Chapter 6 PROFITS AND GAINS OF BUSINESS OR PROFESSION

6.1 INCOMES CHARGEABLE TO TAX UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS OR PROFESSION" [Section 28]

(1) Profits and gains of any business or profession carried on by assessee at any time during previous year.

(2) Compensation or other payment due to or received by any person –

- **(a)** managing whole or substantially whole of affairs of an Indian company or any other company in India at or in connection with the termination of his management or modification of the terms and conditions relating thereto;
- **(b)** on termination or modification of contract of his agency in India;
- **(c)** For vesting the management of any property or business in Government or any corporation owned or controlled by the Government.

(3) Income derived by trade, professional or other similar association from specific services rendered to its members. *This clause is an exception to general rule that income from mutual activity is not chargeable to tax.*

(4) Profits on sale of import licence; or Profits on transfer of Duty Entitlement Pass Book (DEPB) or Duty Free Replenishment Certificate (DFRC) under EXIM Policy;

(5) Cash assistance against exports from Government of India and Duty Drawback;

(6) Value of any benefit or perquisite, whether convertible into money or not arising from exercise of business or profession;

(7) Interest, salary, bonus, commission or remuneration due to or received by partner from the firm. *Such income is taxable in hands of partners to the extent it is allowed as deduction in hands of firm. Any amount not allowed as deduction to firm under Section 40(b), is not taxable in the hands of partner.*

(8) Any sum received or receivable, in cash or in kind, under an agreement for –

- **(a)** *Non-competition* i.e. not carrying out any activity in relation to any business; or
- **(b)** *Exclusivity* i.e. not sharing any know-how, patent, copyright, trademark, 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 of services.

Exceptions : However, sum received for transfer of business, or transfer of right to manufacture, produce or process any article/thing, which is chargeable under 'Capital Gains' is not taxable under this Section.

(9) Any sum (including bonus) received under Keyman Insurance Policy.

Case Laws:

When there was a temporary suspension of business with the object of tiding over the crisis condition and during such period the machinery, hitherto used in the business, is leased out then the rental income there from is to be identified as' business income'. CIT vs. Vikram Cotton Mills Ltd 169 ITR 597 (SC) and CEPT vs. Shri Lakshmi Silk Mills Ltd., 20 ITR 451 (SC).

However, lease of factory after assessee stopped business with no intention of reviving the business will amount to earning lease rental which is not in the nature of business income. In such a case the income is assessable head ' income from other sources '-

Universal Plast Ltd. vs. CIT, 237 ITR 454 (SC).

6.2 MODE OF COMPUTATION OF INCOME UNDER THE HEAD 'PROFITS AND GAINS OF BUSINESS OR PROFESSION' [Section 29]

	Rs.
Net Profit as per Profit & Loss A/c	XXX
Add: Non-Allowable expenses debited to Profit & Loss A/c *[Sec. 37(2B), 38, 40, 40A, 43B; expenses allowable under any other head or capital expenditure]*	XXX
Less: Expenses Allowable under this head but not debited to Profit & Loss A/c *[Sec. 30 to 37(1)]*	XXX
Less: Incomes credited to P&L A/c but not taxable under this head *[Section 15, 22, 45 and 56 or incomes exempt u/s 10]*	XXX
Add: Incomes not credited to P&L A/c but chargeable under this head *[Section 28, 41]*	XXX
Profits and Gains of Business and Profession	**XXX**

6.3 GENERAL CONDITIONS TO BE FULFILLED FOR CHARGING AN INCOME UNDER THE HEAD 'PROFITS AND GAINS OF BUSINESS OR PROFESSION'

(1) *There should be profits and gains*: Only real profits and gains are liable to income tax and not mere gross receipts. However, there is an exception; stock-in-trade is valued at lower of cost or market price.

(2) *Profits and gains may be of any business or profession:* Profits and gains from an illegal business are also chargeable to tax under this head. However, the following incomes are not taxable under this head :

- **(a)** Rent of house property is taxable under Section 22 even if property constitutes stock in trade of recipient of rent or the recipient of rent is engaged in the business of letting properties on rent.
- **(b)** Dividends are taxable under the head 'Income from Other Sources' even if securities are held as stock-in-trade or asseseee is a dealer in shares.

(3) *Business or profession must be carried on by assessee:* The profits and gains from business or profession are taxable in the hands of the person who has the right to carry on the business.

- A company becomes a legal entity in the eye of law only when it is incorporated. Therefore, the pre-incorporation profits cannot be included in the assessment of the assessee-company. For such profits, only the promoters can be held liable.

(4) *Business or profession should be carried on at any time during previous year:* The business or profession must have been carried on for some time during the previous year. However, a temporary suspension of activities of the business does not necessarily amount to discontinuance of the business.

However, in the following cases, the receipts are taxable even if the assessee/recipient carried on no business or profession during the previous year:

(a) Amount unutilized or misutilised from Tea/Coffee/Rubber Development Account *[Section 33AB]*

(b) Amount unutilized or misutilised from Site Restoration Fund *[Section 33ABA]*

(c) Sale of telecommunication license *[Section 35ABB]*

(d) Amounts taxable under Section 41(1), 41(2), 41(4) and 41(4A)

(e) Sale of mineral oil business *[Section 42]*

(f) Any sum received after discontinuance of a business or profession *[Section 176(3A)/176(4)]*

6.4 CONCEPT OF 'BUSINESS' AND 'PROFESSION'

(1) **Business**: According to Section 2(13), 'Business' includes any -

Trade	It means purchase and sale of goods carried on with profit motive
Commerce	It means trade carried on a large scale.
Manufacture	Making of new and different article out of input material by physical or mechanical labour.
Any adventure or concern in the nature of trade, commerce or manufacture	- The expression adventure in nature of trade clearly suggests that the transaction cannot be properly regarded as trade or business. A single isolated transaction outside the assessee's line of business may constitute adventure in nature of trade and commerce. - Whether an activity is an adventure or concern in the nature of trade, commerce or manufacture is to be decided on the basis of cumulative effect of the facts and circumstances of each case. - An example of such adventure or concern is where the assessee purchases a plot of land and builds a complex on it and divides it into office spaces and sells each of these, thereby making a profit from the entire activity.
Essential features of a business are : (a) Regularity of transactions or continuity of activities; *(b)* Objective of earning profits; *(c)* Application of labour and skill	

(2) **Profession**: As per Section 2(36), profession includes vocation.

Profession	It involves occupation requiring purely intellectual or manual skill, which is based on continuous learning and experience. It is exercised to earn a living. *E.g.* Politics is a profession.
Vocation	It means any work performed on the strength of one's natural ability for that work. It need not be for making an income nor need it involve any systematic and organized activity.

METHOD OF ACCOUNTING FOR COMPUTING BUSINESS INCOME (section 145):

Income under the head, profits and gains of business or profession is computed as per the method of accounting regularly employed by the assessed.

If the assessee follows mercantile system of accounting, the income will be computed on accrual basis and adjustments will be made for outstanding income/expenses, prepaid expenses and unearned incomes.

However, if the assessee follows cash system of accounting, only the items of income/expenses actually received/paid during the previous year will be considered.

METHOD OF ACCOUNTING IN RESPECT OF SALES, PURCHASES AND INVENTORY [Section 145A]

For computing income chargeable under this head, the valuation of purchase and sale of goods and inventory (opening and closing) shall be done as per method of accounting regularly employed by assessee.

Tax, duty, cess or fee paid to be included : The said value will be further adjusted by the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation. Further, the amount of tax, duty, cess or fee, as aforesaid, shall include all such payment notwithstanding any right arising as a consequence of such payment. *E.g.* If the assessee is allowed any CENVAT credit of excise paid by him then such amount of credit shall be included in the valuation of purchase and sale of goods and inventory in determining business income.

Valuation of Closing Stock under various circumstances:

	Situations	Valuation of Stock
1.	Stock existing in the business	Cost or market price, whichever is less
2.	Stock acquired by inheritance, gift or will	Market price on the last day of the previous year
3.	Capital asset converted into stock in trade	Market price of such conversion
4.	Stock withdrawn from business	Withdrawn at price at which it was recorded in books
5.	When a firm is dissolved, and –	
	(a) business of firm is discontinued; or	At market price – *A.L.A. Firm v. CIT [1991] 189 ITR 285 (SC)*
	(b) business of the firm is continued by the reconstituted firm	Same mode of valuation as regularly

		adopted by the firm. *[Sakthi Trading Co. v. CIT [2001] 250 ITR 871 (SC)*

2. Assessee company underwrites public issue of shares of other companies. The unsubscribed shares are purchased by the assessee. Underwriting commission on such shares has not been taken to profit and loss account but adjusted to reduce cost of shares. such a treatment in accounting is in accordance with the accepted principles of accounting and the underwriting commission in respect of shares subscribed by the assessee company is not separately assessable as income-CIT vs. U.P State Industrial Development Corporation, 225 ITR 703 (SC).

3. Although method of accounting followed by the assessee is the basis for computation of income under this head, there are certain provisions which apply independent of the method of accounting followed by the assessee. For example, the claim for depreciation in respect of assets used does not depend upon cash mercantile system of accounting. It can be claimed under cash method of accounting even if the assets are not fully paid for. similarly, opening stock and closing stock will have to be reckoned even under cash method of accounting for computing proper income for the each year-CIT vs. Krishnaswami Mudaliar - 53 ITR 122(SC). Again, even if the assessee follows accrual system of accounting, certain expenses falling within the purview of section 43B shall be allowed only if payment is made within the stipulated time limit. Deduction under section 35D, 35DDA etc, are allowed over a period of 5 years irrespective of the method of accounting. Although the concept of deferred revenue expenditure is not known to tax law, these provisions specifically provide for deduction spread over a period. Similarly, the Supreme Court in Madras Industrial Investment Corporation Ltd. 225 ITR 802 held that the discount on the redeemable debentures shall be allowed as revenue deduction spread over during the life of the debentures..

32. Book entries are not final and conclusive

Courts have held that book entries are not decisive or conclusive in determining the allowability or taxability of a particular item of expenditure or income. Mere existence or absence of entries in books of account does not lead to any conclusion under the income-tax act. Kedarnath Jute Manufacturing Co Ltd. vs. CIT, 82 ITR 363 (SC). Similarly held in the case of CIT vs. Bharat Carbon and Ribbon Manufacturing Company Pvt. Ltd., 239 ITR 505 (SC).

Similarly, where assets are revalued and the appreciation is quantified and credited to the profit and loss account, there is no generation of income by such book entry. Such amount cannot be charged to tax. Only when the asset is transferred, the taxability of the income arises-CIT vs. Hazarimal Milapchand Surana, 262 ITR 573 (Raj).

6.5 SPECULATIVE TRANSACTIONS AND TAXABILITY OF SPECULATION BUSINESS

(1) <u>Speculative Transaction [Section 43(5)]</u>: "Speculative Business" means a transaction in which a contract for purchase/sale of any commodity/stocks/ shares is settled otherwise than by the actual delivery or transfer of the commodity or scrips.

Transactions not regarded as speculative transaction: However, following transactions shall not be deemed to be speculative transactions –

- **(A)** Contract in raw materials/merchandise entered into by a dealer/ manufacturer in the normal course of business to guard against loss due to price fluctuations in respect of his contracts for actual delivery of finished goods.
- **(B)** Contract in stocks and shares entered into by a dealer/investor to guard against loss through price fluctuations in his holdings of stocks and shares.
- **(C)** Contract entered into by a member of forward market or a stock exchange in the course of jobbing or arbitrage to guard against loss in the ordinary course of business as such member.
- **(D)** Eligible transaction in respect of trading in derivatives carried out electronically in a recognized stock exchange through a registered intermediary and supported by a time stamped contract note having unique client identity number and PAN number.

(2) <u>Deemed Speculation Business [Expl. To Section 73]</u> : In case a company is engaged in business of purchase and sale of shares of other companies, then such company shall be deemed to be carrying on a speculation business to the extent of such business. However, in case of the following companies, the aforesaid business shall not be deemed to be speculation business –

- **(A)** A company whose gross total income consists mainly of income under heads "Income from House Property", "Capital Gains" and "Income from Other Sources"; and
- **(B)** A company whose principal business is banking or the granting of loans and advances

(3) <u>Taxability of Speculation Business [Expl. 2 to Section 28]</u>: Where the speculative transactions carried on by an assessee are of such a nature as to constitute a business, such business shall be taxed as a distinct and separate business. Thus, in that case –

- The profits and gains arising from such business shall be shown separately.
- The loss of a speculation business cannot be set off against any other income arising under any other source or head but can be set off only against speculation income.
- This loss can be carried forward for 4 years.

Important Points-

1. All transactions, which are settled or adjusted without delivery, cannot be treated as speculative. Where the intension is to take or give delivery but it has not be possible to do so, because of supervening circumstances, then such transactions cannot be treated as speculative transaction.
2. Damages awarded as compensation, on a dispute between the parties due to breach of contract, cannot be regarded as a 'speculative transaction'.

(3) Where the assessee carries on both speculative and non-speculative transactions on composite bases and maintains common accounts, it is necessary to determine the income on loss separately and distinctly from speculative business and non-speculative business. For this purpose the business expenditure incurred should be allocated between speculative business activities and non-speculative business activities on a reasonable basis. This view is affirmed by the Bombay High Court in Sind National Super Mills Pvt. Ltd., vs. CIT, (121 ITR 742).

6.6 DEDUCTION IN RESPECT OF LOSSES INCIDENTAL TO BUSINESS

Before analyzing the various provisions relating to computation of income, it requires to be mentioned that income chargeable to tax under the head ' profits and gains of business or profession ' shall be computed on the basis of common principles of commercial expediency subject to the express provisions of the act. It is not practical for law makers to specifically provide for an allowance of all types of expenses that may be incurred during the course of business or profession. Therefore, courts have held that general commercial principles should also be borne in mind in this regard-Calcutta Co Ltd. Vs. CIT, 37 ITR 1 (SC).

