

Profits and Gains from Business or Profession (Section 28 to 44)

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Learning Objectives

- Types of Income under 'Profits and Gains of Business or Profession'
- Business
- Profits and Gains
- Business Loss – Instances
- Method of Accounting Sections 145 & 145A
- Deductions against Business Income
- How to Calculate Depreciation
- Actual Cost and Written Down Value
- Maintenance of Accounts by Certain Persons Carrying on Profession or Business [Section 44AA]

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- Audit of Books of Accounts [Section 44AB]
- Special Provision for Computing Profits and Gains of Business of Plying, Hiring or Leasing Goods Carriages [Section 44AE]
- Special Provision for Computing Profits and Gains of Retail Business [Section 44AF]
- Summary - Scheme of Presumptive Income and Presumptive Taxation
- Income from Undisclosed Sources

Types of Income under 'Profits and Gains of Business or Profession'

- ▶ Profits and gains of any business or profession carried on by the assessee at any time during the previous year;
- ▶ any compensation or other payment due to or received by any person –
 - ✓ in connection with the termination of his management or the modification of the terms and conditions relating thereto;
 - ✓ at or in connection with the termination of his office or the modification of the terms and conditions relating thereto;
 - ✓ in connection with the termination of the agency or the modification of the terms and conditions relating thereto ;
- income derived by a trade, professional or similar association from specific services performed for its members

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- ❖ profits on sale of a license granted under the Imports (Control) Order, 1955;
- ❖ cash assistance received or receivable by any person against exports under any scheme of the Government of India;
- ❖ any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules;
- ❖ any profit on the transfer of the Duty Entitlement Pass Book Scheme;
- ❖ any profit on the transfer of the Duty Free Replenishment Certificate;
- ❖ the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession ;

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- ❖ any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm;
- ❖ any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy;
- ❖ any sum, whether received or receivable, in cash or kind, under an agreement for—
 - ✓ not carrying out any activity in relation to any business; or
 - ✓ not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique
- ❖ any sum received or receivable on account of any capital asset being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

Business & Profession

- The term 'business' is defined to include any —
 - ✚ trade,
 - ✚ commerce,
 - ✚ manufacture, or
 - ✚ any adventure or concern in the nature commerce or manufacture.
- The definition is not exhaustive, it covers even an occupation carried on by a person with a view to earning profit.
- **Profit motive** - The word "business" would mean some real, substantial and systematic or organized course of activity with a set purpose which would normally be profit motive.

Trade & Commerce

Trade:

- Trade primarily means the exchange of goods for goods or goods for money.
- It would also signify that it is a kind of repeated activity in the nature of business carried on with a profit motive.

Commerce:

- If a person purchases goods with a view to sell them at profit, it is an ordinary case of trade and If such transactions are repeated on a large scale, it is called commerce.
- In determining a case of trade or commerce, in crucial issue is that of investment.
- One has to take into account the nature of the assets, the occupation of assessee, the frequency and volume of transactions etc. to distinguish trading from commercial activity.

Manufacture

- Manufacture is the making of articles or materials by physical labour or mechanical Power.
- The essence of manufacturing is that something is produced or brought into existence which is different from that out of which it is made, in the sense that the thing produced is by itself commercial commodity which is capable as such of being sold or supplied.
- Means an activity that original article or thing resulting in transformation of the object or article or thing having a different name, character and use.

Any adventure in the nature of trade, commerce or Manufacture

- The following guiding principles would apply while deciding as to whether a transaction of purchase or sale forms an adventure in the nature of trade or an investment –
 - The commodity purchased plays an important role in deciding whether a person is indulging in an adventure in the nature of trade or is making an investment.
 - Whether the transaction is an isolated one or forms part of a series of transactions showing a tendency to indulge in trade.
 - The fact that the property bought has been sold within a short time does not by itself indicate that the transaction is in the nature of trade.
 - If the property purchased is capable of yielding income, then again the inference will be that an investment was intended to earn income and is not an adventure in the nature of trade.

Profession

- The expression 'profession' has been defined in section 2(36) of the Act to include any 'vocation'.
- According to generally accepted principles the meaning of the term 'profession' involves the concept of an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator.
- A profession is normally associated with the exercise of intellectual or technical equipment resulting from learning or service.
- Profession involves occupation requiring purely intellectual or manual skill

Exception to Business carried during previous year

- The following receipts are taxable even if no business or profession is carried on by the assessee during the previous year –
 - ❖ Recovery or excess recovery against a deduction claimed earlier
 - ❖ Sale of an asset used for scientific research
 - ❖ Recovery or excess recovery against bad debts claimed
 - ❖ Amount withdrawn from a reserve created under section 36(1)(viii)
 - ❖ Sum received after discontinuance of a business or profession
 - ❖ Sale of depreciable assets by power generating unit
 - ❖ Sum received for restrictive covenant

PROFITS AND GAINS

- The tax is upon income, profits or gains; it is not a tax on gross receipts.
- The profit of a trade or business is the surplus by which the receipts from the trade or business exceeded the expenditure necessary for the purpose of earning those receipts.
- As accounting year is a self-contained year, taxable profit is the profit accrued or arising in that year. Anticipated or potential profits or losses, which may occur in future, are not considered for arriving at taxable income of a previous year.

Income from illegal business

- The income-tax law is not concerned with the legality or illegality of business or profession. The income of illegal business or profession is not exempt from tax.

Business

Loss

- The business losses can be allowed as deduction only if the following conditions are satisfied –
 - ✓ The loss should be revenue in nature;
 - ✓ The losses should be incurred during the previous year;
 - ✓ The loss should be incidental to the business or profession carried on by the assessee;
 - ✓ The loss not be notional or fictitious;
 - ✓ The loss should have been actually incurred and not merely anticipated to incur in future; and
 - ✓ there should not be any, direct or indirect, restriction under the Act against the deductibility of such loss.

Instances of Losses deductible from Business

- ❖ Loss of stock-in-trade due to destruction by Fire,
- ❖ Loss of stock-in-trade by an act of God,
- ❖ Loss of stock-in-trade due to theft,
- ❖ Loss on account of advances given to employee's welfare co-operative stores which becomes irrecoverable,
- ❖ Loss of Cash due to theft,
- ❖ Depreciation in funds kept in foreign currency due to exchange fluctuation,
- ❖ Loss incurred due to devaluation of rupee in foreign country which is being utilized in course of business,
- ❖ Loss due to embezzlement by an employee,
- ❖ Loss incurred on account of insolvency of banker with which current account is maintained,

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- ❖ Loss incurred due to sale of lands acquired from a business-debtor in satisfaction of debt,
- ❖ Loss on account of non-recovery of advances given by assessee-company to its 100% subsidiary company,
- ❖ Loss arising from sale of securities held in the regular course of business,
- ❖ Loss arising due to non-realisation of the loan advanced to the importer,
- ❖ Loss of cash and securities in a banking company on account of dacoity,
- ❖ Loss incurred due to forfeiture of deposits made for residential accommodation of employees of the assessee-company

