PROFITS AND GAINS FROM BUSINESS OR PROFESSION

1) Anticipated hedging loss under a contract to purchase raw material.
2) Non-recovery of a bill due to negligence of an employee.
3) Initial expenditure incurred on installation of fluorescent tube lights.
4) Non-recovery of advance allowed to 100% subsidiary company engaged in the business of financing subsidiary companies.
5) Consultation fees paid to tax advisor.
6) Lump sum payment made to acquire a licence regarding technical information to reduce the production cost.
7) Payment made to catering agency for providing food/beverages to employees, working in overtime @ Rs 75 per employee for 20 days.
8) Subsidy received from the government to compensate the loss suffered in exports under government sponsored scheme, has been directly credited to Capital Reserve A/c. The assessee claims it as exempt.
9) Compensation paid to an employee under voluntary retirement scheme which does not conform to the guide lines under Sec. 10(10C).
10) Commission accrued during the year but not credited in books as it has been held back due to breach of certain conditions, which may create liability to pay damages.
11) Rent of quarters, located near factory, let out to the employees of the factory, was treated as income from house property.
12) Fees of Rs 30,000 were paid by the company to a lawyer to defend the company in a court case. Lawyer is the brother of the director of the company. The fees have been paid by a bearer cheque and it is found excessive to the extent of Rs 20,000.
13) Employees contribution to the recognised provident fund, Rs 60,000 has been charged to the profit and loss account but only Rs 25,000 was credited to their accounts on due date and the balance was credited to their account on the due date fixed for furnishing return of income for the relevant previous year.
14) Bonus/commission to employees was paid: (a) during the previous year; or (b) after the previous year but on or before the due date of return of income for that year, or (c) after the due date the return of income for that previous year.
15) Salary has been paid to a resident employee outside India and non-resident employee in India but no tax has been paid thereon or deducted therefrom.
16) Advertisement expanses incurred outside India in foreign currency. RBI permission has not been obtained.
17) Municipal taxes and land revenue in respect of staff quarters were paid after due date of furnishing return of income for the relevant previous year.
18) Foreign tour expanses of the managing director for 10 days. However, 2 days were devoted to personal work.
19) Advertisement in a journal published by political party.
20) 600 VIP brief cases, costing Rs.1,500 each, presented to customers.
21) Voluntary payment of gratuity paid an account of commercial expediency to an employee who died on business tour.
22) Traveling expenses to explore the feasibility of new line of business.
23) Annual payments in installments over a period of 10 years to seek assistance in technical know-how for improving quality of product.
24) Expenses incurred for registration of trademarks.

25) Employees were issued shares at par to protect business interest. Difference of market price and par value was charged as revenue expenditure.

26) Expenditure incurred on neon-sign board for the business premises.

27) Theft of stock-in-trade assuming (a) it is insured (b) it was uninsured

28) Expenditure incurred for new telephone connection.

29) Purchase of sanitary and pipeline for factory

30) Legal charges incurred for framing the scheme of amalgamation of C company with the assessee company.

31) Compensation paid to cancel the purchase order of a machine due to abnormal rise in its price. The assessee claims it as trading loss, or capital loss.

32) Confiscation of goods, imported without a valid import licence. The assessee was also fined by custom authorities. The assessee claims deduction for both of them under general deductions Sec. 37(1).

33) The assessee claims the set-off unabsorbed depreciation of a discontinued business against the profits of another business.

Solution:

1) Anticipated hedging loss under a forward contract is not allowed to be deducted.

2) Loss caused due to negligence of employee is allowed to be deducted.

3) Initial expenditure on installation of fluorescent tube lights is a capital expenditure, not deductible [Sec. 37(1)].

4) As the business of 100% subsidiary is to finance subsidiary company, loss on account of non-recovery of such advances relates carrying on business. Such loss is an allowable deduction.

5) Consultation fee paid to tax-advisor is allowed under Sec. 37(1).

6) Payment made to acquire licence regarding technical information is a capital expenditure. Depreciation is allowed under Sec. 32 on such cost.

7) Payment made to catering agency to provide food/beverages to employees is allowed under Sec. 37(1). However, the employer becomes liable to pay Fringe Benefit Tax.

8) Subsidy granted by government against loss suffered by exporters under government-sponsored scheme, is a trading receipt. Recovery of loss is taxable under Sec. 41(1).

9) Compensation paid under voluntary retirement scheme is allowed to be deducted in five equal annual instalments [Sec. 35DDA]. Scheme of voluntary retirement need not be in accordance with the guidelines of Sec. 10(10C).

10) Commission accrued during the year is taxable under mercantile system. Liability to pay damages for breach of certain conditions is a contingent liability. No deduction can be allowed for such provision.

11) Rent from quarters, let out to employees, is a business income provided the letting is subservient and incidental to the main business.

12) Payment made by a company to the brother of the director of the company, is covered under Sec. 40A(2). Therefore, excessive fees of Rs 20,000 have to be disallowed. Provisions of Sec. 40A(3) apply to the balance payment since it has been made by bearer cheque. Accordingly, the balance of Rs.20,000 shall have to be disallowed in computing taxable business profits, w.e.f. A.Y.2009-10.

