PROFITS AND GAINS OF BUSINESS AND PROFESSION

SLECTED TOPICS FROM PGBP

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INDEX OF THE TOPICS

CHAPTER 3: PROFIT & GAINS FROM BUSINESS/ PROFESSION

SECTION 28: CHARGING SECTION

The following incomes shall be chargeable to tax under "<u>Profits & gains Of Business & Profession</u>":

(i) The profits & gains of any business or profession which was carried on by the assessee at any time during the year.

(ii) **Profits** on sale of a **license** granted under license import (control) order under a scheme of exports.

(iii) Cash assistance received or receivable against export under any scheme of the government.

(iv) Any duty of **customs or excise** repaid or repayable as **DRAWBACK** against Exports under the scheme of the government.

(v) Any profits from the transfer of **duty Entitlement Pass book*** scheme being the duty remission scheme under the export & import policy.

(vi) Any profits from the transfer of **Duty Free replenishment Certificate*** being the duty remission scheme under the export & import policy.

(vii) The value of any benefit or perquisite, whether convertible into money or not, arising from any business or profession.

(viii) Income derived by a **trade, professional or similar association** from specific services performed for its members.

(ix) Any interest, salary, bonus, commission or remuneration **due to or received** by a partner or a firm from such firm. It means the above said amount will be taxable in hands of partners as **PGBP** to the extent allowed to the firm u/s 40(b).

(x) Any sum received or receivable in cash or in kind, under an agreement for:

- ❖ **Not carrying out any activity i.r.t. any business.**
- ❖ **Not sharing any know-how, patent, copyright etc.**

It means that if I receive any amount not to carry on business of same commodity or not to share any know-how…then amount received by me is taxable as "PGBP".

Provided that this above said clause shall not apply:

- Any sum chargeable under the head " Capital gain" **on account of transfer of the right to manufacture, produce etc.**

- Any sum received against CARBON CREDITS for not manufacturing CFC/HCFC under the terms of the agreement entered into with the government of India.

REASON: **"UNITED NATION"**

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Signed agreement of all the Countries → That govt. must order companies not to produce CFC / HCFC.

Now "UN" : **Will give CARBON CREDITS or COMPENSATION to the government(s) for not producing CFC/ HCFC.**

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Then these governments give the amount of compensation to the companies. As such when companies receive such compensation, **it is NOT TAXABLE.**

(xi) Any sum received under a **keyman insurance policy** including the sum allocated by way of bonus on such policy**.**

REASON: Insurance taken for an important person of a business. But the companies do:

Company take insurance of its MD of ₹ 20 crore & pays ₹ 1 crore each year as premium for years. In third year company surrender the policy and receive ₹ 2.25 crores. This amount is endorsed to MD. Company contented that nothing taxable in its hand…& No taxability in the hands of MD since amount received is from LIC.

Now the above tax planning had been crushed by making the following amendment:

COMPANY	**MANAGING DIRECTOR**
Now if company receive amount Company receive amount under Keyman insurance policy, then ***Taxable under PGBP.***	If a person in whose name policy was taken, then the amount received is taxable under ***section 17***

(xii) Any sum whether received or receivable , **in cash or kind,** on account of any **capital assets being demolished, destroyed, discarded or transferred**(other than **goodwill, land or financial instruments)** , if whole of the **<u>expenditure on such capital asset</u>** has been **allowed as a deduction** under section 35AD.

* Refer point **V & VI** in **<u>page 1</u>**

Accounting Entry of sale of DEPB/ DFRC :

Bank Account Dr.	**10,20,000.00**	
To DEPB / DFRC		**10,00,000.00**
To Profit on sale of DEPB/DFRC		**20,000.00**

SECTION 32(1) (II): DEPRECIATION

Some important points in the topic **depreciation:**

1.) Depreciation shall be allowed on tangible assets as well as non-tangible assets.

2.) Asset may be owned wholly or partly by the assessee.

Example: ABC ltd company owns plant & machinery worth ₹ 100 crore in a mega project of ₹ 500 crore. Now ABC ltd can claim depreciation on ₹ 100 crore.