Instances of Losses NOT deductible from Business Income

- ✘ Loss of advances made for setting up a new business which ultimately could not be started,
- ✘ Depreciation of funds kept in foreign currency for capital purpose,
- ✘ Loss arising from non-recovery of tax paid by an agent on behalf of the non-resident,
- ✘ Anticipated future losses,
- ✘ Loss relating to any business or profession discontinued before the commencement of previous year,
- ✘ Loss of security deposit made to obtain selling agency,
- ✘ Provision made by assessee in respect of non-performing assets

Method of Accounting

- Income chargeable under the head – “Profits and gains of business or profession” or “Income from other sources” shall be computed in accordance with either –
 - ✚ Cash system of accounting; or
 - ✚ Mercantile system of accounting
- Notwithstanding anything to the contrary contained in Section 145, the valuation of Purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be—
 - ✓ in accordance with the method of accounting regularly employed by the assessee; and
 - ✓ further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

AS-l: Disclosure of accounting policy

- All significant accounting policies adopted be disclosed
- Such disclosure shall form part of the financial statement.
- Any change in the accounting policies having significant/material effect on the results for the current or future years must be disclosed.
- For this, the major consideration in selection of the accounting policies must be
 - Prudence
 - Substance over form
 - Materiality
 - Consistency

AS-II: Disclosure of Prior period and extraordinary items

- AS-II prescribes the treatment of income and expenditure of Prior period and that of extraordinary items.
- Prior period items are required to be separately disclosed in the profit and loss account in the previous year together with their nature and amount so that their impact on profit or loss in the previous year can be perceived.
- Extraordinary items of the enterprise during the previous year shall be disclosed in the profit and loss account as part of taxable income.
- The nature and amount of each such item shall be separately disclosed so that their relative significance and effect on the operating results of the previous year can be perceived.

Rent, Rates, Taxes, Repairs and Insurance for Buildings [Section 30]

- In respect of rent, rates, taxes, repairs and insurance for premises, used for the purposes of the business or profession, the following deductions shall be allowed —
 - where the premises are occupied by the assessee-
 - ✓ as a tenant, the rent paid for such premises; and further if he has undertaken to bear the cost of Current Repairs to the premises, the amount paid on account of such repairs;
 - ✓ otherwise than as a tenant, the amount paid by him on account of current repairs to the premises;
 - any sums paid on account of land revenue, local rates or municipal taxes
 - the amount of any premium paid in respect of insurance against risk of damage or destruction of the premises.

Current Repairs

- The expression 'current repairs' means expenditure on buildings, machinery, plant or furniture which is not for the purpose of renewal or restoration but which is only for the purpose of preserving or maintaining an already existing asset and which does not bring a new asset into existence or does not give to the assessee a new or different advantage.
- 'Current repairs' means repairs undertaken in the normal course of user for the purpose of preservation, maintenance or proper utilization or for restoring it to its original condition.
- 'Current repairs' aim to restrict the allowance to expenditure incurred for preservation and maintenance of the asset in its current state of its working. It does not include expenditure incurred on any improvement or an addition to the asset. It would be only the repairs for its use during the current year and not the repairs arising for its use over past years.

Repairs and Insurance of Machinery, Plant and Furniture [Section

- In respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed-
 - ✓ the amount paid on account of current repairs;
 - ✓ the amount of any premium paid in respect of insurance against risk of damage or destruction thereof.
- The amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure

DEPRECIATION (Section 32)

- Depreciation usually means loss or decline in value which occurs gradually over useful life of a material thing, due to physical wear, tear and decay, and is generally limited to losses or decline in value which cannot be restored by current repairs and maintenance.

Conditions for Claiming Depreciation:

- Asset must be owned by the assessee,
- It must be used for the purpose of business or profession,
- It should be used during the relevant previous year,
- Depreciation is available on tangible as well as intangible assets

Block of Assets

- "Block of assets" means a group of assets falling within a class of assets comprising—
 - ❑ Tangible assets, being buildings, machinery, plant or furniture; and
 - ❑ intangible assets, being know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

Rates of Depreciation

Number	Nature of Assets	Rate of Depreciation
Block-1	Buildings - Residential buildings other than hotels and boardinghouses	5%
Block-2	Buildings - Office, factory, godowns or buildings which are not mainly used for residential purpose [it covers hotels and boarding houses but does not cover those which are covered under Blocks 1 and 3]	10%
Block-3	(a) Buildings acquired on or after September 1, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under section 80-IA(4)(i).	100%
	(b) temporary erection such as wooden structures	100%
Block-4	Furniture - Any furniture/fittings including electrical fittings	10%
Block-5	Plant and machinery - Any plant or machinery [not covered by Block 6, 7, 8, 9, 10, 11 or 12] and Motor cars (other than those used in a business of running them on hire) acquired or put to use on or after April 1, 1990	15%
Block-6	Ocean-going ships, Vessels ordinarily operating on inland waters including speed boats	20%
Block-7	Plant and machinery - Buses, lorries and taxies used in the business of running them on hire, machinery used in semi-conductor industry, moulds used in rubber and plastic goods factories,	30%
Block-8	Plant and Machinery - Aero planes	40%

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Number 100%	Nature of Assets	Rate of Depreciation
Block-9	Plant and machinery - Containers made of glass or plastic used as refills	50%
	New commercial vehicle acquired during 2001-02 and put to use before March 31, 2002 for the purpose of business or profession;	50%
	Machinery/plant used in weaving, processing and garment sector of textile industry	50%
Block-10	Plant and machinery - Computers including computer software	60%
Block-11	Plant and machinery - Energy saving devices; renewal energy devices; rollers in flour mills, sugar works and steel industry.	80%
Block-12	Plant and machinery - Air pollution control equipments; water pollution control equipments; solid waste control equipments, recycling and resource recovery systems; machinery acquired and installed on or after September 1, 2002 in a water supply project or water treatment system or for the purpose of providing infrastructure facility; wooden parts used in artificial silk manufacturing machinery;	100%
	cinematograph films, bulbs of studio lights; wooden match firms; some plants used in mines, quarries and salt works;	100%
	Books owned by assessee carrying on a business in running lending libraries	100%
Block-13	Intangible assets (acquired after March 31, 1998)	25%

Some Important Points for Depreciation

- ✚ Where an asset is **acquired by the assessee** during the year and is **put to use** the business purposes **for less than 180 days** in that year, the deduction in respect of such asset shall be restricted to **50 per cent of the normal depreciation**.
- ✚ In case of succession of business entities by merger, de-merger etc. the aggregate depreciation shall be restricted as if it would have been to the original entity in the ratio of the number of days for which the assets were used by them.
- ✚ In case of buildings where the Assessee holds only lease right of occupancy and any capital expenditure is incurred by the assessee for the construction of any structure or for renovation or extension, improvement of the building then the depreciation shall be allowed thereon as if the said structure or work is a building owned by the assessee.
- ✚ The expressions "Know-how" means any industrial information or technique

Additional Depreciation

- Where any new machinery or plant, has been **acquired and installed** after the 31st day of March, 2002 by an assessee engaged in the business of manufacture or production of any article or thing, **a further sum to the extent of 20% of the actual cost** of such machinery or plant shall be allowed as deduction by way of depreciation.