13) Deduction is allowed for employees' contribution credited to their account on the due date under provident fund rules. No deduction is allowed for such contribution credited to their account thereafter. Employees' contribution, deducted from their salaries, is first treated as business income. If the same has not been credited to their account, the same has to be treated business income first.

14) Bonus/commission paid to the employees during the previous year or paid after the previous year but before the due date fixed for furnishing return of income for the previous year is allowed to be deducted in the same previous year in which the liability to pay such bonus/ commission arose. Any bonus/commission, paid to employees after such due date, is allowed to be deducted in the previous year in which the date of payment falls.

15) Salary paid to any person outside India (resident or non-resident) or salary paid to a non-resident in India is not allowed to be deducted if tax has not been paid thereon nor deducted therefrom [Sec. 40(a)(iii)]. Thus, no deduction is allowed in the instant case. It is operative from the assessment year 2005-2006.

16) Advertisement expenditure incurred in India or outside India is allowed to be deduction under Sec. 37(1) provided it is not of capital nature and it is incurred wholly and exclusively for the purposes of business. Permission of RBI is not relevant.

17) Deduction of municipal taxes and land revenue in respect of staff quarters, will be deducted in the previous year in which the date of payment falls (Sec. 43B).

18) Proportionate foreign tour expenses of the director relating to personal work are not to be allowed; such expenditure has not been incurred wholly and exclusively for the purposes of business. However, air fare (both ways) will be fully allowed.

19) No deduction can be allowed for advertisement in the journals published by a political party [Sec. 37(2B)].

20) Presentation of VIP bags to customers is allowed as expenditure on advertisement under Sec. 37(1). There is no ceiling limit for gift articles.

21) Voluntary payment of gratuity on account of commercial expediency is allowable deduction under Sec. 37(1).

22) Travelling expenditure for exploring new line of business is a capital expenditure. It is not allowed under Sec. 37(1). It may be capitalised for the purposes of Sec. 35D.

23) Annual instalment paid for technical know-how is a revenue expenditure. It is allowed under Sec. 37(1).

24) Expenses incurred for registration of trademark is a revenue expenditure. It is, therefore, allowed under Sec. 37(1).

25) Waiver of premium while issuing shares to employees, is not a trading transaction. It is not deductible.

26) Expenditure incurred on neon-sign board is a capital expenditure. It is not allowed in computing business in-come [(Sec. 37(1)]. However, depreciation can be claimed on it @ 15%.

27) Loss of stock-in-trade due to theft is allowed under Sec. 29 as incidental to business. However, if it is insured insurance compensation will be a trading receipt.

28) Expenditure on new telephone lines is allowed under Sec. 37(1). It is a revenue expenditure incurred for the purposes of business.

29) Purchase of sanitary pipe-line is a capital expenditure, not allowable under Sec. 37(1). However, depreciation is allowed under Sec. 32 @ 15%.

30) Amalgamation expenses are allowed to be deducted in computing taxable profits under Sec. 35DD in five equal annual instalments.

31) Compensation paid to cancel the purchase order of a machine, is a capital expenditure. It avoids futile investment in machine. It cannot be deducted under Sec. 37(1). As there is no "transfer" of a capital asset, compensation paid cannot be claimed is a capital loss also.

32) Explanation to Sec. 37(1) does not allow any illegal expense in computing taxable profit of business. Therefore, fine imposed for illegal import cannot be allowed [Explanation to Sec. 37(1)]. However, loss by way of the confiscation of goods can be allowed as incidental to business under Sec. 29.

33) Unabsorbed depreciation of a discontinued business now can be set-off against the profits of any other business and thereafter against the income of any other head. It is operative from the assessment year 2002-2003.

PROBLEMS

1. Mr Sudhir Sharma, resident in India, for the year ending on 31 March 2009. Compute his income from business and his gross total income for the assessment year 2009-2010.

Profit & Loss Account for the year ended 31.3.09

Expenditure	Rs	Receipts	Rs
To purchases	1,90,000	By sales less returns	5,69,300
To salaries and wages	1,40,000	By bad debts recovered,	2,000
To trade expenses	1,000	allowed in earlier years by the	
To purchase of trademarks	50,000	Assessing Officer	
To registration of trademarks	2,000	By interest on securities (gross)	892
To rent, rates and taxes	5,000	By dharmada, mandir and	2,000
To discount allowed	1,500	gaushala receipts	
To household expenses	6,000	By refund on income tax	1,008
To advertisement bill paid in cash	30,000	By proceeds of life insurance	43,500
To income tax	10,000	policy on maturity	
To sales tax paid	3,000		
To purchased technical know-how	12,000		
To expenses incurred on income tax and sales tax proceedings	15,100		
To contribution paid to a trust for staff welfare	1,000		
To staff welfare expenses incurred	700		
To OYT deposit	5,000		
To postage and telegrams	1,300		
To donation to National Defence Fund	2,500		
To life insurance premium on the life of the assessee	2,000		
To interest on capital	5,000		
To interest on loan taken to pay income tax	500		
To wealth tax	500		
To audit fee	1,000		
To entertainment expenditure	30,000		
To gifts and present to five customers, costing Rs 3,000 each	15,000		
To expenses on apprentice training	4,000		
To emergency risk insurance	200		
To fire insurance premium for stock	200		
To provision for bad and doubtful debts	3,000		
To reserve for pecuniary losses	5,000		
To net profit	76,000		
Total	**6,18,700**		**6,18,700**

