

INCOME FROM PROFITS AND GAINS OF BUSINESS OR PROFESSION

E Elango

Business

- Activity
 - Devotion of time
 - Attention
 - Labour
-
- With a motive to make profits

Business..

- Trade
- Commerce
- Manufacture
- Concern
- Adventure
- (Factors to be looked into: nature, intention, periodicity and efforts)

Profession

- Vocation
- Not necessarily because of Ability & Knowledge by University Degrees
- Can be of Inborn talent, skills & attributes

Outline of provisions: Sec 28

- Profits and gains of any business/profession
- Compensation due to modification or termination of a contract relating to business activity/ management of affairs in India/Indian company/Any other company/in favour of Government
- Income from any trade
- Export-> Profit on sale of import/export, cash assistance, duty draw back

Outline of provisions: Sec 28 ..

- Profit on transfer of Duty entitlement passbook scheme /Duty replenishment certificate (Duty remission scheme under EXIM policy)
- The value of benefit or perquisite arising from Business/Profession
- Any sum received under keyman insurance policy

Method of accounting

- Cash basis
- (Receipts and Payments)
- Due basis
- (Principle of “right to receive and “liability to pay”)
- Hybrid system

Speculation u/s 73

- Purchase or Sale of commodity including stocks and shares otherwise than by actual delivery or transfer
- (Exception: to guard against loss due to price fluctuation)
- Whether allowed?
- Accounts are to be
- Separate and
- Distinct

Admissible deductions

- Section 30 : Building
- **for tenants**
- rent paid
- cost of repairs, if undertaken

Building..

- **for owners**
- current repairs(to preserve and maintain)
- land revenue,
- local rates
- property taxes
- insurance premium

Section 31 : Machinery

- Current repairs
- (without changing the capacity and enhancing its efficiency)

CIT Vs Polyolifins Industries Ltd 169 ITR 538
(Bombay)

- Insurance premium

Explanation to sec 30 and sec 31

- Current repairs shall not include any expenditure in the nature of capital expenditure
- Replacement
- Defective or old
- Sold as junk
- No increase in productive capacity after replacement

Depreciation : Section 32

- Mandatory
- Explanation 5 – depreciation allowable under section 32 is mandatory and therefore shall be allowed even if the assessee has not claimed the deduction in respect of depreciation in computing his total income.

Basic conditions for availing depreciation

The assessee

- Must be the **owner** of the asset
- Must use the asset for the business
- Should put to use during the previous year
- The asset should fall within the eligible classification of assets viz. buildings, machinery, plant and furniture, patents, copyrights, trade marks, licences, franchises etc.

Owner?

- Tenant incurring for renovation, extension or improvement
- Hire purchase-proportionate
- Beneficial ownership(Title deed not registered)

Intangible assets

- Know-how
- Patents
- Copy rights
- Trade marks
- Licences
- Franchises
- Acquired on or after 1.4.1998

Block of assets

- Buildings = Roads Bridges Wells Tube wells
- Plant = Ships Vehicles Books
- Lands and Personal assets are NOT qualified for depreciation
- Passive use or potential use
- Not necessarily active use

Depreciation?

- Ram mandir
- 3 lakhs
- Atlas Cycle Industries Ltd (P&H) 134 ITR 458
- A sort of mental recreation

Two methods of depreciation

1. Written down value method
2. _____

Unabsorbed Depreciation

- Shall be allowed to be carried forward under subsection (2) of Section 32
- Can be set off not only against income under the head profits and gains of business or profession but also against income under any other head
- Can be carried forward indefinitely
- Business need not be continued in order to get the benefit of carry forward

Depreciation for Power sector

- Generation or generation and distribution of power
- WDV or Straight line
- Method : Optional (Once exercised, final)

Expenditure on Scientific Research – Section 35

- Sec.43(4) – Scientific research means any activities for the extension of knowledge in the fields of natural or applied sciences including agriculture and animal husbandry and fisheries.

Deduction is allowed on:

- Capital and revenue expenditure
- Expenditure 3 yrs preceding the year of commencement of business allowed on year of commencement
- In cases where contribution for scientific research made to approved Research Institutes, Universities, National Laboratories etc. – Deduction = $1\frac{1}{4}$ times

Deduction is allowed on..

- No deduction shall be allowed u/s 35 in respect of cost incurred for acquiring land
- In respect of capital expenditure allowed as deduction u/s 35, no depreciation can be claimed u/s 32

35AD-Specified business – 150%..

