LESSON 7
PROFITS AND GAINS OF BUSINESS OR PROFESSION

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STRUCTURE

7.0 INTRODUCTION

The income from business and profession is known as profit and gains. While calculating the profit and gains, we deduct various expenses from it. The expenses to be deducted for calculating the gain are defined in the income tax act. Sections 30 to 37 cover expenses, which are expressly allowed as deduction while computing business income, sections 40, 40A and 43B cover expenses which are not deductible.

Expenses deductions under section 30 to 37 are of two types. The first is specific deductions which are covered under section 30 to 35 and second is general deductions which are covered under section 36 and 37. Specific deductions are allowed only to some of the businesses while general deductions are allowed to all the businesses.

There are certain provisions which allow an assessee to calculate the profit on the presumptive basis, i.e., the profit is presumed on certain basis. These provisions are contained under section 44.

7.1 OBJECTIVES

After going through this lesson you should be able to understand:

- Calculation of taxable profit and gains
- Calculation of depreciation
- Various specific deductions allowed
- Various general deductions allowed
- Presumptive taxation provisions

7.2 BASIS OF CHARGE

Under section 28, the following income is chargeable to tax under the head "Profits and gains of business or profession":

a. profits and gains of any business or profession;

b. any compensation or other payments due to or received by any person specified in section 28(*ii*);

c. income derived by a trade, professional or similar association from specific services performed for its members;

d. the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;

e. export incentive available to exporters;

f. any interest, salary, bonus, commission or remuneration received by a partner from firm;

g. any sum received for not carrying out any activity in relation to any business or not to share any know-how, patent, copyright, trademark, etc.;

h. any sum received under a Key man insurance policy including bonus;

i. profits and gains of managing agency; and

j. income from speculative transaction.

Income from the aforesaid activities is computed in accordance with the provisions laid down in sections 29 to 44D.

7.3 METHOD OF ACCOUNTING

Income under the heads "Profits and gains of business or profession" and "Income from other sources" shall be computed in accordance with method of accounting regularly employed by the assessee.

- There are two main methods of accounting—mercantile system and cash system.
- In the case of mercantile system, net profit or loss is calculated after taking into consideration all income and expenditure of a particular accounting year irrespective of the fact whether income is not received or expenditure is not actually paid during the accounting period. Therefore, if books of account are kept by an assessee on the basis of mercantile system, income of a business or profession, accrued during the previous year, is taxable whether it is received during the previous year or in a year preceding or following the previous year. Similarly, expenditure of business or profession, relating to the previous year, is deductible even if it is not paid during the previous year.
- In the case of cash system of accounting, on the other hand, a record is kept of actual receipts and actual payments of a particular year. If books of account are kept by an assessee on the basis of cash system of accounting, income collected during the previous year is taxable whether it relates to the previous year or a year preceding or following the previous year. Similarly, expenditure actually paid during the previous year is deductible irrespective of the fact whether it relates to the previous year or some other year(s).

7.4 SCHEME OF BUSINESS DEDUCTIONS

Section 28 defines various income which are chargeable to tax under the head "Profits and gains of business or profession". Section 29 permits deductions and allowances laid down by sections 30 to 43D while computing profits or gains of a business or profession.

7.5 SPECIFIC DEDUCTIONS UNDER THE ACT

Sections 30 to 37 cover expenses, which are expressly allowed as deduction while computing business income, sections 40, 40A and 43B cover expenses which are not deductible. The following expenses are expressly allowed as deductions against profits and gains of business or profession:

7.5.1 RENT, RATES, TAXES, REPAIRS AND INSURANCE FOR BUILDING

Under section 30, the following deductions are allowed in respect of rent, rates, taxes, repairs and insurance for premises used for the purpose of business or profession:

a. the rent of premises, the amount of repairs (not being capital expenditure), if he has undertaken to bear the cost of repairs (this is applicable if the assessee has occupied the property as a tenant);

b. the amount of current repairs (not being capital expenditure) (if the assessee has occupied the premises otherwise than as a tenant);

c. any sum on account of land revenue, local rates or municipal taxes; and

d. amount of any premium in respect of insurance against risk of damage or destruction of the premises.

Application of section 43B - Land revenue, local rates or municipal taxes are deductible subject to the conditions as specified by section 43B.

7.5.2 REPAIRS AND INSURANCE OF MACHINERY, PLANT AND FURNITURE

The expenditure incurred on current repairs (not being capital expenditure) and insurance in respect of plant, machinery and furniture used for business purposes is allowable as deduction under section 31.

7.5.3 DEPRECIATION

Depreciation shall be determined according to the provisions of section 32.

CONDITIONS FOR CLAIMING DEPRECIATION - In order to avail depreciation, one should satisfy the following conditions:

Condition 1	Asset must be owned by the assessee.
Condition 2	It must be used for the purpose of business or profession.
Condition 3	It should be used during the relevant previous year.
Condition 4	Depreciation is available on tangible as well as intangible assets.

ASSET SHOULD BE OWNED BY THE ASSESSEE - The asset should be owned by the assessee or the assessee should be the co-owner of the asset.

ASSET MUST BE USED FOR THE PURPOSE OF BUSINESS OR PROFESSION - The asset, in respect of which depreciation is claimed, must have been used for the purpose of business or profession.

USER OF THE ASSET IN THE PREVIOUS YEAR - The asset, in respect of which depreciation is claimed, must have been used for the purpose of business. Normal depreciation (*i.e.,* full year's depreciation) is available if an asset is put to use at least for sometime during the previous year. However, depreciation allowance is limited to 50 per cent of normal depreciation, if the following two conditions are satisfied—

a. where an asset is acquired during the previous year; and

b. it is put to use for the purpose of business or profession for less than 180 days during that year.

DEPRECIATION IS AVAILABLE ON TANGIBLE AS WELL AS INTANGIBLE ASSETS - Under the Income-tax Act, one can claim depreciation in respect of the following assets—

Tangible assets	Building, machinery, plant or furniture
Intangible assets acquired after March 31, 1998	Know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature.

Building - "Building" means the superstructure only and does not include site.

Plant - "Plant" includes ships, vehicle, books (including technical know-how report), scientific apparatus and surgical equipments used for the purpose of business or profession. It does not include tea bushes or livestock or buildings or furniture and fittings.

CONSEQUENCES WHEN ABOVE CONDITIONS ARE SATISFIED - If the above conditions are satisfied, depreciation is available. Depreciation is available whether or not the assessee has claimed the deduction for depreciation in computing his total income.

To understand method of computation of depreciation, one must know the meaning of the following terms:

- Block of assets
- Written down value
- Actual cost

BLOCK OF ASSETS [SEC. 2(11)] - The term "block of assets" means a group of assets falling within a class of assets comprising —

a. tangible assets, being buildings, machinery, plant or furniture;

b. 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.

A taxpayer may have 19 different blocks of assets.