Computation of Gross Total Income for the Assessment Year 2009-2010

Particulars	Rs	Rs
Income from Business		
Net profit as per profit and loss account		76,000
Add: Expenses inadmissible in computing profits and gains from business or profession:		
Purchase of trademarks	50,000	
Household expenses [Sec. 37(1)]	2,500	
Advertisement bills paid in cash [Sec. 37(1) r.w. Sec. 40A(3)]	30,000	
Income tax [Sec. 40(a)(ii)]	10,000	
Purchase of technical know-how	12,000	
Contribution to a Trust for staff welfare fund [Sec. 40A(9)]	1,000	
Donation for National Fund [Sec. 37(1)]	2,500	
Life Insurance premium [Sec. 37(1)]	2,000	
Interest on capital [Sec. 36(1)(iii)]	5,000	
Interest on loan to pay income tax [Sec. 37(1) r.w. 40{a)(ii)]	500	
Wealth tax [Sec. 40(a)(iii)]	500	
Provision for bad and doubtful debts [Sec. 37(1) r.w. 36(1)(vii)(2)]	2,000	
Reserve for pecuniary losses [Sec. 37(1)]	6,000	
	1,24,000	1,24,000
		2,00,000
Less:		
(a) Income not relating to business or profession: [Sec. 28(i)] Interest on government securities	892	
(b) Dharada, mandir and gaushala receipts	2,000	
(c) Refund of income tax	1,008	
(d) Proceeds of L.I.P.: It is not a business receipt and exempt [Sec. 10(10)]	43,500	
(e) Depreciation on trademarks; 25% of Rs 50,000	12,500	
(f) Depreciation on know-how: 25% of 12,000	3,000	59,400
Income from business		**1,40,600**
Statement of Gross Total Income for the Assessment Year 2009-2010		
1. Income from business		1,40,600
2. Income from other sources— Interest on securities		892
Gross total income		**1,41,492**

Note :

1) Bad debts deducted in earlier years and now recovered, has been rightly included in the profit and loss account as business income [Sec. 41(4)].
2) Since payment of income tax is not deductible, its refund cannot be taxed as deemed profits [Sec. 41(1)].
3) OYT (own your telephone) deposit is an allowable deduction in the year in which it is paid.

4) "Dharmada", "mandir" and "gaushala" receipts are customarily levies by trader for charitable purposes. Amount received under these heads are not trading receipts. The fact that the amount collected under these heads are spent for other purposes would amount to breach of trust but it would not affect the initial nature and character of the receipt. Such receipts are not taxable
5) The assessee is entitled to the deduction in respect of donation to National Defence Fund under Sec. 80G.
6) Life insurance paid by assessee on his life is allowed to be deducted in imputing total income under Sec. 80C.
7) Any payment on advertisement exceeding Rs. 20,000 should be made by on account payee cheque or account payee bank draft. Since the payment has been made in cash, 20% of advertisement has been disallowed [Sec. 37(1) r.w. Sec. 40A(3)]. 'Crossed cheque' requirement has been amended by 'account payee' cheque. It is operative from 13-07-2007.
8) From the assessment year 2000-2001, intangible assets also fall within the scheme of depreciation. Hence, depreciation has been allowed on trademarks and know-how.
9) Registration expense of trademarks is revenue expenditure, allowed under Sec. 37(1).

2. Dr L.Kochagaway is a renowned medical practitioner. He furnishes his receipts and payments account for the financial year 2008-2009:

Receipts	Rs.	Expenditure	Rs.
To balance b/d	35,000	By rent of clinics:	
To consultation fees :		2006-2007 13,600	
2006-2007 25,000		2007-2008 44,800	
2007-2008 1,80,000		2008-2009 26,600	85,000
2008-2009 2,62,000	4,67,000	By electricity and water	12,000
To visiting fees	1,30,000	By purchase of professional books	18,000
To loan from bank for professional purposes	2,25,000	By household expenses	97,800
		By municipal taxes paid in respect of property	12,000
To sale of medicines	1,73,000		
To gift/presents from patients	15,000	By purchase of motor car	2,45,000
To remuneration from articles published in professional magazines	26,000	By Telephone Charges	10,000
		By fire insurance in respect of property	3,200
To rent from house property	96,000	By surgical equipment	44,700
To interest on Post Office National Savings Certificates	17,000	By advance income tax	43,000
		By salary and perquisite to compounder	72,000
		By entertainment expenses	16,000
		By purchase of X-ray machine	2,00,000
		By expenses of income-tax proceedings	15,000
		By life insurance premium	25,000
		By gifts to wife	25,000
		By interest on loan	12,000
		By loan a/c—instalment paid	25,000
		By donation to Political Party	2,500
		By car expenses	36,000
		By purchase of medicines	1,05,000
		By balance c/d	79,800
	11,84,000		11,84,000

Compute his income from profession and gross total income for the assessment year 2009-2010 after taking into account the following additional information:

1. One-third of the car expenses are in connection with personal use.
2. Depreciation on motor car is allowed at the rate of 15%.
3. The construction of the house property was completed in March 2004. It was let out for residential purposes.
4. Expenses on income tax proceeding include Rs 1,000 paid for the preparation of return of income.
5. Receipts outstanding from patients for 2008-2009, amount to Rs 8,000.
6. Closing stock of medicines is Rs 8,000 but its current market price is Rs 12,000.
7. Books purchased include annual publications of Rs 12,000, purchased in December 2008.

