INTEREST ON CAPITAL

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. Interest on Capital can be treated as either:

➢ An Appropriation of profit
➢ A Charge against profits

Interest on Capital: An Appropriation of Profits:

In Case of Losses	Interest on Capital is NOT ALLOWED
In Case of Sufficient Profits	Interest on Capital is ALLOWED IN FULL
In case of Insufficient Profits	Interest on Capital is allowed only to the extent of profits in the ratio of interest on capital of each partner

Interest on Capital: As a Charge against Profits: *Interest on Capital is always allowed in full irrespective of amount of profits or losses.*

In case of sufficient Profits

Profit and Loss Adjustment A/c   Dr.
        To Interest on Capital A/c
(Being interest on capital transferred to P&L Adjustment A/c)

In case of Insufficient Profits or Losses

Profit and Loss / Profit and Loss Adjustment A/c   Dr.
        To Interest on Capital A/c
(Being interest on capital transferred to P&L Adjustment A/c)

Note: Interest on Capital is always calculated on the OPENING CAPITAL BALANCE of a year. If Opening Capital is not given in the question, it should be ascertained as follows:

PARTICULARS	DETAILS	AMOUNTS
Capital at the End Add : 1. Drawings	xxxxxx	_____
2. Interest on Drawings	xxxxxx	
3. Losses during the Year	xxxxxx	_____
Less : 1. Additional Capital Introduced 2. Profits during the year	(xxxxx) (xxxxx))	(……………….)
Opening Capital		_____

For additional capital interest is calculated for period for which capital is utilised.

For example: Sona invested additional capital is introduced on 1 April, 2018 in firm where accounts are closed on 31st December, 2018.

Interest = Amount introduced x Rate/100 x 9/12 **as money is utilised for 9 Months**

INTEREST ON DRAWINGS

Interest on drawings in charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn.

- **When Rate of Interest on Drawings is given in %:** Interest on Drawings is calculated with a flat rate irrespective of date of drawings.

- *When Rate of Interest on Drawings is given in % p. a.*
    - *When date of Drawings is not given*
        - Interest on Drawing = Total Drawings x Rate/100 x 6/12

        (Note : Interest is calculated for a period of 6 months)
    - *When date of Drawings is given*
        - Interest on Drawing = Total Drawings x Rate/100 x Time Left after drawings/12

- *When different amount are withdrawn on different date :*

We have the following two methods to calculate the amount of Interest on Drawing:

a. **Simple Interest Method:** In this method, interest on drawing is calculated for each amount of drawing individually of the basis of periods for which

b. **Product Method:** In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period, Interest for 1 month is calculated on the sum of these products.

We can explain the above mentioned two methods with the help of an example.

Example: Anushka and Simran are partners in a firm. During the year ended on 31st March 2011, Anushka makes the drawings as under:

Date of Drawing	Amount (Rs)
01-08-2010	5,000
31-12-2010	10,000
31-03-2011	15,000

Partnership Deed provided that partners are to be charged interest on drawings @ 12% p.a. Calculate the interest chargeable to Anushka Drawing by using Simple Interest Method and Product Method.

SOLUTION

Simple Interest Method

Date of Withdrawal	Amount of Drawings (Rs)	Months till March 31, 2011	Interest @ 12% p.a. (Rs)
01.08.2010	5,000	08	400
31.12.2010	10,000	03	300
31.03.2011	15,000	00	000
		TOTAL	**700**

Product Method

Date of Withdrawal	Amount of Drawings (Rs)	Months for which amount has withdrawn till December 31, 2011	Total Product (Rs)
01.08.2010	5,000	08	40,000
31.12.2010	10,000	03	30,000
31.03.2011	15,000	00	00,000
		TOTAL	**70,000**

Interest on Drawing = Total Product x Rate/100xTime/12 (in months)

= 70,000x12/100x1/12

=Rs 700

Case 4 : When an equal amount is withdrawn regularly

Interest on Drawing can be calculated using either Product Method or Direct Method (i.e., Short Cut Method)

Direct Method will be used only if all the following three conditions are satisfied:

➢ Amount should be same throughout the period
➢ Date of Drawings should be same throughout the period
➢ Drawings should be made throughout the period regularly without any gap.