3.) Depreciation is allowed on **written Down Value of the block of assets.**

4.) It is **mandatory** to claim depreciation as per **explanation 5 to section 32(1).**

SOME CASES STUDIES:

5.) To claim depreciation it is not necessary that asset to be registered in the name of the assessee. **Registration of name under the Registration Act is not determinative of ownership. WHAT HAS TO BE SEEN IS THE BENEFICIAL OWNERSHIP.**

-- Case of **Mysore Minerals Limited**

6.) Depreciation is **allowed** when the asset is **actually put to use.**

-- Case of **Dineshkumar Gulabchand Agarwal**

7.) Temple inside factory will be a part of **building** & eligible for **depreciation.**

-- Case of **Atlas Cycle Industries Limited**

8.) A stock exchange card is a **"license"** and eligible for depreciation u/s 32(1)(ii) .

-- Case of **Techno Shares & stocks (SC) (2010)**

SECTION 43(3): DEFINITION OF “PLANT “

“Plants “to include **SHIPS, BOOKS, VEHICLES, SCIENTIFIC APPARATUS AND SURGICAL EQUIPMENTS** used for the purpose of business or profession but **doesn’t include** TEA BUSHES, LIVESTOCK OR BUILDING OR FURNITURE.

EXPLANATION 1 TO SEC- 32(1): CONCEPT OF “DEEMED BUILDING “

Where the business or profession of the assessee is carried on in a building

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NOT OWNED BY HIM (BUT HOLDS A LEASE OR OTHER OCCUPANCY RIGHT) AND HE INCURS ANY CAPITAL EXPENDITURE

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THEN SUCH CAPITAL EXPENDITURE WILL BE TREATED AS THE BUILDING OWNED BY THE ASSESSEE.

SECTION 32(1) (iia): CONCEPT OF “ADDITIONAL DEPRECIATION “

-- In case of any new plant or machinery,

-- other than SHIPS & AIRCREFTS

-- acquired & installed after **31-03-2005** by an assessee

-- engaged in the business of **manufacture or production** of any article/thing

-- a further sum equal to 20% of actual cost of such plant & Machinery

-- shall be allowed as deduction under section 32(1) (ii).

Concept of additional depreciation not applicable on:

(a) Any machinery/plant, **before its installation by the assessee,** was used in or outside India by any other person.

(b) Any machinery/ plant **installed in office premises, residential accommodation**
In nature if guest house also.

(c) Any office appliance or road transport vehicle.

(d) Any machinery/ plant, **the whole of the actual which is allowed as deduction.**

SECTION – 50: SPECIAL PROVISION FOR COMPUTATION OF CAPITAL GAIN IN CASE OF DEPRECIABLE ASSETS

Notwithstanding **(overruling)** anything contained in section 2(42A)***[Sec-2(42A) is of PERIOD OF HOLDING.]** where the capital asset forming part of **block of assets** in respect of which depreciation is allowed, THEN any amount of capital gain will be SHORT TERM CAPITAL GAIN. It covers the following 2 cases:

1.) **Total sales consideration > (Expenditure on transfer + WDV of block of assets at beginning of previous year + Actual cost of any assets acquired during the year)**

***Here notwithstanding is written i.e. over ruling section 2(42A) i.e. under section 50, whatever the amount of capital gain & whatever may be the period of holding, capital gain will always be SHORT TERM CAPITAL GAIN.**

As per section 2(42A) : Asset hold more than 36 months: LONG TERM CAPITAL GAIN
Asset hold less than 36 months: SHORT TERM CAPITAL GAIN

The above asset doesn't include SHARES. In shares the time period is **12 months** instead of **36 months**

2.) **Where the block of asset ceases to exist** for the reason that **all the assets** are **transferred** during the previous year. **Short term capital gain**:

