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Profits and Gains of Business or Profession

6.1 Meaning of ‘Business’, ‘Profession’ and ‘Profits’

(i) The tax payable by an assessee on his income under this head is in respect of the profits and gains of any business or profession, carried on by him or on his behalf during the previous year. The term “business” has been defined in section 2(13) to “include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture”. But the term “profession” has not been defined in the Act. It means an occupation requiring some degree of learning. Thus, a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and, even an astrologer are persons who can be said to be carrying on a profession but not business. The term ‘profession’ includes vocation as well [Section 2(36)]. However, it is not material whether a person is carrying on a ‘business’ or ‘profession’ or ‘vocation’ since for purposes of assessment, profits from all these sources are treated and taxed alike.

(ii) Business necessarily means a continuous exercise of an activity; nevertheless, profit from a single venture in the nature of trade would also be assessable under this head if the venture had come to an end or after the entire cost had been recouped. For example, where a person had purchased a piece of land, got it surveyed, laid down a scheme of development, divided it into a number of building plots and sold some of the plots from time to time, though he would not be charged tax on a notional profit made on the individual sale of plots, he would be liable to pay tax on the surplus after all the plots have been sold and the venture has come to an end or after he has recovered the cost of all the plots and expenditure incidental thereto and has a surplus left.

(iii) Profits may be realised in money or in money’s worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind. Capital receipts are not generally to be taken into account while computing profits under this head. Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer’s professional service to another would be assessable as the lawyer’s income.

(iv) Application of the gains of trade is immaterial. Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily
by the assessee-owner personally, but it should be under his direction and control.

(v) The charge is not on the gross receipts but on the profits and gains in their natural and proper sense. Profits are ascertained on ordinary principles of commercial trading and commercial accounting. According to section 145, income has to be computed in accordance with the method of accounting regularly and consistently employed by the assessee. The assessee may account for his receipts on the cash basis or mercantile basis.

(vi) The Act, however, contains certain provisions for determining how the income is to be assessed. These must be followed in every case of business or profession. The illegality of a business, profession or vocation does not exempt its profits from tax: the revenue is not concerned with the taint of illegality in the income or its source. Income is taxable even if the assessee is carrying on the business, profession or vocation without any profit motive. The liability to tax arises once income arises to the assessee; the motive or purpose of earning the income is immaterial. Thus, profit motive is not essential for describing the income from that activity as income from business or profession.

(vii) The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the business carried on by the assessee. Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act.

(viii) Income arising from business assets which are temporarily let out e.g., an oil mill, cinema theatre, hotel, ginning or textile factory, rice mill or jute press would be assessable as business income. But if the commercial asset is permanently let the income is taxable as income from house property or income from other sources, depending on the facts and circumstances of the case.

6.2 Income Chargeable under this Head [Section 28]

The various items of income chargeable to tax as income under the head ‘profits and gains of business or profession’ are as under:

(i) Income arising to any person by way of profits and gains from the business, profession or vocation carried on by him at any time during the previous year.

(ii) Any compensation or other payment due to or received by:

(a) Any person, by whatever name called, managing the whole or substantially the whole of (i) the affairs of an Indian company or (ii) the affairs in India of any other company at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;

(b) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto;

(c) any person, for or in connection with the vesting in the Government or any corporation
owned or controlled by the Government under any law for the time being in force, of the
management of any property or business;

By taxing compensation received on termination of agency or on the takeover of management
(which is a capital receipt) as income from business, section 28(ii) provides exception to the
general rule that capital receipts are not income taxable in the hands of the recipient.

(iii) Income derived by any trade, professional or similar associations from specific services
rendered by them to their members. It may be noted that this forms an exception to the general
principle governing the assessment of income of mutual associations such as chambers of
commerce, stock brokers' associations etc. As a result a trade, professional or similar association
performing specific services for its members is to be deemed as carrying on business in respect of
these services and on that assumption the income arising therefrom is to be subjected to tax. For
this purpose, it is not necessary that the income received by the association should be definitely or
directly related to these services.

(iv) Profits on sale of a licence granted under the Imports (Control) Order, 1955 made
under the Imports and Exports (Control) Act, 1947.

(v) Cash assistance (by whatever name called) received or receivable by any person
against exports under any scheme of the Government of India.

(vi) Any Customs duty or Excise duty drawback repaid or repayable to any person against
export under the Customs and Central Excise Duties Drawback Rules, 1971.

(vii) Any profit on the transfer of the Duty Entitlement Pass Book Scheme, being Duty
Remission Scheme, under the export and import policy formulated and announced under
section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

(viii) Any profit on the transfer of Duty Free Replenishment Certificate, being Duty Remission
Scheme, under the export and import policy formulated and announced under section 5 of the

(ix) The value of any benefit or perquisite whether convertible into money or not, arising
from business or the exercise of any profession.

(x) Any interest, salary, bonus, commission or remuneration, by whatever name called, due to
or received by a partner of a firm from such firm will be deemed to be income from business.
However, where any interest, salary, bonus, commission or remuneration by whatever name
called, or any part thereof has not been allowed to be deducted under section 40(b), in the
computation of the income of the firm the income to be taxed shall be adjusted to the extent of the
amount disallowed. In other words, suppose a firm pays interest to a partner at 20% simple interest
p.a. The allowable rate of interest is 12% p.a. Hence the excess 8% paid will be disallowed in the
hands of the firm. Since the excess interest has suffered tax in the hands of the firm, the same will
not be taxed in the hands of the partner.

(xi) Any sum received under a Keyman insurance policy including the sum allocated by way
of bonus on such policy will be taxable as income from business. *Keyman insurance policy*
means a life insurance policy taken by a person on the life of another person who is or was
the employee of the first mentioned person or is or was connected in any manner whatsoever
with the business of the first mentioned person.

(xii) Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which deduction has been allowed under section 35AD) being demolished, destroyed, discarded or transferred.

(xiii) any sum whether received or receivable, in cash or kind, under an agreement

(a) for not carrying out any activity in relation to any business; or

(b) not to share any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

However, the above sub-clause (a) shall not apply to -

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head “Capital gains”;

(ii) 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 into with the Government of India.

The Explanation for the purposes of this clause provides that

(i) “agreement” includes any arrangement or understanding or action in concert,-

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(ii) “service” means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

6.3 Speculation Business

Explanation 2 to section 28 specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business. Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculative business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from other profits and gains of business and profession.
According to section 43(5), the expression “speculative transaction” means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Further, in view of Explanation to section 73, the transaction of purchase and sale of shares by non-banking and non-investment companies must also be deemed to be speculative transactions for tax purposes. However, the following forms of transactions shall not be deemed to be speculative transaction:

(i) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him; or

(ii) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation; or

(iii) a contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or

(iv) an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange; or

(a) “eligible transaction” means any transaction,–

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;

(b) “recognised stock exchange” means a recognised stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose. The stock exchanges notified as recognized stock exchanges for the purpose of section 43(5) are National Stock Exchange, Bombay Stock Exchange, MCX Stock Exchange and United Stock Exchange.

(v) an eligible transaction in respect of trading in commodity derivatives carried out in a recognized association.

An “eligible transaction” in relation to commodity derivatives has been defined as a transaction -
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(1) carried out electronically on screen based systems;
(2) carried out through member or an intermediary, registered under the bye-laws, rules and regulations of the recognized association for trading in commodity derivative in accordance with the provisions of Forward Contracts (Regulation) Act, 1952 and the related rules, regulations etc.;
(3) supported by a time stamped contract note issued by such member or intermediary to every client.

The contract note should indicate the –

(a) unique client identity number allotted under FCRA, 1952 and related rules, regulations etc.,
(b) unique trade number; and
(c) permanent account number (PAN) allotted under the Income-tax Act, 1961.

“Recognised association” means an association to which recognition for the time being has been granted by the Central Government under section 6 of Forward Contracts (Regulation) Act, 1952 in respect of goods or classes of goods specified in such recognition.

The instances stated above constitute the exceptions specifically provided by the Act, whereby certain transactions (e.g., hedging contracts) entered into by manufacturers and merchants in the course of their business to guard against the loss through price fluctuations are excluded from the definition of speculative transactions. This provision should be liberally construed to cover not only hedging forward contracts for purchase of goods but also such contracts for sale.

The Supreme Court held in CIT v. Shantilal (P) Ltd. [1983] 144 ITR 57 (SC) that an award of damages for breach of contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. In this view of the matter, the court held that in a case where a company contracted to sell a certain commodity to a party but was unable to effect delivery due to a sharp rise in the price of the commodity and the dispute which arose out of such breach of contract was settled by payment of damages as decided by an arbitrator, the transaction could not be described as a ‘speculative transaction’ within the meaning of section 43(5). This principle has been followed by various High Courts also.

6.4 Computation of income from business [Section 29]

(i) According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.

(ii) An item of loss or expenditure not falling within any of the express deductions may be allowed if it is deductible on the basis of common principles of commercial expediency. Thus, in
determining whether a particular item (other than those covered by sections 30 to 36) is deductible from profits, it is necessary first to enquire whether the deduction is expressly or by necessary implication prohibited by the Act and then, if it is not so prohibited, to consider whether it is of such nature that it should be charged against income in the computation of the “profits and gains of business or profession”. Accordingly, a loss due to embezzlement or theft of cash by an employee during the course of business is allowable as a deduction in computing the business profit, even though they are not covered by any specific provision of the Act. Losses of non-capital nature which are incidental to the trade and arise unexpectedly in the regular course of the business would be allowed as losses incidental to the trade though there is no specified provision in the Act for allowing such deductions. Examples of such losses are embezzlement, theft, robbery or destruction of assets, overdrawal by employees, loss of stock in trade by damage or by fire or by ravages of white ants or by enemy action during war or by negligence or fraud of employees, etc. However, if a businessman, having business connection with a non-resident, is unable to recover from the non-resident the amount of tax, he cannot claim it as a bad debt or business loss incidental to the trade on principles of commercial accounting as was held in CIT v. Abdullahbai Abdul Kadar [1961] 41 ITR 546 (SC).

(iii) Where a trader stands surety for the debt of another and such guarantee is not in the course of or for the purposes of trade, any payment made as a result of such guarantee cannot be deducted as a business loss except in a case where the contract of guarantee is entered into in the course of business pursuant to a trade or custom of which mutual accommodation is the essence e.g., trader standing surety for one another. Loss of cash in a bank on account of robbery by dacoits or loss through burglary of cash which the assessee is under legal obligation or business necessity required to keep in till it would be allowable as loss incidental to the trade. Losses arising from payments made as advances to employees and money lent by the managed company to the managing agents which had become irrecoverable would be incidental to the business provided that the amounts paid in advance or as loan were so made with reasonable business prudence and hence would be deductible.

(iv) Loss caused by embezzlement is allowable as a deduction not necessarily in the year in which the embezzlement takes place, but when there is no reasonable chance of obtaining restitution and the amount is found to be irrecoverable. Normally when a businessman writes off the amount, it is a prima facie evidence of the fact that the amount has become irrecoverable. If embezzled or stolen moneys which are allowed as deduction in any year are subsequently recovered, they should be brought to tax as a revenue receipt from the business in the year of recovery.

(v) In respect of wasting assets or exhaustion of capital, no deduction is allowable from the income derived from such capital or wasting asset. Accordingly, where an annuity is purchased, the entire amount of annuity received is taxable regardless of the capital paid away and exhausted for the purchase of annuity. Likewise, in the case of a lease, the capital cost of the lease is not allowed to be deducted over the life of the lease.

6.5 Admissible Deductions

(i) Rent, rates, repairs and insurance for buildings [Section 30]: Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the
assessee for the purpose of his business or profession. However, where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction. Where the assessee has sublet a part of the premises, the allowance under the section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The rent payable would be an allowable deduction under this section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner. Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where (i) the assessee is the owner of the building or (ii) the assessee is a tenant who has undertaken to bear the cost of repairs to the premises. Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.

In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed. Where the premises in respect of which these expenses are incurred are not utilized wholly for the purposes of the business, then, the deduction allowable should be of an amount proportionate to the use of the premises for the purposes of the business.