Solution : (a) Computation of income from profession for the assessment year 2009-2010:

Particulars	Rs	Rs
(a) Receipt from profession:		
1. Consultation fees: [Sec. 28(i)]: (Rs 25,000 + Rs 1,80,000 + Rs 2,62,000)	4,67,000	
2. Visiting fees [Sec. 28(i)]	1,30,000	
3. Sale of medicines [Sec. 28(i)]	1,73,000	
4. Gifts and presents from patients [Sec. 28(iv)]	15,000	
5. Remuneration from articles published in professional magazines [Sec, 28(i)]	26,000 8,11,000	8,11,000
(b) Closing stock of medicines		8,000
Total receipts and closing stock		8,19,000
Less: Expenses allowable:		
1) Rent of clinic [Sec. 30]	85,000	
2) Electricity and water [Sec. 37(1)]	12,000	
3) Salary of compounder [Sec. 37(1)]	72,000	
4) Entertainment expenses [Sec. 37(1)]	16,000	
5) Expenses on income-tax proceedings [Sec. 37(1)]	15,000	
6) Interest on loan [Sec. 37(1)(iii)]	12,000	
7) Purchase of medicines [Sec. 37(1)]	1,05,000	
8) Car expenses [Sec. 37(1)] (2/3 x Rs 36,000)	12,000	
9) Depreciation on professional books:		
• Annual publications: 12,000 x 100% x 50%	6,000	
• Other books: 6,000 x 60%	3,600	
10) Depreciation on car [Sec. 32 r.w. Sec. 38]: 15% of 2,45,000 × 2/3	24,500	
11) Depreciation on plant and machinery:		
(i) X-ray machine	2,00,000	
(ii) Surgical equipment	44,700	
Depreciation @ 15% of	2,44,700	36,705

12) Telephone Charges	10,000	4,09,805
Taxable profits from profession		
(b) Computation of income from house property:		
Gross annual value on the basis of rental valuation	96,000	
Less*:* Full municipal taxes paid by the owner	12,000	
Net annual value	84,000	
Less: Statutory deduction: 30% of net annual value	25,2000	
	58,800	
Income from house property		58,800
Gross total income		**4,67,995**
Less: Deduction u/s 80C (LIC premium paid)		**25,000**
Less: Deduction u/s 80GGC		**2,500**
Actual amount of donation to political party		
Total Income		**4,40,495**
Total Income rounded off u/s 288A		**4,40,490**

Notes:

1. Purchase of motor car is capital expenditure. Hence, it is not deductible. Depreciation has been allowed on motor car.
2. Plant includes books and surgical equipment. Depreciation on professional books is allowed @ 60% but annual publications are written off @ 100%. However, as annual publications have been put to use for less than 180 days during the year, depreciation has been allowed @ 50%. The assessee can claim depreciation on surgical equipment at general rate.
3. Contribution of articles to periodicals and magazines constitutes income from vocation of the assessee.
4. Expenses in income-tax proceedings are wholly deductible [Sec. 37(1)].
5. One-third of car expenses and proportionate deprecation in respect of motor car have been disallowed as they are in connection with the personal use of the assessee.
6. Interest on Post Office National Saving Certificates is exempt from income tax [Sec. 10(15)].
7. Profits and gains of the business or profession are computed according to the method of the accounting regularly followed by the assessee (Sec. 145). Since the assessee has adopted cash system of accounting. "Income" is taxable on receipt basis and "expenditure" is allowed to be deducted on payment basis, irrespective of the previous year to which the receipt of payment belongs. Receipts outstanding for the previous year 2008-2009 will not be taken into consideration.
8. Profits and gains of business profession is required to be computed according to the system of accounting regularly followed by the assessee but if the income cannot be properly deduced therefrom, the Assessing Officer may compute the income on such basis and in such manner as he may deem fit [Proviso to Sec. 145(1)].

   In view of this, the Assessing Officer may take into account the value of closing stock while determining profits even under cash system of accounting
9. Donation to Political Party is allowed to be deducted from gross total income under Sec. 80GGC.

