PROFITS AND GAINS OF BUSINESS OR PROFESSION (Chapter IV-D of Income Tax Act, 1961)

CHAPTER OVERVIEW

6.1 Preliminaries

6.1.1 Items under "Profits & Gains of Business or Profession"

S.28	Income under the head "Profits and Gains of Business or Profession"
(i)	Profits and Gains of Business or Profession carried on by the Assessee at any time during the previous year.
(ii)	**Compensation taxable as Business Income:** Compensation or other payment for - (a) Termination or modification of Managing Agent's agreement in relation to an Indian Company. (b) Termination or modification of Managing Agent's agreement in relation to any other Company in India. (c) Termination or modification of contract relating to an agency in India. (d) Vesting of management of property or business with Government / Corporation. (e) **(W.e.f 01.04.2019)** at or in connection with the termination or the modification of the terms and conditions, of any contract **relating to business.**
(iii)	Income received by a Trade or Professional Association, from **services** rendered **to its Members.**
(iiia) (iiib) (iiic) (iiid) (iiie)	**Export Incentives taxable as Business Income:** Profit on Sale of Import License. Cash Assistance against exports. Duty Drawback. Profit on Transfer of Duty Entitlement Pass Book (DEPB) Scheme. Profit on Transfer of Duty Free Replenishment Certificate (DFRC).
(iv)	Value of **Benefit or Perquisite** arising from Business / Profession, whether convertible into money or not.
(v)	Interest, Salary, Bonus, Commission or Remuneration receivable or received by a Partner of a Firm, from the Firm in which he is a Partner.
(va)	Sum received or receivable in cash or in kind under an **agreement** for non-competency. **(See Point 6.1.2)**
(vi)	Sum received under **Keyman Insurance Policy,** including sum allocated by way of Bonus on such policy.
(via)	**W.e.f. 01.04.2019** Profits or gains arising from conversion of inventory into capital asset or its treatment as capital asset shall be charged as business income.
(vii)	Sum received or receivable (in cash or kind) on account of any Capital Asset (other than Land or Goodwill or Financial Instrument) allowed as deduction u/s 35AD, being demolished, destroyed, discarded or transferred.

Note: Sec.2(13): Business includes any Trade, Commerce or Manufacture or any Adventure or Concern in the nature of Trade, Commerce or Manufacture.

[Sec.29]: Income under the head "Profits and Gains of Business or Profession" shall be computed in accordance with provisions contained in Sec. 30 to 43D.

For Computation Table, See Fast Track Referencer

6.1.2 Non-Competency Fee [Sec.28(va)]

The following items of Non-Competency Fees / Income are chargeable under the head "Profits & Gains of Business or Profession: Any sum received or receivable in cash or in kind under an **agreement** for -

1. Not carrying out any activity in relation to any **business or Profession except —**

(a) Transfer of right to manufacture, produce or process any article or thing or right to carry on any business **or Profession** which is chargeable under the head **"Capital Gains",**

(b) Any sum received as compensation, from the Multilateral Fund of the Montreal Protocol on Substances that deplete the Ozone Layer under the United Nations Environment Programme, in accordance with the terms of agreement entered in to with the Govt, of India.

2. Not sharing any Know-how, Patent, Copyright, Trademark, License, Franchise or any other Business or

Commercial Right of similar nature or information or technique likely to assist in the manufacture or

processing of goods or provision for services.

Note:

(a) **"Agreement" includes** any arrangement or understanding or action in concert -

- whether or not such arrangement, understanding or action is formal or in writing, or
- whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

(b) **"Service" means service of any description which is made available to potential users.** It includes

provision of services in connection with business of any industrial or commercial nature such as -

• Accounting	• Communication	• Insurance
• Advertising	• Construction	• Processing
• Amusement	• Conveying of News / Information	• Real Estate
• Banking	• Education	• Storage
• Boarding & Lodging	• Entertainment	• Supply of Electrical or other energy
• Chit Funds	• Financing	• Transport

6.1.3 Special Points

Issue	**Treatment**
1. Income from Vocation	The Assessee carried on a vocation of practicing against atheism and was engaged in a movement for the spread of religion. Sum received as donations from his friends, shall be treated as Business or Professional Income. **[Dr. K. George Thomas 156 ITR 412]**
2. **Lease Rent on temporary suspension of business**	Rental Income of leasing out Machinery used in the business, because of temporary suspension of business to tide over the crisis condition, is **"Business Income". [Shri Lakshmi Mills Ltd, 20 ITR 451, Vikram Cotton Mills Ltd, 169 ITR 597 (SC)]**
3. **Lease Rent on stoppage of Business**	Receipt of Lease Rental of factory after stoppage of business is chargeable under **"Income from Other Sources". [Universal Plast Ltd 237 ITR 454 (SC)]**
4. Cash Equivalent of a Prize	Where an Assessee received cash equivalent to a Gift (Ambassador Car) under a scheme of a Company for achieving a target, it is Business Income in the hands of the Recipient. **[Boeing 120 Taxman 49 (Mad.)]**
5. Prizes won by Professionals	Prize Money received by a professional Photographer in a photography contest, is taxable as Professional Income. **[Avinash Pasricha 251 ITR 360 (Del.)]**
6. **Award received by Sportsmen**	Awards won by a Sportsman is in the nature of benefit received in exercise of his profession, and hence taxable as Business Income. In case of others, it will be in the nature of **gift** and will not be liable to tax as Business Income. **[Circular No. 427 dt. 22.1.1986]**
7. **Power Subsidy**	Power Subsidy received by an Assessee is revenue in nature, since it goes to reduce the Electricity Bills and hence **taxable u/s** 28. **[Rajaram Maize Products** 251 **ITR** 427 (SC)]

Issue	Treatment
8. **Revenue Subsidy**	Subsidy given by the Government after the commencement of business and with a view **to assist the Assessee in carrying on such business** like refund of Sales Tax, Subsidy on Electricity Charges/ Water Charges is **treated as Revenue Subsidy,** and taxable under the head "Profits and Gains of Business or Profession". **[Sawhney Steel & Press Works Ltd. & Others 228 ITR 253 (SC)]**
9. **Capital Subsidy**	Subsidy for acquiring Capital Asset for the business shall be reduced from the actual cost for the purpose of claiming depreciation.
10. Compensation for termination of Contract	Compensation paid to Assessee, a Journalist, by a Foreign Publisher upon termination of contract for performance of authorship/ professional services for a continuous period of 23 years, is to be regarded as Capital Receipt not liable to tax. **|Sharda Sinha (2016) 65 taxmann.com 153 (Del)(HC)]**

6.1.4 Taxability of Conversion of Stock-in-trade into Capital Asset [W.e.f.01.04.2019]

1. Nature of Income: Any profit or gains arising from **conversion of inventory into capital asset** or its

treatment as capital asset shall be charged to tax as business income.

2. **Value of Consideration:** FMV of the inventory on the date of conversion/ treatment determined in the

prescribed manner, shall be deemed to be the full value of the consideration received or accruing as a result

of such conversion or treatment.

6.1.5 Principles for Taxability of Interest

1. Taxed under Income from Other Sources:

(a) Interest on Fixed Deposits and other Deposits **before commencement of business.**

(b) Income from Interest on Deposits of surplus money, during the **construction period.**

(c) Interest Income in respect of the **surplus money, not required** for **business** and deposited in Banks, or with persons as **idle money**, for **safe-keeping.**

(d) If the Income from **interest** is from a Fund which has been brought as **Surplus Capital.**

(e) Interest from Investment of **Surplus Fund.**

(f) Interest earned on money borrowed for purchase of Plant, and kept in Short-Term Deposits. **[Autokast Ltd 248 ITR 110 (SC)]**

(g) Interest on Share Application Money kept in Deposit, accrues to the Company only in the year in which the allotment was completed and not in the year of accrual, as the same cannot be regarded as an amount which is fully available to the Company for its own use from the time the interest accrued. **[Henkel Spic India Ltd 139 Taxman 40 (Mad.)]**

2. **Taxed under Profits and Gains of Business or Profession:**

(a) Interest from advances out of surplus funds, where such advances are made with the intention to carry on business of money lending, are taxable and the income therefrom would be income from business.

(b) Interest on Fixed Deposits made as Margin Money or Collateral Security for a loan for the purpose of business.

(c) Interest Income on the awards of arbitration are trading receipts, and hence taxable as Business Income. **[Govinda Choudhry & Sons 203 ITR 881 (SC)]**

6.1.6 Method of Accounting u/s 145 and 145A

Income under the Head	**Method of Accounting**

• Profits and Gains of Business or Profession • Income from Other Sources	Cash or Mercantile System of accounting **regularly employed** by the Assessee.

1. The Central Government has notified **10** Income Computation & Disclosure Standards **(ICDS)** to be followed by all assessees following the mercantile system of accounting for the purpose of computation of Income chargeable for any class of Assessees or in respect of any class of income.

2. The Assessing Officer may make a Best Judgment Assessment as specified in Sec. 144, in case he is not satisfied about correctness and completeness of books, Method of Accounting and Income Computation & Disclosure Standards followed by the Assessee.

3. **Method of Accounting in certain cases: [Sec. 145A]**

(a) Applicability: For determining the income chargeable under the head "Profits and gains of business or profession.

(b) **Valuation as prescribed under ICDS notified u/s 145(2):**

Valuation of	**Treatment**
Inventory	Lower of Actual Cost or NRV, computed as per ICDS
Inventory being- • Unlisted Securities, or • Listed Securities , but not quoted on a recognised stock exchange with regularity from time to time	Actual Cost initially recognised as per ICDS
Inventory being Securities other than those referred above	Lower of Actual Cost or NRV, computed as per ICDS

Note 1: The comparison of Actual Cost and NRV of securities shall be made category-wise.

Note 2: Inventory being securities held by a scheduled bank or public financial institution shall be valued in accordance with ICDS notified u/s 154(2) after taking into account the extant guidelines issued by the RBI in this regard.

(c) **Valuation – Inclusive of Taxes:** Valuation of Purchase and Sale of Goods or Services, and of Inventory, shall be adjusted **to include** the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.

Note 2: For the purposes of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment.

4. **Sec, 145B – Taxability of certain income**

Nature of Income	**Deemed to be income in -**
Interest received on any Compensation or on Enhanced compensation	the PY in which it is received.
Claim for escalation of price in a contract or Export Incentives	the PY in which **reasonable certainty** of its realisation is achieved.
Income being Subsidy or grant or Cash Incentive or Duty Drawback or waiver or concession or reimbursement as referred u/s 2(24)(xviii)	the PY in which it is received, if not charged to income-tax in any earlier PY.

6.1.7 Maintenance of Accounts [Sec.44AA]

1. Books or Books of Account include Ledgers, Day-Books, Cash Books, Account-Books and Other Books, whether kept in written form or as print-outs of data stored in a Floppy, Disc, Tape or any other form of electro-magnetic data storage device. **[Sec. 2(12A)]**

2. **Document** includes an **Electronic Record** as defined u/s 2(1)(t) of the Information Technology Act, 2000.

3. **Maintenance of Books of Accounts is compulsory** in the following cases -

Specified Professionals	**Others**
Assessees carrying on profession of- (a) Law, (b) Medicine, (c) Accountancy, (d) Engineering/ Architecture, (e) Technical Consultancy, (f) Interior Decoration, (g) Authorised Representative, (h) Film Artist, (i) Information Technology Professionals whose Gross Receipts exceed`**1,50,000, in all the prior three years or during current previous year in which business is commenced.**	(a) Income under the head Business or Profession exceed`1,20,000, in any of the prior 3 years or likely to exceed`1,20,000 during current previous year in which business is commenced, **[w.e.f 01.04.2018, for Individuals & HUF, the limit is 2,50,000]** (b) Where the Turnover or Sales or Gross Receipts exceeds`10,00,000 in any of the 3 preceding previous years or likely to exceed`10,00,000 during current previous year in which business is commenced, **[w.e.f 01.04.2018, for Individuals & HUF, the limit is 25,00,000]** (c) When the Assessee has declared **lower income** than as prescribed u/s 44AE, 44BB, 44BBB, (d) Assessee whose Income exceeds basic exemption, but declaring **lower income** than as prescribed u/s **44 AD.** (e) **w.e.f. 01.04.2017, Eligible Assessee** to whom provisions of Sec.44AD(4) applies, and whose Income exceeds the maximum amount which is not chargeble to tax in any previous year.

4. Books to be maintained: u/r 6**F**

Nature of Books	**Who has to Maintain**	**Period for which to be kept**
(a) Cash Book (b) Journal (c) Ledger (d) Bills and Vouchers (e) Copies of Bills exceeding`25	All Professional Assessees.	For a period of 6 years.
(f) Daily Case Register (Form 3C) (g) Medicine Inventory Register	Doctor Only.	

5. **Consequence of non-maintenance [Sec. 271A]:** Failure to keep / maintain / retain books of accounts, documents, etc. in accordance with Sec. 44 AA will attract a penalty of`25,000.

6. **Time Period where assessment has been re-opened:** In cases where the assessment in relation to any assessment year has been re-opened u/s 147, within the period u/s 149, all books of account and other documents which were kept and maintained at the time of re-opening of the assessment shall continue to be so kept and maintained **till the completion of such assessment.**

Illustration – Sec.44AA – Maintenance of Books of Accounts – M 01 (Mod), M 08

Vinod is a person carrying on profession as Film Artist. His Gross Receipts from profession are as under -

Financial Year	**2015-2016**	**2016-2017**	**2017-2018**
Amount Received	*t* **1.15.000**	**`1.80.000**	**`2.10.000**

What is his obligation regarding maintenance of books of accounts for each Assessment Year u/s 44AA?

Principle: Refer **Point 3 of Para 6.1.8 above** for Specified Professionals (Film Artist).

Hint: Vinod (being a Film Artist, i.e. Specified Professional) is **not required** to maintain books of account for

FY 2018-2019, since his Gross Receipts have **not** exceeded`1,50,000 in each of the 3 preceding years (PY 2015-2016`1,15,000 only).

6.1.8 Tax Audit u/s 44AB

1**. Applicability:** Tax Audit is applicable in the case of -

(a) Assessee carrying on any Business where Total Turnover or Gross Receipts exceeds`**1 Crore,** or

(b) Assessee carrying on Profession, where Gross Receipts exceeds`**50 Lakhs,** or

(c) Assessee carrying on business referred to u/s 44AE, 44BB, 44BBB and declaring lower income than prescribed under those Sections

(d) **w.e.f. AY 2017-18:** Assessee carrying on Profession, having Income exceeding Basic Exemption Limit, and declaring income lower than prescribed u/s 44ADA, in any PY,

(e) **w.e.f. AY 2017-18:** Assessee carrying on Business for whom provisions of Sec.44AD(4) are applicable and his Income exceeds the Basic Exemption Limit in any previous year.

(f) **Sec.44AB w.e.f.01.04.2018 New Proviso – Exclusion from the requirement of Tax Audit u/s 44AB:**

From the requirement of Audit of Books of Accounts u/s Sec.44AB, following person is **excluded -**

- Eligible person, who declares Profits for the PY u/s 44AD(1) **and**
- his Total Sales, Total Turnover or Gross Receipts, in business **does not exceed`2 Crores** in that PY

2. **Audit:** Tax Audit shall be conducted by an "Accountant" as explained u/s 288 of the Income Tax Act.

3. **Due Date for Filing of Report:** Due date for furnishing Return of Income as specified u/s 139(1). 5 6

4. **Forms of Report:**

Nature of Person	**Audit Report**	**Statement of Particulars**
In case of a person who carries on business or profession and whose books are **required to be audited by or under any law.**	Form 3CA	Form 3CD
In case of person who carries on business or profession but **not being a person referred to above.**	Form 3CB	Form 3CD

5. **Other Points:**

(a) **Turnover:** Turnover / Receipts considered for declaration of Presumptive Income u/s 44AD / 44AE shall not be considered for determining the prescribed turnover limit u/s 44AB.

(b) **Agents:** In case of Agents, this Section is applicable only if the Gross Commission exceeds`1 Crore.

(c) **Shipping Business and Operating Aircrafts:** This Section does not apply to persons who derive Income referred u/s 44B and 44BBA.

6. **Consequence of non-compliance:**

(a) **Defective Return:** If the Audit Report obtained u/s 44AB is not filed along with the Return of Income, then the Assessing Officer **may** treat the return as Defective Return. Presently, Tax Audit Report should be e-filed, along with the Return of Income.

(b) **Penalty u/s 271B:** Failure -

- To get accounts audited, Assessee is liable to pay a **penalty at 0.5%**
- To obtain an Audit Report required u/s 44 AB, or of Gross Turnover / Receipts or`**1,50,000**
- To furnish the said report before the due date, **whichever is less,** subject to Sec.273B.

(c) No penalty shall be leviable, if he proves that there was a reasonable cause of such failure. [Sec.273B]

7. **Situations considered as "reasonable cause" for Non-Filing of Audit Report:**

(a) Resignation of Tax Auditor,

(b) Bonafide interpretation of the term 'Turnover' based on expert advice,

(c) Death or physical inability of the Partner in-charge of the accounts,

(d) Labour problems such as Strike, Lock-Out, for a long period,

(e) Loss of books of accounts by theft, fire, etc. beyond the control of the Assessee,

(f) Non-availability of accounts on account of seizure,

(g) Natural calamities, commotion, etc.

No Penalty u/s 27IB if penalty u/s 271A levied	Where **books** of accounts for preceding assessment years were not up to date, it is not possible to get the books audited. Hence, Penalty u/s 27IB cannot be imposed for the subsequent years. **[Tea King (2002) 123 Taxman 162 (Guj.)]**

8**. Items to be considered for determining "Turnover":**

Included in Turnover	**Not included in Turnover**
(a) Profit on Sale of a License / Cash Assistance / Duty Drawback. (b) Gross Interest income received by a Moneylender. (c) Commission, Brokerage, Service and other incidental Charges received in the business of Chit Funds. (d) Reimbursement of expenses incurred (e.g. Packing, Forwarding, Freight, Insurance, Travelling, etc.) and if it is credited to a separate account in the books, only the Net Surplus on this account should be added to the turnover for the purposes of Sec.44AB (e) Net Exchange Rate difference on Export Sales during the year. (f) Hire Charges of Cold Storage. (g) Liquidated Damages. (h) Insurance Claims – except for Fixed Assets. (i) Sale Proceeds of Scrap, Wastage, etc unless treated as part of Sale or Turnover, whether or not credited to Miscellaneous Income Account. (j) Gross Receipts including Lease Rent in the business of Operating Lease. (k) Lease Rent or Interest on financing in the business of Finance Lease. (l) Hire Charges and Installments received in the course of Hire Purchase. (m) Advance Received or forfeited from customers.	(a) Discount Allowed in the Sales Invoice. (b) Cash Discount. (c) Turnover Discount. (d) Special Rebate allowed to Customers. (e) Price of goods returned. (f) Sale Proceeds of Fixed Assets (g) Sale Proceeds of assets held as Investments. (h) Rental Income, unless the same is assessable as Business Income. (i) Dividends on Shares, except in the case of an Assessee dealing in Shares. (j) Income by way of Interest, unless assessable as Business Income. (k) Reimbursement of Customs Duty and other charges collected by a Clearing Agent. (l) In the case of a Recruiting Agent, Advertisement Charges received by him by way of reimbursement of expenses incurred by him. (m) In the case of a Travelling Agent, Amount received from the Clients for payment to the Airlines, Railways, etc. (n) In the case of an Advertising Agent, amount of Advertising Charges recovered by him from his Clients, provided these are by way of reimbursement. (o) Write back of amounts payable or provisions no longer required.

6.2 Depreciation

6.2.1 Depreciation – Basic Terms / Concepts

1. **Assets [Sec.** 32]: The following are the assets-

(a) **Tangible Assets:** Building, Machinery, Plant or Furniture.

(b) Intangible Assets: Asset that does not have a physical identity or existence, but they confer rights and benefits to owners.

- **Examples:** U/s 2(11), the following are Intangible Assets – Know-How, Patent, Copyright, Trademark, Licences, Franchises or any other business or Commercial Right of similar nature.
- **Rate: Rate of Depreciation for Intangible Assets is 25%**

2. **Block of Assets [Sec. 2(11):** Block of Assets means -

(a) **Same Class of Assets:** Group of Assets falling within the same class of assets, and

(b) **Same Rate of Depreciation:** In respect of which same rate of depreciation shall be charged under WDV Method as per Income Tax Rules.

3. **Plant [Sec. 43(3)]:**

Plant Includes	**Plant Excludes**
Ships, Vehicles, Books, Scientific Apparatus and Surgical Equipment used for purpose of Business or Profession.	Tea Bushes, or Livestock, or Buildings, or Furniture and Fittings.
Case Decisions on Inclusions in Plant: • Sanitary and Pipeline Fitting installed in a Hotel. **[Taj Mahal Hotel** 82 **ITR** 44 (SC)] • Nursing Home building with Operation Theatre Facilities **[Dr.B.Venkat Rao** 243 **ITR** 81 (SC)] • Generating Station Buildings which are integral to Generating System. **[Karnataka Power Corpn. 247 ITR 268 SC)]**	**Case Decisions on Exclusions in Plant:** Theatre Building and Hotel Building cannot be treated as Plant for the purpose of claiming Depreciation. **[Anand Theatres** 244 **ITR** 192 (SC)]

4. Conditions for Allowability of Depreciation [Sec. 32[: In order to claim depreciation, the Assessee has to fulfill the following conditions -

(a) **Ownership:** The asset shall be **wholly or partly owned by the Assessee.**

(b) **Use:** The Assets should be **wholly or partly used for the purpose of business** during the previous year.

(c) **Block of Assets:** It shall fall within the classification of Block of Assets.

Note: "Used for Business or Profession" includes both active usage and passive usage. **Example:** Depreciation can be claimed by a Transport Company on Spare Engines kept in store in case of need, though they have not actually been used by the Company. Thus, passive use should also be for Business Purpose.

5. **Mandatory Deduction:** Sec 32(1) shall apply, whether or not the Assessee has claimed the deduction in respect of depreciation in computing his Total Income. **[Expln. 5 to Sec. 32(1)(ii)[**

Depreciation for Trial Run	In case of existing business, the Assessee is entitled to claim depreciation by mere trial run of new machinery. **[Ashina Sintex Ltd 251 ITR 133 (Guj.), Union Carbide (I) Ltd 124 Taxman 859 (Cal.)]**
Depreciation on assets used for Scientific Research	Depreciation shall not be allowed on assets where deduction for expenditure on Scientific Research has been allowed. **[Escorts Ltd and another vs UOI 112 Taxman 197 (SC)]**
Roads laid by Municipality	Roads laid by Municipality do not qualify as Building for depreciation purposes, as there is no other construction except roads, and the roads themselves do not constitute Buildings. **[Indore Municipal Corpn. 248 ITR 803 (SC)]**
Road laid within the Factory Premises	Road laid within the Factory Premises for providing approach to the building to carry on the business activities is eligible for depreciation. **[Gwalior Rayon 248 ITR (SC)]**

6.2.2 Ownership for Depreciation purposes

1. Immovable Property not yet registered in Assessee's Name:

(a) **Ownership vs Possession of Immovable Property:** If the Assessee is in possession of the Building on part payment, and it is not registered in his name, he is entitled to claim depreciation as wide meaning of "Owner" u/s 32. **[Mysore Minerals Ltd. 239 ITR 775** (SC), **Dalmia Cement Bharat Ltd. 247 ITR 267 (SC)]**

(b) **Conditions for Depreciation:** If the following conditions are fulfilled in case of Immovable Property, the Assessee can claim depreciation -

(i) Possession of the property is with the Assessee,

(ii) The Asset is used by the Assessee in his own business or profession,

(iii) Substantial consideration towards the transfer of the property was paid.

2. **Vehicle not registered in the Assessee's name:**

(a) In case of a Motor Vehicle, ownership is determined by **possession** of the Vehicle, and the Assessee has to prove that it is used for the purpose of his business. Registration under the Motor Vehicles Act is only a **permission** for driving the vehicle on road. **Salkia Transport Associates 143 ITR 39 (Cal.), Dilip Singh Sardar Singh Bagga 201 ITR 985 (Bom.), Nidhi Transport Corpn. 76 CTR 221 (Ker.)**

(b) A Corporation was set up by the State Government transferring all the buses owned by it for a consideration of`75 Lakhs, which was discharged by the Corporation by issue of Equity Shares. If the Corporation proves that they are in possession of the vehicles and that the Vehicles are used by them for their own business, and the consideration was paid, then they are entitled to claim depreciation. **J&K Tourism & Devp. Corpn. 114 Taxman 734 (Del.).**

3. **Renovation of Building taken on Lease:** In case of a Leasehold Building used by the Assessee for the purpose of his business or profession, any **Capital Expenditure** incurred in relation to **renovation, extension or improvement** of such building shall be **entitled for depreciation,** as if such structure or work is owned by him. **[Expln 1 to Sec.32(1)]**

4. **Assets acquired under Hire Purchase (HP) / Instalment System: Instruction No.1079** [This view is affirmed in **Add. CIT vs General Industries Corporation 155 ITR 430 (Del.)]**

(a) **Instalment Purchase:** In case of purchase of assets by instalments by the Assessee, where ownership is transferred at once to the Assessee (Lessee), **Depreciation should be allowed on the entire Purchase Price,** as per the agreement.

(b) **Hire Purchase:** In the case of Hire Purchase Transactions -

(i) Consideration for Hire shall be allowed as **Revenue Expenditure** in the assessment.

(ii) Payment on account of cost of the asset shall be entitled for depreciation in the hands of the Assessee.

(c) **Terms of Agreement:** Whether the transaction is one of Hire Purchase / Instalment, is to be verified from the terms of agreement in each case. The Income Tax Department will insist on the production of Agreement under which the payment is made.

5. Assets in Partner's Name: Firm is entitled to claim depreciation on Immovable Properties brought by Partners as their Capital contribution, even if such assets are not registered in the name of the Firm.

6. **Discarded Machinery:** Depreciation on discarded machines are also eligible for depreciation since it was used in the past. **[Yamaha Motors (2004) –TIOL`427-HC-(Del)].**

6.2.3 Depreciation Table / Rates

The Income Tax Rules specify the rates at which is depreciation is allowable on various categories of assets -

TABLE OF RATES AT WHICH DEPRECIATION IS ADMISSIBLE UNDER WDV METHOD

ASSET	**Depreciation**
PART A – TANGIBLE ASSETS	**Rate %**
I Building (1) Buildings which are used mainly for residential purposes, except Hotels & Boarding Houses.	5

(2) Buildings other than those used mainly for residential purposes and not covered by sub-items (1) above and (3) below.	10
(3) Buildings acquired on or after 1st September 2002, for installing Machinery and Plant forming part of Water Supply Project or Water Treatment System, and which is put to use for the purpose of business of providing infrastructure facilities u/s 80-IA(4) Clause (I).	40
(4) Purely temporary erections such as wooden structures.	40
II Furniture and Fittings: Furniture and Fittings including Electrical Fittings.	10
III Machinery and Plant (1) Machinery and Plant other than those covered by sub-items (2), (3) and (8) below.	**15**
(2) Motor Cars, other than those used in a business of running them on hire, acquired or put to use on or after 1st April 1990.	**15**
(3) Any New Machinery or Plant installed to Manufacture or Produce any article or thing by using any Technology or other Know How developed in a laboratory owned or financed by the Government or a laboratory owned or financed by the Public Sector Company or a University or an Institution recognized by the Secretary, Department of Scientific and Industrial Research, Government of India, shall be treated as a part of the Block of Assets **[Rule 5(2)]**	**40**
(4) (i) Aeroplanes – Aeroengines	**40**
(ii) Motor Buses, Motor Lorries & Motor Taxis used in a business of running them on hire.	**30**
(iii) New Commercial Vehicle which is acquired and put to use on or before 30.09.2009	40
(iv) Moulds used in Rubber and Plastic Goods Factories.	30
(v) Air Pollution Control Equipment, Water Pollution Control Equipment, Solid Waste Control Equipment.	40
(vi) Machinery and Plant, used in semi-conductor industry covering all Integrated Circuits (ICs) (excluding Hybrid Integrated Circuits) ranging from Small Scale Integration (SSI) to Large Scale Integration / Very Large Scale Integration (LSI/VLSI) as also discrete semi-conductor devices such as Diodes, Transistors, Thyristors, Triacs, etc. other than those covered by entry (viii) of this sub-item and sub-item (8) below.	30
(vii) Life-saving Medical Equipment.	**40**
(5) Containers made of Glass or Plastic used as re-fills.	40
(6) **Computers including Computer Software**	**40**
(7) Machinery and Plant, used in weaving, processing and garments sector of Textile Industry, which is purchased under TUFS on or after 01.04.2001 but before 01.04.2004 and is put to use before 01.04.2004.	40
(8) Machinery and Plant, acquired and installed on or after 01.09.2002 in a Water Supply Project or a Water Treatment System and which is put to use for the purpose of business of providing infrastructure facility u/s 80-IA(4) Clause (I).	40
(9) (i) Wooden Parts used in artificial silk manufacturing machinery	40
(ii) Cinematograph Films – bulbs of studio lights	40
(iii) Match Factories – Wooden Match Frames	40

(iv) Mines and Quarries: (a) Tubs, Winding Ropes, Haulage Ropes and Sand Stowing Pipes (b) Safety Lamps	40
ASSET	**Depreciation**
PART A – TANGIBLE ASSETS	**Rate %**
(v) Salt Works – Salt Pans, Reservoirs and Condensers, etc. made of earthy, sandy or clayey material or any other similar material	**40**
(vi) Flour Mills – Rollers	**40**
(vii) Iron and Steel Industry – Rolling Mill Rolls	**40**
(viii) Sugar Works – Rollers	**40**
(ix) Energy Saving Devices	**40**
(x) Gas Cylinders including Valves and Regulators	**40**
(xi) Glass Manufacturing Concerns – Direct fire glass melting furnaces.	**40**
(xii) Mineral Oil Concerns: (a) Plant used in field operation (above ground) distribution – Returnable packages (b) Plant used in field operations (below ground) , but not including kerbside pumps including underground Tanks and Fittings used in field operations (distribution) by Mineral Oil Concerns	**40**
(xiii) Renewal Energy Devices (Windmills, Devices which run on windmills, Electric Generators and Pumps running on Wind Energy installed on or after **01-04-2014. [Notfn. 43/2014, dt 16.09.14]**	**40**
(10) Books owned by Assessees carrying on a profession: (a) Books, being annual publications (b) Books, other than those covered by entry (a) above	 **40** **40**
(c) Books owned by assessees carrying on business in running lending libraries	**40**
IV. Ships and other Water Vessels	20
PART B – INTANGIBLE ASSETS	
Know-how, Patents, Copyrights, Trademarks, Licences, Franchises or any other business or commercial rights of similar nature.	**25**

Note

Accelerated Depreciation for Commercial Vehicles-Notfn. No.10/2009 as amended by Notfn No.37/ 2009

Public Carrier (conveyance) used for the haulage of men and material for commercial consideration may be termed as Commercial Vehicles. Whereas, manufacture of buses, trucks and three wheelers would fall under the category of Commercial Vehicles, manufacture of Cars, Motor Cycles, Scooters, Mopeds, etc. would not fall under the category of commercial vehicles'. **[Letter F.No.202/12/76-IT(A-II) dated 25.10.1976]**

[Source: A Commentary on the Income Tax Act, 1961 by A.C. Sampath Iyengar Tenth Edition 2005 Vol. II Pg.2710]

On the above grounds, Motor Cars that are not used in the business of hire cannot be interpreted to be Commercial Vehicles, and hence cannot be eligible for Accelerated Depreciation under III (3)(via).

