

Key Issues in the Presumptive Taxation Scheme of Section 44AD



CA. Shashank Ajay Mehta

The author is a member of the Institute. He can be reached at shashankmehta1695@gmail.com and eboard@icai.in

This article attempts to highlight key issues which have surfaced over the period of time under the presumptive taxation scheme of section 44AD of the Income-tax Act, 1961. Though the presumptive taxation scheme was introduced to simplify the law for small business/profession, the legal position to certain aspects of these provisions are still subject to diversified views and interpretation. An attempt is made to explain these aspects with illustrations and after considering judicial precedents on the said matters. Read on...

Introduction

Considerate about the hardship faced by small business classes in maintaining of books and other records, getting it audited and other compliances; section 44AD and section 44AE of the Income-tax Act, 1961 ("the Act") were introduced *vide* Finance Act, 1994 w.e.f. 01.04.1994. Over these years, there have been several amendments in these presumptive provisions apart from new provisions being introduced. In this article, we shall be attempting to address certain prominent intricacies prevailing in section 44AD.

Section 44AD provides that an eligible assessee who is engaged in an eligible business may opt for presumptive taxation and can declare a minimum of 8%

of his turnover/gross receipt as income under chapter IV-D. Proviso to sub-section (1) provides for incentivized deemed profit rate of 6% in respect of that part of turnover/receipt which is received by specified banking channel or specified electronic mode.

Imperative to understand that section 44AD does not operate independently and has interplay with other provisions like section 44AA (maintenance of accounts) and section 44AB (requirement to get accounts audited) which we shall be dealing herewith.

I. Section 44AD applies only to 'business' or even to 'profession'?

Sub-section (6) specifically provides that a person





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carrying on any profession as referred to in section 44AA(1) cannot avail benefit of section 44AD. However, what if a person is carrying on a profession which is not covered by sub-section (1) of section 44AA, can such professional opt for section 44AD?

The title of section 44AA reads as '*Maintenance of accounts by certain persons carrying on profession or business*'. Further, section 44AA(1) deals with certain specific profession whereas section 44AA(2) deals with 'business' or 'profession'.

Similarly, clause (a) of section 44AB specifically provides for threshold limit of 'business' to get accounts audited and clause (b) of section 44AB specifically provides for threshold limit of 'profession' to get accounts audited.

Thus, it can be observed that the legislature in its wisdom has specifically used the term 'business'

or 'profession' wherever required. Now, for the purpose of section 44AD the legislature has only used the term 'business'; **thus, in my opinion provisions of section 44AD shall be applicable only to an activity which qualifies to be called as 'business' and not for 'profession'.**

To support this contention, reference may also be drawn from the decision of *Hon'ble Supreme Court in the case of G.K.Choksi & Co. v. CIT [2007] 295 ITR 376 (SC)* wherein it was held that wherever Legislature intended that benefit of a particular provision should be for both business or profession, it has used the words 'business or profession' and wherever it intended to restrict benefit to either business or profession, it has used either word 'business' or word 'profession'. The scope of the word 'business' as appearing in section 32(1) (iv) does not include in its word 'profession'. The ratio laid down in this case may even apply to the present intricacy.

Further, can a partner of a firm opt for section 44AD w.r.t. the remuneration and interest earned from the firm?

Hon'ble High Court of Madras in the case of Anandkumar vs. ITO [2021] 430 ITR 391

(*Madras HC*) held that a partner of a firm in his individual capacity cannot be said to be carrying on business just on account of remuneration/interest received from such firm. Therefore, the remuneration and interest received by the assessee from the partnership firm cannot be termed to be a turnover/gross receipts of the assessee.

Accordingly, a partner of a firm cannot opt for section 44AD for the remuneration/interest earned.

II. Difference in actual income and presumed income

On plain reading of sub-section (1) of section 44AD it can be ascertained that the section allows the eligible assessee to declare profit of 8% of the turnover/gross receipt or such higher amount as claimed to have been earned by such assessee.

However, a vital question which is asked by the taxpayers is whether in case higher profit is earned (i.e.,



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more than 8%) then is it mandatory to offer such a higher rate of profit only.

Firstly, on interpretation of the phrase '*a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee*' it can be ascertained that the legislature has left upon the assessee to determine and declare the deemed rate of percentage, subject to minimum of 8%. Further, the use of phrase '*sum claimed to have been earned, shall be deemed to be the profits and gains of such business*' itself leaves some room for discretion upon the Assessee. Here, the Assessee has to determine the income by himself based on his estimation. This does not mean that he should maintain each and every minute detail so as to substantiate the rate of profit, if that was so then the very purpose of presumptive taxation gets defeated.

By inserting the word 'claimed' the legislature has left the discretion/estimation upon the Assessee. Further, the word 'presumptive' as used in the title of the section itself suggests that income shall be determined based on 'estimation'.

Because it is not obligatory to adopt a profit rate of 8% only; hence, it is imperative that the businessmen, based on their understanding and

prudence, offer the business income at the profit rate which they are of the view, their business might have reasonably generated (subject to minimum of 8%).