3. The Profit and Loss Account of RAI & Co. for the previous year 2008-2009 is given as follows:

Particulars	Rs	Particulars	Rs
Purchases of goods	10,00,000	Sale of goods	26,00,000
Salaries, bonus and commission	8,00,000	Closing stock	50,000
Rent, rates and taxes	60,000	Interest on drawings	7,000
Depreciation @ 16% on WDV	20,000	Interest on securities	20,000
Travelling expenses	1,50,000		
Interest on capital	25,000		
Advertisement	1,20,000		
Entertainment expenses	60,000		
Expenditure on neon-sign board	50,000		
New telephone deposit under OYT scheme	5,000		
Compensation for cancelling purchase order of an outdated machine	10,000		
Expenses for promoting family planning among employees	20,000		
Net profit	3,57,000		
	26,77,000		26,77,000

Additional Information:

(i) Salaries, bonus and commission include: Rs

(a) Salary to the proprietor 1,50,000

(b) Bonus paid to employees on 31-10-2009 75,000

(c) Salary of Rs 1,20,000 was paid in India to B, a non-resident employee but neither any tax was deducted at source nor paid thereon. However, B is a PAN holder and has cleared his tax liability.

(d) Advertisement includes:

(i) a hoarding bill paid in cash, Rs.20,050

(ii) advertisement published in souvenir, published by a political party Rs.10,000

(e) Depreciation has been charged on plants and machinery and furniture and fittings in proportion of 3:2.

Depreciation @ 15% on plant and @10% on furniture.

(f) Purchases include goods of Rs.1,00,000, imported without a licence and confiscated by the customs authorities.

(g) Travelling expenses include a sum of Rs.1,00,000 on foreign travel to purchase a machine. Negotiations have not been finalized.

(h) Annual stock taking revealed a theft of goods, costing Rs.30,000.

(i) This year stock valuation was deviated from the market price to cost price which is 20% less than its market price.

Compute taxable business profits for the Assessment year 2009-10.

Computation of Taxable Business Profits for the Assessment Year 2009-2010

	Particulars		Rs	Rs
	Income from Business			
	Net profit as per profit and loss account			3,57,000
Add:	Inadmissible Expenses			
(a)	Salary paid to Proprietor		1,50,000	
(b)	Bonus paid to employees: Deduction will be allowed in Previous Year 2009-10 (Sec.43B, being disallowance of unpaid liability)		75,000	
(c)	Salary paid to non-resident employee, without deducting or paying TDS[Sec.40(a)(iii)]		1,20,000	
(d)	Advertisement bills paid in cash [Sec. 37(1) r.w. Sec. 40A(3)]		20,050	
(e)	Advertisement in sourvenir published by political party [Sec.37(2B)]		10,000	
(f)	Depreciation to be treated separately			
(g)	Expenses on family planning: allowable only to a company assessee [Sec.36(1)(ix)]		20,000	
(h)	Foreign travel to acquire a new machine, (being capital in nature, deal not yet finalized. It may be added to the cost of the asset when such asset is actually procured)		20,000	
(i)	Interest on capital [Sec. 36(1)(iii)] [There is no borrowings]		1,00,000	
(j)	Expenditure on neon sign board, being a capital expenditure on advertisement, hence disallowed.		25,000	
(k)	Compensation paid to cancel a capital liability, capital in nature, hence disallowed u/s 37(1)		50,000	
(l)	Under valuation of closing stock:[50,000/80% - 50,000]		10,000	
	Less: Expenses allowed:			
	Interest on Drawings		12,500	6,12,550
	Depreciation u/s 32:			9,69,550
(a)	Plant and machinery:			
	WDV on 01.04.4007 : 20,000 x 4/5 x 100/16	1,00,000	7,000	
Add:	Cost of neon-sign board	50,000		
		1,50,000		
Less:	Depreciation @15%	22,500		
	WDV as on 31.3.08	1,27,500		
(b)	Furniture and Fittings:		22,500	
	WDV on 01/04/07: 20,000 × 1/5×100/16	25,000		
Less:	Depreciation @10%	2,500		
	WDV on 31.3.2008	22,500	2,500	
Less:	**Incomes credited to Profit and Loss A/c to be treated under separate Head of Income**			
	Interest on Government Securities		20,000	52,000
	Taxable Business Profits			**9,17,550**

Note :

(1) Loss due to theft of stock-in-trade is allowable in computing business profits u/s 29. Such loss is incidental to business operation. Since purchase of goods have already been debited to profit and loss account, no separate adjustment is required.

(2) Loss in illegal business may be allowed u/s 29. Explanation to Sec.37(1) does not apply to Sec.29.

(3) Deposit for new telephone connection is allowable u/s 37(1). Hence, no adjustment is required.

4. The Profit & Loss Account of Mr.Dipak Sinha for the previous year 2008-2009 is given below:

Particulars	Rs	Particulars	Rs.
Cost of goods sold	16,00,000	Sales	34,70,000
Salaries wages	9,00,000	Rent of staff quarters	3,00,000
Rent of business premises, owned by the assessee	2,50,000	Sale price of machinery block on 31-03-2009	5,00,000
Repairs and renewals	1,40,000		
Income tax paid	60,000		
Excise duty paid	1,00,000		
Sales tax payable	2,00,000		
Legal expenses	3,00,000		
Municipal taxes payable for staff quarters	10,000		
Provision for bad debts	60,000		
Contingency reserve	1,00,000		
Employees contribution to recognised fund	50,000		
Net profit	5,00,000		
	42,70,000		42,70,000

Additional Information:

(i) Salaries include:

(a) Rs 1,20,000 was paid outside India to an employee, "resident" in India but neither tax was deducted nor tax has been paid thereon,

(b) Rs 90,000 was paid in India to an employee "resident" in India but neither tax deducted therefrom nor paid thereon.