WRITTEN DOWN VALUE [SEC. 43(6)] - Written down value for the assessment year 2006-07 will be determined as under:

Step 1	Find out the depreciated value of the block on the April 1, 2005.
Step 2	To this value, add "actual cost" of the asset (falling in the block) acquired during the previous year 2005-06.
Step 3	From the resultant figure, deduct money received/receivable (together with scrap value) in respect of that asset (falling within the block of assets) which is sold, discarded, demolished or destroyed during the previous year 2005-06.

➢ *Other points* - The following points should be noted—

1. The resulting amount is the written down value of the block of assets on March 31, 2006 relevant for the assessment year 2006-07.

2. The amount of reduction under *Step 3* cannot exceed the value of assets computed under *Step 1* and *Step 2.*

3. One may determine written down value for other assessment years on similar basis.

4. In some cases, computation of written down value is based upon notional figures [*see* problem 91-P6].

5. Under *Step 3,* only actual money (received or receivable in cash or by cheque or draft) is deductible. In other words, any other things or benefit (which can be converted in terms of money) cannot be deducted under *Step 3.*

CHECK YOUR PROGRESS

Activity A:

Compute the written down value from the following information for the assessment year 2006-07—

Blocks of asset	*Rate of depreciation (per cent)*	*Depreciated value on April 1, 2005* *Rs.*
1. Plant A, B and C	15	10,40,000
2. Plant D and E	40	2,60,000
3. Plant F	50	70,000

4. Building A, B, C and D	10	10,90,600
5. Building E, F and G	5	7,10,200
6. Building H, I, J and K	100	16,90,000

After April 1, 2005, the company purchases the following assets —

Assets	*Date of purchase*	*Rate of depreciation(per cent)*	*Actual cost Rs.*
Plant G	April 6, 2005	50	6,000
Plant H	May 11, 2005	15	18,000
Furniture	June 6, 2005	10	56,000
Car	July 7, 2005	15	2,56,000
Building L	September 26, 2005	5	7,28,700
Computer	September 27, 2005	60	90,000
Copyright	September 30, 2005	25	17,50,000

The following assets are transferred —

Assets	*Date of sale*	*Sale consideration Rs.*
Plant B	December 20, 2005	25,10,900
Plant D	January 31, 2006	12,000
Building L	March 6, 2006	6,00,000

SOLUTION: *Block 1 - Plant and machinery (rate of depreciation 15%)*	*Rs.*
Depreciated value of the block consisting of Plants A, B and C	10,40,000
Add : Actual cost of Plant H and car	(+)2,74,000
Total	13,14,000
Less : Sale proceeds of Plant B [although sale proceeds of Plant B is more than Rs. 13,14,000, amount to be deducted is restricted to Rs. 13,14,000]	(–)13,14,000
Written down value of the block consisting of Plants A, C and H on March 31, 2006	*Nil*
Block 2 - Plant and machinery (rate of depreciation: 40%)	
Depreciated value of the block consisting of Plants D and E on April 1, 2005	2,60,000
Less : Sale proceeds of Plant D sold during 2005-06	`
Written down value of the block consisting Plant E on March 31, 2006	2,48,000
Block 3 - Plant and machinery (rate of depreciation: 50%)	
Depreciated value of the block consisting of Plant F on April 1, 2005	70,000
Add : Cost of Plant G purchased during 2005-06	6,000
Written down value of the block consisting of Plants F and G on March 31, 2006	76,000
Block 4 - Building (rate of depreciation: 10%)	
Depreciated value of the block on April 1, 2005 consisting of Buildings A, B, C and D	10,90,600
Written down value on March 31, 2006	10,90,600
Block 5 - Buildings (rate of depreciation: 5%)	
Depreciated value of the block consisting of Buildings E, F and G	7,10,200
`	7,28,700
Less : Sale proceeds of Building L sold during 2005-06	(–)6,00,000
Written down value of the block consisting of Buildings E, F and G on	

March 31, 2006	8,38,900
Block 6 - Building (rate of depreciation: 100%)	
Depreciated value of the block consisting of Buildings H, I, J and K on April 1, 2005	16,90,000
Written down value	16,90,000
Block 7 - Furniture (rate of depreciation: 10%)	
Depreciated value on April 1, 2005	*Nil*
Add : Cost of furniture purchased during 2005-06	56,000
Written down value on March 31, 2006	56,000
Block 8 - Plant (rate of depreciation: 60%)	
Depreciated value on April 1, 2005	*Nil*
Add : Cost of computer purchased during 2005-06	90,000
Written down value on March 31, 2006	90,000
Block 9 - Copyright (rate of depreciation: 25%)	
Depreciated value on April 1, 2005	*Nil*
Add : Cost of copyright purchased during 2005-06	17,50,000
Written down value on March 31, 2006	17,50,000

7.5.4 EXCEPTIONS TO THE RULE

In the cases given below, the above-mentioned rule is not applicable:

Exception one	If written down value of the block of asset is reduced to zero, though the block is not empty
Exception two	If the block of assets is empty or ceases to exist on the last day of the previous year (though the written down value is not zero)
Exception three	If in the first year in which an asset is acquired, it is put to use for less than 180 days

When the written down value of a block of asset is reduced to zero - No depreciation is admissible where written down value has been reduced to zero, though the block of assets does not cease to exist on the last day of the previous year.

Illustrated 7.1 - On April 1, 2005, depreciated value of a block of assets (rate of depreciation: 15 per cent) is Rs. 80,000. It consists of Plants A and B. The assessee purchases Plant C (rate of depreciation: 15 per cent) during the previous year 2005-06 for Rs. 30,000 and sells Plant A on May 3, 2005 for Rs. 1,80,000. In this case on March 31, 2006, the assessee has Plant B and Plant C in the block of the assets, though the written down value of the block is zero. No depreciation will be admissible for the previous year 2005-06 (*i.e.,* the assessment year 2006-07) as is evident from the computations given below:

	Rs.
Depreciated value of the block consisting of Plants A and B	80,000
Add : Actual cost of Plant C	30,000
Total	1,10,000
Less : Sale consideration of Plant A [though the plant is sold for Rs. 1,80,000, the amount of reduction cannot exceed Rs. 1,10,000 ; the difference of Rs. 70,000 is short-term capital gain under section 50(1)—*see* para 98.1-3 for detailed discussion]	1,10,000
Written down value of the block consisting of Plants B and C	*Nil*
Less : Depreciation for the previous year 2005-06	*Nil*
Depreciated value of the block consisting of Plants B and C on April 1, 2006	*Nil*

If block of assets ceases to exist - If a block of assets ceases to exist or if all assets of the block have been transferred and the block of assets are empty on the last day of the previous year, no depreciation is admissible in such case.