A loss (other than capital loss), which is incidental to the trade, is allowable in computing the business profits on ordinary principles of commercial trading. Such trading losses can be claimed as deduction provided the following conditions are satisfied:

(a) Loss should be real in nature and not notional or fictitious;

(b) It should be a revenue loss and not capital;

(c) Loss should have resulted directly from carrying on of business i.e. it should be incidental to business;

(d) Losses should have actually occurred during the previous year;

(e) There should be no direct or indirect restriction under the Act against the deductibility of such loss.

E.g. Loss of stock-in-trade on account of fire, embezzlement/theft of cash in course of business, or loss on account of advances/guarantees granted during course of business, are admissible in the computation of taxable income on the basis of common principles of accounting and commercial expediency.

Case Law:

Dr. T. A. Quereshi v. CIT [20061 287 rTRs47(s c)	Illegal business loss is different from illegal expenditure covered by section 37(1).in computing income from illegal business, the losses sustained are allowable as deduction. Therefore ,in case a doctor engaged in heroine business, the value of sized heroine, which formed a part in the stock in trade, is allowable as a deduction as business loss.

6.7 BASIC PRINCIPLES GOVERNING ALLOWANCE OF DEDUCTION UNDER SECTIONS 30 TO 44DA:

(1) The allowances laid down under Section 30 to 37 are cumulative and not alternative i.e. if an expenditure of a nature described in a particular provision in allowable/disallowance in view of that provision, then such item cannot be held to be disallowable/allowable under any other provision.

(2) Expenditure should have been incurred in connection with assessee's own business.

(3) Expenditure should relate to the previous year in which business has been carried on.

(4) Onus to prove the admissibility of expenditure lies on the assessee.

(5) *No allowance in respect of expenditure incurred before date of setting-up of business*: In case of newly set up business or profession, previous year commences on the date of its setting-up. So, any expenditure incurred before setting up of business or profession is not deductible.

It is only when the unit has been put into such a shape that it can start functioning as a business or manufacturing organization that it can be said to be set up.

6.8 DEDUCTION IN RESPECT OF RENT, RATES, TAXES, REPAIRS AND INSURANCE, ETC. FOR BUILDINGS, PLANT AND MACHINERY AND FURNITURE [Section 30 and 31]

The following are allowable as deduction in computing the income under the head 'Profits and Gains of Business or Profession' –

(1) Rent paid for premises occupied by assessee as tenant and used for his Business or Profession.

(2) Expenditure on repairs of premises paid by owner thereof or tenant. However, capital expenditure on repairs shall not be eligible for deduction, but depreciation can be claimed thereon.

As per Section 32(1), for capital expenditure incurred by the tenant on extension, renovation and alteration of building, he shall be entitled to claim depreciation on the said capital expenditure.

(3) Land revenue, local rates or municipal taxes paid for premises, *subject to the provisions of Section 43B.*

(4) Insurance premium paid for premises, plant and machinery or furniture against risk of damage or destruction thereof.

(5) Current repairs *(excluding capital expenditure)* paid for plant and machinery or furniture.

Building, etc. partly used for business or profession [Sec. 38]: If buildings or plant and machinery or furniture are not exclusively used for business and profession, then –

(a) *In case of rent of premises* : Deduction = Rent Paid × [Annual value of part used for business ÷ Annual value of entire premises];

(b) *In any other case:* Deduction = Expenditure incurred × Proportion of part of asset (or expenditure) used for Business.

'Paid' – meaning of [Section 43(2)]: "Paid" means actually paid or incurred according to method of accounting on the basis of which profits/gains are computed under head "Profits and Gains of Business or Profession".

Current repairs vs. capital expenditure

If existing assets is restored to its normal or original condition by incurring certain expenditure without changing the capacity or enhancing the efficiency beyond its original efficiency, then such expenditure can be regarded as current repairs. On the contrary, consequent to the incurring of expenditure, if a new or additional enduring advantage is created in the assets or the capacity of efficiency is enhanced beyond its original ability to perform, then the expenditure cannot be allowed as current repairs. being capital expenditure in nature, it cannot also be considered for deduction under section 37 (1). Such expenditure requires to be capitalised to the asset cost for the purpose of claiming depreciation.

The expression ' current repairs ' means expenditure on buildings, machinery, plant or furniture which is not for the purpose of renewal or restoration but which is only for the purpose of preserving or maintaining already existing assets. Current repairs are such repairs as are attended to as and when need arises and the question as to when the need arises must be decided not by any academic or theoretical tests but by the test of commercial expediency. If the amount spent is for the purpose of bringing into existence a new asset or obtaining a new or fresh advantage, such expenditure cannot be regarded as current repairs but shall be treated as capital expenditure. Applying this principle, the Supreme Court has held that when new machinery, new furniture, new sanitary fittings and new electrical wiring were installed beside extensively repairing the structure of the building resulting in a total renovation of the theatre, such expenditure cannot be allowed as ' current repairs ' – Ballimal Naval Kishore and Another vs. CIT, 224 ITR 414.

6.9 CONDITIONS TO BE FULFILLED IN ORDER TO CLAIM DEPRECIATION UNDER SECTION 32

In order to claim depreciation under Section 32, the following conditions are required to be fulfilled:

(1) **Depreciation is available on 'assets' and 'block of assets'**: The assets may be tangible (Buildings, Machinery, Plant and Furniture) or intangible (know-how, patents, copyrights, trademarks, licences, franchises, etc.) in nature. 'Block of Assets' means group of assets comprising of tangible or intangible assets in respect of which the same rate of depreciation is prescribed.

Plant [Section 43(3)]: 'Plant' includes ships, vehicles, books, scientific apparatus and surgical equipment used for business and profession *but does not include tea bushes or livestock or buildings or furniture and fittings.*

(2) **Asset must be owned wholly or partly by the assessee:** Depreciation is allowable only to the owner of the asset. However, in Mysore Minerals Ltd. v. CIT [1999] 239 ITR 775 (SC), it was held that registered ownership is not necessary.

Other Points:

(a) Depreciation is allowed on fractional ownership and co-ownership also in respect of part or fraction of asset owned by the assessee.

(b) Depreciation on leased asset is available to lessor. *Lessee is entitled to depreciation on construction of any superstructure on land taken on lease; or on renovation/extension/improvement of building.*

(c) (ii) Circular No. 9 dated 23.3.1943

In the case of hire purchase contract by which assessee acquires an asset for the purpose of business or profession, depreciation can be claimed by capitalising the value equivalent to cash price of such asset. The remaining amount payable can be claimed as hire charges during the period of the contract. In the case of installment purchase, the amount agreed to be paid as price for the asset can be capitalised for depreciation. This view is affirmed in Addl. CIT vs. General Industries Corporation (1985) 155 ITR 430 (Del).

Under the income-tax act, in all leasing transactions, the owner of the asset is entitled to the depreciation is the same is used in the business under section 32 of the income-tax act. The ownership of the asset is determined by the terms of contract between the lesser and the Lessee. as per the accounting standards 19 issued by The Institute of Chartered Accountants of India, in a finance lease transaction, the asset is required to be capitalised by the lessee and not by the lesser. This accounting treatment will have no implication on the allowance of depreciation on such assets under the income-tax act. In view of this clarification issued by the CBDT , the lesser who is the legal owner of the asset shall be eligible to claim depreciation for tax purposes.-circular No.2 dated 9-2-2001.

(d) In case of purchase of assets under instalment payment system, the deduction should be allowed to the purchaser on entire purchase price as per the agreement.

(3) **Asset must be used for the purpose of business or profession of the assessee** : However, as per Section 38(2), in case of an asset partly used for business and profession, deduction shall be –

Deduction = Depreciation referred u/s 32(1) (ii) (i.e. on Block of Assets) × Fair proportionate part having regard to user of building, plant, machinery or furniture.

(4) **Asset should be used during the relevant previous year:** Degree of utilization is immaterial.

However, if the asset is acquired by the assessee during the previous year and put to use for less than 180 days during that previous year (i.e. in the year of acquisition), then depreciation thereon will be restricted to 50% of the depreciation allowable as per the rate prescribed for such asset. If asset is used for less than 180 days in any subsequent previous year, depreciation is fully allowable.

Actual use v. Ready for use: The question 'whether depreciation is available only on actual use of the asset for the purposes of business' or profession or the same is available even if asset is kept ready for use ' has been a subject matter of wide litigation with differing views of various High Courts. The recent decision in DCIT v.

Yellamma v. dasappa Hospital [2007]159 Taxman 58 (Kar) also supports actual use theory. The following points make an attempt to reconcile such differing views:-

(A)No depreciation on an asset 'not available for use': An asset that was acquired during the previous year but could not be made available for use in that year, as it was not received during the previous year itself, cannot be eligible for depreciation.

(B)No depreciation in year of acquisition until asset is put to use: Even if asset was available for use in year acquisition, no depreciation can be allowed thereon until it is out to use in that year itself.

(C)Depreciation allowable on 'Trial Run', as 'trial run' is 'use': Even if the machinery is used for 'trail run', it is 'actually used for purpose of business of assessee' and thus, it qualifies for depreciation.

(D)Depreciation allowable on spare engines/standby equipments: The specific nature of business of certain assesses requires them to keep some engines or equipments as spare or as standby for use in case of need. When an asset is devoted to the needs of business, it is actually used for the needs of business, as it is required for efficient conduct of business. Thus ,the same qualifies for depreciation.

Depreciation claim is mandatory [Explanation 5 to Sec. 32(1)] : The provisions of Section 32(1) relating to claim of depreciation shall apply whether or not the assessee has claimed it in computing his total income.

In case of succession of business : In case of succession of firm or proprietary concern by a company as referred to in Section 47(xiii)/(xiv); or succession u/s 170; or amalgamation or demerger of company, the deduction on account of depreciation, calculated as per prescribed rates, shall be apportioned between predecessor and successor, or amalgamating company and amalgamated company, or demerged company and resulting company, *in the ratio of the number of days for which the assets were used by them.*

6.10 RATES OF DEPRECIATION IN CASE OF BLOCK OF ASSETS [Rule 5 and Appendix I to the Income Tax Rules, 1962]

Tangible Assets	Rate
(I) BUILDING :	
(1) Residential Buildings except hotel and boarding houses	5
(2) Non-residential Buildings [office, factory, godown, hotels, boarding houses but other than (1) above and (3)(i) below]	10
(3) (i) Buildings for installing Plant and Machinery forming part of water supply or water treatment system for infrastructure business u/s 80-India IA (4)(i).	100
(ii) Purely temporary erections such as wooden structures	
(II) FURNITURE AND FITTINGS :	
(4) Furniture and Fittings including electrical fittings ("Electrical Fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.	10
(III) PLANT AND MACHINERY	

(5) Motor Cars not used in business of running them on hire; and Plant & Machinery other than those covered in other Blocks	15
(6) Ships and vessels	20
(7) Motor buses, lorries and taxis used in business of running on hire; Moulds used in rubber and plastic goods factories; Plant & Machinery used in semi-conductor industry including circuits;	30
(8) Aeroplane-Aeroengines; Life-saving Medical Equipments	40
(9) Glass and Plastic containers used as refills	50
(10) (i) Computer including computer software (ii) Books other than those covered in (12)(i) below (iii) Gas Cylinders including valves and regulators (iv) Glass Manufacture – Melting Furnaces, Mineral Oil Concerns;	60
(11) Flour Mills-Rollers, Rolling Mill rolls in Iron and Steel Industry; Energy renewal and energy saving devices; Rollers in Sugar Works	80
(12) (i) (a) Books (annual publications) owned by assessee carrying on profession; and (b) Books owned by assessee carrying on business in running lending libraries (ii) Plant and Machinery in water supply and treatment system for infrastructure u/s 80IA(4)(i); Wooden part in artificial silk manufacturing Plant & Machinery; Cinematograph films-Bulbs of studio lights; Wooden Match frames in Match factories; Mines and Quarries-rubs, ropes, lamps, pipes; Salt works – Clay and salt pans, etc.; Air-pollution, Water-pollution, Solidwaste control equipments and Solidwaste recycling system.	100
INTANGIBLE ASSETS	
(13) Know-how, patents, copyrights, trademarks, licences, franchises, or any other business or commercial rights of similar nature	25

6.11 DEPRECIATION IN CASE OF POWER GENERATING UNITS [Section 32(1) (i)]

(1) ***Applicability***: This section is applicable to undertakings engaged in the generation of power; or undertakings engaged in the generation and distribution of power.

Note: Not applicable to undertaking engaged only in distribution of power.

(2) ***Option available and when can it be exercised*** : Such undertakings have an option to claim depreciation under the Straight Line Method on individual assets, which option should be exercised before due date of furnishing return of income u/s 139(1) for the assessment year relevant to the previous year in which undertaking begins to generate power. The option once exercised shall be final. *The rates of depreciation are given in Appendix I-A to Income Tax Rules, 1962.*

(3) ***Consequences on subsequent sale, discard, etc. of such assets*** : If such tangible assets (on which depreciation under SLM is claimed) is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it is first brought into use); then it gives rise to 'terminal depreciation' or 'balancing charge' the treatment of which are given below :

(a) *Terminal depreciation [Section 32(1)(iii)]* : If moneys payable (including scrap) is less than the written down value of the asset, then the difference is written off in the books as 'Terminal Depreciation' in the year when such asset is sold or discarded, etc.

(b) *Balancing Charge [Section 41(2)]:* If the moneys payable (including scrap) is greater than WDV of asset then such excess to the extent of depreciation already claimed is taxable as 'Balancing Charge' in form of deemed business profits u/s 41(2) in the year in which moneys payable become due whether or not business is in existence in that previous year. Surplus over and above the actual cost is taxable as capital gains. Thus –

Balancing Charge = [(Lower of Actual Cost or Moneys Payable) – WDV of asset]

Capital Gains = [Moneys Payable – Actual Cost of the asset] (if positive)

Notes :-

➔ Moneys payable include sale price, insurance, salvage & compensation in respect of such asset.

➔"sale" includes exchange or compulsory acquisition under any law but does not include a transfer of any asset by an amalgamating company / banking company to an Indian amalgamated company / banking company in a scheme of amalgamation.

6.12 CONCEPT OF "WRITTEN DOWN VALUE" (WDV) [Section 43(6)]

(1) **WDV in general**: In case of assets acquired in previous year, WDV = Actual cost to the assessee.