	Sales consideration in respect of transfer of assets	XXX
Less :		
(i)	W.D.V. of block of assets at beginning of previous year	XXX
(ii)	Actual cost of the assets falling within the block Acquired during the previous year	XXX
(iii)	Expenditure incurred wholly & exclusively in connection With the transfer	XXX
	SHORT TERM CAPITRAL GAIN	**XXX**

SECTION – 43(1): ACTUAL COST

“ACTUAL COST” means:

Actual cost of the asset to the assessee **less** portion of the cost which has been met directly/indirectly by other person

SOME CASES STUDIES:

(A.) Interest paid before commencement of **business** to be added to **actual cost.**

-- Case of **Challapali Sugar Mills Ltd. (SC)**

(B.) Expenses on test run of machinery prior to production are **– PART OF COST.**

-- Case of **Food Specialties Ltd.**

(C) Salaries, expenses of guest house maintained for erection staff, traveling, vehicle and general expenses to set up the plant **forms part of the actual cost.**

-- Case of **Hindustan Polymers ltd.**

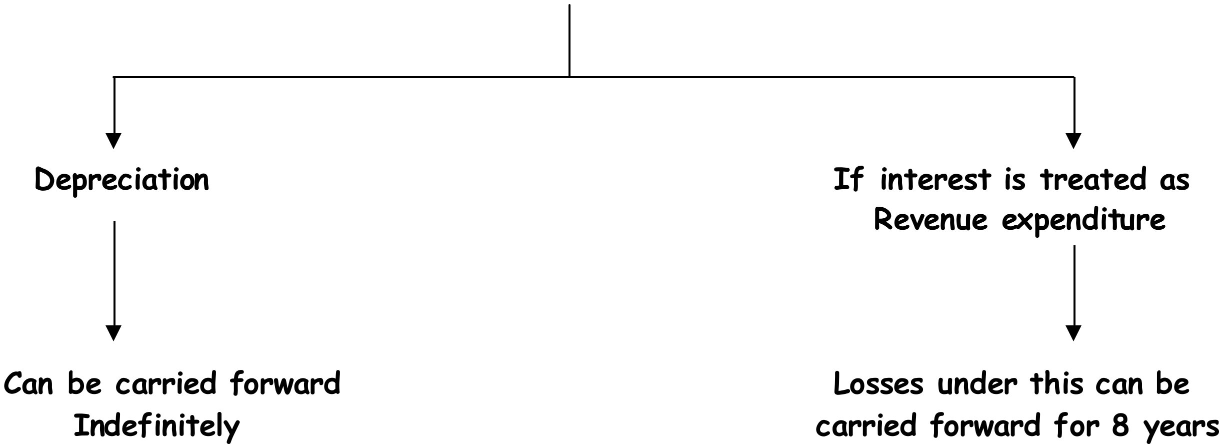
EXPLANATION 8 TO SECTION 43(1)

Interest paid after the asset put to use shall not be included in the actual cost of the assets. It means that such amount has to be treated as revenue expenditure.

Reason of inserting this explanation:

Reliance used to capitalize interest on loan even after the commencement of the business. It was done because of the following reasons:

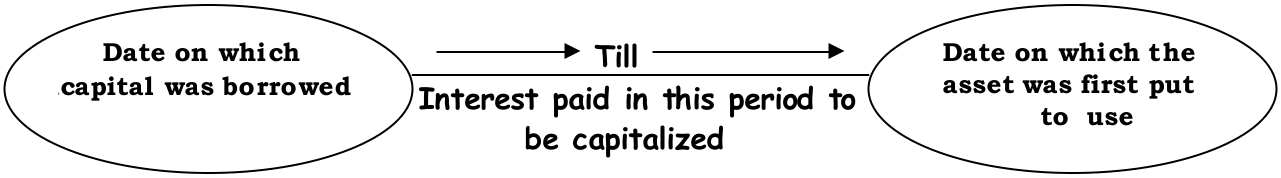
- Depreciation rate was high so that results in **lower profits** or **zero tax**.
- Also in case of losses suffered by the company :



So such tax planning was nullified by inserting the explanation 8 to section 43(1)

Another important Point:

Amount of interest paid on borrowed capital for the **acquisition of an asset for extension of existing business or profession**



EXPLANATIONS TO SECTION – 43(1): DETERMINATION OF ACTUAL COST IN SPECIAL CASES

1.) **EXPLANATION 1**

Asset is used for the Scientific research **& then used** → **for** Business

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(Here deduction of 100% is allowed u/s 35)

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Actual cost to assessee is NIL
[COA = NIL]

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2.) **EXPLANATION 2**

<u>If assessee acquires the asset by way of GIFT/ INHERITANCE:</u>

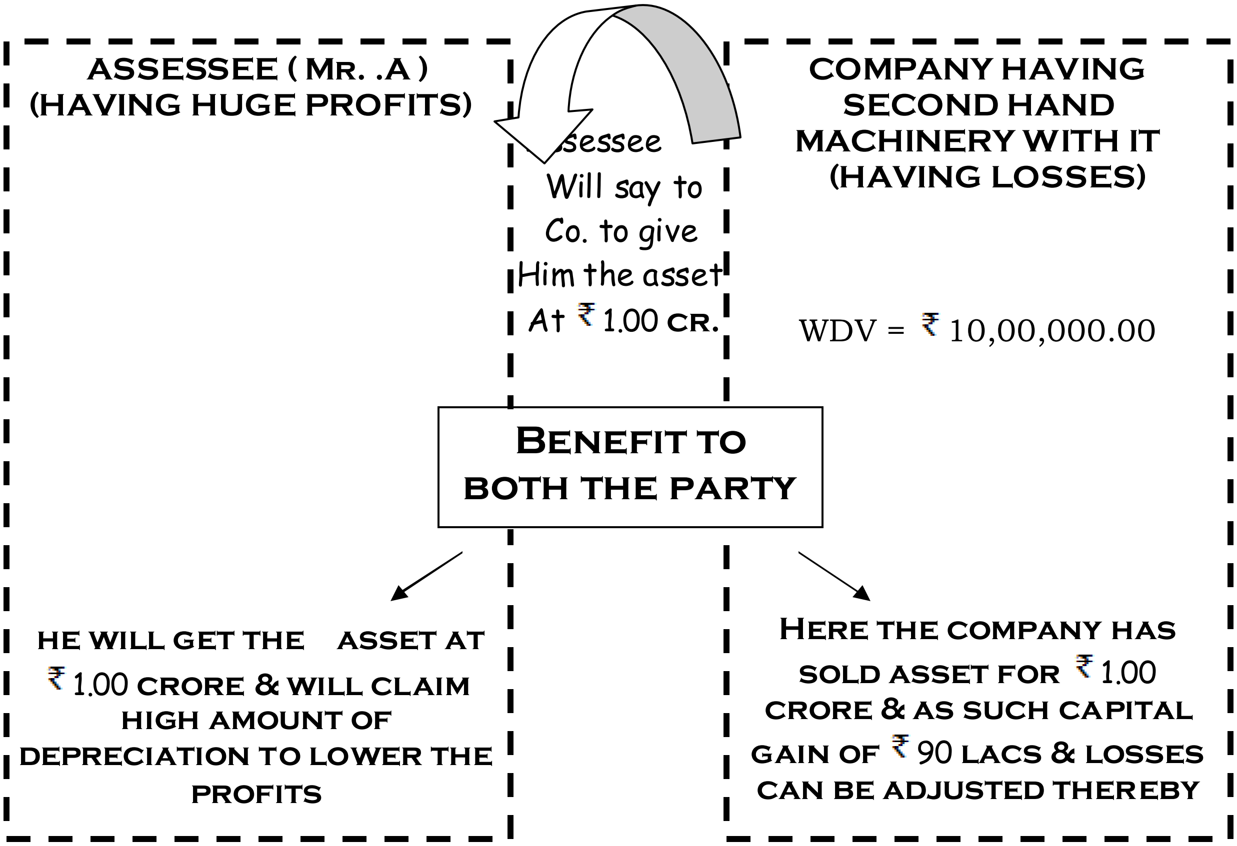
Cost to the assessee:

PARTICULARS	***AMOUNT***
Cost to previous Owner	**XXX**
Less: 1. Depreciation allowed up to AY 87-88 2. Depreciation would have been allowed as if it is the only asset in the block of assets	**XXX**
TOTAL	**XXX**

In case the previous owner **(other than the assessee)** is not claiming depreciation, then in order to arrive at the actual cost to assessee no depreciation has to be deducted from the cost.