No Additional Depreciation if:

- ✗ *any old/used machinery or plant that was used either within or outside India by any other person; or*
- ✗ *any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house; or*
- ✗ *any office appliances or road transport vehicles; or*
- ✗ *Where 100% depreciation (whether by way of depreciation or otherwise) is allowed in any one previous year*

Claim of Depreciation and Unabsorbed

Claim of Depreciation is not optional –

- From A.Y. 2002-03, It is compulsory to claim depreciation even in case of loss from business or profession.

Unabsorbed Depreciation –

- Where the depreciation cannot be fully absorbed by the profits for the year, the unabsorbed part of the depreciation is to be carried forward and is to be treated as the depreciation for the next year and so on for the succeeding previous years.
- It is important to note that past unabsorbed depreciation gets merged in to current year's depreciation. However, when there is unabsorbed business loss, it gets priority over the unabsorbed depreciation.

Actual Cost

- ❏ "Actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.
- ❏ Actual cost when Asset is acquired by the assessee by way of gift or inheritance –
 - ❑ Where an asset is acquired by the assessee by way of gift or inheritance, the actual cost of the asset to the assessee shall be the actual cost to the previous owner, as reduced by—
 - ✓ the amount of depreciation actually allowed or would have been allowable to the assessee as if the asset was the only asset in the relevant block of assets.

Contd.

Actual cost—Asset once belonged to Assessee - Sold to third part - Once again re-acquired:

- ❑ Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be-
- the actual cost to him when he first acquired the asset as reduced by the amount of depreciation actually allowed or would have been allowable to the assessee as if the asset was the only asset in the relevant block of assets.
- the actual price for which the asset is re-acquired by him,

Whichever is Lower

Contd...

- Actual cost—A building previously the property of the assessee is brought into use for the purpose of the business or profession:
 - ❑ Where a building previously the property of the assessee is brought into use for the purpose of the business or profession, the actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rate in force on that date that would have been allowable had the building been used for the aforesaid purposes since the date of its acquisition by the assessee
- Actual cost—A capital asset is transferred by a holding company to its subsidiary company and vice versa:
 - ❑ The actual cost of the transferred capital asset to the transferee-company shall be taken to be the same as it would have been if the transferor-company had continued to hold the capital asset for the purposes of its business.

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- Actual cost—Transfer in a scheme of amalgamation by the amalgamating company to the amalgamated company:
 - ❑ Any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the actual cost of the transferred capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.
- Actual cost—Demerger - capital asset is transferred to the resulting Indian company:
 - ❑ Any capital asset is transferred by the demerged company to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

Contd.

- Interest payable on loan etc. for acquiring the asset up to the period the asset is first put to use is part of actual cost.
- Actual cost shall be reduced to the extent of that part of the cost which is met directly or indirectly by the Central Government or a State Government in the form of a subsidy or grant or reimbursement.
- Actual cost—NRI—acquired asset outside India:
 - ❑ Where an asset which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his business or profession, the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.

Written down value (WDV): [Section 43(6)]

- ❖ In the case of assets acquired in the previous year, the WDV shall be the actual cost to the assessee;
- ❖ in the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation actually allowed to him under the Act;
- ❖ In the case of any Block of Assets,—
 - the aggregate of the written down values of all the assets falling within that block of assets at the beginning of the previous year and adjusted,—
 - ✓ by the increase by the actual cost of any asset falling within that block, acquired during the previous year;
 - ✓ by the reduction of the moneys payable in respect of any asset falling' within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so, however, that the amount of such reduction does not exceed the written down value

Contd.. Succession in Business –

☐ WDV of the successor shall be same as that of his predecessor

Where Block of assets transferred -

- by holding company to its subsidiary company (and vice versa)
- by amalgamating company to the amalgamated company

The actual cost (of the block) to Transferee Company shall be the WDV to Transferor Company in immediately preceding year less Depreciation actually allowed for the current year.

Demerger - any asset in a block of asset is transferred by a demerged company to the resulting company:

For Transferor Company (Demerged Company),

WDV of the larger Block LESS WDV of the part of the block which is transferred to new Company

For resulting company

WDV will be same as WDV of transferred assets as in the books of account of the demerged company before the demerger

Tea / Coffee / Rubber development Account (Section 33AB)

The assessee must satisfy the following conditions –

- The assessee must be engaged in Tea, Coffee or Rubber plantation
- It must make a deposit in “special account”
- The deposit should be made within specified time limit
- The accounts of the assessee should be audited

Amount of Deduction:

- A sum equal to amounts deposited in special account, or
- 40 % of the profit of such business

whichever is Lower.

Withdrawal of Amount Deposited:

The amount standing to the credit of the “special account” may be withdrawn only for the purpose specified in approved scheme except in the circumstances of closures of business.

• **Contd...**
 Consequences if the new asset is transferred within 8 years –

To whom it is transferred	Transfer within 8 year from the end of previous year in which the asset is acquired	Transfer after 8 years
Transfer to Central Government, State government, local authority, statutory corporation or a government company	Deduction will not be withdrawn	Deduction will not be withdrawn
Transfer in a scheme of succession of a firm by a company [see note]	Deduction will not be withdrawn	Deduction will not be withdrawn
Transfer in any other case	Deduction will be withdrawn	Deduction will not be withdrawn

Site Restoration Fund(Section 35ABA)

The assessee must satisfy the following conditions –

- The assessee must be engaged in production of petroleum / natural gas in India.
- The assessee has an agreement with the central government
- It must make a deposit in “special account”
- The deposit should be made within specified time limit
- The accounts of the assessee should be audited

Amount of Deduction:

- A sum equal to amounts deposited in special account, or
- 20 % of the profit of such business

whichever is Lower.

Withdrawal of Amount Deposited:

The amount standing to the credit of such special account or site restoration account may be withdrawn only for the purpose specified in scheme or deposit scheme.

Contd.

Closure of Business:

- Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account shall be chargeable to income-tax as the income of the previous year.

Amount withdrawn cannot be utilized for certain purpose:

- The amount withdrawn cannot be utilized for the purpose of any machinery or plant to be installed in any office premises or residential accommodation including guest houses; any office appliance (other than computers);

Consequences if the new asset is transferred within 8 years –

- Where the new asset is transferred to Government or under any scheme of succession, Deduction will not be withdrawn,
- In every other case if the new asset is transferred within 8 years, Deduction will be withdrawn.

Expenditure on Scientific Research [Section 35]

- ❖ The following deduction for expenditure incurred on scientific research shall be allowed against income from business or profession –
 - ✓ any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business.
 - ✓ an amount equal to **1.25 times** of any sum paid to a scientific research association and other institutions engaged in approved scientific research, university, college or other institution
 - ✓ Where an assessee pays any sum to a company, to be used by it for scientific research, then there shall be allowed a deduction of **1.25 times** the sum so paid.
 - ✓ the whole of such capital expenditure incurred in any previous year shall be deducted for that previous year [no deduction shall be admissible here in which is for acquisition of any land].