In case of assets acquired before previous year, WDV = Actual cost to assessee *less* depreciation actually allowed *(including unabsorbed depreciation, if any)* to the assessee.

(2) **WDV in case of Block of Assets** :

Written Down Value of the block of assets as on 1st day of previous year	XXX
Add : Actual Cost of asset falling within the block, acquired during previous year	XXX
Less : Moneys payable (including scrap) for asset falling within block which is sold, discarded, demolished, destroyed during the previous year to the extent of (A) + (B) above	XXX
WDV of block of assets eligible for depreciation	XXX

Note : In CIT v. Kasturi and Sons Ltd. (1999) 237 ITR 24 (SC), it has been held that the expression "moneys payable" has to be interpreted only as actual moneys payable in cash or cheque/draft and not any other thing or benefit which can be converted into money.

(3) <u>WDV in Special Cases</u> :

(A) In case of ***slump sale*** i.e. transfer of undertaking(s) without assigning values to individual assets and liabilities as such, the WDV shall be calculated as follows:

WDV of Block of Assets as calculated in (2) above	XXX
Less : Deduction on account of slump sale to the extent of amount above *(See Note)*	XXX
WDV of Block of Assets eligible for depreciation	XXX

Note: Deduction on account of slump sale is computed as follows:

Actual cost of assets falling in the Block, which is transferred by slump sale	XXX
Less : Depreciation that would have been allowed if that asset was the only one in the Block	XXX
Deduction on account of slump sale	XXX

(B) In case of transfer of block in succession of business or profession in following cases:

(a) WDV in hands of successor u/s 170 = WDV in hands of the predecessor;

(b) WDV in hands of transferee company *(being holding/subsidiary company, where transfer is made by one to the other fulfilling conditions u/s 47(iv)/(v))* = WDV in hands of transferor company;

(c) WDV in hands of amalgamated *Indian* company = WDV in hands of amalgamating company

(d) WDV of assets transferred to resulting company = WDV in hands of demerged company

Note: The WDV of the assets so transferred to resulting company shall be reduced from the WDV of demerged company on the 1st day of the previous year.

(e) WDV in hands of company formed by corporatisation of recognized stock exchange = WDV in hands of such recognized stock exchange immediately before such corporatisation.

(4) When block exists, but there is no positive WDV due to moneys payable being higher, then, there will be no depreciation and there will be short-term capital gains to the extent of such excess.

However, where block ceases to exist, but there is positive WDV, the WDV will be short-term capital loss and no depreciation will be allowed.

WDV in case assessee was covered by exemption in any previous year [Amendment by Finance Act,2008 w .r.e.f.1-4-2003]: In case an assessee was not required to compute his total income for any previous year(s) preceding the current previous year i.e. assessee was covered by exemption from income-tax in any preceding previous year, then for the purposes of computing depreciation, the actual cost of any' asset shall be computed after negating the effect of any revaluation as follows:-

Actual cost of an asset as per the books of account	*
Adjust : Amount attributed to the revaluation of such asset, if any, in the books of account (Add in case of downward revaluation; less in case of upward revaluation)	*
less: Depreciation on adjusted cost of the asset (i.e. Total depreciation' on such asset, provided in the books of account of assessee in respect of such preceding previous year(s)- Depreciation attributed to upward revaluation + Depreciation attributable to downward revaluation)	*
Actual cost of the asset for the purposes of the Act.	*

6.13 "ACTUAL COST" [Section 43(1)]:

"Actual Cost = Actual cost of the assets to the assessee *less* Portion of such cost as has been met directly or indirectly by any other person or authority.

Mode of computation of actual cost: On combined reading of Section 43(1), Explanations 8 to 10 given thereunder and Section 43A, the actual cost of the asset can be computed as follows:

Purchase price of the asset	XXX
Add: Costs directly attributable to bring asset to its working condition for intended use (i.e. Expenses incurred for acquiring the asset – like freight, insurance, loading and unloading, etc. and expenses incurred in connection with the installation of the asset)	XXX
Add: Interest on capital borrowed for acquisition of asset till it is first put to use (Interest for period after asset is first put to use is not included in actual cost) *[Explanation 8]*	XXX
Less: Amount of excise or customs duty levied on it and included in its cost, for which claim of credit has been made and allowed under Cenvat Credit Rules, 2004 *[Explanation 9]*	XXX
Less: Portion of cost of asset, met directly/indirectly by Government or any authority/other person in form of subsidy/grant/reimbursement. However, if subsidy/grant/reimbursement cannot be directly related to the asset acquired, following amount shall be deducted – *[Explanation 10]* $\text{Amount to be deducted} = \frac{\text{Total amt. of subsidy/grant/reimbursement} \times \text{Cost of that Asset}}{\text{Total cost of the assets for which subsidy/grant/reimbursement is given}}$	XXX
Add/Less : Increase or decrease in cost due to exchange rate fluctuation *[Section 43A]*	XXX
Actual Cost of the asset for purpose of Section 43(1)	XXX

6.14 CIRCUMSTANCES WHEN ACTUAL COST OF AN ASSET IS TAKEN AT NOTIONAL FIGURES [Explanation to Section 43(1)]

Expl.	*Mode of Acquisition*	*Actual Cost*
(1)	Asset actually acquired for scientific research related to business and subsequently used for business purposes.	Actual cost less deduction availed under Section 35 (i.e. NIL)
(2)	Asset acquired by way of gift or inheritance.	WDV to the previous owner.
(3)	Where assessee purchases second-hand business assets and Assessing Officer is satisfied that main purpose of such transfer was to claim depreciation on enhanced cost and thereby reduce tax liability.	Actual cost as determined by Assessing Officer with prior approval of Joint Commissioner, having regard to all circumstances of the case.
(4)	Where assessee had transferred business asset owned by him and now, the same is reacquired by him.	Lower of WDV at the time of original transfer or price paid for reacquiring it.
(4A)	*Sale and lease back* : Assessee X purchases the asset belonging to Y, who had earlier claimed depreciation on such asset, subsequently, leases/hires the same to Y.	Cost to X shall be the WDV of the assets to Y at the time of transfer.
(5)	Building previously used for private purposes, now brought into use for the business of the assessee. **Note:** Rate of depreciation applicable in previous year of bringing the asset into business use is applied.	Actual cost of building *less* notional depreciation calculated at rate applicable to that year upto year of bringing it to business use.
(6)	Capital asset transferred by holding company to its subsidiary company or vice versa satisfying conditions u/s 47(iv)/47(v).	Cost to transferee company = WDV in the hands of transferor company.
(7)	Transfer of capital asset by amalgamating company to amalgamated Indian company in a scheme of amalgamation	Cost to amalgamated company = WDV to the amalgamating company. *In case of transfer of stock-in-trade, the provisions of Section 43C shall apply.*
(7A)	Transfer of capital asset by a demerged company to the resulting Indian company in a scheme of demerger	Cost to resulting company = WDV of the assets to the demerged company
(11)	An asset acquired outside India by a non-resident, subsequently brought to India and used for his business and profession in India	Purchase price less notional depreciation computed at respective rates from the date of its acquisition.

	Note: Depreciation is computed at rates that would have been allowable had the asset been used in India for his business and profession since the date of its acquisition.	
(12)	Capital asset acquired in scheme of corporatisation of Recognised Stock Exchange approved by SEBI.	WDV of asset to such stock exchange had there been no such corporatisation.

Treatment of receipts during construction of project: The amounts received/incomes earned during the construction of a project are to be treated as follows:-

(1) The receipts connected with/incidental to the work of construction of the project/plant are capital receipts, which shall go to reduce the cost. The examples being interest on advances given to contractors; rentals from hire of building/plant & machinery to contactors; amounts charged from contractors for various facilities provided to them, etc.

(2) Interest on surplus loan funds invested in short-term deposits is not connected with or incidental to the work of construction of the project/plant, hence, such interest is revenue receipt liable to tax as income from other sources.

Treatment of Exchange Rate Fluctuations in Case of Purchase of an Asset from outside India [Section 43A]:

(1) **Applicability:** The provisions of this section apply if:-
- (a) an asset is acquired from outside India for assessee's business or profession;
- (b) subsequently, after the date of acquisition, there is a change in the rate of exchange of currency during any previous year;
- (c) such exchange-rate fluctuations results in increase or reduction in the liability of the assessee (as expressed in Indian currency) at the time of making the payment-
  - (i) Towards the whole or part of the cost of the asset; or
  - (ii) Towards the repayment (along with interest) of whole or part of the money borrowed by him from any person in any foreign currency specifically for acquiring the asset.

(2) **Treatment**: the amount by which the liability is so increased or decreased (along with increase/decrease in interest) at the time of making payment, shall be added to or reduced from the following:-
- (a) Actual cost of asset, or capital expenditure incurred on scientific research of family planning; or
- (b) Cost of acquisition of capital asset (other then depreciable asset), in computing capital gains u/s 48.

(3) **Other relevant points**:

(a) These adjustments are to be made only on actual payment by an assessee towards the cost of asset or repayment of the loan or interest irrespective of method of accounting adopted by assessee.

(b) Where whole or part the liability is not met by an assessee but is met by any other person, no adjustments of exchange-rate fluctuations shall be made with respect to the liability so met.

(c) When assessee has entered into forward exchange contract with "authorized dealer" for purchase of foreign currency to discharge the liability as referred above, the increase or decrease in liability is computed with reference to rate of exchange specified in the contract.

6.15 PROVISIONS IN RESPECT OF ADDITIONAL DEPRECIATION [Section 32(1)(iia)]

(1) ***Applicability*** : Additional depreciation is available on *new machinery or plant (other than ships and aircraft)* which has been acquired and installed after 31.3.2005, to an assessee engaged in business of manufacture or production of any article or thing only if he claims depreciation on block of assets u/s 32(1)(ii).

(2) ***Deduction:*** A further deduction of 20% of actual cost of such plant and machinery is allowed. However, in case the asset acquired during previous year is put to use for a period of less than 180 days, then additional depreciation on such asset will be calculated @ 10% of actual cost.

(3) ***No Deduction:*** Additional depreciation is not allowed in respect of - (*a)* Second-hand plant and machinery; (*b)* Any office appliances or road transport vehicles; (*c)* Plant and Machinery installed in office premises or residential accommodation (including guest houses); and *(d)* Plant & Machinery whose whole of actual cost is deductible (by way of depreciation or otherwise) in any one previous year in computing income under the head 'Profits and Gains of Business or Profession'.

6.16 CARRY FORWARD AND SET-OFF OF UNABSORBED DEPRECIATION [Section 32(2)]

(1) Amount of depreciation remaining unabsorbed shall be allowed to be carried forward whether or not the business/asset to which it relates exists. It shall be treated as part of current year depreciation.

(2) Return of loss is not required to be submitted to carry forward unabsorbed depreciation.

(3) Brought forward business losses (speculative or non-speculative) under Section 72(2) and 73(3) shall be given priority of set off over unabsorbed depreciation.

(4) While allowing unabsorbed depreciation, the expression 'Profit and Gains Chargeable to Tax' includes profits and gains arising not only under the head 'Profits and Gains of Business or Profession' but also under other heads. Thus, the unabsorbed depreciation can be set off from any head of income.

6.17 DEDUCTION IN RELATION TO TEA, COFFEE AND RUBBER DEVELOPMENT A/C [Section 33AB] and DEDUCTION IN RELATION TO SITE RESTORATION FUND [Section 33ABA]

Particulars	Tea, Coffee and Rubber Development A/c	Site Restoration Fund
1. Business of Assessee should be	Growing and manufacturing tea or coffee or rubber in India	Prospecting for or extraction/ production of petroleum/natural gas in India, as per his agreement with Central Government
2. A/c in which amounts to be deposited	(i) Special Account with NABARD; or (ii) Deposit Account (framed by Tea, Coffee or Rubber Board)	(i) Special account opened with SBI; or (ii) Site Restoration Account, opened in accordance with relevant scheme
3. Time limit for deposit	Before expiry of 6 months from the end of previous year or before due date for filing return of income, whichever is earlier	Before the end of the previous year
4. Amount of deduction	Lower of the following – (a) Amount deposited in deposit a/c or (b) 40% of income under head business or profession (as computed before allowing deduction under this section and before setting off b/f business loss u/s 72)	Lower of the following – (a) Amount deposited in deposit a/c; or (b) 20% of income under head business or profession (as computed before allowing deduction under this section and before setting off b/f business loss u/s 72) *Interest credited is also deemed to be deposit.*

Other points common for both:

(1) ***Withdrawal of Amount***: Amount can be withdrawn only for the purposes specified in the scheme. The amount utilized out of such deposit account in accordance with the scheme shall not be allowed as deduction in computing income chargeable under head "Profits and Gains of Business or Profession".

(2) ***Audit:*** The accounts of assessee are required to be audited by a Chartered Accountant and a report thereof is to be furnished along with the return of income. *If accounts have already been audited under any other law, then only a further report in prescribed form is to be furnished along with such Audit Report.*

(3) ***In case the assessee is Firm/AOP/BOI***: In case of assessee being a firm/AOP/BOI, no deduction shall be allowed in the computation of income of any partner or member of such entity.

(4) If any amount is allowed as deduction under this section, no deduction shall be allowed in respect of that sum under any of the provisions of the Act in any assessment year.

(5) ***When does deemed business profit arise*** : Deemed profits arise in the following cases –

(a) ***Misutilisation of Deposit*** : If the amount credited to deposit account is utilized for purchase of –

(1) Any machinery or plant to be installed in office premises or residential accommodation or any guest-house; or

(2) Any office appliances (not being computers); or

(3) Any machinery or plant whose actual cost is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains of Business or Profession" of any one previous year; or

(4) Any new machinery or plant to be installed in an industrial undertaking for business of construction, manufacture or production of any article/thing specified in Eleventh Schedule,

Then, the whole of the amount so utilized is taxable in the year in which the amount is so utilized.

However, in case of Section 33ABA, amount of depreciation claimed earlier in relation to such misutilised amount shall be disallowed i.e. such amount shall be taxable in year in which it was allowed as demand.