Illustrated 7.2 - X Ltd. owns two plants—Plant A and Plant B—on April 1, 2005 (rate of depreciation: 15 per cent, depreciated value on April 1, 2005: Rs. 2, 37,000). The company purchases Plant C on May 31, 2005 for Rs. 20,000 and sells Plant A (on April 10, 2005), Plant B (on December 12, 2005) and Plant C (on March 1, 2006) for Rs. 10,000, Rs. 15,000 and Rs. 24,000, respectively.

Written down value of the block of assets will be determined as under :

	Rs.
Depreciated value of the block consisting of Plants A and B	2,37,000
Add : Cost of Plant C	20,000
Total	2,57,000
Less : Sale proceeds of Plants A, B and C	49,000
Written down value of the block (which is empty)	2,08,000

In the aforesaid case, no depreciation is admissible, as the block of assets ceases to exist on the last day of the previous year. Rs. 2,08,000 will be treated as short-term capital loss on sale of Plants A, B and C. Depreciated value of the block on the first day of the next previous year (*i.e.,* on April 1, 2006) will be taken as *nil* (*i.e.,* written down value on March 31, 2006 : Rs. 2,08,000 *minus* short-term capital loss : Rs. 2,08,000).

In the case study given above if Plants A, B and C are transferred for a consideration which is higher than Rs. 2,57,000 (say, Rs. 3,57,000), then no depreciation will be available and Rs. 1,00,000 shall be taken as short-term capital gain on sale of Plants A, B and C.

CHECK YOUR PROGRESS

Activity B: Compute depreciation admissible to X for the assessment year 2006-07 on the basis of the following information:

Plant & Machinery A, B and C – Written Down Value as on April 1, 2005 Rs. 5, 00,000 rate of depreciation 15%. Plant D purchased on June 12, 2005 rate of depreciation 15% for Rs. 40,000. Plant A sold on December 8, 2005 for Rs. 1, 60,000.

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7.6.5 EXPENDITURE ON SCIENTIFIC RESEARCH

The term "scientific research" means "any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries". With a view to accelerating scientific research, section 35 provides tax incentives. Under this section amount deductible in respect of scientific research may be classified as under:

Expenditure on research carried on by the assessee	*Contribution to outsiders*
1. Revenue expenditure under section 35(1)(*i*) *2.* Capital expenditure under section 35(2) 3. Expenditure on an approved in-house research under section 35(2AB)	*1.* Contribution to an approved scientific research association under section 35(1)(*ii*)/(*iii*) 2. Payment to National Laboratory under section 35(2AA)

*REVENUE EXPENDITURE INCURRED BY THE ASSESSEE HIMSELF [SEC. 35(1) (*i*)]* - Where the assessee himself carries on scientific research and incurs revenue expenditure, deduction is allowed for such expenditure only if such research *relates* to the business.

Provisions illustrated - Suppose X Ltd. is engaged in the business of manufacture of paper and it incurs revenue expenses for conducting scientific research for improving the quality of steel, such expenditure is not deductible, as it is not related to the business of the taxpayer.

CONTRIBUTION MADE TO OUTSIDERS [SEC. 35(1)(ii)/(iii)] - Where the assessee does not himself carry on scientific research but makes contributions to other institutions for this purpose, a weighted deduction is allowed. The amount of deduction is equal to one and one-fourth times of any sum paid to a scientific research association or to a university, college or other institution if —

a. the payment is made to an approved scientific research association which has, as its object, undertaking of scientific research *related or unrelated* to the business of the assessee [sec. 35(1) (*ii*)];

b. the payment is made to an approved university, college or institution for the use of scientific research *related or unrelated* to the business of the assessee [sec. 35(1) (*ii*)]; and

c. the payment is made to an approved university, college or institution for the use of research for social science or statistical research *related or unrelated* to the business of the assessee [sec. 35(1)(*iii*)].

Approval under section 35(1) (*ii*)/ (*iii*) is given by the Central Government and not by a prescribed authority.

CAPITAL EXPENDITURE INCURRED BY AN ASSESSEE HIMSELF [SEC. 35(2)] - Where the assessee incurs any expenditure of a capital nature on scientific research related to his business, the whole of such expenditure incurred in any previous year is allowable as deduction for that previous year.

One should note the following points —

1. If an assessee incurs capital expenditure on scientific research related to his business, then deduction is available even if the relevant asset is not put to use for research and development purposes during the previous year.

2. The above expenses may be on plant or equipment for research or constructing building (excluding cost of land) for research or expenses of capital nature connected with research like expenses on purchase of buses to transport research personnel.

3. Where any capital expenditure has been incurred on scientific research related to business before the commencement of business, the amount of such expenditure, incurred within three years immediately preceding the commencement of the business, is deductible in the previous year in which the business is commenced [*Explanation* to section 35(2)(*i*)].

4. The aforesaid deduction is not available in respect of capital expenditure incurred on the acquisition of any land.

5. No deduction by way of depreciation is admissible in respect of an asset used in scientific research.

6. If the asset is sold *without having been used* for other purposes, surplus (*i.e.,* sale price) or deduction already allowed under section 35, whichever is less, is chargeable to tax as business income of the previous year in which the sale took place [section 41(3)]. The excess of sale price over cost of acquisition (or indexed cost of acquisition) is chargeable to tax under section 45 under the head "Capital gains".

CONTRIBUTION TO NATIONAL LABORATORY [SEC. 35(2AA)] - The payment is made to National Laboratory; or University; or Indian Institute of Technology; or Specified person as approved by the prescribed authority for undertaking scientific research programme.

AMOUNT OF DEDUCTION - If the aforesaid conditions are satisfied, the taxpayer is eligible for weighted deduction, which is equal to one and one fourth times of actual payment. Such contribution, which is eligible for weighted deduction, is not eligible for any other deduction under the Act.

EXPENDITURE ON IN-HOUSE RESEARCH AND DEVELOPMENT EXPENSES [SEC. 35(2AB)] - Section 35(2AB) provides for a weighted deduction in respect of expenditure on in-house research and development expenses subject to the following conditions—

1. The taxpayer is a company.

2. It is engaged in the specified business.

3. It incurs any expenditure on scientific research and such expenditure is of capital nature or revenue nature (not being expenditure in the nature of cost of any land and building).

4. The above expenditure is incurred on in-house research and development facility up to March 31, 2007.

5. The research and development facility is approved by the prescribed authority.

6. The taxpayer gets audit of the accounts maintained for such a facility.

➢ *Amount of deduction* - If all the above conditions are satisfied, then a sum equal to one and one-half times of the expenditure so incurred shall be allowed as deduction.

7.6.6 AMORTISATION OF PRELIMINARY EXPENSES

Certain preliminary expenses are deductible under section 35D.

WHO CAN CLAIM DEDUCTION - Deduction under section 35D is available in case of an Indian company or a resident non-corporate assessee. A foreign company even if it is resident in India, cannot claim any deduction under section 35D.

