

PROFITS & GAINS OF BUSINESS OR PROFESSION ~ I

Section 28 : Basis of Charge

Following incomes are chargeable to tax under the head PGBP :

- (A) Profits and gains of any business / profession carried on by the assessee at any time during the previous year.
- (B) Profit on sale of import entitlement licence granted on account of export under any scheme of the Government of India.
- (C) Cash assistance received / receivable against exports.
- (D) Drawback of custom / excise duties.
- (E) Value of any benefit or perquisite, whether convertible into money or not, arising from business or profession.
- (F) Any sum received under a key man insurance policy including bonus.
- (G) Income derived by a trade, professional or similar association from “specific services performed” for its members.
- (H) Any interest, salary, bonus, commission or remuneration due to or received by “partner” to the extent allowed to the firm.
- (I) Any compensation or other payment due to or received by :
 - (i) any person in connection with termination (or modification) of his agreement for managing the whole (or substantially the whole) of the affairs of an Indian company (or any other company);
 - (ii) any person holding an agency in India for any part of the activities relating to the business of any other person, at (or in connection with) the termination (or modification) of the terms of the agency.
 - (iii) any person for (or in connection with) the vesting in the Government (or in any corporation owned by or controlled by the Government), under any law for the time being in force, of the management of any property or business.
- (J) Any sum received or receivable in cash or in kind under an agreement for :
 - (i) not carrying out any activity in relation to any business; or
 - (ii) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.
- (K) Income from *speculative transaction*.
- (L) *any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD [Section 28(vii)].*

Section 43 (5) : Speculative transaction

“*Speculative transaction*” means a transaction in which a contract for the purchase or sale of any commodity (including shares and stocks) is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

Explanation 2 to Section 28

Where the *speculative transactions* carried on by an assessee are of such a nature as to constitute a business, such business (i.e. “Speculation business”) shall be deemed to be distinct and separate from any other business.

Section 29 : PGBP - How computed?

The income referred to in section 28 shall be computed in accordance with the provisions contained in Sections 30 to 43D.

Section 30 : Rent, rates, taxes, repairs and insurance for buildings

Nature of expenditure	Deduction if building is taken on rent	Deduction if building is owned
Rent <i>paid</i> ***	Allowed	-----
Cost of repairs (Revenue nature)	Allowed	Allowed
Cost of repairs (Capital nature)	Not allowed	Not allowed
Land Revenue, Municipal Tax, Local Rates	Allowed	Allowed
Premium on insurance of building against damage or destruction	Allowed	Allowed

Section 43 (2)

For the purposes of Section 28 to 43, the word “*paid*”*** means “actually paid” or “incurred” according to the *method of accounting* upon the basis of which income is computed under the head PGBP.

Section 145 : Method of accounting

Income chargeable under the head PGBP shall be computed in accordance with method of accounting regularly employed by the assessee. In other words :

- ☞ If Mercantile System is regularly employed by the assessee, the income is taxable on “accrual” basis.
- ☞ If Cash System is regularly employed by the assessee, income is taxable on “receipt” basis.
- ☞ If method of accounting have not been regularly followed by the assessee, the A.O. may make Best Judgment Assessment after giving an opportunity of being heard to the assessee.

Method of accounting irrelevant in some cases :

In the case of incomes chargeable under the head IHP, Salaries and Capital Gains the method of accounting adopted by the assessee is not relevant in determining taxable income because under these heads of income Income-tax Act, 1961 expressly provide the treatment of income and expenditure.

Section 31 : Repairs and insurance of machinery, plant & furniture

- (a) Repairs (revenue nature) – Deduction is allowed
- (b) Repairs (capital nature) – Deduction is not allowed
- (c) Insurance against damage / destruction – Deduction is allowed

Section 32 : Depreciation

In respect of :

- (i) Building, machinery, plant or furniture, being **tangible** assets;
- (ii) Know-how, patents, copyright, trademarks, licences, franchises or any other business or commercial rights of similar nature, being **intangible** assets acquired on or after 1-04-1998,
 - owned wholly or partly by the assessee
 - and used for the purposes of the business or profession
 - depreciation shall be allowed
 - on the WDV of the block of assets
 - at the prescribed percentage.

Notes :

1. If any asset falling within a block of assets is **acquired during the P.Y.** and is **put to use** for less than 180 days in that P.Y. then depreciation will be restricted to 50% of depreciation allowable. Restriction of 50% depreciation is applicable for the **year of acquisition only** and is applicable for both tangible as well as intangible assets. In other words :
 - (a) If in the first year, in which an asset is acquired, it is put to use for less than 180 days, 50% of the normal depreciation is available.
 - (b) If an asset is not used at all, no depreciation in respect of that asset is available. This rule is applicable in the first year in which the asset is acquired as well as in the subsequent years.
 - (c) In the subsequent year if the asset is put to use for sometime (may be less than 180 days), normal depreciation is available.
2. If business / profession is carried on by the assessee in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy then any **Capital expenditure** incurred by him will be treated as building **owned by him** [Explanation 1 to Section 32 (1)].
3. The aggregate deduction, in respect of depreciation allowable to :
 - (a) The predecessor and the successor in case of succession referred to in Section 47(xiii) or Section 47(xiiib) Section 47(xiv) or Section 170; or
 - (b) The amalgamating company and the amalgamated company in case of amalgamation; or
 - (c) The demerged company and the resulting company in case of demerger
 - as the case may be
 - shall not exceed in any P.Y. (in which succession/amalgamation/demerger takes place), the deduction calculated at the prescribed rates as if the succession / amalgamation / demerger had not taken place. Such deduction shall be apportioned between transferor and the transferee in the ratio of number of days for which asset was **used** by them.

Section 47 (xiii) :

Transfer of a capital asset by a firm to a company as a result of succession of firm by a company

Section 47 (xiib) :

Transfer of a capital asset by a private company/unlisted public company to LLP as a result of Conversion of private company/unlisted public company into LLP

Section 47 (xiv) :

Transfer of a capital asset by a proprietorship concern to a company as a result of succession of proprietorship concern by a company

Section 170 : Succession of business otherwise than on death :

Where a person succeeds business / profession of any other person :

- Predecessor shall be assessed in respect of the income of the P.Y. in which the succession took place up to the date of succession &
- Successor shall be assessed in respect of the income of the P.Y. after the date of the succession.

4. Table of rates at which depreciation is admissible – See “Appendix – 1”

Section 2 (11) : Block of Assets

“Block of assets” means a group of assets falling within a *class of assets* [i.e. a) and b) below] comprising :

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know- low, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature

in respect of which same percentage of depreciation is prescribed.

Notes :

1. Assets eligible for depreciation have been classified into four classes :
 - I. Building
 - II. Furniture and fittings
 - III. Plant and machinery
 - IV. Intangible assets
2. If an asset is stolen / destroyed from block of assets and no insurance compensation is received and there are other assets in the block, then no separate tax treatment will be required. The loss on theft / destruction of assets shall be contained in the WDV of the block and shall be allowed as depreciation over a no. of years.
3. If in the above case, the asset stolen/damaged was the only asset in the block, the WDV of the block shall become *nil* since the block ceases to exist. In this case Section 50 is not attracted since there is no transfer and no insurance compensation is received. The WDV of the block has no tax treatment and is a capital loss (i.e. dead loss). To avoid such capital loss the assessee should purchase an asset in the said block of asset. In such a case depreciation shall be allowed on the opening WDV plus actual cost of the asset so purchased.

Section 43 (6) : Written Down Value

WDV of the block of assets at the beginning of <i>P.Y.</i> (i.e. as on 1-4-2010)	*****
Add : <i>Actual cost</i> of the asset falling within the block acquired during the previous year	*****
Less : <i>Money payable</i> in respect of the assets sold / discarded / demolished / destroyed during the <i>P.Y.</i> and the amount of scrap value	*****
WDV of the block at the end of the <i>P.Y.</i> (i.e. as on 31-3-2011) for the purpose of charging depreciation for the <i>P.Y.</i>	*****
Less : Depreciation for <i>P.Y.</i> 2010-11	*****
WDV of the block at the beginning of next previous year (i.e. as on 1-4-2011)	*****

Notes :

1. *Actual cost* means the actual cost of the asset to the assessee, reduced by that portion of the cost which has been directly or indirectly met by any other person or authority.
2. *Money payable* means Sale Price and includes insurance compensation.
3. The reduction of *money payable* shall only be to the extent that WDV becomes NIL.
4. Depreciation on fractional ownership is allowed.
5. No depreciation is admissible where WDV has been reduced to zero, though the block of assets does not cease to exist (i.e. *block of the assets is not empty*) on the last day of the previous year.
6. If a block of asset cease to exist or if all assets of the block have been transferred and the *block of the assets is empty* on the last day of the previous year, no depreciation is admissible in such case.

Section 50 : Special provision for computing CG in case of depreciable assets

Computation of capital gain / loss can be made only in following two situations :

1. On the last day of the previous year, *WDV of the block of assets is zero*, although block of assets is not empty because all assets in that block are not transferred during the previous year.
2. When the *block of assets is empty on the last day of the previous year* because all assets in that block are transferred during the previous year

Computation of capital gain

Sale Consideration		*****
Less : WDV of the block of assets at the beginning of <i>P.Y.</i> (i.e. as on 1-4-2010)	*****	
<i>Actual cost</i> of the asset falling within the block acquired during the previous year	*****	
Transfer expenses	*****	*****
Short-term capital gain		*****

Notes :

1. It is not necessary that depreciation is allowed for the year under consideration. If the depreciation is allowed in the current year (or any of the earlier years), Section 50 will be applicable.
2. If Section 50 is not attracted then the expenditure on transfer of asset from the block of assets shall be allowed as business expenditure under Section 37(1). It shall not be reduced from sales consideration.
3. Value of any money or *FMV of assets* received as compensation from insurance company shall be deemed to be full value of consideration received as a result transfer of capital asset which was destroyed [Section 45(1A)].

 Section 38 (2)

Where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, then :

- the deduction under Section 30 (Rent, rates, taxes, repairs and insurance for buildings),
- the deduction under Section 31 (Repairs and insurance of machinery, plant & furniture) and
- the deduction under Section 32 (depreciation)

shall be restricted to a fair proportionate part thereof which the assessing officer may determine having regard to the use of such building, machinery, plant or furniture for the purposes of business or profession.

Illustration :

Suppose on 15-04-2010, X purchased a car for ₹ 2 lakhs on which depreciation @ 15% is admissible. Car is used by X both for his business as well as personal purposes. Assessing officer determined that 30% of total use of car is attributable to the personal purposes of X. Determine the depreciation admissible for the assessment year 2011-12 and assessment year 2012-13.

Solution :**Assessment year : 2011-12**

Actual cost of the car		2,00,000
Less : Depreciation (₹ 2,00,000 x 15%)	30,000	
Less : Disallowed for personal use u/s 38 (2) [30% of ₹ 30,000]	<u>9,000</u>	21,000
WDV as on 01-04-2011		<u>1,79,000</u>

Assessment year : 2012-13

WDV as on 01-04-2011		1,79,000
Less : Depreciation (₹ 1,79,000 x 15%)	26,850	
Less : Disallowed for personal use u/s 38 (2) [30% of ₹ 26,850]	<u>8,055</u>	18,795
WDV as on 01-04-2012		<u>1,60,205</u>

Section 32 (2) : Unabsorbed depreciation

Following steps are to be followed while dealing with unabsorbed depreciation :

Step I	Depreciation allowance of the current previous year is first deductible from the income chargeable under the head “PGBP”
Step II	If depreciation allowance is not fully deductible under the head “PGBP” because of absence or inadequacy of profits, it is deductible from income chargeable under other heads of income (except income under the head “Salaries”) of the current previous year.
Step III	If depreciation allowance still remains unabsorbed, it can be carried forward to the subsequent assessment year(s) by the same assessee.

Notes :

- Unabsorbed depreciation can be carry forward and set off, even if ROI is filed after the **due date** of furnishing of return of income.
- No time limit is fixed for the purpose of carrying forward of unabsorbed depreciation, it can be carried forward for indefinite period, if necessary.
- In the subsequent A.Y.(s), unabsorbed depreciation can be set off against any income whether chargeable under the head “PGBP” or under any other head (except income under the head “Salaries”). In the matter of set off, the following order of priority is followed in the subsequent A.Y.(s) :
 - Depreciation of current previous year.
 - Brought forward business loss.
 - Brought forward unabsorbed depreciation

If in the subsequent assessment year(s), there is no **brought forward business loss**, brought forward unabsorbed depreciation can be added to **depreciation of current previous year** for the purpose of claiming deduction.

- For claiming depreciation, the assessee should be the **beneficial owner** of the asset. It is not necessary that he should be registered owner.
- Revaluation of assets does not have any impact under Income Tax Act. For calculation of depreciation, revaluation should be ignored.

Tax treatment of sum received under Key Man Insurance policy

Sum received by employee :

Employer & employee relationship exists = Taxable as salary.

Employer & employee relationship does not exist = Taxable as IOS

Sum received by management :

Taxable as PGBP

Section 2(29BA)

“Manufacture”, with its grammatical variations, means a change in a **non-living** physical object or article or thing :

- resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or
- bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

APPENDIX ~ 1

TABLE OF RATES AT WHICH DEPRECIATION IS ADMISSIBLE

Assets eligible for depreciation have been classified into four classes :

- I. Building
- II. Furniture and fittings
- III. Plant and machinery
- IV. Intangible assets

I. Class of asset : Buildings

Block No.	Name of Asset	Rate of Depreciation
Block 1	Residential buildings.	5%
Block 2	Non-residential buildings (e.g. office, factory, godown, hotels, boarding houses etc.).	10%
Block 3	Purely temporary erections such as wooden structures.	100%

Note : “Buildings” include roads, bridges, culverts, wells and tube-wells.

II. Class of asset : Furniture and fittings

Block No.	Name of Asset	Rate of Depreciation
Block 1	Furniture and fittings including <i>electrical fittings</i> .	10%

Note : “*Electrical fittings*” include electrical wiring, switches, sockets, other fittings and fans etc.

III. Class of asset : Plant and machinery

Block No.	Name of Asset	Rate of Depreciation
Block 1	(a) Motor cars (other than those used in a business of running them on hire). (b) Any plant and machinery (other than those covered by Block No. 2 to 8 below).	15%
Block 2	Ocean-going ships, vessels ordinarily operating on inland waters including speed boats.	20%
Block 3	(a) Motor buses, motor lorries and motor taxis used in a business of running them on hire. (b) Moulds used in rubber and plastic goods factories. (c) Machinery used in semi-conductor industry.	30%

Block 4	(a) Aeroplanes – Aeroengines. (b) Specified life saving medical equipments.	40%
Block 5	(a) Containers made of glass or plastic used as re-fills.	50%
Block 6	(a) Computers including computer software. (b) Books (other than annual publication) owned by a professional. (c) Gas cylinders. (d) Plant used in field operations by mineral oil concerns. (e) Direct fire glass melting furnaces used in glass manufacturing concerns.	60%
Block 7	(a) Energy saving devices (e.g. Automatic Voltage Controller). (b) Renewal energy devices (e.g. Flat Plate Solar Collectors). (c) Rollers in flour mills, sugar works and steel industry.	80%
Block 8	(a) Air pollution control equipments. (b) Water pollution control equipments. (c) Solid waste control equipments. (d) Wooden parts used in artificial silk manufacturing machinery. (e) Cinematograph films, bulbs of studio lights. (f) Wooden match frames in match factories. (g) Some plants used in mines, quarries and salt works. (h) Books (annual publication) owned by a professional. (i) Books (may or may not be annual publication) owned by assessee carrying on business in running libraries.	100%

I V . C l a s s o f a s s e t : I n t a n g i b l e a s s e t s

Block No.	Name of Asset	Rate of Depreciation
Block 1	Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial right of similar nature.	25%

PROFITS & GAINS OF BUSINESS OR PROFESSION ~ I

PRACTICAL PROBLEMS

Question No. 1 :

- (a) X acquired a building on 1-1-1995 for ₹ 2,00,000. No depreciation was ever claimed on this building and this building was not taken to any block of assets. X sold the building on 15-1-2011 for ₹ 6,00,000. Compute capital gain taxable in the hands of X.
- (b) What will be your answer if depreciation of ₹ 20,000 was claimed on the above building in assessment year 1995-96 only ?

Question No. 2 :

Discuss tax implication in the following situations, assuming rate of depreciation being 25% :

Situation 1 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	3,00,000
Asset F acquired on 30-06-2010	4,00,000
Asset A & B sold on 31-12-2010	5,00,000

Situation 2 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	3,00,000
Asset F acquired on 31-5-2010	7,00,000
Asset A & B sold on 30-04-2010	6,00,000

Situation 3 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	2,00,000
Asset F acquired on 31-5-2010	3,00,000
Asset A sold on 31-01-2011	9,00,000
Asset B sold on 31-06-2011	2,00,000

Situation 4 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	5,00,000
Asset F acquired on 01-06-2010	1,00,000
All assets (A, B, C, D, E & F) sold on 31-12-2010	2,00,000

Situation 5 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	5,00,000
Asset F acquired on 01-06-2010	1,00,000
All assets (A, B, C, D, E & F) sold on 31-12-2010	9,00,000

Situation 6 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	2,00,000
Asset F acquired on 30-06-2010	1,00,000
Asset A destroyed in fire on 31-12-2010 and insurance compensation received	1,50,000

Situation 7 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	2,00,000
Asset F acquired on 30-06-2010	1,00,000
Asset A destroyed in fire on 31-12-2010 and insurance compensation received	7,00,000

Situation 8 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	2,00,000
Asset F acquired on 30-06-2010	1,00,000
All assets destroyed in fire on 01-01-2011 and insurance compensation received	1,50,000

Situation 9 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	5,00,000
Asset F acquired on 30-06-2010	2,00,000
Asset A destroyed in fire on 31-12-2010 and insurance compensation payable by insurance company	3,00,000
The above insurance compensation is determined on 18-02-2011 and is received on 31-12-2011.	

