

Critical Analysis of New Section 44AD

(inserted by Finance (No 2) Act, 2010)

Till the 31st March, 2010, the Chapter Profit & gains of Small business on Presumptive Basis was having majorly 3 sections for Indian entities.

- Section 44AD civil construction
- Section 44AE Transporters
- Section 44AF Retail Traders

From 01.04.2010 the honorable finance minister Mr. Pranab Mukharjee has kept the last two intact and has amended the first section i.e. 44AD along with 5 sub sections to facilitate the business operations of small taxpayers.

Earlier this section was extended to civil constructions only but now this section has been extended to all small businesses.

Apparently the section 44AD is very straightforward, but has lots of implications on the taxpayers.

I have tried to analyse the section in all its tiny parts and upto all its implications.

The new section 44AD is as follows:

44AD (1)

"Notwithstanding anything to the contrary contained in sections 28 to 43C, in the 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, as the case may be, 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".

For better understanding of sub section 1 of newly inserted section 44AD, we must know the meaning of following:

- Eligible Business
- Eligible Assessee
- Total Turnover/Gross receipts
- Significance of Word Gross Receipts
- Claimed to have been earned

Who is an Eligible Assessee?

(explanation 1 to Section 44AD)

Eligible Assessee means:-

- (1) an individual
- (2) Hindu undivided family
- (3) a partnership firm
- (4) who is a resident.

but does not include a limited liability partnership firm as defined under clause (n) of sub-section (1) of section 2 of the Limited Liability Partnership Act, 2008 (6 of 2009).

Additional Criteria:

A assessee who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA under the heading "C. - Deductions in respect of certain incomes" in the relevant assessment year;

Who all are the assesseees not covered under Section 44AD?

- Individual who is not resident
- HUF who is not Resident
- Association of Person

- Firm having non resident Status.
- A local Authority
- A co-operative Society
- Limited Liability Partnership bith Indian as well as Foreign
- Companies both Domestic and Foreign comapny
- Every Artificial Juridical Person
- Individual/HUF/Firms claiming deduction under chapter III of the Act i.e Section 10A,10AA,10B,10BA relating to units located in FREE Trade Zone, Hardware & Software Technology Park etc.
- Individual/HUF/Firms claiming deduction under Chapter VIA Part-C (deductions in respect of certain Incomes) i.e Section 80H to 80TT

After understanding the meaning of Eligible assessee, now we move to Eligible Business:

What is eligible Business ?

“eligible business” means,—

- (i) any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE; and
- (ii) whose total turnover or gross receipts in the previous year does not exceed an amount of [sixty lakh rupees].

Meaning of the above section:

- Eligible Business covers any business except Transport Business (Transportation Business has special treatment under section 44AE).

This provision is straightforward and includes all the business whether it is:

- Manufacturing
- Trading
- Wholesale
- Retail
- Job Work

- Service business
- Speculative/ Non speculative.

The only criteria is that, the turnover of eligible Business should not exceed Rs. Sixty lacs in the previous Year.

What is not included in the Business?

The profession is not included in the business because:

- -There is specific reference to the word "**Business**" in Section 44AD, which does not include profession, and
- There is specific Turnover limit of Rs. 15 Lakhs for Profession under section 44AB, which means that profession is totally separate from "**Business**".

What do you mean by Total Turnover/Gross Receipts?

- Total Turnover / Gross Receipts are amount received/receivable from clients in respect of sale of Previous Year.
- Section 145 relating to Method of Accounting applicable to Section 44AD As per this section the assessee has an option to choose either Mercantile or cash method.
- Gross Receipts are the amounts received from clients for the services provided or to be provided and does not include the value of material supplied by the client.

What are the receipts which form Part of Turnover?

- 1) Sales Tax, excise duty, Cess, and other Levy.
- 2) Sales of unusables empties and Packages.
- 3) Service Charges charged for delivery

Then what are the Receipts which does not form Part of Turnover?

- 1) Sale of Property, Plant and equipments
- 2) Advance received from customers, deposits Received or retention money.
- 3) Any Security, retention or other deposit obtained from employees.