- On or after 01/04/2012
- A cold chain facility
- Ware housing
- Hospital with minimum of 100 beds
- Housing project-affordable-CBDT notified
- Fertilizer

35AD-Specified business – 100%

- Natural gas/Crude oil/Petroleum
- * * Hotel and above
- Housing Project-Slum Development-CBDT
- Inland container depot
- Bee keeping/Honey production
- Storage of sugar
- Pipeline for transporting iron ores
- Semi conductor wafer fabrication

VRS Compensation

- Allowable?
- 1/5
- u/s 35 DDA

OTHER DEDUCTION - SECTION 36(1):

- Insurance premium paid against risk of damage of stocks or stores
- Insurance premium paid for life of cattle owned by a member of primary co-operative society
- Insurance premium paid by cheque for insuring health of employed under approved schemes

SECTION 36(1)..

- Bonus or commission paid to employees for services rendered
- Interest paid in respect of capital borrowed for the purpose of business or profession
- Contribution to recognized PF, Gratuity Fund, Superannuation Fund

SECTION 36(1)..

- In respect of animals used for the purposes of business or profession otherwise than as stock-in-trade and have died or become permanently useless for such purposes, the difference between the actual cost and the amount, if any, realized in respect of the carcasses or animals
- Bad debt written off as irrecoverable

SECTION 37(1) – Any expenditure not being

- Expenditure of the nature described in section 30 to 36
- In the nature of capital expenditure
- In the nature of personal expenditure
- And the expenditure which is laid out or expended wholly or exclusively for the purposes of the business or profession

Amounts expressly disallowed – Sec 40

- Interest
- Royalty
- Fees for technical services paid
to Non-resident without TDS u/s 40(a)

Amounts expressly disallowed..

- W.e.f. Asst. Year: 2005-06 u/s 40(a)(ia)
- Payments made within India where no TDS is made on
 - Interest
 - Commission on brokerage
 - Fee for Technical & Professional Services
 - Contract payments
 - Rental payments

Amounts expressly disallowed..

- Securities Transaction Tax u/s 40(a)(ib)
- Income tax u/s 40(a)(ii)
- Wealth Tax u/s 40(a)(iia)
- Fringe Benefit Tax 40(a)(ie)
- Payments to relatives (to the extent unreasonable) – 40A(2)

Income tax Return..

- Expenses on Income tax proceedings (including the expenses paid for preparation of return of income)
- Allowable
- 40A(12)-Discontinued...

Entertainment Expenses..

- Allowable under section 37(1)
- Provisions of section 37(2) for partial disallowance of such expenses have been omitted

Section 40A(3)

- Cash payments in respect of expenditure exceeding Rs.20,000/- in a day
- Rs.35,000/- for plying, hiring, leasing goods carriages
 - Disallowance shall be made at 100% on the whole of the amount
 - This provision shall not apply in respect of expenditure for which no deduction is claimed

Rule 6DD

Rule 6DD

- Banks
- Government
- LIC
- Agriculture/Fish/Animal husbandry
- No bank-Holiday/strike
- Authorised money exchanger
- On behalf of someone

Sum paid to..

- Cash payment made to a consumer cooperative society
- Not allowable
- Attar Singh Gurmukh Singh Vs ITO (1991) 59 Taxmann 11 (SC)

Exceptions – Rule 6DD

- Govt./Bank/Financial Institutions
- Dairy/Poultry/Fisheries
- Cottage Industries
- Authorised dealer/Money Exchanger/Traveller cheques
- Banks closed
- On behalf of somebody

Provision for gratuity

- Allowed u/s 40A(7)
- Non statutory/Unrecognised welfare funds are disallowed u/s 40A(9)

Deduction based on actual payment u/s 43B

- Evidence for payment within due date for filing of RoI along with evidence
- Tax/Duty/Cess/Fee
- Contribution to recognised PF/SF/Gratuity
- Any bonus/Commission
- Interest
- Paid on Leave encashment
- If paid after due date?
- Claim, next year

Maintenance of books of accounts – Sec.44 AA:

- Where the income from such business or profession has exceeded Rs.1,20,000/- in any of the three preceding previous years or is likely to exceed Rs.1,20,000/- during the current year
- If the turnover or sales or gross receipts has exceeded Rs.10,00,000/- during the current previous year

Books to be maintained :

- CASH BOOK
- LEDGER
- JOURNAL (if Mercantile system is adopted)
- BILLS AND VOUCHERS IN RESPECT OF EXPENSES INCURRED (Above Rs.50/-)
- COPIES OF BILLS ISSUED (Above Rs.25/-)
- IN THE CASE OF MEDICAL PRACTITIONERS
 - DAILY CASE REGISTER (FORM 3C)
 - INVENTORY(At the place of business/profession, for 6 years)

AUDIT OF ACCOUNTS - SECTION 44AB

- Books of accounts are required to be audited by a CA before the due date specified u/s.139(1) for filing return of income and audit report obtained and furnished in the case of any person

Audit of accounts..