3.) **EXPLANATION 3**

First we will take the example and then read the language of the section:



ASSESSEE (MR. .A)
(HAVING HUGE PROFITS)

sessee
Will say to
Co. to give
Him the asset
At ₹ 1.00 CR.

COMPANY HAVING SECOND HAND MACHINERY WITH IT
(HAVING LOSSES)

WDV = ₹ 10,00,000.00

BENEFIT TO BOTH THE PARTY

HE WILL GET THE ASSET AT ₹ 1.00 CRORE & WILL CLAIM HIGH AMOUNT OF DEPRECIATION TO LOWER THE PROFITS

HERE THE COMPANY HAS SOLD ASSET FOR ₹ 1.00 CRORE & AS SUCH CAPITAL GAIN OF ₹ 90 LACS & LOSSES CAN BE ADJUSTED THEREBY

This tax planning was therefore nullified by inserting EXP.-3 to section 43(1)

Law language:

-- Where before the date of acquisition by the assessee,

-- The asset **was at any time used by any person (Company having loss)**

-- For the purpose of his business

-- And the assessing officer **is satisfied that the main purpose of transfer of such asset, directly or indirectly to the assessee**

-- was the reduction of income tax liability (In **this case- Mr. A)**

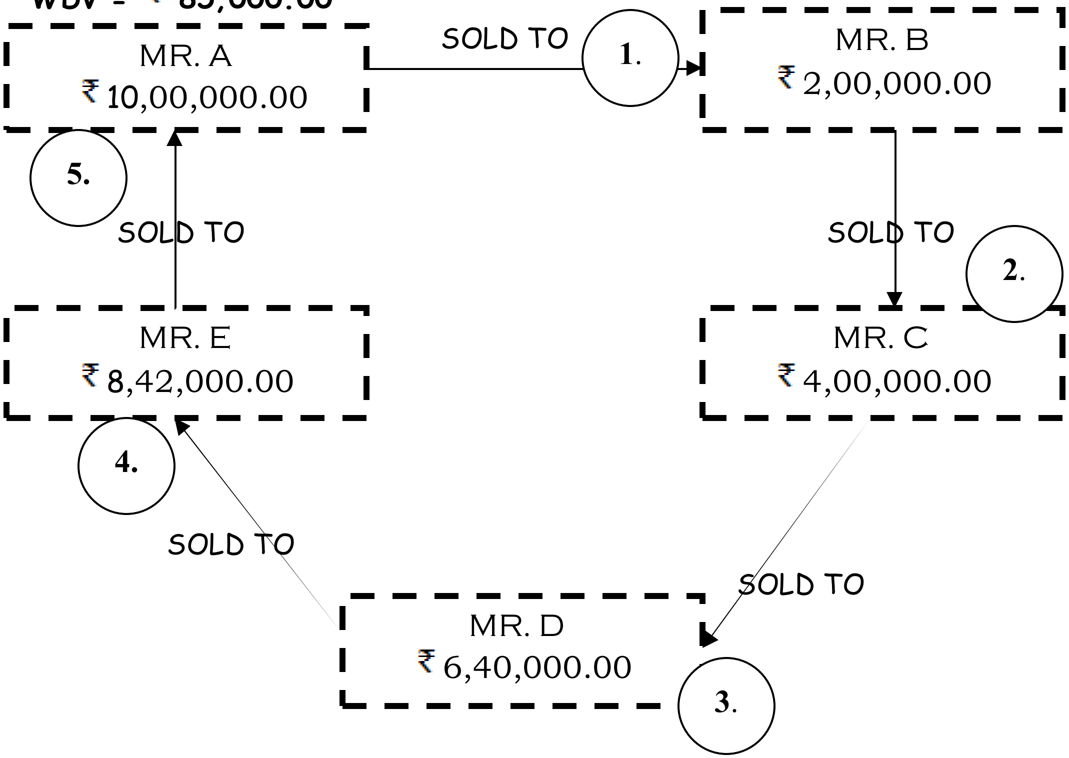
-- **THE ACTUAL COST of ASSET TO THE ASSESSEE** will be **determined** by the **ASSESSING OFFICER** with the prior approval of **JOINT COMMISSIONER.**