Situation 10 :

Depreciated value of block as on 1-4-2010 (Asset A, B, C, D & E)	5,00,000
Asset F acquired on 30-06-2010	2,00,000
Asset A destroyed in fire on 31-12-2010 and insurance compensation payable by Insurance Company	10,00,000
The above insurance compensation is determined on 18-02-2011 and is received on 31-12-2011.	

Question No. 3 :

Assessee is a tenant in a building in which he carries on his business. On 31-12-2008, he incurred an expenditure of ₹ 2,00,000 on constructing a room to be used as an office. On 4-12-2010, he vacated the building and receives from the landlord :

Case I	Nil
Case II	₹ 1,20,000
Case III	₹ 2,50,000

Show tax treatment for the relevant assessment years.

Question No. 4 :

X submits the following particulars :

	<u>P.Y. 2010-11</u>	<u>P.Y. 2011-12</u>
Income from salary	1,00,000	2,00,000
Business profits (before depreciation)	16,000	18,000
Current depreciation	1,34,000	1,32,000
Income from other sources	10,000	80,000

Determine the taxable income of X for the assessment years 2011-12 and 2012-13.

Question No. 5 :

X submits the following particulars :

	<u>P.Y. 2010-11</u>	<u>P.Y. 2011-12</u>
Business profits (before depreciation)	(-) 50,000	45,000
Current depreciation	18,000	20,000
Income from other sources	20,000	70,000

Determine the net income of X for the assessment years 2011-12 and 2012-13.

Question No. 6 :

Written down value of a block of assets (consisting of assets A, B, C, D & E) as on 1-4-2010 is ₹ 6,00,000 (Rate of depreciation : 20%). Compute the amount of depreciation admissible u/s 32 in the following different situations :

Different situations	Name of asset acquired on 15-11-2010	Actual cost of asset acquired on 15-11-2010	Name of asset transferred on 28-12-2010	Sale consideration of asset transferred on 28-12-2010
I	F	1,50,000	-----	-----
II	F	1,50,000	B	2,50,000
III	F	1,50,000	B	6,00,000
IV	F	1,50,000	B	7,00,000
V	F	1,50,000	B	7,50,000
VI	F	1,50,000	F	2,00,000
VII	F	1,50,000	F	1,00,000

PROFIT & GAINS OF BUSINESS OR PROFESSION ~ I**SOLUTIONS TO PRACTICAL PROBLEMS****Answer to Question No. 1 (a) :**

Section 50 is attracted only if a particular asset is taken to a block of assets. Since X neither claimed any depreciation on building nor taken the building to any block of asset, Section 50 is not attracted. In such a situation capital gain shall be computed as under :

Computation of capital gains**Name of assessee : X****P.Y. : 2010-11****A.Y. : 2011-12**

Period of holding : 01-01-1995 to 14-01-2011

Nature of capital asset = Long-term capital asset

Sale consideration	6,00,000
Less : Indexed cost of acquisition : $2,00,000 \times 711/259$	5,49,035
LTCG	<u>50,965</u>

Answer to Question No. 1 (b) :

Since X had claimed depreciation in A.Y. 1995-96, it is clear that he had taken the building into a block of asset and therefore Section 50 will be attracted. Capital gain shall be computed as under :

Sale consideration	6,00,000
Less : WDV as on 1-4-2010 (₹ 2,00,000 – ₹ 20,000)	1,80,000
STCG	<u>4,20,000</u>

Solution to Question No. 2 :**Situation 1 :****Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	3,00,000
Add : Actual cost of the assets acquired	4,00,000
	7,00,000
Less : Money payable in respect of the assets sold	5,00,000
WDV of the block as on 31-03-2011	2,00,000
Less : Depreciation for P.Y. 2010-11 : On ₹ 2,00,000 @ 25%	50,000
WDV of the block as on 1-4-2011	<u>1,50,000</u>

Section 50 is not attracted.

Situation 2 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	3,00,000
Add : Actual cost of the assets acquired	7,00,000
	10,00,000
Less : Money payable in respect of the assets sold	6,00,000
WDV of the block as on 31-03-2011	4,00,000
Less : Depreciation for P.Y. 2010-11 : On ₹ 4,00,000 @ 25%	1,00,000
WDV of the block as on 1-4-2011	<u>3,00,000</u>

Section 50 is not attracted.

Situation 3 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	2,00,000
Add : Actual cost of the assets acquired	3,00,000
	<u>5,00,000</u>
Less : Money payable in respect of the assets sold	5,00,000
WDV of the block as on 31-03-2011	Nil
Less : Depreciation for P.Y. 2010-11	Nil
WDV of the block as on 1-4-2011	<u>Nil</u>

Section 50 is attracted.

Computation of capital gain (A.Y. 2011-12)

Sale Consideration	9,00,000
Less : WDV of the block as on 1-4-2010	2,00,000
Actual cost of the assets acquired	3,00,000
Transfer expenses	<u>5,00,000</u>
Short-term capital gain	<u>4,00,000</u>

Computation of depreciation (A.Y. 2012-13)

WDV of the block as on 1-4-2011	Nil
Add : Actual cost of the assets acquired	Nil
	<u>Nil</u>
Less : Money payable in respect of the assets sold	Nil
WDV of the block as on 31-03-2012	Nil
Less : Depreciation for P.Y. 2011-12	Nil
WDV of the block as on 1-4-2012	<u>Nil</u>

Section 50 is attracted.

Computation of capital gain (A.Y. 2012-13)

Sale Consideration	2,00,000
Less : WDV of the block as on 1-4-2011	Nil
Actual cost of the assets acquired	Nil
Transfer expenses	<u>Nil</u>
Short-term capital gain	<u>2,00,000</u>

Situation 4 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	5,00,000
Add : Actual cost of the assets acquired	1,00,000
	<u>6,00,000</u>
Less : Money payable in respect of the assets sold	2,00,000
WDV of the block as on 31-03-2011 (Block ceases to exist)	<u>Nil</u>

Section 50 is attracted.

Computation of capital gain (A.Y. 2011-12)

Sale Consideration	2,00,000
Less : WDV of the block as on 1-4-2010	5,00,000
Actual cost of the assets acquired	1,00,000
Transfer expenses	<u>6,00,000</u>
Short-term capital gain	<u>(4,00,000)</u>

Situation 5 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	5,00,000
Add : Actual cost of the assets acquired	1,00,000
	6,00,000
Less : Money payable in respect of the assets sold	9,00,000
WDV of the block as on 31-03-2011 (Block ceases to exist)	Nil

Section 50 is attracted.

Computation of capital gain (A.Y. 2011-12)

Sale Consideration	9,00,000
Less : WDV of the block as on 1-4-2010	5,00,000
Actual cost of the assets acquired	1,00,000
Transfer expenses	----- 6,00,000
Short-term capital gain	3,00,000

Situation 6 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	2,00,000
Add : Actual cost of the assets acquired	1,00,000
	3,00,000
Less : Money payable in respect of the assets destroyed	1,50,000
WDV of the block as on 31-03-2011	1,50,000
Less : Depreciation for P.Y. 2010-11 :	
On ₹ 1,50,000 @ 25%	37,500
WDV of the block as on 1-4-2011	1,12,500

Section 50 is not attracted.

Situation 7 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	2,00,000
Add : Actual cost of the assets acquired	1,00,000
	3,00,000
Less : Money payable in respect of the assets destroyed	3,00,000
WDV of the block as on 31-03-2011	Nil
Less : Depreciation for P.Y. 2010-11	Nil
WDV of the block as on 1-4-2011	Nil

Section 50 is attracted.

Computation of capital gain (A.Y. 2011-12)

Sale Consideration	7,00,000
Less : WDV of the block as on 1-4-2010	2,00,000
Actual cost of the assets acquired	1,00,000
Transfer expenses	----- 3,00,000
Short-term capital gain	4,00,000

Situation 8 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	2,00,000
Add : Actual cost of the assets acquired	1,00,000
	<u>3,00,000</u>
Less : Money payable in respect of the assets destroyed	1,50,000
WDV of the block as on 31-03-2011 (Block ceases to exist)	<u>Nil</u>

Section 50 is attracted.

Computation of capital gain (A.Y. 2011-12)

Sale Consideration	1,50,000
Less : WDV of the block as on 1-4-2010	2,00,000
Actual cost of the assets acquired	1,00,000
Transfer expenses	<u>-----</u>
	<u>3,00,000</u>
Short-term capital gain	<u>(1,50,000)</u>

Situation 9 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	5,00,000
Add : Actual cost of the assets acquired	2,00,000
	<u>7,00,000</u>
Less : Money payable in respect of the assets destroyed	3,00,000
WDV of the block as on 31-03-2011	<u>4,00,000</u>
Less : Depreciation for P.Y. 2010-11 : On ₹ 4,00,000 @ 25%	1,00,000
WDV of the block as on 1-4-2011	<u>3,00,000</u>

Section 50 is not attracted.

No tax treatment of insurance compensation received on 31-12-2011.

Situation 10 :**Computation of depreciation (A.Y. 2011-12)**

WDV of the block as on 1-4-2010	5,00,000
Add : Actual cost of the assets acquired	2,00,000
	<u>7,00,000</u>
Less : Money payable in respect of the assets destroyed	7,00,000
WDV of the block as on 31-03-2011	<u>Nil</u>
Less : Depreciation for P.Y. 2010-11	<u>Nil</u>
WDV of the block as on 1-4-2011	<u>Nil</u>

Section 50 is attracted. However STCG shall be taxable in the A.Y. 2012-13 as per the provision of Section 45(1A) which provides that capital gain shall not be taxable in the year in which the asset is destroyed but shall be taxable in the year in which money is received or an asset is received from the insurance company.

Computation of capital gain (A.Y. 2012-13)

Sale Consideration	10,00,000
Less : WDV of the block as on 1-4-2010	5,00,000
Actual cost of the assets acquired	2,00,000
Transfer expenses	<u>-----</u>
	<u>7,00,000</u>
Short-term capital gain	<u>3,00,000</u>

Solution to Question No. 3 :**Computation of depreciation (Assessment Year : 2009-10)**

WDV of the block as on 1-4-2008	Nil
Add : Actual cost of the assets acquired [Deemed building as per Explanation 1 to Section 32 (1)]	2,00,000
	<u>2,00,000</u>
Less : Money payable in respect of the assets sold	Nil
WDV of the block as on 31-03-2009	2,00,000
Less : Depreciation for P.Y. 2008-09 : On ₹ 2,00,000 @ 10% but restricted to 50%	10,000
WDV of the block as on 1-4-2009	<u>1,90,000</u>

Computation of depreciation (Assessment Year : 2010-11)

WDV of the block as on 1-4-2009	1,90,000
Add : Actual cost of the assets acquired	Nil
	<u>1,90,000</u>
Less : Money payable in respect of the assets sold	Nil
WDV of the block as on 31-03-2010	1,90,000
Less : Depreciation for P.Y. 2009-10 (on ₹ 1,90,000 @ 10%)	19,000
WDV of the block as on 1-4-2010	<u>1,71,000</u>

Computation of depreciation (Assessment Year : 2011-12)

	Case I	Case II	Case III
WDV of the block as on 1-4-2010	1,71,000	1,71,000	1,71,000
Add : Actual cost of the assets acquired	-----	-----	-----
	<u>1,71,000</u>	<u>1,71,000</u>	<u>1,71,000</u>
Less : Money payable in respect of the assets sold	Nil	1,20,000	1,71,000
WDV of the block as on 31-03-2011 (Block ceases to exist)	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>

Section 50 is attracted since block ceases to exist by reason of transfer of deemed building.

Computation of capital gains (Assessment Year : 2011-12)

	Case I	Case II	Case III
Sale Consideration	Nil	1,20,000	2,50,000
Less : WDV of the block as on 1-4-2010	1,71,000	1,71,000	1,71,000
Actual cost of the assets acquired	Nil	Nil	Nil
Transfer expenses	Nil	Nil	Nil
STCG	<u>(1,71,000)</u>	<u>(51,000)</u>	<u>79,000</u>

Solution to Question No. 4 :**Computation of taxable income****Name of assessee : X****Previous year : 2010-11****Assessment Year : 2011-12**

	₹	₹
<u>A. Income from salaries :</u>		
Income from salaries		1,00,000
<u>B. Profits and gains of business or profession :</u>		
Business profits (before depreciation)	16,000	
Less : Depreciation (i.e. Current depreciation)	1,34,000	Nil
Unabsorbed depreciation	<u>1,18,000</u>	
<u>C. Income from other sources :</u>		
Income from other sources	10,000	
Less : Unabsorbed depreciation	1,18,000	Nil
Unabsorbed depreciation to be carried forward to the next year	<u>1,08,000</u>	
Total income / net income / taxable income		<u>1,00,000</u>

Computation of taxable income**Previous year : 2011-12****Assessment Year : 2012-13**

	₹	₹
<u>A. Income from salaries :</u>		
Income from salaries		2,00,000
<u>B. Profits and gains of business or profession :</u>		
Business profits (before depreciation)	18,000	
Less : Depreciation (i.e. current depreciation : ₹ 1,32,000 + Unabsorbed depreciation of the P.Y. 2010-11 : ₹ 1,08,000)	2,40,000	Nil
Unabsorbed depreciation	<u>2,22,000</u>	
<u>C. Income from other sources :</u>		
Income from other sources	80,000	
Less : Unabsorbed depreciation	2,22,000	Nil
Unabsorbed depreciation to be carried forward to the next year	<u>1,42,000</u>	
Total income / net income / taxable income		<u>2,00,000</u>

Solution to Question No. 5 :**Computation of taxable income****Name of assessee : X****Previous year : 2010-11****Assessment Year : 2011-12**

	₹	₹
<u>A. Income from other sources :</u>		
Income from other sources	20,000	
Less : Business Loss	50,000	Nil
Business loss to be carried forward to the next year	30,000	
Total income / net income / taxable income		Nil
Amount to be carried forward :		
Business Loss	₹ 30,000	
Unabsorbed depreciation	₹ 18,000	

Computation of taxable income**Previous year : 2011-12****Assessment Year : 2012-13**

	₹	₹
<u>A. Profits and gains of business or profession :</u>		
Business profits (before depreciation)	45,000	
Less : Depreciation (i.e. current depreciation)	20,000	
Profit after depreciation	25,000	
Less : Brought forward business loss of P.Y. 2010-11	30,000	Nil
Business loss of P.Y. 2010-11 to be carried forward to the next year (Note 1)	5,000	
<u>B. Income from other sources :</u>		
Income from other sources	70,000	
Less : Unabsorbed depreciation of P.Y. 2010-11	18,000	52,000
Total income / net income / taxable income		52,000

Note 1 : Brought forward business loss can be set off only against business profits and not against any other income.

Solution to Question No. 6 :**Situation I :**

WDV of the block as on 1-4-2010	6,00,000	
Add : Actual cost of the assets acquired (Asset F)	1,50,000	
	7,50,000	
Less : Money payable in respect of the assets sold (Asset B)	-----	
WDV of the block as on 31-03-2011	7,50,000	
Less : Depreciation for P.Y. 2010-11 :		
On ₹ 1,50,000 @ 20% but restricted to 50%	15,000	
On ₹ 6,00,000 @ 20%	1,20,000	1,35,000
WDV of the block as on 1-4-2011		6,15,000

Situation II :

WDV of the block as on 1-4-2010	6,00,000
Add : Actual cost of the assets acquired (Asset F)	1,50,000
	7,50,000
Less : Money payable in respect of the assets sold (Asset B)	2,50,000
WDV of the block as on 31-03-2011	5,00,000
Less : Depreciation for P.Y. 2010-11 :	
On ₹ 1,50,000 @ 20% but restricted to 50%	15,000
On ₹ 3,50,000 @ 20%	70,000
	85,000
WDV of the block as on 1-4-2011	4,15,000

Situation III :

WDV of the block as on 1-4-2010	6,00,000
Add : Actual cost of the assets acquired (Asset F)	1,50,000
	7,50,000
Less : Money payable in respect of the assets sold (Asset B)	6,00,000
WDV of the block as on 31-03-2011	1,50,000
Less : Depreciation for P.Y. 2010-11 :	
On ₹ 1,50,000 @ 20% but restricted to 50%	15,000
WDV of the block as on 1-4-2011	1,35,000

Situation IV :

WDV of the block as on 1-4-2010	6,00,000
Add : Actual cost of the assets acquired (Asset F)	1,50,000
	7,50,000
Less : Money payable in respect of the assets sold (Asset B)	7,00,000
WDV of the block as on 31-03-2011	50,000
Less : Depreciation for P.Y. 2010-11 :	
On ₹ 50,000 @ 20% but restricted to 50%	5,000
WDV of the block as on 1-4-2011	45,000

Situation V :

WDV of the block as on 1-4-2010	6,00,000
Add : Actual cost of the assets acquired (Asset F)	1,50,000
	7,50,000
Less : Money payable in respect of the assets sold (Asset B)	7,50,000
WDV of the block as on 31-03-2011	Nil
Less : Depreciation for P.Y. 2010-11	Nil
WDV of the block as on 1-4-2011	Nil

Situation VI :

WDV of the block as on 1-4-2010	6,00,000
Add : Actual cost of the assets acquired (Asset F)	1,50,000
	7,50,000
Less : Money payable in respect of the assets sold (Asset F)	2,00,000
WDV of the block as on 31-03-2011	5,50,000
Less : Depreciation for P.Y. 2010-11 :	
On ₹ 5,50,000 @ 20% (Since asset F was sold)	1,10,000
WDV of the block as on 1-4-2011	4,40,000

Situation VII :

WDV of the block as on 1-4-2010	6,00,000
Add : Actual cost of the assets acquired (Asset F)	<u>1,50,000</u>
	7,50,000
Less : Money payable in respect of the assets sold (Asset F)	<u>1,00,000</u>
WDV of the block as on 31-03-2011	6,50,000
Less : Depreciation for P.Y. 2010-11 :	
On ₹ 6,50,000 @ 20% (Since asset F was sold)	<u>1,30,000</u>
WDV of the block as on 1-4-2011	<u>5,20,000</u>

PROFITS & GAINS OF BUSINESS OR PROFESSION ~ II



Section 35D : Amortization of preliminary expenses

1. Deduction can be claimed by :
 - (a) Indian Company or
 - (b) A person other than a company who is resident in India.
2. Deduction is available in respect of expenditure incurred :
 - (a) before commencement of any business
 - (b) after commencement of business in connection with extension of existing undertaking or in connection with setting up a new unit.

