

Professional Fees Paid to a Partner: Does the Section 35(e) Limit Apply?

Description

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Quick summary

- A firm can deduct a working partner's remuneration only if the partnership deed authorises it and only within the aggregate limit in section 35(e) of the Income-tax Act, 2025; fees for separate professional services are not named in the section.
- The Supreme Court has held that a commission paid to a partner stays under the old section 40(b) even if it is paid under a separate contract; the "different capacities" relief it accepts covers interest only.
- We found no reported Supreme Court or High Court judgment on fees paid to a partner for an independent practice, so the view that they fall outside section 35(e) is arguable but untested.
- The safer plan is to fit the fee under the limit together with normal remuneration, authorise it in the deed before the year starts, and keep proof of an independent practice and of market rates.

A partner in a firm often wears more than one hat. He may run his own consultancy, practise a profession or sell goods through his own business, and the firm may hire him for a specific job. When the firm pays him, the Income-tax Act, 2025 (from 01/04/2026) raises one question first: is this **remuneration to a partner**, which is deductible only within a limit, or an ordinary business expense paid to an outside supplier who happens to be a partner?

The answer matters in money. A working partner's remuneration is deductible only if the partnership deed authorises it, and only up to the aggregate limit in **section 35(e)**; anything above the limit is added back to the firm's income. This post covers what the section says, what the Supreme Court has decided, how a fee for services differs from a purchase of goods, and how to structure the payment so that the firm is not left exposed. It builds on our post on partners' remuneration and interest under section 35(e), which explains the limit in detail.

An example to keep in mind

Here is an illustrative case. A firm of software consultants has a working partner who also runs his own forensic analysis practice, registered under GST. The practice serves other companies at the same rates, and it also

sells goods to the firm at market price. For one assignment the firm pays him ?6,00,000 as fees. Can the firm deduct all of it, or does it count towards the limit on partners' remuneration?

What section 35(e) covers

- The section applies to expenditure of a firm "in the nature of salary, bonus, commission or remuneration, by whatever name called" paid to a partner (section 35(e)(i) and (ii)).
- Remuneration to a partner who is **not a working partner** is not deductible at all (section 35(e)(i)).
- Remuneration to a **working partner** is deductible only if the partnership deed applicable for the period authorises it, and only if the total for all working partners is within the limit: on the first ?6,00,000 of book profit, ?3,00,000 in case of a loss or 90% of the book profit, whichever is higher, and on the balance 60% (section 35(e)(ii) and (iii)).
- A **working partner** is an individual actively engaged in conducting the affairs of the business or profession of the firm (section 35(e)(v)(B)).
- **Book profit** is the net profit in the profit and loss account, computed under Chapter IV-D, increased by the remuneration to all partners if it has been deducted (section 35(e)(v)(A)).

The section does not use the words "professional fees", and it does not mention purchases of goods. That gap is what this post is about.

The old section 40(b) spoke of "any payment of salary, bonus, commission or remuneration". The 2025 Act speaks of expenditure "in the nature of" those items. Both versions add "by whatever name called", so the label on the invoice does not decide the question. We have not found a decision on whether the new wording changes anything.

What the Supreme Court has said

Rashiklal & Co. v. CIT, (1998) 229 ITR 458 (SC), decided on 09/12/1997. A firm paid ?28,579 as commission to one of its partners under a separate agreement of 1978, at 37 paise for every tonne of mineral the firm sold. The firm said he received it as the karta (head) of his Hindu undivided family (HUF) and not as a partner. The Supreme Court rejected that. It held that a firm is only a collective name for its partners, that a partner acts in his personal capacity within the firm, and that the old section 40(b) bars a deduction for commission paid to a partner even where a special contract provides for it.

