be, by a person entitled under law to represent him.

- (4) The application shall be made before the end of the previous year for the assessment year in respect of which registration is sought:

Provided that the ¹¹[Assessing] Officer is satisfied that for sufficient reason the original instrument cannot conveniently be produced, he may accept a copy of it certified in writing by all the partners (not being minors), or, where the application is made after the dissolution of the firm, by all the persons referred to in clause (b) of sub-section (3), to be a correct copy, or a certified copy of the instrument; and in such cases, the application shall be accompanied by a duplicate copy of the original instrument.

- ¹²(6) The application shall be made in the prescribed form and shall contain the prescribed particulars.

- (7) Where registration is granted ¹³[or is deemed to have been granted] to any firm for any assessment year, it shall have effect for every subsequent assessment year:

Provided that-

- (i) there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the registration was granted; and
- ¹⁴ [(ii) ¹⁵ the firm furnishes, before the expiry of the time allowed under ¹⁶ [sub-section (1) of section 139)0 for furnishing the return of income for such subsequent assessment year, a declaration to that effect, in the prescribed form and verified in the prescribed manner, so, however, that where the ¹⁷ [Assessing] Officer is satisfied that the firm was prevented by sufficient cause from furnishing the declaration within the time so allowed, he may allow the firm to furnish the declaration at any time before the assessment is made.]

(8) Where any such change has taken place in the previous year, the firm shall apply for fresh registration for the assessment year concerned in accordance with the provisions of this section.

Procedure on receipt of application.

¹⁸ 185. (1) On receipt of an application for the registration of a firm, the ¹⁷ [Assessing] Officer shall inquire into the genuineness of the firm and its constitution as specified in the instrument of partnership, and-

- (a) if he is satisfied that there is or was during the previous year in existence a genuine firm with the constitution so specified, he shall pass an order in writing registering the firm for the assessment year;
- (b) if he is not so satisfied, he shall pass an order in writing refusing to register the firm.

¹⁹[Explanation: For the purposes of this section and section 186, a firm shall not be regarded as a genuine firm if any partner of the firm was, in relation to the whole or any part of his share in the income or property of the firm, at any time during the previous year, a benamidar-

- (a) of any other partner to whom the first-mentioned partner does not stand in the relationship of a spouse or minor child, or
- (b) of any person, not being a partner of the firm, and any of the other partners knew or had reason to believe that the first-mentioned partner was such benamidar and such knowledge or belief had not been communicated by such other partner to the ²¹[Assessing] Officer in the prescribed manner.]

²²[(2) Where the ²¹[Assessing] Officer considers that the application for registration is not in order, he shall intimate the defect to the firm and give it an opportunity to rectify the defect in the application within a period of one month from the date of such intimation; and if the defect is not rectified within that



period, the ²¹[Assessing] Officer shall, by order in writing, reject the application.

(3) Where the ²¹[Assessing] Officer considers that the declaration furnished by a firm in pursuance of sub-section (7) of section 184 is not in order, he shall intimate the defect to the firm and give it an opportunity to rectify the defect in the declaration within a period of one month from the date of such intimation; and if the defect is not rectified within that period, the ²¹[Assessing] Officer shall, by order in writing, declare that the registration granted to the firm shall not have effect for the relevant assessment year.]

²³(4) Where a firm is registered for any assessment year, the ²¹[Assessing] Officer shall record a certificate on the instrument of partnership or on the certified copy submitted in lieu of the original instrument, as the case may be, to the effect that the firm has been registered under this Act, for that assessment year; and where a declaration under sub-section (7) of section 184 is furnished by the firm, for the relevant subsequent assessment year.

(5) Notwithstanding anything contained in this section, where, in respect of any assessment year, there is, on the part of a firm, any such failure as mentioned in section 144, the ²¹[Assessing] Officer may refuse to register the firm for the assessment year.