DEPRECIATION STATEME1V T AS PER 11 VCOME TAX ACT, 1961

Particulars of Asset	**WDV as on 01.04....**	**Additions at Actual Cost**	**Deductions**	**Net Value of Block**	**Depreciation for Current Year**	**WDV as on 31.03...**
1	2	3	4	5	6	7

Lessor of the Vehicles would be entitled to higher depreciation provided the Lessee had used the Vehicles in the business of **running them on hire.**	**Kotak Mahindra Finance Ltd 130 Taxman 432 (Bom.)**
Leasing of Commercial Vehicles by a Finance Company is entitled for higher depreciation, because leasing shall be treated as business of running them on hire.	**Bansal Credits Ltd 126 Taxman 149**

6.2.4 Actual Cost, for Depreciation purposes

Determination of Actual Cost under Different CircumstancesfSec. 43(1) Expin.]

Expln.	**Mode of acquisition**	**Actual Cost**
8, 9& 10	**Acquisition of Asset:** Where assessee himself acquires the asset.	Purchase Price **Add:** (a) Interest on Loan for the period upto the date of usage of the asset (b) Freight and Insurance (c) Loading, Unloading Charges (d) Installation and Erection Charges **Less:** (a) Any amount met by any Authority or any other person by way of Subsidy or Grant, (b) CENVAT Credit
1	**Assets used in Scientific Research** subsequently put into use for business.	Nil [Since Asset Cost wholly deductible u/s 35(1)(iv)]
1A	Capital Asset referred to u/s 28(via) is used for the puiposes of business or profession	Fair market value which has been taken into account for the purposes of the said clause.
2	Asset received under **Gift, Will or Inheritance.**	WDV to the Previous Owner.
2C	**Unlisted Public Company Or Private Company To LLP:** Transfer By An Unlisted Public Company Or Private Company To Limited Liability Partnership.	WDV of the Block of Assets on the date of conversion from Company to LLP
3	**Acquisition** of asset to claim depreciation on enhanced cost **to reduce tax liability, in the opinion of A.O.**	Cost as determined by the Assessing Officer, having regard to all circumstances of the case, with the prior approval of Joint Commissioner of Income Tax.
4	**Transfer and Re-acquisition:** Transfer of an asset and re-acquisition of the same.	**WDV** at the time of Original Transfer or repurchase price, whichever is **less.**
4A	**Sale and Lease Back:** Sale of an asset to the Lessor and taking them back on lease.	WDV to the Transferor.

5	**Building previously used for private purpose:** Building used for private purpose and subsequently put into use for the purpose of business.	Cost of Acquisition or Construction, as reduced by the **Notional / Deemed Depreciation** for the period of personal use. **Notional / Deemed Depreciation:** Total Depreciation that would have been allowable had the Building been used for Business since its acquisition.
	Succession of Business	WDV to the Previous Owner.
7	**Amalgamation**	WDV to the Amalgamating Company.
6	**Parent to Subsidiary:** Transfer by Holding Company to Subsidiary Company.	WDV to Holding Company.
Expln.	**Mode of acquisition**	**Actual Cost**
6	**Subsidiary to Parent:** Transfer by Subsidiary Company to Holding Company.	WDV to Subsidiary Company.
7A	**Demerger:** In the hands of **Demerged Company** after demerger.	WDV of Demerged Company before Demerger **Less:** WDV of Assets transferred to Resulting Co. **Note:** The Actual Cost shall not exceed the WDV of the Asset.
7A	**Demerger:** In the hands of **Resulting Company.**	WDV to Demerged Company (Before Demerger as if the Company continues to hold the Asset)
11	**Assets brought into India by a Non-Resident.**	Actual Cost of Acquisition **Less:** Notional Depreciation for the period held outside India
12	Asset acquired by a Company under a **scheme of Corporatisation** of **Recognised Stock Exchange.**	Actual Cost, as if there is no such corporatisation.
13	Asset used in Business u/s 35 AD subsequently transferred by gift, will, irrevocable trust, Holding to Subsidiary Company & vice versa, Amalgamation, Demerger, Firm / Proprietary Concern to Company or Company to LLP.	Actual Cost is Nil.
Proviso	Where any Capital Asset for which deduction or part of deduction allowed u/s 35AD is deemed to be the income of the assessee u/s 35AD(7B), then,	**Actual Cost of the asset** = Actual Cost to the Assessee (-) Amount of Depreciation that would have been allowable from the date of its acquisition.
14	Receipt of **Subsidy / Grant / Reimbursement** for the acquisition of asset from Central Government or State Government	Actual Cost shall be reduced by cost as related with such Subsidy/ Grant / Reimbursement

In determining **Actual Cost,** the following points are to be considered -

1. **Elements of Actual Cost:** The cost should be Actual Cost of **the asset** to **the Assessee.** The Cost **should not** include any **cost met** directly or indirectly **by any other person / authority.**

2. **Cost includes** the following elements -

(a) **Interest on Loan:** Interest is considered part of cost of asset, only if they are incurred **before** the commencement of production or date of actual use of the asset.

(b) **Trial Run Expenses:** Expenses on Trial Run of Plant and Machinery. **Food Specialties Ltd 136 ITR 203 (Del.),** Income from trial run should be reduced from the cost and not offered as income.

(c) **Pre-Commencement Expenses:** Expenses like Salaries, Guest-house for Erection Staff, Travelling, etc. pertaining to setting up of Plant.

(d) **Loss on Exchange Rate:** Increase in Foreign Currency Liability for acquisition of asset due to increase in Exchange Rate. However, Actual Cost for this purpose means Actual Cost **Less** Depreciation till date.

3. **Cash Expenditure exceeding`10,000 not to be included in Actual Cost:** Expenditure in respect of which a payment or aggregate payments made to a person in a day **in excess of**`10,000is made, otherwise than by way of Account Payee Cheque / Demand Draft / Use of Electronic Clearing System through a Bank Account is disallowed. (Earlier the amount was in excess of`20,000) 4

4. **Moneys Payable:** "Moneys Payable" in respect of any Building, Machinery, Plant or Furniture **includes -**

- Any Insurance, Salvage or Compensation moneys payable in respect thereof,
- Where the Building, Machinery, Plant or Furniture is sold, the price for which it is sold

Explanation to Sec.41 (2): If the moneys payable for Building, Machinery, Plant or Furniture used for business become due in a previous year where the business is no longer in existence, Sec. 41 will apply as if the Business is in existence in that Previous year.

Important Issues

Land	Cost of Land is **not** eligible for depreciation. **[Alps Theatre 65 ITR 377 (SC)]**
Conversion Charges	Commercialization Charges paid for conversion of a Residential Building into commercial usage shall form **part of actual cost** of the Building, and the Assessee is entitled for depreciation. **[Hindustan Times Ltd** 231 **ITR** 741 (SC)]
Interest on Loan	Interest on loan borrowed for acquiring the asset, payable upto date of commencement of production will be **capitalized. [Challappali Sugars Ltd** 98 ITR 167 **(SC)]**
Income during Expansion Period	• Interest Receipts and Hire Charges from Contractors are treated as **Capital Receipts** and will **reduce the capital cost.** • **Rent** or **Hire Charges** for Plant and Machinery received, or Interest from Advances, or Royalty for excavation and use of stones received from Contractors, or income accrued on account of construction work shall go to **reduce the cost** of construction. **[Karnataka Power Corporation** 247 **ITR** 268 **(SC), Bokaro Steels Ltd** 236 **ITR** 315 **(SC)]**
Pre commencement receipts	Receipts before the business is set up could be capitalised and will be **reduced** from the Capital Investment and Asset. **[Bongaigaon Refinery & Petro-chemicals Ltd** 251 **ITR** 329 (SC)]
Income relating to Assets	Interest earned on deposits made to open **Letter of Credit** for purchase of any asset is **capital** in nature, and would go to **reduce the cost** of acquisition. **[Karnal Co-operative Sugar Mills Ltd** 243 ITR 2 **(SC)]**
Interest on Surplus Funds	Interest Income earned on deposits made out of Surplus Funds before commencement of business is **taxable as Income from Other Sources. [Coromandel Cements Ltd** 234 **ITR** 412, **Tuticorin Alkali Cements & Fertilizers Ltd** 227 **ITR** 172]

Illustration – Depreciation on Building held for personal use put into business – N 99(F), M 13 Dr. Vijay Manvas purchased a house property on 01.12.2016 for`10,00,000. Till 01.05.2018, the same was self-occupied as a residence. On this date, the said building was brought into use for the purpose of his medical profession.

1. What would be the depreciation allowable for the Assessment Year 2019-2020 assuming that he owns no other building and the rate of depreciation is 10%?

2. Will the answer be different if the House Property had been gifted to him by his father, who had purchased the same on 01.05.2015 for`9,00,000?

3. Will the treatment be the same if the item under consideration was not a Building, but a Car?

Assessee: Dr. Vijay Manvas Previous Year: 2018-2019 Assessment Year: 2019-2020

1**. Building used for Private Purpose earlier:** As per Expln. 5 to Sec.43(1), when Building is used for private purpose and subsequently put into use for the purpose of business, the cost of acquisition for the purpose of business shall be -

Cost of Acquisition / Construction **Less** Notional Depreciation for the period of personal use at existing rate.

Particulars	
Cost of Acquisition of Residential House Property as on 01.12.2016 **Less:** Deemed Depreciation for FY 2016-2017 at 50% of 10% (period of usage < 180 Days)`10,00,000 x 10% x 50%	10,00,000 (50,000)
WDV on 01.04.2017 **Less:** Deemed Depreciation for FY 2017-2018 =`9,50,000 x 10%	**9,50,000** (95,000)
Particulars	*X*
WDV on 01.04.2018 = Actual Cost to Assessee for the purpose of claiming Depm	**8,55,000**
Depreciation admissible u/s 32 for FY 2018-2019 –`8,55,000 x 10%	**85,500**

2. **Property inherited by Assessee:** U/s 43(1) when Building is used for private purpose and subsequently put into use for the purpose of business, the Cost of Acquisition for the purpose of business shall be equal to Cost of Acquisition / Construction to the Previous Owner **Less** Notional Depreciation for the period of personal use at existing rate.

Particulars	*X*
Cost of Acquisition of Residential House Property as on 01.05.2015 **Less:** Deemed Depreciation for FY 2015-2016 =`9,00,000 x 10%	9,00,000 (90,000)
WDV on 01.04.2016 **Less:** Deemed Depreciation for FY 2016-2017 =`8,10,000 x 10%	8,10,000 (81,000)
WDV on 01.04.2017 **Less:** Deemed Depreciation for FY 2017-2018 =`7,29,000 x 10%	**7,29,000** (72,900)
WDV on 01.04.2018 = Actual Cost to Assessee for the purpose of claiming Depm Depreciation admissible u/s 32 for FY 2018-2019 =`6,56,100 x 10%	**6,56,100** **65,610**

3. **Motor Car:** Explanation 5 to Sec.43(1) is applicable only for **Building** brought into Business / Profession, and not for any other Capital Asset. Hence, it is not applicable for Motor Car brought into Profession. Hence, the treatment is as under -

(a) The Car was **acquired earlier,** but put into use during the current previous year. The **WDV** shall be the Actual Cost to the Assessee, because no depreciation was allowed under the Act on this Asset.

(b) Also, the Asset was **not acquired** as such during the previous year. Hence, even if it is used for less than 180 days, the Assessee will be entitled for the normal rate of depreciation.

(c) So, Depreciation admissible u/s 32 for FY 2018-2019 =`10,00,000 x 15% =`**1,50,000.**

Illustration – Treatment of Trial Run Expenses and Income

Vinai Ltd acquired a pressing machine for`10,00,000. It had incurred`1,50,000 towards Trial Run Expenses in buying Steel Plates, Pressing Tools, etc. The product generated during the trial run was sold for`40,000. Compute the cost of the machine for the purpose of charging depreciation. What will be the cost if the Trial Run Income amounted to`2,00,000?

Assessee: Vinai Ltd Previous Year: 2018-2019 Assessment Year: 2019-2020

Particulars	*X*	*X*

If Trial Run Income were	**40,000**	2,00,000
Expenses on Trial Run **Less:** Income on Sale of Products generated during trial run	1,50,000 (40,000)	1,50,000 (2,00,000)
Net Cost / (Gain)	1,10,000	**(50,000)**
Actual Cost of the Machine **Add:** Net Cost / (Gain) on Trial Run	10,00,000 1,10,000	10,00,000 (50,000)
Cost of the Asset for Depreciation purpose	11,10,000	**9,50,000**

Illustration – Treatment of Foreign Currency Fluctuation

U & I Ltd purchased a Machinery from Germany for USD 1,00,000 on 03.11.2017 by borrowing from East West Bank Ltd. The rate of exchange on the date of acquisition was`63.00. The assessee (U & I), took a Forward Exchange Rate on 05.10.2018 when the Rate specified in the contract was`65 per USD. Compute depreciation for AY 2018-2019 and 2019-2020.

Assessee: U & I Ltd Computation of Depreciation

Particulars			
	Cost of the Asset	(USD 1,00,000 x`63.00)	63,00,000
Less:	Depreciation at 50% of 15% (Period of Usage < 180 days) for AY 18-19 (`63,00,000x 15%x 50%)		(4,72,500)
	WDV as on 01.04.2018		**58,27,500**
Add:	Exchange Rate Difference [`65 –`63]	(`2 x USD 1,00,000)	2,00,000
	WDV for claiming depreciation		**60,27,500**
Less:	Depreciation at 15% for AY 2017-2018	(`60,27,500 x 15%)	(9,04,125)
WDV as on 01.04.2019			**51,23,375**

Note: Additional Depreciation at 10% [50% on 20%] can be claimed subject to conditions and making suitable assumptions.

6.2.5 Written Down Value (WDV)

Determination of Written Down Value (WDV) [Sec. 43(6']: WDV is determined as under -

Situation	**WDV =**
Asset acquired during the Previous Year	Actual Cost to the Assessee.
Asset acquired in earlier Previous Year(s)	Actual Cost to the Assessee **Less** All Depreciation allowed under IT Act
In case of Succession, Amalgamation or Demerger	WDV of the Predecessor Company or Transferor Company or Demerged Company.
Asset acquired by a Company in a Scheme of Corporatization approved by SEBI	WDV of the Transferred Assets immediately before the transfer

• Asset sold or transferred otherwise, Scrap Value exceeds WDV of beginning of the year as increased by Actual Cost of any new asset acquired, or • All the assets in the relevant Block are transferred during the year.	WDV shall be NIL

2. **Computation of WDV: In case of any Asset, WDV is computed as under -**

Particulars	
Opening Value of the Block in the particular Class of Asset as on the first day of the Previous Year	**xxxx**
Add: Actual Cost of Assets acquired during the Previous Year in the same block.	**XXX**
Less: Moneys payable in respect of any Asset, which is sold, discarded, demolished or destroyed in that block including any Scrap Value.	**(XXX)**
Written Down Value for the purpose of computation of Depreciation	**xxxx**
Less: Depreciation at the rate prescribed for the block	**(XXX)**
Closing Written Down Value of the Block	**XXXX**

3. **Partly Agricultural and Partly Business Use:** In case of an Asset used for partly agricultural purpose and partly for business, depreciation shall be computed as if the asset is fully used for business. The depreciation so computed shall be **deemed** to be the depreciation actually allowed, and WDV shall be computed accordingly.

4. WDV for Assessees not required to compute Total Income previously:

	Particulars	*X*
	Actual Cost to the Assessee	xxxx
Add/Less:	Gain or Loss on Revaluation (as per books of account)	**XXX**
	Cost of Asset before Depreciation	**XXX**
Less:	Depreciation as per books of the accounts for the preceding previous years after adjusting for Depreciation attributable to the extent of revaluation	**(XXX)**
	Written Down Value of the Block	**XXXX**

Illustration – Computation of Depreciation

A Company imported Machinery on 15.09.2018 at a cost of`10 Crores. The Custom Duty payable thereon was 20%. The Company claimed IGST Credit of`1 Crore. The rate of depredation on the Machinery is 15%. Assuming that it was put to use on 15.10.2018, what is the depreciation allowable on the machinery for the Assessment Year 2019-2020?

1. Actual Cost = Purchase Cost + Customs Duty – IGST Credit = [10 + (20% on 10) – 1] =`11 Crores

2. Depreciation allowable u/s 32 =`**11** Crores x 15% x 50%=`**0.825 Crores.** (Usage Period < 180 days)

6.2.6 Depreciation on Newly Acquired Assets

1. **Newly Acquired Asset used in Current Previous Year:** In case of asset newly acquired during the previous year is put to use for the purpose of business or profession during the same previous year for a period less than 180 days, then the Assessee is entitled to claim depreciation at **50%** of the normal rate of depreciation allowable under this Act. **(For the Previous Year 2018-2019, Assets put to use on or before 03.10.2018 are entitled for full depreciation).**

2. **Newly Acquired Asset, used only in Subsequent Previous Year:** If the Asset is acquired during the current previous year (say 2018-2019) and put into use only in the subsequent previous year (say

2019- 2012), but for less than 180 days, the above condition **does not apply.** (Assessee entitled for full depreciation for the subsequent previous year).

Illustration – Normal and 50% Depreciation – N 12

Honest Industry furnishes you the following details pertaining to the Previous Year 2018-2019:

Description	**Plant & Machinery**	**Building**	**Intangible Assets (Patents)**
Rate of Depreciation	**15%**	**10%**	**25%**
Opening Balance as on 01.04.2018	**`14,50,000**	**`25,00,000**	**`15,00,000**
Acquired before 30.09.2018	**`12,00,000**	**Nil**	**`5,00,000**
Acquired after 01.12.2018	**`4,00,000**	**`18,00,000**	**Nil**
Transferred in March 2019 one of the Patents held for the past 2 years	**—**	—	**`3,00,000**

A Machinery acquired in July 2018, Original Cost`1,50,000 was destroyed by Fire and the Assessee received compensation of`50,000 from the Insurance Company. Newly acquired Building given above includes value of Land of`3,00,000. Calculate the Eligible Depreciation Claim for the AY 2019-2020. Ignore Additional / Accelerated Depreciation.

Assessee: Honest Industry Previous Year: 2018-2019 Assessment Year: 2019-2020

Depreciation Statement as per Income Tax Act, 1961 (?)

Particulars of Asset	**WDV as on 01.04.2018**	**Additions at Actual Cost**	**Deductions**	**Net Value of Block**	**Depn for current year**	**WDV as on 31.03.2019**
Plant & Machinery 15%	14,50,000	12,00,000 (before 30.09.2018) 4,00,000 (after 01.12.2018)	**50,000 (Note 3)**	30,00,000	4,20,000 (3,90,000 + 30,000)	25,80,000
Buildings	25,00,000	15,00,000 (after 01.12.2018)	NIL	40,00,000	3,25,000 (2,50,000 + 75,000)	36,75,000
Land 0%	—	3,00,000 (after 01.12.2018)	NIL	3,00,000	NIL	3,00,000
Intangible Assets 25%	15,00,000	5,00,000 (before 30.09.2018)	3,00,000	17,00,000	4,25,000	12,75,000
Total Depreciation Admissible					**11,70,000**	

Notes:

1. Machinery acquired after 01.12.2018 put into use for < 180 days is entitled for 50% of Normal Depreciation, i.e. 7.5%.

2. Buildings acquired after 01.12.2018 put into use for <180 days is entitled for 50% of Normal Depreciation,

i.e. 5%.

3. U/s 45(1 A), in case of damage or destruction of **Depreciable Assets,** Compensation received shall be **reduced** from the WDV of the Block.

Illustration – Sec.32 – Computation of Depreciation – M 07

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during Previous year 2018-19 at the cost shown against each item.

Calculate the amount of depreciation that can be claimed from his Professional Income for A.Y.2019-2020.

Asset	**Date of Acquisition**	**Date when put to use**	
(a) Computer	**27th Sep 2018**	**2nd Oct 2018**	**35,000**
(b) Computer Software	**2nd Oct 2018**	**4th Oct 2018**	**8,500**
(c) Computer Printer	**2nd Oct 2018**	**3th Oct 2018**	**12,500**
(d) Books (of which Books being Annual Publication are of`12,000)	**1st April 2018**	**1st April 2018**	**13,000**
(e) Office Furniture (acquired from practicing CA)	**1st April 2018**	**1st April 2018**	**3,00,000**
(f) Laptop	**26th Sep 2018**	**4th Oct 2018**	**43,000**
(g) Fire Extinguisher	**1st April 2018**	**No instance arose to use during F.Y.2018—2019**	**2,500**

Purchased practicing CA's office in Apr I 2018 which had been run for 4 years, for`5 Lakhs which includes`2 Lakhs for Goodwill and`3 Lakhs for cost of furniture (included in Item "e" above).

Assessee: Mr. Dhaval

Previous Year: 2018-2019 Assessment Year: 2019-2020

Depreciation as per Income Tax Act, 1961

Particulars of Asset (Rate of Depreciation)	**Date when put to use**	**Value of the asset (`)**	**No. of days in use**	**Depreciation (`)**	**WDV as on 31.03.2019 (`)**
Block I – 10%: Furniture	01.04.2018	3,00,000	365	30,000	2,70,000
Block 11-15%: Fire Extinguisher **(See Note)**	01.04.2018	2,500	365	375	2,125
Block III – 25%: Goodwill	01.04.2018	2,00,000	365	50,000	1,50,000
Block III – 40%					
Computers	02.10.2018	35,000	181	14,000	21,000
Software	04.10.2018	8,500	179	1,700	6,800
Laptop	04.10.2018	43,000	179	8,600	34,400
Printer	03.10.2018	12,500	180	5,000	7,500
Other Books	01.04.2018	1,000	365	400	600
Books – Annual Publication	01.04.2018	12,000	365	4,800	7,200
Total Depreciation				**1,14,875**	

Note: Depreciation can be claimed, though the asset have not actually been used by the Company. Usage includes both active & Passive usage.

6.2.7 Additional Depreciation

Applicability	Applicable to Assessees engaged in the business of manufacture / production of any article / thing or in the business of Generation or **transmission or distribution of power, [w.e.f. 01.04.2017]**
Manufacture [S. 2(29BA)]	Manufacture means a change in a non-living physical object/ article/ thing - • resulting in a transformation of the object or article or thing into a new and distinct object or article or thing, having a different name, character and use, or • bringing into existence of a new and distinct object or article or thing, with a different chemical composition or integral structure.
Eligible Asset	Any new **Machinery or Plant** acquired and installed **after 31.3.2005.**
Ineligible Assets	(a) Ships and Aircrafts, (b) Any Machinery or Plant which, before its installation by the assessee, was used either within or outside India by any other person, or (c) Any Machinery or Plant installed in any Office Premises or any Residential Accommodation, including accommodation in the nature of a Guest House, or (d) Any Office Appliance or Road Transport Vehicle, or (e) Any Machinery or Plant, the whole cost of which 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.
Rate	Rate of Additional Depreciation = **20% of the Actual Cost** of Machinery or Plant.
Usage Period < 180 days	1. In case of Assets newly acquired and put to use in the same previous year for less than 180 days, the Additional Depreciation shall be provided at 50% of normal rate applicable, i.e. at 10%. 2. Balance 50% shall be allowed u/s 32 in the immediately succeeding previous year in respect of such asset.

W.e.f. 01.04.2016: Special Rate of Additional Depreciation for Machinery or Plant for Undertakings in

Backward Areas of Specified States:

(a) **Date of Commencement:** Assessee should set up an Undertaking or Enterprise for manufacture or production of any article or thing, on or after 01.04.2016.

(b) **Location:** In any **Backward Area** notified by the Central Government, in the State of Andhra Pradesh or Bihar or Telangana or West Bengal.

(c) **Machinery Dates:** Assessee should acquire and install new Machinery or Plant (other than Ships and Aircraft) for the purposes of the said Undertaking or Enterprise during the period 01.04.2016 to 31.03.2021.

(d) **Rate:** Additional Depreciation shall be at **35%** instead of **20%.**

(e) **Usage < 180 days:** Only 50% Depreciation of the depreciation is allowed if Asset used for <180 days in the previous year. Balance 50% is allowed in the **immediately** succeeding previous year.

Illustration – Depreciation and Additional Depreciation – N 11, RTP M/s. Dollar Ltd a Manufacturing Concern furnishes the following particulars -

S.No	Particulars	`
(i) (ii) (iii)	**Opening Written Down Value under Income Tax of Block Plant and Machinery Purchase of Plant and Machinery (put to use before 01.10.2018) Sales Proceeds of Plant and Machinery which became obsolete – The Plant and Machinery was purchased on 01.04.2016 for`5,00,000**	**5.00. 00 0 2.00. 00 0 5,000**

Further, out of purchase of Plant and Machinery:

(a) Plant and Machinery of 20,000 has been installed in office.

(b) Plant and Machinery of`20,000 was used previously for the purpose of business by the seller. Compute Depreciation and Additional Depreciation for the Assessment Year 2019-2020.

Assessee: M/s. Dollar Ltd Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Depreciation and Additional Depreciation

Particulars of Asset (Rate of Depn.)	**WDV as on 01.04.2018**	**Additions at Actual Cost**	**Deduction**	**Net Value of Block**	**Depreciation Current Year**	**WDV as 31.03.2019**
Plant and Machinery (15%)	5,00,000	2,00,000	5,000	6,95,000	1,36,250 (1,04,250 + 32,000)	5,58,750

Normal Depreciation = 6,95,000 **x** 15% =`1,04,250.

Additional Depreciation = (`2,00,000 – 20,000 – 20,000) x 20% =`32,000 **[Note 2]**

Note:

1. Plant & Machinery put to use before 01.10.2018 is eligible for 100% Depreciation, since it is used for a period of more than 180 days.

2. Plant & Machinery installed in Office and Second Hand Machinery (previously used by Seller) are not eligible for Additional Depreciation u/s 32(1)(iia).

6.2.8 Proportionate Depreciation for Succession of Business

1**. Circumstances:** Under the following circumstances, Depreciation can be claimed on a **proportionate basis -**

(a) Succession of a Partnership Firm by a Company u/s 47(xiii).

(b) Succession of a Private Company or Unlisted Public Company by a LLP u/s 47(xiiib)

(c) Succession of a Proprietary Concern by a Company u/s 47(xiv).

(d) Succession of Business otherwise than on death u/s 170.

(e) Amalgamation of Companies.

(f) Demerger of Companies.

(g) Amalgamation / Demerger of Co-Operative Banks (u/s 44DB).

2. **Computation:** The following provisions are applicable in cases of Business Re-organisation or Succession -

(a) **Calculation of Depreciation:** Depreciation shall be calculated at the prescribed rates, as if the Succession or Amalgamation or Demerger had **not** taken place.