4) Interest Income or other similar receipts

5) Value of Inventory

How to calculate limit of 60 lakhs?

- The Total Turnover and Gross receipts should be less than 60 lacs in the previous Year.
- It includes all the eligible businesses carried on by a eligible assessee during the previous year and the 60 lakhs will be for all of them cumulatively.

Few Examples:

1. X, A Resident individual, is carrying on three eligible business, the turnover of which is as under :
 - Business A (Manufacturing) Rs.25 Lac
 - Business B(Trading) Rs.15 Lac
 - Business C (Service) Rs.25 Lac

Whether section 44AD applicable on him?

The Answer is **NO** because turnover of eligible business exceed Rs.60 Lakhs.

2. X, A Resident individual, is carrying on two business, the turnover of which is as under :
 - Business A (Eligible Business) Rs.55 Lacs
 - Profession Rs. 10 Lacs
 - Business B(Transport u/s 44AE) Rs.6 Lacs

Section 44AD and 44AE both are applicable, as profession is not included under section 44AD and section 44AD and 44AE are independent of each other.

Who bears the onus of proof to prove the turnover?

- The onus of proof is on the assessee. It is his duty to prove the turnover. If the assessee is maintaining the books of accounts, then it will be easy for him to prove the same, but if he is not maintaining the books of accounts, then it will be very difficult for him to prove, because there is no specific provision for the same.

What documents you should provide to the AO to prove the turnover?

- - copies of invoices issued during the PY
- - copies of cash memo
- - copies of Purchase bill
- - Bank statement
- - Inventory details, if any maintained
- - Average G.P rate applicable to Particular business
- - Returns filed under sales tax/vat/excise/service Tax laws.

What is the meaning of **"Notwithstanding Anything to contrary contained in section 28 to 43C"**

- Section 44AD(1) starts with wording "Notwithstanding Anything to contrary contained in section 28 to 43C" it means section 28 to 43C of Income Tax Act, 1961 is not applicable on eligible assessee carrying on small business.
- The some of the benefits & losses of this wording is enumerated as under by way of examples :

Few examples:

- Ramesh has paid Rs.28000/- for purchase of goods in cash. No disallowance can be made under section 40A(3) for the same.
- Suresh has paid Rs.42000/- to transporter for freight in cash. No disallowance can be made under Section 40A (3).
- Dinesh has contributed certain sum to national Laboratory which qualifies for deduction under section 35(2AA), if he chooses section 44AD , he will not eligible for benefit of this section.
- Ganesh has recovered certain bad debts written off in earlier years of Rs.35000/-. It may not be added in specified amount declared.

What is the meaning of Claimed to have been earned?

By the introduction of these words in section 44AD(1), the legislature shows his intention to accept specified income as returned income even if higher sum is earned by eligible assessee unless it is claimed by assessee in his Income Tax Return.

Example

X is carrying on small business . The Turnover is Rs.50 lakh. The profit as per his books or calculation is Rs.8 Lakhs. However, he opts to return the income under section 44AD @ 8% i.e Rs.4 Lakh. The proceeds of business are deposited in a bank account.

Can the AO assess the difference amount as undisclosed income?

No, The Answer is No due to following reasons:

- The section has been amended for the benefit of the assessee.
- The word "Claim" signifies the right of assessee, and it is not an obligation of the assessee.

The distinction between Right and obligation is very necessary here.

The language of section of section 44AD(1) requires claims to have been made by an assessee for returning higher income.

If there is no claim made by assessee in return for higher income, there is no higher income.

JUDICIAL DECISIONS

- The following judicial decisions support this view:
 - Samta construction Co V. Pawan Kumar sharma(2000) 244 ITR 845 (MP)
 - CIT V. ARVIND MIILS LTD(1992) 193 ITR 255(SC)
 - AC,BANGLORE VELLIAPA TEXTILES LIMITED AND ANOTHER (2003) ITR 560(SC)

Section 44AD(2)

(2) Any deduction allowable under the provisions of sections 30 to 38 shall, for the purposes of sub-section (1), be deemed to have been already given full effect to and no further deduction under those sections shall be allowed :

Provided that where the eligible assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed under sub-section (1) subject to the conditions and limits specified in clause (b) of section 40.