Brij Mohan Das Laxman Das v. CIT, (1997) 223 ITR 825 (SC), decided on 10/12/1996, and Suwalal Anandilal Jain v. CIT, (1997) 224 ITR 753 (SC), decided on 10/03/1997. A partner who was karta of an HUF had also lent his own money to the firm. The Supreme Court held that the interest on that loan was not caught by section 40(b), accepting that one person can deal with a firm in more than one capacity. In Rashiklal the Court explained that those cases rested on an Explanation to the section that dealt only with interest, with no counterpart for commission. The 2025 Act keeps the same relief only for interest (section 35(e)(iv)(A) and (B)).

What these cases do not decide. All three involved a partner who represented an HUF. None of them concerns a partner who runs a genuine independent profession and bills the firm for a separate assignment, and in our search of reported decisions available online we found no judgment of the Supreme Court or of any High Court that decides that point either way. Rashiklal was also decided under the old section 40(b), which then barred such payments to any partner outright, while the present section allows a working partner's remuneration within limits. Even so, its reasoning is what the Revenue can be expected to rely on. A firm that treats a partner's fees as outside section 35(e) is therefore relying on principle, not on a decided case.

Goods are different from services

A purchase of goods from the partner's own business is not salary, bonus, commission, remuneration or interest, so section 35(e) does not apply to it and the firm claims the cost in the usual way. It is still a payment to a specified person (a related party), so section 36 applies. If the Assessing Officer considers the expenditure excessive or unreasonable compared with the fair market value of the goods, the legitimate needs of the business or the benefit derived, that part is not allowed (section 36(2)).

For a firm, a partner is a "specified person", and so is any person carrying on a business or profession in which a partner has a substantial interest, which means a right to at least 20% of its profits (section 36(3)). A partner's own proprietary business is therefore covered. Selling to the firm at the price he charges other customers answers the test. So does paying by bank: payments of more than ?10,000 in a day to one person that do not go through a bank or a specified online mode are generally not deductible (section 36(4)).

Services are the harder case. A fee for services looks more like remuneration, because the partner is being paid for his own work.

Two ways the fee can be treated

View	How the fee is treated	Deduction for the firm	Main risk
The fee is an outside business expense	Business expenditure under section 34, tested for reasonableness under section 36	Allowed in full if it is reasonable	The Revenue treats it as remuneration, because the partner is paid for his work and the section covers remuneration "by whatever name called"
The fee is remuneration to a working partner	Part of the partners' remuneration under section 35(e)	Allowed only if the deed authorises it and the total stays within the limit	Anything above the limit is disallowed, and the whole fee can be disallowed if the deed does not authorise it

Worked example: same facts, two views

Take a firm whose working partners are paid ?10,00,000 as remuneration under the deed, with a further ?6,00,000 of fees paid to one of them. Profit before deducting any partner remuneration and before the fee is ?20,00,000.

Item	Fee treated as remuneration	Fee treated as a business expense
Profit before partner remuneration and the fee	?20,00,000	?20,00,000
Book profit for the limit	?20,00,000 (the fee is added back)	?14,00,000 (the fee stays deducted)

Item	Fee treated as remuneration	Fee treated as a business expense
Limit on remuneration (90% of the first ?6,00,000 plus 60% of the balance)	?13,80,000	?10,20,000
Remuneration counted against the limit	?16,00,000	?10,00,000
Disallowed under section 35(e)	?2,20,000	Nil (the fee is still tested under section 36)

The second view gives the firm more room here, but it also lowers the book profit, and with it the limit, by the amount of the fee. When the book profit is above ?6,00,000, the limit works out at 60% of the book profit plus ?1,80,000, which gives a quick test. If the profit before partner remuneration and the fee had been ?30,00,000, both views would allow everything, with limits of ?19,80,000 and ?16,20,000. Under the first view, the disallowed amount is added to the firm's income and taxed at the firm's rate, with interest on the extra tax.