- Carrying on business where the total sales, turnover or gross receipts exceeds Rs.1Crore; or
- Carrying on profession where the gross receipts exceed Rs.25 lakhs;

PROVISIONS FOR DEEMED INCOME-44AD

- If gross receipts are less than Rs.1Crore
- 8% → Income
- Gross receipts do not include materials supplied at fixed cost by contractee
- Brij Bhushan Lal Parduman Kumar Vs CIT 115 ITR 824 (SC)
- No need to maintain books of account
- No need to pay advance tax till 15/03

Transport Operation Business – 44AE

- Plying, hiring, leasing of goods carriages
- Not more than 10 goods carriages
- Estimate income is :
- Rs.7,500/-p.m. for vehicle
- No exemption for advance tax

Common points for Sec.44AD and Sec.44AE

- All deductions u/s. 30 to 38 including depreciation shall be deemed to have been allowed
- Written down value of assets used for the purposes of such business shall be calculated as if the depreciation has been actually allowed

Common points for Sec.44AD and Sec.44AE..

- Assessee can claim that the profits and gains of these businesses are lower than the income deemed in these provisions provided the assessee maintains books of accounts as per Sec.44AA and gets the accounts audited and furnishes audit report as required u/s.44AB.

Common points for Sec.44AD and Sec.44AE..

- In case of a firm..
- Salary and Interest paid shall be deducted from income computed under these provisions

Loss incidental to Business

- Hasimara Industries Ltd Vs CIT 230 ITR 927 (SC)
- Nature?
- Capital? Or Revenue?
- Deposit for a new business
- Stock loss is fire
- Ramesh Narain Saxena Vs CIT (1996) 86 Taxmann 65 (SC)

Penalty

- Contravention of law
- Compensatory nature
- Composite levy
- Standard Batteries Vs CIT 211 ITR 444 (SC)
- Swadeshi Cotton Mills Vs CIT 233 ITR 199 (SC)
- CIT Vs Reliable Water supply service of India Ltd., (1980) 124 ITR 199 (All.)

Issue Expenses

- Shares
- Debentures
- India Cements Ltd Vs CIT 60 ITR 52

Know how Expenses

- For existing business
- While purchasing machinery for existing business - capitalise
- For new business - capitalise
- CIT Vs Greaves Cotton Ltd 244 ITR 149 (Madras)
- CIT Vs Powerbuild Ltd 244 ITR 19 (Gujarat)

Compensation for workmen

- Entire business – Capital
- One unit - Revenue
- CIT Vs Nagpal Opticals 248 ITR 665

Secret Commission

- Onus on the assessee
- Not opposed to public policy
- CIT Vs Transport Corporation of India Ltd 256 ITR 701(AP)

Travelling

- To extend existing business – Revenue
- New line of business – Capital
- CIT Vs Woodcraft Products 217 ITR 862(Calcutta)
- Spouse?
- CIT Vs Hajeemoosa 153 ITR 422 (Gujarat)

Valuation of closing stock

- If business discontinued..
- Market value
- Ala Firm Vs CIT 189 ITR 285 (SC)

37(2B)

- Advertisement in a souvenir of a political party
- Disallowed

Donation to political parties

- Not allowable under P&L Account
- Deduction u/s 80 GGB / GGC
- Any sum

Provision for Leave Encashment

- Allowable
- Bharat Earthmovers Vs CIT (2000)112 Taxmann 61 (SC)

Interest – Sales tax

Interest paid on instalments granted for
payment of sales tax

Mahalaxmi Sugarmills Vs CIT 123 ITR 429

Demurrage

- Allowable
- Demurrage paid to Railways for not lifting goods is incidental to business
- Haji Aziz Abdul Shakoor Bros. Vs CIT 41 ITR 350 (SC)

Warranty Provisions

- Allowable
- CIT Vs India Transformers Ltd (2004) 270 ITR 259 (Kerala)

To save reputation

- Payment made to advocate to defend the managing director in a criminal case to save the reputation of the company partakes the character of business expenditure and is, therefore, allowed u/s 37(1) sec
- CIT Vs Ahmedabad controlled Iron & Steel Reg. Stock-holders association (p) Ltd., (1975)99 ITR 567

Dharmada

- Amounts collected as Dharmada from the willing customers are not trading receipts and, therefore, they are not treated as assessee's income
- CIT Vs Channoo Lal Damodar Dass (1978) 113 ITR 759 (All.)

Provident Fund

- Amount paid under 14B of the Employees Provident fund Act as damages for default in making payment of PF contribution is PENAL in character and is not allowable as business expenditure
- CIT Vs Albuquerque & Sons (1992) 198 ITR 609 (Karnataka)

Sum paid to competitor

- Sum paid to competitor in order not to bid at auction sale to enable to secure stock in trade at an advantageous price is allowable
- V Damodaran Vs CIT (1967) 64 ITR 26 (Kerala)
- Not allowable
- Bangalore Arrack Co.(1992) 108 CTR 57 (Karnataka)

Interest on loan..