TIME AND PURPOSE OF PRELIMINARY EXPENSES - Expenses incurred at the following two stages are qualified for deduction under section 35D —

When expenses are incurred	*Why expenses are incurred*
1. Before commencement of business	For setting up any undertaking or business
2. After commencement of business	In connection with extension of an industrial undertaking or in connection with setting up a new industrial unit

Note - Deduction under section 35D is not available in respect of expenditure incurred after commencement of business if such expenditure is incurred in connection with extension of (or setting up) a non-industrial undertaking.

QUALIFYING EXPENDITURE -The heads of qualifying expenditure are the following —

➢ Expenditure in connection with preparation of feasibility report, preparation of project report, conducting a market survey (or any other survey necessary for the business of the assessee), etc.

➢ Legal charges for drafting any agreement.

- Legal charges for drafting the memorandum and articles of association.
- Printing expenses of the memorandum and articles of association.
- Registration fees of a company under the provisions of the Companies Act.
- Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
- Any other expenditure, which is prescribed.

QUALIFYING EXPENDITURE - MAXIMUM CEILING - The aggregate expenditure cannot exceed the following—

In the case of a corporate assessee	*In the case of a non-corporate assessee*
a. 5 per cent of cost of project; or	5 per cent of cost of project
b. 5 per cent of capital employed, whichever is more	

- *Cost of project* - It means the actual cost (or additional cost incurred after commencement of business in connection with extension or setting up an industrial undertaking) of fixed assets, namely, land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.
- *Capital employed in the business of a company* - It means the aggregate of the issued share capital, debentures and long-term borrowings, as on the last day of the previous year in which the business of the company commences.

AMOUNT OF DEDUCTION - One-fifth of the qualifying expenditure is allowable as deduction in each of the five successive years beginning with the year in which the business commences, or as the case may be, the previous year in which extension of the industrial undertaking is completed or the new industrial unit commences production or operation.

7.6.7 BONUS OR COMMISSION TO EMPLOYEES

Bonus or commission paid to an employee is allowable as deduction subject to certain conditions:

- *Admissible only if not payable as profit or dividend* - One of the conditions is that the amount payable to employees as bonus or commission should not otherwise have been payable to them as profit or dividend..
- *Deductible on payment basis* - Bonus or commission is allowed as deduction only where payment is made during the previous year or on or before the due date of furnishing return of income under section 139.

7.6.8 INTEREST ON BORROWED CAPITAL

Interest on capital borrowed is allowed as deduction if the following conditions are satisfied —

Condition one	The assessee must have borrowed money.
Condition two	The money so borrowed must have been used for the purpose of business.
Condition three	Interest is paid or payable on such borrowing.

7.6 GENERAL DEDUCTION

Section 37(1) is a residuary section. In order to claim deduction under this section, the following conditions should be satisfied:

Condition one	The expenditure should not be of the nature described under sections 30 to 36.
Condition two	It should not be in the nature of capital expenditure.
Condition three	It should not be personal expenditure of the assessee.
Condition four	It should have been incurred in the previous year.
Condition five	It should be in respect of business carried on by the assessee.
Condition six	It should have been expended wholly and exclusively for the purpose of such business.
Condition seven	It should not have been incurred for any purpose, which is an offence or is prohibited by any law.

Activity 2: Are the following expenses allowable as deduction under section 37(1):
1. Litigation expenses for official purposes.
2. Expenses relating to purchase of stationary for official purpose.
3. Interest on loan taken for the purpose of paying income-tax.

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7.7 SPECIFIC DISALLOWANCE

The following expenses given by sections 40, 40A and 43B are expressly disallowed by the Act while computing income chargeable under the head "Profits and gains of business or profession".

7.7.1 AMOUNT NOT DEDUCTIBLE UNDER SECTION 40(a)

In the case of any assessee, the following expenses are expressly disallowed under section 40(*a*):

INTEREST, ROYALTY, FEES FOR TECHNICAL SERVICES PAYABLE TO A NON-RESIDENT [SEC. 40(a) (i)] - Disallowance under section 40(*a*) (*i*) is attracted if the following conditions are satisfied:

<table>
<tr><td>Condition one</td><td colspan="3">The amount paid is interest (not being interest on any loan issued for public subscription before April 1, 1938), royalty, fees for technical services or other sum.</td></tr>
<tr><td>Condition two</td><td colspan="3">The aforesaid amount is chargeable to tax under the Act in the hands of the recipient.</td></tr>
<tr><td rowspan="4">Condition three</td><td colspan="3">The aforesaid amount is paid/payable as follows—</td></tr>
<tr><td>Situation</td><td>Place of payment</td><td>To whom it is paid/payable</td></tr>
<tr><td>Situation 1</td><td>Outside India</td><td>To a resident or non-resident</td></tr>
<tr><td>Situation 2</td><td>In India</td><td>To a non-resident or foreign company</td></tr>
<tr><td>Condition four</td><td colspan="3">In respect of the aforesaid, tax is deductible but tax has not been deducted; or tax has been deducted but after deduction it has not been paid to the Government in the previous year [or in a subsequent year before the expiry of time given under section 200(1)]</td></tr>
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CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED - If the above conditions are satisfied, the aforesaid expenditure is not deductible.

CONSEQUENCES IF TAX IS DEDUCTED SUBSEQUENTLY - If tax is deducted/paid subsequently, then deduction is available in some cases.

COMPLIANCE OF TDS PROVISIONS IN CASE OF A RESIDENT [SEC. 40(a) (ia)] - Section 40(*a*) (*ia*) is applicable from the assessment year 2005-06 if the following conditions are satisfied—

1. It covers interest, commission or brokerage, fees for technical services, fees for professional services and payment to contractors/ sub-contractors.

2. In the above cases recipient is resident in India.

3. In respect of the aforesaid—

a. tax is deductible but tax has not been deducted; or *b.* tax has been deducted but after deduction it has not been paid to the Government in the previous year [or in a subsequent year before the expiry of time given under section 200(1)].

CONSEQUENCES IF THE ABOVE CONDITIONS ARE SATISFIED - If the above conditions are satisfied, the aforesaid expenditure is not deductible with effect from assessment year 2005-06.