(b) ***Non-utilisation of Deposit***: If the amount withdrawn from deposit account is not utilized in accordance with the scheme, then amount not so utilized is taxable in the year of withdrawal.

(c) ***On closure of business or on dissolution of firm:*** In case of Section 33AB, if business is closed or firm is dissolved, the amount withdrawn from deposit account shall be taxable in year of withdrawal. However, in case of withdrawal from deposit account on death of asessee or on partition of the HUF or on liquidation of the company, the amount withdrawn shall not be taxable.

In case of Section 33ABA, if any amount is withdrawn on closure of account, the amount so withdrawn *less* any sum payable to the Central Government as profit/production share shall be taxable in year in which it is so withdrawn, whether or not business is in existence in that year.

Transfer of asset acquired from Deposit A/c before expiry of 8 years: If an asset acquired in accordance with the deposit scheme is sold or otherwise transferred in any previous year before expiry of 8 years from year of its acquisition, such part of cost of asset as relates to the deduction already allowed under this Section shall be deemed to profits of business in the year of such sale/transfer.

However, this provision is not applicable if –

(1) Such sale or transfer is made to the Government, or a local authority, or a statutory corporation, or a Government company; or

(2) Such sale or purchase is made, in course of succession of partnership firm by company and –

(i) all assets and liabilities of firm before succession become assets and liabilities of company,

(ii) all shareholders of such company were partners of such firm before succession, and

(iii) This deposit scheme continues to apply to Successor Company also.

6.18 'SCIENTIFIC RESEARCH' AND DEDUCTION IN RELATION THERETO:

Scientific Research: As per Section 43(4), 'scientific research' means activities carried for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries.

Deduction in relation to expenditure incurred on scientific research [Sec. 35]

Sec.35	Expenditure incurred	Amount of deduction	Conditions/Remarks
(1)(i)	• Revenue expenditure on scientific research related to business • Expenditure on scientific research before commencement of business, by way of – (a) Purchase of materials; or (b) salary (other than perquisite) of employees	Amount of expenditure incurred	Expenditure incurred *within 3 years* immediately preceding commencement of business is allowed as deduction in year of commencement of business to the extent certified by prescribed authority.
(1)(ii)	• Sum paid to approved scientific research association, university, college or institution whose object is undertaking scientific research.		⏭ Such association, university college or institution must be approved in accordance with prescribed guidelines and must be notified by Central Government (Amendment by Taxation Laws Amendment Act, 2006 w.e.f. 1.4.06)
(1) (iia)	Sum paid to a company having as its main object 'scientific research and development' to be used by it for scientific research (Amdt. by Finance act, 2008 w.e.f 1-4-2009)	1.25 × Sum paid	⏭ Such company is registered in India, is approved by prescribed authority and fulfils other prescribed conditions.
(1)(iii)	• Sum paid to approved university, college, or institution for social science or statistical research (See Note 1)		⏭ Deduction is allowed even if research is not related to business.
(1)(iv)/(2)	• Capital expenditure *(except expenditure on the purchase of land)* on scientific research related to business • Capital expenditure *(except expenditure on the purchase of land)* incurred before the commencement of business	Amount of expenditure incurred	⏭ Expenditure incurred within 3 years immediately preceding the commencement of business is allowed in the year of the commencement of the business ⏭ No depreciation is allowable.
(2AA)	• Sum paid to – **(a)** A National Laboratory; or **(b)** A university; or **(c)** An Indian Institute of Technology; or **(d)** A specified person *(See Note 1)*	1.25 × Sum paid	⏭ Sum is paid with a specific direction that it shall be used for scientific research undertaken under a programme approved in this behalf by Prescribed authority ⏭ No deduction shall be allowed in respect of such sum under any other provisions of the Act.
(2AB)	• Expenditure *(not being in nature of cost of any land or buildings)* on in-	1.5 × Expenditure	⏭ Such *Research and Development* facility is approved by prescribed

	house research and development facility incurred by a company engaged in the business of bio-technology, manufacture or production of any drugs, pharmaceuticals, electronic equipments, computers, tele-communication equipments, chemicals or any other notified articles ➢ *Notified Articles* : Manufacture/ production of helicopter or aircraft or computer software ➢ Expenditure on scientific research in relation to drugs and pharmaceuticals includes expenditure on clinical drug trial, obtaining approval from any regulatory authority and filing an application for patent	incurred	authority ⏭ Such assessee should enter into an agreement with prescribed authority for co-operation in such Research and Development facility and audit of accounts maintained for that facility ⏭ Expenditure should be incurred on or before *March 31, 2012* ⏭ No deduction shall be allowed in respect of such sum under any other provision of the Act.

Notes:

(1) Deduction not toe denied even if approval withdrawn subsequently *(Amendment by the Taxation Laws Amendment Act, 2006 w.e.f. 1.4.2006)* : The deduction allowable under this Section shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee –

- **(a)** the approval granted to association, university, college, other institution referred to under Section 35(1)(ii)/(iii), or the Laboratory or specified person referred to under Section 35(2AA) has been withdrawn; or
- **(b)** The approval granted to the programme undertaken by the National Laboratory, University, Indian Institute of Technology or specified person, has been withdrawn.

(2) Expenditure incurred on scientific research includes all expenditure incurred for the prosecution, or the provision of facilities for the prosecution of scientific research, but do not include any expenditure incurred in the acquisition of rights in, or arising out of scientific research.

(3) Research related to business or class of business includes –

- **(a)** Any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all business of that class.
- **(b)** Any scientific research of a medical nature, which has a special relation to the welfare of workers, employed in that business/all businesses of that class.

(4) According to Section 35(4) unabsorbed scientific research capital expenditure is carried forward and set-off in the same manner as unabsorbed depreciation.

(5) Actual use for scientific research during the previous year-not necessary: deduction under section 35 (1) (iv) is available only if the asset was acquired during the previous year for the purposes of scientific research. There is no further requirement that asset must be put to use in the revel in previous year.

(6) In a case, when a company avails deduction at the rate of 125% by contributing the sum to other company which is engaged in scientific research, such scientific research company shall not claim another weighted deduction in respect of expenditure it in incurs for scientific research.

(7) In the case of amalgamation, the amalgamating company cannot claim any deduction under section 35. However, the amalgamated company (being an Indian company) can avails deduction under section 35.

6.19 TAX TREATMENT IN CASE OF SALE OF SCIENTIFIC RESEARCH ASSETS

(A) Sale without being used for any other purpose [Section 41(3)]:

Treatment	Taxable amount
Deemed business profit arise under Section 41(3) in the previous year in which sale took place whether or not business is in existence in that year.	Deemed profit is the lower of the following – (a) [Moneys payable + Total deductions allowed under Section 35(2)] – Cost of the asset; or (b) Total deductions allowed under Section 35(2).
Capital gains or losses arise in this case which are to be computed u/s 45 in the year of transfer	Capital gains = Sale proceeds – [Expenditure on transfer + Cost of acquisition (normal or indexed)]
Moneys payable include sale price, insurance, salvage and compensation, etc. in respect of such asset. "Sale" includes exchange or compulsory acquisition under any law but does not include a transfer, in a scheme of amalgamation, if amalgamated company is an Indian company.	

(B) *Sale after being used for business purposes*: At the time when scientific research is converted into business asset, the actual cost thereof (i.e. NIL) will be added to the block of assets. Thereafter, at the time of sale of such asset, treatment is done as if an asset forming part of block is sold. Capital gains arise which are to be computed under Section 50.

6.20 DEDUCTION IN RELATION TO EXPENDITURE ON OBTAINING LICENCE TO OPERATE TELECOMMUNICATION SERVICES [Section 35ABB]

(1) Conditions to be fulfilled or allowability of deduction under this section:-

(a) The expenditure should be of capital nature;
(b) it is incurred for acquiring any right to operate telecommunications services;
(c) it can be incurred either before or after commencement of the business; and
(d) it must have been actually paid during the year, irrespective of method of accounting employed.

(2) ***Extent of Deduction*** :

$$\text{Dedcution for each of the relevant previous years} = \frac{\text{Expenditure for acquiring such rights}}{\text{Number of relevant previous years}^{**}}$$

** *Number of relevant previous years is worked out as follows*:-

(a) Where license fee is paid before commencement of the business, the previous year in which such business is commenced to the previous year in which effective period of licence expires.

(b) In any other case, the previous year in which the fees is actually paid to the previous year in which effective period of licence expires.

Note: Once the deduction is allowed in respect of any license under this section in any previous year, no depreciation shall be allowed thereon for that previous year or any other previous year.

(3) ***Tax treatment in case of sale of such licence*** :

(A) *Case I*: Whole or part of the income is transferred and sale proceeds (only capital sum) exceeds the expenditure remaining unallowed: Deduction u/s 35ABB = Nil in current year or any other year.

The following deemed profits will be taxable in year of transfer even if business doesn't exist –

(a) Sale proceeds *Less* Expenditure remaining unallowed; or

(b) Expenditure incurred *Less* Expenditure remaining unallowed, whichever is less.

(B) *Whole of the income is transferred and sale proceeds are less than expenditure remaining unallowed:* Deduction u/s 35ABB in year of transfer = Expenditure remaining unallowed *Less* Sale proceeds.

(C) *Part of licence is transferred and sale proceeds do not exceed expenditure remaining unallowed* : Deduction u/s 35ABB for year of transfer and for each subsequent years till the last relevant previous year =

$$\frac{\text{Expenditure remaining unallowed Less Sale Proceeds (capital sum only)}}{\text{Number of relevant previous years unexpired at the beginning of previous year of transfer}}$$

Note: As the licence is a capital asset, capital gain or loss arises on its sale and therefore, the same is to be computed under Section 45.

(4) ***In case of amalgamation or demerger*** : If the licence is sold or otherwise transferred in a scheme of amalgamation or demerger, then the provisions falling in (A) and (B) of (3) above, shall not apply to the amalgamating or demerged company, and the provisions of this section shall, so far as may be, apply to amalgamated or resulting company.

6.21 DEDUCTION IN RELATION TO EXPENDITURE ON ELIGIBLE PROJECTS/ SCHEMES [Section 35AC]

(1) Eligible Assessee and Amount of Deduction:

Assessee	***Conditions***	***Extent of deduction***
Non-corporate assessee	The sum should have been paid to a public sector company, a local authority or an association or institution approved by the	100% of such payment made

	National Committee for carrying out any eligible project or scheme	
Company	Expenditure can be incurred either by way of payment of any sum as aforesaid or directly on the eligible project or scheme	100% of such expenditure incurred
"Eligible project or scheme" means a notified project or scheme for promoting the social and economic welfare of, or the uplift of, the public. Note: If a deduction has been allowed under this Section for any assessment year, no deduction shall be allowed in respect of such expenditure under any other provision for that or any other assessment year.		

(2) ***Certificate to be furnished***: The assessee must furnish along with his return of income a certificate in prescribed form, obtained from the authority/ company to whom the eligible payment is made. In case of direct expenditure by company, such certificate must be obtained from a chartered accountant.

(3) ***Withdrawal of approval and consequences thereof***: If -

(a) the said project/scheme is not being carried on in accordance with conditions of its approval; or

(b) a report in respect thereof is not furnished in prescribed form and within prescribed time,

Then, National Committee may withdraw approval of such project/scheme, or association/institution, etc., after giving it an opportunity of being heard and forward a copy thereof to the Assessing Officer.

In case any such approval is withdrawn, the amount received by such public company/authority, etc. or, the deduction claimed by the company assessee for direct expenditure, shall be deemed to be income of such company/ authority, etc. for the previous year in which such approval or notification is withdrawn and it shall be taxed at maximum marginal rate in force for that year.

(4) ***Deduction not to be denied even if approval withdrawn subsequently*** *(Amendment by the Taxation Laws Amendment Act, 2006 w.e.f. 1.4.2006)*: The deduction, to which the assessee is entitled in respect of any sum paid to a public sector company or a local authority or to an association or institution for carrying out the eligible project or scheme referred to in this section, shall not be denied merely on the ground that subsequent to the payment of such sum by the assessee -

(a) the approval granted to such association or institution has been withdrawn; or

(b) The notification notifying eligible project or scheme carried out by the Public Sector Company or local authority or association or institution has been withdrawn.

DEDUCTION IN RESPECT OF PAYMENT TO ASSOCIATION & INSTITUTION FOR CARRYING OUT RURAL DEVELOPMENT PROGRAMME [Section 35CCA]:

(1) ***Deduction :*** 100% of the amount paid by an assessee to any of the following is allowed as deduction :

- **(a)** An association/institution having object of undertaking of *rural development programme approved and started before 1.3.1983,* if the sum paid to it is to be used to carry our such programme; or
- **(b)** An association/institution training persons for implementing the aforesaid programme; or
- **(c)** Rural development fund set-up and notified by Central Government; or
- **(d)** National Urban Poverty Eradication Fund set-up and notified by Government.

(2) ***Deduction not to be denied even if approval withdrawn subsequently*** *(Amendment by Taxation Laws Amendment Act, 2006):* The deduction to which the assessee is entitled in respect of any sum paid to an association or institution for carrying out the said rural development programme, shall not be denied merely on the ground that subsequent to payment of such sum by assessee, the approval granted to such rural development programme or to the association/institution has been withdrawn.

(3) If deduction is allowed under this section for any assessment year, no deduction will be allowed in respect of such expenditure under any other provision for that or any other assessment year.

6.22 DEDUCTION IN RELATION TO PRELIMINARY EXPENSES [Section 35D]

(1) ***Eligible assessee***: Indian company or a non-corporate assessee resident in India.

(2) ***Eligible Expenditure:*** Expenditure eligible for deduction should be incurred in connection with commencement of business or extension of the industrial undertaking of the assessee or setting up a new industrial unit. The following expenses are eligible for deduction :

- **(a)** Expenditure on preparation of feasibility/project report, conducting market or any other survey necessary for business or engineering services carried out by assessee or an approved concern.
- **(b)** Legal charges for drafting any agreement at the time of setting up or conduct of business.
- **(c)** In case of company assessee –
  - Legal charges for drafting and printing its Memorandum and Articles of Association; or
  - Registration Fees for its registration under the Companies Act, 1956; or
  - Underwriting commission, brokerage/charges for preparation/ advertisement of prospectus, etc. incurred in connection with issue of shares or debentures for public subscription.
- **(d)** Any other prescribed expenditure if not allowed under any other provisions of the Act.