(b) **Apportionment:** The computed depreciation shall be **apportioned** between the Predecessor and the Successor, in the ratio of **number of days** for which the assets were used by them.

Change in Constitution of Firm: In case of change in constitution of a Firm, Depreciation shall be allowable on the WDV of the Asset, and **not** on the enhanced cost at which the assets are taken over by the new Firm.	**Alagappa Cotton Mills Ltd 253 ITR 100 (Mad.)**

Illustration – Conversion of a Private Limited Company to a LLP – M 11

Harish Jayaraj Pvt Ltd is converted in to Harish Jayaraj LLP on 01.01.2019. The following particulars are available to you:

Particulars	

1.	**WDV of Land as on 01.04.2018**	**5.00. 000**
2.	**WDV of Machinery as on 01.04.2018**	**3,30,000**
3.	**Patents acquired on 01.06.2018**	**3.00. 000**
4.	**Building acquired on 12.03.2017 for which deduction was allowed u/s 35AD**	**7.00. 000**
5.	**Above Building was revalued as on the date of conversion into LLP as**	**12,00,000**
6.	**Unabsorbed Business Loss as on 01.04.2018 (A.Y. 2015-2016)**	**9.00. 000**

Though the conversion into LLP took place on 01.01.2019, there was disruption of business and the assets were put into use by the LLP only from 1st March, 2019 onwards. The Company earned profits of`8 Lakhs, prior to computation of depreciation.

Assuming that the necessary conditions laid down in Sec. 47(xiiib) of the Income Tax Act, 1961 have been complied with, explain the tax treatment of the above in the hands of the LLP.

Principle: Refer Para 6.2.6 above. **1. Computation of Apportionable Depreciation:**

Asset	**Computation**	**Apportionable Depreciation (`)**
Land	Not a Depreciable Asset	Nil
Machinery	3,30,000 x 15%	49,500
Patents	3,00,000 x 25%	75,000
Building	100% deduction in the year of purchase	Nil
Total		**1,24,500**

2. Apportionment of computed depreciation shall be in the ratio of number of days for which the assets were used by them. In the given case, the converted LLP used the assets only for 31 days (from 1st March) in the previous year due to disruption of business.

3.

Apportionment of Depreciation and Allowable Depreciation:

Assessee	**No. o**	**Days**	**Total Deprn allowable for AY 2019-2020** (`)
	Machinery	**Patents**	
Private Company	01.04.2018 to 31.12.2018 = **275 Days**	01.06.2018 to 31.12.2018 **= 214 Days**	**(**`49,500 x 275/306**)** + (`75,000 x 214/245) =`**1,09,995**
LLP	01.03.2019 to 31.03.2019 **= 31 Days**	01.03.2019 to 31.03.2019 **= 31 Days**	**(**`49,500 x 31/306) **+** (`75,000 x 31/245) =`**14,505**

4. Unabsorbed Business Loss of`9,00,000 shall be carry forward and set-off is permissible for 8 assessment years immediately succeeding the Assessment Year for which the loss was computed.

Illustration – Apportionment of Depreciation- N 14

Mr.Gopi, carrying on business as a Proprietor, converted the same into a Limited Company by the name Gopi Pipes (P) Ltd from 01,07.2018. The details of the Assets are given below -

Block I: WDV of Plant and Machinery (Rate of Depreciation at 15%)	**`12,00,000**
Block II: WDV of Building (Rate of Depreciation at 10%)	**`25,00,000**

The Company Gopi Pipes (P) Ltd acquired Plant and Machinery in December 2018 for`10,00,000. It has been doing the business from 01.07.2018.

Compute the quantum of depreciation to be claimed by Mr.Gopi and Successor Gopi Pipes (P) Ltd, for the Assessment Year 2019-2020. Note: Ignore Additional Depreciation.

Solution:

1. **Days for apportionment of Depreciation:** (a) Proprietor: 01.04.2018 to 30.06.2018 = 30 + 31 + 30 = **91 days,** (b) Hence, Company shall claim Depreciation for 365 – 91 = 274 days, (c) Ratio is **91** : **274.**

2. **Depreciation for the year on Assets transferred:**

(a) Plant and Machinery: On Opening WDV:`12,00,000 x 15% =`1,80,000

(b) Building: On Opening WDV:`25,00,000 x 10% =`2,50,000

3. **Apportionment of Depreciation and Allowable Depreciation:**

Block	**Total Depreciation**	**Apportioned to Proprietor**	**Apportioned to Company**
I: Plant & Machinery	On Opening WDV:`12,00,000 x 15% =`1,80,000 On Additions (after succession):`10,00,000 x 15% x 50%	`1,80,000x91/365 =`44,877 NIL	`1,80,000x274/365 =`1,35,123`75,000
II: Building	On Opening WDV:`25,00,000 x 10% =`2,50,000	`2,50,000x91/365 =`62,329	`2,50,000x274/365 =`1,87,671
	Total	**`1,07,206**	**`3,97,794**

Illustration – Amalgamation of Companies – Apportionment of Depreciation – N 10 Sai Ltd has a Block of Assets carrying 15% rate of Depreciation, whose Written Down Value on

01.04.2018 was`40 Lakhs. It purchased another Asset of the same Block on 01.11.2018 for`14.40 Lakhs and put to use on the same day. Sai Ltd was amalgamated with Shirdi Ltd with effect from 01.01.2019.

You are required to compute the Depreciation allowable to Sai Ltd 8i Shirdi Ltd for the Previous Year ended on 31.03.2019 assuming the Assets transferred to Shirdi Ltd at`60 Lakhs.

1. Apportionable Depreciation:

Particulars of Asset in 15% Block	
Depreciation on WDV as on 01.04.2018 [40,00,000 **x** 15%] Deprecation on Additions as on 01.11.2018 [14,40,000 **x** 15% **x** 50%]	6,00,000 1,08,000
Total Apportionable Depreciation	**7,08,000**

2. **Apportionment of Depreciation:**

Assessee	**No. of days**	**Total Depreciation allowable**
Sai Ltd	01.04.2018 to 31.12.2018 = **275 days**	7,08,000 x 275/365 =`425 365
Shirdi Ltd	01.01.2019 to 31.03.2019 = **90 days**	7,08,000 x 90/365 =`**1,74,575**

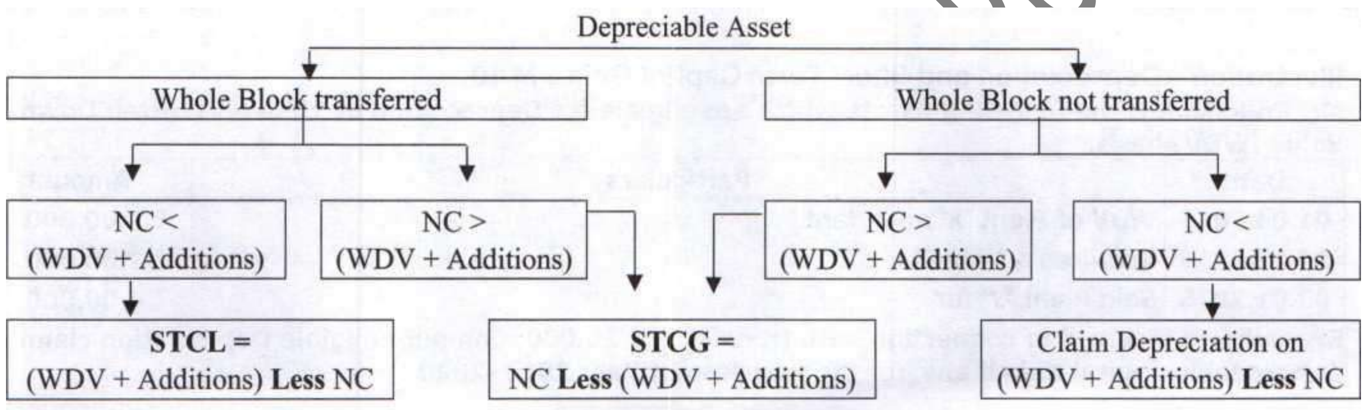
6.2.9 Capital Gains on Depreciable Assets [Sec. 50]

The method of Computation of Capital Gains for Depreciable Assets is as under -

Particulars	
Consideration for Transfer **Less**: Expenses of Transfer	**xxxx** (xxx)
Net Consideration **Less:** (a) Opening WDV of the Block (b) Actual Cost of Assets acquired during the previous year in the Block	**XXXX** (xxx) **(XXX)**
Difference [Surplus / (Deficit)]	**XXXX**

Particulars	Situation (A)	Situation (B)
Situation	All the Assets in the Block are not transferred	All Assets in the Block are transferred
Sec.	Sec. 50(1)	Sec. 50(2)
Tax Treatment	**If Difference as computed above is -** (a) **Deficit –** Depreciation can be claimed u/s 32 at relevant rates, on the Balance Value. (b) **Surplus-** • Taxable as Short Term Capital Gains. • WDV of the Block shall be NIL.	If **Difference is -** (a) **Surplus-**Short Term Capital Gains. (b) **Deficit – Short Term Capital Loss.**

Computation of Capital Gains on Depreciable Assets [Sec.50]



Note: NC = Net Consideration, **WDV** = Written Down Value, **STCG / STCL** = Short Term Capital Gain / Loss.

Illustration – Sec.50 – Transfer of Part of the Assets within the Block – N 08 Singhania & Co. own six machines, put into use for business in March, 2018. The depreciation on these machines is charged at 15%. The Written Down Value of these machines at the end of the previous year relevant to Assessment Year 2018-2019 was`8,50,000. A new Plant was bought for`8,50,000 on 30th November, 2018. Three of the old machines were sold on 10th June 2018 for`11,00,000.

(a) Determine the claim of Depreciation for Assessment Year 2019-2020.

(b) Compute the Capital Gains liable to Tax for Assessment Year 2019-2020.

(c) If Singhania & Co. had sold the three machines in June, 2018 for`21,00,000, will there be any difference in your above workings? Explain.

Assessee: Singhania & Co. Previous Year: 2018-2019 Assessment Year: 2019-2020

1. Computation of Depreciation for the AY 2019-2020, when Sale Consideration is`11,00,000

Particulars	
Opening WDV as on 01.04.2018 **Add:** Additions on 30.11.2018	8.50.000 8.50.000
Gross Block Value **Less:** Sale Value of 3 Machines (10.06.2018)	**17,00,000** (11,00,000)
Net Block Value **Less:** Depreciation at 15% x 50% (See Note 1) Additional Depreciation at 20% x 50% (See Note 2)	6,00,000 (45.000) (60.000)

Closing WDV as on 31.03.2019	**4,95,000**

Note:

1. Since the value of Depreciable Block is fully constituted by the newly acquired Machinery, which are held for less than 180 days. Depreciation and Additional Depreciation is claimed at 50% of the normal rates only.

2. Balance 50% of Additional Depreciation shall be allowed in AY 2019-2020. However, this Benefit is not applicable for Normal Depreciation.

2. Computation of Short Term Capital Gain for AY 2019-2020, when Sale Consideration is`21,00,000

Particulars	
Opening WDV as on 01.04.2018 **Add:** Additions on 30.11.2018	8,50,000 8,50,000
Gross Block Value **Less:** Sale value of 3 Machines	**17,00,000** (21,00,000)
Short Term Capital Gain u/s 50	**4,00,000**
WDV of Block as at 31.03.2019	**NIL**

Illustration – Depreciation and Short Term Capital Gain – M 10

Mr. Prakash has the following Assets which are eligible for Depreciation at 15% on Written Down Value (WDV) basis:

Date	**Particulars**	**Amount**
01.04.2015 **10.12.2018** **02.01.2018**	**WDV of Plant 'X' and Plant 'Y'** **Acquired a New Plant 'Z' for** **Sold Plant 'Y' for**	**`2,00,000`2,00,000`4,00,000**

Expenditure incurred in connection with transfer is`10,000. Compute eligible Depreciation claim / chargeable Capital Gain if any, for the Assessment Year 2019-2020.

Assessee: Mr. Prakash Previous Year: 2018-2019 Assessment Year: 2019-2020

1. Computation of WDV as on 01.04.2017

Particulars	
WDV of Plant X and Plant Y as on 01.04.2015 **Less:** Depreciation for the year 2015-2016 (2,00,000 x 15%)	2,00,000 (30,000)
WDV of Plant X and Plant Y as on 01.04.2016 **Less:** Depreciation for the year 2016-2017 (1,70,000 x 15%)	1,70,000 (25,500)
WDV of Plant X and Plant Y as on 01.04.2017 **Less:** Depreciation for the year 2017-2018 (1,44,500 x 15%)	1,44,500 (21,675)
WDV of Plant X **and Plant Y as on 01.04.2018**	**1,22,825**

2. Computation of Short Term Capital Gains

Particulars	
Opening WDV as on 01.04.2018	**1,22,825**

Add: Cost on Acquisition of New Plant on 10.12.2018		2,00,000
Gross Block Value		3,22,825
Sale Consideration **Less:** Expenses on Transfer	4,00,000 (10,000)	
Net Consideration	3,90,000	3,90,000
Short Term Capital Gain (3,90,000 – 3,22,825)		**67,175**
WDV for the purpose of computation of Depreciation		**NIL**

6.2.10 Depreciation in case of Power Sector Units – SLM

1. **Eligible Assessees:** Power Sector Units engaged in the business of generation or generation and distribution of power can charge depreciation on their assets under **Straight-Line Method,** at the rates prescribed in Appendix-1 of the Income Tax Rules.

2. **Eligible Assets:** Power Sector Units can claim depreciation on SLM method **only on Tangible Assets.** For Intangible Assets, only WDV Method shall be applicable.

3. **Usage less than 180 days: In case of newly acquired assets** put into use for less than 180 days, depreciation is allowable at **50% of the normal rate.**

4. Option for WDV:

(a) **WDV:** Power Sector Units can **also opt for** claiming depreciation under **Written Down Value Method.**

(b) **Time of exercise of option:** They have to exercise such option **before the due date of furnishing the**

Return u/s 139(1) relevant to the previous year in which they **begin** to generate power.

(c) **Nature of Decision:** The option once exercised shall be final. 5

5. **Sale in year of First Use:** Where the asset is sold or discarded in the previous year in which it is first put to use, any **loss arising therefrom shall be treated as Capital Loss,** i.e. Loss under the head "Capital Gains."

r

6. **Transfer of Depreciable Assets by Power Sector Units:** Capital Gains on transfer of Depreciable Assets

leld by Power Sector Units shall be computed as follows -

Situation	Condition	Treatment
I	Net Consideration is less than WDV	**Terminal Depreciation** u/s 32 = WDV **Less** Net Consideration.
II	Net Consideration is greater than WDV	**Balancing Charge** u/s **41(2)** =Net Consideration **Less** WDV
III	Net Consideration is greater than Original Cost of Asset	**Capital Gain** = Net Consideration **Less** Original Cost **[Note:** Sec.48 and 49 applies for Capital Gains] **Balancing Charge** [Sec.41(2)] = Original Cost **Less** WDV

Vote:

- Net Consideration = Consideration for Transfer **Less** Expenses of Transfer.
- The amount of Balancing Charge **should not exceed** the difference between **Actual Cost and the WDV.**

Computation of Capital Gains on Depreciable Assets [Sec.50]

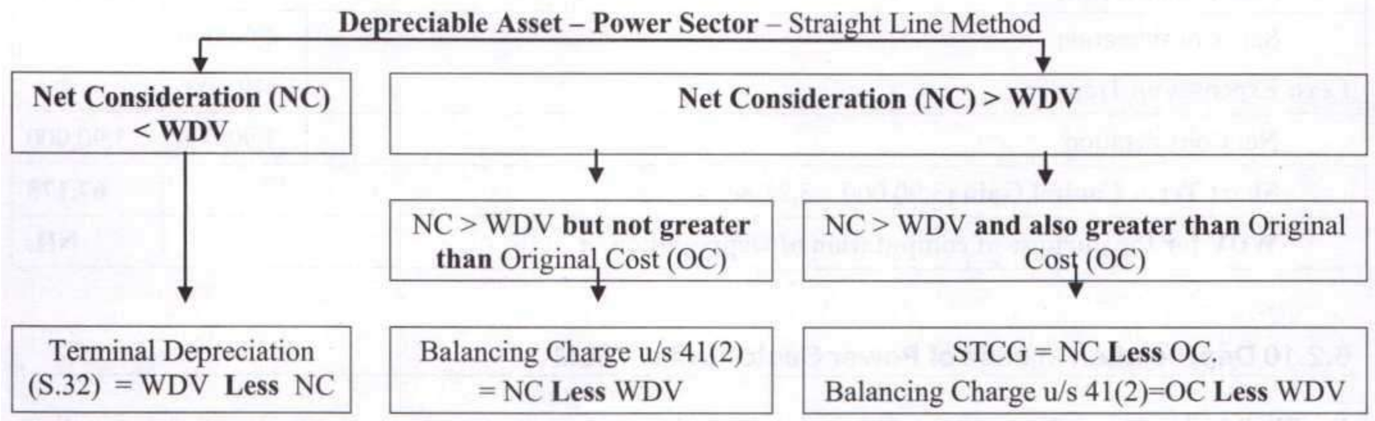


Illustration – Power Sector – WDV Option – Depreciation and Additional Depreciation – N 13 Mr. Abhimanyu is engaged in the business of generation and distribution of electric power. He always opts to claim depreciation on Written Down Value for Income-Tax purposes. From the following details, compute the Depreciation allowable as per the Income-Tax Act, 1961 for the Assessment Year 2019-2020:

Particulars	**`Lakhs**
(i) Opening WDV of Block (15% Rate)	**42**
(ii) New Machinery purchased on 12-10-2018	**10**
(iii) Machinery imported from Colombo on 12-04-2018. This Machine has been used only in Colombo earlier and the Assessee is the first user in India.	**9**
(iv)New Computer installed in Generation Wing of the unit on 15-07-2018	**2**

Assessee: Mr. Abhimanyu Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Depreciation allowable u/s 32 (in`)

Particulars	**Block I (15%)**	**Block II (40%)**
Opening WDV as on 01.04.2018	**42,00,000**	**-**
Particulars	**Block I (15%)**	**Block II (40%)**
Add: Additions made during the year		
Second hand Machinery (Imported from Colombo) (12.04.2018)	9,00,000	
New Machinery (12.10.2018)	10,00,000	
New Computer Installation (15.07.2018)	-	2,00,000
Value of Block before charging Depreciation	**61,00,000**	2,00,000
Less: Depreciation for the year		
Normal Depreciation (for entire year)	(42,00,000 + 9,00,00) x 15% = 7,65,000	2,00,000 x 40% = 80,000
On New Plant and M/c put to use for less than 180 days at 50%	`10,00,000 x 15%x 50% = 75,000	

Additional Depreciation on New Machinery (restricted to **50%** being less than **180** days of use) **(Note 3)**	`10,00,000 x 20% x 50% = 1,00,000	
Total Depreciation Allowable u/s 32	**9,40,000**	**80,000**
Closing WDV on 31.03.2019	**51,60,000**	1,20,000

Notes:

1. Additional Depreciation is **not** allowed in respect of Second Hand Machinery, even if Assessee is the first user in India.

2. No Additional Depreciation is allowed in respect of Assets other than Plant & Machinery. Hence, New Computer Installation is **not** considered as Eligible Asset for the purpose of Additional Depreciation.

3. Balance 50% of Additional Depreciation shall be allowed in AY 2020-2021. However, this Benefit is not applicable for Normal Depreciation.

6.2.11 Unabsorbed Depreciation

1. Treatment for Current Year depreciation

Step 1	Claim deduction of Current Year Depreciation from the business to which it relates.
Step 2	Deficiency in Step 1 can be set off against Profits or Gains of any other business of the assessee.
Step 3	Deficiency in Step 2 can be set off against any other head of Income of current previous year.
Step 4	Deficiency in Step 3 is **"Unabsorbed Depreciation"** for the current previous year.

2. **Treatment for Unabsorbed depreciation:**

(a) Unabsorbed Depreciation of the current previous year shall be **added** to the **following previous year's depreciation.**

(b) It can be set off against **any head** of Income.

(c) It can be carried forward to **any number of years,** until it is fully set-off.

(d) In case of carry forward of Business Loss or Speculation Loss, the set-off shall be done after setting off current depreciation and such losses. 3

3. **Continuity of Business:** Continuity of business is **not relevant** for set-off and carry forward.

4. **Carry Forward of Depreciation:** Depreciation can be carried forward by the same Assessee, except in case of Amalgamation, Demerger and Business Reorganisation u/s 47(xiii) / 47(xiv).

To carry forward Unabsorbed Depreciation, it is **not** compulsory to file the Return. Unabsorbed Depreciation can be set off during the current period, even if no valid return was filed for the previous Assessment Year. **[Haryana Hotels Ltd 148 Taxman 373 (P&H)]**

Also see Sec. 72 in Chapter 10 "Set Off and Carry Forward of Losses"

6.3 Specifically Allowable Deductions

6.3.1 Building related Expenditure [Sec.30]

1. **Condition:** The Building should be used for the purpose of Business or Profession during the relevant previous year.

2. **Deduction:** The following expenses are allowed as a deduction:

(a) Rent paid as a Tenant.

(b) Current Repair Expenses towards the Premises.

(c) Land Revenue or Local Rates or Municipal Taxes.

(d) Insurance Premium paid in respect of damage or destruction of the Building.

3. **Inadmissible Expenditure:**

(a) Current Repairs of **Capital Nature** shall **not** be allowed as a deduction.

(b) Any Insurance and Repair Charges of assets which have been discarded (though owned by Assessee) or have not been used for business during the previous year, would not be allowed as deduction.

6.3.2 Repairs, etc, to Plant, Furniture [Sec.31] 1 2 3 4

1. **Condition:** The Plant / Machinery / Furniture should be used for the purpose of Business or Profession during the relevant previous year.

2. **Deduction:** The expenses allowed as a deduction are -

(a) Amount paid on account of Current Repairs.

(b) Insurance Premium paid against damage or destruction thereof.

3. **Inadmissible Expenditure:** Current Repairs of **Capital Nature** shall **not** be allowed as a deduction.

4. **Used for Part of the Year:** Even if the assets are used for only a part of the previous year, the Assessee **can claim full deduction.**

Note: Where an Asset (Building, Plant, Machinery, Furniture, etc.) is partly used for Business or Profession and partly for Personal purposes, the deduction u/s 30, 31 and 32 shall be based on the **fair proportionate basis** as determined by the Assessing Officer. **[Sec.38]**

6.3.3 Investment in New Plant or Machinery [Sec.32AD] – w.e.f. 01.04.2016

Eligible Assessee	All Assessees
Period of Acquisition & Installation	During the period from **01.04.2015 to 31.03.2020**
Condition	(a) **Commencement:** Assessee should set up an Undertaking or Enterprise on or after 01.04.2015. (b) **Location:** In any notified **Backward Area in the State of** Andhra Pradesh or Bihar or Teiangana or West Bengal.
Deduction for that AY	15% of the Actual Cost of such New Assets.
Last Year of Deduction	AY 2020-2021

Conditions for Sec.32AD:

1. Assessee should be engaged in the business of manufacture or production of any article or thing.

2. **Sale of New Asset:**

(a) In case of transfer of New Asset within 5 years from the date of its installation, the amount claimed as deduction shall be chargeable to tax in the previous year of transfer.

(b) In case of sale / transfer under amalgamation / demerger within 5 years from date of installation, the above provision shall apply to the Amalgamated Company / Resulting Company, in the same way as it would have applied to the Amalgamating Company / Demerged Company.

Note: For Sec.32AD, Sale / Transfer by way of Re -organization is also included.

3. **"New Asset"** means any new Plant or Machinery (other than Ship or Aircraft), but does **not** include -

(a) Any Plant or Machinery which before its installation by the assessee was used whether within or outside India by any other person,

(b) Any Plant or Machinery installed in any Office Premises or any Residential Accommodation including accommodation in the nature of a Guest House,

(c) Any Office Appliances including Computers or Computer Software,

(d) Any Vehicle,

(e) Any Plant or Machinery the whole of the Actual Cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains from Business or Profession" of any previous year.

Illustration – Application of Sec.32AD

(a) **Raju & Co. Firm set up a manufacturing unit in notified backward area in the state of Teiangana on 01.06.2018. It invested`90 Crore in New Plant and Machinery on 01.06.2018. Further, it invested`75 Crore in the Plant and Machinery on 01.11.2018, out of which`15 Crores was second hand Plant and Machinery. Compute the Depreciation allowable u/s 32. Is Hari Ltd entitled for any other benefit in respect of such Investment? If so, what is the benefit available?**

(b) Assume the said assets were installed only on 01.04.2019, what will be the benefit for AY 2019-2020?

Assessee: Raju Ltd Previous Year: 2018-2019 Assessment Year: 2019-2020

1. Computation of Depreciation and Additional Depreciation u/s 32

Particulars	**Computation**	**`in Crores**
Plant and Machinery (Acquired on 01.06.2018) Plant and Machinery (Acquired on 01.11.2018)		90.00 75.00
WDV as on 31.03.2019		**165.00**
Particulars	**Computation**	***X*in Crores**
Less:		
(i) Normal Depreciation @ 15% u/s 32		
on`90 Crores – (90 x 15%) Usage Period > 182 days	13.50	
on`75 Crores – (75 x 15% x 50%) Usage Period < 182 days	5.64	
(ii) Additional Depreciation @ 35% (being located in Telangana)		
on`90 Crores – (90 x 35%) Usage Period > 182 days	31.50	
on`60 Crores – (60 x 35% x 50%) Usage Period < 182 days	10.50	61.14
WDV as on 01.04.2019		**103.86**

Note:

1. Plant & Machinery put to use for less than 180 days is eligible for 50% Depreciation only.
2. Balance 50% of Additional Depreciation will be available in the subsequent Assessment Year.
3. Special Rate of Additional Depreciation for Machinery or Plant for Undertakings in Backward Areas in the State of Andhra Pradesh or Bihar or Telangana or West Bengal, shall be at 35% instead of 20%. Additional Depreciation shall not be allowed in respect of Second Hand Machinery.

2. Computation of Deduction u/s 32AD for X Ltd for AY 2019-2020

Particulars	**Computation**	**`in Crores**
Deduction u/s 32AD @ 15% (Since Investment in Notified Backward Area)	`150 Crores x 15%	22.50

Note: Deduction u/s 32AD shall not be allowed in respect of Second Hand Machinery.

6.3.4 Scientific Research Expenditure [Sec.35]

1. Meaning:

(a) **Scientific Research** includes any activities for the extension of knowledge in the fields of natural or applied science, including agriculture, animal husbandry or fisheries.

(b) **Expenditure on Scientific Research** includes all expenditure for prosecution or provision of facilities for Scientific Research, **except** any expenditure incurred in the acquisition of rights in or arising out of scientific research.

(c) A Scientific Research **related to a business** or class of business includes -

- Any Scientific Research which may lead to or facilitate an extension of that business or classes of all business,
- Any Scientific Research of a medical nature which has a special relation to the welfare of the workers employed in that business or all classes of business. 2

2. **Allowability of Scientific Research Expenditure:** The different types of allowable expenditure are analysed under the following points -

A. Expenditure on In-House Research

B. Weighted Deduction of In-House Research for Companies in Special Business

C. Expenditure on Payments / Contributions made

A. Expenditure on In-House Research [Sec.35(1) & 35(2)]: The principles relating to deduction for expenditure incurred by the Assessee on Scientific Research related to the Assessee's business are as under -

- Current Year Revenue Expenditure or Capital Expenditure on Scientific Research, is allowed as deduction.
- Prior Period Revenue Expenditure (i.e. Salary and Materials, to the extent certified by Prescribed Authority), or Capital Expenditure incurred during 3 years immediately preceding the date of commencement of business will be allowed as deduction in the previous year in which the Assessee commenced the business,
- Expenditure on acquisition of Land will **not** be allowed as a deduction. Land includes any interest in Land.
- Assessee is **not** entitled to claim any depreciation on the Capital Expenditure allowed as deduction u/s 35(2).

Significant Issues

Year for claiming Capital Expenditure	Where the Capital Expenditure was incurred for the purpose of Scientific Research, and the conditions u/s 35 are fulfilled, the assessee is entitled to deduction in the year in which expenditure was incurred **even** if the asset was not yet put into use or not ready for use. **[Gujrat Aluminium Extrusions P Ltd 133 Taxman 542 (Guj.) Rane Brakelinings Ltd 255 ITR 395 (Mad.)]**
Buses or Cars	**Buses or Cars** used to transport employees engaged in scientific research – Fully deductible. **[Smithkline & French (India) Ltd 77 Taxman 153 (Kar.)]**
Approach Road	Construction of **approach road** to Research and Development Laboratories – Fully deductible. **[Sandoz (India) Ltd 74 Taxman 225 (Bom.)]**

B. Weighted Deduction of In-House Research for Companies in Special Business [S.35(2AB)]:

In case of a Company engaged in business of Bio-Technology, or of manufacture or production of any article or thing, (not being an article or thing specified in the list of the Eleventh Schedule), an amount equal to **150%** of the expenditure incurred on Scientific Research is allowed as deduction.