Contd.

Where the assessee pays any sum to –

- A National Laboratory, or
- A University, or
- An Indian Institute of Technology

then—

- ✓ There shall be allowed a deduction of **1.25 times** the sum so paid
- For companies engaged in the business of bio-technology or manufacture or production of any drugs, pharmaceuticals, electronic equipments, computers, telecommunication equipments, chemicals or any other article or thing notified by the Board –
 - ✓ Such Company incurs any expenditure on scientific research - it may be of revenue nature or capital nature (but not being on land or building) on in-house research and development facility as approved by the prescribed authority
 - ✓ Such expenditure should be incurred before 31.3.2007

Expenditure for obtaining license to operate telecommunication services Amortization of Telecom Licensing Fees [Section 35ABB]

Conditions to be satisfied:

- ✓ the expenditure should be in the nature of capital expenditure
- ✓ It should be for acquiring any right to operate telecommunication services
- ✓ It is incurred either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year
- ✓ for this the payment has actually been made to obtain a license.

Deduction Available –

- ❖ The deduction is available over the previous years over which the license fee is paid.
- ❖ The deduction starts from the year in which the license fee is actually paid and ends in the year in which the license comes to an end.

Contd.

Treatment when such License is sold –

- When license is fully sold @ Loss:- Un-allowed expenditure not fully covered by sale - such loss allowed in the year of transfer of license
- When license is fully sold @ Profit:- The expenditure that was allowed in past shall be taxable as Business Income of the year of transfer of license
- When license is partly sold @ Loss:- Un-allowed expenditure not fully covered by sale - such loss shall be allowed over the remaining (unexpired) life of the license
- When license is partly sold @ Profit:- the excess upto the expenditure that was allowed in past shall be taxable as Business Income of the year of transfer of license

Deduction in respect of expenditure on specified business [Section

“Specified Business”^{35AD} means –

- ❑ Setting up and operating a cold chain facility;
- ❑ Setting up and operating a warehousing facility for storage of agricultural produce;
- ❑ Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network.
- ❑ Building and operating, anywhere in India, new HOTEL of 2 star or above category as classified by central government
- ❑ Building and operating, anywhere in India, a new HOSPITAL with at least 100 beds for patients;
- ❑ Developing and building housing project under a scheme for slum re-development or rehabilitation framed by central government or state government as the case may be

Contd.

Deduction Available –

The expenditure incurred, wholly and exclusively, for the purposes of any specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business.

Conditions need to be fulfilled to avail deduction:

- ✓ The business is not set up by splitting up, or the reconstruction, of a business already in existence;
- ✓ The business is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;
- ✓ Such Business is owned by a company formed and registered in India
- ✓ has been approved by the Petroleum and Natural Gas Regulatory Board

Amortization of certain Preliminary Expenses [Section 35D]

- Where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs any specified expenditure-
 - before the commencement of his business, or
 - after the commencement of his business, in connection with the extension of his industrial undertaking or in connection with his setting up a new industrial unit,the assessee shall be allowed a deduction of an amount equal to **20%** of such expenditure **for each of the five successive years from the business commencement.**
- Such expenditure are restricted to 5% of Cost of Project or Capital Employed by the Company.

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Expenditure Covered –

- ✓ preparation of feasibility report; ••
- ✓ preparation of project report;
- ✓ conducting market survey or any other survey necessary for the business of the assessee;
- ✓ engineering services relating to the business of the assessee;
- ✓ legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;
- ✓ Expenses by way of legal charges for drafting the Memorandum and Articles of Association of the company;
- ✓ on printing of the Memorandum and Articles of Association;
- ✓ by way of fees for registering the company under the provisions of the Companies Act
- ✓ in connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus;

Amortization of expenditure incurred under Voluntary Retirement Scheme

- The whole expenditure incurred by the assessee in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, each part payment being entitled to deduction in **five equal annual installments** (@ 20% PA) beginning from the year in which such part payment is made to the employee.
- Benefit of this is available where the company or the undertaking is transferred before availing the full benefit of this deduction is not availed by the original party –
 - ✓ an Indian company amalgamated with another Indian company
 - ✓ in a scheme of demerger
 - ✓ where a firm is succeeded by a company
 - ✓ Where a proprietary concern is succeeded by a company

Deduction for expenditure on prospecting, etc, for Certain Minerals [Section 35E]

Where the expenditure is incurred regarding –

- operations relating to prospecting for, or extraction or production of any mineral or
 - on any operations relating to prospecting for any mineral or group of associated minerals or
 - on the development of a mine or other natural deposit of any such mineral or group of associated minerals
- then on fulfillment of conditions specified there behalf the following deduction is available –
- ❖ an amount equal to one-tenth of the expenditure incurred; or
 - ❖ such amount as is sufficient to reduce to NIL the income,
- whichever is Lower

Other Deductions (Section 36)

- ✚ The amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession;
- ✚ The amount of any premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society;
- ✚ The amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees;
- ✚ The amount of the interest paid in respect of capital borrowed for the purposes of the business or profession;
- ✚ Any sum paid by the assessee as an employer by way of contribution towards a recognized provident fund or an approved superannuation fund;
- ✚ Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund;

Contd...

- ✚ in respect of animals which have been used for the purposes of the business or profession have died or become permanently useless for such purposes, the difference between the actual cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals;
- ✚ subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year;
- ✚ any expenditure bona fide incurred by a company for the purpose of promoting family planning amongst its employees;
- ✚ any sum paid by a public financial institution by way of contribution towards any Exchange Risk Administration Fund set up by public financial institutions;
- ✚ any expenditure incurred by the assessee, on or after the 1st day of April, 1999 but before the 1st day of April, 2000, wholly and exclusively in respect of a non-Y2K compliant computer system;

Contd...

- ✚ Any expenditure incurred by a corporation or a body corporate, constituted or established by a Central, State or Provincial Act;
- ✚ Any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him;
- ✚ Any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries;
- ✚ An amount equal to the securities transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head “profits and gains of business or profession”

Provisions for deduction for a bad debt or part thereof (Section 36(2))

- No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year;
- If the amount ultimately recovered on any such debt or part of debt is less than the difference between the debt or part and the amount so deducted, the deficiency shall be deductible in the previous year in which the ultimate recovery is made;
- Where such debt or part of debt relates to advances made by an assessee, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause.

Interest on Borrowed Capital [Section 36(1)

- (iii) Assessing Officer can examine genuineness of interest claimed
- The AO is undoubtedly entitled to examine whether the amount paid as interest is really 'interest', and if he finds that it is not wholly interest but partly interest and partly payment for extra commercial consideration, to allow only that part of the so called interest which in his opinion is 'interest', and disallow the balance which is for extraneous commercial considerations.
- Borrower and lender must be two different entities. The same entity cannot be its own lender and borrower nor interest can be paid to self.
- interest paid by one unit of assessee to its another unit cannot be allowable because it is paid and received by the same person and not by one person to another. This would be so even where separate accounts were maintained for the two units

Contd...