(3) ***Qualifying Expenditure*** : Lower of the following qualifies for deduction –

- **(a)** Aggregate amount of eligible expenditure; or
- **(b)** 5% of Cost of the project**

** In case of Indian company, 5% of cost of project or 5% of capital employed, whichever is higher, will be taken.

- 'Cost of project' means actual cost of fixed assets acquired or developed in relation to such commencement, extension or set up, and which are shown as on 31st March of relevant previous year.
- Capital employed in the business of company = [Issued share capital + Debentures + Long-term borrowings] in relation to such commencement, extension or set up and which are shown as on 31st March of the relevant previous year.

Relevant previous year means the year in which the business is commenced; or the extension of such industrial undertaking is completed; or the new industrial unit commences production or operation.

(4) ***Deduction and Period:*** 1/5th of 'qualifying expenditure' is allowed as deduction for each of the five successive previous years starting with the relevant previous year.

(5) If, in case of amalgamation or demerger, the amalgamated/resulting company is an Indian company, no deduction shall be allowed to amalgamating or demerged company in the year of transfer, and the provisions of this section shall, as far as may be, apply to the amalgamated or resulting company.

(6) ***Audit***: In case of an assessee *other than company/co-operative society*, the accounts for year(s) in which the expenditure is incurred must be audited by a Chartered Accountant and a report thereof in prescribed form must be furnished along with return of income for the first year in which deduction is claimed.

(7) If a deduction is allowed under this section for any assessment year, no deduction shall be allowed in respect of such expenditure under any other provision for the same or any other assessment year.

(8) Deduction available to service sector units also [Amdt. by Finance act, 08 w.e.f 1-4-09]: *deduction under this section was, hitherto, available only to industrial undertaking/unit. Word 'industrial' has been omitted with the result that the deduction is now available to service sector units as well.*

6.23 DEDUCTIONS FOR EXPENDITURE INCURRED ON AMALGAMATION/ DEMERGER [Section 35DD] & DEDUCTION FOR EXPENDITURE INCURRED ON VOLUNTARY RETIREMENT [Section 35DDA]:

	Expenditure on amalgamation/ demerger	***Expenditure on voluntary retirement***
Assessee	Indian company	Any person
Eligible expenditure	100% of expenditure incurred *wholly or exclusively* for amalgamation or demerger of an undertaking	100% of payment of any sum to an employee *in connection with voluntary retirement* in any year in accordance with relevant scheme(s)
Deduction	1/5th of eligible expenditure is	1/5th of eligible expenditure is

and period	deductible in each of the 5 successive previous years starting with the previous year in which amalgamation or demerger takes place.	deductible in each of the 5 successive previous years starting with the previous year in which such expenditure is incurred
Additional provisions of Section 35DDA : If, in case of amalgamation or demerger of an Indian company or succession of business of a firm or a proprietary concern by a company fulfilling conditions laid down in 47(xiii)/(xiv), the resultant company is an Indian company, then, no deduction shall be allowed to such amalgamating or demerged company, or such firm or proprietary concern in the year of transfer, and the provisions of this Section shall apply to the amalgamated/resulting/successor company.		

6.24 DEDUCTION FOR EXPENDITURE ON PROSPECTING, ETC. FOR MINERALS [Section 35E]

(1) ***Assessee***: Indian company or non-corporate assessee resident in India engaged in prospecting for, or extraction or production of any mineral.

(2) ***Eligible expenditure*** : The eligible expenditure shall be calculated as follows:

	Rs.
Expenditure incurred *during year of start of commercial production and four previous years preceding that year* for prospecting for minerals or development of mine or natural deposit thereof	XXX
Less : Any portion of expenditure as above met directly or indirectly by any person or authority	XXX
Less : Realisation of sale, salvage, compensation or insurance moneys in respect of property or right created out of expenditure referred above	XXX
Less : Expenditure on acquisition of site of source or deposits of such mineral	XXX
Less : Capital expenditure on plant, machinery, building or furniture, eligible for depreciation	XXX
Eligible expenditure under this Section	**XXX**

(3) ***Deduction*** : Deduction is allowed for each of 10 successive previous years starting from the year of start of commercial production, to the extent of lower of the following –

- **(a)** $1/10^{th}$ of eligible expenditure; or
- **(b)** Income from such business for that previous year before making deduction under this Section.

Any portion of instalment ($1/10^{th}$ of such expenditure) remaining unallowed, shall be carried forward and added to the instalment relating to the next previous year. However, no part of any instalment shall be carried forward beyond the 10^{th} previous year from the year of commercial production.

(4) ***Audit and provisions in case of amalgamation/demerger:*** Same as given under Section 35D.

(5) If a deduction is allowed under this Section for any assessment year, no deduction shall be allowed in respect of such expenditure under any other provision for the same or any other assessment year.

6.25 OTHER DEDUCTIONS ALLOWABLE UNDER SECTION 36(1)

36(1)	*Deductible Expenditure*	*Conditions/Remarks*
(i)	Insurance premium of stock or stores against damage or destruction thereof	Such stock or stores are used for business or profession
(ia)	Insurance premium paid by Federal Milk Co-operative Society on life of cattle owned by a member of a Primary Co-operative Society	Such primary society should be engaged in supplying milk raised by its members to such federal milk co-operative society
(ib)	Health insurance premium paid otherwise than by cash by an employer on the health of his employees under a scheme.	Such scheme must be – *(a)* framed by GIC and approved by Central Government, or *(b)* framed by any other insurer and approved by IRDA *(Amendment by Finance Act, 2006)*
(ii)	Bonus or commission paid to an employee for services rendered (not otherwise have been payable to him as profit or dividend) Deduction is subject to the provisions of Section 43B and Section 40A (2).	Voluntary payments are deductible if it is for services rendered. Any bonus exceeding the statutory amount is allowed if such excess payment has been made on account of commercial expediency.
(iii)	Interest on capital borrowed for the purposes of business or profession. However, interest paid on capital borrowed for acquisition of a new asset for extension of existing business or profession pertaining to period upto the date on which such asset is first put to use, shall be capitalized and shall not be allowed. Periodical subscriptions paid by shareholders, or subscribers in Mutual Benefit Societies shall be deemed to be capital borrowed.	Capital means *money*, not any other asset. Deduction subject to Section 43B and 40(a)(i). Interest on own capital is not deductible. The need of assesee to borrow cannot be examined by the Assessing Officer. Interest on money borrowed for payment of tax or interest on late payment of advance tax or for late filing of return is not deductible. In order to decide whether interest on funds borrowed by the assessee to give an interest-free loan to a sister concern (for example, a subsidiary to the assessee) should be allowed as a deduction under section 36 (1) (iii) of the income-tax act, 1961 one has to enquire whether the loan was given by the assessee as a measure of commercial expediency . The expression ' commercial expediency ' is one of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. Supreme Court held that the expenditure may not have been incurred under any legal obligation, but yet it is allowable as business expenditure if it was incurred on grounds of commercial expediency. S.A. Builders Ltd vs. Commissioner of Income-Tax (Appeals) [2007] 288 ITR 1 (SC).

(iiia)	Discount on zero coupon bond calculated in *pro rata* manner over the life of such bond. Discount = Amount payable by issuer on maturity/redemption of such bond *Less* Amount received or receivable on issue of the bond. Zero coupon bonds means a notified bond issued by any infrastructure capital company/ fund or public sector company, in respect of which no payment and benefit is received or receivable before maturity or redemption.	Life of bond = Period starting from the date of issue of the bond and ending on the date of maturity or redemption of such bond. For computing life of the bond, if the month in which bond is issued or is redeemed/matured is a part of the month, then such month shall be rounded off to the nearest one i.e. if such part is 15 days or more, it will be taken as one month, otherwise it will be ignored.
(iv)	Contribution made by employer to recognized provident fund/ approved superannuation fund	Deduction is subject to the provisions of Section 43B.
(v)	Sum paid by employer towards an approved gratuity fund set up for benefit of his employees.	Deduction is subject to the provisions of Section 43B.
(va)	Sum received by assessee from his employees as contributions to Provident Fund or Employee State Insurance Fund or Superannuation Fund or any other employee-welfare fund. Such sum received by the assessee is first treated as income under Section 2(24) (x) and thereafter, deduction is allowed in respect of such sum if the relevant conditions are satisfied.	Such sum should be credited by the assessee to the employee's account in the relevant fund(s) on or before the due date. Due date means date by which the assessee is required as an employer to credit an employee's contribution to his account in the relevant fund(s) under any law, standing order, award, contract of service or otherwise.
(vi)	Loss in respect of animals, used for business or profession *(otherwise than as stock-in-trade)* which have died or become permanently useless.	Deduction allowed = [Actual cost of the animal – Sale proceeds of carcasses or animals]
(vii)/ (viia)	Bad Debts and Provision for Bad and Doubtful Debts	Discussed later.
(viii)	Special reserve created and maintained by- (a) (i) financial corporations specified u/s 4A of the companies act, 1956, or (ii) financial corporations which is a public sector company, or (iii) A banking company or (iv) a co-operative bank other than primary agricultural credit society or primary cooperative agricultural and rural development bank', in respect of eligible business being providing long-term finance for industrial or agricultural or development of nfrastructure facility in India or for construction or purchase of residential	The least of the following his deductible:- (a) 20% of profit from such eligible business computed under the head " profits and gains of business or profession" before making deduction under this clause; or (b) profit transferred to special reserve a/c or (c) [2 × (paid-up share capital + General reserves on last day of previous year)]-[balance of special reserve a/c on 1st day of previous year] **taxability of withdrawals from special reserve a/c [section 41 (4A)] :** any amount withdrawn from reserve a/c, for which deduction has been allowed here, is taxable as deemed business profit in the year of withdrawal whether or not the business is in existence in that previous year.

	houses in India; or (b) housing finance company formed and registered in India with main object of carrying on the eligible business of providing long-term finance for construction of purchase of residential houses in India; (c) any other financial Corporation including a public company, in respect of eligible business of providing long-term finance for development of infrastructure facility in India.	Long-term finance means any loan or advance, which is a repayable along with interest during a period of 5 years or More; Infrastructure facility means business referred to in section 80-IA or housing project business referred to in section 80-IB.
(ix)	• Expenditure incurred *bonafide* by a company for promoting family planning amongst its employees • Extent of deduction and period : **(a)** *Where expenditure is of revenue nature*: 100% in the previous year in which it is incurred. **(b)** *Where expenditure is capital in nature* : 1/5th of such expenditure deductible in 5 consecutive previous years beginning with the previous year in which the expenditure is incurred	• Any unabsorbed family planning expenditure is carried forward and set off in the same manner as unabsorbed depreciation • No depreciation allowable under Section 32 if deduction has been claimed here. • Tax treatment in case of sale of such asset : Same as in Section 35
(x)	• Revenue expenditure incurred by corporation or a body corporate constituted or established under a Central, State or Provincial Act	• Such expenditure should be incurred for objects and purposes authorized by the Act under which it was constituted or established.
(xi)	• Any amount of banking cash transaction tax (BCTT) paid by the assessee during the previous year on the taxable banking transactions entered into by him.	• "Banking Cash Transaction Tax" and "taxable banking transaction" have the same meanings assigned to them under Chapter VII of the Finance Act, 2005.
(xii)	• Any contribution made by a public financial institution to a notified Credit guarantee fund	• Public Financial Institution means Corporation specified in sec 4A of the Companies Act •
(xiii)	security transaction tax (STT) paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year. (Amdt. by Finance act, 08 w.e.f (1-4-2009).	
(xiv)	Commodities transaction tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year. (Amdt. by Finance act, 08 w.e.f 1-4-2009).	

6.26 DEDUCTIONS IN RELATION TO BAD DEBTS AND PROVISION FOR BAD AND DOUBTFUL DEBTS [Section 36(1) (vii)/ (viia) and Section 36(2)]

(1) ***Deduction in respect of Bad Debts [Section 36(1) (vii) and 36(2)]***: Bad Debts written off as irrecoverable in the accounts (Profit & Loss A/c) of the assessee are deductible. *However, no deduction is allowed for any provision for Bad and Doubtful Debts.* This deduction is allowed subject to the following conditions :

(a) There must be a debt and the debt must be incidental to the business or profession of the assessee. Thus, loan advanced by a firm of solicitors to a company, in whose formation it acted as legal advisor, is not deductible on its becoming irrecoverable because that is not a part of the profession of a solicitor and such debt is not revenue in nature.

(b) Such debt must have been taken into account in computing the income of the assessee of previous year in which it is written off or of an earlier previous year; or it represents money lent in ordinary course of banking or money lending business carried on by assessee.

In case of Bad Debts Recovery [Section 41(4)] : In case any amount allowed as Bad Debts is ultimately recovered, the following sum shall be chargeable to tax whether or not business is in existence in that previous year –

Amount recovered on such debt – [Actual amount of Bad Debts – Amount deducted u/s 36(1) (vii)]

If the aforesaid sum is negative, the same shall be allowed as deduction as Bad Debts.

Successor of business – Bad Debts allowable business-wise not assessee-wise : The successor to the business is entitled to deduction in respect of the debts incurred by the predecessor if the business is not dissolved and the identity of the business after succession remains the same. Deduction for Bad Debts is allowed business-wise and not assessee-wise. *CIT v. Veerbhadra Rao K. Koteshwara Rao and Co. [1985] 155 ITR 152 (SC)*

(2) ***Deduction of Provision for Bad and Doubtful Debts in case of certain assessees [Section 36(1)(viia)]*** :

Assessee	***Deduction***	***Additional Deduction***
• Indian scheduled bank**; or • Any non-scheduled bank**	Not exceeding 7½% of its total income *(before making deduction under this clause and Chapter VIA)*	10% of aggregate average advances made by its rural branches
• A foreign bank	5% of its total income as above.	Nil
• Public financial institution or state financial corporation or state industrial in corporation	5% of its total income as computed above.	Nil
• Co-operative bank other than a primary agricultural society or primary agricultural and rural development bank	Not exceeding 7½% of its total income *(before making deduction under this clause and Chapter VIA)*	10% of aggregate average advances made by its rural branches

***Further deduction:* An Indian scheduled bank or any non-scheduled bank, as its option, is allowed a further deduction of an amount of exceeding the income derived from redemption of securities in accordance with scheme framed by Government. This deduction is available only if such income has been disclosed in the Return of Income under the head "Profits and Gains of Business or Profession".