Notes:

(a) Cost of Building is not entitled for weighted deduction, but eligible for 100% deduction u/s 35(1)(iv).

(b) Cost of any Land shall not be allowed as a deduction.

(c) The Company engaged in specified Business should enter into an agreement with the Prescribed Authority, for the purpose of – (i) co-operation in R&D, and (ii) audit of accounts maintained. The Company should fulfill such conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in prescribed manner.

(d) The Prescribed Authority shall submit its report in Form 3CL in relation to the approval of the said facility to PCCIT/CCIT/PDGIT / DGIT within 120 days from the date of approval or submission of audit report.

(e) Report from an accountant to be furnished in Form 3CLA relating to in-house scientific research and development facility shall be filed Before due date for furnishing Return of Income u/s 139(1).

(f) For Drugs and Pharmaceuticals, Expenditure on Scientific Research shall include expenditure incurred L on clinical drug trial, obtaining approval from any Regulatory Authority under Indian law, and filing an application for a patent under the Patents Act, 1970.

In House Scientific Research Expenditure – Comparison:

Particulars	**General [Sec.35(1)&(2)]**	**Specific]Sec.35(2AB)]**
(a) Revenue Expenditure	100%	150%
(b) Capital Expenditure		
(i) Land	NIL	NIL
(ii) Building	100%	100%
(iii) Others	100%	150%
(d) Prior Period Expenses being Salary, Material used for Scientific Research (Certified by Prescribed Authority)	100%	100%

C. Expenditure on Payment/Contribution made:

Sec.35	**Payment made to**	**Conditions**	**Eligible Deduction (w.e.f. 01.04.2018)**
(1) («)	(a) Any Research Association, or (b) Any University, College or Other Institution, to be used for scientific research.	(a) Object of Research Association should be the undertaking of Scientific Research. (b) The Association / University /College / other Institution should be approved in accordance with the Guidelines, such to prescribed conditions and should be notified by Central Government.	**150%** of sum paid.
(1) (iia)	Company	(a) Company should be registered in India. (b) Its main object for Scientific Research & Development. (c) The Company should be approved by Prescribed Authority and should fulfill other prescribed conditions.	100**%** of sum paid
(1) (ill)	(a) Any Research Association, or (b) Any University, College or Other Institution	(a) Object of Research Association should be the undertaking of Research in Social Science or Statistical Research. (b) If paid to University /College / other Institution, it should be used for research in Social Science or Statistical Research.	100**%** of sum paid
(2AA)	National Laboratory or University or IIT or Specified Person	Payment should be made with a specific direction that the said sum shall be used for Scientific Research undertaken under a Programme approved by Prescribed Authority.	**150%** of sum paid.

Votes:

Clause	Remarks
(ii) / (iii)	The deduction, to which the Assessee is entitled in respect of any sum paid to a Research Association, University, College or other Institution to which Clause (ii) or Clause (iii) applies, shall not be denied merely on the ground that, subsequent to the payment of such sum by the Assessee, the approval granted to the association, University, College or other Institution referred to in Clause (ii) or Clause (iii) has been withdrawn.
(2AA)	**National Laboratory** means a Scientific Laboratory functioning at the National Level under the aegis of the Indian Council of Agricultural Research, the Indian Council of Medical Research, the Council of Scientific and Industrial Research, the Defence Research and Development Organisation, the Department of Electronics, the Department of Bio-Technology or the Department of Atomic Energy and which is approved as a National Laboratory by the Prescribed Authority in the prescribed manner.

Conditions for claiming benefit as Scientific Research Institution [Notfn. No. 2 / 2009 dt 05.01.2009] [W.e.f. 01.04.2009, Rule 5D /5E]

The Scientific Research Association / University / College / other Institution shall, by the due date of furnishing the Return of Income u/s 139(1), furnish a statement to the CIT / PCIT / DIT / PDIT containing-

- Detailed Note on the research work undertaken by it during the previous year,
- Summary of Research Articles published in National or International Journals during the year,
- Any Patent or other similar rights applied for or registered during the year,
- Programme of Research Projects to be undertaken during the forthcoming year and the financial allocation for such programme.

3. **Carry-forward and set-off of Unabsorbed Capital Expenditure:** If deduction on account of Capital Expenditure u/s 35(1)(iv) cannot be allowed, fully or partly, because of inadequacy or absence of profits of the business, the deficiency so arising is to be carried forward for unlimited years and set-off in any subsequent assessment year, in the same manner as Unabsorbed Depreciation.

4.

Consequences in case of amalgamation:

Situation		Consequence
In pursuance of an agreement of amalgamation, Amalgamating Company transfers asset representing Capital Expenditure eligible for deduction u/s 35.	►	Sec.35 would apply to the Amalgamated Company as it would have applied to the Amalgamating Company, as if the Amalgamation had not taken place.

5. Effect of Transfer of Assets used for Scientific Research:

Nature of Transfer	Treatment
(a) Transfer of asset to an Outsider, without using for any other purposes of business	1. If the amount realized does not exceed the deduction allowed, then the realized amount is treated as Business Income u/s 41(3). 2. If the amount realized exceeds the deduction allowed, then - (a) To the extent deduction allowed treated as Business Income. (b) Excess Amount realized over and above the deduction allowed is treated as "Capital Gains".
(b) Transfer of asset for other purposes of business and subsequently sold.	• Added to the Block of Assets on the basis of nature of asset. • Cost shall be NIL. • On subsequent sale, Sec. 50 shall apply.

6. **No other deduction:** Any amount allowed as deduction u/s 35 will not qualify for deduction under any other provision of the Income Tax Act.

Illustration – Application of Sec. 35(2AB) – N 07

Vivitha Bio Medicals Ltd is engaged in the business of manufacture of biomedical items. The following expenses were incurred in respect of activities connected with Scientific Research.

Year ended	**Particulars**	**Amount (`)**
30.04.2016	**Land**	**16,00,000**
30.04.2016	**Building**	**25,00,000**
31.03.2018	**Plant and Machinery**	**5,00,000**
31.03.2018	**Raw Materials**	**2,20,000**
31.03.2019	**Raw Materials and Salaries**	**1,80,000**

The business was commenced on 01.09.2019.

In view of availability of better model Plant & Machinery, the existing Plant & Machinery were sold for`16,00,000 on 01.03.2019.

Discuss the implications of the above for AY 2019-2020 along with brief computation of deduction permissible u/s 35, assuming that necessary conditions have been fulfilled. You are informed that the Assessee's line of business is eligible for claiming deduction u/s 35 at 150% on eligible items.

Assessee: Vivitha Bio Medicals Ltd Previous Year: 2018-2019 Assessment Year: 2019-2020

1. **Deduction for Contribution/ Exemption:** U/s 35, the following expenditure incurred by the assessee on scientific research in relation to the assessee's business shall be allowed as a deduction -

(a) Current year Revenue or Capital Expenditure on Scientific Research.

(b) Prior Period Revenue Expenditure incurred for Raw Materials or Salary during 3 years immediately preceding the date of commencement of business, will be allowed as deduction in the previous year in which the assessee commenced the business.

(c) In case of a Company engaged in the business of bio-technology or of manufacture or production of any article or thing, **(not** being an article or thing specified in Eleventh Schedule), 150% of the expenditure incurred on Scientific Research shall be allowed as deduction.

(d) Building is **not** entitled for weighted deduction. Land is **not** entitled for deduction.

2. Computation of Deductible Amount u/s 35:

Nature of Expenditure	**Actual Expenses (`)**	**% of deduction**	**Deductible Amt** (`)
Building acquired in the preceding 3 FYs.	25,00,000	100%	25,00,000
Plant and Machinery	5,00,000	150%	7,50,000
Raw Materials acquired in the preceding year	2,20,000	100%	2,20,000
Current Year exp. on Raw Materials & Salaries	1,80,000	150%	2,70,000
Total deduction for the Previous Year 2018-2019			**37,40,000**

3. Consequence of Sale of Capital Asset:

(a) U/s 41(3), where a Capital Asset used for Scientific Research is sold without introducing the same into the business, the Sale Proceeds of the asset, upto the amount of deduction claimed shall be treated as Business Income of the Previous Year in which such transfer took place. Any excess amount shall be taxed under the head Capital Gains.

(b) In this case, Amount of **Short Term Capital Gains** u/s 45 = Total Sale Consideration less Deduction

Allowed =`16,00,000 –`7,50,000 =**`8,50,000.**

Illustration – Computation of Deduction u/s 35 – M 11

Mr. Praveen Kumar has furnished the following particulars relating to payments made towards Scientific Research for the year ended 31.03.2019:

Particulars	**(`in Lakhs)**
1. Payments made to K Research Ltd.	**20**
2. Payment made to LMN College	**15**
3. Payment made to OPQ College	**10**
Note: K Research Ltd and LMN College are approved Research Institutions and	
these payments are to be used for the purposes of Scientific Research.	
4. Payment made to National Laboratory	**8**
5. Machinery purchased for in-house Scientific Research	**25**
6. Salaries to research staff engaged in-house Scientific Research	**12**

Compute the amount of deduction available u/s 35 of the Income Tax Act, 1961 while arriving at the Business Income of the Assessee.

Solution: Computation of Deductible Amount u/s 35: (`in Lakhs)

Particulars	**Amount**	**%of deduction**	**Deductible Amt**
Payments made to K Research Ltd. (approved institution)	20.00	100%	20.00
Payment made to LMN College (approved institution)	15.00	150%	22.50
Payment made to OPQ College (not an approved institution)	10.00	Nil	Nil
Payment made to National Laboratory	8.00	150%	12.00
Machinery purchased for In-House Scientific Research	25.00	100%	25.00
Salaries to Research Staff engaged in In-House Scientific Research	12.00	100%	12.00
Total deduction for the Previous Year 2018-2019			**91.50**

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6.3.5 Deduction for Eligible Projects / Programmes

The deductions described herein are -

A. Rural Development Programme [Sec.35CCA] C. Skill Development Project [Sec.35CCD]

B. Agricultural Extension Project [Sec.35CCC]

A. Rural Development Programme u/s 35CCA

1. **Applicability:** All Assessees.

2. **Nature of Expenditure:** Contribution made to the following funds set up and notified by Central Government – (a) National Fund for Rural Development, (b) National Urban Poverty Eradication Fund.

3. **Deduction:** Actual Expenditure incurred.

4. **No other deduction:** No deduction will be available under any other Section, in respect of expenditure claimed and allowed u/s 35CCA.

Once the Assessee fulfills all conditions laid down u/s 35CCA for claiming deduction of amount donated, there is no obligation on his part to see that the amount donated is actually utilized for purpose for which it was donated. The deduction is only for the certificate furnished. **[Chotatingrai TEA 126 Taxman 399 (SC)]**

B. Agricultural Extension Project u/s 35CCC

1. Applicability: All Assessees.

2. **Nature of Expenditure:** Any expenditure on Agricultural Extension Project, as notified by CBDT, as per prescribed guidelines.

3. **Deduction: 150%** of the expenditure incurred.

4. **No deduction:** No deduction will be available under any other Section, in respect of expenditure claimed and allowed u/s 35CCC.

C. Skill Development Project u/s 35CCD

1. Applicability: All Assessees.

2. **Nature of Expenditure:** Any expenditure other than cost of Land and Building on Skill Development project, as notified by CBDT, as per prescribed guidelines.

3. **Deduction: 150%** of the expenditure incurred.

4. **No deduction:** No deduction will be available under any other Section, in respect of expenditure claimed and allowed u/s 35CCD.

Note: National Manufacturing Policy: Expenditure incurred on Public Private Partnership Project for Skill

Development in the ITIs in the manufacturing sector is eligible for deduction.

6.3.6 Special Deduction for Specified Business [Sec.35AD]

1. Eligible Assessee: Assessee engaged in following specified business -

Specified Business	**Commencement**	**Deduction**
(a) Laying & operating a cross-country Natural Gas or Crude or Petroleum Oil **Pipeline Network** for distribution, including Storage Facilities being an integral part of such network.	on or after 01.04.2007	100%
(b) Setting up and operating a **Cold Chain Facility,**	on or after 01.04.2009	100**%**
(c) Setting up and operating a **Warehousing Facility** for storage of **Agricultural Produce.**	on or after 01.04.2009	100**%**
Specified Business	**Commencement**	**Deduction**
(d) Building and operating a **Hotel** of two star or above category as classified by the Central Government.	on or after 01.04.2010	100%
(e) Building and operating a **Hospital** with atleast 100 beds for patients.	on or after 01.04.2010	100**%**
(f) Developing and building a Housing Project under a scheme for **Affordable Housing Slum Redevelopment** or **Rehabilitation Scheme** framed by Central or State Government and notified by CBDT.	on or after 01.04.2010	100%
(g) Developing and building a Housing Project under a scheme for **Affordable Housing** framed by the Central Government or State Government and notified by CBDT **[Guidelines as per Notification No. 1/2012]**	on or after 01.04.2010	100**%**
(h) New Plant or in newly installed capacity in an existing Plant, for production of **Fertilizer.**	on or after 01.04.2010	100**%**
(i) Setting up and operating an **Inland Container Depot** or **Container Freight Station** notified or approved under the Customs Act.	on or after 01.04.2012	100%

(j) Bee-keeping and production of **Honey and Beeswax.**	on or after 01.04.2012	100%
(k) Setting up and operating a **Warehousing** Facility for storage of **Sugar.**	on or after 01.04.2012	100%
(1) Laying and operating a **Slurry Pipeline** for the transportation of Iron Ore.	on or after 01.04.2014	100%
(m) Setting up and operating **Semi-Conductor Wafer Fabrication** Manufacturing Unit notified by CBDT.	on or after 01.04.2014	100%
(n) **w.e.f. 01.04.2018** Business of developing or maintaining and operating or developing, maintaining and operating a New Infrastructure Facility	On or after 01.04.2017	100%

2. **Meanings of Specified Terms:**

Cold Chain Facility	A chain of facilities for storage or transportation of – (a) agricultural and forest produce, (b) meat and meat products, (c) poultry, (d) marine and dairy products, (e) products of horticulture, floriculture and apiculture, and (f) processed food items, under **scientifically controlled conditions** including refrigeration and other facilities necessary for the preservation of such produce.
Associated Person	Associated Person means who - (a) **Participation in Management:** Participates in the management / control / capital of the undertaking either directly or indirectly or through one or more intermediaries. (b) **Voting Power:** Holds atleast 26% of the voting power in shares either directly or indirectly. (c) **Power to appoint Governing Board:** Appoints more than half of the Board of Directors or Members of the Governing Board, or one or more Executive Directors or Executive Members of the Governing Board of the Assessee. (d) **Guarantor:** Guarantees not less than 10% of the Total Borrowings of the Assessee.

3. **Conditions to be fulfilled:**

(a) It is not set up by splitting up or reconstruction of a business already in existence.

(b) It is not set up by the transfer to the specified business of Machinery or Plant previously used for any purpose. [See **exceptions** in Note 1 below.]

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(c) **Additional Conditions** of Gas / Oil Pipeline Network Business should be satisfied. **[See Note 2 below]**

(d) **Additional Conditions** relating to New Infrastructure Facility should be satisfied-

(i) **Formation:** It is owned by a Company Registered in India or by a consortium of such Companies or by an Authority or a Board or Corporation or any other Body established or constituted under any Central or State Act.

(ii) **Agreement:** Such Entity has entered into an agreement with the Central Government or a State Government or a Local Authority or any other Statutory Body for developing or operating and maintaining or developing, operating and maintaining, a New Infrastructure Facility.

(iii) **"Infrastructure Facility" Means -**

- a Road, including Toll Road, a Bridge or a Rail System,
- a Highway Project including Housing or other activities being an integral part of the highway project,
- a Water Supply Project, Water Treatment System, Irrigation Project, Sanitation and Sewerage System or Solid Waste Management System,
- a Port, Airport, Inland Waterway, Inland Port or Navigational Channel in the Sea.

Note:

1. **Exception for Point (b) above:** Any Machinery or Plant which was used outside India by any person other than the assessee shall not be regarded as Machinery or Plant previously used for any purpose **if-**

• Machinery or Plant was not at any time prior to the date of the installation by the assessee used in India

• Machinery or Plant is imported into India from any country outside India, and

• No deduction on account of depreciation in respect of such Plant or Machinery has been allowed under the Act in computing the Total Income of any person for any period prior to the date of the installation of the Machinery or Plant by the assessee.

• Where in case of Specified Business, if any Machinery or Plant or any part thereof previously used for any purpose is transferred to the specified business, then the total value of the Machinery or Plant or part so transferred shall not exceed 20% of the total value of the Machinery or Plant used in such business.

2. **Additional Conditions for Gas / Oil Pipeline Network Business:**

(a) **Ownership:** The undertaking is owned – (i) by a Company registered in India, or (ii) by a consortium of such Companies, or (iii) by an Authority / Board / Corporation established under Central or State Act.

(b) **Approval:** It has been approved by the Petroleum & Natural Gas Regulatory Board, and notified by Central Government.

(c) **Common Carrier Usage:** Such proportion of its total pipeline capacity, as specified under Petroleum and Natural Gas Regulatory Board Act, 2006 is available for use on common carrier basis, by any person other than the Assessee or an Associated Person.

(d) **Others:** It should fulfill any other condition as may be prescribed. 3

3. **Deduction:**

(a) **General to all Eligible Assessees:**

• **Current Year Expenditure:** Capital Expenditure (other than expenditure incurred on acquisition of **Land, Goodwill or Financial Instrument)** incurred wholly and exclusively for the purposes of any specified business carried on during the previous year in which such expenditure is incurred by him.

• **Prior Period Expenditure:** Expenditure incurred wholly and exclusively for the purposes of specified business prior to the commencement of operation shall be allowed as a deduction in the previous year of commencement of operation, if the amount is capitalised in the Assessee's books on the date of commencement of operations.

(b) **No Deduction in case of cash payments exceeding`10,000:** Capital Expenditure in respect of which, payment or aggregate of payments made to a person in a day, **exceeding**`10,000is made otherwise than by an Account Payee Cheque drawn on a Bank or an Account Payee Bank Draft or use of Electronic Clearing system through a Bank account is disallowed.

4. **Transfer of Operations in Hotel Business:** Where the Assessee builds a Hotel of two star or above category as classified by the Central Government and subsequently, while **continuing to own the Hotel,** transfers the operation thereof to another person, the assessee shall be deemed to be carrying on specified business u/s 35AD.

5. **Restrictions / Conditions:**

(a) Where a deduction is claimed and allowed u/s 35AD in respect of the specified business for any assessment year, no deduction shall be allowed under Section 10AA or Chapter VIA in relation to such Specified Business for the same or any other assessment year.

(b) No deduction in respect of this expenditure shall be allowed to the Assessee under any other Section in any previous year, or under this Section in any other previous year.

(c) Sec.80A(6) and 80-IA (7) / (10) shall apply in respect of goods or services or assets held for the purposes of the specified business.

6. **Asset to be used in Specified Business for 8 years:** Any asset in respect of which a deduction is claimed and allowed u/s 35AD shall be used **only** for the Specified Business, for 8 years beginning with the previous year in which such asset is acquired or constructed.

7. **Taxability on non-usage of Asset:**

(a) **Situation:** Asset, in respect of which a deduction is claimed and allowed u/s 35AD, is used for a purpose other than the Specified Business during the 8-year period [except demolished / discarded / destroyed / transferred as referred u/s 28(vii)].

(b) **Taxable Amount:** Total Amount of deduction claimed and allowed in one or more previous years, as reduced by the amount of Depreciation Allowable u/s 32, shall be **deemed** to be the Income of the Assessee, as if no deduction u/s 35AD was allowed.

(c) **Manner of Charge:** It is chargeable under the head "Profits and Gains of Business or Profession" of the previous year in which the asset is so used.

(d) **Exception:** The above shall not apply to a Company which has become a Sick Industrial Company u/s 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, during the 8 year period.

8. **Set off and Carry forward of Losses [Sec.73A]:** Brought Forward Loss of Specified Business u/s 35AD can be set-off against Income from another Specified Business u/s 73A, irrespective of whether the latter is eligible for deduction u/s 35AD.

Illustration – Deduction u/s 35 AD – M 12

MNP Ltd commenced operations of the Business of a new Four-Star Hotel in Chennai on

01.04.2018. The Company incurred Capital Expenditure of`40 Lakhs during the period January, 2018 to March, 2018 exclusively for the above Business, and capitalised the same in its Books of Account as on April, 2018. Further, during the Previous Year 2018-2019, it incurred Capital Expenditure of`2.5 Crores (out of which`1 Crore was for Acquisition of Land) exclusively for the above Business.

Compute the Income under the heading Profits and Gains of Business or Profession for the Assessment Year 2019-2020, assuming that MNP Ltd has fulfilled all the conditions specified for claim of deduction u/s 35AD and has not claimed any deduction under Chapter VI-A under the heading "C- Deductions in respect of certain incomes". The Profits from the Business of running this Hotel (before claiming deduction u/s 35AD), for the Assessment Year 2019-2020 is`80 Lakhs.

Assume that the Company also has another existing Business of running a Four—Star Hotel in Kanpur, which commenced Operations 6 years back, the Profits from which was`130 Lakhs for the AY 2019-2020.

Assessee: MNP Ltd Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Deduction u/s 35AD

Particulars	**`Lakhs**
1. Income from Four Star Hotel in Chennai **Less:** Eligible deduction u/s 35AD:	80
(i) Prior Period Expenditure (40) (ii) Capital Expenditure (`250 Lakhs –`100 Lakhs) (150)	(190)
Total [Loss can be set-off only against the Income from any Specified Business] **[Sec.73A]**	(110)
2. Income from Four Star Hotel in Kanpur [Being a Specified Business, above Loss is eligible to be set- off against this Income u/s 73A].	130
Income under the head Profits & Gains of Business/Profession	20

Note: Expenditure relating to acquisition of Land is not allowable as a deduction u/s **35AD.**

Illustration – Deduction u/s 35AD – M 11

Win Limited commenced the Business of operating Three Star Hotel in Tirupati on 01.04.2018. It

Particulars	**`(In Lakhs)**
(i) Cost of Land (acquired in June 2017)	**60**

(ii) Cost of Construction of Hotel Building	
Financial Year 2017-2018	**30**
Financial Year 2018-2019	**150**
(iii) Plant and Machineries (all new) acquired during Financial Year 2018-2019	**30**
[All the above expenditures were capitalized in the books of the Company]	
Net Profit before Depreciation for the Financial Year 2018-2019	**80**
Determine the amount eligible for deduction u/s 35AD, for the Assessment Year 201*	

Assessee: Win Limited Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Deduction u/s 35AD (In`Lakhs)

Particulars	**Deduction u/s 35AD**
Expenditure incurred in the Prior Previous Year capitalized in the books of the Company	
(i) Land – Excluded u/s 35AD	NIL
(ii) Construction of Hotel Building – (`30 +`150)	180
(iii) Plant and Machineries	30
Total Eligible Deductions u/s 35AD	210
Computation of Income	
Income for the Previous Year	80
Less: Deductions computed above restricted to Income as above	(80)
Total Income	**NIL**

Note: The Balance Deduction of`130 Lakhs (210-80) can be carried for any number of years, and can be set off only against the Income of Specified Business. **[Sec.73A]**

6.3.7 Preliminary Expenses

1. **Applicability:** The Assessee should be an -Indian Company, or Non-Corporate Resident Assessee.
2. **Purpose of Preliminary Expenses:**

Time of incurring Expenses	**Purpose of Expenses**
Before commencement of business	For setting up of any undertaking or business.
After commencement of business	Extension of the existing Undertaking or setting up New Unit.

Note: The benefit u/s 35D is also available to Non—Industrial Undertakings incurring expenditure with extension of its business after its commencement.

3. **List of Specified Expenditure [Sec.35D(2)]:** Expenditure incurred in connection with-

Non-Corporate Resident Assessee	**Indian Company**

(a) Preparation of Feasibility Report, Project Report, or for conducting Market Survey or any other survey or engineering services relating to the business of the Assessee. (b) Legal Charges for drafting any agreement for setting up or for conduct of any business.	(a) Preparation of Feasibility Report, Project Report, or for conducting Market Survey or any other survey, or Engineering Services relating to the business of the assessee. Any work in connection with the above activity for the time being shall be approved by Board. (b) Legal Charges for drafting any agreement for setting up or for conduct of any business. (c) Expenses incurred for - • Legal Charges for drafting and printing Memorandum and Articles of Association, • Fees for registering the Company under Companies Act, • Issue of Shares or Debentures of the Company, Underwriting Commission, Brokerage and Charges for drafting, typing, printing and advertisement of Prospectus. (d) Other Expenditure as prescribed by CBDT for the purpose of amortization **(Note:** So far, nothing has been prescribed).

4. Maximum Permissible Expenditure [Sec. 35D(3)[:

(a) In case of Indian Company, 5% of Cost of Project or 5% of Capital Employed in the business of the Company, at the option of the Company.

(b) In case of any other Assessee, 5% of the Cost of Project.

Note:

- **Cost of Project** means Actual Cost of Fixed Assets like Land, Buildings, Leasehold, Plant and Machinery, Furniture and Fittings and Railway Sidings as shown in the books of the Assessee, on the last day of the previous year in which the Assessee commences business / extension of the undertaking is completed / new industrial unit commences production.
- **Capital Employed** = Issued Share Capital + Debentures + Long Term Borrowings.

5. **Amount of deduction:** Least of (a) Actual Expenditure or (b) Maximum Permissible Expenditure as above, will be allowed as a deduction in **five equal instalments,** beginning from the year of commencement of production or operation.

6. **Audit Report:** Assessees other than Company and Co-Operative Society, are required to furnish Audit Report in Form 3AE, along with the Return of Income for the first year of claiming deduction.

7. **Business Re-organization:** In case of Amalgamation or Demerger of an Indian Company, the Amalgamated or the Resulting Company are entitled to deduction from the previous year in which the Amalgamation / Demerger takes place.

8. **No other deduction:** No deduction will be available under any other Section in respect of expenditure claimed and allowed u/s 35D.

Management Fees and Lease Rent incurred before commencement of production have not been included u/s **35D** and the same is not entitled for deduction u/s **35D [Ennar Steel & Alloy P Ltd 261 ITR 347 (Mad.)|**

Share Issue Expenses cannot be claimed as general deduction, it is allowable only u/s 35D. **[Brooke Bond India Ltd 225 ITR 798 (SC)]**

Illustration – Sec.35D -Preliminary Expenses -MOO

Jardine Ltd. is an existing Indian Company, which sets up a new industrial unit. It incurs the following expenditure in connection with the new unit: ?

Preparation of Project Report	**4,00,000**
Market Survey Expenses	**5,00,000**

Leaal and other charaes for issue of additional capital required for the new unit 2.00,000

Total	**11,00.000**

The following further data is given:

Cost of Project	**30,00,000**
Capital Employed in the new unit	**40,00,000**

What deduction is admissible to the Company u/s 35D for Assessment Year 2019-2020?

Assessee: Jardine Ltd PY: 2018-2019 AY: 2019-2020 Status: Indian Company

1. Actual Preliminary Expenses =

Project Report (4,00,000) + Market Survey (5,00,000) + Legal Charges (2,00,000) =`11,00,000

2. **Maximum Permissible Amount to be amortised:** Least of (a) or (b)

(a) Higher of the following, i.e. `2,00,000

5% of Cost of the Project =`30,00,000 x 5% =`1,50,000,

5% of Capital Employed = *t* 40,00,000 x 5% = `2,00,000,

(b) Actual Preliminary Expenses `11,00,000

3. **Amount eligible for Amortisation:**`2,00,000

4. **Deduction for AY 2019-2020: l/5th of Eligible Amount** = 1/5 x`2,00,000 =`40,000. The balance will be allowed in the next four assessment years.

6.3.8 VRS Compensation Expenditure [Sec.35DDA]

1. Applicability: All Assessees.

2. **Expenditure:** Amount paid to an Employee in connection in his Voluntary Retirement.

3. **Deduction:** The amount of expenditure so paid will be allowed in 5 equal installments commencing from the previous year in which such payment / part payment was made.

4. **Business Re-organisation:** In the following cases, the deduction will be allowed as under -

Nature	**Assessee entitled to deduction**	**Years of deduction**
Amalgamation	Amalgamated Company	From the year of Amalgamation or Demerger or Business Reorganization or Conversion
Demerger	Resulting Company	
Partnership Firm or Proprietary Concern converted into Company subject to fulfilling conditions u/s 47(xiii) / 47(xiv)	New Company	
Private Company or Unlisted Public Company converted into LLP subject to conditions u/s 47(xiiib).	Limited Liability Partnership (LLP)	

5. **No other deduction:** No deduction shall be available under any other section in respect of expenditure claimed and allowed under this section.

6.3.9 Specified Deduction u/s 36

The deductions are classified in the following manner herein -

A. Expenditure Allowable for all Assessees

B. Expenditure Allowable for all Employers

C. Entity-Specific Allowable Expenditure

A. EXPENDITURE ALLOWABLE FOR ALL ASSESSEES

1. Stock Insurance [Sec. 36(1)(i)[:

(a) **Nature of Expenditure:** Insurance Premium on risk of damage or destruction of Stocks / Stores used in the business.