- Interest for the period before acquisition of the asset till the date on which such asset was first put to use:
- ✓ Interest paid in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.
- ✓ For allowing interest expenditure claimed, it is not necessary that the assessee must have used the business asset for doing business in the relevant accounting year.
- ✓ For allowing interest, what is necessary to examine is whether the assessee has used the borrowed capital for the purpose of business. If that is found to be true, then, one need not examine further as to whether the asset purchased with the borrowed capital has been in fact used by the assessee.

Contd...

- Some general propositions in case of deductibility of interest expenditure are as follows –
 - Interest paid by firm to partner - Not allowed in excess of 18% p.a.
 - Interest paid by AOP to member - Not allowed
 - Interest paid by HUF to member - Allowed
 - The loan/borrowing must be used for business
 - It is not necessary for allowing interest, that business should yield profits only
 - It is not necessary for allowing interest, that AO should be satisfied that there was need to borrow money
 - The interest on loan borrowed for payment of dividend is allowed.
 - Interest payable for delayed payment of tax duty etc. is allowable, if the tax or duty itself is allowable

Contd...

- Interest paid on loan borrowed for purchase of fixed assets is treated as under –
 - ❖ If paid for the period before starting business, it should be capitalized
 - ❖ If paid for the period after starting business, and after installation of asset, allowed as revenue expenses.
 - ❖ If paid for the period after starting business, but before installation of assets, it is either capitalized or allowed as revenue expenditure, at the option of the assessee.

Other Allowable Expenses u/s 36

- EMPLOYERS CONTRIBUTION TO RPF AND APPROVED SUPERANNUATION FUND ETC.:
 - It is allowed only if, actually paid during previous year or within 15 days of by due date under the respective law as per Section 43B.
- CONTRIBUTION TOWARDS APPROVED GRATUITY FUND:
 - Contribution towards approved gratuity fund created under irrevocable trust, for the benefit of the employees would be allowed as follows:
 - ✓ Total employers contribution = NOT TO EXCEED 8.33% of employers salary. It is subject to section 43B.
- EXPENSES ON PROMOTION OF FAMILY PLANNING:
 - No deduction is available to Non-Corporate Assessee.
 - Revenue expenses fully allowed.
 - Capital Expenses allowed as 1/5 in the previous year, Balance in equal installments in 4 subsequent years.

BAD DEBTS [Section 36(1)(vii)]

Bad Debts is allowable subject to following conditions –

- ➡ There must be a debt.
- ➡ Debt must be incidental to business or profession of the assessee.
- ➡ Debt must have been considered in computing business Income
Allowed only if, debt considered as income of previous year or earlier year
- ➡ Debt must have been written off in books of accounts of the assessee.
- ➡ If ultimate recovery of debt is more than the estimated bad debt, the difference is charged to tax. If it is less the difference allowed in the year of recovery.
- ➡ Bad debt discontinued business not allowed.
- ➡ Bad debt allowable in the hands of successor in certain cases.

Transfer to Special Reserve [Section 36(1)

(viii)] Provision Applicable to –

- ❑ Approved financial corporation (including Public co., and Govt. co.) providing long-term finance for industrial or agricultural development or development of infrastructural facility in India.
- ❑ Approved public company providing long term finance for construction or purchase of residential houses.

Amount of deduction –

- ✓ An amount not exceeding 20 % of the profits derived from the aforesaid business of providing long term finance (computed under section 28 before making this deduction) carried to a special reserve account created (and maintained) by the aforesaid financial corporation/public company is deductible.
- However, the aggregate of the amounts carried to such reserves from time to time exceeds twice the paid up share capital and genera' reserves, no allowance is made in respect of such excess.

GENERAL DEDUCTIONS : [Section 37]

- Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".
- It is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.
- No allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

Contd.

- Under residual head, the deduction of business expenditure is allowed in the following manner –
 - ❑ It is not an expenditure of the nature described in sections 30 to 36 of the Act
 - ❑ It is not in the nature of capital expenditure or personal expenses of the assessee
 - ❑ It is laid out or expended wholly and exclusively for the purposes of the business
 - ❑ Any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure
 - ❑ No allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party

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- **Capital Expenditure:**

Any expenses/initial expenses incurred for acquiring or bringing into existence an asset or advantage of enduring nature, or for substantial replacement of an existing, asset is a capital expenditures.

- **Wholly and Exclusively:**

The word 'wholly' refers to quantum of expenditure. The word 'exclusively' refers to the motive, objective and purpose of the expenditure and gives jurisdiction to the taxing authorities to examine these matters.

- **For the purpose of business:**

The words 'for the purpose of business' would mean for the purpose of keeping the trade going and making it pay. The expression 'for the purpose of business' is wider in scope than the expression 'for the purpose of earning profits'. Its range is wide; it may take in not only the day-to-day running of a business but also the rationalization of its administration and modernization of its machinery.

Expenses allowable as Business

- ✓ Under mercantile system of accounting, expenditure due but not provided in the accounts;
- ✓ Interest on borrowings for acquiring tax-free securities held to be allowable;
- ✓ Interest on loan for purchase of capital asset;
- ✓ Legal expenses for defending civil litigation;
- ✓ Remuneration to Karta/Members of H.U.F.;
- ✓ Royalty paid under mining lease agreement;
- ✓ Expenditure for use of technical research and patents of foreign collaborators;
- ✓ Lump sum payment, once for all, for acquisition of know-how for improving or updating process so as to result in higher yield of product already being manufactured;
- ✓ Expenditure incurred for raising loans;

Contd.

- ✓ Contribution for development of roads owned by Govt.;
- ✓ Amount paid for use of goodwill of a firm;
- ✓ Amount paid under a short-term agreement to avoid competition;
- ✓ Municipal property tax paid in foreign country;
- ✓ Amount paid for purchase of "loom hours";
- ✓ Successor of a business entitled to claim bad debts in respect of an amount receivable by predecessor. Legal expenses for takeover of business allowable;
- ✓ In the case of indivisible business, entire expenditure will be permissible even if some of the activities may yield tax free income;
- ✓ Provision for liability towards leave encashment held allowable;
- ✓ Expenses on acquisition of goodwill are a capital expenditure. Expenses on right to use the goodwill are revenue expenses.

Contd...

- ❑ Whether expenditure was wholly and exclusively laid out for the purpose of the business, reasonableness of the expenditure has to be adjudged from the point of view of the business and not of the revenue.
- ❑ Accumulated gratuity amount appurtenant to employees of a division transferred to the successor company was allowable expenditure.
- ❑ Amount paid for use of patents and designs for a definite period with secrecy clause was held deductible expense being a payment in the nature of license fees.
- ❑ Where expenditure incurred has definite and continuing benefits over specified years, deduction is to be allowed on proportionate basis in each year.
- ❑ Payment made to the workmen under a settlement agreement upon closure of some of the units of the assessee held as allowable revenue expenditure

Expenses should be commercially

- ✚ The test of commercial expediency must be applied from the view point of assessee and not revenue.
- ✚ Penalty for contravention of any specific provision, not allowed but expenses of civil and criminal litigation are allowed.
- ✚ Expenses incurred on retrenchment compensation to workers by Govt. taking can be allowed.
- ✚ Expenses can be claimed as a deduction even if it is for promoting business and there is no compelling necessity for the expenses.
- ✚ The onus of proving necessary facts, in order to avail deduction u/s. 37(1) is on the assessee; therefore if assessee fails to establish the facts, expenditure is not admissible.
- ✚ Expenses on issue of initial shares and bonus shares are capital expenditure.