In case of aforesaid assessees, deduction for Bad Debts = Bad Debts written off in accounts according to Section 36(1)(vii) ***less*** Credit balance in Provision for Bad and Doubtful Debts A/c made u/s 36(1)(viia).

6.27 GENERAL DEDUCTION [Section 37]

(1) Conditions: Deduction under this Section is permissible only if following conditions are satisfied:

- **(a)** The expenditure should not be of the nature described under Section 30 to 36.
- **(b)** It should not be personal expenditure of the assessee.
- **(c)** It should not be in the nature of capital expenditure.
- **(d)** It should have been incurred in the previous year.
- **(e)** It should be in respect of the business carried on by the assessee.
- **(f)** It should have been expended wholly or exclusively for purpose of such business or profession.

(2) Disallowance: The following expenses are expressly disallowed under Section 37 -

- **(a)** Expenditure incurred by an assessee for any purpose, which is an offence, or which is prohibited by law *[Explanation to Section 37(1)]*
- **(b)** Expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. *[Section 37(2b)].*

Case Law:

Dr. T. A. Quereshi v. CIT [20061 287 ITR 47(SC)	Illegal business loss is different from illegal expenditure covered by section 37(1).in computing income from illegal business, the losses sustained are allowable as deduction. Therefore ,in case a doctor engaged in heroine business, the value of sized heroine, which formed a part in the stock in trade, is allowable as a deduction as business loss.

6.39 BENEFIT OF ENDURING NATURE

One of the important conditions for claiming deduction u/s 37(1) is that the expenditure should not be in the nature of capital expenditure. This particular issue has all along proved to be a fertile area for litigation where many cases went up to the level of Supreme Court to decide about the capital or revenue nature of an expenditure. The land mark decision of the Supreme Court in *Empire Jute Co. Ltd. vs. CIT 124 ITR* has propounded that the test of the benefit of enduring nature may fail in certain cases and the expenditure giving rise to such benefit would still be deductible if the benefit is in the revenue field. The settled position of law in this regard is as follows:

Insert Chart

6.40 ADDITIONAL POINTS U/S 37(1)

(1) Expenditure incurred by employer on training of apprentices covered under the Apprentices Act, 1961 is a allowable expenditure u/s 37(1).

(2) Deposit made under the "Own Your Telephone Scheme". The Central Board of Direct Taxes have issued instruction to the effect that deduction will be allowed in the year of payment and in case that the telephone is not installed and money is paid back, it will be charged to tax u/s 41(1) of the Income Tax Act, 1961.

(3) Security deposit for telex connection : The Central Board of Direct Taxes have clarified in Circular No.420 dated 4.6.1985 that the amount paid towards security deposit may be treated as a revenue expenditure and allowable as a deduction when Telex is installed. However, when Telex connection is finally closed, the deposits so refunded shall be treated as income of the year in which it is received.

(4) Thatkal Telephone Deposit Scheme: By Circular No.571 dated 27.10.1993, the CBDT has clarified that the deposit made under this scheme shall be allowed as deduction and when the amount is refunded it shall be taxed as income.

Advertisement in Publications of a Political Party – Section 37(2B)

No allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, pamphlet or the like published by a political party.

LIST OF EXPENSES ALLOWABLE U/S 37 (1) BASED ON IMPORTANT CASES:

(a) penalty/interest for late payment of sales tax, as the same is not penal but compensatory in nature;
(b) Expenses for altering, memorandum and articles of association revenue expenditure.
(c) Provision for meeting warranty liability towards warranty extended in respect of products manufactured and sold by the assessee is the revenue expenditure.
(d) Expenditure for shifting an administrative office.

LIST OF EXPENSES NOT ALLOWABLE U/S 37(1) BASED ON IMPORTANT CASES:

(a) Redemption fine paid to get back goods confiscated by Central Excise Department;
(b) Payments for perfecting title or for removing defects in title are ' capital payments';

(c) Interest paid or payable on delayed payments to micro and small enterprises in accordance with Micro, small and medium enterprises and development act, 2006 is not allowable;
(d) Secret commission is disallowable if the same is incurred for a purpose, which is offence, or which is prohibited by law.
(e) **Payment for use of asset v. payment for purchase of asset:** distinction lies between case where royalties/rent is being paid and where entire amount of lease is paid either at a time all in installments. In former case, the royalty /rent is for use of an asset and is revenue expenditure, while, in the latter case, the amount is for acquisition of asset of enduring nature and is capital expenditure.

Some issues:

(1) **Expenditure on issue of shares v. expenditure on issue of bonus shares:**

Expenditure on expansion of capital base is capital in nature. Thus, expenditure incurred on issuing shares to increase share capital including fee paid to registrar of companies for consequent increase in authorized share capital is not deductible. - Brooke bond India Ltd v. CIT [1997] 225 ITR 798 (SC).

It has been held in CIT v. general insurance Corporation [2006] 286 ITR 232 (SC) that expenses incurred by a company on account of stamp duty and registration fees for the issue of bonus shares is not of capital nature, as the issue of bonus shares doesn't result in inflow of fresh funds or increase in the capital employed. Hence, the said expenses are deductible.

(2) **present liability v. contingent liability - provision therefore:** the following principles have been laid down by the Supreme Court in Bharat Earth Movers v. CIT [[2000] 245 ITR 428 (SC) in this respect-

(a) If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain in the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible.
(b) If these requirements are satisfied, the liability is not a contingent one. The liability is present liability though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.

(3) **Disputed liability:** the liability doesn't cease to be a liability because the same is disputed before a court of law. If the incurrence of liability is certain, but its quantification only is uncertain, the provision therefor, based on reasonable estimation, will be allowed. However, if the incurrence of the

liability itself is uncertain i.e. the liability is contingent one, the provision therefor will not be allowed..

(4) discount on issue of debentures and premium on redemption of debentures:

In Madras Industry and Investment Corp Ltd v. CIT [1997] 225 ITR 802 (SC) it was held that discount on debentures is a liability which the company has incurred in present although it is payable in future. Although the assessee has incurred the liability to pay the discount in the year of issue of debentures, the payment is to secure a benefit over a number of years. The liability should, therefore, be spread over the period of life of the debentures.

Similarly in CIT v. Jagatjit industries Ltd [2006] 154 taxman 229 (Del.) it was held that the liability to pay premium on redemption arises in the year in which the debentures are issued and, thus, such premium can be claimed as deduction proportionately during the period of life of debentures.

6.28 AMOUNTS NOT DEDUCTIBLE IN COMPUTING INCOME UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS AND PROFESSION" [Section 40(a)]

Notwithstanding anything contained in Section 30 to 38, the following shall not be allowed as deduction –

(1) payments outside India or to non-residents on which TDS not made/paid: any interest, royalty, fees for technical services or other sum chargeable in the hands of recipient under this act and payable-

- (a) outside India, or
- (b) in India to non-resident (not being a company) or to a foreign company, on which-
  - (i) Tax required to be deducted at source has not been so deducted at source; or
  - (ii) After such deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under section 200 (1).

However, such sums shall be allowed as a deduction in computing the income of the subsequent previous year in which it has been so deducted and paid.

Note: if the amount of tax deducted at source is not paid during the previous year but is paid within the time limit prescribed in section 200 (1), then, the payment in respect of which tax has been deducted at source shall be allowed as deduction in the previous year to which it relates.

E.g.: if TDS in respect of interest payable outside India during financial year 2008-09 is not paid in 2008-09, but is paid within time period prescribed in section 200 (1), then, such interest shall be allowed as deduction in assessment year 2009-10 (i.e. previous year 2008-09) only. However, if such TDS is paid during financial year 2009-10 after expiry of time period prescribed in section 200 (1), then, interest will be allowed as deduction during assessment year 2010-11 (previous year 2009-10).

(2) **payments to residents on which TDS is not made/paid:** any interest, a commission of brokerage, rent, royalty, fees for professional or technical services payable to a resident, or amounts payable to contractor or sub-contractor, being a resident, for carrying out any work (including supply of labour for carrying out any work), on which-

(i) Tax required to be deducted at source has not been so deducted at source; or

(ii) After such deduction, has not been paid on or before the following date-

If such tax was deductible and was so deducted during March month of the previous year-	On or before the due date of furnishing return of income u/s 139(1)
In any other case-	On or before 31st march of the previous year

However if the TDS in respect of any sum-

(a) has been deducted in any subsequent year; or
(b) has already been deducted but paid after the applicable due-date given above,

Then such sum shall be allowed as a deduction in computing the income of the subsequent previous year in which the TDS has been so paid. (amendment by Finance act, 08 w,r.e.f 1-4-2005)

For example,-

(1) if tax of Rs 10,000 was deductible in May, 2008 in respect of interest of rupees 1 lakh payable to a resident, then, the interest expenditure will be allowed during previous year 2008-09, if the TDS of Rs.10,000 is paid on or before 31-3-2009. If such TDS is paid on 1-4-2009, then, the interest will be allowed as deduction in the previous year 2009-10.

(2) If tax of Rs 10,000 was deductible in March, 2009 in respect of interest of Rs.1 lakh payable to a resident, then, the interest expenditure will be allowed during previous year 2008-09, if the TDS of Rs 10,000 is paid on or before due date of furnishing return of income. If such TDS is paid after such due date in financial year 2009-10, then, are the interest will be allowed as deduction in the previous year 2009-10.

(2) Fringe Benefit Tax and Wealth Tax.

(3) Tax on perquisites, as referred to in Section 10(10CC) actually paid by the employer.

(4) *Income Tax*: Any rate/tax levied or assessed on the basis of profits or gains of any business/profession.

Foreign income tax also not deductible: Any income tax paid outside India and eligible for relief of tax u/s 90 or 90A or 91 shall not be deductible. *(Amendment by the Finance Act, 2006)*.

(5) Salaries payable – (a) outside India or (b) to a non-resident, if tax has not been deducted at source and, if deducted, not paid. *[Note: Even if tax is deducted on* *such salary in subsequent previous year, such salary will not be allowed as deduction in that previous year]*

(6) Any payment by the assessee-employer to provident fund or other employee-welfare fund unless he has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are taxable under the head "Salaries".

6.41 DISALLOWANCE IN THE CASE OF PARTNERSHIP FIRMS – Section 40(b)

(i) Interest paid to a partner by a firm is not deductible unless the following conditions are fulfilled:

(1) It should be authorized by and in accordance with the partnership deed.

(2) It should relate to a period falling after the date of the partnership deed.

(3) It should be not exceeding 12% p.a. simple rate of interest.

Further, the disallowance of interest is subject to the following explanations:

Explanation 1: If a person is a partner in his representative capacity in the firm and if he receives interest in his individual capacity from the firm, such interest should not be disallowed.

Explanation 2: If a person who is a partner in his individual capacity receives interest for and on behalf of some one else from the firm in which he is a partner, such interest should not be disallowed.

(ii) Any amount paid by way of salary, bonus, commission or remuneration by a firm to a partner is not deductible in the computation of income of the firm unless the following conditions are fulfilled:

(1) It should be authorized by and in accordance with partnership deed.

(2) It should relate to a period falling after the date of partnership deed.

(3) It should be within the prescribed limits. The prescribed limits are as follows :

BOOK PROFITS		REMUNERATION
Professional Firms	**Other Firms**	**As a % of book profits**
On the first Rs.1 lakh or in case of a loss	On the first Rs.75,000 or in case of a loss	Rs.50,000 or 90% whichever is higher
On the next Rs.1 lakh	On the next Rs.75,000	60%
On the balance	On the balance	40%

(4) It should be paid to a working partner.

For the purpose of remuneration paid to a working partner by a firm, the following explanations are relevant:

Explanation 3: "Book profit" means the Net Profit, as shown in the Profit & Loss A/c for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.

Explanation 4: "Working partner" means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

According to Section 2(23), the terms “FIRM”, “PARTNER” and “PARTNERSHIP” have the meanings respectively assigned to them in the Indian Partnership Act, 1932. The expression “PARTNER” shall also include any person who is a minor admitted to the benefits of partnership.

CBDT has issued circular No.739 dated 25.3.1996 stating that disallowance of salary to partners shall be made in the case of a firm if the partnership deed does not specify the amount of remuneration payable to each individual working partner or it does not lay down the manner of quantifying such remuneration.

Students can remember that the deductible amount of interest and salary shall be the amount payable as per partnership deed or amount calculated u/s 40(b), whichever is less. Further, rent paid to a partner by the firm in respect of assets belonging to the partner and used by the firm is not covered by Section 40(b) and therefore, deductible.

Disallowance in the case of association of persons and body of individuals – Section 40(ba):

Any payment by way of interest, salary, bonus, commission or remuneration paid by an association of persons or body of individuals to any of its members shall be disallowed.

Explanation 1: If the member who received interest from the AOP or BOI also pays interest to the AOP or BOI during the same previous year only the net excess interest paid by the AOP to such member should be disallowed.

Explanation 2: If a person is a member in his representative capacity in the AOP or BOI and if he received interest in his individual capacity from the AOP or BOI, such interest should not disallowed.

Explanation 3: If a person who is a member in his individual capacity received interest for and on behalf of some one else from the AOP or BOI in which he is a member, such interest should not be disallowed.

6.29 EXPENSES OR PAYMENTS NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES [Section 40A]

(1) *Payment to relatives in excess of fair value – not deductible [Section 40A (2)]*: If -

(a) the assessee incurs any expenditure for which payment is made to specified persons; and

(b) the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to – *(i)* the fair market value of goods, services or facilities for which payment has been made; or *(ii)* the legitimate needs of the business or profession of the assessee; or *(iii)* the benefit derived by or accruing to assessee therefrom,

Then, such excessive/unreasonable part of the expenditure will not be allowed as deduction.