²⁴[(6) Notwithstanding anything contained in sub-sections (1) to (4), where a firm has made an application for registration

in relation to an assessment year and has furnished the return for that assessment year, such firm shall be deemed to have been registered under this section on the expiry of the period for serving notice as specified in the proviso to sub-section (2) of section 143 in respect of such return:

Provided that nothing in this sub-section shall affect the power of the Assessing Officer to intimate the defect to the firm under sub-section (2) and where any such intimation is sent, all the provisions of sub-section (2) shall apply.

(7) The provisions of this section as they stood immediately before their amendment by the Direct Tax Laws (Second Amendment) Act, 1989, shall apply to and in relation to any assessment for the assessment year commencing on the 1st day of April 1988, or any earlier assessment year and references in this section to the other provisions of this Act shall be construed as references to those provisions as for the time being in force and applicable to the relevant assessment year.]

Cancellation of Registration.

186. (1) If, where a firm has been registered ²⁵[or is deemed to have been registered), or its registration has effect under sub-section (7) of section 184 for an assessment year, the ²⁶[Assessing] Officer is of opinion that there was during the previous year no genuine firm in existence as registered, he may, after giving the firm a reasonable opportunity of being heard ²⁷[***] cancel the registration of the firm for that

assessment year:

Provided that no such cancellation shall be made after the expiry of eight years from the end of the assessment year in respect of which registration has been granted ²⁵[or is deemed to have been granted] or has effect:

²⁵Provided further that the Assessing Officer shall not cancel the registration granted under sub-section (1) of section 185 except with the previous approval of the Deputy Commissioner.]

(2) If, where a firm has been registered ²⁵[or is deemed to have been registered] or its registration has effect under sub-section (7) of section 184 for any assessment year, there is, on the part of the firm, any such failure in respect of the assessment year as mentioned in section 144, the ²⁶[Assessing] Officer may cancel the registration of the firm for the assessment year, after giving the firm not less than fourteen days' notice intimating his intention to cancel its registration and after giving it a reasonable opportunity of being heard.

(3) Where the registration of a firm is cancelled for any assessment year, the ²⁶[Assessing] Officer shall amend the assessments of the firm and its partners for that assessment year on the footing that the firm is an unregistered firm.

(4) The provisions of section 154 shall, so far as may be, apply to the amendments of the assessments of the firm and its partners under sub-section (3) of this section, the period of four years specified in sub-section (7) of that

section being reckoned from ²⁸[the end of the financial year in which the order cancelling the registration was passed.]]

The following sections 184 and 185 shall be substituted for existing sub-heading "B" and sections 184, 185 and 186 by the Finance Act, 1992, w.e.f. 1.4.1993.

Assessment as a firm.

184. (1) A firm shall be assessed as a firm for the purposes of this Act, if-

- (i) the partnership is evidenced by an instrument; and
- (ii) the individual shares of the partners are specified in that instrument.

(2) A certified copy of the instrument of partnership referred to in sub-section (1) shall accompany the return of income of the firm of the previous year relevant to the assessment year commencing on or after the 1st day of April, 1993, in respect of which assessment as a firm is first sought.

Explanation: For the purposes of this sub-section, the copy of the instrument of partnership shall be certified in writing by all the partners (not being minors) or, where the return is made after the dissolution of the firm, by all persons (not being minors) who were partners in the firm immediately before its dissolution and by the legal representative of any such partner who is deceased.

(3) Where a firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution

of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the assessment as a firm was first sought.

(4) Where any such change had taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year and all the provisions of this section shall apply accordingly.

(5) Notwithstanding anything contained in the foregoing provisions of this section, where, in respect of any assessment year, there is on the part of a firm any such failure as is mentioned in section 144, the firm shall not be assessed as such for the said assessment year and, thereupon, the firm shall be assessed in the same manner as an association of persons, and all the provisions of this Act shall apply accordingly.

Assessment when section 184 not complied with.

185. Where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be assessed for that assessment year in the same manner as an association of persons, and all the provisions of this Act shall apply accordingly.

C.-Changes in constitution, succession and dissolution

Change in constitution of a firm.