(ii) Repairs and insurance of machinery, plant and furniture [Section 31] : Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession. In order to claim this deduction the assets must have been used for purposes of the assessee’s own business the profits of which are being taxed. The word ‘used’ has to be read in a wide sense so as to include a passive as well as an active user. Thus, insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

The term ‘repairs’ will include renewal or renovation of an asset but not its replacement or reconstruction. Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions: (i) The insurance must be against the risk of damage or destruction of the machinery, plant or furniture. (ii) The assets must be used by the assessee for the purposes of his business or profession during the accounting year. (iii) The premium should have been actually paid (or payable under the mercantile system of accounting). The
premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances. It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

Cost of repairs and current repairs of capital nature not to be allowed: As per section 30(a), deduction for cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, is allowed.

As per section 31, the amount paid on account of current repairs of machinery, plant or furniture is allowed as deduction in the computation of income under the head “profits and gains of business or profession”

A view has been taken in Hanuman Motor Service v. CIT (1967) 66 ITR 88, 91 (Mys.) that in considering a claim for deduction under section 10(2)(v) of the 1922 Act (corresponding to section 30(a)(ii) of the Income-tax Act, 1961), the question whether the expenditure is a capital expenditure or revenue expenditure is irrelevant. Once an expenditure has been established to be cost of repairs or current repairs, the same is allowable whether it is of a revenue or capital nature.

Under the Income-tax Act, 1961, the concept of capital and revenue is of fundamental importance. The Income-tax Act, 1961 is an Act to bring to charge only revenue and not capital. Wherever the legislature has felt that capital receipts have to be charged to income-tax they have specifically included such capital receipts in the definition of income e.g. Capital gains. In the same way, wherever the legislature desired that capital expenditure should be allowed as a deduction, specific provisions have been made for such allowance e.g. capital expenditure on scientific research. While computing income under the Income-tax Act, 1961, only revenue receipts are to be considered against which only revenue expenditure is allowable unless the Act specifically allows the deduction of capital expenditure. Hence it is clear that in respect of cost of repairs and current repairs, as per correct accounting principles, only expenditure of revenue nature can be allowed.

To clarify this, the Explanation to section 30 and section 31 provides that the amount paid on account of the cost of repairs and the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

(iii) Depreciation [Section 32]

(1) Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The Explanation to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

(2) The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.
(a) The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:

(i) buildings, machinery, plant or furniture, being tangible assets;

(ii) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998.

The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income. No depreciation is allowable on the cost of the land on which the building is erected because the term ‘building’ refers only to superstructure but not the land on which it has been erected. The term ‘plant’ as defined in section 43(3) includes books, vehicles, scientific apparatus and surgical equipments. The expression ‘plant’ includes part of a plant (e.g., the engine of a vehicle); machinery includes part of a machinery and building includes a part of the building. However, the word ‘plant’ does not include an animal, human body or stock-in-trade. Thus plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability. Similarly the term ‘buildings’ includes within its scope roads, bridges, culverts, wells and tubewells.

(b) The assets should be actually used by the assessee for purposes of his business during the previous year - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year.

Asset used for less than 180 days - However, it has been provided that where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed at 50 per cent of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

If the assets are not used exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

Use includes passive use in certain circumstances: One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. Courts have held that, in certain circumstances, an asset can be said to be in use even when it is “kept ready for use”. For 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. Hence, in such cases, the term “use” embraces both active use and passive use.
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However, such passive use should also be for business purposes.

The Delhi High Court, in CIT v. Insilco Ltd. (2009) 179 Taxman 55, observed that the expression “used for the purposes of business” appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

(c) The assessee must own the assets, wholly or partly - In the case of buildings, the assessee must own the superstructure and not necessarily the land on which the building is constructed. In such cases, the assessee should be a lessee of the land on which the building stands and the lease deed must provide that the building will belong to the lessor of the land upon the expiry of the period of lease. Thus, no depreciation will be allowed to an assessee in respect of an asset which he does not own but only uses or hires for purposes of his business.

However, in this connection, students may note that the Explanation 1 to section 32 provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets “wholly” owned by the assessee but also in respect of assets “partly” owned by him and used for the purposes of his business or profession.

(3) In case of succession of firm/sole proprietary concern by a company or amalgamation or demerger of companies - In order to restrict the double allowance under the proviso to section 32, in the cases of succession or amalgamation or demerger, the aggregate deduction in respect of depreciation allowable in the hands of the predecessor and the successor or in the case of amalgamating company and the amalgamated company or in the case of the demerged company and the resulting company, as the case may be, shall not exceed the amount of depreciation calculated at the prescribed rates as if the succession/amalgamation, demerger had not taken place. It is also provided that such deduction shall be apportioned between the two entities in the ratio of the number of days for which the assets were used by them.

In case of conversion of a private company or an unlisted public company into an LLP, fulfilling the conditions mentioned in section 47(xiib), the aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them.
(4) **Hire purchase** - In the case of assets under the hire purchase system the allowance for depreciation would under Circular No. 9 of 1943 R. Dis. No. 27(4) I.T. 43 dated 23-3-1943, be granted as follows:

1. In every case of payment purporting to be for hire purchase, production of the agreement under which the payment is made would be insisted upon by the department.

2. Where the effect of an agreement is that the ownership of the asset is at once transferred on the lessee the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This principle will be applicable in a case where the lessor obtains a right to sue for arrears of instalments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of hire purchase agreement.

3. Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by the hirer should for all tax purposes be regarded as made up of (i) the consideration for hirer which will be allowed as a deduction in assessment, and (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lessee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement. The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If, however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination of agreement.

For the purpose of allowing depreciation an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset. In cases where no such certificate or other evidence is furnished the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum. For the purpose of allowing depreciation the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in installments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(5) **Computation of Depreciation Allowance** - Depreciation allowance will be calculated on the following basis:

(i) In the case of assets of an undertaking engaged in generation or generation and
distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

**Rule 5(1A)** - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix I of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power. It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

(ii) In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

**Block of Assets** - 1. A “block of assets” is defined in clause (11) of section 2, as a group of assets falling within a class of assets comprising—

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature,

in respect of which the same percentage of depreciation is prescribed.

**Know-how** - In this context, ‘know-how’ means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

(iii) **Additional depreciation on Plant & Machinery acquired by an Industrial Undertaking**: Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power at the rate of 20% of the actual cost of such machinery or plant.

Such additional depreciation will not be available in respect of:

(i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person; or

(ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or

(iii) office appliances or road transport vehicles; or

(iv) any machinery or plant, the whole or part of the actual 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.

(iv) **Terminal depreciation:** In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year, the depreciation amount will be the amount by which the monies payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

“**Moneys payable**” in respect of any building, machinery, plant or furniture includes—

(a) any insurance, salvage or compensation moneys payable in respect thereof;

(b) where the building, machinery, plant or furniture is sold, the price for which it is sold, so, however, that where the actual cost of a motor-car is, in accordance with the proviso to clause (1) of section 43, taken to be ₹ 25,000, the moneys payable in respect of such motor-car shall be taken to be a sum which bears to the amount for which the motor-car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of ₹ 25,000 bears to the actual cost of the motor-car to the assessee as it would have been computed before applying the said proviso;

“**Sold**” includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.

(6) **Actual Cost [Section 43(1)]** : The expression “actual cost” means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

**Actual cost in certain special situations [Explanations to section 43(1)]**

(i) Where an asset is used for the purposes of business after it ceases to be used for scientific research related to that business, the actual cost to the assessee for depreciation purposes shall be the actual cost to the assessee as reduced by any deduction allowed under section 35(1)(iv) [Explanations 1].

(ii) Where an asset is acquired by way of gift or inheritance, its actual cost shall be the written down value to the previous owner [Explanations 2].

(iii) Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost) the actual cost to the assessee
6.15 Income Tax

shall be taken to be such an amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case [Explanation 3].

(iv) Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be —

(a) the written down value at the time of original transfer; or

(b) the actual price for which the asset is re-acquired by him whichever is less [Explanation 4].

(v) Where before the date of acquisition by the assessee say, Mr.A, the assets were at any time used by any other person, say Mr.B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr.B and such person acquires on lease, hire or otherwise, assets from Mr.A, then, the actual cost of the transferred assets, in the case of Mr.A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr.B [Explanation 4A].

We can explain the above as follows—

A person (say “A”) owns an asset and uses it for the purposes of his business or profession. A has claimed depreciation in respect of such asset. The said asset is transferred by A to another person (say “B”). A then acquires the same asset back from B on lease, hire or otherwise. B being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of B shall be the same as the written down value of the said assets at the time of transfer.

Explanation 4A overrides Explanation 3 - Explanation 3 to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having satisfied himself about such purpose of transfer, may determine the actual cost having regard to all the circumstances of the case.

In the Explanation 4A, a non-obstante clause has been included to the effect that Explanation 4A will have an overriding effect over Explanation 3. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. Explanation 4A is activated in every situation described above without inquiring about the main purpose.

(vi) Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession, its actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee [Explanation 5].

(vii) When any capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company then, if the conditions specified in section
47(iv) or (v) are satisfied, the transaction not being regarded as a transfer of a capital asset, the actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business [Explanation 6].

(viii) In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated company, the actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business [Explanation 7].

In the case of a demerger, where any capital asset is transferred by the demerged company to the resulting company, the actual cost of the transferred asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the asset. However, the actual cost shall not exceed the WDV of the asset in the hands of the demerged company [Explanation 7A].

(ix) Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use. Certain judicial rulings also favoured this approach. This capitalisation implies inclusion of such interest in the ‘Actual Cost’ of the asset for the purposes of claiming depreciation, investment allowance etc. under the Income-tax Act. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counter-acting tax avoidance through this method and placing the matter beyond doubt, Explanation 8 to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset [Explanation 8].

(x) Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944 [Explanation 9].

(xi) Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee [Explanation 10].

(xii) Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession,
the actual cost of asset to the assessee shall be the actual cost the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee [Explanation 11].

(xiii) Where any capital asset is acquired under a scheme for corporatisation of a recognised stock exchange in India approved by the SEBI, the actual cost shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation[Explanation 12].

(xiv) Explanation 13 has been inserted in section 43(1) to provide that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be nil. This would be applicable in the case of transfer of asset by the assessee where -

1. the assessee himself has claimed deduction under section 35AD; or
2. the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of -
   a. gift, will or an irrevocable trust;
   b. any distribution on liquidation of the company;
   c. any distribution of capital assets on total or partial partition of a HUF;
   d. any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;
   e. any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;
   f. any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;
   g. any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;
   h. any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualisation or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);
   i. any transfer of a capital asset or intangible asset by a sole proprietary concern to a company, where the sole proprietary concern is succeeded by a company (fulfilling the conditions specified) which would have been regarded as actual cost had there been no such corporatisation.
   j. any transfer of a capital asset by a company to an LLP as a result of conversion of
the company into LLP (fulfilling the conditions prescribed).

**Definition of plant [Section 43(3)]** – "Plant" includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

(7) **Written down value [Section 43(6)]**

(i) In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.

(ii) In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee less the aggregate of all deductions actually allowed in respect of depreciation. For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with *Explanation 3*].

The written down value of any asset shall be worked out as under in accordance with section 43(6)(c) -

(1) The aggregate of the written down value of the block of assets at the beginning of the previous year.

(2) The sum arrived at as above shall be increased by the actual cost of any asset falling within that block which is acquired by the assessee during the previous year.

(3) The sum so arrived at shall be reduced by the sale proceeds and other amounts receivable by the assessee with regard to any asset falling within that block which is sold, discarded, demolished or destroyed during that previous year.

(iii) When in the case of a succession to business or profession, an assessment is made on the successor under section 170(2), the written down value of an asset or block of assets shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to [*Explanation 1* to section 43(6)].

(iv) Where in any previous year any block of assets is transferred by a holding company to a subsidiary company or vice versa and the conditions of clause 47(iv) or (v) are satisfied or by an amalgamating company to an amalgamated company the latter being an Indian company then the actual cost of the block of assets in the case of transferee-company or amalgamated company as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or amalgamating company, as the case may be, for the immediately preceding year as reduced by depreciation actually allowed in relation to the said previous year [*Explanation 2* to section 43(6)].