How to build the case that the fee is outside section 35(e)

A firm that wants to take this position should be able to show that the partner is paid as an independent professional and not for working in the firm:

1. **A separate engagement letter before the work starts,** with the scope, deliverables, fee and date, approved by the other partners.
2. **A genuine independent practice:** other clients served at the same rates, its own registration (for example under GST), premises or staff, bank account and books.
3. **Evidence of the market rate:** invoices to unrelated clients for similar work.
4. **Work that is not part of his duties as a working partner,** and no second claim for the same work as normal remuneration.
5. **A proper invoice, paid through the bank,** with tax deducted at source under the right item (see below).
6. **Not a captive supplier:** if the firm is most of his practice, the independent label weakens.

None of this makes the argument a settled one, but it is the evidence that gives it the best chance.

The safer plan: make the fee fit under the limit

Because the outside view is untested for services, the safer plan is to make sure that the fee, added to the partners' normal remuneration, fits within the limit, so that the label does not matter. Before the tax year begins:

1. **Estimate the book profit and the limit,** as in the example above.
2. **Compare the limit with the normal remuneration plus the fee.** If the limit is enough, both views give the same result.
3. **Amend the partnership deed before the year starts.** Remuneration that is not authorised by the deed applicable for the period, or that relates to a period before the date of the deed, is not deductible (section 35(e)(ii)). For tax year 2027-28 (01/04/2027 to 31/03/2028) the deed should be signed by 31/03/2027.
4. **State the amount or the method in the deed.** The Revenue has long relied on CBDT Circular 739 of 25/03/1996, which wants the deed to fix each working partner's remuneration or the way it is worked out. The Himachal Pradesh High Court held in Durga Dass Devki Nandan v. ITO (11/03/2011) that the circular goes beyond the section, but the Delhi Tribunal upheld a disallowance in Sood Brij & Associates

v. JCIT (29/10/2010) where the deed did not state the total remuneration or the partners' shares. The circular was issued under the 1961 Act, and we have not checked whether it has been carried over to the 2025 Act. Stating the amount or the method costs nothing and removes the argument.

5. **Keep the engagement letter and the evidence listed above anyway.** They support either view.

Tax deducted at source and GST

- **TDS:** If the payment is treated as fees for professional or technical services, the firm deducts tax under section 393(1), Table Sl. No. 6(iii) (old section 194J): 10%, or 2% for technical services that are not professional services, above the threshold in the table. If it is treated as a sum in the nature of remuneration paid to a partner, section 393(3), Table Sl. No. 7 (old section 194T) applies at 10% above ?20,000. Our TDS rate chart under section 393 gives the table. Use the same treatment in the TDS return and in the returns of the firm and the partner.
- **GST:** A partner who is registered under GST and bills the firm for services issues a tax invoice and charges GST in the usual way. This post does not cover the GST rules, so confirm the rate and the input tax credit position separately.

Make the partner's return match

Salary, bonus, commission or remuneration that a partner receives from the firm is not treated as salary (section 15(4)). The part that is allowed to the firm under section 35(e) is business income of the partner (section 26(1)(g)). If the firm's deduction is later cut, the partner's assessment can be amended to remove the matching income, within the time limit in section 288 (Table Sl. No. 1).

If the partner has reported the same sum as ordinary professional income instead, that route may not fit, so the firm and the partner should settle the treatment together before either return is filed.

What we have and have not checked

We read the Income-tax Act, 2025 as amended by the Finance Act 2026, and the judgments linked below. In our search of reported decisions available online we found none that decides whether fees for an independent professional practice paid to a partner are outside section 35(e). The law can change with the next Finance Act, so recheck it before acting.

How CSM & Co LLP can help

We draft and update partnership deeds, compute book profit and partner remuneration, review related-party payments and file the returns of firms and partners. Please reach out to our team and we will be happy to assist.

Frequently asked questions

Does section 35(e) apply to professional fees paid to a partner?

The section does not mention professional fees. It applies to expenditure "in the nature of" salary, bonus, commission or remuneration, by whatever name called, paid to a partner. Whether fees for separate professional services count is not settled: we found no reported judgment of the Supreme Court or a High Court that decides it, and the Supreme Court has held, for a commission, that a separate contract does not take the payment outside the old section 40(b). Plan on the basis that the fee may be treated as

remuneration.