3. Deduction shall be an amount equal to :

If expenditure is incurred <i>before 1-04-1998</i>	1/10th of expenditure for 10 successive years beginning with the year in which business commences or extension of the existing undertaking is completed or the new unit commences production or operation.
If expenditure is incurred <i>on or after 1-04-1998</i>	1/5th of expenditure for 5 successive years beginning with the year in which business commences or extension of the existing undertaking is completed or the new unit commences production or operation.

4. Following expenses will be allowed :

- Preparation of feasibility / project report.
- Market survey expenses.
- Legal charges for drafting agreement between assessee and any other person relating to the setting up of the business of the assessee.
- Legal charges for drafting Memorandum of Association and Article of Association, printing of Memorandum of Association and Article of Association, legal fee for registration of company, underwriting commission, brokerage, stamp duty.
- Expenses in connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.
- Expenses on refund of over-subscription of shares.
- Any other expenditure as may be prescribed

5. The aggregate expenses cannot exceed :

In case of company	In case of others
5%* of <i>Cost of project</i> or 5%* of <i>Capital employed</i> , whichever is more.	5%* of <i>Cost of project</i>

*2.5% if expenditure incurred ***before 1-04-1998***.

6. “*Cost of project*” means :

- (a) In case of new business : Actual cost of fixed assets shown in the books on the last day of the P.Y. in which business commences.
- (b) In case of extension / setting up of new unit : Actual cost of fixed assets shown in the books on the last day of the P.Y. in which extension of the existing undertaking is completed or the new unit commences production or operation.

7. “*Capital employed*” means :

- (a) In case of new business : Share capital (Issued) + Debentures + Long-term borrowings on the last day of the P.Y. in which business commences.
- (b) In case of extension / setting up of new unit : Share capital (Issued) + Debentures + Long-term borrowings on the last day of the P.Y. in which extension of the existing undertaking is completed or the new unit commences production or operation.

8. Expenses are allowed only if accounts are audited *for year in which expenses are incurred* and furnished along with ROI.

Section 35DD : Amortization of expenditure in case of amalgamation or demerger

1. Allowed to *Indian company* only.
2. Deduction will be 1/5th of expenses for 5 successive P.Y. beginning with P.Y. in which amalgamation or demerger took place.
3. No deduction under other provisions of I.T. Act.

Section 35DDA : Amortization of expenses incurred under VRS

1. Any expense for VRS is allowed.
2. Allowed in 5 equal installments commencing from year in which expense is incurred.
3. No deduction will be allowed under any other provisions of I.T. Act.
4. Each part of payment in connection with voluntary retirement is deductible in 5 years in 5 equal instalments.

Section 35DDA(4A) [Applicable from A.Y. 2011-12] :

Where a private company or unlisted public company is succeeded by a LLP, the provisions of Section 35DDA shall apply to the successor LLP, as they would have applied to the predecessor company.

However, as per Section 35DDA(5), no deduction under Section 35DDA shall be allowed to the predecessor company in the previous year in which the conversion takes place.

Illustration :

According to Voluntary Retirement Scheme of X Ltd. (unlisted company) each employee will get voluntary retirement compensation of ₹ 15 Lakhs in two instalments (35% at the time of voluntary retirement and 65% on November 1 of the first financial year immediately after retirement). The scheme is opened for the financial year 2009-10 only. During the financial year 2009-10, 6 employees took voluntary retirement. X Ltd. is converted into LLP on November 30, 2010 (X Ltd. goes into liquidation immediately after conversion). The amount deductible under Section 35DDA in the hands of X Ltd. and LLP for different previous years will be as follows :

<i>Previous year in which payment is deductible</i>	<i>First instalment of ₹ 31.5 lakhs (being 35% of 90 Lakhs) payable during the P.Y. 2009-10</i>	<i>Second instalment of ₹ 58.5 lakhs (being 65% of 90 Lakhs) payable on November 1, 2010</i>	<i>Total</i>	<i>Deductible in the hands of</i>
2009-10	6.30 lakhs	-----	6.30 lakhs	X Ltd.
2010-11	6.30 lakhs	11.70 lakhs	18.00 lakhs	LLP
2011-12	6.30 lakhs	11.70 lakhs	18.00 lakhs	LLP
2012-13	6.30 lakhs	11.70 lakhs	18.00 lakhs	LLP
2013-14	6.30 lakhs	11.70 lakhs	18.00 lakhs	LLP
2014-15	-----	11.70 lakhs	11.70 lakhs	LLP
2015-16	-----	-----	-----	-----

Section 35 : Expenditure on scientific research

Deduction under Section 35 is allowed to all assesses. Following deductions are allowed under Section 35 :

- Any revenue expense on research if business is already commenced. [Section 35(1)(i)]
- Aggregate of expenditure incurred in respect of salary to employees (except perks) and materials used in research within 3 years immediately preceding the date of commencement of business :
 - deduction in the P.Y. in which business commences.
 - expenses must be certified by the prescribed authority. [Section 35(1)(i)]
- Any capital expenditure (except expenditure on acquisition of land) if business is already commenced. [Section 35(1)(iv)]
- Any capital expenditure (except expenditure on acquisition of land) incurred within 3 years immediately preceding the date of commencement of business :
 - deduction in the P.Y. in which business commences. [Section 35(1)(iv)]
- An amount equal to 125% [175% from the A.Y. 2010-11] of any sum paid to certain bodies (e.g. Apollo Hospital), approved by Central Govt. to be used for *scientific research*. [Section 35(1)(ii)]
- An amount equal to 125% of any sum paid to a **company** to be used by it for scientific research, provided that such company :
 - is registered in India,
 - has its main object the scientific research and development,
 - is for the time being approved by the prescribed authority in the prescribed manner, and
 - fulfils such other conditions as may be prescribed. [Section 35(1)(ia)].

Note : With a view to avoid multiple claims for deduction, it has been provided that the company receiving any sum for its scientific research under the provisions of Section 35(1)(ia) will not be entitled to claim weighted deduction of 150% under Section 35(2AB).

- An amount equal to 125% of any sum paid to certain bodies (e.g. ICAI), approved by Central Govt. to be used for research in *social science or statistical research*. [Section 35(1)(iii)]

Section 35 (2AA) : Contribution to National Laboratory etc.

If assessee pays any sum to *National Laboratory, University or an IIT or a specified person* with a specific direction to use for scientific research undertaken under a programme approved in this behalf by the prescribed authority then a sum equal to 125% **[175% from the A.Y. 2010-11]** of payment will be allowed as deduction under Section 35 (2AA).

Section 35 (2AB) : Expenditure on in-house research and development facility

1. Deduction is available only to *companies* engaged in business of Bio-technology **or any business of manufacture or production of any article or thing, not being an article or thing specified in the Eleventh Schedule***.
2. Deduction is available in respect of any expenditure incurred (except land and building) by company on in-house research and development facility approved by prescribed authority.
3. Deduction is 150 % **[200% from the A.Y. 2010-11]** of the expenditure so incurred.
4. With a view to avoid multiple claims for deduction, it has been provided that the company receiving any sum for its scientific research under the provisions of Section 35(1)(ia) will not be entitled to claim weighted deduction of 150% under Section 35(2AB).

***Article or thing specified in the Eleventh Schedule**

1. Beer, wine and other alcoholic spirits.
2. Tobacco and tobacco preparations, such as, cigars and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff.
3. Cosmetics and toilet preparations.
4. Tooth paste, dental cream, tooth powder and soap.
5. Aerated waters in the manufacture of which flavouring concentrates in any form are used.
6. Confectionery and chocolates.
7. Gramophones, including record-players and gramophone records.
8. Projectors.
9. Photographic apparatus and goods.
10. Office machines and apparatus such as typewriters, calculating machines, cash registering machines, cheque writing machines, intercom machines and teleprinters.
11. Steel furniture, whether made partly or wholly of steel.
12. Safes, strong boxes, cash and deed boxes and strong room doors.
13. Latex foam sponge and polyurethane foam.
14. Crown corks, or other fittings of cork, rubber, polyethylene or any other material.
15. Pilfer-proof caps for packaging or other fittings of cork, rubber, polyethylene or any other material.

Section 35A : Expenditure on acquisition of Patent Rights or Copyrights

1. Deduction under this Section is available only for those expenditures which are capital in nature. If expenditure is revenue in nature then assessee can claim deduction under Section 37 (1).
2. **Capital expenditure incurred before 1-04-1998 :**
Deduction in equal installments over a period of 14 years or over the unexpired life whichever is less. Deduction will be available from the P.Y. in which such rights were acquired.
3. **Capital expenditure incurred on or after 1-04-1998 :**
Qualify for depreciation under block of Intangible assets.
4. In case expenditure incurred before commencement of business, the period of 14 years will be computed from P.Y. in which business commenced.

Section 35AB : Expenditure on Know-how

1. **Lump-sum consideration paid/payable before 1-04-1998 :**
 - a) **For acquiring know-how from any source other than clause (b) below :**
Deduction in equal instalments over 6 years commencing from the P.Y. in which the expenditure is incurred.
 - b) **Where the know-how is developed in a Government owned laboratory or a laboratory financed by the Govt. or owned by a university and the assessee has purchased the know-how from such agency :**
Deduction in equal instalments over 3 years commencing from the P.Y. in which the expenditure is incurred.
2. **Lump-sum consideration paid/payable for acquiring know-how on or after 1-04-1998 :**
Depreciation @ 25 % under block of intangibles.

Section 36 : Other Deductions

- a) Insurance premium of stock / stores used for business / profession.
Khodidas Motiram Panchal : Insurance policy on the lives of the partners is personal expenditure and not deductible.
Note : However premium paid under Keyman Insurance Policy will be allowable under Sec. 37(1).
- b) Premium paid by any mode other than cash (i.e. crossed cheque/bearer cheque/account payee cheque/crossed draft/account payee draft/any other mode other than cash) for insurance on health of employees under specified scheme of :
 - General Insurance Corporation of India and approved by the Central Government or
 - Any other insurer and approved by the IRDA.
- c) Interest on capital borrowed for business purposes.
- d) Deduction in respect of animals used for business otherwise than as SIT and have died or become permanently useless. Deduction = Actual cost – realization.
- e) Contribution by employer to recognized P.F. or approved Superannuation Fund subject to limit specified in those funds.

- f) Contribution to approved Gratuity fund for exclusive benefit of employees.
- g) Any sum received by assessee from any of his employees as contribution to any P.F / Superannuation fund / other fund for welfare of employees provided such sum is credited by the assessee to employees' account in the relevant fund on or before due date [Section 36(1)(va)].
- h) Bonus or commission paid to an employee for services rendered, where such sum would not have been payable to him as profits or dividend.

Illustration :

Name of shareholders	% of shareholding	Whether employee or not ?	Dividend paid to shareholders	Bonus paid to employees
P	25%	Not an employee	50,000	-----
Q	25%	Not an employee	50,000	-----
R	25%	Employee	10,000	70,000
S	25%	Employee	10,000	70,000

In the above case ₹ 40,000 + ₹ 40,000 = ₹ 80,000 is in the nature of dividend which has been shown as bonus to R and S. Hence ₹ 80,000 is disallowable and only ₹ 60,000 (i.e. ₹ 1,40,000 – ₹ 80,000) is allowable as bonus paid to employees u/s 36.

- i) Bad debt [Refer Section 36(1)(vii) for details].
- j) Any **revenue** expense bonafide incurred by a **company** for the purposes of promoting family planning amongst the employees [Section 36(1)(ix)].
- Note :** If family planning expense is **capital** in nature : Deduction in 5 equal instalments commencing from the P.Y. in which the expenditure is incurred.
- k) Discount (i.e. Amount payable on maturity or redemption – Amount received by issuing entity) on **Zero Coupon Bonds** will be allowed as deduction on the basis of period of life of the bonds (i.e. period from date of issue to date of maturity or redemption) on **pro- rata basis** [Section 36(1)(iiia)].
- l) Any amount of **Banking Cash Transaction Tax** paid by the assessee during the previous year on the taxable banking transaction entered into by him [Section 36(1)(xiii)].
- m) Any amount of Securities Transaction tax (STT) paid by the assessee in respect of taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head “Profits and gains of business or profession” [Section 36(1)(xv)].

Section 37 (1) : General Clause for deduction

Any expenditure other than referred to in section 30 to 36 shall be allowed provided following conditions are satisfied :

1. It should not be in the nature of capital expenditure.
2. It should not be in the nature of personal expenditure.
3. Incurred wholly and exclusively for the purpose of business or profession.

Note : Any expenditure incurred for any purpose which is an offence or which is prohibited by law (e.g. protection money, extortion, hafta, bribes etc.) shall not be allowed u/s 37 (1).

Section 37 (2B)

Expenses on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a **political party** not allowed.

Section 40 : Amount specifically not deductible

Notwithstanding anything contained in Section 30 to 38, no deduction shall be allowed in respect of the following :

- a) Any interest, royalty, fees for technical services or other sum chargeable under Income-tax Act, if :
- (i) the same is paid/payable outside India *or* paid/payable in India to a non-resident or foreign company and
 - (ii) tax is deductible at source but has not deducted by the assessee *or* tax has been deducted at source but after the deduction it has not been paid to the Government [**Section 40(a)(i)**].

Note :

If, however, TDS is paid as per the time limits prescribed under the I.T. Act for deposit of TDS, then the deduction shall be allowed in the P.Y. in which liability to pay such sum was incurred. For example if TDS of P.Y. 2010-11 is payable by 31.05.2011 and the assessee has paid the TDS on or before 31.05.2011 then deduction will be allowed to the assessee in P.Y. 2010-11 even though it is paid in the P.Y. 2011-12. However, if assessee pays tax after 31.05.2011 deduction will be allowed in that P.Y. in which date of payment falls. For example if assessee pays TDS on 01.06.2011 then deduction will be allowed in the P.Y. 2011-12.

Illustration :

Nature of payment (Liability incurred during the financial year 2010-11)	Date on which tax is supposed to be deducted	Actual date of tax deduction	When tax should be deposited as per Income tax Act	Actual date of tax deposit	P.Y. in which expense is deductible
Interest	26-06-10	26-06-10	07-07-10	07-07-10	2010-11
Royalty	01-12-10	Not deducted	07-01-11	Not deposited	Not deductible
Technical fees	26-07-10	26-07-10	07-08-10	02-09-10	2010-11
Commission	31-03-11	31-03-11	31-05-11	31-05-11	2010-11
Professional fees	31-03-11	31-03-11	31-05-11	01-06-11	2011-12
Brokerage	16-05-10	16-05-10	07-06-10	Not deposited	Not deductible
Rent	10-06-10	20-04-11	07-07-10	20-07-13	2013-14

- b) Any interest, commission or brokerage, rent, royalty, fee for professional or technical services, or any payment to a contractor or sub-contractor for carrying out any work (including supply of labour for carrying out any work), if :
- (i) the same is paid/payable to a resident in India and
 - (ii) tax is deductible at source but has not deducted by the assessee *or* tax has been deducted at source but after the deduction it has not been paid to the Government [**Section 40(a)(ia)**].

Note :

Cases	Is such expenditure deductible in the previous year	Is such expenditure deductible in any subsequent previous year
Tax is deductible but not deducted.	No deduction in the current previous year	If tax is deducted in any subsequent year, the expenditure will be deducted in the year in which TDS will be deposited by the assessee with the Government.
Tax has been deducted at source but after the deduction it has not been paid to the Government <u>on or before the due date of submission of ROI.</u>	No deduction in the current previous year	If the tax is deposited with the Government after the due date of submission of return of income, the expenditure will be deductible in that year in which tax is deposited.