(b) **Condition:** Deduction allowable only in the year of **payment.**

2. **Interest on Borrowed Capital [Sec. 36(1)(iii)]:**

(a) **Nature of Expenditure:**

• Interest on Borrowed Capital not used for the purpose of business shall not be allowed as deduction u/s 36(1)(iv). **[Madhav Prasad Jatia 118 ITR 200 (SC), Vijay Kumar Mills Ltd 194 ITR 197, Hira Lai & Sons 190 ITR 408 (SC)]**

• Interest will be deductible irrespective of the fact that it is borrowed for Working Capital or for acquiring Capital Asset. **[India Cements Ltd 60 ITR 52 (SC)]**

• There should be **nexus** between the expenditure and the purpose of the business, which need not necessarily be the business of the Assessee himself. **[S.A. Builders Ltd vs CIT 206 CTR 631 (SC)]**

• Interest on Borrowings is deductible, if Capital is used for business purpose irrespective of what may be the result of using the Capital which assessee has borrowed. **[DCIT vs Core Health Care Ltd 167 Taxman 206 (SC)]**

• Recurring Subscriptions paid periodically by Shareholders, or Subscribers in Mutual Benefit Societies which fulfill prescribed conditions, shall be deemed to be capital borrowed for the purposes of this Clause.

(b) Conditions:

• Money should be borrowed for purpose of business. Interest on Borrowed Capital **not used** for the purpose of business shall not be allowed as deduction u/s 36(1)(iii). **[Vijay Kumar Mills Ltd 194 ITR 197]**

• In case of amount borrowed from Financial Institutions or any Loan or Advance from Banks, interest should be paid on or before **due date of filing Return of Income. [Sec. 43B]**

• Interest on **delayed payment to SSI** will **not** be **allowed** as a deduction.

• Interest on the capital borrowed **for the purchase of asset,** paid from the date on which the capital was borrowed upto the date such asset was first put to use, shall **not** be allowed as a deduction. 3

3. **Animal Allowance [Sec. 36(1)(vi)]:** This is a deduction / allowance for dead / permanently useless animals,

which were used for purpose of business.

(a) **Conditions:** Animals should **not** be held as Stock-in-Trade.

(b) **Deduction** = Actual Cost of Animals **Less** Amount realised on sale of the animal or their carcasses.

4. **Bad Debts (excluding Provision for Bad Debts) [Sec. 36(1)(vii)]:**

(a) **Nature of Expenditure:**

• Amount written off in P&L A/c as Bad Debts are allowable as deduction, on fulfillment of **conditions** stated below. **[General Insurance Corp. of India 254 ITR 204 (Bom.)]**

• Successor of Business is entitled to write off Predecessor's Debt. **[Veerabadra Rao K Koteswara Rao & Co. 155 ITR 152 (SC)]**

(b) **Conditions:**

• The Debt must be **incidental** to the business.

• Such Debt should be **revenue** in nature.

• It must have been **taken into account** in computing the Income of the Assessee.

• The Debt may be money lent in the ordinary course of banking or money lending business.

• The Bad Debt must have been **written off** in the books of the Assessee.

• The **business** in which such Debt is incurred should be **continued** during the previous year.

• Any Debt or part of Debt debited to Provision for Bad & Doubtful Debts A/c, shall relate to all types of Advances, including Advances made by Rural Branches.

(c) **Subsequent Recovery of Bad Debts:**

- If Bad Debts written off are subsequently recovered at an amount higher than Unallowed Amount (i.e. Total Bad Debts less Amount Allowed u/s 36), then such excess amount shall be deemed to be

* income of the previous year in which it is recovered irrespective of the existence of business or profession. **[Sec. 41(4)]**

- If Subsequent Recovery is less than the Unallowed Amount, the deficiency is deductible in the previous year in which ultimate recovery is made. **[Sec. 36(2)(ii)]**

(d) **Situation:** If whole or part of Debt has been included in Income of PY in which, it becomes irrevocable or earlier PYs based on notified ICDS without recording the same in the accounts.

(e) **Effect:** Such Debt amount shall be allowed in PY in which, it becomes irrevocable and it shall be deemed that such amount has been written off in the accounts.

5. **Commodities Transaction Tax (CTT) [Sec. 36(1)(xvi)]:**

(a) Taxable Commodities Transactions should be entered into in the course of the Assessee's business during the previous year.

(b) Income arising from such transactions is included under "Profits and Gains of Business or Profession".

(c) **Meanings:**

- **Taxable Commodities Transaction** means a transaction of Sale of Commodity Derivatives, in respect of commodities other than agricultural commodities, traded in Recognized Associations.

- **Commodity Derivative:** It means -

(i) A contract for delivery of goods which is not a ready delivery contract,

(ii) A contract for differences which derives its value from prices or indices of prices -

(a) of such underlying goods or

(b) of related services and rights such as Warehousing and Freight, or

(c) with reference to weather and similar events and activities.

having a bearing on the Commodity Sector.

(d) **Rate:** CTT is to be levied at 0.01% on sale of Commodity Derivative, and it shall be paid by Seller.

6. **Deduction in respect of Marked to Market Loss or other Expected loss [Sec. 36(1)(xviii)]:**

(a) **Nature of Deduction:** Deduction in respect of Marked to Market loss or other expected loss shall be allowed as a deduction.

(b) **Condition:** The loss should be computed in accordance with Income Computation and Disclosure Standards notified u/s 145(2).

B. EXPENDITURE ALLOWABLE FOR ALL EMPLOYERS

36(1)	**Nature of Expenditure**	**Amount of Deduction/Conditions**
(ib)	**Insurance Premium paid on health of Employees**	Payment should be made any mode other than cash, under - 1. Scheme framed by General Insurance Corporation and approved by Central Government, or 2. Scheme framed by any other Insurer, and approved by IRDA.
(ii)	**Bonus or Commission paid to employees**	1. Allowable as deduction only if such sum is not payable as profit or dividend. 2. Payment shall be made on or before due date of filing Return of Income. **[Sec. 43B]**
(iv)	**Contribution to Recognised PF** or **Approved Superannuation Fund**	Payment should be actually made on or before the due date of filing Return of Income. **[Sec. 43B]**

(iva)	**Contribution towards Pension Scheme u/s 80CCD**	1. Contribution should not exceed 10% of the Salary of the Employee in the previous year. 2. Salary includes DA if the terms of employment so provide, but excludes all other Allowances and Perquisites.
(v)	**Contribution to Approved Gratuity Fund**	1. Payment should be made on or before the due date of filing Return of Income. **[Sec. 43B]** 2. Payment directly to LIC towards Group Gratuity Fund is deductible. **[Textool Co. Ltd 122 Taxman 668 (Mad.)]**
(va)	**Contribution from Employees towards Welfare Fund Accounts**	1. Remittances must be made on or before the due date under the relevant Act for the relevant Fund. 2. Payment made within the grace period allowed under the respective Act (i.e. EPF Act, ESI Act, etc.) is allowed. **[Shri Ganapathy Mills Co. Ltd. 243 ITR 879 (Mad.)l**

C. ENTITY-SPECIFIC ALLOWABLE EXPENDITURE

1. Promoting Family Planning amongst Employees [Sec. 36(1)(ix)]:

(a) **Applicability:** Companies

(b) Conditions:

- Revenue Expenditure is fully allowed as deduction.
- Capital Expenditure incurred will be allowed in **5 years in equal instalments,** commencing from the previous year in which it was incurred.
- Unabsorbed Capital Expenditure on Family Planning shall be carried forward in the same manner as Unabsorbed Depreciation.
- In case of amalgamation, the Amalgamated Company will be allowed to write off the balance amount unallowed in the hands of the Amalgamating Company. 2

2. **Insurance Premium on Life of Cattle** owned by a Member of a Primary Co-Operative Society. **[Sec. 36(1)(ia)]:**

(a) **Applicability:** Federal Milk Co-operative Societies.

(b) **Deduction:** Deduction will be allowed only in the year of **payment.**

3. **Discount on Zero Coupon Bonds |Sec. 36(1)(iiia)|:**

(a) **Applicability:** Infrastructure Capital Company / Fund, Public Sector Company, Scheduled Bank being a Issuer of Zero Coupon Bonds.

(b) Conditions:

- Discount can be written off on a pro-rata basis over the period of the Bond.
- Discount is the difference between Maturity / Redemption Value and the Issue Price.

4. Contribution to Credit Guarantee Fund Trust for small industries |S. 36(1)(xiv)]:

(a) **Applicability:** Public Financial Institution

(b) **Condition:** The Credit Guarantee Fund Trust must be **notified** by the Central Government.

6.3.10 General Deductions / Expenditure [Sec.37]

1. **Conditions for allowability of Expenditure:**

(a) **Revenue:** There should be an expenditure of revenue nature incurred during the Previous Year.

(b) **Not Capital in Nature:** The expenditure should not be of Capital in nature.

(c) **Connection:** It should be incurred in connection with business or profession carried on by the Assessee.

Example: Expenditure incurred on replacement of linen and carpets in Hotel Business is towards maintenance of Fixed Assets, and is hence allowable. **[CIT vs Piem Hotels Ltd 1 SOT 382 (Mum.)]**

(d) **Wholly / Exclusively:** It should have been expended wholly & exclusively for the purpose of business or profession.

(e) **Not covered in Sec. 30 to 36:** The expenditure should not be in the nature as prescribed u/s 30 to 36.

(f) **Non-personal:** It should not be in the nature of personal expenditure.

(g) **Legal:** It should not be incurred for any purpose, which is an offence or in contravention of any provision of law. **Example:** Sum incurred as Freebies by Pharmaceutical Industries to Medical Practitioners, is in contravention of law and hence not allowed as deduction. **[Circular No. 5/2012 dt. 01.08.2012]**

(h) **Non-CSR:** Expenses relating to Corporate Social Responsibility (CSR) referred u/s 135 of the Companies Act, 2013 shall **not** be allowed u/s 37.

2. **General Principles for claiming expenditure u/s 37:**

(a) **Motive:** Motive to earn profit is not essential.

(b) **Benefit:** Giving direct benefit to the business is not essential.

(c) **Purpose:** Purpose and concern should be verifiable.

(d) **Nexus:** Nexus between expenses and business is essential.

(e) **Third Party:** Expenditure will be allowed even if third party is benefited.

(f) **Prudence:** Prudence is a basic principle of accounting.

(g) **Feasibility:** Commercial feasibility related to business.

3. **Allowable Expenditure u/s 37 under specific instructions of CBDT:**

(a) **Harvesting and Transportation Expenses** incurred by **Co-Operative Sugar Mills** for procuring sugarcane from farmers, who are members of such Co-operative Sugar Mills and who are bound under an agreement to supply the sugarcane exclusively to the concerned Sugar Mill. **[C.No. 6/2007, dt.**

11.10.2007]

(b) **Diwali and Muharat** Expenses. **[C.No. 13/A/20/68/3.10.1968]**

(c) **Telephone Deposit** paid under **Tatkal** Telephone Deposit Scheme. **|C.No. 671/27.10.1993]**

(d) **Telephone Deposit** under OYT Scheme or Security Deposit for Telex connection. **[C.No. 204/70/75/10.05.76]**

(e) Expenditure on **Fluorescent Tubes** including wiring and fitting expenditure – Initial expenditure is of capital nature but all **replacement expenditure** should be treated as revenue nature. **[C.No. 69/27.11.1951]**

(f) Insurance **Premium** paid on account of **loss of profits. (C.No. A/2171/6A/139/59-60/ 07.04.1961]**

(g) **Lagan or mahamai contribution** collection by the Trade Association from their Members, on the business transactions. **[C.No. 5/28.2.1962]**

(h) Amount paid to ROC to discharge any **obligation** under Company law. **[C.No. 10/25/63/18.6.1994]**

(i) Annual **Listing Fees** paid to Stock Exchange. **[C.No. F-10/67/65/26.8.1965]**

(j) **Commitment Charges** paid **by** Borrower to Lender. **[C.No. 2B/23.8.1965]**

(k) Training Expenditure on **apprentices** covered under Apprentices Act, 1961. **[C.No. 192/10.3.1976]**

(l) Expenditure incurred by business concern on **civil defence measures. (C.No. 316/30.9.1981]**

(m) **Professional Tax** paid. **[C.No. 16& 18/18.9.1969]**

(n) Expenditure incurred by the management for the first 3 years in connection with setting up of **Consumer Co-Operative Stores. [C.No. 16/54/63/25.4.1963]**

(o) Revenue Expenditure for the maintenance of **industrial home guard units. [C.No. 10/80/64/26.2.1965|**

(p) **Interest payable** on the unpaid purchase price of Plant & Machinery. **[F.No. 10/92/64-IT (A-I)/13.09.1965]**

4, Allowable Deductions as per Legal Decisions:

Set – A: SPECIFIC ITEMS AND DEDUCTIONS	
Nature of Expense	**Allowable Deduction as per Legal Decisions**
(a) **Capital Vs Revenue Expenditure – Revenue nature**	• **Rent** paid by **Lessee** for **acquiring leasehold right** to **extract minerals** as one fixed amount for entire lease is **Capital Expenditure,** and proportionate amount of rent **not allowable** as deduction. **[Enterprising Enterprises vs DCIT** 293**ITR** 437 **(SC)]** • Where an Assessee, being a Lessee, **according to the terms of the lease agreement,** demolishes the existing construction and **constructed a new building** for its business at its **own expenses,** the expenditure incurred on the same shall be **allowed as Revenue Expenditure. [Madras Auto Service Private Limited** (1998) 238 **ITR** 468] • Where as per the Lease Deed, the **expenses incurred by the Lessee** in building a ground floor above the existing basement floor in leasehold premises are **not to be reimbursed** by the Lessor of such premises, such expenditure is **revenue in nature. [CIT vs Hari Vignesh Motors P. Ltd. (2005) 282 ITR 338 (Mad.)]** • Payment made for **removal of restriction, obstruction** or disability may result in acquiring benefits to the business, but that by itself would not import the meaning of a Capital Asset. **[Bikaner Gipsum Ltd.** 53 **Tax** 279 (SC)] • Expenditure incurred for **purchase of loom hours** is allowable expenditure. **[Empire Jute Co. Ltd. 124 ITR 1 (SC)]** • One time **non-refundable fee for Membership of OTC Exchange** of India is a Revenue Expenditure. **[Neset Holdings P Ltd 151 Taxman 309 (Del.)]** • **Expenditure** incurred in **obtaining a right** for reproduction of film songs **for a specific period** is in **revenue nature,** because - (i) Royalty is based on the percentage of sales. (ii) Royalty is unascertainable at the time of agreement. (iii) Sale is dependent on the popularity of songs. **[M. Subramaniam 272 ITR 525 (Mad.)]**

Set – A: SPECIFIC ITEMS AND DEDUCTIONS	
Nature of Expense	**Allowable Deduction as per Legal Decisions**

	• **Expenditure** incurred on **preparation of a Feasibility Report** for setting up of mini cement plant which would provide raw materials required for the existing asbestos plant is deductible as revenue expenditure. **[Assam Asbestos Ltd. (2003) 132 Taxman 808 (Gau.)]** • Amount paid by the Assessee to the Government for legalising authorized construction, which was made for the purpose of business is allowable. **[Jaswant Trading Co. 212 ITR 293 (Raj.)]** • Assessee Bank is entitled to claim deduction on account of fall in the market value of Government securities, which was held by it as Stock-in-Trade. **[Lakshmi Vilas Bank Ltd 154 Taxman 301 (Mad)]** • Demolition of Old Cell Room and Erection of New Cell Room is a capital Expenditure and not current repairs of Revenue in Nature, since the expenditure is on new asset and not on the old asset. **[CIT Vs Modi Industries Ltd 339 ITR 467]** • Replacement of old Mono Sound System in Cinema Theater with new Dolby Stereo System does not in any way increase the Total Income, and hence such expenditure is Revenue Expenditure. **[CIT vs Sagar Talkies 325 ITR 133 (Karn)]** • Second hand Machinery purchased for use as spare parts is allowed as deduction u/s 37. **[Dr. Aswath N Rao vs ACIT 326 ITR 188 (Karn.)[** • Feasibility Studies were conducted for the existing business with a common administration and common fund, and the studies were abandoned without creating a new asset. But, the expenses were of Revenue Nature. **[CIT vs Priya Village Roadshows Limited. (2011) 322 ITR 594 (Del.)]**
(b) Depreciation	Claim for Depreciation on account of enhanced cost of assets due to fluctuation in exchange rate is admissible u/s 37. **[Maruti Udyog Ltd TIOL-116-SC-IT]**
(c) **General Welfare Expenses**	• Amount paid by Assessee-Company for **Flag Day Fund** on Government's Appeal. **(Kattabomman Trpt. Corpn. Ltd. 245 ITR 153 (Mad.)]** • Contribution towards Export Promotion Fund, incurred wholly and exclusively for purposes of business, is allowable. **[Rajasthan Spinning & Weavg. Mills Ltd 137 Taxman 367 (Raj.)]**
(d) Employee Welfare Expenses	• Contribution made by the Assessee Company to State Housing Board for **construction of tenements for its workers,** ownership of which tenements remained with the Housing Board. **[Bombay Dyeing & Mfg. Co. Ltd. 219 ITR 521 (SC)]** • Contribution by the Assessee to **Employee's Welfare Trust** and Subsidy to **House-Building Society. [Cheran Transport Corporation Ltd 241 ITR 137 (Mad.)]** • **Purchase of Bus** by the Assessee **and donating the same to a school** where the children of its employees were studying, is an Employee Welfare Expenditure eligible for deduction u/s 37. **[Rajasthan Spinning & Weaving Mills Ltd 281 ITR 408 (Raj.)]** • Decision of the Assessee to establish Welfare Trusts for the Employees in the year in which it earned huge profits is a **prudent commercial decision,** and the expenditure incurred by way of contribution to these Welfare Trusts is deductible u/s 37. **[BG Shirke and Co. (2002)264 ITR 83 (Bom.)]** • Expenditure incurred for renovation and repairs of the building of a **Club used for recreation of its employees** is allowable, and the Company is located in a remote place, entitled for deduction. **[Assam Brook Ltd 139 Taxman 229 (Cal.)]** • Gratuity paid to widow of a Director in accordance with Company's Articles of Association is allowable. **[Seshasayee Bros. P Ltd 11 Taxman 18 (Mad)]**
	Set – A: SPECIFIC ITEMS AND DEDUCTIONS

Nature of Expense	Allowable Deduction as per Legal Decisions
	• Keyman Insurance Policy Premium is allowable as business expenses. Merely because the policy was assigned after sometime would not mean that the expenditure incurred in the first instance would lose the flavour of it being Business Expenditure. **[Rajan Nanda vs CIT 18 Taxmann 98 (Del.)]**
(e) **Technical Knowhow related**	• Expenditure incurred as part of the price for the acquisition of Technical Know-how and satisfaction of condition precedent to, may be allowed as a deduction. **[British Industrial Corporation 165 ITR 51 (SC)]** • Payments made by Assessee-Company to obtain the **report of consultants for improving the efficiency** of business. **[Crompton Engineering Co. Ltd. 242 ITR 317 (Mad)]**
(f) **Illegal Business Loss – allowable**	• Explanation to Sec.37 deals only with **business expenditure** which is an offence or prohibited by law and **not with business loss. Heroin seized** by the Department is Stock-in-Trade, and has to be treated as a Business Loss, and hence it is an **allowable deduction. [Dr. T.A. Qureshi vs CIT 287 ITR 547 (SC)]** • Demurrage charged by Port Authorities is allowable, even if the **Assessee unauthorisedly imported goods,** which were confiscated by the Customs Authorities. **[Nanhoomal Jyoti Prasad 3 Taxman 60 (All.)]**
(g) **Interest vs Penalty**	In case, imposition of penalty is for contravention of provisions of CST Act, the levy is not compensatory and therefore not deductible, but **interest** is in compensatory nature and is allowable. **[Malwa Vanaspati & Chemical Co. 225 ITR 383, Swadeshi Cotton Mills Ltd 233 ITR 199 (SC) Std. Batteries Ltd 211 ITR 444 (SC)]**
(h) Statutory Expenses	Manufacturers are entitled to deduction of Excise Duty and Customs Duty paid in the year of accounting and debited to Profit and Loss Account. **[Berger Paint India Ltd** 266 **ITR** 99 (SC)]
(i) **Expense incurred in lock out/closure**	• Where an assessee has a number of units under a single business, the expenditure incurred in the lock out of any one of the units can be claimed as a deduction in the business. **[Ravindranathan Nair 247 ITR 178 (SC)]** • **Retrenchment Compensation** paid by a Company to its workers **on closure** of one of its units / division running in loss **is allowable as business expenditure. [Sasson J David & Co. P Ltd 118 ITR 261 (SC), J K Cotton Spg. & Wvg. Co. Ltd. 145 Taxman 591 (All.)]** • There is no sale or purchase or any manufacturing activity carried on in relevant Previous Year. Expenditure incurred to keep the business alive is to be allowed since the business in not closed in the relevant Previous Year. **[CIT vs Integrated Technologies Ltd (Del.)]** • Payment of compensation to workers on closure of one Textile Mill Unit is treated as Revenue Expenditure since after closure the remaining business is continued, and there was inter-connection in the functioning of different units. **[CIT vs DCM Ltd. 320 ITR 307 (Del.)]**
(j) Current vs Accumulated Repairs	Replacement of old frames for efficient functioning of machines without breakdowns, is allowable as deduction u/s 37 and not u/s 31, because it is not current repairs, but accumulated repairs. **[Gitanjali Mills Ltd** 136 **Taxman** 21 **(Mad.)]**
(k) **Guarantee commission**	Guarantee Commission paid to Bank for assuring due payment of instalments is revenue expenditure. **[Sivakami Mills Ltd. 227 ITR 465 (SC)]**
(1) Provision for Warranty	• Claim for deduction of warranty claims and free service charges of cars sold in earlier years is not an ad hoc amount or wholly contingent in nature, and it is an allowable deduction. **[Investments Ltd 77 ITR 533 (SC)]**

Nature of Expense	Allowable Deduction as per Legal Decisions
	• A provision is deductible if it is a present obligation resulting from past events which may require outflow of resources to settle and a reliable estimate may be made. If warranty is integral part of and is attached to the sale price of the product, provision is deductible. Hence, Provision for Warranty provided along with sale of valve actuators is allowed u/s 37. [Rotork Controls India (P) Ltd Vs CIT Compaq Computer (I) P.Ltd. Hewlett Packard India (P) Ltd (2009) (SC) 314ITR 62] • Provision for Future Warranty expenses is not contingent liability and is allowable deduction, since it is a liability capable of being construed in definite terms, which had arisen in an Accounting Year, though its actual quantification and discharge might be deferred to a future date. [Vinitec Corpn. Pvt. Ltd 278 ITR 337 (Del.) [2005] TIOL 69 (Del.)]
(m) Damages or losses on cancellation of contracts	• Any damages incurred by the assessee on account of non-fulfillment of business contract for reasons beyond his control, is incidental to business, and it is an allowable deduction. [Shantilal Pvt. Ltd 144 ITR 57 (SC)] • Damages paid due to breach of warranty [Prafulla Kumar Mallick 73 ITR 119 (Ori.)] • Loss on account of cancellation of a hedging contract for foreign currency is an allowable deduction. [Badridas Gauridu P Ltd 134 Taxman 376 (Bom.)]
(n) Legal / Litigation Expenses	• Litigation Expenses in protecting trade or business [Dalmia Jain & Co. Ltd 81 ITR 754 (SC)] • Expenditure which is incurred in opposing coercive Governmental action, with the object of saving taxation and safeguarding business [Birla Cotton Spg. & Wvg. Mills Ltd. &. Birla Bros P Ltd 82 ITR 166 (SC)] • Legal Charges for obtaining a loan from a Financial Institution [Orissa Cement Ltd 73 ITR 14 (Del.)] • Legal Expenses incurred in altering the Articles of Association, so as to bring it in conformity with the changes brought about in the Companies Act. [Elphinstone Spg. & Wvg. Mfg. Co. Ltd 100 ITR 139 (Bom.)]
(o) Expenses for availing loan	• Expenditure incurred to secure Overdraft Facilities for business purposes. [Jeewanlal (1929) Ltd 74 ITR 753 (SC)] • Expenses for obtaining loan for acquiring Capital Assets, cannot be treated as Capital Expenditure, because of their nexus with the acquiring of the loan, and not with the acquiring of any asset. [Patel Filters Ltd 264 ITR 21 (Guj.)] • Expenditure incurred on Issue and Collection of Debentures is treated as Revenue Expenditure, even in case of Convertible Debentures. [ITC Hotels Ltd 334 ITR 109 (Kar.)] • Money borrowed by issue of Debentures is in the nature of a loan and cannot assume the characteristic of investment. Therefore, the expenditure in the nature of commitment at the time of issuing such Debentures would be on revenue account only. Hence, Commitment Charges are allowable as deduction u/s 37. [Mihir Textiles Ltd 316 ITR 403 (Guj.)] • Brokerage paid for mobilising Public Deposit is revenue expenditure. [Karnataka Power Corporation Ltd. 51 taxmann.com 543 (Kar)(HC)(2014)]
(p) Interest Expenses	• Interest paid on outstanding balance of purchase consideration is allowable. [Bombay Steam Navigation Co. (1953) P Ltd 56 ITR 52 (SC)] • Whether interest on loans borrowed for expansion or diversification is allowable or not, depends upon new activity forms part of the existing business or not. |Prithvi Insurance Co. Ltd. 63 ITR 632, Produce Exchange Corpn. Ltd. 77 ITR 739 (SC)]

Set – A: SPECIFIC ITEMS AND DEDUCTIONS

Nature of Expense	Allowable Deduction as per Legal Decisions

(q) Profit—related Payments	• Share of Profit given by Debtor to Creditor besides interest. (Dharamvir Dhir 42 ITR 7 (SC)] • Commission paid at a %age of profits to General Manager. |J.K.Woollen Mfrs 72 ITR 612] • Amount paid to an ousted Partner, for the purpose of avoiding litigation with a view to ensure smooth carrying on business, is allowable business expenditure. [Bedi Sales Agencies 89 Taxman 613 (MP)] • Diversion by overriding title: Share in the Profit of a Firm paid to a Retired Partner pursuant to Section 37 of the Partnership Act is a diversion of income by overriding title and is deductible. *[Students' Note:* U/s 37 of Partnership Act, an Outgoing Partner is entitled to share in the Profits of the Firm, if he has not received his capital in full and the Firm uses his capital for running the business.] [Varanashi Nagar Vikas 275 ITR 140 (All)]
(r) Maintenance Expenditure	• Up-keeping Hotels: Expenditure incurred by Assessee-Company at regular intervals in order to maintain and upkeep its hotel situated in hilly area (due to severe climatic conditions in that region) is a revenue expenditure. [Hotel Control P. Ltd. 265 ITR 109 (Uttaranchal)] • Expenditure incurred by Airport Authority towards removal of illegal encroachments in and around Security Area of Airports and towards rehabilitation of encroachers would be allowed as Revenue Expenditure. [Airport Authority of India vs CIT 18 Taxmann 174 (Del.)]
(s) Others	• Expenditure on MS Office Software is allowable business expenditure. |CIT vs GE Capital Services Ltd (2007) 300 ITR 420] • Upgradation of Computers by changing certain parts is a Revenue Expenditure. [CIT vs Sundaram Clayton Limited 321 ITR 69 (Mad.)] • Product Development Expenses for upgrading existing products which require constant upgradation due to severe competition and which has life span for hardly a year, is Revenue Expenditure [Tejas Networks India P Ltd 52 taxmann.com 513 (Kar)] • Since sale of scrap generated out of demolition of buildings is treated as Income, interest paid on delayed payment, a contractual obligation is to be treated as revenue expenditure. [Kerala Road Lines Vs CIT 299 ITR 343 (SC)] • Expenditure on revaluation of existing assets. [Asiatic Oxygen & Acetylene Co. Ltd 132 ITR 506 (Cal.)] • Depreciation on Govt. Securities: Change in valuation of Government Securities from cost to market price and claim of depreciation on difference is an allowable deduction. |Karur Vysya Bank Ltd [2005] TIOL 29 (Mad.)] • Entertainment Expense: Expenditure incurred towards hospitality to guests or customers is an essential business expenditure including maintaining goodwill, and hence deductible. [Escorts Tractors P Ltd |2005] TIOL 68 (Del.)] • Ransom Money paid to Kidnappers for release of a Whole Time Director was a allowable deduction u/s 37(1). No Provision is brought to notice that payment of ransom is prohibited by law. In the absence of it, the explanation of Sec.37(1) would not be applicable. |CIT vs Khemchand Motilal Jain (2011)(MP)] • Expenditure for alteration of dam to ensure sharing of water with State Government without having any right of ownership in the dam or water is a Revenue Expenditure. [(Hindustan Zinc Limited 322 ITR 478 (Raj.)]