(v) Where in any previous year any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets of the demerged company for the immediately preceding year shall be reduced by the written down value of the assets transferred to the resulting company [*Explanation 2A* to section 43(6)].

(vi) Where any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets in the case of resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [*Explanation 2B* to section 43(6)].
(vii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [Explanation 2C to section 43(6)].

(viii) Where any asset forming part of a block of assets is transferred in any previous year by a recognised stock exchange in India to a company under a scheme for corporatisation approved by SEBI, the written down value of the block shall be the written down value of the transferred assets immediately before the transfer [Explanation 5 to section 43(6)].

(ix) **Depreciation provided in the books of account deemed to be depreciation actually allowed [Explanation 6 to section 43(6)]**

Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee less all depreciation actually allowed to him under the Income-tax Act, 1961. Persons who were exempt from tax were not required to compute their income under the head “Profits and gains of business or profession”. However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act, 1961 in respect of assets acquired during the years when the person was exempt from tax.

*Explanation 6 to section 43(6)* provides that—

(a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;

(b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act, 1961 for the purposes of section 43(6);

(c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

(x) **Explanation 7** provides that in cases of ‘composite income’, for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable under the head “Profits and Gains of business or profession”. The depreciation so computed shall be deemed to have been “actually allowed” to the assessee.

For instance, Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax. If the turnover is, say, ₹ 20 lakh, the depreciation ₹ 1 lakh and other expenses ₹ 4 lakh, then the income would be ₹ 15 lakh. Business income would be ₹ 6 lakh (being 40% of ₹ 15 lakh). As per earlier Court decisions, only the depreciation “actually allowed” i.e., ₹ 40,000, being 40% of ₹ 1 lakh, has to be deducted to arrive at the
written down value. The ambiguity in this case has arisen on account of the interpretation of the meaning of the phrase “actually allowed” used in section 43(6)(b). However, the correct legislative intent is that the WDV is required to be computed by deducting the full depreciation attributable to composite income i.e. ₹ 1 lakh in this case. Explanation 7 clarifies this legislative intent.

(xi) The written down value of any block of assets, may be reduced to nil for any of the following reasons:

(a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or

(b) All the assets in the relevant block may be transferred during the year.

(8) Rates of depreciation - All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

**PART A TANGIBLE ASSETS**

**I Buildings**

Block 1. Buildings (other than covered by sub-item (3) below) which are used mainly for residential purposes 5%

Block 2. Buildings which are not used mainly for residential purposes and not covered by sub-items (1) above and (3) below 10%

Block 3. Buildings acquired on or after the 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 under clause (i) of sub-section (4) of section 80-IA 100%

Block 4. Purely temporary erections such as wooden structures 100%

**II Furniture and Fittings**

Block 1. Furniture and fittings including electrical fittings 10%

**III Plant & Machinery**

Block 1. Motors buses, motor lorries, motor taxis used in the business of running them on hire 30%

Block 2 Aeroplanes, aeroengines 40%

Block 3. Specified air, water pollution control equipments, solid waste control equipment and solidwaste recycling and resource recovery systems 100%
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| Block 4. | Energy Saving Devices (as specified) | 80% |
| Block 5. | Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990. | 15% |
| Block 6 | Computers including computer software | 60% |
| Block 7 | Annual publications owned by assesseees carrying on a profession | 100% |
| Block 8 | Books owned by assesseees carrying on business in running lending libraries | 100% |
| Block 9 | Books, other than annual publications, owned by assesseees carrying on a profession | 60% |
| Block 10 | Plant & machinery (General rate) | 15% |

### IV Ships
| Block 1. | Ocean-going ships | 20% |
| Block 2. | Vessels ordinarily operating on inland waters not covered by sub-item (3) below | 20% |
| Block 3. | Speed boats operating on inland water | 20% |

### PART B INTANGIBLE ASSETS

- Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature | 25% |

Students should refer to Income-tax Rules for the detailed classification of assets under Rule 5(1) and the rates applicable thereto.

**Note** - New commercial vehicles acquired on or after 1.1.2009 but before 1.10.2009 and put to use before 1.10.2009 for the purposes of business or profession would be classified under the head MACHINERY AND PLANT and would be eligible for depreciation at the rate of 50%.

**9** Increased rate of depreciation for certain assets - Rule 5(2) - 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 by a 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 qualifying for depreciation@ 40%.

**Conditions to be fulfilled**

1. The right to use such technology to manufacture such article has been acquired from the owner of such laboratory or any person deriving title from such owner.
2. The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and
Industrial Research, Government of India to the effect that such article is manufactured by using such technology developed in such laboratory or such article has been invented in that laboratory.

3. The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh schedule.

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

(10) Carry forward and set off of depreciation [Section 32(2)] - Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

However, in the order of set-off of losses under different heads of income, effect shall first be given to business losses and then to unabsorbed depreciation.

The provisions in effect are as follows:

- Since the unabsorbed depreciation now falls part of the current year’s depreciation, it can be set off against any other head of income.
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

Current depreciation to be deducted first - The Supreme Court, in CIT v. Mother India Refrigeration (P.) Ltd. [1985] 23 Taxman 8, has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.

Illustration 1

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2013-14 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y. 2014-15:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Description</th>
<th>Date of acquisition</th>
<th>Date when put to use</th>
<th>Amount `</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Computer</td>
<td>27 Sept., 13</td>
<td>1 Oct., 13</td>
<td>35,000</td>
</tr>
<tr>
<td>2.</td>
<td>Computer software</td>
<td>2 Oct., 13</td>
<td>4 Oct., 13</td>
<td>8,500</td>
</tr>
</tbody>
</table>
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<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4.</td>
<td>Books (of which books being annual publications are of ₹ 12,000)</td>
<td>1 Apr., 13</td>
</tr>
<tr>
<td>5.</td>
<td>Office furniture (Acquired from a practising C.A.)</td>
<td>1 Apr., 13</td>
</tr>
<tr>
<td>6.</td>
<td>Laptop</td>
<td>26 Sep., 13</td>
</tr>
</tbody>
</table>

Solution

**Computation of depreciation allowable for A.Y.2014-15**

<table>
<thead>
<tr>
<th>Block of Assets</th>
<th>Rate</th>
<th>Depreciation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Block 1: Furniture</td>
<td>10%</td>
<td>30,000</td>
</tr>
<tr>
<td>Block 2: Plant (Computer, computer software, laptop &amp; books)</td>
<td>60%</td>
<td>37,050</td>
</tr>
<tr>
<td>Block 3: Plant (Books)</td>
<td>100%</td>
<td>12,000</td>
</tr>
<tr>
<td>Block 4: Plant (Printer)</td>
<td>15%</td>
<td>1,875</td>
</tr>
<tr>
<td><strong>Total depreciation allowable</strong></td>
<td></td>
<td><strong>80,925</strong></td>
</tr>
</tbody>
</table>

Notes:

1. **Computation of depreciation**

<table>
<thead>
<tr>
<th>Block of Assets</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Block 1: Furniture – rate 10%</strong></td>
<td></td>
</tr>
<tr>
<td>Put to use for more than 180 days [₹ 3,00,000 @10%]</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Block 2: Plant – rate 60%</strong></td>
<td></td>
</tr>
<tr>
<td>(a) Computer (put to use for more than 180 days) [₹ 35,000 @ 60%]</td>
<td>21,000</td>
</tr>
<tr>
<td>(b) Laptop (put to use for less than 180 days) [₹ 43,000 @ 30%]</td>
<td>12,900</td>
</tr>
<tr>
<td>(c) Computer Software (put to use for less than 180 days) [₹ 8,500 @ 30%]</td>
<td>2,550</td>
</tr>
<tr>
<td>(d) Books (other than annual publications) (Put to use for more than 180 days) [₹ 1,000 @ 60%]</td>
<td>600</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>37,050</strong></td>
</tr>
<tr>
<td><strong>Block 3: Plant – Rate 100%</strong></td>
<td></td>
</tr>
<tr>
<td>Books (being annual publications) put to use for more than 180 days [₹ 12,000 @100%]</td>
<td>12,000</td>
</tr>
</tbody>
</table>
2. Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2013-14 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer software.

Illustration 2

Gamma Ltd. was incorporated on 1.1.2013 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 1.5.2013. The company commenced its manufacturing operations on 1.6.2013. The total cost of the plant and machinery installed in the unit is ₹ 120 crore. The said plant and machinery included second hand plant and machinery bought for ₹ 20 crore and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹ 15 crore.


Solution

Computation of depreciation allowable for the A.Y. 2014-15 in the hands of Gamma Ltd.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total cost of plant and machinery</td>
<td>120.00</td>
</tr>
<tr>
<td>Less: Used for Scientific Research (Note 1)</td>
<td>15.00</td>
</tr>
<tr>
<td>Normal Depreciation at 15% on ₹ 105 crore</td>
<td>15.75</td>
</tr>
</tbody>
</table>

Additional Depreciation:

| Cost of plant and machinery                               | 120.00     |
| Less: Second hand plant and machinery (Note 2)            | 20.00      |
| Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) (Note 2) | 15.00 |
|                                                          | 35.00      |
|                                                          | 85.00      |

Additional Depreciation at 20%                               17.00

Depreciation allowable for A.Y.2014-15                      32.75
6.25 Income Tax

Notes:

1. As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee’s business, since deduction is allowable under section 35 in respect of such capital expenditure.

2. As per section 32(1)(iiia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in, inter alia, the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, inter alia, –

(i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;

(ii) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head “Profit and gains of business or profession” of any one previous year.

In view of the above provisions, additional depreciation cannot be claimed in respect of -

(i) Second hand plant and machinery;

(ii) New plant and machinery purchased for scientific research relating to assessee’s business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).

Illustration 3

Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2013-14. Compute the depreciation allowable under section 32 for A.Y.2014-15, while computing its income under the head “Profits and gains of business or profession”. The company has opted for the depreciation allowance on the basis of written down value.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Opening Written down value of Plant and Machinery (15% block) as on 01.04.2013 (Purchase value ₹ 8,00,000)</td>
<td>5,78,000</td>
</tr>
<tr>
<td>2. Purchase of second hand machinery (15% block) on 29.12.2013 for business purpose</td>
<td>2,00,000</td>
</tr>
<tr>
<td>3. Machinery Y (15% block) purchased and installed on 12.07.2013 for the purpose of power generation</td>
<td>8,00,000</td>
</tr>
<tr>
<td>4. Acquired and installed for use a new air pollution control equipment on 31.07.2013</td>
<td>2,50,000</td>
</tr>
<tr>
<td>5. New air conditioner purchased and installed in office premises on 08.09.2013</td>
<td>3,00,000</td>
</tr>
<tr>
<td>6. New machinery Z (15% block) acquired and installed on 23.11.2013 for the purpose of generation of power</td>
<td>3,25,000</td>
</tr>
</tbody>
</table>
7. **Sale value of an old machinery X, sold during the year (Purchase value ₹ 4,80,000, WDV as on 01.04.2013 ₹ 3,46,800)**

**Answer**

**Computation of depreciation allowance under section 32 for the A.Y. 2014-15**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>Plant and Machinery (15%) (₹)</th>
<th>Plant and Machinery (100%) (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening WDV as on 01.04.2013</td>
<td></td>
<td>5,78,000</td>
<td>-</td>
</tr>
<tr>
<td>Add: Plant and Machinery acquired during the year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Second hand machinery</td>
<td>2,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Machinery Y</td>
<td>8,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Air conditioner for office</td>
<td>3,00,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Machinery Z</td>
<td>3,25,000</td>
<td>16,25,000</td>
<td></td>
</tr>
<tr>
<td>- Air pollution control equipment</td>
<td></td>
<td>-</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Less: Asset sold during the year</td>
<td>3,10,000</td>
<td></td>
<td>2,50,000</td>
</tr>
<tr>
<td>Written down value before charging depreciation</td>
<td>18,93,000</td>
<td>2,50,000</td>
<td>-</td>
</tr>
</tbody>
</table>

**Normal depreciation**

100% on air pollution control equipment

Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)

- Second hand machinery (₹ 2,00,000 × 7.5%) 15,000
- Machinery Z (₹ 3,25,000 × 7.5%) 24,375 39,375

15% on the balance WDV being put to use for more than 180 days (₹ 13,68,000 × 15%) 2,05,200

**Additional depreciation**

- Machinery Y (₹ 8,00,000 × 20%) 1,60,000
- Machinery Z (₹ 3,25,000 × 10%) 32,500 1,92,500 Nil

**Total depreciation**

4,37,075 2,50,000

**Notes:**

(2) Additional depreciation is not allowed in respect of second hand machinery.

