

Payments to Partners of a Firm. Applicability of New TDS Rule from April 1, 2025

Background

The Finance (No. 2) Act, 2024 introduced a new section, section 194T, to the Income-tax Act, 1961 ("the Act") which requires tax to be deducted at source on payments made to the Partners of a Firm (including Limited Liability Partnership). The new TDS rule is effective from **01-April-2025**.

Coverage

Section 194T requires TDS on the following payments made by a "Firm" to its Partners:

- Salary
- Remuneration
- Commission
- Bonus or
- Interest on any account.

Under Section 2(23)(i) of the Act, definition of the 'Firm' includes an LLP as well. This TDS rule will therefore also apply to LLPs paying their Partners. However, profit distributions [being the Appropriation of the taxed profits] and capital repayments by a firm are not covered within the TDS rule.

Now the Path forward....

If you keenly observe, In the last few years, the scope of TDS provisions has seen very high expansion. Be it TDS under 192/ 193/ 194 / 195, TCS under 206C [including 206C (1H), which is obsolete now]. And now, section 194T is an addition to this. It is a well-known fact that, the TDS provisions are not charging sections, they are not the tax ascertainment / determination sections, but are tax collection sections. While most of the streams of the income earned by the Assesseees were covered under the TDS / TCS provisions, the income of the partners earned from the Firms like interest, salary, bonus, commission, remuneration etc were outside these TDS / TCS provisions. All along, this interest, salary, bonus, commission, remuneration earned from firms are taxable under the head 'Profits and gains of business or profession', provided, such payments are not subject to disallowance under section 40(b) of the Act. This resulted in such income being not subject to TDS provisions and partners were to pay tax on such income on their own, either by way of advance tax or as self-assessment tax.

However, with effect from April 1, 2025, since TDS is applicable on these payments, the recipient Partners have to adjust their advance tax/self-assessment tax obligations accordingly.

Section

Quote....

Following section 194T shall be inserted after [section 194S](#) by the Finance (No. 2) Act, 2024, w.e.f. 1-4-2025:

Payments to partners of firms.

194T. (1) *Any person, being a firm, responsible for paying any sum in the nature of salary, remuneration, commission, bonus or interest to a partner of the firm, shall, at the time of credit of such sum to the account of the partner (including the capital account) or at the time of payment thereof, whichever is earlier shall, deduct income-tax thereon at the rate of ten per cent.*

(2) *No deduction shall be made under sub-section (1) where such sum or the aggregate of such sums credited or paid or likely to be credited or paid to the partner of the firm does not exceed twenty thousand rupees during the financial year.*

.... Unquote

Mechanism



That is ...

- as per section 194T of the Act, tax is to be deducted at the rate of 10 percent on certain specified payments made to the Partners of the firm provided such sum credited or paid or likely to be credited or paid to the partner exceeds the threshold of Rs 20,000 during the financial year.
- The liability to deduct tax would arise at the time of credit of such sum to the account of the partner (including the capital account) or at the time of payment thereof, whichever is earlier.

Section 194T vis-à-vis 192/194A

- Section 192 deals with tax deduction at source on income chargeable under the head salary. Section 17 of the Act defines Salary very exhaustively considering any and all payments / receipts from the Employer to the Employee. Also, due to the definition of the Employer – Employee relation, the payments by the Firm to the partner are not covered under the definition of Salary.
- Apart from this, explanation 2 to section 15 of the Act specifically states that *Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as "salary" for the purposes of this section.*
- Similarly, section 194A which deals with tax deduction at source on income by way of interest other than income by way of interest on securities, specifically excludes under 194A(3)(iv), if *such income credited or paid by a firm to a partner of the firm.*

Salary and interest paid/ payable to a partner which were outside the ambit of the TDS provisions have now been brought within the ambit of TDS under the new section 194T.