Set – A: SPECIFIC ITEMS AND DEDUCTIONS	
Nature of Expense	**Allowable Deduction as per Legal Decisions**
	• Admission Fee paid towards Corporate Membership is an expenditure incurred wholly and exclusively for the purpose of business and not towards capital account, and hence allowed as deduction u/s 37, **[(CIT vs Samtel Color Ltd 326 ITR 425 (Del.)]**

Set B: COMPANY-SPECIFIC ALLOWABLE EXPENSES	
Nature of Expense	**Allowable Deduction as per Legal Decisions**
(a) **Debentures Issue**	• Expenses in relation to **issue of debentures** are allowable as revenue expenditure. **[CIT vs Secure Meters Ltd 175 Taxman 567 (Raj.)]** • Expenditure incurred on **Partly Convertible Debentures** is revenue expenditure. **[CIT vs South India Corporation (Agencies) Ltd (2007) 290 ITR 217 (Mad.)]**
(b) Bonus Issue Expenses	Expenditure incurred in connection with the issuance of Bonus Shares **constitutes revenue expenditure. [General Insurance Corporation 205 CTR (SC) 280].**
(c) **Personal vs Business Expense**	Where a **Company permits its Director to use Company's vehicles** for personal purpose as perquisite, it cannot be said that such expenses were for personal use, since a Company is a **distinct assessable entity. [Sayaji Iron & Engg. Co. 253 ITR 749 (Guj.)]**
(d) Discount on Debentures	Discount Allowed on issue of Redeemable Debentures is allowable proportionately over the years of redemption. **[Madras Industrial Investment Corporation, 225 ITR 802 (SC)]**
(e) **Premium on Zero-Interest Debentures**	In case of Zero-Interest Convertible Debentures redeemable at premium after certain period, the **Premium shall be distributed over the period of debentures. [SM Holdings & Finance P Ltd. 264 ITR 370 (Bom.)]**
(f) **Legal Expenses for getting title to Shares**	Allowability of legal expenses incurred to protect or obtain perfect the title to the Share, depends upon the nature of holding of such shares by the Assessee Company, and is explained below **-** • Held as Stock in Trade – Expenses treated as **revenue** and written off against income. • Held as Investments – Expenses added to **Cost** of the Assets. **[Jaya Hind Industries P Ltd 161 ITR 842 (Bom)]**

Set C: PRINCIPLES FOR DETERMINING DEDUCTIONS U/S 37	
Nature of Expense	**Expenses allowable as Deductions as per Legal Decisions**
(a) **Incurrence of liability**	In order to claim deduction of what should be **certain** is the **incurrence of the liability.** In the absence of any details, accepting the claim of **percentage** on the **turnover** and **additional service charges** paid to **Parent Company** without evidences of additional services rendered, could **not be sustained. [CIT vs Rotork controls India Ltd & Ors. 293 ITR 311 (Mad.)]**
(b) Accounting Entry not conclusive	• **Book Entries** are **not decisive** or conclusive in determining the allowability or taxability of a particular item of expenditure or income. **[Bharat Carbon and Ribbon Mfg. Co. Pvt. Ltd. 239 ITR 505 Kedarnath Jute Mfg. Co. Ltd. 82 ITR 363 (SC)]** • The treatment of particular expense or a provision in the Books of Accounts can never be conclusively determinative of the nature of expense. An Assessee cannot be denied claim for deduction which is otherwise tenable in law on the ground that the Assessee had treated it differently in the books. **|CIT vs Asahi India Safety Glass Ltd (Del.)]**
Set C: PRINCIPLES FOR DETERMINING DEDUCTIONS U/S 37	
Nature of Expense	**Expenses allowable as Deductions as per Legal Decisions**

(c) **Goodwill measures**	Expenditure incurred as a goodwill measure to provide drinking water and school facility for the local residents, will be allowed as a deduction. This is not outside the ambit of the business of the Assessee, since its undertaking was generating some pollution. **[Madras Refineries Ltd 266 ITR 170(Mad)]**
(d) **Welfare related Expenses**	Contribution to Public Welfare Fund which is directly related to business or which will result in benefit to the business is allowable u/s 37(1). **[Sri Venkata Sathyanarayana Rice Mill Contractors Co. 223 ITR 101(SC)]**
(e) **Business Advantage**	Any expenditure incurred to obtain a business advantage and not to acquire any Capital Asset, is a allowable Revenue Expenditure. **[Madras Auto Services (P) Ltd 23 ITR 468 (SC)]**
(f) **Enduring Rev. Benefit**	Any expenditure incurred by Assessee which brings out any asset but does not belong to the Assessee, is deductible bringing benefit of enduring nature in revenue field. **[Associated Cements Cos. Ltd. 172 ITR 257 (SC))**
(g) **Revenue Benefit**	• Even in case of expenditure, which fails the test of benefit of enduring nature is deductible, if the benefit is in the revenue field. **[Empire Jute Co. Ltd 124 ITR 1 (SC)]** • Expenditure relating to Fans Association at the time of release of New Films and for their regular maintenance is for the purpose of promoting the films of popular Cine Artists, and therefore was part of professional activities and expenditure thereon was deductible. **[CIT vs A.Vijaykant 234 CTR 103 (Mad.)]**
(h) Custom related	Payments made to **discharge obligation of another party** by a courtesy on Joint Borrowings, under well-recognised commercial practice. **[Jagannath Kissonlal 41 ITR 360** (SC)]

5. **Inadmissible Expenses as per Legal Decisions:**

Set A: Specific Items disallowed	
Nature of Expense	**Inadmissible expenses**
(a) **Contingent Liability Items**	• **Provision** in respect of a Contingent Liability is not allowable. **[Indian Molasses Co. (P.) Ltd. 37 ITR 66 (SC)]** • **Provision of Excise Duty liability** on the basis of **forecast notice** shall not be entitled to deduction. **[Indian Smelting & Refining Co. Ltd. 248 ITR 4 (SC)]** • **Contribution** made by the assessee **to the Insurance Fund** for meeting **any liability that may arise out** of the use of Motor Vehicle is a **contingent liability and not deductible. [Tamil Nadu State Transport Corp. Ltd. 139 Taxman 330 (Mad.) 187 CTR 671]**
(b) **Expenses for / in violation of law**	• Where expenditure to be incurred under some law requires prior approval of the Govt, or Statutory Authority, the liability to incur such expenditure does not accrue, unless such approval has been obtained. **[Nensuch Tea Estate Ltd 98 ITR 189** (SC)] • Expenditure incurred for **evading provisions of FERA** is not deductible. **[Maddi Venkataraman & Co. Pvt. Ltd. 229 ITR 534 (SC)]** • **Compounding Fee** paid to Municipal Corporation for **condoning the violation** of law relating to construction of property not allowable. **[Mamta Enterprises (2004) 266 ITR 356 (Kar)]** • Sum incurred as Freebies by Pharmaceutical Industries to Medical Practitioners is in contravention of law and hence not deductible. **[Circular No.5/2012 dt. 01.08.2012]**
Set A: Specific Items disallowed	
Nature of Expense	**Inadmissible expenses**

	• It is on the part of Assessee to satisfy the AO that the expense is not in violation of the Law. **[Confederation of Indian Pharmaceutical Industry (SSI) vs CBDT (2013)353 ITR 388 (HP)].** • **Damages** paid for **late payment of Provident Fund** is not allowable. [L.H.Sugar **Factories & Oil Mills Ltd.** 123 ITR 596 **(All.)]** • **Fine** paid for **traffic offences** is not allowable. **[Jaipur Golden Transport 226 ITR 399 (Delhi)]** • Payment made (other than for security) to Police, and Goondas as a precautionary measure, so that the Assessee shall not get any disturbance in his business premises, is illegal, and hence not allowable as deduction. **[CIT vs Neelavathi & Others 322 ITR 643 (Karn.)]** • Amount paid to compound an offence is obviously a penalty and does not qualify for deduction u/s 37. The character of payment is relevant and not its nomenclature. **(Millennia Developers (P) Ltd. Vs DCIT 322 ITR 401 (Karn.)]**
(c) **Capital Vs Revenue Expenditure – Capital Nature**	• **Payment made to avoid competition** in business to a rival, will constitute Capital Expenditure. **[Coal Shipments P Ltd 82 ITR 902 (SC)]** • Amount paid as **Land Development Charges** by an Assessee, to Lessor of land, for providing or improving the facilities in the existing land is capital in nature, as the benefit realized is of enduring nature. **[Manoj Dyeing Company 212 ITR 189 (SC)]** • **Amount paid** by the Assessee carrying on the business of mineral development, to the Electricity Board, for **laying cables** cannot be treated as revenue expenditure u/s 37 in the year in which the installation is completed. The amount invested in shortterm deposits cannot be qualified as Capital Employed in its new industrial undertaking for the purpose of relief. **[Gujarat Mineral Development Corpn 249 ITR 787 (SC)]** • Payment made in consideration of **acquiring a monopoly right** to manufacture a product is not deductible. However, Royalty payable on the basis of goods produced under the same arrangement is deductible. **[Mewar Sugar Mills Ltd 87 ITR 400 (SC)]** • Sum paid for the purpose of **becoming a Member of Stock Exchange** is Capital Expenditure. **[Rajendra Kumar Bachawat [2003] TIOL 115 (Kol.)]** • Compensation paid on **termination of agreement** with a **Marketing Distributor** is **Capital Expenditure.[TI Diamond Chain Ltd** [2005] **TIOL** 70 **(Mad.)]** • Repair and Reconditioning expenditure incurred on a machine which broke down long back shall be treated as Capital Expenditure. There is a benefit of enduring nature to the Assessee even though technically, no new asset came into existence.**[Bharat Gears Ltd (2011) 337 ITR 368 (Delhi)]**
(d) **Transfer to Reserves**	Amount transferred to **Contingency Reserve,** Development Reserve by **Electricity Company** is not deductible. **[Vellore Electric Corporation** 227 **ITR** 557 **(SC)]**
(e) **Certain Legal Expenses**	• Litigation expenditure incurred for **curing any defective title** of assets or completing that title is not allowable. **[V.Jaganmohan Rao** 75 **ITR** 373 (SC)] • Expenditure in **defending disciplinary proceedings** against Auditors is not allowable. **[Deccan Sugar** &**Abkari Co. Ltd 104 ITR 458 (Mad.)]** • Expenditure incurred on a **suit for specific performance of a contract** of sale of **property** is not allowable. **[Sankranti Agarbathi Co. 243 ITR 712 (Kar.)]**

Set A: Specific Items disallowed	
Nature of Expense	**Inadmissible expenses**

(f) **Interest under IT law**	• Interest paid for **delayed payment of Advance Tax** is not an allowable deduction. **[Bharat Commerce & Industries Ltd. 98 Tax 151 (SC)]** • Interest paid on **delayed payment of tax u/s 220(2)** is not allowable. **[National Engineering Industries Ltd. 113 ITR 252]** • **Tax paid by the Assessee** (who is a defaulter by not deducting TDS u/s 195) **on behalf of the Non-Resident** not deductible. **[Indian Aluminium Co. Ltd 79 ITR 514** (SC)[
(g) **Pension on humane grounds or other gratuitous payments**	• Pension paid to the **widows of ex-Directors on humanitarian grounds** only is not deductible. **[ITAT v. E.Hill & Co. (P.) Ltd Tax LR 1423 (All.)]** • Pension paid to the **wife of departed Chairman** of Company as a **mark of respect** and not on commercial consideration is not deductible. **[Amalgamations Ltd Tax LR 617 (Mad.)]** • **Medical aid** provided to **MD** of a Company in the nature of **gratuitous payment** is **not** deductible u/s 37. **{Sambandam Spinning Mills P. Ltd (Mad.) 263 ITR 115]** • Where a **Firm** is **making payment of Insurance Premium** on the **lives of the Partner** with a view to provide funds to pay off the dues to the Partners on their death, then such payment is **not incidental** to the Firm's business purpose, and so, not a deductible expenditure. **[Khodidas Motiram Panchal 161 ITR 99 (Guj.)]**
(h) Cum-interest purchase of investment	In case of **Cum-Interest Purchase** of Investments, though the Purchase Cost of Securities includes interest accrued on such securities also, **no portion** of the price paid can be **attributed to interest expenditure** to be claimed as deduction against income from the securities. **[Vijaya Bank Ltd 157 ITR 541 (SC)]**
(i) **No Nexus between Expense and Business / Personal vs Business Expense**	• Heart cannot be treated as a Plant, since the same cannot be included in the Balance Sheet of the Assessee and the cost of acquisition of the same cannot be determined. • The contention that the expenditure on Heart Surgery is incurred wholly for the purpose of Business is not valid, since a healthy Heart increases the efficiency of the human in all fields including his professional Work. • There is no direct nexus between the expenditure incurred and his efficiency in the professional field. Therefore the claim for allowing the expenditure u/s 37 is not valid. **[Shanthi Bhushan vs CIT 336 ITR 26 (Del.)]**
(j) Purely Personal Expense	Agreement entered into between Father and Son, wherein the Son agreed to reimburse the amount spent by his Father towards his maintenance and education is unheard of under the provisions of the Hindu Law, and therefore Son cannot claim such payments. **[CIT vs Mahesh Bupathi 43 DTR 163 (Kar.)]**
(k) **Colourable Transactions**	Where Assessee Company paid C&F Fees to a Company for which there was no evidence of service and there was no increase in sale, funds were actually passed to the Chairman and his wife of Holding Company of Assessee as Interest Free Loans, transactions would be held to be colourable and hence the C&F charges are liable to be disallowed. **[CIT vs Punjab Breweries Ltd (P&H)]**

Set B: COMPANY SPECIFIC INADMISSIBLE EXPENSES	
(1) Share Capital related Expenses	• Fees paid to the Registrar of Companies for **enhancement of capital** is a capital expenditure, not deductible u/s 37(1) but **deductible u/s 35D. [Punjab State Industrial Development Corporation Ltd 225 ITR 792 (SC)[** • Value of Shares allotted to **Foreign Collaborator** in consideration for **supply of technical know-how [Eimco K.C.P. Ltd . 242 ITR 659 (SC)]**

	• Fees paid for **increase of Authorised Capital** is not deductible. **[Mohan Meakin Breweries Ltd. 117 ITR 501 (HP)]** • Expenditure incurred by the assessee on the **issue of Right Shares** is not deductible. **[Motor Industries Co. Ltd. 173 ITR 374 (Kar.)]** • Share Issue Expenses incurred by a Company is to be treated as capital in nature, though the Public Issue could not ultimately materialize on account of non-clearance by SEBI. **[Mascon Technical Services Ltd** (2013) 358 **ITR** 545 **(Mad.)]**
(m) **Related Party Payments**	When there is no nexus between the expenditure on higher studies of the Director's Son and the business, the same shall not be allowed as deduction. Nexus here is, the Director's son is not an approved Trainee of the Company and the expenditure is not incurred for the purpose of its business. **[Echjay Forgings Ltd vs ACIT 328 ITR 286 (Bom.)]**

6. Losses allowable as deduction:

(a) Loss on account of **embezzlement,** in the previous year in which embezzlement is discovered.

(b) Loss by way of **forfeiture of Security Deposits,** for failure to comply with conditions of contract in the **normal course** of business, e.g. failure to purchase a stipulated quota of materials as per contract.

(c) Loss caused by **forfeiture** of Security Deposits given at the time of submission of tenders for supply of goods.

(d) **Loss of Stock-in-Trade** by fire and other natural calamities, or due to negligence of the employees or due to enemy action, or in transit.

(e) Loss on account of **robbery or theft,** provided it is in the course of business and incidental to the trade whichever trade it is.

(f) **Loss on Chits** is a business loss, if the money received is utilised for the purpose of the business.

(g) Loss caused by **non-recovery of advances** made in course of business, provided it is a Trading Loss.

(h) Loss due to issue of Demand Draft by a Bank on the basis of a forged letter of the Secretary of the Company.

(i) Loss caused on account of **fluctuations in exchange rate,** at the time of remitting the money for purchase of raw material.

(j) Loss incurred in financing its **Subsidiary Company.**

(k) Loss on sale of Government Bonds purchased by an Assessee to increase his business with Government, or with the object of retaining the goodwill of the authorities for purpose of his business.

(l) Loss by the failure of Bank in which money is deposited.

(m) Loss caused due to **breach of contract** for delivery of goods by either party.

7. **Losses not allowable as deduction:**

(a) Loss sustained **before the business is commenced,** e.g. pre-incorporation loss of the business taken over by the Company.

(b) Violation of law is not a normal incident of trade and an expense incurred by way of **penalty for infraction of laws** is not deductible.

(c) Loss incurred due to **damage, destruction, etc. of capital assets.**

(d) Loss which is **not incidental** to the carrying on of the business of the assessee

(e) Loss due to sale of securities held as Investments.

(f) Losses incurred in **closing down** of the business.

(g) Loss caused by forfeiture of advances given for purchase of Capital Assets.

(h) **Anticipated losses** of subsequent years cannot be allowed as a deduction in the current year.

Illustration – Allowability of Expense – N 12

Raghav Industries Ltd furnishes you the following information for the year ended 31.03.2019:

1. Scientific Research Expenditure related to its Business`2,40,000 fully of revenue in nature.

2. Building acquired for Scientific Research (including Cost of Land`5,00,000) in June 2018 for`12,00,000.

3. Amount paid to Indian Institute of Science, Bangalore for Scientific Research`50,000.

4. Demerger Expenses incurred in Previous Year 2017-2018`5,00,000.

5. Contribution to the account of Employees as per Pension Scheme referred u/s 80CCD amounted to`30,00,000. Amount above 10% of the Salary of Employees is`7,00,000.*

6. Amount recovered from Employees towards PF Contribution`12,00,000 of which amount remitted upto the end of the year was`7,00,000 and the balance was remitted before the due date for filing the Return prescribed u/s 139(1).

7. Tax on Non-Monetary Perquisites provided to the Employees, borne by the Employer ?

4,50,000.

8. Gain due to change in the Rate of Exchange of Foreign Currency`1,00,000 related to Import of Machinery. The Machinery was acquired two years ago and put to regular use since then.

Explain in brief how the above said items would be dealt with for the Assessment year 2019-2020.

Computation of Total Income is not required.

Assessee: Raghav Industries Ltd Previous Year: 2018-2019 Assessment Year: 2019-2020

Nature of Expenditure	**Amount Allowable**	**Reason**
Scientific Research Exp. revenue in nature	**`2,40,000**	U/s 35, Revenue Expenditure on Scientific Research is fully allowable.
Building acquired for Scientific Research	12,00,000-5,00,000 =**`7,00,000**	U/s 35, Deduction is allowable only in respect of Cost of Building and no deduction is allowed for Cost of Land.
Amt paid to IIs, Bangalore for Scientific Research	50,000 x 150% =**`75,000**	U/s 35(2AA), Deduction to the extent of 200% of the amount contributed is allowed.
Demerger Expenses incurred in PY 2017-2018	5,00,000 x 1/5 =**`1,00,000**	U/s 35DD, Expenditure incurred for the purpose of Demerger will be allowed as a deduction in **5 equal instalments** commencing from the previous year in which the Demerger took place.
Contribution towards Pension Scheme u/s 80CCD	30,00,000 – 7,00,000 =**`23,00,000**	Contribution in excess of 10% of Salary of the Employee shall be disallowed as per Sec. 36(1)(iva).
Contribution from Employees towards Provident Fund	NIL	Employees' Contribution recovered by Employer shall be paid before the due date specified under the respective Act, in order to claim deduction against payment. Therefore entire amount is not allowed as deduction.
Tax on Non-Monetary Perquisites, borne by the Employer	NIL	Tax on Non-Monetary Perquisites provided to the Employees by the Employer is not an allowable expenditure u/s 40(a)(v).
Gain due to change in Forex Rate relating to import of machinery	NA	Gain of`1,00,000 shall be reduced from the Cost of the Machinery.

6.4 Inadmissible Expenditure / Payments

6.4.1 Expenditure Disallowed for All Assessees

Sec.	**Nature of Expenditure**	**Amount Inadmissible/Condition**
37(2B)	Advertisement in Souvenir, Brochure, Pamphlet, etc. of **Political Party.**	Amount incurred/ paid towards advertisement.

40(a)(1)	• **Nature of Expense:** Interest, Royalty, Fees for Technical Services or other similar sum, on which Tax is- (i) Payable outside India, or (ii) Payable in India to – (a) **Non-Resident** not being a Company, or (b) **Foreign Company.** • **Default:** (a) Tax has not deducted at source, or (b) after deduction, tax has not been paid before the time limit specified in Sec. 139(1).	Such Expense will be disallowed in the year of non-compliance. Will be allowed as a deduction in computing the Income of the previous year in which such tax has been paid.
40(a)(iii)	**Salaries** payable outside India or in India, to a **Non- Resident, without deduction of tax** at source.	Amount paid.
40(a)(ia)	**Payment to Residents:** Any payment made to a Resident, on which tax is deductible, but (a) tax has not been deducted, or (b) after deduction, tax has not been paid within time limit u/s 139(1).	**30%** of Amount Paid without deduction of tax, or where tax has been deducted, amount not remitted to the Government, will be disallowed in computing the income of the previous year. The disallowed amount will be allowed in the year of payment. **[See Note 1 below]**
40(a)(ii)	**Rates or Taxes** levied **on Profits or Gains** of any Business or Profession.	Amount paid, including tax paid abroad eligible for relief u/s 90 / 90A or deduction from Income Tax Payable u/s 91.
40(a)(iia)	**Wealth Tax**	Amount paid
40(a) (iib)	Any amount paid by way of Royalty, License Fee, Service Fee, Privilege Fee, Service Charge or any other Fee or Charge levied on, or appropriated either directly or indirectly from, **State Government Undertakings** by the State Government.	Amount paid. **See Note 2 below for meaning of State Government Undertakings**
40(a)(iv)	Payment to Provident Funds / Other Funds established for the benefit of the Employees, for which no effective arrangements are made to secure or deduct tax at source.	Amount paid
40(a)(v)	Any Tax of the Employee paid by the Employer u/s 10(10CC)	Amount paid

Note:

1. **Sec.40(a)(ia):** Where an Assessee fails to deduct TDS but is **not** deemed to be an Assessee in default u/s 201(1), then it shall be deemed that the Assessee has deducted and paid the tax on such sum on the date of furnishing of Return of Income by the Resident Payee. Therefore, 30% of the Payment will be disallowed in the year of incurrence, and allowed in the year of TDS Remittance or in which the Return is furnished by the Resident Payee.

2. **Sec.40(a)(iib):** State Government Undertakings include -

(i) a Corporation established by or under any Act of the State Government.

(ii) a Company in which more than 50% of the Paid-Up Equity Share Capital is held by State Government.

(iii) a Company in which more than 50%of the Paid-Up Equity Share Capital is held by the Entity referred to in Clause (i) or Clause (ii) (whether singly or taken together).

(iv) a Company or Corporation in which the State Government has the right to appoint the majority of the Directors or to control the management or policy decisions, directly or indirectly, including by virtue of its Shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

(v) an Authority, a Board or an Institution or a Body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.

For making disallowance of 'other sum chargeable' u/s 40(a)(i), the appropriate portion of the sum which is chargeable to tax shall be determined by AO. Also, determination made u/s 195(2)/(3)/(4) will form the basis for disallowance u/s 40(a)(i). **|C. No.3/2015 dated 12.02.2015|**

Sec. 194C(3) vs Sec. 40a(ia): In case of payments made to sub-contractors, non-fding of Form No. 15-I/J is only a technical defect and provisions of Sec.40(a)(ia) are not attracted in such a case.**[Sri Marikamba Transport Company Tax 57 Taxmann 273 (2015)(HC)(KAR)|**

Illustration – TDS Related Disallowances – M 11 (Mod)

During the Financial Year 2018-2019, the following payments / expenditure were made / incurred by Mr. Yuvan Raja, a Resident Individual (whose turnover during the year ended 31.03.2018 was `54 Lakhs):

1. Interest of`12,000 was paid to Rehman & Co, a Resident Partnership Firm.

2. Interest of`4,000 was paid as interest to Mr. R.D. Burman, a Non-Resident.

3. `3,00,000 was paid as salary to a resident individual.

4. He had sold goods worth`5 Lakhs to Mr. Deva. He gave Mr. Deva a cash discount of`12,000 later. Commission of`15,000 was paid to Mr. Vidyasagar on 02.07.2018.

5. In none of these transactions, tax was deducted at source.

Briefly discuss whether any disallowance arises under the provisions of Sec. 40(a)(i) / 40(a)(ia) of the Income Tax Act, 1961.

Assessee: Mr. Yuvan Raja Previous Year: 2018-2018 Assessment Year: 2019-2020

1. **Payment of Interest and Commission:** The Assessee is not subject to Tax Audit in the preceding PY since the Turnover of`54 Lakhs is less than the prescribed limit of u/s 44AB for PY 2017-2018. Therefore the Assessee is **not liable to deduct Tax** for both interest u/s 194A and commission u/s 194H. The amounts of`12,000 (Interest) and`15,000 (Commission) are allowable expenditures.

2. Interest, Royalty, Fees for Technical Services or other similar sum payable outside India or in India to a **Non-Resident** not being a Company, or to a **Foreign Company,** on which tax has not been paid or deducted at source or after deduction, tax has not been paid before the prescribed time u/s 139(1) will be allowed as a deduction in computing the income of the previous year in which such tax has been paid and not in the previous year to which it relates to. Hence, the interest of`4,000 paid to Mr. Burman without deduction of tax is **not an allowable expenditure** for the Previous Year 2018-2019. 3

3. **Salary to a Resident:** TDS on Salaries to Resident Employees in India is also covered u/s 40(a)(ia). So, payment of`3,00,000 to a Resident Individual on which Tax was not deducted is disallowed to an extent of 30%. However, is allowed in the year of TDS remittance.

4. Sale of Goods and Cash Discount are business transactions and **TDS is not attracted** for these transactions. Therefore the amounts are **not disallowed u/s 40(a)(ia).**

6.4.2 Interest / Remuneration to Partners of Firm / Member of AOP

A. Interest on Partner's Capital [Sec.40(b)j

1. **Conditions**	(a) The payment should be **authorised** by the Partnership Deed. (b) It should be for the **period** falling **after the date** of the Partnership Deed.
2. **Exception**	The above condition does not apply in the following situations - (a) Where an Individual is a Partner on behalf of or for the benefit of any other person (Karta of HUF, Director of Company), and interest is paid by the Firm to the individual otherwise than as Partner in a representative capacity. (b) Where an Individual is a Partner in his individual capacity and interest is received by such individual from the Firm on behalf of or for the benefit of any other person (Karta of HUF, Director of Company). However provisions of Sec.40A(2) may apply in such a case.

3. **Admissible Deduction**	The **maximum** rate of interest allowable is **12% p.a.** at simple rate of interest.

Interest on Current Account: Interest given on Current Account of **Novel Distributing Enterprises vs** a Partner will **not** be allowable as deduction. **Deputy CIT 251ITR 704 (Ker.)**

B. Remuneration to Partner [Sec.40(b)]

1. Conditions: Any Salary or Bonus or Commission or Remuneration paid by a Firm to a Partner is allowable as deduction subject to the following conditions **-**

(a) The payment should be **authorised** by the Partnership Deed.

(b) **It** should be for the **period** falling **after the date** of the Partnership Deed.

(c) It should be paid to a **Working Partner.**

Specification in Partnership Deed is must: Deduction will be allowed only if the Partnership Deed specifies the amount of remuneration payable to each individual Partner, or lays down the manner of quantum of such remuneration. **[C.No.739 / 25.03.1996]**

Where the Partnership Deed does not specify the remuneration payable to each individual working Partner but lays down the **manner of fixing the remuneration,** the Assessee Firm is entitled to deduction in respect of remuneration paid to the Partners subject to the limits specified u/s 40(b)(v). **[CIT vs Anil Hardware Store 323 ITR 368]**

2. **Working Partner** means an individual who is a Partner of the Firm and is actively engaged in conducting the affairs of the business or profession of the Firm. 3

3. **Book Profits:**

(a) The Maximum Permissible Remuneration is derived on the basis of Book Profits of the Firm.

(b) In computation of Book Profits, any income from any other head or brought forward losses or deduction under Chapter **VIA** shall **not** be considered.

(c) The computation of Book Profits of the Firm is as under -

Step 1	Find out the **Net Profit** of the Firm as per Profit and Loss Account.
Step 2	Make adjustments for admissible and inadmissible expenditures, and compute Income as per Chapter IV-D, before giving any deduction towards Interest or Remuneration to Partners u/s 40(b).
Step 3	Compute Allowable Interest u/s 40(b), i.e. Interest as per Partnership Deed or **12%** p.a. whichever is **less.**
Step 4	Book Profits = Step 2 – Step 3
Step 5	Deduct Allowable Remuneration u/s 40(b) **[Refer Table below]**
Step 6	Business Income of the Firm = Step 4 – Step 5

4. Maximum Permissible Remuneration:

Book Profit	**Maximum Remuneration**
On the first`3 Lakhs of Book Profits or in case of Loss	**`1,50,000** or **90%** of the Book Profits, whichever is **higher.**
On the balance of the Book Profits	60% of Book Profits.