CONSEQUENCES IF TAX IS DEDUCTED SUBSEQUENTLY - If tax is deducted/paid subsequently, then deduction is available in some cases. The same is explained in the table given below—

Different situations	*Deductible in which year*
If in respect of expenses mentioned above, (*a*) tax has been deducted under the relevant sections, and (*b*) paid to the Government in the same year and before the expiry of time limit given under section 200(1)	Deductible in the year in which the liability to pay interest, commission, brokerage, etc., is incurred
If in respect of expenses mentioned above , (*a*) tax has been deducted under the relevant sections, and (*b*) paid to the Government in the same financial year but after the expiry of time limit given under section 200(1)	Deductible in the year in which the liability to pay interest, commission, etc. is incurred
If in respect of expenses mentioned above, (*a*) tax has been deducted under the relevant sections, and (*b*) paid to the Government in the subsequent year but before the expiry of time limit given in section 200(1)	Deductible in the year in which the liability to pay interest, commission, brokerage, etc., is incurred
If in respect of expenses mentioned above, (*a*) tax has been deducted under the relevant sections, and (*b*) paid to the Government in a subsequent year [but after the expiry of time-limit given in section 200(1)]	Deductible in the year in which tax has been paid
If in respect of expenses mentioned above, (*a*) tax has not been deducted, or (*b*) tax has been deducted but not paid to the Government	Not deductible

PROVISIONS ILLUSTRATED - To have better understanding, the following illustrations are given—

Nature of payment (liability incurred during the financial year 2005-06)	*Date on which tax is supposed to be deducted*	*Actual date of tax Deduction*	*When tax should be deposited under section 200(1)*	*Actual date of tax deposit*	*Previous year in which it is deductible*
Interest	June 26, 2005	June 26, 2005	July 7, 2005	July 7, 2005	2005-06

Technical fees	July 26, 2005	July 26, 2005	August 7, 2005	Sep. 2, 2005	2005-06
Commission	March 31, 2006	March 31, 2006	May 31, 2006	May 31, 2006	2005-06
Professional fees	March 31, 2006	March 31, 2006	May 31, 2006	June 1, 2006	2006-07
Brokerage	May 16, 2005	May 16, 2005	June 7, 2005	Not deposited	Not deductible
Payment to contractor	Dec. 1, 2005	Not deducted	Jan. 7, 2006	Not deposited	Not deductible
Interest	June 10, 2005	April 20, 2006	July 7, 2005	July 20, 2008	2008-09

SECURITIES TRANSACTION TAX [SEC. 40(a) (ib)] - Securities transaction tax is not deductible while calculating business income.

FRINGE BENEFIT TAX [SEC. 40(a) (ic)] - Fringe benefit tax is not deductible while calculating business income from the assessment year 2006-07.

*INCOME-TAX [SEC. 40(*a*) (*ii*)]* - Any sum paid on account of income-tax (*i.e.*, any rate or tax levied on the profits or gains of any business or profession) is not deductible. Similarly, any interest/penalty/fine for non-payment or late payment of income-tax is not deductible. This rule is applicable whether income-tax is payable in India or outside India.

*WEALTH-TAX [SEC. 40(*a*)(*iia*)]* - Any sum paid on account of wealth-tax under the Wealth-tax Act, 1957, or tax of a similar nature chargeable under any law outside India is not deductible.

*SALARY PAYABLE OUTSIDE INDIA WITHOUT TAX DEDUCTION [SEC. 40(*a*) (*iii*)]* - Section 40(*a*) (*iii*) is applicable if the following conditions are satisfied—

Condition one	The payment is chargeable under the head "Salaries" in the hands of the recipient.
Condition two	It is payable— *a.* outside India (to any person resident or non-resident); or *b.* in India to a non-resident.
Condition three	Tax has not been paid to the Government nor deducted at source under the Income-tax Act.

If the aforesaid conditions are satisfied, then the payment is not allowed as deduction.

Illustrated 7.3 - The following illustration is given in respect of salary payable for the previous year 2005-06 by a company to (*a*) any person outside India or (*b*) a non-resident in India—

Amount Rs.	*Date on which tax is supposed to be deducted (*i.e.*, the date of salary payment)*	*Actual date of tax deduction*	*When tax should be deposited under section 200(1)*	*Actual date of tax deposit*	*Previous year in which salary payment is deductible*
40,000	July 31, 2005	July 31, 2005	August 7, 2005	November 10, 2005	2005-06
90,000	March 31, 2006	March 31, 2006	April 7, 2006	April 7, 2006	2005-06
1,60,000	March 31, 2006	March 31, 2006	April 7, 2006	April 12, 2006	2005-06
70,000	March 31, 2006	Not deducted	April 7, 2006	April 12, 2006	2005-06
75,000	March 31, 2006	March 31, 2006	April 7, 2006	Not deposited	2005-06
95,000	March 31, 2006	Not deducted	April 7, 2006	Not deposited	Not deductible

*PROVIDENT FUND PAYMENT WITHOUT TAX DEDUCTION AT SOURCE [SEC. 40(*a*) (*iv*)]* - Any payment to a provident fund (or other fund established for the benefit of employees of the assessee) is not deductible if the assessee has not 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".

*TAX ON PERQUISITE PAID BY THE EMPLOYER [SEC. 40(*a*) (*v*)]* - The provisions of section 40(*a*) (*v*) are given below—

1. The employer provides non-monetary perquisites to employees.

2. Tax on non-monetary perquisites is paid by the employer.

3. The tax so paid by the employer is not taxable in the hands of employees by virtue of section 10(*10CC*).

4. While calculating income of the employer, the tax paid by the employer on non-monetary perquisites is not deductible under section 40(*a*) (*v*).

7.7.2 AMOUNT NOT DEDUCTIBLE IN RESPECT OF PAYMENT TO RELATIVES

Any expenditure incurred by an assessee in respect of which payment has been made to the specified persons is liable to be disallowed in computing business profit to the extent such expenditure is considered to be excessive or unreasonable, having regard to the fair market value of goods or services or facilities, etc.

As per section 2(41), the term relative in relation to an individual means husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

7.7.3 AMOUNT NOT DEDUCTIBLE IN RESPECT OF EXPENDITURE NOT EXCEEDING RS. 20,000

The provisions of section 40A (3) are given below -

RULE - The following conditions should be satisfied -

Condition one	The assessee incurs any expenditure, which is otherwise deductible under the other provisions of the Act for computing business/profession income (*e.g.,* expenditure for purchase of raw material, trading goods, expenditure on salary, etc.). The amount of expenditure exceeds Rs. 20,000.
Condition two	A payment in respect of the above expenditure (or part thereof) exceeds Rs. 20,000.
Condition three	The payment mentioned in condition two is made in cash or by bearer cheque (*i.e.*, not by crossed cheque or crossed demand draft).

If all the above conditions are satisfied, then 20 per cent of such payment is not allowable as deduction. However there are certain exceptions to the above rule.

7.8 AMOUNT NOT DEDUCTIBLE IN RESPECT OF CERTAIN UNPAID LIABILITIES

Section 43B is applicable only if the taxpayer maintains books of account on the basis of mercantile system of accounting. The provisions of section 43B are given below—

GENERAL RULE - CERTAIN EXPENSES ARE DEDUCTIBLE ON PAYMENT BASIS - The following expenses (which are otherwise deductible under the other provisions of the Income-tax Act) are deductible on payment basis—

a. any sum payable by way of tax, duty, cess or fee (by whatever name called under any law for the time being in force);

b. any sum payable by an employer by way of contribution to provident fund or superannuation fund or any other fund for the welfare of employees;

c. any sum payable as bonus or commission to employees for service rendered;

d. any sum payable as interest on any loan or borrowing from a public financial institution (*i.e.*, ICICI, IFCI, IDBI, LIC and UTI) or a state financial corporation or a state industrial investment corporation;

e. interest on any loan or advance taken from a scheduled bank including a co-operative bank; and

f. any sum payable by an employer in lieu of leave at the credit of his employee.