Illustration :

Nature of payment by Mr. X (Liability incurred during the financial year 2010-11)	Date on which tax is supposed to be deducted	Actual date of tax deduction	When tax should be deposited as per Income tax Act	Actual date of tax deposit	P.Y. in which expense is deductible
Professional fees	01-01-11	Not deducted	07-02-11	Not deposited	Not deductible
Interest	10-03-11	10-03-11	31-05-11	10-07-11	2010-11
Interest	10-03-11	10-03-11	31-05-11	01-08-11	2011-12
Contract Money	30-10-10	30-10-10	07-11-10	31-03-11	2010-11
Contract Money	30-10-10	30-10-10	07-11-10	01-04-11	2010-11
Commission	29-02-11	29-02-11	07-03-11	20-04-12	2012-13

- c) Payment of Fringe Benefit Tax.
- d) Payment of Income Tax (or interest or penalty) in India or in a foreign country. However relief can be claimed under Section 91 (Double Taxation Avoidance Agreement).

Note : Service Tax and professional tax are deductible under Section 37(1) .

- e) Payment of Wealth tax in India or in a foreign country.
- f) Any payment of interest, salary, bonus, commission or remuneration by AOP/BOI to any of its members.
- g) Any payment of interest, salary, bonus, commission or remuneration made by a partnership firm to the partners. However abovementioned payments shall be allowed subject to the limit specified under Section 40(b).

Section 40A : Expenses / Payments not deductible under certain circumstances

A) Section 40A(2)

Where the assessee incurs **any expenditure** in respect of which payment has been made to certain **specified person**, the A.O. may disallow so much of the expenditure as he considers to be excessive or unreasonable having regard to the :

- fair market value** of the goods, services or facilities for which payment is made **or**
- legitimate needs** of the business/profession **or**
- benefit derived** to the assessee as a result of the expenditure.

“Specified person” : Specified persons in case of various persons are as under :

Assessee (i.e. who has incurred the expenditure)	Specified persons (i.e. to whom the payment is made)
Individual	(a) Any relative of such individual (b) Any person in whose business or profession the assessee (i.e. individual) himself or his relative has substantial interest .
Company, Firm, AOP or HUF	(a) Any director of the company, partner of the firm, or member of the AOP or HUF, or any relative of such director, partner or member. (b) Any person in whose business or profession the assessee or director, partner or member of the assessee or any relative of such director, partner or member has a substantial interest.
All assessees	(a) Any individual who has substantial interest in the business or profession of the assessee. (b) A company, firm, AOP or HUF having a substantial interest in the business or profession of the assessee or any director, partner or member of any such company, firm, AOP or HUF, or any relative of any such director, partner or member. (c) A company, firm, AOP or HUF of which a director, partner or member has a substantial interest in the business or profession of the assessee, or any director, partner or member of any such company, firm, AOP or HUF, or any relative of any such director, partner or member.

“Relative” : The term “relative”, in relation to an individual, means the husband, wife, brother or sister or any lineally ascendant or descendant of that individual [Section 2(41)].

“Substantial Interest”:

In case of a company : A person, shall be deemed to have substantial interest in a company, if he is *at any time during the year*, **beneficial owner** of equity shares carrying 20% or more voting power in the company

In case of other person : A person shall be deemed to have substantial interest in a concern, if he is *at any time during the year*, **beneficially** entitled to at least 20% income of such concern.

“Beneficial owner” : Beneficial owner is one who exercises all power in respect of shares and also receives dividend irrespective of the fact that he may or may not be a registered holder of shares.

B) Section 40A(3)

Where the assessee incurs any expenditure in respect of which a payment **or aggregate of payments made to a person in a day**, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.

Note : Section 40A(3) is not applicable if assessee purchases a capital asset.

Section 40A(3A)

Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds twenty thousand rupees.

First Proviso to Section 40A(3) & Section 40A(3A)

No disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under Section 40A(3) and Section 40A(3A) where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, in such cases and under such circumstances as mentioned in Rule 6DD.

Second Proviso to Section 40A(3) & Section 40A(3A)

In the case of payment made for plying, hiring or leasing goods carriages, the provisions of Section 40A(3) and Section 40A(3A) shall have effect as if for the words “twenty thousand rupees”, the words “thirty-five thousand rupees” had been substituted [Inserted by the Finance (No. 2) Act, 2009, w.e.f. 1-10-2009].

In other words, with effect from October 1, 2009, the monetary limit of ₹ 20,000 under Section 40A(3) and 40A(3A) has been raised to ₹ 35,000 in the case of payment made for plying, hiring or leasing goods carriages. For other payments, the limit of ₹ 20,000 will continue.

Rule 6DD : Some of the various circumstances prescribed under Rule 6DD are as under :

- (i) Where the payment is made to a person who ordinarily resides or carries on business in a village not served by any bank.
- (ii) Payment of income tax, wealth tax, custom duty, excise duty, sales tax etc. to Central or State Government as the case may be.
- (iii) Payment to banks, LIC, UTI, and financial institutions like IDBI, State Financial Corp. etc.
- (iv) Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike.
- (v) Where the payment is made by an assessee by way of salary to his employees after deducting the income tax at source & when such employee :
 - is temporarily posted for a continuous period of 15 days or more in a place other than his normal place of duty or in a ship **and**
 - does not maintain any bank account at such place or ship.
- (vi) Where payment is made by an authorized dealer or money changer against purchase of foreign currency or travelers' cheques in the normal course of his business.

Attar Singh Gurmukh Singh (Supreme Court)

Purchases of stock or raw materials *constitute expenditure* referred to in Section 40A (3). Therefore if payments are made exceeding ₹ 20,000/- otherwise than by an account payee cheque drawn on a bank or an account payee bank draft, then such expenditure will be disallowed under Section 40A (3).

Vijay Kumar Ajit Kumar (Allahabad High Court)

Where the goods are purchased against cash whether the payment is made prior to the delivery of the goods or after the delivery of goods, it is payment in cash and is payment of consideration for the goods purchased and the same is covered by Section 40A (3).

Aloo Supply Company (Orissa High Court)

For applicability of Section 40A (3), the *expenditure as well as payment* should exceed ₹ 20,000/-.

Illustrations :

(a) X Limited purchases goods on credit from Y Limited on May 6, 2010 for ₹ 86,000 which is paid as follows :

- ₹ 15,000 in cash on May 11, 2010
- ₹ 30,000 by a bearer cheque on May 12, 2010
- ₹ 41,000 by an account payee cheque on May 13, 2010.

Answer :

Nothing will be disallowed out of payment of ₹ 15,000 in cash on May 11, 2010, as the payment does not exceed ₹ 20,000. 100% of ₹ 30,000 will be disallowed. Nothing will be disallowed out of ₹ 41,000.

(b) Z Limited purchases goods on credit from A Limited on May 10, 2010 for ₹ 16,000 and on May 30, 2010 for ₹ 15,000. The total payment of ₹ 31,000 is made by a crossed cheque on June 1, 2010.

Answer :

Though the amount of payment exceeds ₹ 20,000, nothing shall be disallowed. To attract disallowance, the amount of bill (i.e. expenditure) as well as the amount of payment should be more than ₹ 20,000.

(c) A Limited purchases goods on credit on June 20, 2010 for ₹ 1,10,000. ₹ 20,000 is paid in cash on June 24, 2010 and ₹ 70,000 is paid on June 25, 2010 as follows :

- ₹ 6,000 in cash at 10:30 a.m.;
- ₹ 11,000 in cash at 11:00 a.m.;
- ₹ 18,000 by a crossed cheque at 1:30 p.m.;
- ₹ 5,000 by a bearer cheque at 2:00 p.m.;
- ₹ 30,000 by an account payee cheque at 4:00 p.m.

Answer :

Nothing will be disallowed in respect of payment of ₹ 20,000 in cash on June 24, 2010. However, ₹ 40,000 (i.e. ₹ 6,000 + ₹ 11,000 + ₹ 18,000 + ₹ 5,000) paid on June 25, 2010 will be disallowed under Section 40A (3).

(d) P Limited is a manufacturing company. On March 31, 2010, the company made a provision for outstanding bill of ₹ 80,000 for purchase of raw material. The provision appeared on the liability side of the Balance Sheet as well as on the debit side of the Profit & Loss Account. It was allowed as deduction for computing the income of the company for the A.Y. 2010-11. Out of the outstanding

balance, ₹ 30,000 is paid on September, 2010 (₹ 20,000 in cash at 10:45 a.m., ₹ 6,000 by crossed cheque at 11:30 a.m. and ₹ 4,000 in cash at 3:30 p.m.).

Answer :

₹ 30,000 will be taken as business income of the company for the A.Y. 2011-12 by virtue of section 40A (3A) and it will be taxable.

(e) X purchases goods of ₹ 80,000 from Y on 10-07-2010 and makes the payment to Y on 15-07-2010 at once by account payee cheque : ₹ 61,500 and by cash : ₹ 18,500.

Answer :

No because the cash payment does not exceed ₹ 20,000.

(f) X purchases a building for ₹ 5,00,000 from Y and makes payment in cash.

Answer :

No because section 40A (3) is not applicable if assessee purchases a capital asset.

(g) X, a dealer in real estate purchases a building for ₹ 10,00,000 and makes the payment in cash.

Answer :

Yes because building, for an assessee who is dealer in real estate, is stock-in-trade. ₹ 10,00,000 shall be disallowed under Section 40A (3).

(h) X makes an advance of ₹ 50,000 on 15-08-2010 in cash to Y for purchase of goods and delivery of the goods is made on 25-09-2010.

Answer :

Yes because as per decision of Allahabad High Court in the case of **Vijay Kumar Ajit Kumar**, Section 43A (3) is attracted if goods are purchased against cash, whether the payment is made prior to the delivery of goods or after. ₹ 50,000 will be disallowed u/s 40A (3).

(i) X pays ₹ 24,000 as salary to his employee Y on 14-07-2010 by a crossed cheque.

Answer :

Yes. ₹ 24,000 will be disallowed under Section 40A (3).

(j) X purchases goods in cash of ₹ 60,000 from his brother. Fair market value of the goods is ₹ 50,000.

Answer :

₹ 10,000 (₹ 60,000 – ₹ 50,000) will be disallowed under Section 40A (2) and balance ₹ 50,000 will be disallowed under Section 40A (3).

(k) X purchases goods in cash of ₹ 30,000 from his brother. Fair market value of the goods is ₹ 19,000.

Answer :

If the A.O. applies Section 40A (2) then ₹ 11,000 (₹ 30,000 – ₹ 19,000) will be disallowed under Section 40A (2). Section 40A (3) is not attracted because balance payment (i.e. ₹ 19,000) does not exceed ₹ 20,000.

If the A.O. does not apply Section 40A (2) then ₹ 30,000 will be disallowed under Section 40A (3).

PROFITS & GAINS OF BUSINESS OR PROFESSION ~ III

Section 43B : Certain Deduction on actual payment basis

Following deductions (if allowable under I.T. Act) will be allowed only in the P.Y. in which such sum is **actually paid** (this is irrespective of the P.Y. in which liability is incurred) :

- 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) or;
- b) Employer's contribution to any P.F. / Superannuation fund / Gratuity fund / any other fund for the welfare of the employees;
- c) Bonus / commission payable to the employees for services rendered or;
- d) Interest on loan from any public financial institution (i.e. ICICI, IFCI, IDBI, LIC, UTI) or a State Financial Corporation or a State Industrial Investment Corporation or;

Note : If interest on loan is converted into a loan, the interest so converted and not **actually paid**, shall not be deemed as 'actual payment' and not allowed as deduction.

- e) Interest on any loan or advances from a scheduled bank (includes a Co-operative Bank) or;

Note : If interest on loan or advances is converted into a loan or advances, the interest so converted and not **actually paid**, shall not be deemed as 'actual payment' and not allowed as deduction.

- f) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

Note : The provisions of Section 43B shall not apply in relation to any sum referred to in above Clauses if such sum is actually paid by the assessee on or before the due date of furnishing return of income in respect of the P.Y. in which liability to pay such sum was incurred by the assessee and evidence of such payment is furnished along with the return of income. In other words expenditure shall be allowed in the same previous year in which it is incurred provided payment is made on or before the due date of furnishing return of income in respect of the P.Y. in which liability to pay such sum was incurred by the assessee and evidence of such payment is furnished along with the return of income.

Illustration :

An analysis of the Profit & Loss Account and Balance Sheet of X as on 31-3-2011 reveals that the following expenses which were due, were though debited to the Profit & Loss Account but have been paid after 31-3-2011 :

Sales tax	₹ 50,000	₹ 20,000 paid on 14-07-2011 ₹ 30,000 paid on 01-10-2011
Excise duty	₹ 1,20,000	₹ 40,000 paid on 14-07-2011 ₹ 40,000 paid on 01-10-2011 ₹ 40,000 paid on 01-11-2012
Bonus to staff	₹ 60,000	₹ 48,000 paid on 10-07-2011 ₹ 12,000 paid on 15-12-2011
Employer's contribution to provident fund	₹ 55,000	₹ 25,000 paid on 15-07-2011 ₹ 10,000 paid on 31-07-2011 ₹ 20,000 paid on 15-01-2012

The due date of filing return of income is 31-07-2011. In which previous year can the above payments be claimed as a deduction ?

Solution :

Expenses	Date of payment	Amount paid (₹)	Previous year in which it is deductible
Sales tax	14-07-2011	20,000	2010-11
Sales tax	01-10-2011	30,000	2011-12
Excise duty	14-07-2011	40,000	2010-11
Excise duty	01-10-2011	40,000	2011-12
Excise duty	01-11-2012	40,000	2012-13
Bonus to staff	10-07-2011	48,000	2010-11
Bonus to staff	15-12-2011	12,000	2011-12
Employer's contribution to provident fund	15-07-2011	25,000	2010-11
Employer's contribution to provident fund	31-07-2011	10,000	2010-11
Employer's contribution to provident fund	15-01-2012	20,000	2011-12

** Section 36 (1) (vii) : Bad Debts**

Amount of any bad debt (or part thereof), which is written off as irrecoverable in the accounts of the assessee for the previous year, is allowable as a deduction subject to the following conditions laid down in Section 36 (2) :

- the debt has been taken into account in computing the income of the assessee of the previous year in which the amount is written off or of an earlier previous year, **or**
- it represents money lent in the ordinary course of business of money-lending which is carried on by the assessee.

Illustrations on clause (a) above :

- X, a trader, sells goods on credit. Out of the credit sales made in the current year (or in the earlier years), ₹ 50,000 is written off as bad debt. As sales are considered in calculating income, bad debt so written off is allowable as deduction.
- Y owns an industrial undertaking. One of the plants in the factory is replaced by him. The old plant is sold for ₹ 60,000 on credit to A. A, however, becomes insolvent before making payment of sale consideration. This is capital loss and it cannot be debited to profit and loss account. It is, therefore, not deductible. In other word, "debt" should be revenue in nature.

Illustrations on clause (b) above :

Z, a money-lender, gives a loan to A. Before repaying the loan (i.e. principal) along with interest, A becomes insolvent. In this case if amount of interest is included in income on accrual basis, it can be written off as bad debt and the same is allowable as deduction. Loss on account of non-recovery of amount of loan (i.e. principal) amount is also deductible if it is written off in the books of account (the condition that debt is deductible only if it was taken into account in computing the income of the assessee is not applicable in the case of non-recovery of loan where it represents money lent in the ordinary course of money-lending business. Money is treated as stock-in-trade in case of money-lending business.

Notes :

- (1) **“Debt”** denotes not only the obligation of the debtor to pay but also the right of the creditor to receive and enforce payment.

A **“Debt”** is the present obligation to pay an ascertainable sum of money, whether the amount is payable *in praesenti* or *in futuro*.

- (2) **“Write off”** means to transfer the balance of an account previously regarded as an asset to an expense account or to the Profit & Loss Account. The write-off of a debt, without charging the same to the Profit & Loss Account, is not write off at all.

(3) **Newdeal Finance & Investment Limited (Chennai High Court) :**

It is not for the assessee to establish that the debt had become bad in the previous year. If it has been written off as irrecoverable in the accounts of the assessee for the previous year, it will be sufficient for claiming it as bad debt. It is for the assessee to decide whether the debt has become bad or not and the Assessing Officer can never insist on production of demonstrative and reliable proof that the debt had become bad.

- (4) If amount is transferred to “Provision for Bad & Doubtful Debt Account”, then it shall not be treated as bad debt written off. In other words, “Provision for Bad & Doubtful Debt” is not allowable as deduction.
- (5) No deduction can be claimed in respect of bad debt of business which has been discontinued before the commencement of the previous year. Such bad debt cannot be deducted even from profits of a separate existing business. An assessee can claim deduction of bad debt of business which is carried on by him for atleast sometime during the previous year; it is not necessary that the business should be carried on throughout the previous year.

(6) **T. Veerbhadra Rao K. Koteswara Rao & Co. (Andhra Pradesh High Court) :**

Assessee being successor to a business will be entitled to claim allowance for bad debt even though the debt does not relate to business of the assessee but to the business he succeeded. The predecessor has incurred the debt and the assessee (i.e. successor) writes off the same, deduction of the bad debt shall be allowed to the assessee (i.e. successor).

Supreme Court had also affirmed the aforesaid view of the Andhra Pradesh High Court.



Section 41 (4) : Bad Debt Recovery

Where a deduction has been allowed in respect of a bad debt and the bad debt is subsequently recovered, then the amount so recovered shall be PGBP of the P.Y. in which recovery is made. This shall apply even if the business / profession is not in existence in the P.Y. in which recovery is made.

Illustration :

X, a trader, sells goods of ₹ 1,00,000 on credit to Y. He recovers only ₹ 10,000 from Y during the Previous year 2010-11. On 31-03-2011, X writes off ₹ 32,000 as bad debt. However, on 19-12-2011, X recovers from Y as full and final payment :

- (a) ₹ 15,000, or
- (b) ₹ 55,000, or
- (c) ₹ 70,000.