Interest on Drawing = Total Product x Rate/100 x T/12

NOTE:

➢ T= Time (in months) for which interest is to be charged
➢ T=Time left after first drawing + Time left after last drawing/2

Value of T under Different circumstances will be as under:

SITUATION	Monthly Drawings for 12 Months	Quarterly Drawings for 12 Months	Half Yearly Drawings for 12 Months	Monthly Drawings for 06 Months
When drawing are made in the Beginning of each period	6.5	7.5	9	3.5
When drawing are made in the Middle of each period	6	6	6	3
When drawing are made in the End of each period Illustration	5.5	4.5	3	2.5

Illustration 1: *Calculate interest on drawings of Mr. Amit @10% p.a. if he withdrew Rs1000 per month*

(i)   In the beginning of each Month
(ii)   In the middle of each month
(iii)   At end of each month

Solution:

Total Amount withdrawn = Rs 1000x12 = 12,000

(i) Interest on drawing = Amount x Rate/100 x 6.5/12

$$= 12,000 \times 10/100 \times 6.5/12 = Rs\ 650$$

(ii) Interest on drawing = Amount x Rate/100 x 6/12

$$= 12,000 \times 10/100 \times 6/12 = Rs\ 600$$

(iii) Interest on drawing = Amount x Rate/100x5.5/12

$$= 12,000 \times 10/100 \times 5.5/12 = Rs550$$

Illustration 2: Calculate interest on drawing of Vishal if the withdrew Rs.48000 in year withdrawn evenly @10% p.a.:

➢ at beginning of each Quarter
➢ in the middle of each Quarter
➢ at end of each Quarter.

Solution

➢ Drawing made on beginning of each Quarter
   Interest on drawing = Amount x Rate/100 x 7.5/12
   = 48,000 x 10/100 x 7.5/12 = Rs.3, 000
➢ Drawing made in middle of each quarter
   Interest on drawing = Amount x Rate/100 x 6/12
   = 48,000 x 10/100 x 6/12 = Rs.2, 400
➢ Drawings made at end of each quarter
   Interest on drawing = Amount x Rate/100 x 4.5/12
   = 48,000x10/100 x 4.5/12 = Rs.1, 800

Similarly Interest can be calculated by following formulas:

o Half yearly Drawings for year when

- Drawings are made in the beginning of each period (half year)

   • Interest on drawing = Amount x Rate/100 x 9/12

- Drawings are made in the middle of each period (half year)

   • Interest on drawing = Amount x Rate/100 x 6/12

- Drawings are made at the end of each period (half year)

   • Interest on drawing = Amount x Rate/100 x 3/12

o For monthly drawings for 6 months

- Drawings are made in beginning of each month

   • Interest = Amount x Rate/100 x 3.5/12

- When drawings are made in the middle of each month

   • Interest = Amount x Rate/100 x 3/12

- When drawings are made at the end of each month

   • Interest = Amount x Rate/100 x 2.5/12

INTEREST ON PARTNER'S LOAN

❖ *It is a charge against profits and is provided irrespective of profits or loss.*

❖ *It is always DEBITED to Profit and Loss A/c*

❖ *It will also be provided in the absence of Partnership Deed @ 6% per annum OR else at an agreed rate of interest.*

❖ *Interest on partner's loan is not recorded in partners' capital or current account but it should be recorded to the credit side of partner's loan account.*

The following entries are passed to record the interest on partner's loan

❖ For allowing Interest on loan*:*

           Interest on Partner's Loan A/c   Dr.

                To Partner's Loan A/c

           (Being interest on loan allowed @__% p.a.)

❖ For transferring Interest on Loan to Profit and Loss A/c:

           Profit and Loss A/c   Dr.

                To Interest on Loan A/c

           (Being interest on loan transferred to P & L A/c)

RENT PAID TO A PARTNER

❖ Rent paid to a partner is also a charge against profits and it will also be DEBITED to Profit and Loss A/c.

❖ It will be credited to *partners' current account in case of fixed capital method or to partners' capital account in case of fluctuating capital method.*

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