187. (1) Where at the time of making an assessment under section 143 or section 144, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment:

²⁹₃₀ [Provided that-

- (i) the income of the previous year shall, for the purposes of inclusion in the total incomes of the partners, be apportioned between the partners who, in such previous year, were entitled to receive the same; and
- (ii) when the tax assessed upon a partner cannot be recovered from him, it shall be recovered from the firm as constituted at the time of making the assessment.]]

(2) For the purposes of this section, there is a change in the constitution of the firm-

- (a) if one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change; or
- (b) where all the partners continue with a change in their

respective shares or in the shares of some of them:

³¹[Provided that nothing contained in clause (a) shall apply to a case where the firm is dissolved on the death of any of its partners.]

Succession of one firm by another firm.

188. Where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

³²[Joint and several liability of partners for tax payable by firm.

188A. Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.]

Firm dissolved or business discontinued.

189. (1) Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the ³³[Assessing] Officer shall make an assessment of the total income of the firm as if no such discontinuance or dissolution had

taken place, and all the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act, shall apply, so far as may be, to such assessment.

(2) Without prejudice to the generality of the foregoing sub-section, if the ³⁴[Assessing] Officer or the ³⁵[Deputy Commissioner (Appeals)] ³⁶[or the Commissioner (Appeals)] in the course of any proceeding under this Act in respect of any such firm as is referred to in that sub-section is satisfied that the firm was guilty of any of the acts specified in Chapter XXI, he may impose or direct the imposition of a penalty in accordance with the provisions of that Chapter.

(3) 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, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

³⁷ ³⁸[Explanation: The amount of tax referred to in this sub-section shall also include that part of the share of each partner in the income of the firm before its discontinuance or dissolution which the firm could have retained under sub-section (4) of section 182 but which has not been so retained.]]

(4) Where such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the person referred to in sub-section (3) from the stage at which the proceedings stood at the time of such discontinuance or dissolution, and all the provisions of this Act shall, so far as may be, apply accordingly.

(5) Nothing in this section shall affect the provisions of sub-section (6) of section 159.

³⁹[***]

The following section 189A shall be inserted by the Finance Act, w.e.f. 1.4.1993:

Provisions applicable to past assessments of firms.

189A. In relation to the assessment of any firm and its partners for the assessment year commencing on the 1st day of April, 1992, or any earlier assessment year, the provisions of this Chapter as they stood immediately before the 1st day of April, 1993, shall continue to apply.

2.3 Assessment of Firm : New Procedure:

1. Introduction:

The Finance Act, 1992, has made far-reaching changes in the system of assessment of the firms under the Income-tax Act, 1961. The object of the changes proposed to be made

as stated by the Finance Minister in his Budget speech was 'to avoid double taxation' and 'as a measure of relief, to treat the firm as a tax entity and do away with the taxation of same income in the hands of the partners'. With this view, it was proposed to allow deduction towards interest and salary payments to partners within certain limits and then tax the balance in the hands of the firm at a flat rate of 40 per cent. The Finance Minister expressed hope that: 'This method will result in enormous simplification from the point of view of taxpayers as well as tax administration as the proposed scheme will do away with the complexities, associated with the procedure relating to the registration of firms, rectifications of partners' assessments when firms' assessments are revised, etc.'

2.4 Amendments made in the Act:

The main amendments made in the Act, to be operative from 1.4.1993, are:

- (i) Clauses (39) and 48 of section 2 of the Act containing definition of registered firm and unregistered firm have been deleted.
- (ii) Clause (2A) in section 10 of the Act has been inserted so as to provide that the share of a partner in a firm separately assessed shall not be included in his income.
- (iii) Sections 184 and 185 of the Act have been replaced by new sections. It has now been provided that the share of the

partners should be specified in the partnership deed and certified copy of the partnership deed (to be signed by all the partners except the minors) should be filed with the returns of income. The returns of income should also be verified by all the partners except the minors. No declaration, etc., is required to be filed in subsequent years provided there is no change in the constitution of the firm. In case, there is change in the constitution, certified copy of the revised deed should be filed with the return of income relevant to such previous year. Section 185 provides that if the above procedure is not followed, assessment will be made in the status of the Assessing Officer.

