

Partners' Remuneration and Interest under the Income-tax Act, 2025: Section 35(e) Limits, Book Profit and Partner's Tax (Tax Year 2026-27)

Description

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Quick summary

- A firm can deduct remuneration only to working partners and only if it is authorised by the partnership deed for the period concerned (section 35(e)); the total for all working partners is limited to 90% of book profit on the first ?6,00,000 (or ?3,00,000 in case of a loss, if higher) and 60% of the balance.
- Interest to partners is deductible only if authorised by the deed, and only up to 12% simple interest a year; remuneration to a partner who is not a working partner is not deductible at all.
- Book profit is the net profit of the profit and loss account computed under the business rules, increased by the total remuneration to all partners if it was deducted; a working partner is an individual actively engaged in conducting the affairs of the firm's business or profession.
- In the partner's hands, the share of profit in the profit-sharing ratio is exempt (Schedule III, Sl. No. 2), while remuneration and interest from the firm are business income and not salary (section 15(4)).

A partnership firm that pays salary, commission or interest to its partners can deduct those payments only within limits fixed by the Act. In the Income-tax Act, 2025 (from 01/04/2026) the limits are in **section 35(e)**, in the group of "amounts not deductible", replacing the old section 40(b).

The conditions for a deduction

Payment	Deductible if
Remuneration to a partner who is **not a working partner**	Never (section 35(e)(i))

Payment	Deductible if
Remuneration to a **working partner**	Authorised by the partnership deed applicable for the period for which it is paid. Remuneration that relates to a period before the date of the deed, or that the earlier deed did not authorise, is not deductible (section 35(e)(ii))
Interest to any partner	Authorised by the partnership deed on the same conditions, and within **12% simple interest a year** (section 35(e)(ii) and (iv))
Aggregate remuneration to all working partners	Within the limit below (section 35(e)(iii))

Limit on remuneration to working partners

The aggregate remuneration to all working partners, as authorised by the deed, is allowed up to:

Slice of book profit	Allowed remuneration
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**
On the balance of the book profit	60%

Book profit and working partner

- **Book profit** is the net profit as shown in the profit and loss account for the tax year, computed as per Chapter IV-D, **increased by the aggregate remuneration to all partners** if it has been deducted in arriving at that net profit (section 35(e)(v)(A)).
- A **working partner** is an individual who is actively engaged in conducting the affairs of the business or profession of the firm (section 35(e)(v)(B)).

Example. A firm has a net profit of ?16,00,000 after deducting remuneration of ?8,00,000 to its two working partners. The partnership deed authorises that remuneration. Book profit is ?16,00,000 + ?8,00,000 = ?24,00,000. The allowed remuneration is 90% of the first ?6,00,000 = ?5,40,000, plus 60% of the balance ?18,00,000 = ?10,80,000, so ?16,20,000 in total. The ?8,00,000 paid is within that limit and is fully deductible. If the firm paid ?20,00,000, only ?16,20,000 would be allowed.

Interest to partners in a representative capacity

If an individual is a partner on behalf of, or for the benefit of, another person, interest paid to him in that representative capacity and interest paid to the person represented are both counted for the 12% limit, while interest paid to him otherwise is left out. Where a partner receives interest on behalf of another person but is not a representative partner, his interest is also left out (section 35(e)(iv)(A) and (B)).

Associations of persons and bodies of individuals

Section 35(f) applies a similar rule to an association of persons or body of individuals (other than a company, co-operative society or registered society): interest, salary, bonus, commission or remuneration to a member is not deductible, except that interest is disallowed only to the extent the interest paid by the association exceeds the interest the member paid to it.

How the partner is taxed

- **Share of profit:** the sum received by a partner as his share in the total income of the firm is **exempt** under Schedule III, Sl. No. 2, if the firm is separately assessed and the share is as per the profit-sharing ratio in the partnership deed.
- **Remuneration, bonus, commission and interest** from the firm are **not salary**, even if called salary (section 15(4)). The partner reports them under the head profits and gains of business or profession, as under the old section 28(v); the corresponding clause of the 2025 Act was not separately checked for this post. The partner's share of profit is not taxed again.
- If a firm's remuneration is later found not deductible, the partner's assessment is **amended** to remove the income, within four years from the end of the financial year of the order on the firm (section 288, Table Sl. No. 1).

Practical points

1. **Update the partnership deed before the year starts.** A clause that comes into force later does not support a deduction for the earlier period.
2. **State the working partners and the remuneration formula** clearly in the deed, with the 12% interest ceiling.
3. **Compute book profit each year** before deciding the remuneration, because the limit depends on it.
4. **Compare firm and company structures.** The tax cost of a firm depends on the rate at which the firm is taxed under the Finance Act; check the current rate when planning.

How CSM & Co LLP can help

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

Frequently asked questions

Which section limits the remuneration and interest a firm can deduct?

Section 35(e) of the Income-tax Act, 2025, which replaces section 40(b) of the 1961 Act. Section 288 refers to it when the assessment of a partner is amended after the firm's assessment changes.

What is the limit on partners' remuneration?

The aggregate 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)).

Who is a working partner?

An individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner (section 35(e)(v)(B)). Remuneration to a partner who is not a working partner is not deductible (section 35(e)(i)).

What is the limit on interest to partners?

Interest authorised by the partnership deed is allowed up to 12% simple interest a year; the excess is not deductible (section 35(e)(iv)). Rules apply where an individual is a partner in a representative capacity, so that interest paid to him in that capacity and to the person he represents is taken into account together.

What is book profit?

The net profit shown in the profit and loss account for the tax year, computed under Chapter IV-D (the business and profession rules), increased by the aggregate remuneration to all partners if it has been deducted in arriving at that net profit (section 35(e)(v)(A)).

How is a partner taxed?

The sum received by a partner as share in the firm's total income is exempt in the partner's hands, provided it is as per the profit-sharing ratio in the partnership deed (Schedule III, Sl. No. 2). Remuneration, bonus, commission and interest received from the firm are not salary (section 15(4)); they are business income of the partner, and the firm's payment of them is deductible only as above.

Official sources

- Income Tax Department: Income-tax Act, 2025 (sections 15, 35, 288, Schedule III)

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