Few Examples of Commercial Expedient

- ❖ Expenses on special advertisement comparing, on business survey, on distribution of samples on exhibition on investigation,, research and feasibility study, etc;
- ❖ Demurrage charged by port authority on inadvertent, unauthorised import;
- ❖ Salary/bonus/pension paid for managing business or to maintain industrial peace, to motivate employees;
- ❖ Fees paid for technical survey, annual listing on stock exchange, fees paid to approved value for valuation of assets;
- ❖ Expenditure incurred for lying down water pipes for uninterrupted water supply and to get exemption from municipal taxes for certain years.
- ❖ Expenditure incurred, by film producer, assessee, for providing carpets/screens in cinema theatre, expenditure on films, which were given up on ground of commercial expediency.

Few examples of Capital

- ❖ Expenses incurred for shifting factory - Expenditure relating to shifting of machinery is capital expenditure while expenditure relating to Shifting of employees is revenue expenditure.
- ❖ Purchase price paid by incoming partner for a share of profit in the firm is capital expenses, even if partnership firm is only for a single venture or short duration.
- ❖ Amount paid to outgoing director in consideration of the director convenient not to compete with the company is capital expenditure.
- ❖ Expenses incurred on maintenance of reputation of assessee business are capital expenditures.
- ❖ Bank guarantee commission for purchasing is a capital expenditure.
- ❖ Payment made to rival to ward off competition in business is a capital expenditure.

EXPENDITURE NOT ALLOWED

U/S.37

- ✘ Contribution to political party where there is no direct nexus between contribution and the business of the assessee;
- ✘ Social welfare expenses having no nexus with business are not allowable;
- ✘ Capital Expenditure not allowed under section 37;
- ✘ Acquisition of a capital asset (i.e. Mfg. rights, drawings, designs, specification and export rights) may be payable lump sum at one time or in installment remains capital expenditure only;
- ✘ Expenditure incurred for modernizing machinery (installation of new machinery) is capital nature;
- ✘ Personal expenses not allowed;
- ✘ Expenses incurred by assessee for calling general body meeting of its subsidiary company;
- ✘ Interest paid on borrowings from banks, which were fully given to its 100% subsidiary company as interest free loan
- ✘ Provision in respect of a contingent liability.

Amounts Not Deductible [Section 40]

Section	Nature of Expenditure	Nature of Default	When NOT Allowable	When allowable
40(A)(i)	Any interest, royalty, fees for technical services or other sum chargeable under this Act, payable: (A) outside India; or (B) in India to a non-resident, not being a company or to a foreign Company	Tax is deductible at source but not been deducted or, after deduction, not paid during the previous year, or in the subsequent year before the expiry of the time prescribed u/s 200(1)	Expenditure not allowable in the year in which the expenditure is incurred	If the TDS is paid in any subsequent year after the expiry of the prescribed time, such expenditure shall be allowed against the income of the previous year in which such tax has been paid.
40(A)(ia)	"Interest, commission, brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a Resident contractor/sub-contractor for any work (including supply of labour for any work), on which tax is deductible at source under Chapter XVII-B"	Such TDS is not deducted or, after deduction, is not paid during the previous year, or in the subsequent year before the expiry of the prescribed time u/s 200(1)	Expenditure not allowable in the year in which the expenditure is incurred	If the TDS is paid in any subsequent year after the expiry of the prescribed time, such expenditure shall be allowed against the income of the previous year in which such tax has been paid.

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- **Sec. 40(ii)** any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains;
- **Sec.40(iia)** any sum paid on account of wealth-tax.
- **Sec.40(iii)** any payment which is chargeable under the head "Salaries", if it is payable outside India or to a non-resident, and if the tax has not been paid thereon nor deducted there from
- **Sec.40(iv)** any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head "Salaries";

Sec.40(b) In the case of any firm assessable

- ❖ any payment of salary, bonus, commission or remuneration, to any partner who is not a working partner; or
- ❖ any payment of remuneration or interest, to any partner who is a working partner, which is not authorized by, or is not in accordance with, the terms of the partnership deed; or
- ❖ any payment of interest to any partner which is authorised by, and is in accordance with, the terms of the partnership deed so far as such amount exceeds the amount calculated at the rate of twelve per cent simple interest per annum; or
- ❖ any payment of remuneration to any partner who is a working partner, which is authorised by, and is in accordance with, the terms of the partnership deed exceeds the aggregate amount –

On the first Rs. 3,00,000 of the book-profit or in case of loss

Rs. 1,50,000 ; or
at the rate of 90% of the book-profit,
Whichever is more;

On the balance of the book-profit

At the rate of 60%.

Expenses or payments not deductible in certain circumstances [Section 40A]

- Section 40A of the Income tax Act provides for certain items as being not deductible in certain specified circumstances.
- These restrictions override all other provisions of the Act relating to the computation of income under the head "Profits and gains of business or profession".
- Where the assessee incurs any expenditure which is payable to any relative or associate concerns, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him there from, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction;

Contd...

The relative/associates would include the following persons –

- ✓ where the assessee is an individual any relative of the assessee;
- ✓ where the assessee is a company, any director of the company, partner of firm, association of persons or the firm, or member of the association Hindu undivided family or family, or any relative of such director, partner or member;
- ✓ any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;
- ✓ a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member;

Contd...

- ✓ a company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;
- ✓ any person who carries on a business or profession,—
 - where the assessee being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person; or
 - where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.

Expenditure incurred in CASH - in excess of Rs.20,000/- [Section 40A(3)]

- Where any expenditure incurred and payment is made, in excess of Rs.20,000/- otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, **No Deduction of such expenditure shall not be allowed as a deduction.**
- However, in case of payment made for plying, hiring or leasing goods carriages, the provisions of sub-section (3) and (3A) shall effect, for amount exceeding thirty five thousand rupees and not twenty thousand.
- However, no disallowance under this sub-section shall be made in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

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Exceptions to Section 40A(3) - Rule 6DD:

- + Where payment is made to banking and other credit institutions like RBI/SBI/ Scheduled Banks/Commercial Banks in public and private sector/LIC/UTI/ICICI/IFCI/IDBI/Co-operative bank or land mortgage bank/Primary agricultural credit society/Primary credit society etc.;
- + Payments to Central and State Governments;
- + Payments made by book adjustment by an assessee in the account of payee against money due to assessee for any goods supplied or services rendered by him to payee;
- + Payments through the banking system, like letters of credit, mail transfers, telegraphic transfers, book adjustment in the same bank or between one bank and another, and bills of exchange including hundies made payable to a bank.
- + Payments to a cultivator, grower or producer towards purchase of agricultural or forest produce or produce of animal husbandry (including hides and skins) or dairy or poultry farming or fish or fish products or products of horticulture or apiculture, whether processed or not.