4.) EXPLANATION 4

Lets take an example first, then will do the language of the section

Asset = ₹ 1,00,000.00

WDV = ₹ 85,000.00



Law language:

- Where any asset which had once belonged to the **assessee (here MR. A)**
- And had been used by him for the purpose of his business or profession
- And thereafter ceased to be his property by reason of transfer **(Mr. A sold to Mr. B)**
- Is re-acquired by him **(Here it means when Mr. E sold to Mr. A)**
- **THEN THE ACTUAL COST TO THE ASSESSEE SHALL BE :**

The actual cost for which the asset is re-acquired by him

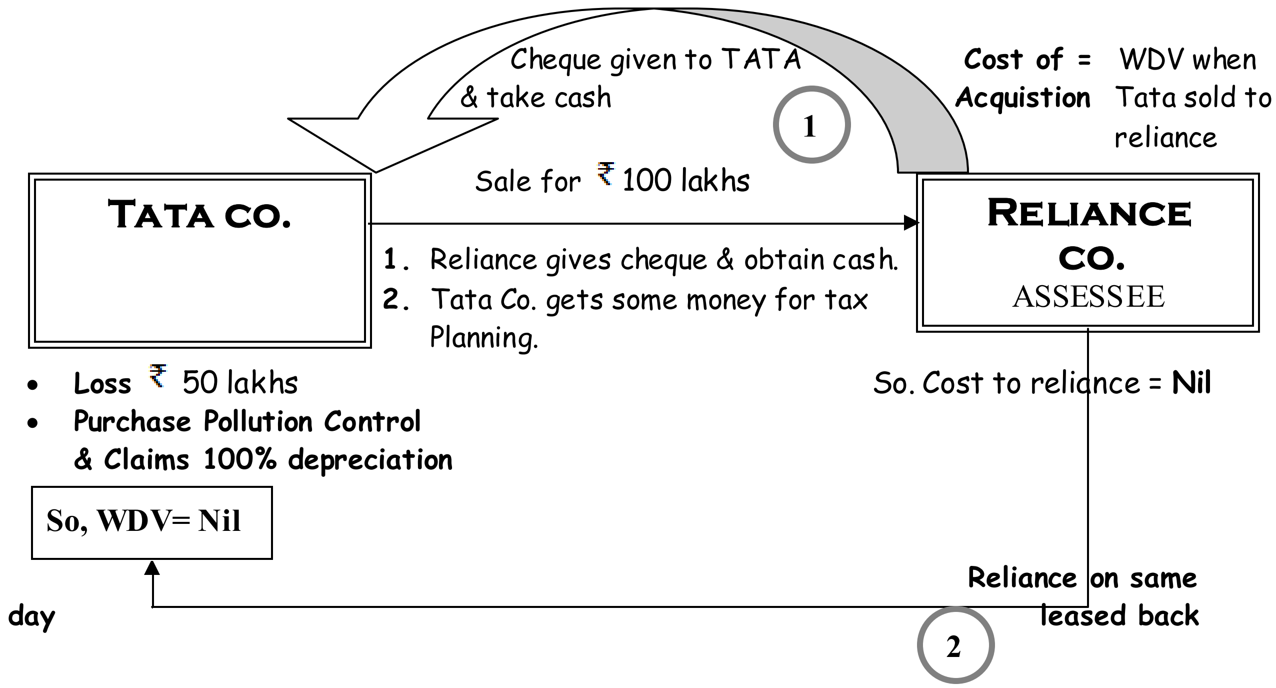
OR

Actual cost to assessee (Mr. A) **reduced by – Depreciation allowable to Mr. A**

} **LOWER OF**

5.) **EXPLANATION 4A**

Lets take an example first, then will do the language of the section



Here as per **explanation 4A,** reliance is the owner of the asset & shall claim depreciation. However in this case, **actual cost in the hands of RELIANCE** will be taken as **NIL.**