What is the limit on partners' remuneration?

The total remuneration to all working partners, as authorised by the partnership deed, is allowed up to: on the first ?6,00,000 of book profit, ?3,00,000 in case of a loss or 90% of the book profit, whichever is higher; and on the balance of the book profit, 60% (section 35(e)(iii)). When the book profit is above ?6,00,000, this works out at 60% of the book profit plus ?1,80,000.

Does the partnership deed settle the matter if it allows the fee?

No. Authorisation by the deed is one condition for deducting remuneration (section 35(e)(ii)), and the total must also stay within the limit (section 35(e)(iii)). In Rashiklal and Co. the commission was paid under a separate agreement, and the Supreme Court still held that it was not deductible under the old section 40(b).

Can a firm buy goods from a partner's own business?

Section 35(e) does not list purchases of goods, so the cost is claimed in the usual way. The firm must be able to show that the price is at market rate, because a payment to a partner, or to a business in which a partner has a right to at least 20% of the profits, can be disallowed to the extent it is excessive or unreasonable (section 36(2) and (3)). As a rule, payments of more than ?10,000 in a day to one person must go through a bank or a specified online mode (section 36(4)).

What happens if the deduction is disallowed?

The disallowed amount is added to the firm's income and taxed at the firm's rate, with interest. The partner's side must match: remuneration from the firm is business income of the partner only to the extent allowed to the firm (section 26(1)(g)), and his assessment can be amended if the firm's deduction is later cut (section 288, Table Sl. No. 1). If the partner has reported the same sum as ordinary professional income, that route may not fit, so settle the treatment before both returns are filed.

How is tax deducted at source on the payment?

If it is treated as fees for professional or technical services, section 393(1), Table Sl. No. 6(iii) applies (old section 194J): 10%, or 2% for technical services that are not professional services, above the threshold in the table. If it is treated as a sum in the nature of remuneration paid to a partner, section 393(3), Table Sl. No. 7 applies (old section 194T): 10% above ?20,000. Use the same treatment in the TDS return and in the returns of the firm and the partner.

By when should the partnership deed be changed?

Before the tax year to which the payment relates. Remuneration that is not authorised by the deed

applicable for the period, or that relates to a period before the date of the deed, is not deductible (section 35(e)(ii)). For tax year 2027-28, which runs from 01/04/2027 to 31/03/2028, the deed should be signed by 31/03/2027.

Official sources

- Income Tax Department: Income-tax Act, 2025 (sections 15, 26, 34, 35, 36, 288, 393)
- Rashiklal and Co. v. CIT, Supreme Court, 09/12/1997, (1998) 229 ITR 458 (judgment text)
- Brij Mohan Das Laxman Das v. CIT, Supreme Court, 10/12/1996, (1997) 223 ITR 825 (judgment text)
- Suwalal Anandilal Jain v. CIT, Supreme Court, 10/03/1997, (1997) 224 ITR 753 (judgment text)
- Durga Dass Devki Nandan v. ITO, Himachal Pradesh High Court, 11/03/2011 (CBDT Circular 739), as reported by TaxGuru
- Sood Brij and Associates v. JCIT, Income Tax Appellate Tribunal, Delhi, order of 29/10/2010 (judgment text)

Related reading

- Income Tax Appeals and Rectification under the Income-tax Act, 2025: Forms 99, 115 and 116, Time Limits and Fees (Tax Year 2026-27)
- When No TDS Is Deducted: Form 121 (Old Form 15G and 15H), Exempt Payees and Personal-Purpose Payments under Section 393 (Tax Year 2026-27)
- What is Income Tax? Meaning, Rules, Tax Slabs, Types and Tax Guide for Tax Year 2026-27

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Date
17/11/2026
Date Created
30/09/2026
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