(3) No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.

(4) Additional depreciation is not allowed in respect of an asset whose actual cost is allowed as deduction in computing the income chargeable under the head “Profit and Gains of business or profession”. It is presumed that the new air pollution control equipment installed is eligible for 100% depreciation. Therefore, no additional depreciation is allowed in respect of the same.

(11) Building, machinery, plant and furniture not exclusively used for business purpose [Section 38(2)] – Where any building, plant and machinery, furniture is not exclusively used for the purposes of business or profession, the deduction on account of expenses on account of current repairs to the premises, insurance premium of the premises, current repairs and insurance premium of machinery, plant and furniture and depreciation in respect of these assets shall be restricted to a fair proportionate part thereof, which the Assessing Officer may determine having regard to the user of such asset for the purposes of the business or profession.

(12) Balancing Charge – Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the monies payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e. in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The Explanation below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(iv) Investment in new plant and machinery [New Section 32AC]

(1) New section 32AC has been inserted by the Finance Act, 2013 to provide a tax incentive by way of investment allowance to encourage huge investment in plant or machinery.

(2) Under new section 32AC, a manufacturing company is entitled to an investment allowance@15% of the aggregate amount of actual cost of new plant and machinery acquired and installed during the financial years 2013-14 & 2014-15, if the same exceeds ₹100 crore.

(3) As per section 32AC, a company assessee would be entitled to deduction@15% of aggregate investment in new plant and machinery if it is –

(a) engaged in the business of manufacture of an article or thing; and
(b) invests a sum of more than ₹100 crore in new plant or machinery during the period beginning from 1st April, 2013 and ending on 31st March, 2015.

(4) For A.Y. 2014-15, a manufacturing company would be entitled to deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the aggregate cost of such assets exceeds ₹100 crore.

For A.Y. 2015-16, a deduction of 15% of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1st April, 2013 and ending on 31st March, 2015, as reduced by the deduction allowed, if any, for A.Y. 2014-15.

(5) The investment allowance@15% under this section is in addition to the depreciation and additional depreciation allowable under section 32(1). Further, the investment allowance would not be reduced to arrive at the written down value of plant and machinery.

(6) “New plant or machinery” does not include—

1. any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;

2. any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;

3. any office appliances including computers or computer software;

4. any vehicle;

5. ship or aircraft; or

6. 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 of business or profession” of any previous year.

(7) The new plant and machinery in respect of which investment allowance has been claimed under section 32AC cannot be sold or otherwise transferred for a period of 5 years from the date of installation. If it is sold or transferred within this period, the deduction allowed earlier would be deemed as income chargeable to tax under the head “Profits and gains of business or profession” of the previous year in which such new plant and machinery is sold or otherwise transferred. This would be in addition to the taxability of gains on transfer of such plant and machinery.

In case of amalgamation or demerger, this restriction would continue to apply to the amalgamated company or resulting company, as the case may be, as it would have applied to the amalgamating or demerged company.
Illustration 4
Compute the admissible investment allowance under section 32AC for A.Y.2014-15 and A.Y.2015-16 in each of the following cases -

<table>
<thead>
<tr>
<th>Company</th>
<th>Investment in new plant and machinery (₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>P.Y.2013-14</td>
</tr>
<tr>
<td>A Ltd.</td>
<td>80</td>
</tr>
<tr>
<td>B Ltd.</td>
<td>75</td>
</tr>
<tr>
<td>C Ltd.</td>
<td>110</td>
</tr>
<tr>
<td>D Ltd.</td>
<td>0</td>
</tr>
<tr>
<td>E Ltd.</td>
<td>105</td>
</tr>
<tr>
<td>F Ltd.</td>
<td>0</td>
</tr>
</tbody>
</table>

Solution

<table>
<thead>
<tr>
<th>Company</th>
<th>Investment in new plant and machinery (₹ in crore)</th>
<th>Investment allowance under section 32AC (₹ in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Ltd.</td>
<td>80</td>
<td>10</td>
</tr>
<tr>
<td>B Ltd.</td>
<td>75</td>
<td>35</td>
</tr>
<tr>
<td>C Ltd.</td>
<td>110</td>
<td>40</td>
</tr>
<tr>
<td>D Ltd.</td>
<td>0</td>
<td>98</td>
</tr>
<tr>
<td>E Ltd.</td>
<td>105</td>
<td>0</td>
</tr>
<tr>
<td>F Ltd.</td>
<td>0</td>
<td>110</td>
</tr>
</tbody>
</table>

Illustration 5
B Ltd., a company engaged in the business of manufacture of sports equipments, furnishes the following particulars pertaining to P.Y.2013-14 and P.Y.2014-15. Compute the depreciation allowable under section 32 as well as the investment allowance allowable under section 32AC for A.Y.2014-15 and A.Y.2015-16, while computing its income under the head "Profits and gains of business or profession". Also, compute the written down value of plant and machinery as on 1.4.2014 and 1.4.2015.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Written down value of plant and machinery (15% block) as on 01.04.2013</td>
<td>25.00</td>
</tr>
<tr>
<td>2. Sold plant and machinery on 20.5.2013 (15% block)</td>
<td>4.00</td>
</tr>
<tr>
<td>3. Purchase of second hand machinery (15% block) on 29.5.2013 for business</td>
<td>12.00</td>
</tr>
<tr>
<td>purpose (the machinery was put to use immediately)</td>
<td></td>
</tr>
<tr>
<td>4. Purchased new computers (60% block) on 8.11.2013 for office</td>
<td>0.40</td>
</tr>
</tbody>
</table>
5. Acquired and installed new plant and machinery (15% block) on 31.7.2013 (₹ 50 crore) and on 31.10.2013 (₹ 40 crore) 90.00
6. New air conditioners purchased and installed in office premises on 30.6.2013 0.15
7. Acquired and installed new plant and machinery (15% block) on 2.4.2014 15.00

Solution

**Computation of depreciation allowance under section 32 for the A.Y. 2014-15**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Plant and Machinery (15%)</th>
<th>Plant and Machinery (60%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>WDV as on 01.04.2013</td>
<td>25.00</td>
<td>-</td>
</tr>
<tr>
<td>Add: Plant and Machinery acquired during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Second hand machinery</td>
<td>12.00</td>
<td></td>
</tr>
<tr>
<td>- New plant and machinery</td>
<td>90.00</td>
<td></td>
</tr>
<tr>
<td>- Air conditioner installed in office</td>
<td>0.15</td>
<td></td>
</tr>
<tr>
<td></td>
<td>102.15</td>
<td></td>
</tr>
<tr>
<td>Computers acquired during the year</td>
<td>-</td>
<td>0.40</td>
</tr>
<tr>
<td>Less: Asset sold during the year</td>
<td>4.00</td>
<td>Nil</td>
</tr>
<tr>
<td>Written down value before charging depreciation</td>
<td>123.15</td>
<td>0.40</td>
</tr>
<tr>
<td>Less: Depreciation for the P.Y.2013-14 (See Note 1 below)</td>
<td>29.47</td>
<td>0.12</td>
</tr>
<tr>
<td>WDV as on 1.4.2014</td>
<td>93.68</td>
<td>0.28</td>
</tr>
</tbody>
</table>

**Note 1 : Computation of depreciation for the P.Y.2013-14**

**Normal depreciation**

Depreciation@30% on computers put to use for less than 180 days (50% of 60% × 0.40 crore) - 0.12

Depreciation on plant and machinery (15% block) 15.47

(40 × 7.5%) + [(123.15-40) × 15%]

**Additional depreciation**

- New plant and machinery installed on 31.7.2013 (₹ 50 crore × 20%) 10
- on 31.10.2013 (₹ 40 crore × 10%) 4 14.00 Nil

**Total depreciation** 29.47 0.12
Note – For the A.Y.2014-15, the company would not be entitled for investment allowance under section 32AC since the investment in new plant and machinery acquired and installed during the year is only ₹90 crores (i.e., less than ₹100 crores). Investment in second hand plant and machinery and air-conditioners and computers installed in office would not be eligible for investment allowance under section 32AC or additional depreciation under section 32(1)(iia).

**Computation of depreciation allowance under section 32 for the A.Y. 2015-16**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Plant and Machinery (15%)</th>
<th>Plant and Machinery (60%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>WDV as on 1.4.2014</td>
<td>93.68</td>
<td>0.28</td>
</tr>
<tr>
<td><strong>Add</strong> Plant and Machinery acquired during the year</td>
<td>15.00</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>108.68</td>
<td>0.28</td>
</tr>
<tr>
<td><strong>Less</strong> Asset sold during the year</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Written down value (before charging depreciation)</td>
<td>108.68</td>
<td>0.28</td>
</tr>
<tr>
<td><strong>Less</strong> Depreciation for the P.Y.2014-15 @15% and 60%, respectively</td>
<td>16.30</td>
<td>0.17</td>
</tr>
<tr>
<td>Additional depreciation@20% on 15 crore</td>
<td>3.00</td>
<td>-</td>
</tr>
<tr>
<td>WDV as on 1.4.2015</td>
<td>89.38</td>
<td>0.11</td>
</tr>
</tbody>
</table>

**Computation of investment allowance under section 32AC for the A.Y.2015-16**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>New plant and machinery acquired and installed during the P.Y.2013-14</td>
<td>90</td>
</tr>
<tr>
<td>New plant and machinery acquired and installed during the P.Y.2014-15</td>
<td>15</td>
</tr>
<tr>
<td>Aggregate investment in new plant and machinery during the period from</td>
<td>105</td>
</tr>
<tr>
<td>1.4.2013 to 31.3.2015</td>
<td></td>
</tr>
<tr>
<td>Investment allowance@15% of ₹ 105 crore</td>
<td>15.75</td>
</tr>
<tr>
<td><strong>Less</strong> Deduction allowed in respect investment allowance during the</td>
<td>Nil</td>
</tr>
<tr>
<td>A.Y.2014-15</td>
<td></td>
</tr>
<tr>
<td>Deduction under section 32AC for the A.Y.2015-16</td>
<td>15.75</td>
</tr>
</tbody>
</table>

Note - The company would be eligible for investment allowance under section 32AC in the P.Y.2014-15, since the aggregate investment in new plant and machinery from 1.4.2013 to 31.3.2015 has exceeded ₹100 crore.
(v) Tea Development Account/Coffee Development Account/Rubber Development Account [Section 33AB]

(1) Where an assessee carrying on the business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of income, whichever is earlier, (i) deposited with a National Bank any amount in a special account maintained by the assessee with that Bank in accordance with a scheme approved by Tea Board or Coffee Board or Rubber Board, or (ii) deposited any amount to be known as Deposit Account opened by the assessee in accordance with the scheme framed by the Tea Board or Coffee Board or Rubber Board, as the case may be, with the previous approval of the Central Government, the assessee shall be allowed a deduction of:

(a) A sum equal to the aggregate of the deposits made or
(b) 40% of the profits of such business computed under the head ‘Profits and gains of business or profession’ before making any deduction under this section, whichever is less.

(2) The above deduction will be allowed before the setting off of brought-forward loss under section 72.

(3) Where the assessee is a firm or any association of persons or any body of individuals the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.

(4) This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant and the assessee furnishes along with his return of income the report of such audit in the prescribed form duly signed and verified by such accountant.

(5) However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

(6) Any amount standing to the credit of the assessee in the special account cannot be withdrawn except for the purposes specified in the scheme, or, as the case may be, in the deposit scheme.