Find out the tax consequences for different assessment year.

Solution :**Assessment year 2011-12**

During the previous year 2010-11, X writes off ₹ 32,000 as bad debt. It is, therefore, deductible for the assessment year 2011-12 u/s 36 (1) (vii).

Assessment year 2012-13

Tax treatment, when recovery is made during the previous year 2011-12, will be as follows :

Amount of debt outstanding as on 1-4-11 (₹ 1,00,000 – ₹ 10,000 – ₹ 32,000) (₹)	Amount recovered as full and final payment (₹)	(Deduction)/Income (₹)
(a) 58,000	15,000	(43,000)
(b) 58,000	55,000	(3,000)
(c) 58,000	70,000	12,000

Situation (a) : ₹ 43,000 is deductible as bad debt if X writes off ₹ 43,000 in his books of account as bad debt during the previous year 2011-12.

Situation (b) : ₹ 3,000 is deductible as bad debt if X writes off ₹ 3,000 in his books of account as bad debt during the previous year 2011-12.

Situation (c) : ₹ 12,000, being the excess recovery, is taxable under the head PGBP, irrespective of the fact whether the business is in existence during the previous year 2011-12 or not.

P. K. Kaimal (Madras High Court)

Assessee who claimed the bad debt and who recovers must be the same for applicability of Section 41(4). No taxability if the assessee who recovers the bad debt is different from the assessee who claimed the bad debt.

Penalties and Interest under various laws - Whether deductible under Section 37 (1)**1. Penalties**

Penalty for infraction of *any law* is not deductible. [**Hazi Aziz & Abdul Shakoore Brothers (SC)**].

Exceptions :

A) Penalty in nature of *compensation* is allowable.

Malwa Vanaspati & Chemicals Company (Supreme Court) :

Assessee paid sales tax of ₹ 1,00,000/- instead of ₹ 2,00,000/- after giving an undertaking to the sales Tax Department that he will sell the goods in the State of M.P. only. Because of his failure to sell the goods in the State Of M. P. only, he had to pay a **penalty** of ₹ 1,25,000/- to the Sales Tax Department. Held that ₹ 25,000/- represents *penalty* which is disallowable and ₹ 1,00,000/- partakes the *nature of compensation and represents nothing but sales tax* which is deductible under Section 37 (1).

B) Penalty for *breach of contract* in the normal course of business is allowable.

Indo Asian Switch Gears (Pvt.) Ltd. :

Where the assessee pays certain penalty to the State Electricity Board on account of late delivery of goods, under a contractual obligation, the loss is incidental to business, and hence cannot be disallowed.

2. Interest

Interest paid under Income tax Act / Wealth Tax Act is not allowable as deduction. However interest paid under **any other law** is allowable as deduction. For example Interest paid by assessee to sales tax department on arrears of sales tax is deductible.

Note : If interest is in the nature of penalty (i.e. Penal Interest), then such penal interest is not allowable as deduction. However, penal interest paid to bank is allowable as deduction since penal interest is payable as per the **agreement** between the bank and the assessee. There is no infraction of any law.

Section 41 (1)

a) Recovery of loss or expenditure allowed as deduction

Where any **loss or expenditure** has been allowed as deduction and subsequently any amount is received in respect of such loss or expenditure, then the amount so received shall be deemed to be the income under the head PGBP of the P.Y. in which such amount is received. This shall apply even if the business is not in existence. If such amount is received by the successor in business, then the amount so received shall be deemed to be the income of the successor under the head PGBP of the P.Y. in which such sum is received.

Illustration :

Previous year : 2008-09

Journal

Expense A/c ----- Dr.	50,000	
To Bank A/c		50,000

However, Amount allowed as deduction is ₹ 30,000.

Previous year : 2010-11

Journal

Bank A/c ----- Dr.	50,000	
To Expense Recovered (Being expense paid in P.Y. 2008-09 recovered)		50,000

₹ 30,000 is taxable as PGBP under Section 41 (1) in the P.Y. 2010-11.

Suppose in the above case the expense recovered was ₹ 45,000 then :

₹ 25,000 [i.e. ₹ 45,000 - (50,000 – 30,000)] is taxable as PGBP under Section 41 (1).

b) Remission or cessation of the trading liability

Where a deduction has been allowed in respect of a **trading liability** and subsequently there is a remission or cessation of the trading liability, then the amount of the trading liability so ceased shall be deemed to be the income under the head PGBP of the P.Y. in which such remission or cessation took place. This shall apply even if the business is not in existence. If the remission or cessation takes place in favour of the successor in business, then the amount of trading liability so ceased shall be deemed to be the income of the successor under the head PGBP of the P.Y. in which such remission or cessation took place.

Writing off the trading liability **unilaterally** (by the assessee or successor) will also bring about a remission or cessation of the trading liability.

Illustration :**Previous year : 2008-09****Journal**

Expense A/c -----	Dr.	50,000	
To Expense Payable A/c			50,000

However, Amount allowed as deduction is ₹ 40,000.

Previous year : 2010-11**Journal**

Expense Payable A/c -----	Dr.	50,000	
To Profit & Loss A/c			50,000
(Being expense liability of P.Y. 2008-09 ceases to exist)			

₹ 40,000 is taxable as PGBP under Section 41 (1) in the P.Y. 2010-11.

Time barred liabilities not written off :

In the case of **M. R. Dhawan**, it was held that when a debt becomes barred by time, the creditor would not be able to recover the amount by enforcing the right in the court. But that will not mean that the liability has come to an end. The assessee may voluntarily pay the liability even when it has become time barred. Therefore, Section 41 (1) is not attracted if a liability becomes time barred.

Note : Section 41 (1) applies to **Trading Liabilities** only. Loan is not a trading liability and therefore Section 41 (1) is not attracted.

Application of Income

Income is received by the person who is actually entitled for it. He is chargeable to tax. Post-tax income is utilized for different purposes. It is application of income.

Diversion of income by overriding title

If the assessee **voluntarily** diverts his income to some other person, then the income so diverted shall be included in the income of the person who diverted the income and shall not be taxable in the hands of the recipient.

Same is not the case where income is diverted by **overriding title**. Diversion of income by overriding title means that the income is diverted because of a **legal obligation**.

Illustration :

X and Y prepare an article for publication in Taxmann, a tax and corporate law weekly magazine on the understanding that remuneration will be shared equally. The article is published in January 8, 2011 issue of Taxmann. On February 7, 2011, X receives the entire remuneration of ₹ 2,000 (as per practice of the magazine, the remuneration is paid to the first author), a half of which is later on paid by X to Y. The payment of ₹ 1,000 (being 50% of ₹ 2,000) by X to Y is diversion of income by overriding title. The taxable income of X will be ₹ 1,000 (payment of ₹ 1,000 to Y will not be treated as income of X as it is diverted by an overriding title). Any expenditure or investment by X out of his income of ₹ 1,000 (after payment of income-tax) will be an **“application of income”**.

Deduction in respect of capital expenditure of certain specified business
[Section 35AD]
(Inserted with effect from A.Y. 2010-11)

❖ Essential conditions for claiming Deduction

1. Business should be “Specified Business” :

Deduction under Section 35AD is available only in case of a “Specified Business” mentioned hereunder :

Specified business	Who should own the business	Approval (if any)	Date of commencement of business
Setting up and operating a <i>Cold Chain Facility</i>	Any person	Not required	On or after 01-04-2009
Setting up and operating a ware housing facility for storage of agricultural produce	Any person	Not required	On or after 01-04-2009
Laying and operating a cross-country natural gas or crude petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network	An Indian company or a consortium of Indian companies or an Authority/Board/Corporation established under any Central or State Act	Should be approved by Petroleum and Natural Gas Regulatory Board and notified by the Central Government	➤ On or after 01-04-2007, in the case of laying and operating a cross-country natural gas pipeline network for distribution or storage. ➤ In other cases on or after 01-04-2009
<i>Building and operating, anywhere in India, a new hotel of two-star or above category as classified by the Central Government</i>	Any person	Not required	<i>On or after 01-04-2010</i>
<i>Building and operating, anywhere in India, a new hospital with at least one hundred beds for patients</i>	Any person	Not required	<i>On or after 01-04-2010</i>
<i>Developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed</i>	Any person	Not required	<i>On or after 01-04-2010</i>

“**Cold Chain Facility**” means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce;

2. **Specified business should be new business :**

The specified business should not be set up by splitting up, or the reconstruction, of a business already in existence. Moreover, it should not be set up by the transfer of old plant and machinery.

Exceptions :

- A. Old plant and machinery can be transferred to the specified business if the total value of the plant and machinery so transferred does not exceed twenty per cent of the total value of the plant and machinery used in such business.
- B. Any plant and machinery which was used outside India by any person other than the assessee shall not be regarded as old plant and machinery if :
 - such plant and machinery was not, at any time prior to the date of the installation by the assessee, used in India; and
 - such plant and machinery is imported into India from any country outside India; and
 - no deduction on account of depreciation in respect of such plant and machinery has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the plant and machinery by the assessee.

3. **Audit of the books of account compulsory :**

Books of account of the assessee should be audited.

❖ Amount of Deduction

100% of the **capital expenditure** incurred wholly and exclusively for the purpose of specified business carried on by an assessee is deductible in the previous year in which the expenditure is incurred. However, this is subject to the followings :

1. Expenditure incurred on the acquisition of any land or goodwill or financial instrument is not eligible for any deduction under Section 35AD.
2. Expenditure incurred **prior** to the commencement of operation, wholly and exclusively, for the purpose of any specified business, shall be allowed as deduction during the previous year in which the assessee commences the operation of his specified business, if the amount is capitalized in the books of account of the assessee on the date of commencement of operation.
3. If the operation of the business of laying and operating a cross-country natural gas distribution network is commenced during April 1, 2007 and March 31, 2009, the capital expenditure (not being for acquiring land or goodwill or financial instrument) incurred before April 1, 2009 (to the extent not allowed as deduction under any Section earlier) will be allowed as additional deduction under Section 35AD for the assessment under year 2010-11.

❖ Consequences of claiming deduction under Section 35AD

1. No deduction in respect of the expenditure in respect of which deduction has been claimed shall be allowed to the assessee under any other provisions of the income-tax Act.

2. Any loss computed in respect of the specified business shall not be set-off ***except against profits and gains, if any, of any other specified business***. To the extent the loss is unabsorbed, the same will be carried forward for set-off against profits and gains from the specified business in the following assessment year and so on.
3. If the assessee own two units and one of them qualifies for deduction under Section 35AD and another one is not eligible for the same and there is inter-unit transfer of goods or services between the two units, then for the purpose of Section 35AD calculation will be made as if such transactions are made at the market value.
4. ***Any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD shall be treated as income of the assessee and chargeable to income-tax under the head "Profits and gains of business or profession [Section 28(vii)].***

Format for computation of Profits and gains of business or profession

	₹
Net profit as per Profit & Loss Account	*****
Add : Expenses debited to Profit & Loss Account but not allowable as deduction	*****
Less : Expenses not debited to Profit & Loss Account but allowable as deduction	*****
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income	*****
Add : Incomes not credited to Profit & Loss Account but taxable under the head Profits and gains of business or profession	*****
Add : Adjustment for Over-valuation of opening stock	*****
Less : Adjustment for Under valuation of opening stock	*****
Add : Adjustment for Under-valuation of closing stock	*****
Less : Adjustment for Over-valuation of closing stock	*****
Add : Adjustment for goods withdrawn by proprietor :	
Cost price	*****
Less : Price charged	*****
Less : Adjustment for goods withdrawn by proprietor :	
Price charged	*****
Less : Cost price	*****
Add : Depreciation as per books of account	*****
Less : Depreciation as per Income-tax Rules	*****
Profits and gains of business or profession	*****

PROFITS & GAINS OF BUSINESS OR PROFESSION ~ III

PRACTICAL PROBLEMS

Question No. 1 :

Dr. Dasgupta, a medical practitioner, furnishes his Receipts & Payments Account for the previous year 2010-11 :

Receipts	₹	Payments	₹
Balance b/d	28,000	Purchase of professional books	10,000
Examiner's fees	1,000	Membership fees of medical association	1,000
Visiting fees	60,000	Household expenses	15,000
Sale of medicine	1,20,000	Rent of clinic :	
Consultation fees :		2009-10	2,000
2009-10	6,000	2010-11	11,000
2010-11	34,000	2nd Instalment of car purchased (out of total of five instalments)	60,000
Salary as a part time lecturer in a medical college	5,000	Income-tax	20,000
Gifts received from patient	10,000	Electricity, water, etc.	4,000
Retainer fees from G Ltd.	3,000	Car expenses	30,000
Interest on post office saving bank account	14,000	Medicine purchased	80,000
Interest on Government securities	20,000	Salary to staff	20,000
		Gifts to wife	10,000
		Surgical equipments	30,000
		Balance c/d	8,000
	3,01,000		3,01,000

Other information :

- 1/3rd of motor car relates to his personal use.
- Gifts include ₹ 1,000 as birthday gift of Dr. Dasgupta.
- Medicine costing ₹ 10,000 was taken for the treatment of his son.
- Depreciation to be charged on motor car @ 15%, on books @ 100% and on surgical equipments @ 25%.

Compute income from profession of Dr. Dasgupta for the assessment year 2011-12.

Question No. 2 :

X Ltd. is engaged in the business of manufacture of goods in India for domestic market. The audited profit and loss account for the year ending March 31, 2011 is as follows :

	₹		₹
Cost of goods sold	13,78,100	Sales	42,70,500
Office expenses	1,30,000	Rent of quarters near factory given to workers	60,000
Salary to employees	12,80,000	Rent of commercial property given on rent to a foreign bank	1,30,000
Expenditure on scientific research	84,000	Sale proceeds of gold (not being stock-in trade)	2,60,000
Bad debts	10,000	Amount charged from persons using guest house of company	10,000
Entertainment expenses	57,000		
Advertisement expenditure	2,27,000		
Travelling expenses	3,20,000		
Interest	82,000		

Income and wealth taxes	1,16,400		
Sales tax, excise duty and customs duty	1,76,000		
Municipal tax of quarters given to workers	16,000		
Municipal tax of commercial property	12,000		
Repairs of workers' quarters	12,000		
Repairs of commercial property given on rent	7,000		
Repairs of factory	10,000		
Insurance	36,000		
Land revenue of worker's quarters	2,000		
Land revenue of commercial building	6,000		
Depreciation	1,86,000		
Other expenses	1,10,710		
Net profit	4,72,290		
	47,30,500		47,30,500

Other information :

- Cost of goods sold** includes the following :
 - Goods of ₹ 3,52,400 purchased on May 10, 2010 from B Ltd. in which Mrs. X holds 70% equity capital (Mrs. X does not hold any share in X Ltd., but X holds 25% share capital in X Ltd., similar goods were purchased on May 11, 2010 from market for ₹ 2,86,000) (out of ₹ 3,52,400, ₹ 3,22,400 is paid by an account payee cheque and ₹ 30,000 is paid in cash);
 - Goods purchased from Y Ltd. of ₹ 28,000 which is paid by a crossed cheque.
- Out of **salary to employees** of ₹ 12,80,000 :
 - ₹ 30,000 is employees' contribution to recognized provident fund, ₹ 17,500 of which is credited in the employee's account in the relevant fund before the "due date";
 - ₹ 28,600 is bonus which is paid on September 13, 2011;
 - ₹ 36,000 is commission which is paid on November 1, 2011;
 - ₹ 10,000 is incentive to workers which is paid on November 10, 2011;
 - ₹ 40,000 is paid outside India on which tax is not deducted at source;
 - ₹ 6,100 being capital expenditure for promoting family planning amongst employees; and
 - ₹ 30,000 being entertainment allowance given to employees.
- Expenditure on scientific research**, includes ₹ 30,000, being cost of land and ₹ 16,000 paid to an approved National Laboratory for undertaking scientific research under an approved programme.
- Entertainment expenses** include the following :
 - Expenses at a five-star hotel : ₹ 14,000
 - Expenses on providing food/beverages to employees in office, factory or other place of their work : ₹ 6,000;
 - Expenses (directly paid to catering service) on providing food/beverages to employees during working hours in place other than place of work : ₹ 8,000 (i.e. ₹ 47 per day for 6 employees for 20 days plus ₹ 10 per day for 4 employees for 59 days);
 - Club bills for entertaining customers : ₹ 9,000.
 - Entertainment expenditure incurred outside India : ₹ 4,700 (permission of RBI has been taken).
- Advertisement expenditure** includes the following :
 - Expenditure incurred outside India : ₹ 46,000 (permitted by RBI to the extent of ₹ 31,800);
 - Articles presented by way of advertisement (60 articles cost of each being ₹ 900, 36 articles cost of each being ₹ 1,700);

- (c) ₹ 16,000 being cost of advertisement which appeared in a newspaper owned by a political party;
- (d) ₹ 11,400 being capital expenditure on advertisement;
- (e) ₹ 22,000 paid in cash;
- (f) ₹ 7,000 paid to a concern in which X has substantial interest (amount is excessive to the extent of ₹ 2,400).
6. **Travelling expenses** include the following :
- (a) ₹ 1,60,000 being expenditure incurred on a foreign tour, ₹ 9,000 out of which is incurred in Indian currency and ₹ 1,51,000 in foreign currency (₹ 1,40,000 permitted by RBI under foreign exchange regulations) for a visit of 8 days to Germany, out of 8 days 2 days are utilized by X for attending personal work;
- (b) ₹ 40,000 being expenditure on air fare in India by a sales manager (who is otherwise entitled for a first class rail travel);
- (c) ₹ 6,000 incurred for purchasing a machine for factory (machine is yet put to use);
- (d) ₹ 58,000 being hotel expenses as follows :
- (i) 4 days visit to Madras : ₹ 16,000
- (ii) 3 days visit to Bombay : ₹ 6,000
- (iii) 17 days visit to Bangalore : ₹ 32,000.
7. Out of ₹ 82,000 (being **interest**) ₹ 60,000 is payable outside India (no tax is deducted at source) and ₹ 15,000 is payable to IDBI (amount is paid on October 6, 2011).
8. **Taxes** debited to P&L Account have been paid as follows (evidence of payment is submitted along with the return of income) :
- (a) Income tax/wealth tax on May 31, 2011;
- (b) Sales tax, excise duty and custom duty : ₹ 1,70,000 on March 31, 2011 and ₹ 6,000 on October 10, 2011;
- (c) Municipal tax (workers' quarters) on June 30, 2011;
- (d) Municipal tax (commercial building) on June 30, 2011.
9. Out of **Insurance** of ₹ 36,000, ₹ 6,000 is fire insurance premium of workers' quarters (paid on April 10, 2011) and ₹ 4,000 is fire insurance premium of commercial building (paid on April 10, 2011).
10. **Land revenue** of ₹ 8,000 is paid on September 10, 2011. Evidence of payment is submitted along with the return of income.
11. **Other expenses** include the following :
- (a) Repairs of guest house : ₹ 6,000;
- (b) Cost of facilities provided in the guest house : ₹ 41,200;
- (c) Cost of maintaining a holiday home for the benefit of 140 employees of the company : ₹ 30,000;
- (d) Amount not deductible under Section 37 (1) : ₹ 4,000.
12. Indexed cost of acquisition of **gold** : ₹ 2,41,000.