If the legislature is entrusting the small businessmen with self-assessment of tax on presumptive basis and provides easement from complex compliance requirements, then it becomes a moral obligation upon such masses to act conscientiously and respect the law.

However, at this juncture it is pertinent to refer to the decision of *Hon'ble High Court of Allahabad in the case of CIT vs. Nitin Soni [2012] 21 taxmann.com 447 (Allahabad)* wherein while interpreting identical provisions of section 44AE it was held that the words '*shall be deemed*' are the keys words and they are indicative of the legislative intent that the tax shall be chargeable on presumptive income. Such presumptive schemes are made just to complete the assessment without further probing. The presumed deemed income is taxable, such deemed income may be more or less than the actual income. Such an assessee is not required to maintain any account books. **Thus, even if, its actual income in a given case, is more than income calculated as**

per presumptive scheme, cannot be taxed.

Hon'ble Punjab & Haryana High Court in case of CIT Vs. Surinder Pal Anand [2010] 192 Taxman 264, held that once under a special provision, exemption from maintaining books is provided and rate of 8% of gross receipts itself is the basis for determining the taxable income then the assessee is under no obligation to explain individual entries of bank unless such entry had no nexus with the gross receipts.

In case of Nandlal Popli Vs. DCIT [ITA no. 1161&1162/Chd/2013], Hon'ble Chandigarh ITAT held that if 8% of gross receipts is 'deemed' income then remaining 92% is also 'deemed' expenditure for the purpose of taxation and the actual income/expenditure may be varying. Assessing officer cannot ask the assessee to prove the expenditure to the extent of 92%.

III. Ineligibility of 5 years

Sub-section (4) of section 44AD provides that if for any assessment year the Assessee has opted for provisions of section 44AD and if anytime in immediately succeeding 5 assessment year such assessee declares profit not in accordance with provisions of section 44AD;

then in such circumstances, the said assessee will be ineligible to opt for the benefit of presumptive taxation of section 44AD for 5 Assessment Years immediately succeeding the year in which the Assessee decides not to declare profit in accordance with section 44AD.

Example

Mr. RST claims to be taxed on presumptive basis under Section 44AD for AY 2019-20. For AY 2020-21 and 2021-22 also he offers income on the basis of presumptive taxation scheme. However, for AY 2022-23, he did not opt for presumptive taxation Scheme. In this case, he will not be eligible to claim benefit of presumptive taxation scheme for next five Assent Years, i.e., from AY 2023-24 to 2027-28.

In other words, once provisions of section 44AD are opted for an Assessment Year, the same shall be opted for subsequent 5 assessment years also; otherwise the said assessee will be ineligible to avail the benefit for 5 Assessment Years subsequent to the Assessment Year of default, moreover he would also be required to get his accounts audited pursuant to sub-section (5) of section 44AD.

IV. Requirement of conducting audit

Sub-section (5) of section 44AD was substituted *vide*

Finance Act, 2016 w.e.f. AY 2017-18. However, before analyzing the present provisions of sub-section (5) of section 44AD it is important to understand the requirement for audit under the erstwhile law.

Requirement for Audit under section 44AD prior to AY 2017-18

The erstwhile sub-section (5) reads as follows:

(5) Notwithstanding anything contained in the foregoing provisions of this section, an eligible assessee who claims that his profits and gains from the eligible business are lower than the profits and gains specified in sub-section (1) and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under sub-section (2) of section 44AA and get them audited and furnish a report of such audit as required under section 44AB.

The erstwhile provision for audit was plain and clear and requirement for maintaining books of accounts and getting them audited arose only when both of these conditions were fulfilled:

1st condition: The assessee claims that his profit rate is lower than the rate of profit

provided in sub-section (1) [i.e., 8%]

2nd condition: Such assessee's total income exceeded the minimum amount not chargeable to tax [i.e., basic exemption limit].

Thus, for any given year assessee declared profit at lower rate than he was required to maintain books of accounts and get them audited **for that particular Assessment Year only**. From the subsequent year, the assessee can again opt for presumptive taxation and there was no ineligible criteria for re-opting section 44AD.

Presently, similar provision exists in section sub-section (4) of section 44ADA where if profits are declared at the rate lower than that prescribed (i.e., 50%) then tax audit requirements is attracted.

Requirement for Audit under section 44AD prior from AY 2017-18

The present sub-section (5) reads as follows:

(5) Notwithstanding anything contained in the foregoing provisions of this section, an eligible assessee to whom the provisions of sub-section (4) are applicable and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under sub-section (2) of

section 44AA and get them audited and furnish a report of such audit as required under section 44AB.

As per the present provisions, an assessee is required to maintain books of accounts and get them audited and furnish audit report if both of the following conditions are fulfilled.

1st condition: Provisions of sub-section (4) are attracted (i.e., opting out of section 44AD).

2nd condition: Such assessee's total income exceeded the minimum amount not chargeable to tax [i.e., basic exemption limit].

As already discussed before, the first consequence of not opting for section 44AD in any of the subsequent 5 assessment year from a particular base assessment year will attract ineligibility to opt for section 44AD for 5 Assessment Years immediately subsequent to the Assessment Year in which section 44AD was not opted.