(ii) Excise duty of Rs 50,000 for the assessment year 2008-2009 was paid on 1 January 2009 but it was not included in the profit and loss a/c.

(iii) Sales tax amounting Rs 1,30,000 was paid on 31 July 2009 and the balance was paid on 1 August 2009, the due date of furnishing return of income is 31 July 2009.

(iv) Repairs/renewals include remodelling and renovation costing Rs.80,000.

(v) Legal expenses include:

(a) Lawyer fee of Rs 50,000 paid by bearer cheque to K, nephew of the proprietor. The Assessing Officer disallowed a sum of Rs.10,000, being found in excess of the desired qualifications;

(b) Gift of Rs 1,20,000, made to wife, a tax-advisor, but disallowed by the A.O.

(vi) Employees contribution include:

(a) Rs 30,000 credited to their account on due date under Provident Fund rules,

(b) Rs 20,000 credited to their account in November 2009.

(vii) Commission receipts of Rs 2,00,000 have not been credited to the profit and loss account as their recovery seems to be doubtful.

(viii) WDV of machinery on 01-04-2008 was Rs 6,50,000.

(ix) WDV of business premises and staff quarters as on 01-04-2007: Rs 10,00,000 and Rs 30,00,000, respectively. Depreciation @ 10% on Business Premises and @ 5% on staff quarters.

Compute taxable profits for the previous year 2008-2009.

Computation of Business Profits for the Assessment Year 2009-10

Particulars	**Rs**	**Rs**
Net profit as per profits and loss a/c		5,00,000
Add: Inadmissible Expenses:		
(i) Rent of business premises owned by the assessee (Sec. 30)	2,50,000	
(ii) Remodelling and renovation, being repairs of capital nature	60,000	
(iii) Income tax paid [Sec. 40(a)(ii)l	60,000	
(iv) Sales tax remaining unpaid up to due date of furnishing return of income	70,000	
(v) Legal expense includes:		
(a) Gift made to wife, Sec. 37(1)	1,00,000	
(b) Fees paid to lawyer (being a relative) Sec. 40A(2)	10,000	
(vi) Salaries paid outside India to a "resident" employee TDS [Sec. 40(a)(iii)]	1,20,000	
(vii) Salaries paid in India to a resident employer without TDS	—	
(viii) Municipal tax payable for staff quarters [Sec. 43B]	10,000	
(ix) Provision for bad debts [Sec. 36]	60,000	
(x) Contingency reserve [Sec. 37(1)]	1,00,000	
(xi) Employees' contribution credited to their account after due date	20,000	
(xii) Commission receipts which have accrued during the year but recovery seems doubtful seems doubtful	1,00,000	
(xiii) Employees' contribution not credited to—profit and loss a/c	50,000	10,30,000
		15,30,000
Less: Inadmissible receipts/ admissible claims:		
(i) Excise duty (Sec. 43B)	50,000	
(iii) Sale price of machine, being capital receipts	5,00,000	
(iv) Depreciation: (a) Staff quarters: 5% of 30,00,000	1,50,000	
(b) Business Premises: 10% of 10,00,000	1,00,000	8,00,000
Taxable business profits		**7,30,000**

Note:

Sale of machinery block*:* Sale of machinery block results into short-term capital loss of Rs 1,50,000 (Rs 6,50,000 -Rs 1,00,000) under Sec. 50.

No capital loss, whether short-term or long term, can be set- off against any income. It is to be carried forward for next 8 assessment years.

5. The firm of M/s Amal & Associates is engaged in the business of growing and manufacturing tea. The Profit & Loss Account for the year, 2008-2009 is given as follows:

Particulars	Rs	Particulars	Rs
Cost of growing and manufacturing tea	40,00,000	Sales	95,00,000
Salaries and wages	15,00,000	Stock	13,50,000
Advertising	5,00,000		
Entertainment expenses	1,00,000		
Travelling expenses	3,00,000		
Fine and penalties	50,000		
Cost of patent rights	6,00,000		
Expenses on scientific research	6,00,000		
General and sundry expenses	2,00,000		
Net profit	30,00,000		
	1,08,50,000		1,08,50,000

You are further informed :

(i) Advertising includes payment of Rs 2,00,000 made to a political party for insertion of advertisement in party's journal. The payment has been made by bearer cheque,

(ii) Travelling expenses include a visit of the director to UK for 10 days (including 2 days for travelling). Five days were utilized for business purpose. Permission for foreign exchange was granted for Rs 50,000. Total expenditure on the visit is Rs 1,00,000 (including air fare of Rs 40,000).

(iii) Expenses on scientific research include:

(a) Purchase of land Rs.1,50,000

(b) Contribution to Agricultural Research Institute, New Delhi which is a National Laboratory Rs.20,000.

(c) Contribution to Bhaba Atomic Research Centre (an approved research association)for statistical research, which is not related to business Rs.30,000.

(iv) Refund of custom duty, deducted in the previous year, 2006-2007, amounting to Rs 50,000, has not been credited to the profit and loss account.