The above expenses are deductible in the year in which payment is actually made.

EXCEPTION - WHEN DEDUCTIBLE ON ACCRUAL BASIS - The exception is applicable if the following two conditions are satisfied—

Condition one	Payment in respect of the aforesaid expenses is actually made on or before the due date of submission of return of income[1].
Condition two	The evidence of such payment is submitted along with the return of income.

If the above two conditions are satisfied and if the assessee maintains books of account on mercantile basis, then the expenditure is deductible on "accrual" basis in the year in which the liability is incurred.

BROAD CONCLUSIONS - The cumulative impact of the rule and exception stated above is presented in the table given below—

Date of payment	*In which year it is deductible*	*Basis of deduction—payment or accrual*
➢ *Situation one* - If the payment in respect of the aforesaid sums is made during the relevant previous year (*i.e.*, the year in which the liability is incurred)	In the year in which the payment is made	Payment basis
➢ *Situation two* - If the payment in respect of the aforesaid sums is made after the end of relevant previous year (*i.e.*, the year in which the liability is incurred) but on or before the due date of submission of return of income[1] for that year and the proof of deposit is submitted along with the return of income	In the relevant previous year on accrual basis (*i.e.*, the year in which the liability is incurred)	Accrual basis
➢ *Situation three* - If the payment is made at any other time (not being covered by the above situations)	In the year in which the payment is made	Payment basis

➢ *Situation four* - If the payment is not made at all	Not deductible	Not deductible

Illustrated 7.4 - X Ltd. maintains books of account on mercantile basis. For the previous year 2005-06 (*i.e.*, the assessment year 2006-07), interest on term loan taken from Punjab National Bank is Rs. 1,95,000. The amount is paid as follows—

Date of payment	*Amount Rs.*
May 2, 2005	25,000
November 20, 2005	20,000
August 16, 2006	25,000
December 5, 2006	30,000
June 12, 2007	35,000
November 2, 2007	40,000
Not paid so far	20,000

As the expenditure is covered by section 43B, it is deductible on payment basis in the year in which payment is made. However, if the payment is made on or before the due date of submission of return of income for the assessment year 2006-07 (*i.e.*, on or before October 31, 2006) and the evidence of payment is submitted along with the return of income, then such payment is deductible on accrual basis for the previous year 2005-06. Consequently, these payments are deductible as follows:

Date of payment	*Amount Rs.*	*Previous year in which deductible*	*Reasons*
May 2, 2005	25,000	2005-06	Payment made during the relevant year is deductible in that year (*Situation one* in the table given above)
November 20, 2005	20,000	2005-06	Payment made during the relevant year is deductible in that
			year (*Situation one* in the table given above)
August 16, 2006	25,000	2005-06	Payment made after the end of the relevant year but on or
			before the due date of submission of return of income (*i.e.*, October 31, 2006) is deductible in the year in which the liability is incurred

			(*Situation two* in the table given above)
December 5,	30,000	2006-07	Payment made after the due date of submission of return of
2006			income (*i.e.*, made after October 31, 2006) is deductible in the year in which the payment is made (*Situation three* in the table given above)
June 12, 2007	35,000	2007-08	Payment made after the due date of submission of return of income (*i.e.*, made after October 31, 2006) is deductible in the year in which the payment is made (*Situation three* in the table given above)
November 2, 2007	40,000	2007-08	Payment made after the due date of submission of return of income (*i.e.*, made after October 31, 2006) is deductible in the year in which the payment is made (*Situation three* in the table given above)
Not paid	20,000	Not deductible	Not deductible as the payment is not made (*Situation four* in the table given above)

7.9 PRESUMTIVE TAXATION

What are the special provisions for computing income on estimated basis under sections 44AD, 44AE and 44AF

These provisions are given below—

Computation of income on estimated basis in the case of taxpayers engaged in the business of civil construction [Sec. 44AD] - The provisions of section 44AD are given below—

WHO IS COVERED BY THE SCHEME OF SECTION 44AD - Section 44AD is applicable only if the following conditions are satisfied—

Condition 1	The taxpayer may be an individual, HUF, AOP, BOI, firm, company, co-operative society or any other person. He or it may be a resident or a non-resident.
Condition 2	The taxpayer is engaged in the business of civil construction or supply of labour for civil construction work. The taxpayer may be a contractor or sub-contractor.
Condition 3	Gross receipts from the above business do not exceed Rs. 40

	lakh.

CONSEQUENCES IF SECTION 44AD IS APPLICABLE - If the aforesaid three conditions are satisfied, then section 44AD is applicable. The following are the consequences if section 44AD is applicable—

INCOME TO BE CALCULATED ON ESTIMATED BASIS @ 8 PER CENT - The income from the above-mentioned business is estimated at 8 per cent of the gross receipts paid or payable to a taxpayer. A taxpayer can voluntarily declare a higher income in his return.

RATE OF 8 PER CENT IS COMPREHENSIVE - All deductions under sections 30 to 38 including depreciation, are deemed to have been already allowed and no further deduction is allowed under this section.

After calculating income in accordance with the aforesaid provisions, one has to follow the following steps—

Step 1	The income as calculated above will be aggregated with income of the assessee from any other business or under other heads of income in accordance with the normal provisions of the Income-tax Act.
Step 2	The brought forward business losses and other losses shall be deducted according to the normal provisions of the Income-tax Act.
Step 3	All deductions permissible under sections 80C to 80U shall be allowed.
Step 4	Tax on net income shall be calculated according to the normal provisions.

PROVISIONS FOR MAINTENANCE OF BOOKS OF ACCOUNT/COMPULSORY AUDIT - NOT APPLICABLE - The following privileges are available to a taxpayer who declares his income from the aforesaid business at the rate of 8 per cent of gross receipts (or at a higher rate)—

Privilege 1	He is not required to maintain books of account according to the provisions of section 44AA in respect of the aforesaid business.
Privilege 2	He is not required to get his books of account audited under section 44AB in respect of the aforesaid business.

It may be noted that the above privileges are available only in respect of the aforesaid business. Even such an assessee has to comply with the requirements of both sections 44AA and 44AB in respect of his business, which are not covered by this scheme.

Provisions illustrated - A person has gross receipts of Rs. 30 lakh from civil construction business and of Rs. 25 lakh from trading in scrap. Although his total gross receipts are Rs. 55 lakh, he will not be required to have his accounts audited, since his gross receipts after excluding those from the business of civil construction are still less than Rs. 40 lakh, the limit provided in section 44AB.