Determine the amount of gross total income of X Ltd. for the assessment year 2011-12.

Question No. 3 :

‘A’ submits to you the following Profit & Loss Account for the year ending 31-3-2011. The date of furnishing the return of income in his case is 30-09-2011.

	₹		₹
Salary	1,50,000	Gross profit	9,08,000
Bonus 25%	37,500	Rent of 50% house property	
Repairs of house property	15,000	given on rent	24,000
Municipal taxes of house property	20,000	Bad debt recovered, earlier	
Repairs of machine	30,000	allowed as deduction	10,000
Expenditure on scientific research	20,000	Excise duty recovered, earlier	
Depreciation @ 25% on machine		not allowed as deduction	5,000
(purchased for scientific research for 6		Receipts from guests	
month)	12,500	using guest house	12,000
Donation to National laboratory for		Gift from father	10,000
Scientific research	10,000	Profit on machine sold	15,000
Patent and copyrights (1/10)	14,000		
Amortization of preliminary expenses			
(2/5)	5,000		
Bad debts	5,000		
Provision for bad and doubtful debts	10,000		
Expenditure on family planning			
amongst employees	12,000		
Donation to approved institution for			
family planning	8,000		
Premia for insurance on health of			
employees	20,000		
Interest on borrowed capital	50,000		
Contribution to recognized provident			
fund @ 14% of employees' salary	18,000		
Contribution to Employees' State			
Insurance (ESI)	6,000		
Entertainment expenses	20,000		
Advertisement expenses	50,000		
Travelling expenses	60,000		
Expenses on guest house :			
Repair of guest house	5,000		
Salary to employees	12,000		
Other expenses	8,000		
	25,000		
Loss due to theft of stocks	10,000		
Life insurance premium of A	5,000		
Loss of stock due to fire	15,000		
Sales-tax	60,000		
Sales-tax penalty	10,000		
Interest for late payment of sales-tax	6,000		
Diwali expenses	10,000		
Lump sum payment for technical			
knowhow acquired on 1-1-2011	30,000		
Income-tax paid	30,000		
Wealth-tax due	20,000		
Depreciation on machine sold @ 20%			
for 9 months	15,000		
Depreciation on machine purchased			
during the year for 9 months @ 20%	24,000		

Depreciation on machine purchased during the year for 3 months @ 20%	6,000		
Depreciation on machine @ 20% for full year	25,000		
Net profit	1,20,000		
	9,84,000		9,84,000

Other information :

- Salary** includes ₹ 10,000 paid to employees as entertainment allowance;
- Bonus** was due on 31-3-2011 which was paid as under :
25-09-2011 ₹ 30,000
30-10-2011 ₹ 7,500
- Municipal taxes** were due on 31-3-2011. ₹ 15,000 was paid on 29-7-2011. The balance is still outstanding. The due date as per municipal laws was 15-4-2011. 50% of the house property is used for own business and the balance 50% has been let out to others for business.
- ₹ 5,000 paid towards **insurance on health of employees** was paid in cash.
- Interest** includes the following :
(a) Interest on money borrowed for purchase of machine during the year put to use immediately : ₹ 20,000. The loan was taken from a financial institution. The interest was due on 31-3-2011 but was paid on 31-10-2011.
(b) Interest on money borrowed for purchase of house property : ₹ 30,000.
- ₹ 1,000 as contribution to **ESI** by employer, already included in P&L Account, was due on 31-3-2011 but was paid on 20-10-2011.
- ₹ 2,000 was recovered as **contribution by workers on account of provident fund** for the month of March, 2011. It was supposed to be deposited by 15-4-2011 but was deposited on 30-4-2011.
- Entertainment expenditure** includes :
(c) ₹ 13,000 spent on providing food and beverages to employees at place of work;
(d) ₹ 6,000 spent on providing food and beverages to customers at office;
- Advertisement expenses** include ₹ 40,000 being cost of 20 brief cases given to customers. It also includes ₹ 5,000 for advertisement given to a political party.
- Travelling expenses** were paid to employees @ ₹ 2,000 per day.
- Sales-tax** includes a sum of ₹ 20,000 due on 31-3-2011. The same was paid on 31-5-2011. The due date under the sales tax law was 15-5-2011. Further, it also includes ₹ 25,000 deposited in cash with the State Bank of India.
- Diwali expenses** include ₹ 2,000 gifts given to wife of A on her visit to office on Diwali day.
- Wealth-tax** was due on 31-3-2011 but the same was paid on 30-6-2011.
- Rate of depreciation** for machinery as per income-tax is 15%.
- Patents** were acquired on 5-6-2010 for ₹ 1,40,000.
- Preliminary expenses** were incurred in the previous year 2007-08.

Compute gross total income of A for the assessment year 2011-12.

PROFITS & GAINS OF BUSINESS OR PROFESSION ~ III**SOLUTIONS****Answer to Question No. 1 :****Computation of profits and gains of business or profession**

Name of assessee : Dr. Dasgupta

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
<u>Taxable receipts :</u>		
Visiting fees		60,000
Sale of medicine		1,20,000
Consultation fees (Note 1)		34,000
Gift received from patients (Note 2)		9,000
Retainer fee		3,000
		2,26,000
<u>Less : Allowable expenses :</u>		
Membership fees	1,000	
Rent of clinic (Note 1)	11,000	
Electricity, water etc.	4,000	
Car expenses ($2/3 \times 30,000$)	20,000	
Medicine consumed (Rs. 80,000 – Rs. 10,000) (Note 3)	70,000	
Salary to staff	20,000	
Depreciation :		
Books (Rs. 10,000 x 100%) (Note 4)	10,000	
Motor car (Rs. 60,000 x 5 x 15% x 2/3)	30,000	
Surgical equipments (Rs. 30,000 x 25%) (Note 4)	7,500	1,73,500
Profits and gains of business or profession		52,500

Notes :

1. Consultation fee and rent of clinic for the year 2009-10 has not been considered assuming Dr. Dasgupta maintains books of accounts on accrual basis.
2. Gifts received from patients are taxable in the hands of Dr. Dasgupta because gifts are generally received by a doctor from his patients in appreciation of his good treatment. As per Section 28, value of any benefit or perquisite, arising from business or profession is always taxable under the head business or profession. However, birthday gifts are not taxable because these are not treated as income under Section 2(24).
3. In the absence of information about opening and closing stock of medicine, entire purchase of medicine (excluding medicine used for son's treatment) is taken as medicine consumed.
4. It has been assumed that books and surgical equipment purchased during the year are put to use for not less than 180 days during the previous year 2010-11.
5. Examiner's fee, salary as a part time lecturer, interest on post office saving bank account and interest on Government securities are not taxable under the head "Profit and gains from business or profession".
6. Household expenses, income tax, gift to wife are not allowable expenses/payments.

Answer to Question No. 2 :**Computation of gross total income**

Name of assessee : X Ltd.

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.	Rs.
<u>A. Income from house property :</u>			
Gross Annual Value (Note 1)		1,30,000	
Less : Municipal tax paid by the owner during the P.Y.		Nil	
Net Annual Value		1,30,000	
Less : Statutory deduction u/s 24(a) [30% of Net Annual Value]		39,000	
Income from house property			91,000
<u>B. Profits and gains of business or profession :</u>			
Net profit as per Profit & Loss Account		4,72,290	
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :			
Excess cost of goods purchased from B Ltd. [not allowed u/s 40A (2)]	66,400		
Payment of Rs. 28,000 by crossed cheque to Y Ltd. [disallowed u/s 40A (3)]	28,000		
Commission paid after September 30, 2011 [not allowed as per Section 43B]	36,000		
Salaries paid outside India on which tax is not deducted at source [not allowed as per Section 40]	40,000		
Capital expenditure on family planning (Rs. 6,100 – Rs. 6,100 x 1/5)	4,880		
Expenditure on scientific research (cost of land)	30,000		
Advertisement in newspaper owned by a political party [not allowed u/s 37 (2B)]	16,000		
Capital expenditure on advertisement	11,400		
Advertisement expenses paid in cash [disallowed u/s 40A (3)]	22,000		
Excess advertisement expenses paid to a relative [not allowed u/s 40A (2)]	2,400		
Travelling expenses of personal nature on foreign tour [Rs. 1,60,000 x 2/8]	40,000		
Travelling expenditure incurred for purchasing machine (not deductible because capital expenditure)	6,000		
Interest paid outside India on which tax is not deducted at source	60,000		
Interest paid to IDBI after due date of furnishing ROI	15,000		
Income tax and wealth taxes	1,16,400		
Sales tax, excise duty and custom duty paid after the due date of furnishing ROI	6,000		
Municipal tax of commercial property given on rent	12,000		
Repairs of commercial property given on rent	7,000		
Fire insurance prem. of com. property given on rent	4,000		
Land revenue of commercial property given on rent	6,000		
Amount not deductible u/s 37 (1)	4,000	5,33,480	
		10,05,770	

Less : Expenses not debited to Profit & Loss Account but allowable as deduction : Amount credited to employees' provident fund before due date Extra 75% deduction for payment to an approved National Laboratory (75% of Rs. 16,000)	17,500 12,000	29,500	
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income : Rent of commercial property given on rent to foreign bank Sale proceeds of gold	1,30,000 2,60,000	9,76,270 3,90,000	
Add : Incomes not credited to Profit & Loss Account but taxable under the head Profit and gains of business or profession : Employees' contribution to recognized provident fund [treated as income as per Section 2 (24)] Profit and gains of business or profession		5,86,270 30,000	6,16,270
C. Capital Gains : Sale consideration Less : Indexed cost of acquisition Capital Gains Gross Total Income		2,60,000 2,41,000	19,000 7,26,270

Notes :

1. In the absence of information about municipal valuation, fair rent and standard rent, actual rent is taken as gross annual value.
2. Payment of Rs. 30,000 to B Ltd. in cash requires no adjustment as Rs. 66,400 paid to B Ltd. is disallowed u/s 40A (2).
3. Repairs of guest house are deductible u/s 30.
4. Rent of quarters given to workers is a business income because quarters are generally given to workers for running the business smoothly.

Answer to Question No. 3 :**Computation of gross total income**

Name of assessee : 'A'
Previous Year : 2010-11
Assessment Year : 2011-12

	Rs.	Rs.	Rs.
<u>A. Income from house property :</u>			
Gross Annual Value (Note 1)		24,000	
Less : Municipal tax paid by the owner (Note 2)		Nil	
Net Annual Value		24,000	
Less : Statutory deduction u/s 24(a) [30% of Net Annual Value]	7,200		
Less : Interest on borrowed capital u/s 24(b) [50% of Rs. 30,000]	15,000	22,200	
Income from house property			1,800

B. Profits and gains of business or profession :			
Net profit as per Profit & Loss Account			1,20,000
Add :	Expenses debited to Profit & Loss Account but not allowable as deduction :		
	Bonus (paid after due date of filing return of income)	7,500	
	Repairs of house property (related to let out portion) [50% of Rs. 15,000]	7,500	
	Municipal taxes (related to let out portion)	10,000	
	Municipal taxes (related to business but paid after the due date of return) [10,000 – (Rs. 15,000 x 50%)]	2,500	
	Patent and copyrights (Since acquired after 31-3-1998, depreciation will be allowed @ 25%)	14,000	
	Amortisation of preliminary expenses in excess of 1/5th	2,500	
	Provision for bad and doubtful debts	10,000	
	Expenditure on family planning (allowed only to company assesseees)	12,000	
	Donation to approved institution for family planning (deduction u/s 80G available)	8,000	
	Premia for insurance on health of employees (allowed only if paid by any mode other than cash)	5,000	
	Interest on borrowed capital (paid to financial institution after the due date of filing return of income)	20,000	
	Interest on borrowed capital (related to let out portion and deduction allowed under the head income from house property)	15,000	
	Contribution to Employees' State Insurance (paid after the due date of return)	1,000	
	Advertisement expenses (payment to political party)	5,000	
	Life insurance premium of A	5,000	
	Sales-tax penalty	10,000	
	Diwali expenses (gift to wife)	2,000	
	Lump sum payment for technical know-how (Since acquired after 31-3-1998, depreciation will be allowed @ 25%)	30,000	
	Income-tax paid	30,000	
	Wealth-tax due	20,000	2,17,000
			3,37,000
Less :	Expenses not debited to Profit & Loss Account but allowable as deduction :		
	100% cost of machine purchased for scientific research (12,500 x 12/6 x 100/25)	1,00,000	
	Extra 75% deduction for donation to national laboratory	7,500	1,07,500
			2,29,500
Less :	Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
	Rent of 50% house property given on rent	24,000	
	Excise duty recovered, earlier not allowed as deduction	5,000	
	Gift from father	10,000	
	Profit on machine sold	15,000	54,000
			1,75,500
Add :	Incomes not credited to P&L Account but taxable under the head Profit and gains of business or profession :		

Contribution of employees towards provident fund not deposited by the employer within due date		2,000	
		1,77,500	
Add : Depreciation as per books of account (Rs. 12,500 + Rs. 15,000 + Rs. 24,000 + Rs. 6,000 + Rs. 25,000)		82,500	
		2,60,000	
Less : Depreciation as per Income-tax Rules (Note 3)		90,500	
Profit and gains of business or profession			1,69,500
Gross Total Income			1,71,300

Notes :

- In the absence of information about municipal valuation, fair rent and standard rent, actual rent is taken as gross annual value.
- Municipal taxes **paid** by the owner **during the previous year** is only allowed to be deducted from the gross annual value. Even if municipal taxes are paid by the due date of return assessee cannot claim deduction in the previous year to which these are related. However, assessee can claim deduction of Rs. 15,000 in P.Y. 2011-12 because these were paid on 29-7-2011.

3. Depreciation as per Income-tax Rules :

(a) WDV of block of machinery as on 1-4-2010 will be as under :

WDV of machine sold (Rs. 15,000 x 12/9 x 100/20) Rs. 1,00,000

WDV of machine on which depreciation is charged for full year
(Rs. 25,000 x 100/20) Rs. 1,25,000-----
Rs. 2,25,000

=====

(b) Actual cost of machinery acquired during the year will be as under :

Actual cost of machine on which 9 months depreciation is charged
(Rs. 24,000 x 12/9 x 100/20) Rs. 1,60,000Actual cost of machine on which 3 months depreciation is charged
(Rs. 6,000 x 12/3 x 100/20) Rs. 1,20,000-----
Rs. 2,80,000

=====

(c) Money payable in respect of machinery sold during the year :

WDV at the beginning of the year Rs. 1,00,000

Less : Depreciation charged as per Profit & Loss Account Rs. 15,000

Rs. 85,000

Add : Profit on sale as per Profit & Loss Account Rs. 15,000

Rs. 1,00,000

=====

Now, depreciation as per Income-tax Rules will be calculated as under :

WDV of the block of machinery as on 1-4-2010 (Rate of depreciation : 15%)	2,25,000	
Add : Actual cost of the assets acquired	2,80,000	
	<u>5,05,000</u>	
Less : Money payable in respect of the assets sold	1,00,000	
WDV of the block as on 31-03-2011	<u>4,05,000</u>	
Less : Depreciation for P.Y. 2010-11 :		
On Rs. 1,20,000 @ 15% but restricted to 50%	9,000	
On Rs. 2,85,000 @ 15%	<u>42,750</u>	51,750
WDV of the block as on 1-4-2011		<u>3,53,250</u>
WDV of the block of intangibles as on 1-4-2010 (Rate of depreciation : 25%)	Nil	
Add : Actual cost of the assets acquired (Patent and technical know-how)	1,70,000	
	<u>1,70,000</u>	
Less : Money payable in respect of the assets sold	Nil	
WDV of the block as on 31-03-2011	<u>1,70,000</u>	
Less : Depreciation for P.Y. 2010-11 :		
On Rs. 30,000 @ 25% but restricted to 50%	3,750	
On Rs. 1,40,000 @ 25%	<u>35,000</u>	38,750
WDV of the block as on 1-4-2011		<u>1,31,250</u>

Therefore, depreciation as per Income-tax Rules = Rs. 51,750 + Rs. 38,750 = Rs. 90,500/-.