Disallowance = Expenditure incurred – FMV of goods/services/facilities/benefit, etc. received by the assessee.

Specified Persons: The specified persons in case of assessees given below are as follows:

In case of	***Specified Persons***
A. Individual	(1) Any relative of the assessee (2) Any person in whose business or profession the assessee or any of his relatives has substantial interest.
B. Company, Firm, AOP or HUF	(1) Any director, partner or member thereof; (2) Any relative of such director partner or member; (3) Any person in whose business or profession – *(a)* the assessee, or *(b)* the director, partner or member of the assessee, or *(c)* any relative of such director, partner or member has substantial interest.
C. All assesses carrying on any business or profession	(1) Any individual having substantial interest in assessee's business or profession, or any relative of such individual. (2) A company/firm/AOP/HUF having substantial interest in the assessee's business or profession or any director/partner/member thereof, or any relative of such director/partner/member. (3) Any company/firm/AOP/HUF whose director/partner/ member have substantial interest in the business or profession of the assessee, or other directors/partners/ members of such company/firm/AOP/HUF, or any relative of any of the directors/partners/members thereof.

Substantial interest: Meaning of: a person shall be deemed to have a substantial interest in a business profession, if such person is, at any time during the previous year,-

(a) in a case where the business of profession is carried on by a company, beneficial owner of equity shares carrying 20% or more of the voting power; and

(b) In any other case, beneficially entitled to 20% or more of profits of such a business profession.

Expenditure in excess of Rs 20,000 in aggregate in a day paid otherwise than by account payee cheque drawn on a bank or account payee bank draft - not allowable [section 40A(3) & 40A(3A), as amended by the Finance act, 2008 w.e.f 1-4-2009]: in case-

(a) Assessee incurs an expenditure, which is allowable and claimed as deduction, and

(b) the payment of aggregate of payments made to person in the day in respect of such expenditure, otherwise than by account payee cheque drawn on a bank or account payee bank draft (i.e. by way of cash bearer cheque/draft or crossed cheque/draft), exceeds Rs 20,000.

Then, no deduction shall be allowed in respect of such expenditure.

Subsequent payment in violation of above provisions-taxable as business income: if-

(a) any expenditure has been claimed as deduction on accrual basis in any previous year, and
(b) subsequently, in any previous year, the assessee makes payments in respect thereof, otherwise than by account payee cheque drawn on a bank or account payee bank draft, and
(c) such payment or aggregate of such payments made to a person in a day exceeds Rs 20, 000,

Then, 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 year in which such payment is made.

Exception [Rule 6DD]: Section 40A (3) does not apply under following circumstances:

(a) Payment to banking/other financial institutions, or payment through banking system like – letters of credit, mail/telegraphic transfers, book adjustment and bills of exchange including hundies.
(b) Payment made to Government (if such payment is required to be made in cash).
(c) Payment for goods or services by book adjustment.
(d) Payment to cultivator, grower or producer in respect of agricultural or forest products, animal husbandry, poultry farming or fish products, etc.
(e) Payment to cottage industry for purchase of products manufactured by it without aid of power.
(f) Payment to person residing or carrying on Business and Profession in place not served with banking facility.
(g) Payments made when bank is closed due to bank holidays or strikes, etc.
(h) Payment to agents for purchase of goods and services on his behalf.
(i) Payments by authorized dealer or moneychanger against purchase of foreign currency.
(j) Payment of gratuity, retrenchment compensation or other terminal benefits in year of retirement or preceding year to an employee drawing salary not exceeding Rs.50,000.
(k) Salary paid after deducting tax at source to the employee who is temporarily posted for a continuous period of 15 days or more in place other than the working place or on a ship and he does not maintain any bank account there.

3) ***Provision for gratuity to be disallowed [sec. 40A (7)]:*** Provision for payment of gratuity to employees is not deductible. However, any provision for contribution towards an approved gratuity fund, or for payment of any gratuity actually payable during the previous year shall be allowed.

Note: Although provision for contribution to be approved gratuity fund is allowed as deduction under this, section, however, it shall be subject to the provision of section 43B.

4) **Disallowance in respect of contribution to non statutory funds (sec. 40A (9)):** any sum (including contribution) paid to non statutory/unrecognized welfare funds is not deductible except where such sum is paid as per provision u/s 36(1) (IV)/ (v) or under any other law for the time being in force.

6.30 DEEMED PROFITS CHARGEABLE TO TAX [Section 41]

(1) ***Recovery or excess recovery against a deduction [Section 41(1)]***: This Section aims at taxing any subsequent benefit accrued out of the deduction or allowance made earlier.

- **(A)** ***Conditions***: The following conditions must be satisfied before this Section is applied:
  - ***(a)*** An allowance or deduction has been made for any assessment year.
  - ***(b)*** Such allowance or deduction has been made in respect of loss, expenditure or a trading liability incurred by the assessee.
  - ***(c)*** Subsequently, during any previous year, the assessee or successor in business has *obtained,* whether in cash or in any other manner whatsoever, -
    - Any amount in respect of such loss or expenditure; or
    - Some benefit in respect of such trading liability by way of its remission or cessation *(Remission or cessation of any liability by a unilateral act by the assessee or successor-in-business by way of writing off such liability in his accounts is also included).*
- **(B)** ***Chargeability to tax***: The amount so obtained or the benefit accruing to such assessee or successor shall be deemed to be profits and gains of business or profession and shall be chargeable to tax in the year of receipt irrespective of whether the business or profession, in respect of which the allowance or deduction had been made, is in existence in that year or not.
- **(C)** ***"Successor-in-business"*** means – (a) In case of amalgamation or demerger, the amalgamated or resulting company; and (b) In case assessee/firm carrying on business or profession is succeeded by any other person/firm in that business or profession, the other person/firm.

The above mentioned sub-section covers loss, expenditure and trading liability. For the understanding of the students, the following examples are given:

i) if travelling or advertisement expenditure is incurred and claimed as deduction but later reimbursed by the manufacturer or distributor of the assessee trader, section 41 (1) will apply.

ii) If stock is destroyed by fire and allowed as trading loss but later insurance compensation is received, the same is assessable under section 41(1).

iii) if credit purchase of raw material is made and claimed as deduction but later, a lesser amount is settled to the supplier creditor, the benefit occurring on remission of the trading liability will be deemed as income under section 41 (1).

(2) ***Balancing Charge [Section 41(2)]***: Discussed under the head 'depreciation'.

(3) ***Sale of an asset used for scientific research [Section 41(3)]***: Discussed in Section 35.

(4) ***Recovery against Bad Debts [Section 41(4)]***: Discussed in Section 36(1) (vii).

(5) ***Amount withdrawn from special reserve [Section 41(4A)]***: Discussed in Section 36(1) (viii)

(6) ***Set off of loss against aforementioned incomes [Section 41(5)]*** : If the business no longer exists and there are deemed profits as referred to under Section 41(1) or 41(3) or 41(4A) in respect of that business, any loss *(not being speculation loss)* which arose in that business and profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall be set off against such deemed profits to the extent of such profits.

Note: students may note that the provisions of section 72 is amended to enable carry forward and set off of losses in respect of a discontinued business with affect from assessment year 2000-01. When section 72 provided that loss of a discontinued business cannot be carried forward, the provisions of sub-section (5) of section 41 was of use to an assessee. Now that section 72 permits carry forward loss of a discontinued business, section 41 (5) is of not much use. It may be useful only where the deemed profit arises beyond 8 assessment years after the discontinuance of the business. In all other cases, section 72 is more beneficial than section 41 (5) since this provision allows only the loss incurred in the year of discontinuance of the business where as section 72 allows the carry forward and set off of the entire accumulated loss of earlier years also so long as the period of 8 years has not expired.

6.31 SPECIAL PROVISIONS FOR DEDUCTION IN THE CASE OF BUSINESS OR PROFESSION, ETC. FOR MINERAL OIL [Section 42]

In case of assessee engaged in business of prospecting for or extraction or production of mineral oils (including petroleum and natural gas), for which the Central Government has entered into agreement with the assessee, the following deductions, as specified in the agreement, shall be allowed –

(1) Infructuous or abortive exploration expenses in respect of any area surrendered by the assessee;

(2) Expenditure incurred in respect of drilling or exploration activities or services or in respect of physical assets used in that connection; and

(3) Depletion of mineral oil in mining area.

Transfer of Business: If the said business of the Assessee is transferred wholly or partly or any interest therein is transferred in accordance with the agreement referred above, then –

(a) In case sale proceeds (only capital sums) is *less than* the expenditure remaining unallowed, then, Deduction to be allowed in the year of transfer = Expenditure remaining unallowed – Sale proceeds.

(b) In case sale proceeds (only capital sums) is *greater than or equal to* expenditure remaining unallowed, then, no deduction shall be allowed and the *lower* of the following sums shall be taxable as deemed profits in the year of transfer whether or not business is in existence in that previous year :

(i) Sale proceeds (only capital sums) – Expenditure remaining unallowed; or

(ii) Total expenditure incurred by assessee – Expenditure remaining allowed.

However, in case of amalgamation/demerger, the aforesaid provisions shall not apply in case of amalgamating or demerged company, but shall apply to the amalgamated or resulting company.

6.32 TREATMENT OF EXCHANGE RATE FLUCTUATIONS IN CASE OF PURCHASE OF AN ASSET FROM OUTSIDE INDIA [Section 43A]

In case of assets acquired from outside India for assessee's business/ profession, where there is change in the rate of exchange during any previous year, and such exchange rate fluctuation results in increase or reduction in the liability of the assessee *(as expressed in Indian currency)* at the time of making the payment-

- Towards the whole or part of the cost of asset; or
- Towards the repayment *(along with interest)* of whole or part of the moneys borrowed by him from any person in any foreign currency specifically for acquiring the asset,

Then, the amount by which the liability is so increased or decreased (along with increase/decrease in interest) at the time of making payment, shall be *added to or reduced from* the following:

(a) Actual cost of the asset, or Capital expenditure incurred on scientific research or family planning; or

(b) Cost of acquisition of capital asset *(other than depreciable asset)*, while computing capital gains u/s 48.

Other relevant points:

- These adjustments are to be made only on actual payment by the assessee towards the cost of asset or repayment of the loan/interest irrespective of the method of accounting adopted by the assessee.
- Where whole or part of the liability is not met by assessee but is met by any other person, no adjustments of exchange rate fluctuations shall be made with respect to the liability so met.
- Where assessee has entered into forward exchange contract with "authorized dealer" for purchase of foreign currency to discharge the liability as referred above, the increase or decrease in liability is computed with reference to *rate of exchange specified in the contract.*

CERTAIN DEDUCTIONS TO BE ALLOWED ON ACTUAL PAYMENT [Section 43B]

Notwithstanding anything contained in any other provision of the Act, the following sums shall be allowed as deduction only on actual payment irrespective of the previous year in which the liability arose:

(a) Any tax, duty, cess or fee, for which assessee incurred liability in the previous year, under any law; or

(b) Contribution by assessee-employer to any Provident Fund or Superannuation or gratuity or other employee-welfare fund; or

(c) Bonus or commission to employees for services rendered, as referred under Section 36(1)(ii); or

(d) Sum in lieu of any leave at the credit of his employee (Leave Encashment); or

(e) Interest on any loan or borrowing or advances from –

(i) Any Public Financial Institution (*e.g.* ICICI, IFCI, IDBI, LIC, UTI, etc.); or

(ii) State Financial Corporation, or State Industrial Investment Corporation; or

(iii) Scheduled Bank

No deduction for interest converted into loan/borrowing/advance: Any interest falling under (e) above, which has been converted into a loan or borrowing or advance shall not be regarded as actually paid and shall not be allowed as deduction. *(Amendment by Finance Act, 2006)*

Manner of Deduction: The expenditure shall be allowed as deduction in the following manner:

Case	Year of Allowance
If the sum relates to any previous year for which payment has been made on or before the due date of furnishing the Return of Income of that year	In the previous year to which it relates
In any other case	In the year of payment

Important points:

(1) Interest converted into loan/borrowing shall not be allowed as deduction. However, when such interest converted into loan/borrowing is actually paid, the same shall be allowed as deduction.

.E.g. A. had taken loan of Rs 2 crores on 31-3-2005, on which interest unpaid @ 12% up to 31-3-2008 is Rs 36 lakhs. In restructuring arrangement, the unpaid interest of Rs 36 lakhs is converted into interest-free Funded Interest Term loan (FITL) and is payable in 12 annual installments of Rs 3 lakhs each starting from the financial year 2008-09.

In this case, installments of FITL of Rs.3 lakhs will be allowed in the A.Y 2009-10 and subsequent years when it is actually paid. The interest on the original principle of Rs 2 crores, if any, actually paid will be independently allowable under section 43B

(2) If the sales tax laws of the State provide that deferred sales tax is to be treated as actually paid, it will be treated as such under this section.

(3) Royalty is a tax for all purposes including section 43B and shall be deducted only on actual payment

(4) Government audit charges are not covered by section 43B.

6.33 COST OF ACQUISITION OF STOCK-IN-TRADE IN CERTAIN CASES [Section 43C]

In case where an asset *(other than capital asset converted into stock-in-trade under Section 45(2))* becomes property of the assessee under – (i) Amalgamation; or (ii) Total or partial partition of HUF; or (iii) Gift, will or irrevocable trust; and it is sold by the assessee as stock-in-trade of the business carried on by him, then, the cost of such asset shall be computed as follows:

Cost of acquisition of such asset in the hands of Amalgamating Company/	XXX

HUF/Donor/Transferor *Add* : Cost of improvement thereto by the Amalgamating Company/HUF/ Donor/Transferor	XXX
Add : Expenditure incurred by the Amalgamating Company/HUF/Donor/ Transferor wholly and exclusively in connection with – (a) Such transfer; (b) Effecting the partition; (c) Acceptance of gift; (d) Obtaining probate in respect of the will; (e) Creation of Trust; (f) Gift-tax paid, if any	XXX
Cost of acquisition of such asset to Amalgamated Company/Assessee	**XXX**
Therefore, profit on sale of such asset = Sale proceeds from transfer – Cost of acquisition as computed above.	