Note:

• **Remuneration in Representative Capacity:** Though a person is a Partner in a Firm in his representative capacity, according to the Firm he is acting on his personal capacity only, so if any remuneration is paid, Sec. 40(b) shall apply. **[Rashik Lai and Co. 229 ITR 458 (SC)]**

- **For Commission purposes, PBT should be considered:** For the purpose of determining Commission to the Partner on the basis of Net Profit, the Net Profit shall be considered **before** deduction of Income Tax Liability.

C. Business/ Professional Income of the Partners, from the Firm

1. Interest: Interest received from the Firm is taxable to the extent, it was allowed as expenditure in the hands of the Firm u/s 40(b). (Subject to a maximum of 12%).

2. **Remuneration:** Remuneration received from the Firm is taxable **to the extent** it is allowed as expenditure in the hands of the Firm u/s 40(b).

3. **Share Income from Firm [Sec. 10(2A)]:** Share Income received from the Firm is exempt.

D. Expenditure not allowed in the assessment of AOP / BOI [Sec.40(lba)]

1. **Nature of Expenditure disallowed**	(a) Interest, Salary, Bonus, Commission, Remuneration paid by an AOP / BOI to its Members is **not allowed** as deduction in computation of Income of the AOP / BOI. (b) If the AOP / BOI receives as well as pays interest to its members during the Previous Year, then the **excess** interest **paid** over and above the interest received shall be **disallowed.**
2. **Exception**	The above condition does not apply in the following situations - (a) Where an Individual is a Member on behalf of or for the benefit of any other person (Karta of HUF, Director of Company), and interest is paid by AOP to the individual otherwise than as Member in a representative capacity. (b) Where an Individual is a Member in his individual capacity and interest is received by such individual from AOP on behalf of or for the benefit of any other person (Karta of HUF, Director of Company). However provisions of Sec. 40A(2) may apply in such a case.

Illustration – Partnership Firm – Book Profits, Permissible Remuneration – N 11

Rao & Jain, a Partnership Firm consisting of two Partners, reports a Net Profit of`7,00,000 before deduction of the following items:

1. Salary of`20,000 each p.m. payable to two Working Partners (as authorized by the Partnership deed).

2. Depreciation on Plant and Machinery u/s 32 (computed)`1,50,000.

3. Interest on Capital at 15% p.a. (as per the Deed of Partnership). The amount of Capital eligible for interest is`5,00,000.

Compute: 1. Book Profit of the Firm u/s 40(b) of the Income Tax Act, 1961.

2. Allowable Working Partner Salary for the Assessment Year 2019-2020 u/s 40(b).

Assessee: Rao & Jain Previous Year: 2018-2019 Assessment Year: 2019-2020

Particulars		
Net Profit of the Firm before deduction of the following items -	7,00,000	
Less: Depreciation u/s 32 of the IT Act	(1,50,000)	
Profits before Deduction u/s 40(b)		5,50,000
Less: u/s 40(b) Interest as per P'ship Deed (or) 12% p.a. whichever is **less** is allowed		
So, 5,00,000 x 12%		(60,000)
Book Profits u/s 40(b)		**4,90,000**
Less: Allowable Salary for Partners – Maximum Permissible Remuneration		
(a) On First`3,00,000 =`1,50,000 or 90% of 3,00,000, whichever is	2,70,000	
higher		

Balance`1,90,000 = 60% of 1,90,000	1,14,000	
	3,84,000	
(b) Salary as per Partnership Deed = 20,000 x 2 Partners x 12 months	4,80,000	
Thus, u/s 40(b), Least of (a) or (b) is **allowable**		(3,84,000)
Profits and Gains from Business or Profession		**1,06,000**

Note: In the Partner's individual assessment, taxable Remuneration will be`1,95,000 each since that is the amount allowed as deduction for the Firm (i.e.`3,84,000 + 2 Partners).

Illustration – Partnership Firm – Permissible Remuneration – N 96

ABC is a Partnership Firm carrying on business, in which A, B and C are Partners sharing profits and losses equally. In respect of Assessment Year 2019-2020, it furnishes the following particulars -

(a) Loss as per P&L A/c after debiting remuneration to Partners and interest on their Capital` 2,50,000

(b) Remuneration to Partners: A – 90,000, B – 60,000, and C – 30,000: Total =`1,80,000

(c) Interest paid on Capital: Capital as on 01.04.2018 Interest

A	**`1,00,000**	**`20,000**
B	**`1,00,000**	**`20,000**
C	**`1,00,000**	**`20,000**

Calculate the Income of the Firm and of the Partners A, B and C assuming that the Partners have no other income.

Assessee: ABC Previous Year: 2018-2019 Assessment Year: 2019-2020 Status: Firm

Computation of Firm's Income under the head Profits and Gains of Business or Profession

Particulars	
Net Loss as per Profit and Loss Account **Add:** Partners Remuneration **Add:** Interest on Capital to Partners	(2,50,000) 1,80,000 60,000
Net Loss before Interest and Remuneration **Less:** Allowable Interest on Capital at 12% (A – 12,000, **B –** 12,000 and C – 12,000)	(10,000) (36,000)
Book Profits **Less:** Remuneration allowable u/s 40(b)`1,50,000 or 90% of Book Profits, whichever is **higher**	(46,000) (1,50,000)
Loss of the Firm	**(1,96,000)**

Computation of Income of Partners under the head Profits and Gains of Business or Profession (in`)

Particulars	**A**	**B**	**C**
Interest on Capital (amount deducted in computing Firm's Income) **Add:** Remuneration to Partners`1,50,000 apportioned as (9 : 6 : 3)	12,000 75,000	12,000 50,000	12,000 25,000
Taxable Income from Partnership Firm	**87,000**	**62,000**	**37,000**

Share of Loss from Firm (`1,96,000 in the ratio of 1 : 1 : 1) **Note:** This cannot be clubbed / set-off with Interest on Capital, etc. Since, the Share Income from a Firm is exempt u/s 10(2A).	(65,334)	(65,333)	(65,333)

6.4.3 Payments to Relatives / Specified Persons [Sec. 40A(2)]

1. Nature of Payment:

(a) The payment is in respect of goods, services or facilities supplied/provided by a **"Relative".**

(b) The amount paid to such Relative is considered to be **excessive or unreasonable** as compared with the market value of such goods, services or facilities.

2. **Amount disallowed:** The **excessive** or **unreasonable sum** shall be disallowed by the Assessing Officer. In this matter, the AO shall have due regard to -

(a) the Market Value of the goods, Service of Facilities for which the payment is made, or

(b) the legitimate needs of the Business or Profession carried on by the Assessee, or

(c) the benefit derived by or accruing to the Assessee from such a payment.

3. **Specified Persons for this Section:**

Payment made by	**Payment made to / received by**
Individual	(i) Relative, or (ii) Person in whose business or profession the individual or his relative has a substantial interest.
Company	(i) Director, (ii) Relative of the Director, (iii) Person in whose business the Company, Director or any relative of such Director has substantial interest. [Relative of such Director / Partner / Member, or any other Company carrying on business or profession in which the first mentioned Company has substantial interest]
Firm	(i) Partner, (ii) Relative of the Partner, (iii) Person in whose business the Firm, any Partner or any Relative of such Partner has substantial interest.
Payment made by	**Payment made to / received by**
AOP	(i) Member, (ii) Relative of the Member, (iii) Person in whose business the AOP, any Member or any relative of such Member has substantial interest.
HUF	(i) Member, (ii) Relative of the Member, (iii) Person in whose business the HUF, any Member or any relative of such Member has substantial interest.
Any Assessee	(i) Individual who has a substantial interest in the Assessee's business or profession, or his relatives, or (ii) Company / Firm / AOP / HUF having substantial interest in the Assessee's business or profession, or any Director / Partner / Member of such Company / Firm / AOP / HUF, or any relative of such Director / Partner / Member.

4. **Relative** to an Individual means Husband, Wife, Brother or Sister or any lineal ascendant or descendant of that individual. **[Sec.2(41)]**

5. **Substantial Interest:** A person shall be **deemed** to have substantial interest in the business or profession, if such person is the **beneficial owner** of **atleast 20%** of Equity Capital or entitled to 20% of the profits of the concern at any time during the previous year.

To invoke provisions of Sec. 40A(2), there must be a payment which is an expenditure. If in the course of business, an Assessee makes a bonafide sale to a person at a price lower than the market price, it does not constitute an expenditure for the purpose of disallowance u/s 40A(2). **[Udhoji Shrikishnadas 139 ITR 827]**

Assessee-Company was engaged in business of Financing and Investment. Where due to efforts of Director of Assessee, the Business of Assessee had increased substantially and he was assisting Assessee in its New Hotel Project, excessive salary payment to him was **reasonable. [Spank Hotels Ltd. 50 taxmann.com 452 (Delhi)(HC)(2014)l**

6.4.4 Payments other than by Account Payee Cheques / Draft (Sec.40A)

1. Nature of Expenditure:

- Expenditure in respect of which **aggregate payments made to a person in a day,**
- in excess of`10,000, [Sec.40A(3)] 35,000 for payment made for plying, hiring or leasing goods

carriages) is made,

- otherwise than by way of Account Payee Cheque / Demand Draft.

2. **Extent of Disallowance: The whole** of such expenditure shall not be allowed as a deduction.

3. **Payment of Outstanding Liabilities Sec.40A(3A):** When an expenditure is allowed on due basis for a previous year, and the liability is settled in the subsequent period -

(a) Otherwise than by Account Payee Cheque / Draft / use of electronic clearing system through a bank account, and

(b) Aggregate of Payment made in a day exceeds`10,000,

Such payment will be deemed to be Business Income of the previous year in the year of actual payment.

4. Applicability:

(a) This Rule does not apply in respect of an expenditure not claimed as deduction u/s 30 to 37.

(b) This Rule is applicable even in respect of advance for an expenditure covered u/s 30 to 37.

(c) Sec.40A(3) is applicable only for computing income under the heads "Profits and Gains of Business or Profession" and "Income from Other Sources". **[Circular No 34 / 5.3.1970)**

(d) Repayment of Loans or payment towards Purchase Price of Capital Assets does not attract provisions of Sec.40A(3). **[Cir.No.34 / 5.3.1970].**

5. **Protection:** Where payment is made by Account Payee Cheque/DD/ use of electronic clearing system in order to avoid disallowance u/s 40A(3), no person shall be allowed to raise a plea that payment was not made or tendered in cash or any other manner, in any suit/proceeding.

6**. Exceptions as per Rule 6DD: [Notification No. 97/2008 dt 10.10.2008]**

(a)	Payment made to Reserve Bank of India, Banking Company, State Bank of India and its Subsidiaries, any Co-operative Bank or Land Mortgage Bank, any Primary Agricultural Credit Society or any Primary Credit Society and Life Insurance Corporation of India.
(b)	Payment made to Government and as per rules such payment is required to be made in legal tender
(c)	Payment through Banking System — 1. any Letter of Credit arrangement through a Bank, 2. a Mail or Telegraphic Transfer through a Bank, 3. Book Adjustment from any account in a Bank to any other account in that or any other Bank, 4. Bill of Exchange made payable only to a Bank, 5. use of Electronic Clearing System through a Bank Account, 6. Credit Card and Debit Card,
(d)	Payment by book adjustment against any liability incurred for goods supplied or services rendered.
(e)	Payment made for agricultural or forest produce or produce of animal husbandry or dairy or poultry or fish or fish products or products of horticulture or apiculture, to the Cultivator, Grower or producer of such products. **[See Note]**
(f)	Payment to Producers of goods in cottage industry without the aid of power.

(g)	Payment made in a place which on the date of such payment is not served by any Bank.
(h)	Any terminal retirement or gratuity payment to an Employee or his legal heirs, provided the aggregate of the sum payable does not exceed`50,000.
(i)	Payment to Employees on temporary posting for a continuous period of 15 days or more if such payment is made after deduction of tax at source and such Employee does not maintain any bank account at such place.
G)	Payment made on a day on which Banks were closed due to holiday or strike
00	Payment made through Agents who is required to make payment in cash for goods or services on behalf of the Principal / Assessee
(1)	Payment through Authorised Dealer or Money Changer against purchase of Foreign Currency or Travellers' Cheque

Notes:

1. Payment for Fish or Fish Products [C.No.10/2008 dt 05.12.2008]:

(a) Fish or Fish Products include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster, etc.'

(b) The 'Producers' of 'Fish or Fish Products' include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by the fishermen from the sea, at the sea shore itself, and then sells the fish or fish products to traders, exporters, etc.

(c) The above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'Producer' and is only a Trader, Broker or any other middleman, by whatever name called. 2

2. **Payment for Produce of Animal Husbandry: [Circular 4 / 2006 dated 29.3.2006]**

(a) **Produce of Animal Husbandry** includes livestock, meat, hides and skins.

(b) **Applicability:**

- Only **Producers** of Animal Husbandry are eligible for this benefit.
- Payments to Traders or Brokers or Middlemen are not eligible.

(c) **No Disallowance:** Payment made to Producer of products of Animal Husbandry **will not be subjected to disallowance** u/s 40A(3), subject to conditions mentioned in (e) below.

(d) **Producer of Livestock and Meat:** Any person who —

- buys animals from the farmers,
- slaughters them, and
- sells the raw meat, carcasses to the meat processing factories or to the Traders / Retail Outlets

will be considered as **Producer** of Livestock and Meat

(e) **Conditions: [Circular 8 / 2006 dated 6.10.2006]**

- **Declaration from Producer of Livestock and Meat:** The person making the payment should receive a declaration from the person receiving the payment (i.e. producer of livestock and meat), that the payment otherwise that by an Account Payee Cheque / Bank Draft was made on his insistence, and
- **Certificate from a Veterinary Doctor** stating that the person specified in the Certificate is a Producer of meat, and that slaughtering was done under his supervision.

6.4.5 Payments to Unrecognised Welfare Funds

1. Provision for Payment of Gratuity to Employees [Sec. 40A(7)[:

Any Provision for Gratuity in the books of accounts shall **not** be allowed as a deduction unless **-**

(a) the provision is made for any contribution towards an Approved Gratuity Fund during the Previous Year, or

(b) the provision is for Gratuity, which has become **due and payable during the Previous Year** by virtue of the Employee's Retirement, Death, Termination of Service, etc.

2. **Payment to any Unrecognised Welfare Fund [Sec. 40A(9)[:**

(a) Any payment for formation or as contribution made by the Assessee, as an Employer, to any Unrecognised or Non-Statutory Welfare Fund is **not** allowable as deduction.

(b) However, payments made to Funds u/s 36 (i) (iv) /(iva)/ (v), or under any law, is allowed as deduction.

6.4.6 Marked to Market Loss or other Expected Loss [Sec.40A(13)](w.r.e.f.01.04.2017)

1. No deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss except as allowable u/s 36(1)(xviii).

2. In other words, loss can be allowed only if it is computed accordance with the provisions of ICDS.

6.4.7 Payments not made before Due Date of Return of Income [Sec. 43B]

1. Nature of Expenses:

(a) Any sum payable by an Employer by way of contribution to PF or Superannuation Fund or other Fund for the welfare of the Employees.

(b) Tax, Duty, Cess or any Fee payable.

(c) Bonus or Commission payable to Employees.

(d) Interest payable on Loan or Borrowing from a Public Financial Institution or Interest on any Loan or Advances payable to a Scheduled Bank, Co-operative Bank (other than a Primary Agricultural Credit Society or a Primary Co-operative Agricultural and Rural Development Bank).

(e) Any sum payable by an Employer in lieu of leave at the credit of his Employee.

(f) w.e.f. 01.04.2017 Any sum payable by Assessee to the Indian Railways for use of Railway Assets.

Note:

The terms Co-operative Bank, Primary Agricultural Credit Society and Primary Co-operative Agricultural and Rural Development Bank shall have the meanings assigned to them u/s 80P(4).

2. **Time Limit for payment:**

(a) To claim deduction, the payment shall be **made either during the relevant previous year or on or before the due date of filing of Return of Income u/s 139(1).**

(b) If the payment is made subsequent to the due date of fding Return, the expenditure shall be allowed only in the **year of payment.**

Important Issues

Issue	**Treatment**
1. **Conversion of Outstanding Interest into Term Loans**	Conversion of Interest Payable into a Loan or Borrowing by Public Financial Institutions shall **not** be deemed to have been actually paid. Consequently, such converted interest will **not** be deductible, but on repayment of such loan, it shall be allowed in the **year of payment. [Kalpana Lamps & Component Ltd (2002) 255ITR 491 (Mad)]**
2. **Employer vs Employee Contributions**	Employers' Contribution to PF, ESI shall be made before the due date of filing return, **but** Employees' Contribution recovered by Employer shall be paid before the due date specified under the respective Act, in order to claim deduction against payment.
3. **Conversion of ST Liability into Loans by Govt Orders**	Amount of Sales Tax Liability converted into loans, may be allowed as deduction in the assessment for the previous year in which such conversion has been permitted by the respective Government's orders. **|C. No. 674 of 1993]**
4. Deduction of Excise Duty, Customs duty included in valuing Closing Stock	The entire amount of Excise Duty / Customs Duty paid by the Assessee in a particular accounting year is allowable u/s 43B as a deduction in respect of that year, irrespective of the assessee's Closing Stock at the end of the accounting year as relating thereto. **[Berger Paints India Ltd [2004] 266 ITR 99 (SC)]**

5. **Sales Tax collection by Broker / Agent**	Sales Tax collected by a Broker / Agent on behalf of the Principal is neither a Trading Receipt nor Business Receipt. So, S.43B is **not** applicable. **[AW Figgis & Co. Ltd 256 ITR 268 (Cal.)]**
6. **Furnishing Bank Guarantee Payment**	Sec.43B requires **actual payment** and not deemed payment of any of the expenses for claiming the deduction. Furnishing Bank Guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the Assessee to the Public Exchequer as such. **[Udaipur Distillery Co. Ltd. 134 Taxman 398 (Raj.)]**
7. **Interest is part of Sales Tax Liability**	Provisions of Sec. 43B applies when the amount of interest paid is part of the Sales Tax Liability. **[Mewar Motors 135 Taxman 155]**
8. **Vend Fee**	Any sum payable whether called Tax, Duty, Cess or Fee or called by some other name, attracts Sec. 43B. Even if the Vend Fee that is paid by the Respondent to the State did not directly fall within the expression 'Fee' contained in Sec. 43B(a), it was a 'Fee' by 'whatever name called', that is even if it was called 'Privilege', Vide Finance Act, 1988, Sec. 43B(a) considerably widened by the addition of the words "by whatever name called". Thus Vend Fee' is a 'Fee for the purposes of disallowance u/s 43B(a). **ITravancore Sugars & Chemicals Ltd 58 Taxmann** 86 **(2015)]**
Issue	**Treatment**
9. **Claim "Other than under Statute"**	Where additional amount which was paid by the assessee under Excise Law, was levied on assessee **not** in terms of the **Statute,** but for not complying with a time- set by the Commissioner, amount paid by Assessee is not covered u/s 43B. **[CIT vs Distillers Co Ltd 290 ITR 419 (SC)]**
10. **Royalty**	Royalty payable to Government for extraction of limestone is a tax, and hence Sec.43B applies. **|Gorelal Dubey 248 ITR 1 (SC)]**
11. Air Travel Tax	Sec. 43 not applicable if 'Air Travel Tax' is not debited to P&L or claimed as deduction. Merely amount shown in Balance Sheet as 'Payable' does not attract Sec.43B disallowance **| Jet Lite (India) Ltd 63 taxmann 62 (2015)(Del)(HC)]**

Note: Expenses to which the Accrual Rule does not apply-

Accrual Concept does not apply under the head Profits and Gains of Business or Profession in the following situations, i.e. the following expenses are allowable **only on payment basis,** irrespective of the time of accrual -

1. **Sec.43B:** Employer's Contribution to PF, ESI, Tax, Duty, Cess, Fees to Government, Interest on Loans and Advances from Banks and Financial Institutions, Provision for Leave Encashment, Bonus or Commission to Employees, etc.

2. **Sec.35D:** Preliminary Expenses distributed over five years.

3. **Sec.35DDA:** Amount paid as VRS compensation distributed over five years.

6.5 Special Provisions / Special Business

6.5.1 Deemed Income

1. Deemed Income from Business or Profession

Sec. 41	**Deduction already allowed u/s**	**Applicability**	**Nature of Receipt treated as Deemed Income**	**Year in which taxable**
(1)	30-38	All Assessees **including** Successor of business.	Recovery of Loss or Expenditure or trading liability which was already allowed, including remission or cessation of liability effected by a unilateral act.	Year in which recovered or written off by the assessee by remission or cessation.

(2)	32(1)(i)	Undertaking engaged in generation and **/** or distribution of **Power.**	Balancing Charge on assets in respect of which depreciation is claimed, is sold / discarded / demolished / destroyed **Balancing Charge** = Net Consideration **Less** WDV	Taxable in the year in which the amount becomes due.
(3)	35(2)	All Assessees.	Amount realised on sale of Capital Assets used for Scientific Research.	Year in which transfer takes place.
(4)	36(1)(vii)	All Assessees **excluding** Successor of Business	Bad Debts earlier allowed subsequently recovered by the Assessee. **[Note:** Predecessor's Debt recovered by the Successor shall **not** be treated as Income of the Successor.]	Year in which it is received.
(4A)	36(1)(viii)	Assessees of Sec.36(1)(viii).	Amount withdrawn from Special Reserve created.	Year in which it is withdrawn.
(5)	-	All Assessees.	**Benefit of set-off loss:** Unabsorbed Loss pertaining to the year in which the business or profession was discontinued, is permitted to be set off against Deemed Business Income u/s 41(1), (3), (4), (4A)	**Deemed Business Income** = Income u/s 41(1)/(3)/(4) / (4A) **Less:** Loss of Discontinued Business.

Important Issues

1. **Remission of Unsecured Loan**	Remission of Unsecured Loan **cannot** be treated as income u/s 41(1) since there have been no allowance or deduction in any of the preceding years in respect of such loan. **[Chetan Chemicals P Ltd 139 Taxman 301** (Guj.)]
2. **Year of taxability of Balancing Charge**	In case of acquisition of property under any law, the Balancing Charge u/s 41(2) is taxable as income of the previous year in which it becomes due and not in the year in which it was settled. **[United Provinces Electric Supply Co. 110 Taxman 134 (SC)]**
3. **Possibility of recovery of Duty Refund received**	Where expenditure is actually incurred by reason of payment of duty on goods and a deduction is claimed in the earlier assessment, the assessee is liable to discharge that benefit as and when he obtains refund of the amount so paid. The possibility of the refund being set at naught on a future date will not be relevant consideration. **[Polyflex (India) P Ltd Vs CIT 257 ITR 343]**
4. Concession to Sick Unit	In case of financial concession or assistance to a sick unit referred to **BIFR,** then the taxability of such concession or assistance shall be considered by **CBDT** in each individual case in coordination with a nodal agency. **[C No. 683 dated 8.6.1994]**
5. Sales Tax Refund	**Sales Tax Refund** made by the Government shall be **deemed** as Business Income u/s 41(1), unless the same was refunded to the customers from whom it was collected. **[Tirumalaiswamy Naidu & Sons 230 ITR 534 (SC)]**
6. **Sales Tax Refund received by Agent**	Amount collected as Sales Tax by a Commission Agent and paid to Department. Sales Tax was found not payable and refunded. It was held as not an Income of the Assessee. **[D. Shankaraiah 247 ITR 798 (SC)]**
7. Excise Duty Refund	**Excise Duty Refund** made by the Government shall be **deemed** as Business Income u/s 41(1). Also, where the assessee maintains a **separate account** in respect of collection and payment of Excise Duty, and such duty were **not** claimed as deduction in the earlier years, Refund of Excise Duty shall **not** be liable to tax. **[Mysore Thermo Electric (P) Ltd 221 ITR 504 (Kar.)]**

8. **Payment of Sales Tax**	Where Assessee due to certain scheme made premature payment of Deferred Sales Tax and on such payment entire liability to pay tax stood discharged, Sec. 41(1) was not applicable. **[McDowell & Co. Ltd. 52 taxmann.com 15 (Kar)(HC)(2014)]**

1. Deemed Income in case of Discontinued Business or Profession

Sec.	**Applicability**	**Nature of Receipt / Conditions**	**Year in which taxable**
176 (3A)	All Assessees	**Discontinued Business** 1. Business should have been discontinued. 2. Any sum should have been actually received. 3. Such sum is taxable in the hands of Recipient. 4. Such sum would have been included in the Total Income of the person who carried on the business had such sum been received before such discontinuance.	Year in which such sum is received by the Assessee
176 (4)	All Assessees	**Discontinued Profession** 1. Profession is discontinued on account of any cause, e.g. cessation of profession, retirement or death of the person. 2. Any sum received after the discontinuance of the profession, taxable in the hands of the Recipient. 3. Such sum would have been included in the Total Income of the person who carried on the profession, had such sum been received before such discontinuance.	Year in which such sum is received by the Assessee

6.5.2 Non-Resident Artists, Entertainers, Sportsmen, etc.

Circular No. 787 discusses the following relating to taxability of Income of Non-Resident Artists, Entertainers, Sportsmen, etc. from International, National or Local Events -

1. Taxable in the following situations:

(a) Consideration received for **live performance or simultaneous live telecast or broadcast in India** is

taxable in India, under the Article on "Artists and Sportsmen" in the Double Taxation Avoidance Agreement (DTAA).

(b) Consideration paid to the Non-Resident Artist for acquiring -

- Copyrights of performance in India for subsequent **sale in India,** or
- Licence for broadcast or telecast **in India,**

is taxable in India as **Royalties,** as per Sec.9(1)(vi).

(c) Endorsement Fees received relating to **performance in India,** shall be taxable in India in accordance with Sec.5.

2. **Not Taxable in the following situations:**

(a) Performance in India **gratuitously,** i.e. without any consideration = No Income, therefore no taxability.

(b) Performance in India to promote sale of his own records, **without any consideration** being paid to him by any one = No Income, therefore no taxability.

(c) Consideration paid to the Non-Resident Artist for acquiring -

- Copyrights of performance in India for subsequent **sale abroad,** or
- Licence for broadcast or telecast **overseas,**

is not taxable due to J **exclusions** in Sec.9(1)(vi).

6.5.3 Film Producers / Distributors

Rule 9A – Deduction in respect of expenditure on **Production of Feature Films.**

Rule 9B – Deduction in respect of expenditure on **Acquisition of Distribution Rights of Feature Films.**

Situations	Quantum of Deduction	
	Films released on or before December 31	**Films released after December 31**
1. Film Producer / Distributor sells all the rights of exhibition of the Film in the previous year.	Entire Cost of Production / Acquisition	Entire Cost of Production / Acquisition
2. Film Producer / Distributor himself exhibits the Film in all or some of the areas. 3. Film Producer / Distributor sells the rights of exhibition of the Film in respect of some of the areas. 4. Film Producer / Distributor himself exhibits the Film in certain areas, and sells the rights of exhibition of the Film in respect of all or some of the remaining areas.	Entire Cost of Production / Acquisition	1. Cost of Production / Acquisition, or 2. Amount realised by releasing / exhibiting the Film or sale of rights of exhibition, **whichever is less.**
5. Film Producer / Distributor neither exhibits the Film, nor sells the right of exhibition.	NIL	NIL

Distribution Rights includes and consist of acquisition and transfer of rights to exhibit, broadcast and satellite rights. **[Smt. Achila Sabharwal 50 taxmann.com 374 (Del)(HC)(2014)]**

Illustration – Computation of Profits and gains of Film Distributors – M 09 "Meghna Film Distributors" have acquired the rights of exhibition of a feature film 'Nasha' in the territory of Rajasthan from the Producers, under an agreement executed on 11.06.2018 against a consideration of`300 Lakhs. It thereafter executed sub-agreement with a distributor to whom the rights of exhibition of film in some of the areas of Rajasthan were assigned against an amount of`100 Lakhs. The film was released for exhibition on commercial basis on 25.12.2018. Collection from the exhibition of film of "Meghna Film Distributors" for 25.12.2018 to 10.01.2019 was`50 Lakhs and thereafter upto 31.03.2019 was`190 Lakhs.

It asks you to clarify that how these transactions will be reflected in Income Tax Return for Assessment Year 2019-2020. Will your answer be different where the film was released for exhibition on 11.01.2019?

In this case, the Distributor himself exhibits the Film in certain areas and sells the rights of exhibition of the Film in respect of all or some of the remaining areas. The Income of **Meghna Film Distributors** shall be computed as under - **(`Lakhs)**

Particulars	Film released on 25.12.2018	Film released on 11.01.2019
Income from the Release of the Film	240.00	190.00
Income from Sale of Distribution Rights	100.00	100.00
Gross Receipts from business of release of Films & Sale of Film Rights	**340.00**	**290.00**
Less: Deduction as per Rule 9B	(300.00)	(290.00)
Net Income from the business	**40.00**	**NIL**
Reason	Since the Film is released before 31.12.2018, deduction upto entire Cost of Acquisition can be claimed as deduction.	As the Film is released after 31.12.2018, deduction upto the **lower** of Cost of Acquisition or Actual Income is permitted.