- Interest on loan to purchase a new machinery
- Allowable
- India Cements Vs CIT (1966) 60 ITR 52(SC)

Building on leased land

- Demolished the existing one and constructed a new one
- Very low rent
- Revenue expenditure
- CIT Vs Madras Auto Service Pvt.Ltd
- 233 ITR 468(SC)

Fee to ROC

- Enhancement of capital
- Capital expenditure
- Punjab State Industrial Development Corporation Ltd Vs CIT
- 225 ITR 792 (SC)

Shifting

- Shifting Machinery
- capital
- Shifting raw material, employees
- Revenue
- CIT Vs Bimetal Bearings Ltd.,
- 143 ITR 424 (Madras)
- Administrative Office
- Revenue
- CIT Vs Madura Coats(2001) 253 ITR 62(Madras)

Renovation

- In a hotel
- Flush system for latrines
- Cement roof
- Water tank
- Revenue expenses
- CIT Vs Hotel Control Pvt.Ltd.,
- 265 ITR 109 (Uttaranchal)

Bus and donation

- A purchased a bus
- Donated to a school where the children of the employees are studying
- Welfare expenditure
- Revenue
- CIT Vs Rajasthan Spinning & Weaving Mills Ltd (2006) 281 ITR 408 (Rajasthan)

Drinking water

- Purchase drinking water
- School in the locality
- Good will of local community
- Revenue
- Madras Refineries Ltd.,(2003)
- 266 ITR 170 (Madras)

Judicial outlook..

- Gaining new dimensions with the passage of time and the change in the nature of the expenditure as demanded by ever changing common principles of commercial expediency and business prudence

Judicial outlook..

- Assessee engaged in promotion of residential colonies claimed the deduction of expenses for construction of a school, with a view to persuade buyers to purchase.
- Revenue expenditure

Judicial outlook..

- Machinery leased out, during temporary suspension- Business Income
- CIT Vs Vikram Cotton Mills 169 ITR 597 (SC)
- Factory leased out, Business stopped, no intention of reviving – Other sources
- Universal Plast Ltd Vs CIT 237 ITR 454 (SC)

Judicial outlook..

- Club earns income by fee/subscription, supply of drinks/refreshments, what about surplus?
- Not taxable – CIT Vs Bankipur Club 226 ITR 97(SC)

Judicial outlook..

- Dr treated a patient, fee paid. Later executed a will gifting an area of 33.36 acres of land as a feeling of gratitude. Taxable?
- No- CIT Vs Dr BM Sundaravadanam 148 ITR 333 (Madras)

Judicial outlook..

- Assessee practising against atheism, received donation from friends, who believed in the cause. Taxable?
- Yes
- Dr K George Thomas Vs CIT 156 ITR 412(SC)

Judicial outlook..

- Payment to Govt for construction of new bridge to facilitate easy movement of goods
- Yes
- CIT Vs Coats Viyella India Ltd(2002)
- 253ITR 667 (New Delhi)

Judicial outlook..

- Building lease for 39 years
- New construction expenditure
- Low rent
- Business advantage
- Yes
- CIT Vs Madras Auto service (1998)
- 233 ITR 468 (SC)

Judicial outlook..

- Expenses for alteration of a dam
- Sharing of water for manufacture
- Yes
- CIT Vs Hindustan Zinc Ltd (2010)
- 322 ITR 478 (Rajasthan)

Judicial outlook..

- Expenditure towards grant of ISO 9001 certification
- Disallowed –enduring nature-capital
- No, revenue expenditure
- CIT Vs Infosys Technologies Ltd (2012)
- 349 ITR 582 (Karnataka)

Judicial outlook..

- Expenditure on water pipelines to municipality
- Exempted from municipal taxes
- Revenue
- CIT Vs Associated Cement Co Ltd (1988)
- 172 ITR 257 (SC)

Judicial outlook..

- Forex loss
- Variation in rate of exchange
- Revenue
- CIT Vs Woodward Governor India (P) Ltd (2009)
- 312 ITR 254 (SC)

Judicial outlook..

- Company director is kidnapped
- Paid ransom to dacoits to release the director
- Revenue
- CIT vs Khemchand Motilal Jain Tobacco products Ltd (2012)
- 340 ITR 99 (MP)

Judicial outlook..

- Commission paid to doctors by a diagnostic centre for referring patients
- AO disallowed it as Illegal and opposed to public policy
- Yes
- CIT Vs Kap Scan & Diagnostic Centre (2012)
- 344 ITR 476 (P&H)