Some practical issues that arise



What about Disallowance U/s 40(b) -

- It is a known fact that, the remuneration / Interest paid by the Firm to the partner are subject to section 40(b). This application of Section 40(b) may result in disallowance of certain portion of the remuneration / interest.
- What is the recourse available to the Firm / Partner for the disallowed portion of the Remuneration / Interest etc. Ideally or logically, If any payment to the partners of the firm has been disallowed under section 40(b) in the income computation of the firm, then same is to be exempt in the hands of the partner as per proviso to section 28(v) as this disallowance has already resulted in an income tax in the hands of the Firm (this is to avoid double taxation). In other words, the Firm may not be called onto pay the TDS on such excluded amount, as TDS is merely a tax collection mechanism.
- However, no such exclusion has been provided under section 194T, which may lead to unnecessary avoidable litigations / differences between the Department and the Firm / Partners. On the other hand, the deduction u/s 194T may only result in a tax deduction at a rate higher than the mandated rate.

What if Partners' effective tax rate is low (or no tax liability)....

- Although Section 194T is applicable after the payment to the Partners cross Rs 20,000/- per month, a 10% deduction of tax on such Partners may therefore may be high and they have to seek refund of the TDS by filing their ITRs after the end of the year. This impacts their cash flows.
- Interestingly, Section 197 does not cover the TDS U/s 194T. Section 197 allows an assessee to seek a lower TDS rate from the tax office and this section specifically mentions the coverage of the sections under which the payment is made and the Assessee is eligible to seek a lower deduction of tax. Unfortunately, 194T is not one of it ie 194T is not mentioned in it.
- However, section 395 of the proposed Income-tax Bill, 2025 (proposed applicability from FY 2026-27) has removed this reference to specific sections that are eligible for lower TDS. This can be inferred that, all TDS sections seem to be eligible for lower TDS, including but not limited to Section 194T. This exemption seems to be beneficial to the assessee. Nonetheless it will result in separate annual activity of seeking the Certificates for lower deduction of tax every year, as such certificates are Year and Receiver specific.

What if Recipient partner is a non-resident

- With the globalisation and opening of the economy, the Firms may be having a Non- Resident Partner. Now, what is the scope of the applicability of section 194T to the payments made to this Non-Resident Partner?
- A plain reading of the language of section 194T, means that, it applies to all Partners, irrespective of their residential status (ie, resident or non-resident).
- However, section 195 is a special TDS section that applies to all payments made to a non-resident. Section 195 starts with *..Any person responsible for paying to a Non-Resident ...* which makes it amply clear that, this is a specific section covering the payments to a specific class of receiver ie NRI.
- Now, Section 194T is silent on this aspect of covering the payments made to NRI. Therefore, this results in an ambiguity when an LLP in India is paying remuneration to its partner who is a non-resident. Now, whether 194T is applicable or 195?
- A better proposition would be in Applying 195 instead of 194T. Since section 195 is more specific to non-resident recipients and section 194T is a more generic section covering the TDS aspects in general receiver.
- This position would also be supported by Legal interpretation - a "specific provision" always overrides a "general provision", meaning that when two conflicting rules exist, the one that specifically addresses a situation takes precedence over the broader, more general rule. This principle is often referred to as "lex specialis" or "generalia specialibus non derogant" (the general does not derogate from the specific). As such, we can suppose that, 194T is not applicable to payments covered under 195. Section 195 will separately, specifically and independently deal with it's own payments.

Finally

- Although introduction and application of 194T, may result in an enhanced compliance costs and burden, it would none the less lead to some clarity and accountability and most importantly, credibility to the grey area of Payments made to Partners. And finally leading to better Tax management and tax applications.
- Also, this will mitigate the Partners from paying the Advance tax and Interest on default of such Advance taxes. 194T will result in better and seamless mechanism of Income earned and it's taxation. This will also result in introduction of a mechanism to ensure timely deduction/ it's remittance. We feel, a long standing issue is being addressed.