- (iv) Section 186 of the Act providing for cancellation of registration of a firm has been omitted.
- (v) Proviso to section 187(1) of the Act has been deleted.
- (vi) Explanation to section 189 of the Act has been deleted.
- (vii) Clause (b) of section 40 of the Act has been replaced by new clause (b). It is now provided that interest paid to partners as does not exceed 18 per cent shall be allowed as deduction, if authorized by the partnership deed. Similarly, salary, bonus, commission or remuneration to working partners shall be allowed as deduction, if authorized by the partnership agreement.

REFERENCES

1. Reintroduced by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1.4.1989. Earlier, it was omitted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. the same date.
2. Shall be omitted by the Finance Act, 1992, w.e.f. 1.4.1993.
3. See also Circular no.260 dated 31.7.1979.
4. Shall be omitted by the Finance Act, 1992, w.e.f. 1.4.1993.
5. Reintroduced by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1.4.1989. Earlier it was omitted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. the same date.
6. Substituted for "Income-tax" by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.
7. Substituted by the Direct Tax Laws (Amendment) Act, 1970, w.e.f. 1.4.1971.
8. Restored to its original provision by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1.4.1989. Earlier, it was substituted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. the same date.
9. For provisions as applicable from the assessment years 1993-94 onwards, see p.1.495.
10. See also Letter [F.No.26/12/67-IT(A-II)] dated 15.11.1967.
11. Substituted for "Income-tax" by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.
12. See rules 22 and 23 and Form nos.11 and 11A.
13. Inserted by the Direct Tax Laws (Second Amendment) Act, 1989, w.e.f. 1.4.1989.
14. Substituted by the Taxation Laws (Amendment) Act, 1970, w.e.f. 1.4.1971.
15. See rule 24 and Form no.12.
16. Substituted for "sub-section (1) or sub-section (2) of section 139 (whether fixed originally or on extension)" by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1.4.1989.
17. Substituted for "Income-tax" by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.

18. Same as (10) above.
19. Substituted by the Taxation Laws (Amendment) Act, 1975, w.e.f. 1.4.1976. Original explanation was inserted by the Taxation Laws (Amendment) Act, 1970, w.e.f. 1.4.1971.
20. See rule 24A and Form no.12A.
21. Substituted for "Income-tax" by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.
22. Substituted by the Taxation Laws (Amendment) Act, 1989, w.e.f. 1.4.1989.
23. See rule 25.
24. Inserted by the Direct Tax Laws (Second Amendment) Act, 1989, w.e.f. 1.4.1989.
25. Inserted by the Direct Tax Laws (Second Amendment) Act, 1989, w.e.f. 1.4.1989.
26. Substituted for "Income-tax" by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.
27. "and with the previous approval of the Deputy Commissioner" omitted by the Direct Tax Laws (Second Amendment) Act, 1989, w.e.f. Earlier, it was amended by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.
28. Substituted for "the date of the order cancelling the registration" by the Taxation Laws (Amendment) Act, 1984, w.e.f. 1.10.1984.
29. Shall be omitted by the Finance Act, 1992, w.e.f. 1.4.1993.
30. Reintroduced by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1.4.1989. Earlier, it was omitted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. the same date.
31. Inserted by the Direct Tax Laws (Amendment) Act, 1984, with retrospective effect from 1.4.1975.
32. Inserted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1989.
33. Substituted for "Income-tax" by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1988.
34. substituted, ibid.

35. Substituted for "Appellate Assistant Commissioner", ibid.
36. Inserted by the Finance (No.2) Act, 1977, w.e.f. 10.7.1978.
37. Shall be omitted by the Finance Act, 1992, w.e.f. 1.4.1993.
38. Inserted by the Taxation Laws (Amendment) Act, 1975, w.e.f. 1.10.1975 and now reintroduced by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. 1.4.1989. Earlier, it was omitted by the Direct Tax Laws (Amendment) Act, 1987, with effect from the same date.
39. Section 189A, which made provisions applicable to past assessments of firms and inserted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1.4.1989, omitted by the Direct Tax Laws (Amendment) Act, 1989, w.e.f. the same date.