The above amount can also be withdrawn in the following circumstances:

(a) Closure of business
(b) Death of an assessee
(c) Partition of HUF
(d) Dissolution of a firm
(e) Liquidation of a company.

(7) Where the sum standing to the credit of the assessee in the Special account or in the Deposit account is released by the National Bank or is withdrawn by the assessee from the
Deposit account and is utilised for the purchase of:

(a) Any machinery or plant installed in any office premises or residential accommodation including a guest house.

(b) Any office appliances (other than computers)

(c) Any machinery or plant the whole of whose actual cost is allowed as deduction by way of depreciation or otherwise in computing the business income.

(d) Any new machinery or plant installed for production of any XI Schedule item, the whole of such amount so utilised will be treated as taxable profits of that year and taxed accordingly.

(8) Where any amount is withdrawn by the assessee from the special account during any previous year on the closure of his business or dissolution of a firm, the whole of such withdrawal shall be deemed to be the profits and gains of business of that previous year and shall be chargeable to tax as the income of that previous year, as if the business had not closed or the firm had not been dissolved.

(9) Where any amount standing to the credit of the assessee in the special account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed in computing the business income.

(10) Where any amount in the special account which is released during any previous year by the National Bank for being utilised by the assessee for the purposes of such business in accordance with the scheme is not so utilised within that previous year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

However, where such amount is released during the previous year at the closing of the account on the death of the assessee, partition of a HUF or liquidation of a company, the above restriction will not apply.

(11) Where an asset acquired in accordance with the scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which it was acquired, such portion of the cost equal to the deduction allowed under this section shall be deemed to be profits of the previous year in which the asset is sold or transferred and shall be chargeable to income-tax as the income of that previous year.

However, the above restriction will not apply in the following cases:

(i) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.

(ii) Where the sale or transfer is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as result of which the firm sells or otherwise transfers any asset to the company and the scheme continues to apply to the company in the same manner as applicable to the firm. Further, all the properties of the firm relating to the business or profession immediately before the succession should become the liabilities of the company and all the shareholders of the company
should have been partners of the firm immediately before the succession.

(12) The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

(13) “National Bank” means the National Bank for Agricultural and Rural Development (NABARD).

**Site Restoration Fund [Section 33ABA] – (1)** This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of prospecting for, or extraction or production, of petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement with such assessee for such business.

(2) It provides that where the assessee has during the previous year -

(i) deposited any sum with the State Bank of India in a special account maintained by the assessee with that bank in accordance with the scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas (hereinafter referred to as the Site Restoration Account), or

(ii) deposited any amount in an account opened by the assessee for the purposes specified in a scheme framed by the said Ministry,

the assessee shall be entitled to a deduction of —

- a sum equal to the sum deposited; or

- a sum equal to twenty per cent of its profits (as computed under the head “Profits and gains of business or profession” before making any deduction under the new section), whichever is less.

(3) For this purpose, it is provided that any amount credited in the special account or Site Restoration Account by way of interest shall also be deemed to be a deposit.

(4) **Non-eligibility** - (i) Where such assessee is a firm or AOP or BOI, the deduction under this section will not be available in the computation of the income of any partner of the firm or the member of the AOP or BOI.

(ii) Where any deduction in respect of any amount deposited in the special account or Site Restoration Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

(5) **Audit** - (i) Section 33ABA(2) provides that deduction under sub-section (1) shall not be admissible unless the accounts of the said business of the assessee for the previous year relevant to the assessment year have been audited by a chartered accountant and the assessee furnishes the report of such audit in the prescribed form along with the return.

(ii) Where the assessee is required by or under any other law to get his accounts audited, it will be sufficient compliance with the provisions of this sub-section if the assessee gets the accounts of the aforesaid business audited under any such law and furnishes the report of the audit and a further report in the prescribed form.
(6) **Withdrawal of deduction** - Any amount standing to the credit in the special account or the Site Restoration Account will not be allowed to be withdrawn except for the purposes specified in the scheme or in the deposit scheme.

No deduction shall be allowed in respect of any amount utilised for the purchase of the following items:

(a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;

(b) any office appliances (not being computers);

(c) any machinery or plant, the whole of the actual 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;

(d) any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

(7) **Withdrawal on closure of account** - (i) Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(ii) Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee in no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(8) **Utilisation from scheme not available as a deduction** - When any amount standing to the credit of the assessee in the special account or in the Site Restoration Account business is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or the deposit scheme such expenditure will not be allowed in computing the income chargeable under the head ‘Profits and gains of business or profession’.

(9) **Consequences of non-utilisation** - Where any amount is released in the previous year by the State Bank of India or is withdrawn from the Site Restoration Account and is not utilised in accordance with the scheme or the deposit scheme, the whole of such amount or the part thereof shall be deemed to be the profits and gains of business and accordingly chargeable to income-tax as income of that previous year. This sub-section will not apply in a case where such amount is released in the event of death of an assessee, partition of a Hindu undivided family or liquidation of a company. These circumstances are provided in clauses (b), (c) and (e) of section 33AB(3).

(10) **Consequences of sale or transfer** - Where any asset acquired in accordance with the scheme or the deposit scheme is sold or otherwise transferred in any previous year by the assessee before the expiry of eight years from the end of the previous year in which such
assets were acquired, such part of the cost of such asset as is relatable to the deduction allowed under section 33ABA(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and shall accordingly be chargeable to income-tax as the income of that previous year.

This sub-section will not apply in the following cases:

(a) where the asset is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by or under a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956; or

(b) where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm, if the following conditions are satisfied;

(i) all the properties of the firm relating to the business or profession immediately before the succession become the properties of the company;

(ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and

(iii) all the shareholders of the company were partners of the firm immediately before the succession.

Specified period - The Central Government may, by notification in the Official Gazette, direct that the deduction allowable under this section will not be allowed after such date as may be specified in such notification.

(vii) Reserves for Shipping Business [Section 33AC]: The tonnage tax scheme, introduced by insertion of Chapter XII-G in the Income-tax Act, 1961, provides for special provisions relating to taxation of income of shipping companies. Consequently, no deduction under section 33AC is allowable from A.Y. 2005-06, where a shipping company has opted for the tonnage tax scheme.

(viii) Expenditure on Scientific Research [Section 35]: This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee. The expression ‘scientific research’ as defined in section 43(4)(i) means activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. A reference to expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any expenditure incurred in the acquisition of rights in or arising out of scientific research. In particular, a reference to scientific research related to a business or a class of business would include (i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be;

1 Section 2(45) of the Companies Act, 2013
(ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

(1) The deduction allowable under this section consists of -

(i) Revenue Expenditure:

(a) Any revenue expenditure incurred by the assessee himself on scientific research related to his business. Expenditure incurred within 3 years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority.

(b) An amount equal to 1¾ times of any sum paid to a university, college or other institution or research association which has as its object, the undertaking of scientific research to be used for scientific research provided that the university, college, institution or association is approved for this purpose by the Central Government by notification in the Official Gazette.

The scope of the above deduction has been extended to cover expenditure on sponsored research carried out in the in-house research and development facilities of public companies. For the purpose, the expression “public sector company” means Government company as defined in section 617 of the Companies Act, 1956.

The payments so made to such institutions would be allowable irrespective of whether (i) the field of scientific research is related to the assessee’s business or not, and (ii) the payment is of a revenue nature or of a capital nature.

(c) A sum equal to 1¼ times of any amount paid to a company to be used by it for scientific research [Clause (iia) of section 35(1)]

However, such deduction would be available only if the company is registered in India and has as its main object the scientific research and development. Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

A company approved under section 35(1)(iia) will not be entitled to claim weighted deduction of 200% under section 35(2AB). However, it can continue to claim deduction under section 35(1)(i) in respect of the revenue expenditure incurred on scientific research.

(d) A sum equal to 1¼ times of any amount paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution approved by the Central Government by notification in the Official Gazette to be used for research in any social science or statistical research.

(e) The applicant association, university, college or other institution shall be approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed. Such association, university, college or other institution should be notified in the Official Gazette by the Central Government.

(f) The deduction would be available only if such association, university, college or other institution is for the time being approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed.
(g) Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

(ii) Capital Expenditure: Any expenditure of a capital nature related to the business carried on by the assessee would be deductible in full in the previous year in which it is incurred.

Capital expenditure prior to commencement of business - The Explanation added to subsection (2) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced. Consequently, any capital expenditure incurred within three years before the commencement of business will rank for deduction as expenditure for scientific research incurred during the previous year.

Expenditure on land disallowed - No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land after 29-2-1984 whether the land is acquired as such or as part of any property.

For the above purpose the expression 'land' would include any interest in land and it shall be deemed to be acquired on the date on which the document purporting to transfer the land is registered under the Registration Act, 1908 and where the possession of any land has been obtained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, on the date on which such possession was obtained.

(2) If any question arises under this section as to whether, and if so, to what extent, any activity constitutes, or any asset is being used, for scientific research, the Board shall refer the question to—

(a) the Central Government, when such question relates to any activity under clauses (ii) and (iii) of sub-section (1) i.e. any scientific research, or any research in social science or statistical research carried on by a university, college or institution approved for this purpose, and its decision shall be final;

(b) the prescribed authority, when such question relates to any activity other than the activity specified in clause (a) above whose decision shall be final.

(3) Carry forward of deficiency - Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year.

(4) No depreciation - Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

(5) Approval by Central Government - The Central Government by notification in the Official Gazette will approve such research association, university, college or institution for the purpose of sections 35(1)(ii) and 35(1)(iii).
The research association, university or college or other institution referred to in section 35(1)(ii) or (iii) shall make an application in the prescribed form and manner to the Central Government for the purpose of grant of approval or continuance thereof under these clauses.

The Central Government may call for such documents (including audited annual accounts) or information from the research association etc. in order to satisfy itself about the genuineness of the activities of the research association.

Notification issued by the Central Government under these clauses shall at any time have effect for not more than three assessment years (including an assessment year or years commencing before the date on which such notification is issued), as may be specified in the Notification. This time limit is applicable in respect of a notification issued by the Central Government under clause (ii) or clause (iii) before 13.7.2006. Consequently, any notification issued on or after 13.7.2006 shall remain in force until approval granted to such entity is withdrawn.

In respect of an application received on or after 13.7.2006, every notification under clause (ii) or clause (iii) shall be issued or an order rejecting the application shall be passed before expiry of 12 months from the end of the month in which the application for approval was received by the Central Government.

(6) Application of section 41 - Section 41, inter alia, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research. Such an asset might be sold, discarded, demolished or destroyed, either after having been used for the purposes of business on the cessation of its use for the purpose of scientific research related to the business or without having been used for other purposes. In either case, tax liability could arise. In the first case, where the asset is sold, etc., after having been used for the purposes of the business, the moneys payable in respect of such asset together with the amount of scrap value, if any, could be brought to charge under section 41(1) the provisions of which are wide enough to cover such situations and to bring to tax that amount of deductions allowed in earlier years. It may be noted that in such cases, the actual cost of the concerned asset under section 43(1) read with explanation would be nil and no depreciation would be allowed by virtue of section 35(2)(iv).

Where the asset representing expenditure of a capital nature on Scientific Research is sold without having been used for other purposes, then the case would come under section 41(3) and if the proceeds of sale together with the total amount of the deductions made under section 35 exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

(7) Sum paid to National Laboratory, etc. [Section 35(2AA)]- Sub-section (2AA) of section 35 provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out programmes of scientific research approved by the prescribed authority will be eligible for weighted deduction of 200% of the amount so paid.

No contribution which qualifies for weighted deduction under this clause will be entitled to deduction under any other provision of the Act.
The authority which will approve the National Laboratory will also approve the programmes and procedure. Such programmes and procedure will be specified in rules.

The prescribed authority can call for each document or information as it considers necessary to satisfy itself about the genuineness of scientific research activities of the National Laboratory applying for approval. The prescribed authority under Rules 6(3) to (7) is Secretary, Department of Scientific & Industrial Research/Director General (Income-tax Exemptions).