Computation of Taxable Profit u/s 44AD in case of Partnership Firm

Profit from Business

Particulars	Amount
44 AD (Say the turnover is Rs.40 lacs) then the income would be 8%	3,20,000
Less:	
Interest allowable u/s 40(b)	1,00,000
Remuneration to partners allowable	1,00,000
Total Income of the Firm U/s. 44AD	1,20,000

Section 44AD (3)

"The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years."

Few Examples

Tapan an Resident individual having a machinery of RS.1,00,000/- as on 31-03-2011 eligible for depreciation under section 32 @ 15%.In A.Y 2011-12, he opts for Section 44AD. In the Assessment Year 2012-13, his turnover is Rs.65 lakh, so he calculated his profit as per normal provisions of the Act. In A.Y 2013-14, he again opts for Section 44AD, In this Assessment year he sold the Assets for Rs.80,000/-.

Calculation of WDV:

Particulars	Amount
WDV as on 31-03-2011	1,00,000

Less: Depreciation @ 15%	15,000
WDV as on 31-03-2012	85,000
Less: Depreciation @ 15%	12,750
WDV as on 31-03-2013	72,250
Less : Sale Price	80,000
WDV as on 31-03-2014	Nil

Calculation of Capital Gains

Particulars	Amount
Sale Consideration	80,000
Less WDV as on 31-03-2013	72,250
Short Term capital gain U/s 50	7,750

Whether the Assessee can carried forward unabsorbed depreciation?

- As per the subsection (3) of section 44AD, the Act clearly states that the Depreciation is deemed to have been allowed u/s. 32 and the same has been deemed to have been set off against the profit. Hence the same cannot be allowed to be allowed to be carried forwarded.

Section 44AD(4)

"The provisions of Chapter XVII-C shall not apply to an eligible assessee in so far as they relate to the eligible business."

- Chapter XVII-C deals with provisions relating to Advance Payment of Tax.

On plain reading of this subsection, we conclude that eligible assesseees are exempt from payment of Advance Tax. But the second part of Provision creates a blunder so far it relates to eligible business, which creates lot of doubt.

The following example will better clear your understanding :

Profit under section 44AD (Say Turnover is RS.50 lakhs)	Rs 4.00 lac
Interest Income	Rs.5.00 Lac
Total Income	Rs.9.00 lac

In this situation, whether the assessee is exempted from provisions of advance tax in all or whether the assessee is liable to Pay advance Tax on interest income of Rs.5.00 lac.

From the understanding of Law, it is clear that the assessee have to pay advance tax on interest income of Rs.5.00 lac. But how this tax calculation is to be made is no where define in legislature?

SECTION 44AD(5)

This sub-section has created lots of doubts and debates in the mind of all the CAs and Tax consultants. This Sub-section is very much important for all the very small businessmen. Please give attention and read it care fully.

"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 assessee is bound to get the books of accounts audited, if the following two conditions are satisfied:-

1. His profits and gains from the eligible business are lower than the profits and gains specified in sub-section (1) i.e. his net profit is lower than 8% of turnover.

and

2. Whose total income exceeds the maximum amount which is not chargeable to income-tax.

Here see both the conditions are simultaneous and the assessee required to get his accounts audit only and only if his profits from the business u/s 44AD are lower than 8% of this turnover and further his total income is more than maximum amount which is not liable to tax.

Though the proposed provision is applicable from assessment year 2011-12 but if for example and to understand the effect of this provision we presume the minimum amount which is not liable to tax is Rs. 1.60 Lakh and the turnover of the eligible business is Rs.38 Lakhs and the Net profit is Rs. 1.52 lacs which comes to only 4% hence the first condition for the compulsory audit is there but since the

income is only Rs.1.52 Lakhs hence the second condition of section 44AD(5) is not complete, hence the audit is not mandatory.

If whatever mentioned above is the intention of law then in most of the cases where the income of the assessee is below taxable limit, they are not required to get their books of accounts audited, even if the rate of profit is below 8%,

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