Now, the second consequence is that the Assessee will be required to maintain books of accounts, get them audited and furnish audit report (only if his total income exceeds the basic amount not chargeable to tax).

Moreover, clause (e) of section 44AB also specifically provides that in case provisions of sub-section (4) are applicable and income exceeds the maximum amount which is not chargeable to income-tax then such assessee shall get accounts

audited and furnish audit report.

Thus, as per the existing provision, the question of getting accounts audited will arise only if provisions of sub-section (4) are attracted (subject to the total income of the assessee).

Further, in the erstwhile provisions the requirement of maintaining books of accounts and audit was restricted only for the relevant Assessment Year in which profits lower than the prescribed rate was declared by an assessee and not for any other subsequent year.

However, as per the existing provisions of sub-section (5) once provisions of sub-section (4) are applicable, maintaining of books and getting them audited applies. However, the moot issue is when the ineligibility provisions of sub-section (4) are attracted, is it applicable for subsequent 5 assessment year. By strict interpretation of sub-section (4) and sub-section (5) of section 44AD read with clause (e) of section 44AB it can be said that once provisions of sub-section (4) of section 44AD is applicable the assessee will be liable to maintain books of accounts, get them audited and furnish report for total of 6 assessment Years (i.e., the AY in which section 44AD is not opted + subsequent 5 assessment years).

The above position is clarified by CBDT in one of the FAQs published on their official website. The same is reproduced below:



Clause (e) of section 44AB also specifically provides that in case provisions of sub-section (4) are applicable and income exceeds the maximum amount which is not chargeable to income-tax then such assessee shall get accounts audited and furnish audit report.

“If a person adopts the presumptive taxation scheme but he opts out from the scheme in any of the subsequent five years, then what are the consequences?”

If a person opts for presumptive taxation scheme, then he is also required to follow the same scheme for the next 5 years. If he failed to do so, then presumptive taxation scheme will not be available for him for the next 5 years.

He is required to keep and maintain books of account and he is also liable for tax audit as per section 44AB from the AY in which he opts out from the presumptive taxation scheme. [If his total income exceeds maximum amount not chargeable to tax]”

The use of the word ‘from’ instead of ‘for’ in the answer to the above FAQ clearly

suggests that the requirement of maintaining books of accounts and audit applies for a total of 6 assessment years.

This provision is somewhat more stringent in nature and needs to be reconsidered because, a small businessman cannot be expected to bear the cost of audit and other compliances even for the future assessment years. At the most he may be considered ineligible for availing the benefit of presumptive taxation for 5 years but getting books of accounts audited for these 5 years may prove to be burdensome.

As per the erstwhile provisions the requirement of audit was only dependent upon one factor i.e., whether the profits are declared at a lower than the prescribed profit rate. Whereas, as per the existing provisions one must bear in mind following factors while determinate applicability of audit:

- a) Whether assessee had opted for section 44AD in the preceding Assessment years?
- b) If yes, then for relevant assessment year whether he desires to opt for section 44AD or he desires to opt out? [if opts to stay under section 44AD – no requirement for audit; if desires to opt out- audit applicable]
- c) Whether the relevant Assessment Years is falling within the time span of ineligible term of 5 years – [If yes, Audit applicable].

Can there be a scenario where assessee declares profit lower than the prescribed profit rate but still is not liable to do audit?

Yes, in the following scenarios it is possible that assessee may declare lower profit rate but still is not required to conduct audit.

Scenario No.1

It is the first year of business, turnover is up to Rs. 1 crore (limit of audit as per section 44AB); assessee maintains proper books of accounts and declare lower profit than 8%. In this scenario, provisions of sub-section (4) are not attracted because it is the first year and there is no preceding year in which section 44AD might have opted so as to opt out in the relevant assessment year.

Scenario No. 2

Business of the assessee is continuing for several years, however in each of these preceding years the assessee has either gotten his accounts audited u/s. 44AB or has maintained proper books of accounts but was not subject to audit (say, turnover was upto Rs. 1 crore).

In this scenario also if assessee declares profit at the lower rate (by duly maintaining books of accounts), he still won't be attracted by provisions of sub-section (4) because he had never opted in for section 44AD so as to opt out of it.

Accordingly, even if lower profit is declared, audit as per clause (e) of section 44AB read with



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sub-section (5) of section 44AD will not be attracted.

Pertinent to mention that compliance of maintaining books of accounts as per the provisions of section 44AA needs to be kept in mind in both of the above scenarios.

Conclusion

Though the presumptive taxation scheme was introduced to simplify the law for small business/ profession. However, the legal position to certain aspects of these sections is still subject to multiple views and interpretation. A layman who wishes to file his income tax return by himself without professional help cannot be expected to know these intricacies and rigors of presumptive taxation scheme, especially the ineligibility and audit requirement as provided in sub-section (4) and (5) of section 44AD. There is certainly a need for further clarifications and easement with regards to certain aspects of these presumptive taxation schemes. ■■■