Contd...

- ✚ Payments to a producer towards purchase of his products if they are manufactured or processed without the aid of power in a cottage industry;
- ✚ Payments made to a person who ordinarily resides or carries on business in a village which is not served by any bank;
- ✚ Payments of terminal benefits like gratuity/retrenchment compensation, etc., to employees drawing salary not exceeding Rs.7,500/- per annum;
- ✚ Payments required to be made on a day on which the banks are closed either on account of holiday or strike;
- ✚ Payment made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- ✚ Payment made by an authorised dealer/money changer against purchase of foreign currency or travelers' cheque in normal course of his business;
- ✚ Salary paid to an employee when such employee is temporarily posted for a continuance period of 15 days or more in a place other than his normal place of duty or on a ship, and he does not maintain any account in any bank at such place or ship.

Payment of gratuity to his employees only, when/except by way of any contribution towards an approved gratuity fund
[Section 40A(7)]

- No deduction shall be allowed in respect of any provision (whether called as such or by any other name) made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.
- However the above shall not apply in relation to any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year.

Certain Profits chargeable to Tax Remission or cessation of trade liabilities [Section

- Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee ('the first-mentioned person') and subsequently during any previous year, the first-mentioned person has obtained,—
 - ✓ any amount in respect of such loss or expenditure or
 - ✓ some benefit in respect of such trading liability by way of remission or cessation thereof,
- the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year

Contd...

- Where the benefit received after business is discontinued -
The successor in business has obtained, (whether in cash or in any other manner whatsoever),
 - ✓ any amount in respect of which loss or expenditure was incurred by the first-mentioned person or
 - ✓ some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof,
the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year.

Balancing charge in respect of any building, machinery, plant or furniture [Section 41(2)]

- Where any building, machinery, plant or furniture –
 - ✓ which is owned by the assessee;
 - ✓ in respect of which depreciation is claimed under clause (/) of sub-section (1) of section 32;
 - ✓ which was or has been used for the purposes of business, is sold, discarded, demolished or destroyed
- the excess of its WDV upto the original cost of acquisition shall be treated as business income of the previous year in which the sale etc. took place. Thus the benefit of depreciation availed stand withdrawn in such cases.

Sale of Capital Asset used for Scientific Research [Section 41(3)]

- Where an asset representing expenditure of a capital nature on scientific research is sold, without having been used for other purposes, and the proceeds of the sale [together with the total amount of the deductions made under clause (i) or, as the case may be, the amount of the deduction under clause (ia) of sub-section (2), or clause (c) of sub-section (213), of section 35] exceed the amount of the capital expenditure, the excess or the amount of the deductions so made, whichever is the less, shall be chargeable to income-tax as income of the business or profession of the previous year in which the sale took place.
- if an asset which is initially purchased for the purpose of scientific research is utilized for business purposes on completion of scientific research, and later on it is sold or transferred then Section 41 (3) is not applicable.

Recovery of Bad Debt [Section 41(4)]

- Bad debt written off (also allowed earlier) and subsequently recovered - is treated as income of the previous year in which the amount actually recovered.
- if the amount subsequently recovered on any such debt or part is greater than the difference between the debt or part of debt and the amount so allowed, the excess shall be deemed to be profits and gains of business or profession of the previous year in which it is recovered, whether the business or profession in respect of which the deduction has been allowed is in existence in that year or not.

Amount withdrawn from special reserve AND Set off of losses of discontinued business

- *Amount withdrawn from special reserve:*

- Where a deduction has been allowed in respect of any special reserve created and maintained under clause (viii) of sub-section (1) of section 36, any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income-tax as the income of the previous year in which such amount is withdrawn.

- *Set off of losses of discontinued business:*

- Where the business or profession referred to in this section is no longer in existence and there is income chargeable to tax under sub-section (1) sub-section (3) or sub-section (4) in respect of that business or profession any loss not being a loss sustained in speculation business which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall so far as may be, be set off against the income chargeable to tax under the sub-section aforesaid.

Certain deductions to be allowed only on Actual Payment [Section 43B]

- A deduction is allowable under in respect of the following expenditure (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) **only in that previous year** in which **such sum is actually paid** by an Assessee –
 - ✚ any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or
 - ✚ any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or
 - ✚ any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or **commission**

Contd.

- + any sum payable by the assessee as interest on any loan or borrowing from any public financial institution;
- + any sum payable by the assessee as interest on any term loan from a scheduled bank;
- + any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee

Payment made before due date of filing the Return –

Nothing contained in this section shall apply in relation to any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under sub-section (1) of section 139 in respect of the previous year in which the liability to pay such sum was incurred as aforesaid and the evidence of such payment is furnished by the assessee along with such return.

MAINTENANCE OF ACCOUNTS BY CERTAIN PERSONS CARRYING ON PROFESSION OR BUSINESS [Section 44AA]

- Every person Carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.
- if his **income** from business or profession **exceeds one lakh twenty thousand rupees** or his **total sales, turnover or gross receipts**, as the case may be, in business or profession exceed or **exceeds ten lakh rupees** in any one of the three years immediately preceding the previous year; or
- where the business or profession is newly set up in any previous year, if his income from business or profession is likely to exceed one lakh twenty thousand rupees or his total sales, turnover or gross receipts, as the case may be, in business or profession are or is likely to exceed ten lakh rupees, during such previous year; or

Contd.

- Where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD or section 44AE or section 44AF or section 44BB or section 44BBB, and the assessee has **claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business**, during such previous year, keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.

The books of account and other documents are namely –

- ✓ a Cash book;
- ✓ a journal (in case of mercantile system of accounting);
- ✓ a ledger;
- ✓ carbon copies of bills, whether machine numbered or otherwise serially numbered;
- ✓ original bills wherever issued to the person and receipts in respect of expenditure incurred by the person or, where such bills and receipts are not issued and the expenditure incurred does not exceed fifty rupees, payment vouchers prepared and signed by the person

Audit of Accounts of Certain Persons carrying on business or profession [Section 44AB]

Every person –

- carrying on business shall, if his total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds Rs. 1 crore (one crore rupees) in any previous year; or
- carrying on profession shall, if his gross receipts in profession exceed Rs.25,00,000/- (Twenty Five lakh rupees) in any previous year; or
- Where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD or section 44AE or section 44AF or section 44BB or section 44BBB, and the assessee has claimed his income to be lower than the profits or gains so deemed to be the profits and gains of his business, during such previous year get his accounts of such previous year audited by a chartered accountant before the specified date (as specified under section 139(1) for furnishing of Return) and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant.