It has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to a National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme [referred to in sub-section (2AA) of section 35] shall not be denied to the donor- assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid done-entities has been withdrawn.

‘National Laboratory’ means a scientific laboratory functioning at the national level under the aegis of the Indian Council of Agricultural Research, Indian Council of Medical Research or 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. ‘Specified person’ means a person who is approved by the prescribed authority.

(8) Company engaged in Business of Drugs, Electronic Equipments, etc. [Section 35(2AB)] : Where a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule incurs any expenditure on scientific research on inhouse research and development facility as approved by the prescribed authority, a deduction of a sum equal to 200% of the expenditure will be allowed. Such expenditure should not be in the nature of cost of any land or building.

For this clause, “expenditure on scientific research” in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any state regulatory authority, and filing an application for a patent under the Patents Act, 1970.

No deduction will be allowed in respect of the above expenditure under any other provision of this Act.

No company will be entitled to this deduction unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of accounts maintained for that facility.

The prescribed authority shall submit its report in relation to the approval of the said facility to the Director General in such form and within such time as may be prescribed.

No deduction shall be allowed in respect of such expenditure incurred after 31-3-2017.

Illustration 6

A Ltd. furnishes the following particulars for the P.Y.2013-14. Compute the deduction allowable under section 35 for A.Y.2014-15, while computing its income under the head “Profits and gains of business or profession”.

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6.41 Income Tax

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Amount paid to Indian Institute of Science, Bangalore, for scientific</td>
<td>1,00,000</td>
</tr>
<tr>
<td>research</td>
<td></td>
</tr>
<tr>
<td>2. Amount paid to IIT, Delhi for an approved scientific research programme</td>
<td>2,50,000</td>
</tr>
<tr>
<td>3. Amount paid to X Ltd., a company registered in India which has as its</td>
<td>4,00,000</td>
</tr>
<tr>
<td>main object scientific research and development, as is approved by the</td>
<td></td>
</tr>
<tr>
<td>prescribed authority</td>
<td></td>
</tr>
<tr>
<td>4. Expenditure incurred on in-house research and development facility as</td>
<td></td>
</tr>
<tr>
<td>approved by the prescribed authority</td>
<td></td>
</tr>
<tr>
<td>(a) Revenue expenditure on scientific research</td>
<td>3,00,000</td>
</tr>
<tr>
<td>(b) Capital expenditure (including cost of acquisition of land ₹ 5,00,000)on scientific research</td>
<td>7,50,000</td>
</tr>
</tbody>
</table>

Solution

Computation of deduction under section 35 for the A.Y.2014-15

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>Section</th>
<th>% of weighted deduction</th>
<th>Amount of deduction (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment for scientific research</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indian Institute of Science</td>
<td>1,00,000</td>
<td>35(1)(ii)</td>
<td>175%</td>
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<td>IIT, Delhi</td>
<td>2,50,000</td>
<td>35(2AA)</td>
<td>200%</td>
<td>5,00,000</td>
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<tr>
<td>X Ltd.</td>
<td>4,00,000</td>
<td>35(1)(iia)</td>
<td>125%</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Expenditure incurred on in-house research and development facility</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue expenditure</td>
<td>3,00,000</td>
<td>35(2AB)</td>
<td>200%</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)</td>
<td>2,50,000</td>
<td>35(2AB)</td>
<td>200%</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Deduction allowable under section 35</td>
<td>22,75,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(ix) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB] - (1) Where any capital expenditure has been incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal annual instalments over the relevant previous years.

“Relevant previous years” means—

(a) in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;
(b) in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent previous year or years during which the licence, for which the fee is paid, shall be in force.

“Payment has actually been made” means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

(2) Moreover, any capital expenditure so incurred before the actual commencement of the business shall also be eligible for deduction under sub-section (1).

(3) Where the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of the transfer, shall be allowed in respect of the previous year in which the licence is transferred.

(4) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred to obtain the licence and the amount of such expenditure remaining unallowed shall be chargeable to income-tax as profits and gains of the business in the previous year in which the licence has been transferred.

Where the licence is transferred in a previous year in which the business is no longer in existence, the above provisions will apply as if the business is in existence in that previous year.

(5) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are not less than the amount of expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the licence is transferred or in any subsequent previous year.

(6) Where a part of the licence is transferred in a previous year, the proceeds of transfer will be subtracted from the expenditure remaining unallowed. Such remainder will be divided by the number of relevant previous years which have not expired at the beginning of the previous year during which the licence is transferred.

(7) Where in a scheme of amalgamation the amalgamating company sells or otherwise transfers the license to the amalgamated company being an Indian company, the above provisions with regard to the chargeability of the surplus will not apply to the amalgamating company. Further, the provisions will apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the license.

(8) The said provisions relating to transfer of license given in (iii), (iv) and (v) above shall not be applicable in the case of demerged company where the demerged company sells or transfers the license to the resulting company (being an Indian company) and the provisions of the section allowing deduction of expenditure incurred for obtaining the licence shall be applicable to the resulting company as it would have applied to demerged company.

(9) Where a deduction is claimed and allowed for any previous year under sub-section (1) of the section 35ABB, then, no deduction on the capital expenditure so incurred shall be allowed.
by way of depreciation under sub-section (1) of section 32 in respect of acquiring any right to operate telecommunication services.

(x) **Promotion of social and economic welfare [Section 35AC]** – (1) Under this section, deduction will be allowed in computing profits of business or profession chargeable to tax, in respect of the expenditure incurred for an eligible project or scheme for promoting social and economic welfare or uplift of the public as may be specified by the Central Government on the recommendations of the “National Committee”. For this purpose, ‘National Committee’ will be the committee constituted by the Central Government from amongst persons of eminence in public life. Rules 11-F to 11-O deal with the National Committee for Promotion of Social and Economic Welfare and the guidelines for granting approval of associations and institutions and for recommending projects or schemes, for the purposes of this provision.

(2) The deduction will be allowed in case where the qualifying expenditure is either incurred by way of payment to a public sector company, a local authority or to an approved association or institution for carrying out any eligible project or scheme.

(3) However, companies will be allowed the deduction also in cases where expenditure is incurred by them directly on an eligible project or scheme.

(4) The claim for deduction under this section should be supported by a certificate obtained from the public sector company, local authority or approved association or institution as the case may be. Where the claim is in respect of expenditure directly incurred by a company on an eligible project or scheme, a certificate should be obtained from a Chartered Accountant.

(5) The deduction to which an assessee (i.e. the donor) is entitled on account of payment of any sum by him to a public sector company or a local authority or to an association or institution shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such association or institution has been withdrawn or the notification notifying the eligible project or scheme referred to in section 35AC has been withdrawn.

(6) The Committee can withdraw the approval to an association or institution if it is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted or if the association/institution has failed to furnish to the National Committee, after the end of each financial year, a progress report within the prescribed time in the prescribed form. The National Committee, should however, give a reasonable opportunity to the concerned association or institution of showing cause against the proposed withdrawal. Further, a copy of the order withdrawing the approval or notification should be forwarded to the Assessing Officer having jurisdiction over the concerned association or institution.

(7) Similarly, the Committee can withdraw a notification regarding an eligible project or scheme if it is satisfied that the project or the scheme is not being carried out in accordance with all or any of the conditions subject to which such project or scheme was notified or a report in respect of such eligible project or scheme has not been furnished after the end of each financial year, in the prescribed form within the prescribed time. The National Committee should however, give a reasonable opportunity of showing cause against the proposed withdrawal.
(8) Further, a copy of the notification by which the eligible project or scheme is withdrawn should be forwarded to the Assessing Officer having jurisdiction over the concerned association, institution, public sector company or local authority, as the case may be, carrying on such eligible project or scheme.

(i) Where the approval of the National Committee or the notification in respect of eligible project or scheme is withdrawn in case of a public sector company or local authority, etc; or

(ii) Where a company has claimed deduction in respect of any expenditure incurred directly on the eligible project or scheme and the approval for such project or scheme is withdrawn by the National Committee,

the total amount of payment received by the public sector company or the local authority, etc., as case may be, in respect of which it has furnished to certificate, or the deduction claimed by the company shall be deemed to be the income of such company/authority, etc. for previous year in which the approval or notification is withdrawn. Further, tax will be charged on such income at the maximum marginal rate in force.

(xi) “Investment-linked tax incentives” for specified businesses [Section 35AD]

(i) Although there are a plethora of tax incentives available under the Income-tax Act, 1961 they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently have the effect of diverting profits from the taxable sector to the tax-free sector. Therefore, with the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely–

- setting-up and operating ‘cold chain’ facilities for specified products;
- setting-up and operating warehousing facilities for storing agricultural produce;
- laying and 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;
- building and operating a hotel of two-star or above category, anywhere in India;
- building and operating a hospital, anywhere in India, with at least 100 beds for patients;
- developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines.
- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government;
- production of fertilizer in India;
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
- bee-keeping and production of honey and beeswax; and
- setting up and operating a warehousing facility for storage of sugar.
(ii) 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

(iii) Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

(iv) **Weighted “investment-linked” tax deduction for certain specified businesses [Section 35AD(1A)]**

The following “specified businesses” would be eligible for weighted deduction @150% of the capital expenditure (including capital expenditure incurred before commencement of operations and capitalized in the books of account on the date of commencement of operations) under section 35AD(1A), if they commence operations on or after 1st April, 2012 –

1. setting up and operating a cold chain facility;
2. setting up and operating a warehousing facility for storage of agricultural produce;
3. building and operating, anywhere in India, a hospital with at least 100 beds for patients;
4. developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government. Such scheme should be notified by the CBDT in accordance with the prescribed guidelines; and
5. production of fertilizer in India.

(v) For claiming deduction (whether 100% or 150%) under section 35AD, the specified business should fulfill the following conditions -

1. it should not be set up by splitting up, or the reconstruction, of a business already in existence;
2. it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose;

In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in the new business.

For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied:

(a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;
(b) the plant or machinery was imported into India from a foreign country;
(c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.

(3) In respect of the business of laying and 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, such business,—

(a) should be owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;

(b) should have been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette.

(c) should have made not less than such proportion of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person. The common carrier capacity condition prescribed by the regulations of the Petroleum & Natural Gas Regulatory Board is –

(1) “one-third” for natural gas pipeline network; and

(2) “one-fourth” for petroleum product pipeline network.

(d) should fulfill any other prescribed condition.

(vi) where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction under the provisions of Chapter VI-A under the heading “C.-Deductions in respect of certain incomes” is permissible in relation to such specified business for the same or any other assessment year.

Correspondingly, section 80A has been amended to provide that where a deduction under any provision of this Chapter under the heading “C.-Deductions in respect of certain incomes” is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.

In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading “C.-Deductions in respect of certain incomes” for the same or any other year and vice versa.

(vii) The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act, 1961 in the current year or under this section for any other year.

(viii) The benefit will be available –

(a) in a case where the business relates to laying and operating a cross-country natural gas pipeline network for distribution, if such business commences its operations on or after 1st April, 2007;

(b) in a case where the business relates to setting and operating “cold-chain” facilities
for specified products or warehousing facilities for storing agricultural produce, if such business commences its operation on or after 1st April, 2009;

(c) in the case of the business of affordable housing projects and production of fertilizer in a new plant or in a newly installed capacity in an existing plant, if such business commences operation on or after 1st April, 2011;

(d) in the case of business of setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, bee-keeping and production of honey and beeswax and setting up and operating a warehousing facility for storage of sugar, if such business commences operation on or after 1st April, 2012;

(e) in any other case, if such business commences its operation on or after 1st April, 2010.

Consequently, profit-linked deduction provided under section 80-IA to the business of laying and operating a cross country natural gas distribution network has been discontinued. As a result, any person availing of this incentive can now avail of the benefit under section 35AD.

Illustration 7

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2013. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2013 to March, 2013 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2013. The cost of land included in the above figures are ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. Further, during the P.Y.2013-14, it incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/reconstruction of the building purchased and used exclusively for the above businesses. Compute the income under the head “Profits and gains of business or profession” for the A.Y.2014-15 and the loss to be carried forward, assuming that Mr. A has fulfilled all the conditions specified for claim of deduction under section 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 setting up a warehousing facility (before claiming deduction under section 35AD and section 32) for the A.Y. 2014-15 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively.