PROFITS & GAINS OF BUSINESS OR PROFESSION

Do yourself **PRACTICAL PROBLEMS**

Problem No. 1 :

R purchased a car on 15-5-2010 for Rs. 5,00,000. Calculate the depreciation for the assessment year 2011-12 and 2012-13, assuming :

- (i) the car is the only item in the block ; and
- (ii) 30% of the use of car is for personal purposes.
- (iii) Rate of depreciation for assessment year 2011-12 is 20% and for assessment year 2012-13 it is 15%.

Problem No. 2 :

Find out the gross total income of Shri Shyam Lal on the basis of the following particulars :

Profit and loss account for the year ended 31-3-2011

	Rs.		Rs.
Interest	1,800	Gross profit b/d	1,22,700
Repairs and renewals	2,200	Interest on debenture (gross)	10,000
Insurance	4,200	Rent from house property	36,000
Depreciation	5,600		
Compensation	10,200		
Law charges	5,100		
Labour Welfare expenses	3,800		
Subscriptions	5,800		
Net profit	1,30,000		
	1,68,700		1,68,700

- (a) Interest includes Rs. 200 on loan taken for purchasing debentures of a company and Rs. 300 on loan taken for reconstruction of house property let out.
- (b) The expenses relating to house property let out are 40% of the repairs and renewal expenses.
- (c) Depreciation includes Rs. 1,200 on house property let out.
- (d) Compensation was paid to an employee whose dismissal was in business interest.
- (e) Insurance includes 30% for fire insurance of the house property let out, 30% for workers' accident insurance and the balance for life insurance.
- (f) Law charges include Rs. 2,000 relating to a petition filed against breach of contract and the balance regarding sales tax appeal.
- (g) Subscriptions include Rs. 2,000 given for election purpose to political parties.
- (h) The amount not debited to profit and loss account are as follows :
 - (i) Expenses incurred on the occasion of Deepawali Rs. 500.
 - (ii) Theft of cash from iron safe Rs. 1,500.
 - (iii) Expenses for new telephone connection in the business Rs. 2,000.

Problem No. 3 :

Mr. Abhishek furnishes the following particulars of his income for the assessment year 2011-12 :

Profit & Loss Account

Particulars	Rs.	Particulars	Rs.
To Office expenses	12,400	By Gross profit	2,98,000
" General expenses	12,000	" Sundry receipts	19,000
" Legal expenses	8,000	" Custom duties recovered	
" Depreciation on machinery	11,000	back from Govt. (earlier not	
" Staff salary	21,000	allowed as deduction)	15,300
" Bonus to staff	15,000	" Bad debts recovered (earlier	
" Contribution to approved Gratuity		allowed as deduction)	3,000
fund	16,000	" Gift from son	40,000
" O/s liability for excise duties	18,000		
" Audit fees	21,000		
" Net profit	2,40,900		
	3,75,300		3,75,300

Other relevant particulars :

1. Bonus to employees according to the Payment of Bonus Act, 1965, comes to Rs. 4,200.
2. Depreciation on machinery shown in the profit and loss account is calculated according to the income-tax provisions.
3. General expenses include payment of Rs. 9,000 to an approved educational institute for the purpose of carrying on scientific research in natural science. The research is, however, not related to the business of the assessee.
4. During the previous year Mr. Abhishek also made a capital expenditure of Rs. 5,000 for the purpose of carrying on a scientific research related to his business. The expenditure is however, not recorded in the profit and loss account.
5. Outstanding liability in respect of excise duty amounting to Rs. 10,500 was paid on 10-6-2011; Rs. 1,000 on 10-7-2011; Rs. 2,000 on 30-7-2011; Rs. 1,000 on 10-9-2011 and Rs. 3,500 is still outstanding. The return is furnished on 30-9-2011 (last date).
6. No tax has been deducted at source on the audit fee Rs. 21,000.

Determine the taxable income of Mr. Abhishek for the assessment year 2011-12 assuming he annually deposit Rs. 10,000 in a PPF Account and his turnover for financial year 2010-11 was Rs. 50,00,000.

Problem No. 4 :

Calculate the taxable business income of the assessee for the assessment year 2011-12 from the particulars given below :

Profit for the previous year 2010-11 (Before allowing the following amounts)	13,70,000
Amount given to approved scientific institution (Research not related to the business of the assessee)	80,000
Cost of land acquired for constructing research laboratory	2,00,000
Cost of building and plant and machinery required for research	12,00,000
Amount given as salary to staff engaged in research (relating to a field related to assessee own business) during 2009-10 (Business started on 1-4-2010). The prescribed authority certifies the amount.	90,000
Salary given to staff engaged in research within the premises during 2010-11.	1,20,000

Problem No. 5 :

R gives you the following particulars for the year ended 31-3-2011 :

Net profit as per profit & loss account (without allowing the following items)	5,20,000
Capital expenditure on family planning	70,000
Lump sum consideration for purchase of tech. Know-how developed in Govt. laboratory	1,20,00
Entertainment expenditure	40,000
Expenditure on acquisition of patent right	80,000
Expenditure on advertisement paid in cash.	25,000
Provision for excise duty (paid Rs. 30,000 on 27-6-2011 and Rs. 12,000 on 1-11-2011).	
Due date of filing of return is 31-7-2011.	60,000
Amount paid to Delhi University for an approved research program in the field of social science not connected with his business.	60,000

Compute R's business income for the assessment year 2011-12.

Problem No. 6 :

Shri Batra is the owner of a small manufacturing unit. He gives you the following details drawn from his books of account for the year 2010-11 :

Computed net profit (after charging the following items)	Rs. 27,500
Provision for doubtful debts	Rs. 15,000
Depreciation reserve	Rs. 20,000
Household expenses	Rs. 46,000
Donation to PM National Relief Fund	Rs. 10,000
Other charitable donations	Rs. 20,000
Cheques issued for purchases	Rs. 60,000
Advertisement expenses (spent on Neon Sign and given to a customer)	Rs. 5,000
Advertisement gifts to 50 customers at a cost of Rs. 100 each.	Rs. 5,000
Audit fees (including expenses on income-tax assessment Rs. 15,000)	Rs. 20,000
Patents purchased during the previous year.	Rs. 70,000

Incomes credited to profit and loss account were :

- (a) Bank interest on F.D. Rs. 5,000.
- (b) Interest on post office savings bank account Rs. 3,000.
- (c) Interest on UTI units Rs. 2,000.

Opening stock is valued at cost plus 10% basis, whereas closing stock was valued at cost minus 10% basis. Opening stock is valued at Rs. 66,000 while closing stock is valued at Rs. 72,000.

Compute net business income for the assessment year 2011-12.

Problem No. 7 :

From the following profit and loss account of R for the year ending 31-3-2011, compute his gross total income for the assessment year 2011-12 :

Profit and Loss Account

	Rs.		Rs.
To Opening stock	4,00,000	By Sales	40,00,00
" Purchases	30,00,000	" Closing stock	4,80,000
" Salaries	8,00,000	" Income from house property	80,000
" Rent rates and taxes	1,20,000	" Dividends from an Indian Co.	9,000
" Legal charges	40,000		
" Miscellaneous expenses	20,000		
" Reserve for bad debts	30,000		
" Provision for gratuity	20,000		
" Provision for income tax	40,000		
" Salary to Mrs. R	36,000		
" Depreciation	40,000		
" Banking cash transaction tax	3,000		
" Net profits	20,000		
	45,69,000		45,69,000

Additional information :

- Purchase includes Rs. 1,00,000 paid in cash to a cultivator for purchase of agricultural produce.
- Purchase also includes Rs. 10,000 paid by way of compensation paid to a supplier as the assessee was unable to take the delivery of goods due to lack of storage space and finances.
- Opening stock was over-valued by 25% and closing stock was under-valued by 25%.
- Salary includes Rs. 15,000 as customary bonus during Diwali over and above the bonus payable under Bonus Act.
- Rent, rates and taxes include Rs. 10,000 on account of disputed sales tax demand, Rs. 3,000 on account of municipal taxes for property let out. It also includes Rs. 5,000 as customs penalty paid during the year.
- An amount of Rs. 20,000 from a customer was written-off from the reserve for bad debts.
- An employee retired on 28-3-2011. Gratuity payable to him was Rs. 20,000. A provision was created for the same this year and it was paid on 2-4-2011.
- Mrs. R is a Law graduate and actively working in the assessee's firm.

Problem No. 8 :

R is the proprietor of a business. The following is the profit and loss account :

Profit and Loss Account

	Rs.		Rs.
To Office salaries	1,98,000	By Gross profit	4,25,000
" Proprietor's salaries	60,000	" Profit on sale of residential	
" General expenses	45,000	house (long-term)	90,000
" Bad debts	11,500	" Bad debts recovered (disallowed	
" Advertisements	8,400	in earlier years assessment)	24,000
" Fire insurance premium	1,500	" Interest from government	
" Depreciation	11,700	securities	14,000
" Motor car expenses	8,500	" Dividends (Gross) received	
" Legal charges for defending suit		from agricultural company	6,000
for alleged breach of a trading		" Interest from Bank A/c	2,000
contract	4,000	" Income from horse racing	
" Donation to ICAI for statistical		(Gross)	10,000
research	10,000		
" Interest on proprietor's capital	15,000		
" Reserve for future losses	4,000		
" Income tax paid on last			
assessment	7,100		
" Life insurance premium	6,000		
" Advance income-tax	4,000		
" Net profit	1,76,300		
	5,71,000		5,71,000

Further information is given :

- General expenses include Rs. 30,000 paid as compensation to an old employee whose services terminated as his continuance in service was considered detrimental to the profitable conduct of the business and Rs. 1,000 as help to a poor university student.
- A sum of Rs. 5,000 being cost of a small machine has also been included in general expenses.
- The advertisement cost includes expenditure of Rs. 6,000 on one wooden show window and Rs. 1,800 on calendars and diaries.
- One fourth of motor car expenses are for personal use of the car.
- The depreciation is found to be in excess by Rs. 2,000 compared to the amount allowable under Income-tax Rules.
- Reserve for future losses represents a demand for sales-tax under dispute.

Compute R's taxable profits from business for the assessment year 2011-12.

Problem No. 9 :

X (age : 66 years), a resident individual, furnishes the following particulars relevant for the assessment year 2011-12 :

Profit and loss account

Particulars	Rs.	Particulars	Rs.
To Salary to staff	34,000	By Gross profit	1,86,000
" General expenses	48,000	" Commission and discount	2,17,200
" Bad debts written off	15,000	" Sundry receipts	43,000
" Reserves for losses	2,000	" Short-term profit on sale of investment	31,000
" Fire insurance premium (Office premises)	4,200		
" Advertisement 2,400			
Add : outstanding 1,600	4,000		
" Interest on X's capital	3,500		
" Interest on bank loan	14,500		
" Expenses on acquisition of patent right acquired and put to use on June 30, 2010	17,000		
" Lump-sum consideration for acquiring know-how on March 3, 2011	60,000		
" Depreciation on plant and machinery	28,000		
" Provision for sales-tax and excise	13,000		
" Net profit	2,34,000		
	4,77,200		4,77,200

Other information :

- Advertisement expenses include Rs 3,400 being cost of 2 dairies (cost of each being Rs. 1,700) presented to customers.
- Depreciation on plant and machinery according to income-tax provision comes to Rs. 29,700.
- Salary to staff includes payment of Rs. 8,000 to a relative which is unreasonable to extent of Rs. 3,000.
- General expenses include : (a) expenditure of Rs. 4,800 incurred by X on training of his employees, (b) commission of Rs. 10,000 for securing a business order, and (c) compensation of Rs. 6,000 paid to an employee while terminating his service in the business interest.
- Out of outstanding sales tax and excise duty, Rs. 3,000 is paid on July 10, 2011 and Rs. 8,000 paid on October 3, 2011. The balance is not paid yet. Due date of filing ROI is July 31, 2011.
- Income of X from company deposit is Rs. 12,000, which is not shown in the profit and loss account.

Determine the taxable income and tax liability of X for the assessment year 2011-12, assuming that insurance premium paid by X on the life insurance policy of Mrs. X is Rs. 3,200.

Problem No. 10 :

X (age : 24 years), a resident individual, furnishes the following information for the A.Y. 2011-12 :

Profit and loss account

Particulars		Rs.	Particulars		Rs.
To	Office expenses	11,000	By	Gross profit	3,78,000
"	Telephone under OYT Scheme	8,000	"	Sundry receipts	8,000
"	Salary to staff	42,000			
"	Depreciation	28,000			
"	Travelling expenses	43,000			
"	Loss on cash by an employees through embezzlement	5,000			
"	Amount transferred to special reserve account	7,500			
"	Expenses on the occasion of Diwali	7,100			
"	Interest and legal expenses	44,000			
"	Sundry expenses	8,500			
"	Net profit	1,81,900			
		3,86,000			3,86,000

Other information :

- Salary to staff includes payment of Rs. 12,000 out of India on which has not been deducted at source nor paid to the Government.
- Depreciated value of plant and machinery on 01.04.10 is Rs. 1,10,000 (rate of depreciation : 15%).
- A plant whose WDV on 01.04.10 is Rs. 17,440 is sold during previous year for Rs. 11,000.
- A machinery (cost price Rs. 20,000) whose written down value on April 1, 2010 is Rs. 2,350 is sold during the previous year for Rs. 15,000.
- During the year, X purchased a new plant for Rs. 1,22,670 which is eligible for depreciation at the rate of 15%. The plant is installed and put to use on May 15, 2010.
- Travelling expenses include Rs. 10,000 being hotel expenditure of an employee in respect of an official visit to Bombay for 5 days.
- Expenditure on the occasion of Diwali includes a gift of Rs. 2,000 to Mrs. X.
- Interest includes a payment of Rs. 3,000 out of India on which tax has not been deducted.
- Sundry expenses include expenditure of Rs. 1,000 on maintenance of guest house in Delhi for the purpose of carrying on the business and Rs. 4,000 being employer's contribution towards ESI out of which Rs. 600 is paid after the due date of submission of return of income.
- Legal expenses include the following payments :
 - Payment of Rs. 4,000 to B, an employee of X, for filing income-tax appeals.
 - Payment of Rs. 5,000 to C, not being an employee of X, for preparation of return of income.
 - Payment of Rs. 11,000 to D, an advocate who is not an employee of X, for filing income-tax appeals and giving tax advice.
 - Payment of Rs. 2,000 to E, a CA. who is not an employee of X, for obtaining tax advice.

Determine the taxable income and tax liability of X for A.Y. 2011-12 assuming that sundry receipts include Rs. 5,000 being amount of endowment insurance policy received from LIC at the time of maturity of the policy (i.e. December 5, 2010) [amount of insurance premium last paid on June 5, 2010 : Rs. 400].

Problem No. 11 :

XYZ Ltd. an Indian company, furnishes the following particulars for the assessment year 2011-12 :

Profit and loss account

	Rs.		Rs.
Salary to staff	2,40,000	Gross profit	7,58,000
Expenses on issue of shares for setting up an industrial undertaking		Rent of flats given to officers	12,000
(Cost of project Rs. 10 lakh)	18,000	Sundry receipts	5,000
Expenditure on promotion of family planning among the employees	3,000	Interest on bank deposits	17,000
Sales tax	2,000	Capital gains on sale of short-term investment	3,000
Contribution to National Laboratory for carrying out approved scientific research	1,06,000		
Gratuity fund	5,000		
Reserve for future losses	20,000		
Bad debts written off	3,000		
Reserve for payment of advance income tax	13,000		
Car expenses	9,000		
<u>Depreciation :</u>			
Machinery	18,000		
Car	3,000		
Furniture	5,000		
Building	3,000		
Office expenses	7,500		
Rent and repairs of building	3,000		
Municipal taxes and ground rent of flats given to officers	7,000		
Sundry expenses	13,000		
Fringe benefit tax	10,500		
Banking cash transaction tax	3,000		
Income-tax	500		
Dividend-tax	700		
Net profit	3,01,800		
	7,95,000		7,95,000

Other information :

1. Expenditure on family planning includes capital expenditure of Rs. 2,500.
2. Car is utilized partly for private purposes by a director. In the past years, one-fourth of this expenditure was disallowed.
3. Sundry expenses include Rs. 9,000 being payment of printing bill to relative of the managing director; payment is unreasonable to the extent of Rs. 4,700.
4. Salary includes payment of Rs. 21,000 in cash to an employee. It also includes "Mediclaime" insurance premium for the benefit of employees of Rs. 15,000 out of which Rs. 6,000 is paid in cash.
5. Though amount of depreciation of building, car and furniture is calculated as per tax provisions, depreciation in respect of machinery is excessive to the extent of Rs. 2,000.
6. Rs. 1,06,000 being payment to National Laboratory is qualified for weighted deduction u/s 35(2AA).
7. The company has deposited Rs. 2,40,000 with Maruti Udyog Limited on March 1, 2011 for purchasing Maruti-800 car. The car is likely to be delivered by June, 2011. The said amount is not debited to profit and loss account.