Special provision for computing profits and gains of business on presumptive basis

- In **[Section 44AD]** case of an eligible assessee engaged in an eligible business, a **sum equal to eight per cent of the total turnover or gross receipts** of the assessee in the previous year on account of such business or, a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee, **shall be deemed to be the profits and gains** of such business chargeable to tax under the head “Profits and gains of business or profession”.
- If claiming this presumptive profit, then No further deductions u/s 30 to 38 is allowable;
- No Books of a/c required to be maintained
- No Audit required u/s 44AB
- If lower income or profit (lower than 8%) is claimed by assessee than specified by these presumptive sections then Books to be maintained u/s 44AA and Audit to be done u/s 44AB.

Special Provision For Computing Profits And Gains Of Business Of Plying, Hiring Of Leasing Goods Carriages [Section 44AE]

If any Assessee –

- **who owns not more than ten goods carriages** at any time during the previous year and
- who is engaged in the business of plying, hiring or leasing such goods carriages,
the income of such business chargeable to tax under the head "Profits and gains of business or profession" shall be deemed to be the aggregate of the profits and gains, from all the goods carriages owned by him in the previous year, computed as under –
- being a **heavy goods vehicle**, shall be an amount equal to **Rs. 5,000** for every month or part of a month
- **other than a heavy goods vehicle**, shall be an amount equal to **Rs.4,500** for every month or part of a month

Contd...

- In above both cases if higher income is returned by the assessee, then such income to so returned will be taken.
- No separate deduction will be allowed under section 30 to 38.
- No depreciation will be allowed separately and written down value will be deemed to have been calculated after allowance of depreciation.
- Provision of Sections 44AA and 44AB shall have no application, so far as they related to the business referred to aforesaid and in computing monetary limits under those section, the gross receipts/higher income will be excluded.

SUMMARY OF PRESUMPTIVE INCOME AND PRESUMPTIVE TAXATION

Section	Category	Presumptive Income	Conditions
44AD	Special provision for computing profits and gains of business on presumptive basis	@ 8 % of Total Turnover or Gross Receipt	Limit of Turnover – Rs. 60 Lakh # 1, 2 & 3
44AE	Business of Plying, Hiring or Leasing of goods carriages having carriages up to 10 only	For Heavy Vehicles – Rs.5,000/- per month For Other Vehicles – Rs.4,500/- per month	# 1, 2 & 3
44B	Shipping Business in case of Non-Resident	@ 7.5% of Gross Receipt	Sec. 28 to 43A – Not Applicable
44BB	Business of exploration etc. of Mineral Oils	@ 10% of Gross Receipt	Sec. 28 to 43A – Not Applicable
44BBA	Business of Operation of Aircrafts in case of Non-Residents	@ 5% of Gross Receipt	Sec. 28 to 43A – Not Applicable

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Section	Category	Presumptive Income	Conditions
44BBB	Foreign Companies in business of civil construction / erection of Plants etc. in turnkey projects	@ 10% of Gross Receipt	Sec. 28 to 43A – Not Applicable
44C	Deduction of Head Office expenditure in case of Non-Residents	Lower of – @ 5% of adjusted total Income OR Expenses incurred attributable to Business in India	-
44D	Royalties and Fees for Technical Services in case of Foreign Companies	Entire expenses if TDS deducted thereon	Sec. 28 to 44AC – Not Applicable
44DA	Royalties and Fees for Technical Services in case of Non-Residents	Entire expenses if TDS deducted thereon	Sec. 28 to 44AC – Not Applicable

Contd

Conditions applicable: ...

1. No Deduction under section 30 to 38
2. In case of Firms, Salary to Working Partner/Interest to Partners to be allowed
3. No Books of Accounts required to be maintained
4. No Audit required under section 44AB
5. If lower income or profit is claimed by assessee than specified by these presumptive sections then Books to be maintained under section 44AA and Audit to be done under section 44AB

Special Provision for Computing Deductions in the case of Business re-organization of co-operative banks [Section 44DB]

- Where business reorganization of a Co-operative bank has been taken place during the financial year, the deduction under section 32, section 35D, section 35DD or section 35DDA shall be allowed.
- The amount of deduction allowable to the Predecessor co-operative bank under section 32, 35D, 35DD or 35DDA shall be determined in accordance with the formula –

$$A*B/C$$

Where,

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganization had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganization; and

C = the total number of days in the financial year in which the business reorganization has taken place.

Contd...

- The amount of deduction allowable to the Successor Co-operative bank under section 32, 35D, 35DD or 35DDA shall be determined in accordance with the formula –

$$A*B/C$$

- Where,

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganization had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganization and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganization has taken place.

Speculative Transactions

- ✚ "Speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

Followings are not Considered as Speculative Transactions –

- ✘ A contract in respect of raw materials or merchandise entered into by a person in the course business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him;
- ✘ a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations;
- ✘ a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss;
- ✘ an eligible transaction in respect of trading in derivatives carried out in a recognised stock exchange.

INCOME FROM UNDISCLOSED SOURCES

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- CASH CREDIT [Section 68]: **TO BE ADDED IN INCOME**
- ❖ Where any sum is found credited in the books of account maintained by the assessee, the Assessee is required to give to the assessing officer an explanation about the nature and source of such amount credited.
- ❖ If the assessee offers no explanation as to its nature and source of such sum credited or the explanation offered by the Assessee is not found satisfactory in the opinion of the Assessing Officer then such sum credited may be charged to Income Tax as income of the assessee of that previous year.
- Unexplained money etc. [Section 69A]:
- ❖ Where in a financial year, the assessee is found to be the owner of any money, bullion, jewellery or other valuable, and such asset is not recorded in the books of account, if any maintained by the assessee and he offers no *Explanation* about its nature and source or the *Explanation* offered is not satisfactory in the opinion of the Assessing Officer, then such asset may be deemed to be the income of assessee for such financial year.

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- Investment etc. not fully disclosed in books of account [Section 69B]:
 - ❖ In a financial year the assessee has made investments or is found to be its owner, and the Assessing Officer finds that it is not fully recorded in the books of account and the assessee offers no *Explanation* regarding such excess investment which is not recorded in books of account or the same *Explanation* is not satisfactory in the opinion of the Assessing Officer, then the excess may be deemed as income of assessee for that financial year.
- Unexplained Expenditure [Section 69C]:
 - In a financial year where an assessee incurs any expenditure and –
 - ✓ offers no explanation regarding its source, or
 - ✓ the explanation offered is not found satisfactory in the opinion of the Assessing Officer

Then

- The amount of expenditure may be deemed to be income for that financial year, and
- Such expenditure shall not be allowed as a deduction under any head of Income

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- **Amount Borrowed or Repaid in Hundies [Section 69D]:**
 - ❖ The amounts borrowed or repaid on Hundies or bills of exchange are required to be borrowed or repaid through an account payee cheque drawn on a bank only
 - ❖ Where an amount is borrowed or repaid in respect of a Hundi - otherwise than through an account payee cheque drawn on a bank, such borrowing or repayment shall be deemed to be income of that person for the previous year in which it was borrowed / repaid.
 - ❖ If borrowing is so treated as income once, it shall not be assessed again when repaid. The repayment for these purposes shall also include Interest.