Answer

Computation of profits and gains of business or profession for A.Y.2014-15

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ (in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)</td>
<td>31</td>
</tr>
<tr>
<td>Less: Depreciation under section 32</td>
<td></td>
</tr>
</tbody>
</table>
### Computation of income/loss from specified business under section 35AD

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Food Grains</th>
<th>Sugar</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)</strong></td>
<td>16</td>
<td>14</td>
<td>30</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 35AD</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital expenditure incurred prior to 1.4.2013 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2013 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)</td>
<td>30</td>
<td>20</td>
<td>50</td>
</tr>
<tr>
<td>Capital expenditure incurred during the P.Y.2013-14</td>
<td>20</td>
<td>15</td>
<td>35</td>
</tr>
<tr>
<td><strong>Total capital expenditure (B + C)</strong></td>
<td>50</td>
<td>35</td>
<td>85</td>
</tr>
<tr>
<td><strong>Deduction under section 35AD</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>150% of capital expenditure (food grains)</td>
<td>75</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% of capital expenditure (sugar)</td>
<td></td>
<td>35</td>
<td></td>
</tr>
<tr>
<td><strong>Total deduction u/s 35AD for A.Y.2014-15</strong></td>
<td>75</td>
<td>35</td>
<td>110</td>
</tr>
<tr>
<td><strong>Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)</strong></td>
<td>(59)</td>
<td>(21)</td>
<td>(80)</td>
</tr>
</tbody>
</table>

**Notes:**

1. Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2014-15 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012. Food grains constitute agricultural produce and therefore, the capital expenditure incurred for setting up a warehousing facility for storage of food grains is eligible for weighted deduction@150% under section 35AD.
(2) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2014-15 in respect of specified business of setting up and operating a warehousing facility for storage of sugar, where operations are commenced on or after 01.04.2012.

(3) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.

(4) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2013-14.

(5) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 80 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.

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

An “associated person” in relation to the assessee means a person—

(1) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee;

(2) who holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the capital of the assessee;

(3) who 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; or

(4) who guarantees not less than 10% of the total borrowings of the assessee.

(x) In respect of the business of hotels and hospitals, the word “new” has been removed from the definition of “specified business”. Therefore, “specified business” means the business of building and operating, anywhere in India, -

(1) a hotel of two-star or above category as classified by the Central Government;

(2) a hospital with at least one hundred beds for patients.

Consequently, the loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. As assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April,
2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.

Illustration 8

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2013. The company incurred capital expenditure of ₹ 50 lakh during the period January, 2013 to March, 2013 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2013. Further, during the P.Y.2013-14, it incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business. Compute the income under the head “Profits and gains of business or profession” for the A.Y.2014-15, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 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 under section 35AD) for the A.Y.2014-15 is ₹ 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations 5 years back, the profits from which are ₹ 120 lakhs for the A.Y.2014-15.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)</td>
<td>25 lakh</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 35AD</strong></td>
<td></td>
</tr>
<tr>
<td>Capital expenditure incurred during the P.Y.2013-14 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakh – ₹ 150 lakh (See point no. (ii) above)</td>
<td>50 lakh</td>
</tr>
<tr>
<td>Capital expenditure incurred prior to 1.4.2013 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2013 (See point no. (iii) above)</td>
<td>50 lakh</td>
</tr>
<tr>
<td>Total deduction under section 35AD for A.Y.2014-15</td>
<td>100 lakh</td>
</tr>
<tr>
<td><strong>Loss from the specified business of new hotel in Madurai</strong></td>
<td></td>
</tr>
<tr>
<td>Profit from the existing business of running a hotel in Coimbatore</td>
<td>120 lakh</td>
</tr>
<tr>
<td>Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A</td>
<td>45 lakh</td>
</tr>
</tbody>
</table>

(xii) 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 of the said hotel to another person, the assessee shall be deemed to be carrying on
the specified business of building and operating a hotel. Therefore, he would be eligible to claim investment-linked tax deduction under section 35AD.

Therefore, in effect, the assessee shall be deemed to be carrying on the specified business of building and operating hotel if –

(1) The assessee builds a hotel of two-star or above category;
(2) Thereafter, he transfers the operation of the hotel to another person;
(3) He, however, should continue to own the hotel.

(xii) Where any goods or services held for the purposes of the specified business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the specified business shall be computed as if the transfer was made at market value.

For the above purpose, “market value” means the price such goods or services would ordinarily fetch in the open market, subject to statutory or regulatory restrictions, if any.

(xiii) The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income.

(xiv) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the specified business due to close connection between the assessee and any other person, or due to any other reason, the Assessing Officer may consider such profits as may be reasonably deemed to have been derived from the specified business for the purpose of computing deduction under this section.

(xii) Contributions for Rural Development [Section 35CCA]: This section allows a deduction of the following expenditure incurred by the assessee during the previous year:

(1) Payment to an association or institution, having the objective of undertaking programmes of rural development. Such payment must be used for carrying out any programme of rural development approved by the prescribed authority.

Conditions for allowance:

(a) The assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that the programme of rural development had been approved by the prescribed authority before 1-3-1983 and

(b) Where such payment is made after 28-2-1983, the programme should involve work by way of (i) construction of any building, or other structure (to be used for dispensary, school, training or welfare centre, workshop, etc.) or (ii) the laying of any road or (iii) the construction or boring of a well or tube well or (iv) the installation of any plant or machinery and such work must have commenced before 1-3-1983.

(2) Payment to an association or institution having as its object the training of persons for implementing rural development programme.
Conditions:

(a) Assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that it has been approved by the prescribed authority before 1-3-1983.

(b) Such training of persons must have started before 1-3-1983.

The deduction to which an assessee is entitled on account of payment of any sum by him to an association or institution for carrying out the programme of rural development shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such programme or, as the case may be, to the association or institution has been withdrawn.

(3) Payment to a rural development fund set up and notified by the Central Government.

The expression ‘programme of rural development’ for this purpose have the same meaning as has been assigned to it under Explanation to section 35CC(l).

(4) Payments made to “National Urban Poverty Eradication Fund” (NUPEF) set up and notified by the Central Government.

It has been specifically provided that in every case where any deduction in respect of contribution for rural development is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to the approved association or institution, no deduction in respect of the same expenditure can again be claimed by the assessee under any other relevant provision.

(xiii) Weighted deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]

(1) In order to incentivize the business entities to provide better and effective agriculture extensive services, section 35CCC provides a weighted deduction of a sum equal to 150% of expenditure incurred by an assessee on agricultural extension project in accordance with the prescribed guidelines.

(2) The agricultural extension project eligible for this weighted deduction shall be notified by the Board.

(3) In case deduction in respect of such expenditure is allowed under this section then, no deduction in respect of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

(xiv) Weighted deduction in respect of expenditure incurred by companies on notified skill development project [Section 35CCD]

(1) The National Manufacturing Policy (NMP) has been notified by the Department of Industrial Policy & Promotion (DIPP) vide Press Note dated 4th November, 2011. As per the notified NMP, the government will provide weighted standard deduction of 150% of the expenditure (other than land or building) incurred on Public Private Partnership (PPP) project for skill development in the ITIs in manufacturing sector. This is to encourage
private sector to set up their own institution in coordination with National Skill Development Corporation.

(2) In order to encourage companies to invest on skill development projects in the manufacturing sector, section 35CCD provides for a weighted deduction of a sum equal to 150% of the expenditure (not being expenditure in the nature of cost of any land or building) on skill development project incurred by the company in accordance with the prescribed guidelines.

(3) The skill development project eligible for this weighted deduction shall be notified by the Board.

(4) In case deduction in respect of such expenditure is allowed under this section then, no deduction of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

(xv) Amortisation of Preliminary Expenses [Section 35D]- (1) Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.

(2) This section applies (a) only to Indian companies and resident non-corporate assesses; (b) in the case of new companies to expenses incurred before the commencement of the business; (c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - to expenses incurred till the new unit commences production or operation.

(3) Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.

(4) Eligible expenses - The following expenditure are eligible for amortisation:

(i) Expenditure in connection with - (a) the preparation of feasibility report (b) the preparation of project report; (c) conducting market survey or any other survey necessary for the business of the assessee; (d) engineering services relating to the assessee’s business; (e) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

(ii) Where the assessee is a company, in addition to the above, expenditure incurred - (f) by way of legal charges for drafting the Memorandum and Articles of Association of the company; (g) on printing the Memorandum and Articles of Association; (h) by way of fees for registering the company under the Companies Act; 1956, (i) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and

(iii) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the
purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

In the case of expenditure specified in items (a) to (e) above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

(5) **Overall Limits** - The maximum aggregate amount of the qualifying expenses that can be amortised has been fixed at 5% of the cost of the project or in the case of an Indian company, or, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher. The excess, if any, of the qualifying expenses shall be ignored.

The assessee is entitled to a deduction of an amount equal to one-fifth of the qualifying amount of the expenditure for each of the five successive accounting years beginning with the year in which the business commences, or as the case may be, the previous year in which the business commences or as the case may be, the previous year in which extension of the undertaking is completed or the new unit commences production or operation.

(6) For purpose of amortisation, the expression, ‘**cost of the project**’ means -

(i) In the case of expenses incurred before the commencement of business the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(ii) in case of extension of the business or setting up of a new unit, the cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, insofar as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.

(7) The expression “**capital employed in the business of the company**” means -

(i) in the case of new company, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;

(ii) in the case of extension of the business or the setting up of a new unit, the aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation insofar as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.

(8) The expression “long-term borrowing,” mentioned above, means any moneys borrowed in...
India by the company from the Government or the Industrial Finance Corporation of India or
the Industrial Credit and Investment Corporation of India or any other financial institution
eligible for deduction under section 36(1)(iii) or any banking institution, or any moneys
borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of
plant and machinery where the terms under which such moneys are borrowed or the debt is
incurred provide for the repayment thereof during a period of not less than seven years.

(9) In cases where the assessee is a person other than a company or a co-operative society,
the deduction would be allowable only if the accounts of the assessee for the year or years in
which the expenditure is incurred have been audited by a Chartered Accountant and the
assessee furnishes, along with his return of income for the first year in respect of which the
deduction is claimed, the report of such audit in the prescribed form duly signed and verified
by the auditor and setting forth such other particulars as may be prescribed.

(10) Special provisions for amalgamation and demerger—Where the undertaking of an
Indian company is transferred, before the expiry of the period of ten years, to another Indian
company under a scheme of amalgamation as defined in section 2(IA) the aforesaid provisions
will apply to the amalgamated company as if the amalgamation had not taken place. But no
deduction will be admissible in the case of the amalgamating company for the previous year in
which the amalgamation takes place.

Sub-section (5A) provides similar provisions for the scheme of demerger where the resulting
company will be able to claim amortisation of preliminary expenses as if demerger had not taken
place, and no deduction shall be allowed to the demerged company in the year of demerger.

It has been clarified that in case where a deduction under this section is claimed and allowed
for any assessment year in respect of any item of expenditure, the expenditure in respect of
which deduction is so allowed shall not qualify for deduction under any other provision of the
Act for the same or any other assessment year.

(xvi) Amortisation of Expenses for Amalgamation/Demerger [Section 35DD]

(1) Where an assessee, being an Indian company, incurs expenditure on or after 1st April,
1999, wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall
be allowed a deduction equal to one-fifth of such expenditure for five successive previous
years beginning with the previous year in which amalgamation or demerger takes place.

(2) No deduction shall be allowed in respect of the above expenditure under any other
provisions of the Act.

(xvii) Amortisation of expenditure incurred under voluntary retirement scheme [Section
35DDA]- (1) This section applies to an assessee who has incurred expenditure in any
previous year in the form of payment to any employee in connection with his voluntary
retirement, in accordance with any scheme or schemes of voluntary retirement.