8. During the previous year 2010-11, the company pays Rs. 15,00,000 as compensation to employees on voluntary retirement under the voluntary retirement scheme of the company. The amount is not debited to the profit and loss account.
9. The company deposits Rs. 10,000 in National Housing Bank.
10. On March 16, 2011, the company gets a refund of sales tax of Rs. 3,000 (it was allowed as deduction for the previous year 2006-07). The amount is not credited to the profit and loss account, as the commissioner's appeal against the refund is still pending in the Delhi High Court.

Determine the taxable income of the assessee-company for the assessment year 2011-12.

Problem No. 12 :

Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose written down value on 01.04.2010 was Rs. 40 lacs. It purchased another asset of the same block on 01.11.2010 for Rs. 14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2011.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2011 assuming the assets transferred to Shirdi Ltd. at Rs. 60 lacs.

PROFITS & GAINS OF BUSINESS OR PROFESSION**Do yourself****SOLUTIONS****Solution to Problem No. 1 :**Assessment year : 2011-12

Actual cost of the car		5,00,000
Less : Depreciation (Rs. 5,00,000 x 20%)	1,00,000	
Less : Disallowed for personal use u/s 38 (2) [30% of Rs. 1,00,000]	<u>30,000</u>	<u>70,000</u>
WDV as on 01-04-2011		<u>4,30,000</u>

Assessment year : 2012-13

WDV as on 01-04-2011		4,30,000
Less : Depreciation (Rs. 4,30,000 x 15%)	64,500	
Less : Disallowed for personal use u/s 38 (2) [30% of Rs. 64,500]	<u>19,350</u>	<u>45,150</u>
WDV as on 01-04-2012		<u>3,84,850</u>

Solution to Problem No. 2 :**Computation of gross total income**

Name of assessee : Shri Shyam Lal

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
<u>A. Income from house property :</u>		
Gross Annual Value (Note 1)		36,000
Less : Municipal tax paid by the owner		Nil
Net Annual Value		36,000
Less : Statutory deduction u/s 24(a) [30% of Net Annual Value]	10,800	
Less : Interest on borrowed capital u/s 24(b)	300	11,100
Income from house property		24,900
<u>B. Profits and gains of business or profession :</u>		
Net profit as per Profit & Loss Account		1,30,000
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Interest on loan for securities and house property (Rs. 200 + 300)	500	
Repairs and renewals of house property (Rs. 2,200 x 40%)	880	
Depreciation on house property	1,200	
Fire insurance premium of house property	1,260	
Life insurance premium (Rs. 4,200 x 40%)	1,680	
Subscription to political parties	2,000	7,520
		1,37,520
Less : Expenses not debited to Profit & Loss Account but allowable as deduction :		
Deepawali expenses	500	
New telephone connection expenses	2,000	
Loss of cash due to theft	1,500	4,000
		1,33,520

Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
Interest on debentures	10,000	
Rent from house property	36,000	46,000
Profit and gains of business or profession		87,520
<u>C. Income from other sources :</u>		
Interest on debentures (Rs. 10,000 – Rs. 200)		9,800
Income from other sources		9,800
<u>Gross Total Income :</u>		
Income from house property		24,900
Profit and gains of business or profession		87,520
Income from other sources		9,800
Gross Total Income		1,22,220

Notes :

1. In the absence of information about municipal valuation, fair rent and standard rent, actual rent is taken as gross municipal value.
2. Subscription of Rs. 3,000 paid to political party is an allowable deduction u/s 80GGC.

Solution to Problem No. 3 :**Computation of gross total income**

Name of assessee : Mr. Abhishek

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
<u>B. Profits and gains of business or profession :</u>		
Net profit as per Profit & Loss Account		2,40,900
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Excise duty outstanding	3,500	
Audit fee (as tax has not been deducted at source) [Sec. 40]	21,000	24,500
		2,65,400
Less : Expenses not debited to Profit & Loss Account but allowable as deduction :		
Capital expenditure on scientific research	5,000	
Additional deduction of 75% for payment of Rs. 9,000 for scientific research	6,750	11,750
		2,53,650
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
Customs duties recovered back	15,300	
Gift from son	40,000	55,300
Profit and gains of business or profession		1,98,350
Gross Total Income		1,98,350
Less : Deduction u/s 80C on PPF		10,000
Total Income		1,88,350

Notes :

1. Outstanding liability for excise duties of Rs. 3,500 is not allowable as deduction as per Section 43B since not paid till the last date of return filing.

2. Payment of Rs. 9,000 to an approved institute for the purpose of scientific research is an allowable deduction u/s 35 @ 175% of the sum paid even though the research is not related to the assessee's business.

Solution to Problem No. 4 :

Computation of taxable business income

Name of assessee :

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
Net profit as per Profit & Loss Account		13,70,000
Less : Allowable revenue expenses :		
Amount given to approved scientific institution (Rs. 80,000 x 175%)	1,40,000	
Amount given as salary to staff engaged in research (relating to a field related to assessee own business) (research before commencement of business)	90,000	
Salary given to staff engaged in research within the premises during 2009-10	1,20,000	3,50,000
		10,20,000
Less : Allowable capital expenses :		
Cost of land	Nil	
Cost of building and plant and machinery	12,00,000	12,00,000
<i>Unabsorbed capital expenditure on research carried forward</i>		<i>1,80,000</i>

Solution to Problem No. 5 :

Computation of taxable business income

Name of assessee : R

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
Net profit as per Profit & Loss Account		5,20,000
Less : Allowable expenses :		
Capital expenditure on family planning (allowed only to companies)	Nil	
Lump sum consideration for purchase of tech. Know-how developed in Govt. laboratory (Depreciation @ 25%)	30,000	
Entertainment expenditure	40,000	
Expenditure on acquisition of patent right (Depreciation @ 25%)	20,000	
Expenditure on advertisement paid in cash [Section 40A(3)]	Nil	
Payment of excise duty before filing of ROI	30,000	
Amount paid to Delhi University for an approved research program (Rs. 60,000 x 175%)	1,05,000	2,25,000
Profit and gains of business or profession		2,95,000

Solution to Problem No. 6 :**Computation of taxable business income**

Name of assessee : Shri Batra

Previous Year : 2010-11

Assessment Year : 2011-12

Computed net profit		27,500
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Provision for doubtful debts	15,000	
Depreciation reserve	20,000	
Household expenses	46,000	
Donation to PM National Relief Fund (Deduction available u/s 80G)	10,000	
Other charitable donations (deduction available u/s 80G if donated to specified fund/institutions)	20,000	
Advertisement expenses (spent on Neon Sign and given to a customer) – Capital expenditure	5,000	
Patents purchased during the previous year.	70,000	1,86,000
		2,13,500
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
Bank interest on F.D.	5,000	
Interest on post office savings bank account [Exempt u/s 10(15)(i)]	3,000	
Interest on UTI units	2,000	10,000
		2,03,500
Add : Adjustment for Over-valuation of opening stock (Rs. 66,000 x 10/110)	6,000	
Adjustment for Under-valuation of closing stock (Rs. 72000 x 10/90)	8,000	14,000
		2,17,500
Less : Depreciation on Neon Signs @ 15% on Rs. 5,000 (assuming used for 180 days or more)	750	
Depreciation on patents @ 25% on Rs. 70,000 (assuming used for 180 days or more)	17,500	18,250
Profit and gains of business or profession		1,99,250

Solution to Problem No. 7 :**Computation of gross total income**

Name of assessee : R

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
<u>A. Income from house property :</u>		
Gross Annual Value (Note 1)		80,000
Less : Municipal tax paid by the owner		3,000
Net Annual Value		77,000
Less : Statutory deduction u/s 24(a) [30% of Net Annual Value]		23,100
Income from house property		53,900

B. Profits and gains of business or profession :		
Net profit as per Profit & Loss Account		20,000
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Disputed sales tax demand	10,000	
Municipal tax for property let out	3,000	
Customs penalty	5,000	
Reserve for bad debt	30,000	
Provision for income-tax	40,000	88,000
		1,08,000
Less : Expenses not debited to Profit & Loss Account but allowable as deduction :		
Bad debt written-off		20,000
		88,000
Add : Adjustment for Over-valuation of opening stock (Rs. 4,00,000 x 25/125)	80,000	
Adjustment for Under-valuation of closing stock (Rs. 4,80,000 x 25/75)	1,60,000	2,40,000
		3,28,000
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
Income from house property	80,000	
Dividend from an Indian company (Not taxable)	9,000	89,000
Profit and gains of business or profession		2,39,000
Gross Total Income :		
Income from house property		53,900
Profit and gains of business or profession		2,39,000
Gross Total Income		2,92,900

Notes :

1. In the absence of information about municipal valuation, fair rent and standard rent, actual rent is taken as gross municipal value.
2. Payment of Rs. 1,00,000 in cash to the cultivator is allowable deduction as per Rule 6DD.
3. Compensation of Rs. 10,000 paid to the supplier of goods is an allowable deduction because Penalty for *breach of contract in the normal course of business* is allowable (Indo Asian Switch Gears (Pvt.) Ltd.).

Solution to Problem No. 8 :**Computation of taxable business profit**

Name of assessee : R

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
Net profit as per Profit & Loss Account		1,76,300
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Proprietor's salaries	60,000	
Donation to poor university student	1,000	
Cost of small machine	5,000	

	Expenditure on wooden show window	6,000	
	Motor car expenses (Rs. 8,500 x ¼)	2,125	
	Interest on proprietor's capital	15,000	
	Reserve for future losses	4,000	
	Income tax paid on last assessment	7,100	
	Life insurance premium	6,000	
	Advance income-tax	4,000	1,10,225
			2,86,525
Less :	Expenses not debited to Profit & Loss Account but allowable as deduction :		
	Extra 25% deduction for donation to ICAI for statistical research		2,500
			2,84,025
Less :	Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
	Profit on sale of residential house (long-term)	90,000	
	Bad debts recovered (disallowed in earlier years assessment)	24,000	
	Interest from government securities	14,000	
	Dividends (Gross) received from agricultural company	6,000	
	Interest from Bank A/c	2,000	
	Income from horse racing (Gross)	10,000	1,46,000
			1,38,025
Add :	Excess depreciation as per Income-tax Rules		2,000
			1,40,025
Less :	Depreciation on small machine (on Rs. 5,000 @ 15%)	750	
	Depreciation on wooden show window (on Rs. 6,000 @ 10%)	600	1,350
	Profit and gains of business or profession		1,38,675

Solution to Problem No. 9 :**Computation of taxable income**

Name of assessee : X

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
Net profit as per Profit & Loss Account		2,34,000
Add :		
Expenses debited to Profit & Loss Account but not allowable as deduction :		
Salary to staff (payment of Rs. 8,000 to a relative which is unreasonable to extent of Rs. 3,000)	3,000	
Reserve for losses	2,000	
Interest on capital	3,500	
Expenses on acquisition of patent right acquired and put to use on June 30, 2010	17,000	
Lump-sum consideration for acquiring know-how on March 3, 2011	60,000	
Outstanding sales tax and excise duty	10,000	95,500
		3,29,500
Less :		
Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
Short-term profit on sale of investment		31,000
		2,98,500
Add :		
Depreciation on plant and machinery as per books of account		28,000
		3,26,500

Less : Depreciation on patent right (on Rs. 17,000 @ 25%)	4,250	
Depreciation on know-how (On Rs. 60,000 @ 25% but restricted to 50%)	7,500	
Depreciation on plant and machinery as per income-tax provision	29,700	41,450
Profit and gains of business or profession		2,85,050

Computation of tax liability

	Rs.
Profit and gains of business or profession	2,85,050
Capital Gains (Short-term profit on sale of investment)	31,000
Income from other sources (Income of X from company deposit)	12,000
Gross Total Income	3,28,050
Less : Deduction under section 80C (payment of insurance premium)	3,200
Total Income (Mr. X is a senior citizen)	3,24,850
Tax on Total Income	8,485
Add : EC @ 2%	170
	8,655
Add : SHEC @ 1%	85
Tax Payable	8,740

Solution to Problem No. 10 :

Computation of taxable business income

Name of assessee : X

Previous Year : 2010-11

Assessment Year : 2011-12

Net Profit as per Profit & Loss Account		1,81,900
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Salary paid outside India (not deductible as tax has not been deducted at source)	12,000	
Gift to Mrs. X	2,000	
Payment of interest out of India (not deductible as tax has not been deducted at source)	3,000	
Employer's contribution towards ESI which is paid after the due date of submission of return of income.	600	
Transfer to special reserve	7,500	25,100
		2,07,000
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :		
Amount of endowment insurance policy received from life insurance corporation on India [Exempt u/s 10(10D)]		5,000
		2,02,000
Add : Depreciation as per books of account		28,000
		2,30,000
Less : Depreciation as per Income-tax provisions (<i>Refer Note below</i>)		31,000
Profit and gains of business or profession		1,99,000

Computation of tax liability

	Rs.
Profit and gains of business or profession	1,99,000
Income taxable under other heads of income	Nil

Gross Total Income	1,99,000
Less : Deduction under section 80C (payment of insurance premium)	400
Total Income	1,98,600
Tax on Total Income	3,860
Add : EC @ 2%	77
	3,937
Add : SHEC @ 1%	39
Tax Payable (Rounded-off)	3,980

Note : Depreciation as per Income-tax provisions :

WDV of the block as on 1-4-2010 (Rate of depreciation : 15%)	1,10,000
Add : Actual cost of the assets acquired	1,22,670
	2,32,670
Less : Money payable in respect of the assets sold (Rs. 11,000 + Rs. 15,000)	26,000
WDV of the block as on 31-03-2011	2,06,670
Less : Depreciation for P.Y. 2010-11 : On Rs. 2,06,670 @ 15%	31,000
WDV of the block as on 1-4-2011	1,75,670

Solution to Problem No. 11 :

Computation of taxable income

Name of assessee : XYZ Limited

Previous Year : 2010-11

Assessment Year : 2011-12

	Rs.	Rs.
Net profit as per Profit & Loss Account		3,01,800
Add : Expenses debited to Profit & Loss Account but not allowable as deduction :		
Expenditure on issue of shares (1/5th of Rs. 18,000 is deductible as per section 35D)	14,400	
Expenditure on family planning [amount deductible is entire amount of revenue expenditure and 1/5th of capital expenditure and thus inadmissible amount is [Rs. 3,000 – Rs. (500 + 1/5th of Rs. 2,500)]]	2,000	
Reserve for future losses	20,000	
Reserve for payment of advance income tax	13,000	
Car expenses (1/4th of Rs. 9,000)	2,250	
Excess depreciation provided on machinery	2,000	
Depreciation on car (1/4th of Rs. 3,000 as car is used partly for private purpose)	750	
Fringe benefit tax	10,500	
Income-tax	500	
Dividend-tax	700	
Excess payment of printing bill to relative of director	4,700	
Salary payment of Rs. 21,000 in cash to an employee	21,000	
Mediclaime insurance premium paid in cash	6,000	97,800
		3,99,600
Less : Expenses not debited to Profit & Loss Account but allowable as deduction :		
Compensation paid under VRS (1/5th of Rs. 15,00,000 is deductible in 5 years u/s 35DDA)	3,00,000	

Extra 75% deduction for payment to an approved National Laboratory (75% of Rs. 1,06,000)		79,500	3,79,500
Less : Incomes credited to Profit & Loss Account but either exempt or taxable under other heads of income :			20,100
Interest on bank deposits		17,000	
Capital gains on sale of short-term investment		3,000	20,000
Add : Incomes not credited to Profit & Loss Account but taxable under the head Profit and gains of business or profession :			100
Sales tax refund (taxable u/s 41(1) even if appeal is pending)			3,000
Profit and gains of business or profession			3,100

Computation of tax liability

	Rs.
Profit and gains of business or profession	3,100
Interest on bank deposits	17,000
Capital gains on sale of short-term investment	3,000
Gross Total Income	23,100
Less : Deduction under section 80C to 80U	Nil
Total Income	23,100
Tax on Total Income @ 30%	6,930
Add : EC @ 2%	139
	7,069
Add : SHEC @ 1%	69
Tax Payable (Rounded-off)	7,140

Notes :

1. The company cannot claim any deduction u/s 80C.
2. It has been assumed that letting out of residential flats to employees is subservient and incidental to the main business of the company. Therefore, rental income is not taxable under the head "IHP".
3. Amount deposited with Maruti Udyog is not deductible.

Solution to Problem No. 11 :

Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for P.Y. 2010-11

<u>Particulars</u>	<u>Rs.</u>
Written down value (WDV) as on 1.4.2010	40,00,000
Addition during the year (used for less than 180 days)	14,40,000
Total	54,40,000
Depreciation on Rs. 40,00,000 @ 15%	6,00,000
Depreciation on Rs. 14,40,000 @ 7.5%	1,08,000
Total depreciation for the year	7,08,000

Apportionment between two companies :

Amalgamating company, Sai Ltd. :

Rs. 6,00,000 × 275/365	4,52,055
Rs. 1,08,000 × 61/151	43,629
	<u>4,95,684</u>

Amalgamated company, Shirdi Ltd. :

Rs. 6,00,000 × 90/365	1,47,945
Rs. 1,08,000 × 90/151	<u>64,371</u>
	<u>2,12,316</u>

Notes :

- (1) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.
- (2) The price at which the assets were transferred, i.e., Rs. 60 lacs, has no implication in computing eligible depreciation.