IS IT POSSIBLE TO DECLARE LOWER INCOME - A taxpayer can declare his income to be lower than the deemed profits and gains as stated above. The following consequences are applicable if the taxpayer declares his income, which is lower than the deemed profits and gains as stated above—

Consequence 1	The taxpayer will have to maintain the books of account as per section 44AA (irrespective of income or turnover).
Consequence 2	The taxpayer will have to get his books of account audited under section 44AB (irrespective of turnover).

Illustrated 7.5 X & Co., a firm, is engaged in the business of civil construction (turnover of 2005-06 being Rs. 37,80,000). It wants to claim the following deduction —

	Rs.
Salary and interest to partners [as permitted by section 40(*b*)]	60,000
Salary to employees	4,90,000
Depreciation	2,70,000
Cost of material used	25,90,000
Other expenses	3,45,000
Total	37,55,000
Net profit (Rs. 37,80,000 *minus* Rs. 37,55,000)	25,000

Determine the net income of X & Co. for the assessment year 2006-07 assuming that (*a*) taxable income from other business is Rs.1,90,000, (*b*) long-term capital gain is Rs. 40,000 and (*c*) the firm is eligible for a deduction of Rs. 5,000 under section 80G.

SOLUTION :	*Rs.*
Income from the business of civil construction (8% of Rs. 37,80,000)	3,02,400
Less : Expenses	
Salary/interest paid to partners as permitted by section 40(*b*)	60,000
Other expenses [except salary/interest to partners in the case a firm, no other expenditure is deductible]	*Nil*
Income from civil construction	2,42,400
Other business income	1,90,000
Profits and gains from business or profession	4,32,400
Capital gains	40,000
Gross total income	4,72,400
Less : Deductions under sections 80C to 80U	5,000
Net income	4,67,400

Computation of income on estimated basis in the case of taxpayers engaged in the business of plying, leasing or hiring trucks [Sec. 44AE] - The provisions of section 44AE are given below—

WHO IS COVERED BY THE SCHEME OF SECTION 44AE - Section 44AE is applicable only if the following conditions are satisfied—

Condition 1	The taxpayer may be an individual, HUF, AOP, BOI, firm, company, co-operative society or any other person. He or it may be a resident or a non-resident.
Condition 2	Taxpayer is engaged in the business of plying, hiring or leasing goods carriages.
Condition 3	The taxpayer owns not more than 10 goods carriages at any time during the previous year.

CONSEQUENCES IF SECTION 44AE IS APPLICABLE - If the aforesaid conditions are satisfied then section 44AE is applicable. The following are the consequences if section 44AE is applicable:

INCOME TO BE CALCULATED ON ESTIMATED BASIS - Income from the aforesaid business shall be calculated as follows:

Type of goods carriage	*Estimated income*
Heavy goods vehicle	Rs. 3,500 for every month (or part of a month) during which the goods carriage is owned by the taxpayer.
Other than heavy goods vehicle	Rs. 3,150 for every month (or part of a month) during which the goods carriage is owned by the taxpayer.

ESTIMATED INCOME IS COMPREHENSIVE - All deductions under sections 30 to 38 including depreciation, are deemed to have been already allowed and no further deduction is allowed under this section.

After calculating income in accordance with the aforesaid provisions, one has to follow the following steps—

Step 1	It will be aggregated with income of the assessee from any other business or under other heads of income in accordance with the normal provisions of the Income-tax Act.
Step 2	The brought forward business losses and other losses shall be deducted according to the normal provisions of the Income-tax Act.
Step 3	All deductions permissible under sections 80C to 80U shall be allowed.
Step 4	Tax on net income shall be calculated according to the normal provisions.

PROVISIONS FOR MAINTENANCE OF BOOKS OF ACCOUNT/COMPULSORY AUDIT - NOT APPLICABLE - The following privileges are available to a taxpayer who declares his income from the aforesaid business at the rate given above (or at a higher rate)—

Privilege 1	He is not required to maintain books of account according to the provisions of section 44AA in respect of the aforesaid business.
Privilege 2	He is not required to get his books of account audited under section 44AB in respect of the aforesaid business.

It may be noted that the aforesaid privileges are available only in respect of the aforesaid business. Even such an assessee has to comply with the requirements of both sections 44AA and 44AB in respect of his business, which are not covered by this scheme.

IS IT POSSIBLE TO DECLARE LOWER INCOME - A taxpayer can declare his income to be lower than the deemed profits and gains as stated above. In such cases, the following consequences should be noted—

Consequence 1	The taxpayer will have to maintain the books of account as per section 44AA (irrespective of income or turnover).
Consequence 2	The taxpayer will have to get his books of account audited under section 44AB (irrespective of turnover).

Illustrated 7.6 X Ltd. is engaged in the business of carriage of goods. On April 1, 2005, it owns 10 trucks (6 out of which are "heavy goods vehicle"). On May 6, 2005, one of the heavy goods vehicles is sold by X Ltd. to purchase a light goods vehicle on May 10, 2005 which is put to use only from June 17, 2005.

Find out the net income of X Ltd. for the assessment year 2006-07 taking into consideration the following data —

Rs.	
Freight collected	8,90,000
Less :	
Operational expenses	6,40,000
Depreciation as per section 32	1,90,000
Other office expenses	15,000
Net profit	45,000
Other business/non-business income	70,000

SOLUTION: Income shall be computed under section 44AE as follows —

Trucks owned by X Ltd.

Type of carriage	*Period during which trucks are owned*	*Number of months (including a part of month)*	*Rate per month*	*Amount [(1) × (3) × (4)]*
(1)	*(2)*	*(3)*	*(4)*	*(5)*
4 Light goods vehicles	April 1, 2005 to March 31, 2006	12	3,150	1,51,200
1 Heavy goods vehicle	April 1, 2005 to May 6, 2006	2	3,500	7,000
5 Heavy goods vehicles	April 1, 2005 to March 31, 2006	12	3,500	2,10,000
1 Light goods vehicle	May 10, 2005 to March 31, 2006	11	3,150	34,650
Total				4,02,850

Computation of income —	*Rs.*
Income from carriage of goods	4,02,850
Other income	70,000
Net income	4,72,850

Scheme for computing profits and gains of retail traders [Sec. 44AF] - The provisions of section 44AF are given below—

WHO IS COVERED BY THE SCHEME OF SECTION 44AF - Section 44AF is applicable only if the following conditions are satisfied—

Condition 1	The taxpayer may be an individual, HUF, AOP, BOI, firm, company, co-operative society or any other person. He or it may be a resident or a non-resident.
Condition 2	The taxpayer is engaged in the business of retail trade in any goods or merchandise.
Condition 3	Total turnover from the above business does not exceed Rs. 40 lakh.

CONSEQUENCES IF SECTION 44AF IS APPLICABLE - If the aforesaid three conditions are satisfied then section 44AF is applicable. The following are the consequences if section 44AF is applicable:

INCOME TO BE CALCULATED ON ESTIMATED BASIS @ 5 PER CENT - The income from the above-mentioned business is estimated at 5 per cent of the total turnover. A taxpayer can voluntarily declare a higher income in his return.