(v) Sundry expenses include a contribution of Rs 60,000 to Kolkata Municipal Corporation for undertaking a Drinking Water Project for slum-dwellers. The Project has been approved by National Committee but KMC has not issued any certificate indicating the progress of the project.

(vi) A deposit of Rs 12,00,000 was made in instalments with National Bank for Agriculture and Rural Development (a) Rs 4,00,000 in September 2008, (b) Rs 6,00,000 in July 2009 and (c) Rs 2,00,000 in December 2009. It has not been included in the profit and loss account. Date of submitting return of income 30/09/2009.

(vii) (a) W.D.V. of machinery on 01-04-2008 (Rate of depreciation 15%) Rs.15,00,000

(b) Machinery purchased in December 2008 for scientific research Rs.5,00,000

(c) Purchase of five small drier machine, each costing Rs.10,000

(d) Sale price of an old machinery (Rate of depreciation 15%) Rs.6,00,000

(viii) Lump sum payment of Rs 5,00,000 was made to acquire a licence regarding technical information to improve tea-flavour. It has not been charged to P/L a/c.

Compute the taxable business profits for the assessment year 2009-2010.

Computation of Business Profits for the Assessment Year 2009-2010

Particulars	Rs	Rs
Net profit		30,00,000
Add: Inadmissible Expenses:		
1. Advertisement payment to a political party [Sec. 37(2B)]	20,00,000	
2. Travelling outside India [Sec. 37(1)]. Proportionate expenses of foreign travel, (excluding air fare) not relating to business: 60,000 × 3/8	22,500	
3. Fine and penalties	50,000	
4. Cost of patent rights	6,00,000	
5. Expenditure on scientific research (Sec. 35): Purchase of land	1,50,000	
6. Contribution to Bombay Municipal Committee (Sec. 35 AC): Since the Certificate indicating progress in the prescribed form has not been issued, no deduction is allowed.	60,000	10,82,500
Add: Deemed profit: Refund of Customs Duty, deducted in earlier years, not credited in the profit and loss a/c [Sec.41(1)]		50,000
Less: Admissible expenses:		
Capital expenditure on scientific research [Sec.35(1)(iv)(2)]	4,00,000	
Depreciation on Patent rights @ 25% of Rs.6,00,000	1,50,000	
Depreciation on know-how: @ 25% of Rs.5,00,000	1,25,000	
Depreciation on Machinery:		
WDV as on 01/04/2008: 15,00,000		
Add: Purchase of driers 50,000		
15,50,000		
Less: Sale of Old Machinery 5,00,000		
WDV as on 31/3/2009 **10,50,000**		
Depreciation @ 15% on Rs.10,50,000		
Weighted Deduction for scientific research:	1,57,500	
(i) National Laboratory: @ 125% of Rs.20,000= Rs.25,000 – Rs.20,000 = Rs.5,000		
(ii) Bhaba Atomic Research Laboratory: @ 125% of Rs.30,000 = Rs.37,500 – Rs.30,000 = Rs.7,500		
Therefore, total deduction Rs.(5,000 + 7,500)	12,500	8,45,000
Composite Profits before making deduction u/s 33AB		**32,87,500**
Less: Deposit with NABARD (Sec.33AB)		
Least of the followings:		
(i) Deposit of Rs.10,00,000 (within the due date of submission of return)		
(ii) 40% of Business Profits: 40% of Rs.32,87,500 = Rs.13.15,000		10,00,000
Composite Profits after deduction u/s 33AB		22,87,500
Apportionment of profits into agricultural income and business income (As per Rule 8)[since the assessee is engaged in the business of growing and manufacturing tea: 40% of Rs.22,87,500		9,15,000

6. State whether the provisions or Sec. 41(1) of the Act can be applied to a case, where refund of excise duty has been obtained by the assessee on the basis of a decision of the CEGAT and where the matter has been taken up in further appeal to the Court by the Central Excise Department.

Solution : This question has been answered by the Apex Court in Polyflex (India) Pvt. Ltd. *v.* CIT [2002] 257 ITR 343. (SC)

The refund of excise duty pursuant to the decision of the CEGAT would be subject to tax by virtue of Sec. 41(1) and it is not necessary that the revenue should await the verdict of a higher court.

7. In the course of an assessment proceeding, the Assessing Officer enhanced the value of the closing stock and added the difference to the total income.

In the assessment year subsequent to this, the assessee wants the Assessing Officer to enhance, by the same amount, the value of the opening stock of the year.

Discuss the validity of the claim.

Solution : The value of the closing stock of the preceding year must be the value of the opening stock of the succeeding year. Hence, if the value of closing stock at the end of a year is enhanced, the enhanced value should be taken as the value of the opening stock of the next year for the purpose of income tax.

The claim of the assessee in this case is, therefore, valid.

8. What would be your advice regarding admissibility of the following items of expenditure in computing the business income:

(a) A donation of Rs 1 lakh made to a University for starting a laboratory for scientific research (i) relating to the assessee's business, (ii) not relating to the assessee's business.

(b) Travelling expenses include a sum of Rs 15,000 incurred by a director in travelling abroad for negotiating purchase of plant and purchase of plant and machinery.

(c) Amount payable as damages to Government on account of shortfall in export target.