Law language:

- Where before the date of acquisition by the assessee (Reliance) **[FIRST PERSON]**
- The asset were at any time used by any other **(Tata) [referred as SECOND PERSON]**
- And depreciation has been claimed in respect of such asset by the second person (TATA**)**
- And such person (TATA) acquires on lease, hire or otherwise, asset from first person **(Reliance)**
- Then notwithstanding **(over-ruling)** anything contained in **explanation 3,**

ACTUAL COST = The written down value of the assets at time of transfer by **second Person (TATA) to first person (RELAINCE).**

6.) EXPLANATION 5

Let's take an example:

Building purchased for ₹ 10,00,000.00 **on 01-01-2007. After that in 2010-11, the building is brought into business (01-01-2011). Compute the actual cost in the hands of the assessee?**

ACTUAL COST	₹ 10,00,000.00
Less: **Depreciation for the year**	
2006-07 @ 5% (half depreciation)	₹ 50,000.00
2007-08 @ 10%	₹ 95,000.00
2008-09 @ 10%	₹ 85,500.00
2009-10 @ 10%	₹ 76,950.00
ACTUAL COST FOR P/Y 2010-11	₹ **6,92,550.00**

Law language:

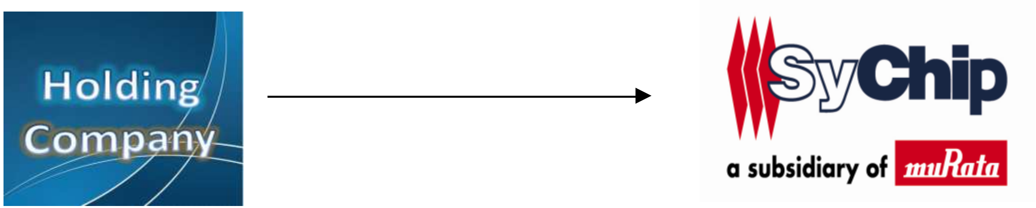
- Where **a building** previously the property of the assessee is **brought** into use for the purpose of the **business or profession,**
- The **ACTUAL COST TO THE ASSESSEE,**

ACTUAL COST OF THE BUILDING REDUCED BY **an amount equal to depreciation calculated at the rate in force on that date* that would have been allowable had the building been used for business purpose since the date of acquisition.**

* On that means **date on which building is brought into business.**

7.) EXPLANATION 6

Where a capital asset is **transferred by**



HOLDING CO. **SUBSIDIARY CO.**

Actual cost of the Transferred asset to subsidiary Co.	=	shall be taken to be same as it would have been if transferor company had continue to hold it as CAPITAL ASSET.

APPLICABILITY OF EXPLANATION 6 TO SECTION 43(1) :

(A) **Asset is non depreciable in hands of the holding co., but is depreciable fro subsidiary co.**

(B) **Holding purchase and sell the asset to subsidiary in same year.**

However following conditions to be satisfied:

(1) The **whole of share capital (100%)** of the subsidiary is held the holding Company.

(2) The subsidiary company is an Indian company.

However, AS PER EXPLANATION 2 TO SECTION 43(6):

Where any block of asset is transferred by holding company to subsidiary company and conditions of <u>section 47 (transfer not regarded as transfer)</u> are satisfied:

ACTUAL COST OF THE BLOCK OF ASSET FOR TRANSFEREE COMPANY	**shall be**	WDV of the block of asset in hands of the holding company **at the beginning of previous year when** the transfer took place.