RATE OF 5 PER CENT IS COMPREHENSIVE - All deductions under sections 30 to 38 including depreciation, are deemed to have been already allowed and no further deduction is allowed under this section.

After calculating income in accordance with the aforesaid provisions one has to follow the following steps—

Step 1	It will be aggregated with income of the assessee from any other business or under other heads of income in accordance with the normal provisions of the Income-tax Act.
Step 2	The brought forward business losses and other losses shall be deducted according to

	the normal provisions of the Income-tax Act.
Step 3	All deductions permissible under sections 80C to 80U shall be allowed.
Step 4	Tax on net income shall be calculated according to the normal provisions.

PROVISIONS FOR MAINTENANCE OF BOOKS OF ACCOUNT/COMPULSORY AUDIT - NOT APPLICABLE - The following privileges are available to a taxpayer who declares his income from the aforesaid business at the rate of 5 per cent of gross receipts (or at a higher rate)—

Privilege 1	He is not required to maintain books of account according to the provisions of section 44AA in respect of the aforesaid business.
Privilege 2	He is not required to get his books of account audited under section 44AB in respect of the aforesaid business.

It may be noted that the aforesaid privileges are available only in respect of the aforesaid business. Even such an assessee has to comply with the requirements of both sections 44AA and 44AB in respect of his business, which are not covered by this scheme.

Provisions illustrated - A person has gross receipts of Rs. 30 lakh from the business of retail trade and Rs. 35 lakh from wholesale trading in paper. Although his total gross receipts are Rs. 65 lakh, he will not be required to have his accounts audited, since his gross receipts after excluding those from the business of retail trade are still less than Rs. 40 lakh, the limit provided in section 44AB.

IS IT POSSIBLE TO DECLARE LOWER INCOME - A taxpayer can declare his income to be lower than the deemed profits and gains as stated above. In such cases, the following consequences should be noted—

Consequence 1	The taxpayer will have to maintain the books of account as per section 44AA (irrespective of income or turnover).
Consequence 2	The taxpayer will have to get his books of account audited under section 44AB (irrespective of turnover).

Illustrated 7.7 Find out the net income in the cases of X (age : 24 years) and Y (age : 32 years) (both are resident retail traders at Delhi) for the assessment year 2006-07 from the following data —

	X *Rs.*	*Y* *Rs.*
Sales turnover	40,00,000	60,00,000
Less : Expenses		
Cost of goods sold	36,00,000	54,00,000
Depreciation	10,000	15,000
Other expenses	3,20,000	4,80,000
Business income	70,000	1,05,000

Other income	15,000	30,000
Public provident fund contribution	30,000	60,000

SOLUTION : In the case of X income shall be computed under section 44AF as his turnover does not exceed Rs. 40 lakh. In the case of Y, however, the normal provisions of the Act will be applicable —

	X *Rs.*	*Y* *Rs.*
Business income [5% of Rs. 40 lakh in the case of X]	2,00,000	1,05,000
Other income	15,000	30,000
Gross total Income	2,15,000	1,35,000
Less : Deduction under section 80C	30,000	60,000
Net income	1,85,000	75,000
Tax	12,000	*Nil*
Add : Surcharge (surcharge is not applicable if net income does not exceed Rs. 10 lakh)	*Nil*	*Nil*
Total	12,000	*Nil*
Add : Education cess (2% of tax and surcharge)	240	*Nil*
Total tax liability	12,240	*Nil*

7.10 LET US SUM UP

This Chapter provides the method for computing income under the head profits and gains from business or profession. The method of accounting regularly employed by the assessee is relevant for the purpose of computing such income. While sections 30 to 37 specify the various allowances or deductions available, section 40, 40A and 43B specify explicitly as to what is not allowable as deduction.

7.11 GLOSSARY

Passive versus active user - The user of the asset should be understood in a wide sense so as to embrace passive as well as active user. If a machine is kept ready for use at any moment in a particular factory, the machinery can be said to be "used" for the purpose of the business which earns profits, although in fact it has not worked during the year. *Assets used partly for business purposes* - Under section 38(2) where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deduction under section 32(1) shall be restricted to a fair proportionate part thereof which the Assessing Officer may determine, having regard to the user of such building, machinery, plant or furniture for the purposes of the business or profession.

Residential quarters - When occupation of residential quarters by the assessees employees is subservient to and necessary for the business, the property is considered as occupied by owner for the purpose of his business. Depreciation is, therefore, allowable on such buildings. Similarly, fans, air-conditioners, refrigerators, furniture, etc., provided by the assessee-employer at the quarters of employees is considered to have been used wholly for the purpose of employer's business and depreciation is admissible.

7.12 SELF ASSESSMENT EXERCISES

1. From the Profit and Loss Account of X (age : 31 years) for the year ending March 31, 2006, ascertain his total income and tax liability for the assessment year 2006-07 :

	Rs.		*Rs.*
General expenses	13,400	Gross profits	3,64,500
Bad debts	22,000	Commission	8,600
Advance tax	21,000	Brokerage	37,000
Insurance	600	Sundry receipts	2,500
Salary to staff	26,000		
Salary to X	32,000		
Interest on overdraft	4,000		
Interest on loan to Mrs. X	42,000		
Interest on capital of X	23,000		
Depreciation	48,000		
Advertisement expenditure	7,000		
Contribution to RPF			
Net profit	1,60,600		
	4,12,600		4,12,600

Other information:
The amount of depreciation allowable is Rs. 37,300 as per the Income-tax Rules.
5. General expenses include (*a*) Rs. 500 given to Mrs. X for arranging a party in honor of a friend who has recently come from Canada.

2. X (age: 26 years), a leading tax consultant, who maintains books of account on cash basis furnishes the following particulars of income and expenditure for the assessment year 2006-07:
Receipt and Payment Account for the year ending March 31, 2006

			Rs.	*Rs.*
Balance brought down	3,83,400		Purchase of a typewriter	6,000
Fees from clients:			Car expenses	18,000
of 2006-07	2,30,500		Office expenses	40,000
of 2005-06	11,500		Salary to staff:	
of 2007-08	13,000		of 2006-07	32,000

Presents from clients	24,000	of 2007-08	11,000
		Repairs of office	12,000
		Interest on loan	10,000
		Income-tax payment	2,000
		Life insurance premium	8,000
		Balance credit down	5,23,400
	6,62,400		6,62,400

Car is partly used for official purposes (40%) and partly for private purposes (60%).

Determine the taxable income and tax liability of X for the assessment year 2006-07.

7.13 FURTHER READINGS AND SOURCES

Income-tax Act, 1961, Taxmann Publications Pvt. Ltd., New Delhi (latest edition).

Singhania, Vinod. K. and Monica Singhania, *Students Guide to Income-tax,* Taxmann Publications Pvt.Ltd., New Delhi (latest edition).