(d) Overdraft from bank for payment of income tax: interest charged by the bank is Rs 20,000.

(e) Payment of interest of Rs 40,000 on monies borrowed from bank for payment of dividends to shareholders.

(f) Rs 12,000 paid for shifting of business from the original site to the present place which is more advantageously located.

(g) Retrenchment compensation of Rs 4 lakh paid to the workmen on the closure of one of the units.

(h) Fees paid to the Registrar of Companies for bringing about a change in the Memorandum and Articles of Association in regard to issue of Equity.

Answers :

(a) The donation has been made to University to be used for scientific research for starting a laboratory. If the University is approved for the purpose of Sec. 35(l)(ii), then irrespective of the consideration whether the scientific research is related to assessee's business or not, deduction could beclaimed@125%ofamountpaid.Ifitisnot approved, donation could not be claimed as a deduction underSec.35inthecomputationofbusinessincome. However, the assessee could claim deduction from Gross Total Income under Sec. 80G, if the same is eligible.

(b) Travelling expenses incurred by the director for negotiating the purchase of plant and machinery is a capital expenditure and hence to be disallowed.

(c) The payment is not for any infraction of law but for failure to reach a target undertaken by the company being payment made wholly in the course of business, it is deductible.

(d) Interest on overdraft taken to pay income tax is not allowable under Sec. 36(1)(iii). Interest on borrowings

(e) utilised for payment of dividend is allowable under Sec. 36(1)(iii).

(f) Shifting expenses of business premises resulting in an expenditure of enduring benefit is a capital expenditure and is not allowable.

(g) Retrenchment compensation payable to workmen on the total closure of a business cannot be allowed as deduction as the expenses are not incurred for the purpose of carrying on of its business. When, however, the tax-payer closes one of its units and continues to carry on the same business as before, the compensation will be admissible under Sec. 37(1).

(h) Fee paid to Registrar of Companies for bringing about change in memorandum and articles of association is a capital expenditure, where it relates to issue of equity shares. Where alterations are warranted by the changes made in the Companies Act, the expenses are allowable.

9. A company engaged in the manufacturing of fertilizer products, commenced its business on 01.04.2008. During the financial years 2005-2006 to 2007-2008 it had incurred Rs 4.00 lakh annually as expenditure on salaries and purchase of raw material for the purpose of research connected with its business. During the previous year 2008-2009 incurred on scientific research, revenue expenditure of Rs 3.00 lakh and a capital expenditure of Rs 4.50 lakh on purchase of plant and machinery. Since the result of the research was unsuccessful, the company sold it its plant and machinery on 31.12.2008 for Rs 8.00 lakh and closed its research activity. Compute the admissible deduction under Sec. 35 for the assessment year 2009-2010.

Computation of deduction u/s 35 for Expenditure on scientific research:

Particulars	Rs.	Rs.
Expenditure incurred during the earlier 3 years on salaries and purchase of raw material for the purpose of research connected with the business— fully allowed in the year of commencement of business by virtue of Explanation to Sec. 35(1)(i): [Rs 4,00,000 × 3]		12,00,000
Revenue expenditure on scientific research incurred during the previous year 2008-2009	3,00,000	
Capital expenditure on scientific research incurred during the previous year 2008-2009	4,50,000 7,50,000	
Total Weighted deduction © 150% on Rs 7.50 lakh u/s 35(2AB)		11,25,00
Admissible deduction u/s 35 for the AY 2009-2010		23,25,000

10. A company engaged in pharmaceuticals manufacturing, debited to its profit and loss account a sum of Rs 50,000, being the interest on loan of Rs 5,00,000 taken for financing its expansion scheme. The plant and machinery purchased for the project with the loan were not received during the year and those were still in transit at the end of the year. A sum of Rs 4,000 was paid to a broker who arranged the loan. Discuss the admissibility of the interest.

Answer: Interest paid in respect of capital borrowed for the purposes of business or profession is admissible u/s 36(1)(iii) As per the Proviso to Sec. 36(1)(iii) inserted by the Finance Act, 2004, from assessment year 2005-2006, interest paid in respect of capital borrowed for acquiring an asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital is borrowed for acquisition of the asset till the date on which such asset is first put to use cannot be allowed as deduction. In this case, the asset has not been put to use till the end of the previous year. Therefore, interest of Rs 50,000 is not be allowed as deduction. However, the cost of the asset is to be increased by the amount of interest and depreciation is admissible on enhanced cost [Proviso to Sec. 36(1)(iii)].The deduction brokerage of Rs 4,000 paid to a broker for arranging the loan there is a bit controversial

One view is that definition of the term “interest” u/s 2(28A) includes service fee or other charges in respect of monies borrowed, “brokerage” can be considered to fall under the scope of the term “other charges” and is therefore included under the definition of interest. Hence, brokerage of Rs 4,000 for arranging the loan should be treated in the same way as interest. As per the other view, where brokerage or commission paid to an agent for arranging a loan for the purpose of business is not allowable as deduction u/s 36(1)(iii), but is allowable under Sec. 37(1). As per this view, Rs 4,000 paid to a broker for arranging a loan is allowable as a deduction under Sec. 37(1).