6.5.4 Speculative Business 1 2 3

1. **Meaning [Sec.43(5)]:** Speculative Transaction means a transaction involving a contract for purchase and sale of commodities, including Stocks and Shares, which is periodically or ultimately settled **other than by actual delivery or transfer** of commodities or scrips.

Note: Any transaction of Purchase and Sales by Non-Banking and Non-Investment Companies are deemed to be Speculative Transactions for tax purposes, and

2. **Price Fluctuations – Not Speculative [Sec.43(5) Proviso]:** A contract entered into, to guard against loss due to price fluctuation in the following cases is **not** a Speculative Transaction -

(a) In respect of Raw Materials or Merchandise in the normal course of business,

(b) In respect of Stocks and Shares entered by Dealers,

(c) In respect of a contract entered by a Member of a Forward Market or Stock Exchange in the course of jobbing or arbitrage.

3. **Transactions relating to trading in agricultural commodity derivatives – Not a speculative transaction: [W.e.f. 01.04.2019]**

(a) **Nature of Transaction:** Trading in agricultural commodity derivatives.

(b) **Condition of CTT not applicable:** For transaction in respect of trading in agricultural commodity derivatives, the requirement of chargeability to commodity transactions under Chapter VII of the Finance Act, 2013 shall not apply.

(c) **Non Speculative Transaction:** A transaction in respect of trading of agricultural commodity derivatives, which is not chargeable to CTT, in a registered stock exchange or registered association , will be treated as non-speculative transaction.

4. **Transfer of Derivatives – Not Speculative:** Eligible Transaction in respect of trading in **derivatives** carried out in a Recognized Stock Exchange is not a speculative transaction. For this purpose, "Eligible Transactions" means transactions -

(a) carried out electronically on screen-based systems through Stock-Broker / Sub-Broker / Other Intermediary registered under – (i) SEBI Act, 1992, or (ii) SCRA, 1956, or (iii) Depositories Act, 1996, or by Banks or Mutual Funds in a Recognized Stock Exchange, and

(b) supported by a Time Stamped Contract Note issued by such Stock Broker / Sub-Broker / Intermediary to every Client indicating therein, the Unique Client Identity Number allotted under that Act and PAN under IT Act.

5. **Transfer of Commodity Derivative – Not Speculative:** Eligible Transaction in respect of trading in Commodity Derivatives carried out in a Recognized Association, which is chargeable to Commodities Transaction Tax, is **not** a speculative transaction. For this purpose, "Eligible Transactions" means transactions -

(a) carried out electronically on screen-based systems through Member or an Intermediary, registered under the bye-laws, rules and regulations of the Recognized Association which is chargeable to Commodities Transaction Tax for trading in Commodity Derivative in accordance with Forward Contracts (Regulation)Act, 1952 and respective directions from Recognized Association, and

(b) supported by a Time Stamped Contract Notes issued by such Member / Intermediary to every Client indicating therein, the Unique Client Identity Number allotted under the Act, Rules, Regulations or Bye-Laws referred above , Unique Trade Number and PAN.

Note:

- **Commodity Derivative** shall have the meaning as assigned in Chapter VII of the Finance Act, 2013.
- **Recognized Association** means a recognized Association which is chargeable to Commodities Transaction Tax as referred to Sec.2 (j) of the Forward Contracts (Regulation) Act, 1952 and which fulfills the prescribed conditions, and is notified by the Central Government for this purpose.

6. **Treatment of Speculative Business: Speculation Business** shall be treated as **distinct and separate** from other business. Speculation Losses are to be treated separately.

Important Issues

Composite Business	In case of composite business, Income or Loss is to be **separately computed** on a reasonable proportion basis. **[Sind National Super Mills Pvt. Ltd. 121 ITR 742 (Bom.)]**

Speculative Loss vs Commission Income	Loss on share dealings which is of speculative nature, cannot be allowed to be set-off against commission earned from share-broking business. **[Jhunjunwala 139 ITR 371 (Cal.)]**
Business of Buying and Selling Units of UTI	Units of UTI cannot be deemed to be a Share. So, the business of buying and selling units of UTI by the Assessee Company did not amount to a speculation business for the purpose of allowing set-off of loss. **[Apollo Tyres Ltd vs CIT 174 CTR 521 (SC)|**

6.5.5 Miscellaneous Matters

A. Treatment for Foreign Currency Fluctuations [Sec.43A]

1**. Applicability:** The Assessee has acquired any Capital Asset from **abroad** for the purpose of his business or profession. Purchase of Capital Asset is on credit or on deferred payment or on loan in **Foreign Currency.**

2. Adjustment and Treatment:

If there is an **increase** or reduction in **liability,** at the time	->	(a) Towards the whole or a part of the **cost of the asset,** or (b) Towards repayment of the whole or a part of the **money borrowed** by him from any person, directly or indirectly, in any **foreign currency,** specifically for the purpose of acquiring the asset along with interest, if any,	->	the increase or reduction in liability shall be **adjusted towards the Cost of the Asset.**

3. **Purposes of Adjustment:**

(a) To compute the Actual Cost of the asset u/s 43(1), or

(b) To determine the amount of Capital Expenditure for Scientific Research u/s 35(1)(iv)

(c) To determine the amount of Capital Expenditure u/s 35A, or

(d) To determine the amount of Capital Expenditure u/s 36(1)(ix)

(e) To compute cost of acquisition of Capital Asset u/s 48 (not being a Capital Asset referred to in Sec.50)

4. **Liability met by other person:** Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall **not** be taken into account for the purposes of Sec. 43 A.

5. **Forward Contracts:** In case of Forward Contracts for settlement of liability, the adjustment in rate of exchange shall be made by reference to the **Forward Rate.**

6. **Instalment Payments:** Increase in liability due to rate fluctuation shall be added to Actual Cost of Asset, irrespective of the fact whether the same is to be discharged in instalments, which become due in near future. **[New India Industries Ltd. 119 CTR 306 (Guj.)]**

B. Taxation of Foreign Exchange Fluctuation [Sec.43AA]

1. **Nature of Income [Sec.43AA(2)]:** Any gain or loss arising on account of the effects of change in foreign exchange rates of all foreign currency transactions, including those relating to—

(i) monetary items and non-monetary items,

(ii) translation of financial statements of foreign operations,

(iii) forward exchange contracts,

(iv) foreign currency translation reserves.

2. **Taxability [Sec.43AA(1)j:** Subject to the provisions of Sec.43A, above referred Gain or Loss shall be treated as Income or Loss, and such gain or loss shall be computed in accordance with the ICDS notified u/s 145(2)

C. For Transfer of Land / Building other than Capital Assets, Full Value of Consideration = Value adopted by Stamp Valuation Authority, [Sec.43CA]

1. Situation: Any Consideration received or accruing as a result of the transfer by an Assessee of an Asset (other than a Capital Asset), being Land or Building or both.

2. **Value of Consideration:** Value adopted / assessed / assessable by the Stamp Valuation Authority of a State Government in respect of such transfer, shall be deemed to be the Full Value of the Consideration received or accruing as a result of such transfer for the purposes of computing Profits and Gains from transfer of such asset.

3. **Sec.50C:** Provisions u/s 50C (2), 50C (3) shall apply in relation to determination of the value adopted or assessed or assessable u/s 43CA(1).

4. Relevant Date for Stamp Duty Value:

(a) **Situation:** Stamp Duty Value on Date of Agreement Stamp Duty Value on Date of Registration.

(b) **Value of Consideration** shall be as follows **-**

Situation	**Relevant Date**
Time: If Whole / Part of the Consideration has been received **on or before** the Date of Agreement & **Mode:** By way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account	Date of Agreement
In any other case	Date of Registration

5. **Determination of Full Value of Consideration**

(a) **Situation:** Value adopted or assessed or assessable by the Stamp valuation authority does not exceed 105% of the consideration received or accruing as a result of the transfer,

(b) **Full value of Consideration:** For the purposes of computing profits and gains from transfer of such asset, the consideration so received or accruing as a result of the transfer shall be **deemed to be the full value** of the consideration.

(c) **Impact:** No adjustments shall be made in Computing Business Income, if the variation between stamp duty value and the sale consideration is not more than 5% of the Sale consideration.

Illustration – Application of Sec.43CA

Determine the full value of Consideration u/s 43CA from the following data and justify with reasons.

Case	**Date of Transfer of Land/ Building held as Stock in Trade**	**Actual Consideration**	**Stamp Duty Value on the Date of Agreement**	**Stamp Duty Value on the Date of Registration**
1	**01.05.2018**	**`1,00,00,000 [`10 Lakhs received by cheque on 31.08.2017]**	**`1,20,00,000 (01.09.2017)**	**`2,10,00,000 (01.05.2018)**
2	**01.05.2018**	**`1,00,00,000 [no Lakhs received by Cash on 31.08.2017]**	**`1,20,00,000 (01.09.2017)**	*t* **2,10,00,000 (01.05.2018)**
3	**31.03.2019**	**`1,00,00,000 [full amount received on the date of registration]**	**`1,20,00,000 (01.05.2018)**	**`2,10,00,000 (31.03.2018)**

Previous Year: 2018-2019 Assessment Year: 2019-2020

Determination of Full Value of Consideration u/s 43CA

Case	Valuation Basis	Full Value of Consideration	Reasoning
1	Stamp Duty Value on the Date of Agreement	`1,20,00,000	Part of the Consideration has been received by **Cheque before** the Date of Agreement.
2	Stamp Duty Value on the Date of Registration	`2,10,00,000	Part of the Consideration has been received by **Cash** before the Date of Agreement.
3		`2,10,00,000	Full Amount received only on the Date of Registration.

D. Computation of Income from Construction and Service contracts. [Sec 43CB]

1. Nature of Income: The profits and gains arising from a construction contract or a contract for providing services

2. **Determination of Income:** Such Income shall be determined on the basis of **Percentage of Completion**

method in accordance with ICDS notified u/s 145(2)

3. **Exception:** For the following services profits and gains shall be based on -

Nature of Contract	Basis of Determination
Duration of contract not more than 90 days	Project completion method
Contract involving indeterminate number of acts over a specific period of time	Straight line method

Note:

(i) Contract revenue shall include retention money.

(ii) Contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.

6.6 Presumptive Income

6.6.1 Presumptive Income of Eligible Business [Sec. 44AD]

Eligible Assessee	(a) Resident Individual, Resident HUF or a Resident Partnership Firm (not being a Limited Liability Partnership Firm), and (b) Deduction u/s 10A, 10AA, 10B, 10BA or 80-IA / IAB / IB / IC / ID / IE / 80JJA / 80JJAA / 80LA / 80QQB / 80RRB is not claimed in the relevant assessment year.
Eligible Business	(a) Any business except the business of plying, hiring or leasing goods carriages specified u/s 44AE, **and** (b) whose Total Turnover or Gross Receipts in the previous year does not exceed`2 Crores.
Ineligible Business	The provisions of Sec.44AD are not applicable to – (a) Person carrying on profession as referred in Sec.44AA, (b) Person earning income in the nature of Commission or Brokerage, or (c) Person carrying on any Agency business.
Amount of Presumptive Income	8% of the Total Turnover or such higher sum as declared by the Assessee, will be **deemed** to be the Profits and Gains of Business or Profession.

Lower Presumptive Income for Transactions in Banking mode	**Presumptive Income u/s 44AD:** 6% of Total Turnover or Gross Receipts **or Higher sum** declared by the Assessee. **Condition for Lower rate:** Total Turnover or Gross Receipts, received by way of an Account Payee Cheque or an Account Payee Bank Draft or Use of Electronic Clearing System through a Bank Account during the PY or before the due date u/s 139(1) for such PY, alone are eligible for this lower rate of tax. **Note:** Existing rate of deemed profit of 8% u/s 44AD, shall continue to apply in respect of Total Turnover or Gross Receipts received in any other mode. (Eg. Cash transactions)
Deduction u/s 30 to 38	Deemed to be allowed.
Allowability of Depreciation for subsequent previous years	WDV of Assets shall be computed, as if Depreciation had been allowed in earlier years.
Maintenance of Books / Audit	Assessee opting for Presumptive Scheme u/s 44AD or u/s 44AE, will **not** be required to maintain Books of Account u/s 44AA and get the accounts audited u/s 44AB, in respect of such Income / Business.
Consideration of Turnover for Tax Audit u/s 44A B	Shall not be considered if the Assessee opts for Sec.44AD/AE.
Benefit of Chapter VIA	Deduction u/s 80C to 80U shall be available to the Assessee.
Advance Tax	Provisions relating to Advance Tax payment are not applicable to an Eligible Assessee, in so far as they relate to the Eligible Business.
When Assessee declares lower Income	Books of accounts to be maintained u/s 44AA and audit u/s 44AB has to be fulfilled. For Assessee engaged in business specified u/s 44AD, only if Income exceeds maximum amount not chargeable to tax, Books of Accounts are to be maintained.
Other Points	1. Civil Construction includes— **[Circular 684 dated 10.06.94]** • Construction or repair of any building, bridge, dam or other structure or any other structure or of any canal or road, • Execution of any works contract like works relating to electrical fitting, plumbing, land filling, landscaping work, etc. 2. Interior Decoration does **not** come under the business of Civil Construction. **(Sanjay Kataria 3 SOT 18 (Del.)]** 3. Material supplied by the Contractee at a fixed cost to the Civil Construction Contractor shall **not** be included in the Gross Receipts or Turnover u/s 44AD. **[Brij Bhusan Lai Parduman Kumar 115 ITR 824** (SC)]

(a) **Restriction on Presumptive Provisions:**

• **Situation:** An Eligible Assessee declares profit for any PY as per Sec.44AD(1), and declares profit for any of the next 5 PY's, not in accordance with Sec.44AD(1).

• **Effect:** The Assessee **shall not be eligible to claim** the benefit u/s 44AD(1) for **the** 5 **consecutive AY's**

subsequent to the AY relevant to the previous year in which the profit has not been declared as per Sec.44AD(1).

(b) **Conditions u/s 44AD(5):** Eligible Assessee for whom Sec.44AD(4) is applicable, is required to maintain books of a/c and other documents as specified in Sec.44AA(2) and get them audited and furnish a report of such audit as required u/s.44AB.

(c) **No Audit:** If an eligible person opts for presumptive taxation scheme as per Sec. 44AD(1), he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant PY does not exceed`2 Crore **[Press Release, dated 20-6-2016]**

Illustration – Sec 44AD – Gross Receipts / Turnover

Ascertain the Taxable Income of a Civil Construction Contractor under the following situations -

	Situation I	**Situation II**
Amount received from Contractee through DD	**`50,00,000**	**`60,00,000**
Cost of Materials suDDlied bv Contractee throuah NEFT?		**35.00.000**
	`45.00.000	
Total Value of Contract	**`85.00.000**	**`1.05.00.000**

Note: Note the **distinction between –** (a) Gross Receipts for Turnover purposes, and (b) Gross Receipts for 6%

purposes, as explained below -

Situation I:

(a) Turnover = Gross Receipts is only`85,00,000, does not exceed`1,00,00,000. The Contractor can subject himself to presumptive taxation u/s 44AD.

(b) **Condition for Lower rate:** Total Turnover or Gross Receipts, received by way of an Account Payee Cheque or an Account Payee Bank Draft or Use of Electronic Clearing System through a Bank Account during the PY or before the due date u/s 139(1) for such PY, alone are eligible for this lower rate of tax. Since the amount received is by way of Demand Draft, lower rate of 6% shall be applicable.

(c) Material supplied by the Contractee at a fixed cost to the Civil Construction Contractor shall **not** be included in the **Gross Receipts or Turnover** u/s 44AD. **[Brij Bhusan Lai Parduman Kumar Case].** So, Gross Receipts for the purpose of **applying** 6**%** Presumptive Income =`**50,00,000 only.**

(d) So, Presumptive Income of the Assessee u/s 44AD =`50,00,000 x 6% =`**3,00,000.**

Situation II:

(a) Exclusion of material supplied by Contractee at fixed cost to the Civil Construction Contractor, is **only** for the purposes of applying 6% Presumptive Income on Gross Receipts u/s 44AD. It will be **included** in determining Gross Receipts for **applicability** of Sec. 44AD.

(b) Gross Receipts of the Contractor`1,05,00,000 **exceeds**`1,00,00,000 in this case. So, Sec.44AD **is not applicable.**

(c) The Assessee will be subject to tax audit u/s 44AB, as his Gross Receipts exceeds`1,00,00,000.

6.6.2 Presumptive Income in case of Profession [Sec.44ADA] (w.e.f. AY 2017-18)

Special Provision for computing Profits and Gains of Profession on presumptive basis:

1. **Applicability:** An Assessee being a Resident in India, engaged in a Profession as per Sec.44AA(1).

2. Assessee's Total Gross Receipts in the previous year does not exceed`**50 Lakhs.**

3. **Presumptive Income** = **50%** of Total Gross Receipts, or higher sum declared by the Assessee in the previous year.

4. Deductions u/s 30 to 38 shall be deemed to be allowed.

5. Depreciation on Assets used for purpose of the Profession shall be deemed to have been calculated and claimed, by Assessee in each of the relevant assessment years.

6. If the Assessee claims that his Profits and Gains from the Profession are lower than the presumptive amount, and Total Income exceeds the Basic Exemption Limit, he is required to-

(a) maintain books of account and other documents as specified in Sec.44AA(1), &

(b) get them audited and furnish a report of such audit as required u/s 44AB.

6.6.3 Presumptive Income of Plying Goods Carriages [Sec.44AE]

Eligible Assessee	Persons carrying on business of plying, hiring, and leasing goods carriages and not owning more than 10 goods carriages at any time during the previous year.

Amt of Presumptive Income	`7,500 for every month or part thereof, during which the Goods Carriage is owned by Assessee in the Previous Year. **Note:** If a higher sum is declared by the Assessee as Income, such higher amount shall be considered.
Deduction u/s 30 to 38	Deemed to be allowed.
Allowability of Depreciation for subsequent previous years	WDV of Assets shall be computed, as if Depreciation had been allowed in earlier years.
Maintenance of Books / Audit	Assessee opting for Presumptive Scheme u/s 44AD or u/s 44AE, will **not** be required to maintain Books of Account u/s 44AA and get the accounts audited u/s 44AB, in respect of such Income / Business.
Consideration of Turnover for Tax Audit u/s 44AB	Shall not be considered if the Assessee opts for Sec.44AD/AE.
Benefit of Chapter VIA	Deduction u/s 80C to 80U shall be available to the Assessee.
When Assessee declares lower Income	Books of accounts to be maintained u/s 44AA and audit u/s 44AB has to be fulfilled. [For Assessee engaged in business specified u/s 44AE, Books to be maintained, only if Income exceeds maximum amount not chargeable to tax.]
Computation of Presumptive Income if Assessee is a Firm	Compute Presumptive Income as above **Less** Interest, Salary and Allowable Remuneration to Partners. The balance is chargeable to tax, as Firm's Income.
Presumptive Income in case of Heavy Goods Vehicle and Other Vehicle	**W.e.f 01.04.2019,** Presumptive Income = **Higher** of sum claimed to have been actually earned from the Vehicle or an amount as computed below - 1. **Heavy Goods Vehicle:`1,000** per ton of gross vehicle weight or unladen weight per month or part of a month during which vehicle is owned by the assessee in the PY. 2. **Other Vehicle:`7,500** per month or part of a month during which vehicle is owned by the assessee in the PY. **Meaning of Terms:** 1. "Heavy Goods vehicle" means any goods carriage, the gross vehicle weight of which exceeds 12000 kilograms (more than 12mt gross vehicle weight). 2. "Goods carriage", "Gross vehicle weight" and "unladen weight" shall have the respective meanings assigned to them u/s 2 of the Motor Vehicles Act, 1988.
Other Points	**1.** Income shall be considered from the date of Ownership. Here, **Ownership = Possession.** 2. An Assessee who is in possession of a Goods Carriage, whether taken on hire purchase or on instalments and for which whole or part of the amount payable is still due, is **deemed** to be the Owner of such Goods Carriage. 3. Income from Vehicles is to be computed for **every month or part** thereof, during which these were **owned** by the Assessee, even though these are not actually used for business.

Illustration – Sec.44AE – M 11

Ramamurthy has 4 Goods Vehicles as on 01.04.2018. He acquired 7 Goods Vehicles on 27.06.2018. He sold 2 Goods Vehicles on 31.05.2018. He has brought forward Business Loss of`50,000 relating to the Assessment Year 2015-2016 of a Discontinued Business. Assuming that he opts for Presumptive Taxation of Income u/s 44AE, compute his Total Income chargeable to Tax for the AY 2019-2020.

1. Computation of Presumptive Income

Nature of Vehicle	Period	Months	Rate pm	No. of Vehicles	Presumptive Income
Owned for entire year	01.04.2018 to 31.03.2019	12	7,500	2	1,80,000
Sold during the year	01.04.2018 to 31.05.2018	2	7,500	2	30,000
Newly acquired Vehicle	27.06.2018 to 31.03.2019	10	7,500	7	5,25,000
Income u/s 44AE	**7,35,000**				

2. Computation of Total Income

Particulars	
Income from Business (u/s 44AE) Brought forward Loss set off u/s 72	7,35,000 (50,000)
Particulars	`
Gross Total Income **Less:** Deduction under Chapter VI-A	**6,85,000** NIL
Total Income	**6,85,000**

Illustration – Sec 44AE – N 11

Mr. Chandran (aged 38) owned 6 Goods Vehicles as on 01.04.2018. He acquired 2 more Goods Vehicles on 01.07.2018. He is solely engaged in the business of Plying Goods Vehicles on Hire since Previous Year 2014-2015.

He did not opt for Presumptive provision contained in Sec. 44AE for the Previous Year 2017-2018. His books were audited u/s 44AB and the Return of Income was filed on 15.10.2018. He has Unabsorbed Depreciation of`70,000 and Business Loss of`1,00,000 for the Previous Year 2017-2018.

Following further information is provided to you -

1. Deposited`20,000 in Tax Saver Deposit with UCO Bank in the name of married son.

2. Paid Medical Insurance Premium of`23,000 for his parents (both aged above 70) by means of Bank Demand Draft.

3. Paid Premium on Life Insurance Policy of his married daughter`25,000.

4. Repaid Principal of`40,000 and Interest of`15,000 to Canara Bank towards Education Loan of his daughter, who completed B.E. two years ago. She is employed after completion of her studies.

Assuming that Mr. Chandran has opted for Presumptive Provision contained in Sec. 44AE of the Income Tax Act, 1961, compute the Total Income of Mr. Chandran for the Assessment Year 2019-2020.

Assessee: Mr. Chandran Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Total Income

Particulars	`	`
Profits and Gains of Business or Profession: Presumptive Income u/s 44AE - - 6 Vehicles x 7,500 p.m x 12 months - 2 Vehicles x 7,500 p.m x 9 months	5.40.000 1.35.000	6,75,000
Less: Unabsorbed Depreciation u/s 32(2) can be set off against any head of Income		(70,000)
Gross Total Income		**6,05,000**

Less: Deduction under Chapter VI-A 80C – Tax Saver Deposit with UCO Bank`20,000 – LIC premium paid`25,000	45,000	
80D – Mediclaim Insurance on Parents – Lower of`23,000 or`50,000	23,000	
80E – Interest on Education Loan [Note 2]	15,000	(83,000)
Total Income		**5,22,000**

Notes:

1. Business Loss of`1 lakh cannot be carried forward / set off as the Return of Income is not filed within the

Due Date u/s 139(1).

2. Deduction u/s 80E shall be eligible irrespective of whether children are dependent or not.

Illustration – Computation of Business Income – N 11

Mr. Gupta is having a Trading Business and his Trading & Profit & Loss Account for the Previous Year 2018-2019 is as under:

Particulars	**Amount**	**Particulars**	**Amount**
To Opening Stock To Purchases To Gross Profit	**1,00,000 49,00,000 20,50,000**	**By Sales By Closing Stock**	**70,00,000 50,000**
Total	**70,50,000**	**Total**	**70,50,000**
To Salary to Employees (including Contribution to PF)	**5,00,000**	**By Gross Profit b/d**	**20,50,000**
To Donation to Prime Minister Relief Fund	**1,00,000**		
To Provision for Bad Debts	**50,000**		
To Bonus to Employees	**50,000**		
To Interest of Bank Loan	**50,000**		
To Family Planning Expenditure incurred on Employees	**20,000**		
To Depreciation	**30,000**		
To Income Tax	**1,00,0000**		
To Net Profit	**11,50,000**		
Total	**20,50,000**	**Total**	**20,50,000**

Other information:

1. Depreciation allowable`40,000 as per Income Tax Rules.

2. No deduction of tax at source on payment of interest on bank loan has been made.

3. Payment of Bonus to workers made in the month of October on the occasion of Diwali festival.

4. Out of Salary,`25,000 pertains to his contributions to Recognized PF which was deposited after the due date. Further, Employees Contribution of`25,000 was also deposited after the due date.

Calculate Gross Total Income of Mr. Gupta for the Assessment Year 2019-2020.

Assessee: Mr. Gupta Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Gross Total Income

Particulars	**Deduction from Profit**	**Addition to Profit**
Net Profit as per Profit and Loss Account		11,50,000
Employee’s Contribution to RPF		25,000
Donation to PM Relief fund		1,00,000
Provision for Bad Debts		50,000
Bonus to Employees paid in the month of October		50,000
Family Planning Expenses		20,000
Depreciation as per books		30,000
Depreciation as per Income Tax Rules	40,000	
Income Tax Paid		1,00,000
Sub-Total	**40,000**	**15,25,000**
Profits and Gains of Business or Profession (15,25,000 – 40,000)		**14,85,000**
Gross Total Income		**14,85,000**

Note:

1. U/s 36(1)(iv), Contribution to RPF by Employer after due date of the relevant act but before filing Return u/s 43B is allowed as an Expense. It is assumed that the same is paid before filing of return u/s 43B.
2. U/s 36(1)(va), Deposit of Employee’s Contribution of PF after the due date of the relevant Act is not allowed as an Expense.
3. Donation to PM Relief Fund is eligible for deduction from Gross Total Income only u/s 80G.
4. Provision for Bad Debts is not allowed as an Expense u/s 36(1)(viia) as it is not an Eligible Entity.
5. TDS need not be deducted on payment of Interest on Bank Loan and it is assumed that interest is actually paid. Flence Interest on Bank Loan is allowed as deduction.
6. Family Planning Expenditure not allowed as an Expense u/s 36(1)(ix) as it is applicable to Companies only.
7. Bonus to Employees is paid after due date of filing Return u/s 139(1), and is hence not deductible u/s 43B.
8. Income Tax paid is not an allowable expenditure as per Sec. 40(a)(ii).

Illustration – Computation of Business Income – N 12 (Mod)

Following is the Profit and Loss Account of Mr. Q for the year ended 31.03.2019:

Particulars	**Amount**	**Particulars**	**Amount**
To Repairs on Building **To Amount paid to IIT, Mumbai for an** **Approved Scientific Research** **Programme** **To Interest** **To Banking Cash Transaction Tax To Travelling To Net Profit**	**1,81,000** **1,00,000** **90.000** **20.000** **1,30,550** **93,950**	**By Gross Profit By I.T. Refund By Interest on Company Deposits**	**6,01,000** **8,100** **6,400**
Total	**6,15,500**	**Total**	**6,15,500**

Following additional information are furnished:

1. **Repairs on Building includes`1,00,000 being cost of laying a toilet roof.**

2. **Interest payments include`50,000 paid to a Resident on which TDS has not been deducted and penalty for contravention of Central Sales Tax Act of`24,000.**

Compute the Income chargeable under the head Profits and Gains of Business or Profession of Mr. Q for the year ended 31.03.2019 ignoring depreciation.

Assessee: Mr.Q Previous Year: 2018-2019 Assessment Year: 2019-2020

Computation of Profits and Gains of Business or Profession

Particulars	**Deduction from Net Profit**	**Addition to Net Profit**
Net Profit as per Profit and Loss A/c		93,950
Current Repairs of Capital Nature on Building		1,00,000
Amount Paid to IIT for Approved Scientific Research Programme (150% is allowed	50,000	
as deduction u/s 35(2AA). Since 100% is deducted, balance is allowed as deduction)		
Disallowed Interest – Interest paid to a Resident, without deduction of tax at source is		15,000
disallowed to an extent of 30% u/s 40(a)(ia) [`50,000 x 30%] **(See Note)**		
Penalty for contravention of Central Sales Tax Act (payment for contravention		24,000
of any provision of law is not an allowable expenditure u/s 37)		
Income tax Refund – Does not form part of Income	8,100	
Interest on Company Deposits – Considered under Income from Other Sources	6,400	
Sub-Total	**(64,500)**	**2,32,950**
Profits and Gains of Business or Profession (2,32,950 – 64,500)		**1,68,450**

Note:

- Interest paid to Resident is disallowed to the extent of 30%. This will be allowed in the year of TDS Remittance. However, if the Payee were a Non-Resident, the entire amount would have been disallowed for TDS default.
- Banking Cash Transaction Tax is allowable as an expenditure u/s 36(1)(xiii).
- Depreciation at 10% can be claimed in respect of cost of laying Toilet Roof. However, since the Question requires solution ignoring depreciation, it has been ignored in respect of Capital Expenditure relating to Toilet Roof.

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