Example : H ltd having WDV of block of asset on 01-04-2010 is ₹5,00,000.00. On 30-01-2011, ltd transfer this block to S ltd for ₹8,00,000.00. Compute the actual cost for S ltd.

Ans : Assuming that conditions of explanation 6 is satisfied & also of section 47, then as per explanation 2 to 43(6), **actual cost to S ltd will be ₹5,00,000.00. (WDV at beginning)**

8.) EXPLANATION 7

Where a capital asset is **transferred by**

AMALGMATING CO. **AMALAGMATED CO**

Actual cost of the Transferred asset to amalgamated Co. = shall be taken to be same as it would have been if amalgamating company had continue to hold it as CAPITAL ASSET.

However, AS PER EXPLANATION 2 TO SECTION 43(6):

Where any block of asset is transferred by amalgamating company to amalgamated company and amalgamated company is an Indian company, then the:

ACTUAL COST OF THE BLOCK OF ASSET FOR TRANSFEREE COMPANY **shall be** WDV of the block of asset in hands of the holding company **at the beginning of previous year when** the transfer took place.

9.) EXPLANATION 8

Discussed on page 11 & 12.

10.) EXPLANATION 9

- Where an asset is or has been **acquired** on or after **01-03-1994** by an assessee.
- The actual cost of asset **shall be reduced by**
- The amount of **duty of excise** or **the additional duty under custom,** in respect of which a claim has been made allowed under the central excise rules, 1994.

Important note:

It means that in case if credit of any amount is taken for excise on the machinery then the assessee can't claim depreciation on the amount of excise & hence to be excluded from the cost of the asset.

11.) EXPLANATION 10

Where a portion of the asset acquired by the assessee have been met directly or indirectly by

- **Central govt.**
- **State govt.**
- **Any authority established under law.**

- **In the form of subsidy, grant, reimbursement,**
- **Then so much of the cost as is relatable to such subsidy/ grant / reimbursement SHALL NOT BE INCLUDED IN THE ACTUAL COST OF THE ASSET TO THE ASSESSEE.**

Some important points under this explanation:

1.) If grant is not directly relatable to the assets, then

$$\frac{\text{Subsidy amount}}{\text{Total cost of all assets}} \text{ X } \text{Cost of individual asset}$$

Example: A company received subsidy in the assets @ 20% of the total value of the assets. Details of the assets:

Plant 1	₹ 40.00 lakhs
Plant 2	₹ 60.00 lakhs
Plant 3	₹ 100.00 Lakhs
	₹ 200 lakhs

Now the amount of subsidy = 20% of ₹ 200.00 lakhs = ₹ 40.00 lakhs. Now this amount of subsidy will be divided among the 3 plants in the ratio mentioned above:

	SUBSIDY AMOUNT	**COST OF ASSET**
PLANT 1:	$\frac{40}{200}$ X 40 = ₹ 8.00 lakhs	₹ 40.00L - ₹ 8.00L = ₹ 32.00L
PLANT 2:	$\frac{40}{200}$ X 60 = ₹ 12.00 lakhs	₹ 60.00L - ₹ 12.00L = ₹ 48.00L
PLANT 2:	$\frac{40}{200}$ X 100 = ₹ 20.00 lakhs	₹ 100.00L - ₹ 20.00L = ₹ 80.00L
	₹ 40 lakhs	₹ 160lakhs

12.) EXPLANATION 11

Where an asset which was acquired assets
Outside INDIA, by assessee being a NON RESIDENT

Asset was brought in India for Business OR profession

Then ACTUAL COST to assessee:

ACTUAL COST	XXX
Less: Amount of depreciation calculated At the rate in force that would have been allowed had the asset been used in India for the said purpose **since the date of its** acquisition by assessee.	XXX

Example:

If an assessee purchase computer on 01.01.2006 outside India & bought that computer in India for business or profession on 01.01.2011, then he will be allowed to claim depreciation from

AY 2006-07, AY 2007-08, AY 2008-09, AY 2009-10, AY 2010-11