6.34 SPECIAL PROVISIONS FOR TAXATION OF INTEREST ON BAD AND DOUBTFUL DEBTS IN CASE OF PUBLIC FINANCIAL INSTITUTION, ETC. [Section 43D]

In case of – *(a)* Public Financial Institution or Scheduled Bank or State Financial Corporation or State Industrial Investment Corporation or (b) Public company being Housing Finance Company, the interest in relation to such categories of bad or doubtful debts as are prescribed under guidelines issued by the Reserve Bank of India or the National Housing Bank, respectively, shall be chargeable to tax –

(1) In the previous year in which it is credited by the assessee to its Profit & Loss A/c for that year; or

(2) In the previous year in which it is actually received by the assessee;

Whichever is earlier.

6.35 COMPUTATION OF INCOME FROM INSURANCE BUSINESS [Section 44]

Profits and gains of insurance business (including that carried on by Mutual Insurance Company or by co-operative society) shall be computed in accordance with rules contained in First Schedule to the Act.

Computation of tax in case of life insurance business [Section 115B]: The profits and gains from life insurance business included in the total income of an assessee shall be chargeable to tax at the flat rate of 12½%.

DEDUCTION OF DEFICIENCY FROM MUTUAL ACTIVITY IN CASE OF TRADE, PROFESSION OR OTHER SIMILAR ASSOCIATION [Section 44A]:

On account of the principle of mutuality, any income arising to a trade, professional or similar association does not partake character of income and thereby, not taxable. But, any deficiency arising therefrom is deductible in accordance with provisions of this section. This section creates an exception to the rule that 'since income from mutual activities is not taxable, therefore, any deficiency arising therefrom is not deductible'. The provisions of this section are as follows:

(1) ***Applicability***: This section applies to every trade, professional or similar association, *other than a professional institution or institution referred under*

Section 10(23A), whose income or any part thereof is not distributed to its members except as grants to any association or institution affiliated to it.

(2) *Deficiency* : The deficiency is computed as follows :

Amount received by it during previous year from its members by way of subscription or otherwise *(not being remuneration received by rendering any specific services to such members)*	XXX
Less : Expenditure *(other than capital expenditure or an expenditure deductible in computing income under any other provisions of the Act)* incurred by such association during that previous year solely for protection or advance of common interests of its members	XXX

(3) *Deduction of deficiency* : The deficiency is deductible as per following steps :

Profits and gains of Business or Profession before allowing deficiency	XXX
Less : Any set-off of allowance or loss under any other provision of the Act carried forward from earlier assessment years	XXX
Less : Deficiency to the extent of lower of the following – (i) Amount of deficiency, or (ii) 50% of the total income (before allowing the deficiency) of association	XXX
In case profits of business are less than such deficiency: In case there is no profits and gains of business or profession or the deficiency allowable exceeds such profits and gains, the whole or the balance of the deficiency shall be allowed as a deduction in computing income of the association assessable for the relevant assessment year under any other head. For deduction thereof, the above steps are followed.	
Note: Any deficiency remaining unabsorbed after giving effect to the above provisions, cannot be carried forward to subsequent years.	

6.36 MAINTENANCE OF BOOKS OF ACCOUNTS BY ASSESSEES CARRYING ON BUSINESS OR PROFESSION [Section 44AA]

(1) *In case of specified professions*: The persons carrying on specified professions are required to maintain specified books of account only if the gross receipts of their profession have exceeded Rs.1, 50,000 in *all of the three* immediately preceding previous years or, where the business is newly set up, the gross receipts are likely to exceed Rs.1, 50,000 during current previous year.

Specified professions: The following are the specified professions

Legal	Accountancy	Technical consultancy	Company Secretary
Film Artist	Architectural	Information Technology	Interior Decorator
Medical	Engineering	Authorised Representative	

Specified Books of Account : (i) Cash Book; (ii) Journal, if mercantile system of accounting is followed; (iii) Ledger; (iv) Carbon copies or counterfoils of bills or receipts issued by him exceeding Rs.25; (v) Original bills issued to him and receipts in respect of expenditure incurred by him. In absence of bills, and where the payment does not exceed Rs.50, payment vouchers.

In case of medical profession, a daily case register in prescribed form; and an inventory (under broad heads) of drugs, medicines and other consumable accessories are also required to be maintained.

(2) ***In case of other assesses*** : Every person carrying on business or profession *(other than specified profession)* shall keep and maintain such books of account as may enable the Assessing Officer to compute his total income. Such books of account are to be maintained only if –

In case of existing business or profession	(a) His income from profession exceeds Rs.1,20,000; or (b) Total sales turnover or gross receipts exceeds Rs.10, 00,000. *in any of the three previous years immediately preceding the previous year.*
In case of newly set up business or profession	During such previous year, (a) his income from profession is likely to exceed Rs.1,20,000; or (b) Total sales turnover or gross receipts is likely to exceed Rs.10, 00,000.
Deemed profits u/s 44AD, 44AE, 44AF, 44BB or 44BBB	If the assessee has claimed his income lower than the profits and gains so deemed, during such previous year.

(3) ***General Points*** :

(a) In case of business carried on at more than one place, the books are to be maintained at the principal place of profession. In case of separate books of accounts for each place of business, the books and documents are to be kept at the respective place of where the profession is carried on.

(b) The books of accounts and other documents are to be kept and maintained for a period of six years from the end of the relevant assessment year.

(c) A person, not falling under (1) and (2) above, is not required to maintain any books of account.

(d) *Penalty for failure to keep, maintain or retain books of accounts and other documents as required by Section 44AA or the rules made thereunder [Section 271A]:* The Assessing Officer or the Commissioner (Appeals) may levy penalty equal to Rs.25, 000 on the defaulter.

However, as per Section 273B, no penalty shall be levied if the person proves that there was reasonable cause for such failure.

TAX AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION [SECTION 44AB]:

(1) Applicability: This section applies to following-

Person carrying on –	Accounts are to be audited for previous year in which –
Business	total sales, turnover or the gross receipts exceeds Rs 40,000

Profession Business covered u/s 44AD, 44AE, 44AF, 44BB and 44BBB.	Gross receipts exceeds Rs.10,00,000 He has claimed his income to be lower than the profits of gains so deemed under the respective of section.

(2) Audit: The assessee is required to get his accounts of such previous year audited by a chartered accountant before 30th September of the assessment year (amendment by the Finance act, 2008 w.r.e.f 1-4-2008) relevant to such previous year and furnish by that date the audit report in form 3CB along with prescribed particulars (form 3CD).

(3) Audit under the Law: If the accounts of such assessee are required to be audited under any other law, it will be sufficient in such audit is completed by 30th September of the assessment year and report thereof is furnished by that date in form 3CA along with prescribed particulars (form 3CD).

(4) This section does not apply to a person deriving income of the nature referred u/s 44B and 44BBA.

(5) Certain gross receipts/incomes not included: For calculating above monetary limits, the gross receipts or income from business whose profits are deemed under section 44 AD, 44AE and 44AF shall be excluded.

6.37 PROVISIONS FOR DEEMED PROFITS AND GAINS IN RESPECT OF CERTAIN PERSONS UNDER SECTIONS 44AD, 44AE AND 44AF

Notwithstanding anything contained in Sections 28 to 43C, the following provisions will apply –

	Section 44AD	***Section 44AE***	***Section 44AF***
Business of Assessee	Civil construction or supply of labour for it, or construction or repair of any building, bridge, dam, canal or road or execution of any works contract.	Plying, hiring or leasing goods carriages owned by him. *(Vehicle taken on hire purchase or on instalments shall be deemed to be owned by him.)*	Retail trade in any goods or merchandise.
This Section applies if	Gross receipts of such business during the previous year *do not exceed Rs.40 lakhs*	Goods carriage owned by assessee at any time during previous year doesn't exceed 10	Total business turnover in that previous year *doesn't exceed Rs.40 lakhs*
Deemed Profits	8% of Gross Receipts or such higher sum as declared by the assessee in his Return of Income	(a) (No. of heavy goods vehicle × Rs.3,500 × NM) + (No. of other vehicles × Rs.3,150 × NM); or (b) Such higher sum as declared by	5% of Gross Receipts or such higher sum as declared by him in his Return of Income

		assessee in Return of Income **NM** = No. of months *(or part thereof)* in previous year during which it is owned by assessee	

Other Common Points for Section 44AD, 44AE and 44AF:

(1) ***No further deduction***: In case of income computed under aforesaid Sections, any deduction allowable u/s 30 to 38 *(including unabsorbed depreciation, unabsorbed capital expenditure on scientific research/family planning)* shall be deemed to have been already deducted and no further deduction under those sections shall be allowed. However, in case of firm, salary and interest paid to its partners shall be deducted from the deemed income subject to the conditions and limits specified under Section 40(b).

(2) ***WDV of assets:*** The WDV of any asset used for said business shall be calculated as if the assessee had claimed and had been actually allowed the depreciation for each of relevant assessment years.

(3) ***Section 44AA and 44AB shall not apply*** to business referred above and in computing monetary limits under those sections, gross receipts or income from said business shall be excluded.

(4) ***Claim of Lower Income*** : An assessee may claim lower profits and gains than the profits and gains deemed above if he keeps and maintains books of account and other documents as per Section 44AA and gets his accounts audited and furnishes a report thereof as required under Section 44AB.

(5) ***No disallowances*** : The provisions of Section 44AD to 44AF are applicable notwithstanding anything contained in Sections 28 to 43C. Therefore, where income is computed under those sections, no disallowance can be made under Section 37, 40 or 40A or any other Section.

(6) Since materials supplied by the contractee do not include any profit element, hence, in case of Section 44AD, the gross receipts shall not include value of such materials even if the same is included in value of bills submitted by the contractor. *– Brij Bhushan Lal Praduman Kumar v. CIT [1976] 115 ITR 82 – (SC)*

Special Provisions for Non-Residents and Foreign Companies:

Business of Non-Residents – Section 44B to 44BBA

In the case of a non-resident, special provisions have been enacted to determine income in the case of certain business activities as indicated hereunder:

Section	**Nature of Business**	**Profit -% on Turnover**
44B	Shipping business	7-1/2%
44BB	Business of providing services or facilities in connection with or supplying Plant & Machinery on hire used in the prospecting for or extraction or production of mineral oils	10%
44BBA	Business of operation of aircraft	5%

The amount on which the percentage shall be applied is –

(a) The amount paid or payable to the assessee or to any person on his behalf on account of the above mentioned business activity carried on in India; and

(b) The amount received or deemed to be received in India by or on behalf of the assessee on account of the above mentioned business activity carried on outside India.

For the purpose of Section 44B, such amount shall also include demurrage charges or handling charges or any other amount of similar nature.

Head Office Expenditure – Section 44C

In the case of a non-resident, deduction for the head office expenditure incurred outside India and attributable to the business or profession carried on in India cannot exceed the following limits:

(i) An amount equal to 5% of adjusted total income; or

(ii) Actual head office expenditure attributable to the business or profession of the assessee in India

whichever is less.

"Adjusted total income" means the total income computed in accordance with the provisions of this Act before allowing deduction under this section or unabsorbed depreciation or brought forward losses or deductions under Chapter VIA or deduction u/s 36(1)(ix).

In case the adjusted total income of the assessee is a loss, the amount under clause (i) shall be computed at the rate of 5% of the average adjusted total income of the assessee.

"Average Adjusted Total Income" means –

(a) In a case where the total income of the assessee is assessable for each of the three assessment year immediately preceding the relevant assessment year; 1/3rd of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid three assessment years.

(b) In a case where the total income of the assessee is assessable only for two of the aforesaid three assessment years; one half of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid two assessment years;

(c) In a case where the total income of the assessee is assessable only for one of the aforesaid three assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year.

"Head Office Expenditure" means the executive and general administration expenditure incurred by the assessee outside India.

Special provision for computing income by way of royalties, etc. in case of non-residents – Section 44DA:

(1) The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-resident including a foreign company with Government or the Indian concern shall be computed under the head "Profit and Gains of Business or

Profession" in accordance with the provisions of the Income Tax Act. However, to avail the benefit of such computation, such non-resident should carry on business in India through a permanent establishment situated therein or perform professional services from a fixed place of profession situated therein and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of profession in India.

(2) In such a computation in accordance with the provisions of the Act, no deduction shall be allowed in respect of any expenditure or allowance which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place of profession in India. Similarly, no deduction shall be allowed in respect of amounts paid by the permanent establishment to its head office or to any of its other offices otherwise than towards reimbursement of actual expenses.

(3) Every such non-resident or a foreign company shall keep and maintain books of account and other documents as required u/s 44AA and get the accounts audited by a Chartered Accountant. Such audit report shall be furnished along with the return of income.

(4) "Permanent Establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

PROVISIONS FOR COMPUTING DEDUCTION IN CASE OF BUSINESS REORGANISATION OF COOPERATIVE BANKS:

In case of amalgamation/demerger of a cooperative bank in a financial year, the deduction referred to in sections 32, 35D, 35DD or 35DDA shall be apportioned between the predecessor bank (i.e. amalgamating/demerged co-operative bank) and the successor bank (amalgamated/resulting cooperative bank) in the ratio of number of days preceding and succeeding the date of such amalgamation/demerger
The relevant computations shall be made as for the following formulas-

$$\text{Deduction allowable to Predecessor bank} = \frac{\text{No. of days from 1st day of financial year upto the date preceding the date of amalgamation/demerger}}{\text{No of days in the financial year}} * \text{deduction allowable u/s 32,35D,35DD or 35DDA to predecessor bank if Amalgamation/ demerger has not taken place.}$$

$$\text{Deduction allowable to successor bank} = \frac{\text{No. of days from the date of amalgamation/ demerger upto the last day of financial year}}{\text{No of days in the financial year}} * \text{deduction allowable u/s 32,35D,35DD or 35DDA to predecessor bank if Amalgamation/ demerger has not taken place.}$$