(2) The amount of deduction allowable is one-fifth of the amount paid for that previous year,
and the balance in four equal installments in the four immediately succeeding previous years.

(3) In case of amalgamation, demerger, reorganisation or succession of business during the
intervening period of the said 5 years, the benefit of deduction will be available to the “new
company9 for the balance period including the year in which such amalgamation/ 
demerger/reorganisation or succession takes place.

(4) This will be applicable in the following situations:

(i) where an Indian company is transferred to another Indian company in a scheme of 
amalgamation;

(ii) where the undertaking of an Indian company is transferred to another company in a 
scheme of demerger;

(iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling 
the conditions in section 47(xiii) or a proprietary concern is succeeded by a company 
fulfilling the conditions in section 47(xiv);

(iv) where a company has converted into a LLP fulfilling the conditions laid down in section 
47(xiii).

(5) In the above cases, the deduction shall be available to the successor company as such 
deduction would have applied to the original entity if such transfer had not taken place at all.

(6) It is further provided that no deduction shall be available to the original entity being the 
amalgamating company, or the demerged company or the firm or proprietary concern (as the case 
may be) for the previous year in which the amalgamation, demerger or succession takes place.

(7) No deduction shall be allowed in respect of the above expenditure under any other 
provision of the Act.

(xviii) Amortisation of expenses for prospecting and development of certain minerals 
[Section 35E] – (1) This provision applies only to expenditure incurred by an Indian company 
or any other person who is resident in India. Thus, foreign companies or foreign concerns and 
non-resident assesses are not entitled for the benefits of deduction under section 35E. In 
order to qualify for amortisation, the assessee should be engaged in any operations relating to 
prospecting for or the extraction or production of any mineral.

(2) Eligible expenses - The nature and kind of expenditure qualifying for amortisation are - 
(i) It must have been incurred during the year of commercial production or any one or more of 
the four years immediately preceding that year, (ii) It must be an expenditure incurred wholly 
and exclusively on any operations relating to the prospecting for or extraction of certain 

(3) Expenditure not allowed for deduction - However, any portion of the expenditure 
which is met directly or indirectly by any other persons or authority and the sale, salvage, 
compensation or insurance moneys realised by the assessee in respect of any property or 
rights brought into existence as a result of the expenditure should be excluded from the 
amount of expenditure qualifying for amortisation. Further, specific provision has been made 
to the effect that the following items of expenses do not qualify for amortisation at all viz.:

(i) Expenditure incurred on the acquisition of the site of the source of any minerals or group 
of associated minerals stated above or of any right in or over such site;
(ii) Expenditure on the acquisition of the deposits of minerals or group of associated minerals referred to above or to any rights in or over such deposits; or

(iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under section 32.

(4) Amount of deduction - The assessee will be allowed for each of ten relevant previous years, a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure. Thus, the deduction to be allowed for any relevant previous year is (i) one-tenth of the expenditure or (ii) such amount as will reduce to nil the income of the previous year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred, whichever figure is less. The amount of the deduction admissible in respect of any relevant previous year to the extent to which it remains unallowed, shall be carried forward and added to the installment relating to the previous year next following and shall be deemed to be a part of the installment and so on, for ten previous years beginning from the year of commercial production.

(5) For purposes of this amortisation, the expression "operation relating to prospecting" means any operation undertaken for the purpose of exploiting, locating or proving deposits of any minerals and includes any such operation which proves to be infructuous or abortive. The expression 'year of commercial production' means the previous year in which as a result of any operation relating to prospecting or commercial production of any material or one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule to Act actually commences. The relevant previous year in which the deduction would be allowed to the assessee are those ten previous years beginning with the year of commercial production.

(6) In the case of amalgamation, such deduction would continue to be admissible to the amalgamated company as if the amalgamation had not taken place.

Sub-section (7A) provides for similar provisions in cases of demerger where such deduction can be availed of by the resulting company as if the demerger had not taken place.

Further, no deduction will be admissible to the amalgamating/demerged company in the year of amalgamation/demerger.

(7) Where a deduction is claimed and allowed on account of amortisation of the expenses under section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profits and gains under any other provisions of the Act for the same or any other assessment year. The provisions with regard to audit of accounts relating to the qualifying expenditure are similar to those applicable for amortisation of preliminary expenses discussed earlier.

(xix) Other Deductions [Section 36] - This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

(1) Insurance premia paid [Section 36(1)(i)] - If insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession, the
premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

(2) **Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)]** - Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.

(3) **Premia paid by employer for health insurance of employees [Section 36(1)(ib)]** - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by (i) the General Insurance Corporation of India and approved by the Central Government; or (ii) any other insurer and approved by the IRDA.

(4) **Bonus and Commission [Section 36(1)(ii)]** - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission. It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

(5) **Interest on borrowed capital [Section 36(1)(iii)]** - In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under section 40A. Under section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business. *Explanation 8* to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should normally be capitalised. However, there was scope for the asssessees to claim it as a revenue expenditure.

It has now been provided that no such deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. It is significant to note here that even after the amendment the scope for claiming such interest as revenue expenditure in respect of existing business still exists.

(6) **Discount on Zero Coupon Bonds(ZCBs) [Section 36(1)(iiiia)]** - Section 36(1)(iiiia) provides deduction for the discount on ZCB on pro rata basis having regard to the period of
life of the bond to be calculated in the manner prescribed. The Explanation seeks to provide the meaning of the expression “discount” as a difference of the amount received or receivable by an infrastructure capital company/infrastructure capital fund/public sector company/scheduled bank on issue of the bond and the amount payable by such company or fund or bank on maturity or redemption of the bond. The expression ‘period of life of the bond’ has been defined to mean the period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

For definitions of “infrastructure capital company” and “infrastructure capital fund”, refer sections 2(26A) and 2(26B) in Chapter 1 of this study material – Basic Concepts.

(7) Contributions to provident and other funds [Section 36(1)(iv) and (v)] - Contribution to the employees’ provident and other funds are allowable subject to the following conditions:

(a) The fund should be settled upon a trust.

(b) In case of Provident or a superannuation or a Gratuity Fund, it should be one recognised or approved under the Fourth Schedule to the Income-tax Act, 1961.

(c) The amount contributed should be periodic payment and not an adhoc payment to start the fund.

(d) The fund should be for exclusive benefit of the employees.

The nature of the benefit available to the employees from the fund is not material; it may be pension, gratuity or provident fund.

(8) Employer’s contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]

(i) Section 36(1)(iva) to provide that the employer’s contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.

(ii) However, the deduction would be restricted to 10% of salary of the employee in the previous year.

(iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

(iv) Correspondingly, section 40A(9), which provides for disallowance of any sum paid by an employer towards contribution to any fund or trust has been amended to exclude from the scope of its disallowance, contribution by an employer to the pension scheme referred to in section 80CCD, to the extent to which deduction is allowable under section 36(1)(iva).

Illustration 9

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees. Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?
Solution

Computation of deduction allowable under section 36(1)(iva) and disallowance under section 40A(9)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Salary</td>
<td>10,00,000</td>
</tr>
<tr>
<td>Dearness Allowance@40% of basic salary [DA forms part of pay]</td>
<td></td>
</tr>
<tr>
<td>Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Actual contribution (20% of basic salary i.e., 20% of ₹ 10 lakh)</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Permissible deduction under section 36(1)(iva)</strong> (10% of basic salary plus dearness pay = 10% of ₹ 14,00,000 = ₹ 1,40,000)</td>
<td>1,40,000</td>
</tr>
<tr>
<td>Excess contribution disallowed under section 40A(9)</td>
<td>60,000</td>
</tr>
</tbody>
</table>

(9) Amount received by assessee as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date - Clause (va) of section 36(1) and clause (ia) of section 57 provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee’s account in the relevant fund on or before the due date. For the purposes of this section, “due date” will mean the date by which the assessee is required as an employer to credit such contribution to the employee’s account in the relevant fund under the provisions of any law on term of contract of service or otherwise.

As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month. A further grace period of 5 days is allowed.

(10) Allowance for animals [Section 36(1)(vi)] - This clause grants an allowance in respect of animals which have died or become permanently useless. The amount of the allowance is the difference between the actual cost of the animals and the price realised on the sale of the animals themselves or their carcasses. The allowance under the clause would thus recoup to the assessee the entire capital expenditure in respect of animal.

(11) Bad debts [Section 36(1)(vii) and section 36(2)] - These can be deducted subject to the following conditions:

(a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.

(b) The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

**Deduction under section 36(1)(vii) for bad debts limited to the amount by which bad debts exceed credit balance in the provision for doubtful debts account under section 36(1)(viia)**

Under section 36(1)(vii), bad debt actually written off as irrecoverable in the books of account of the
assessee is deductible. However, in the case of entities for which provision for bad and doubtful debts is allowable under section 36(1)(viia), deduction for bad debts written off under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia). This is provided in the proviso to section 36(1)(vii).

Further, the provisions of section 36(1)(vii) are subject to the provisions of section 36(2). Section 36(2)(v) provides that where the debt or part thereof relates to advances made by an assessee, to which section 36(1)(viia) applies, no deduction shall be allowed unless the assessee has debited the amount of such debt or part of such debt in that previous year to the provision for bad and doubtful debts account made under section 36(1)(viia).

Explanation 2 to section 36(1)(vii) states that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein shall be made in respect of provision for bad and doubtful debts under section 36(1)(viia) and such account shall relate to all types of advances, including advances made by rural branches.

Therefore, in the case of an assessee to which section 36(1)(viia) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) without any distinction between rural advances and other advances.

Illustration 10

The following are the particulars in respect of a scheduled bank incorporated in India -

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Provision for bad and doubtful debts under section 36(1)(viia) upto A.Y.2013-14</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Gross Total Income of A.Y.2014-15 [before deduction under section 36(1)(viia)]</td>
<td>800</td>
</tr>
<tr>
<td>(iii) Aggregate average advances made by rural branches of the bank</td>
<td>300</td>
</tr>
<tr>
<td>(iv) Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year 2013-14</td>
<td>210</td>
</tr>
</tbody>
</table>

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2014-15.

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ in lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad debts written off (for the first time) in the books of account</td>
<td>210</td>
</tr>
<tr>
<td>Less: Credit balance in the “Provision for bad and doubtful debts” under section 36(1)(viia) as on 31.3.2014</td>
<td></td>
</tr>
<tr>
<td>(i) Provision for bad and doubtful debts u/s 36(1)(viia) upto A.Y.2013-14</td>
<td>100</td>
</tr>
<tr>
<td>(ii) Current year provision for bad and doubtful debts under section 36(1)(viia) [7.5% of ₹ 800 lakhs + 10% of ₹ 300 lakhs]</td>
<td>90</td>
</tr>
<tr>
<td>Deduction under section 36(1)(vii) in respect of bad debts written off for A.Y.2014-15</td>
<td>20</td>
</tr>
</tbody>
</table>
Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery

Further, if on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Recovery of a bad debt subsequently [Section 41(4)] - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

For example, let us assume that a debt of ₹ 10,000 was claimed as a bad debt in the previous year 2012-13. However, the Assessing Officer allowed only a sum of ₹ 5,000 as bad debt. If in the previous year 2013-14, a sum of ₹ 4,000 is recovered ultimately in respect of the debt, then the Assessing Officer should allow a deduction in respect of the deficiency namely, ₹ 1,000 i.e., the difference between the amount ultimately recovered and the amount disallowed earlier under Section 36(1)(vii). If on the other hand, the sum ultimately recovered is ₹ 6,000 then there will be a liability, under section 41(4) in respect of sum of ₹ 1,000, which would be deemed to be the profits and gains of business or profession. Such a liability under section 41(4) would arise even if the business or profession in respect of which deduction has been allowed is not in existence at that time.

(12) Special provision for bad and doubtful debts in cases of Rural Branches of Scheduled Banks [Section 36(1)(viia)]

(a) In the case of a scheduled bank which is not a bank incorporated by or under the laws of a country outside India or a non-scheduled bank, the following deductions will be allowed:

(i) an amount not exceeding 7.5% of the total income (computed before making any deduction under this clause and Chapter VI-A), and

(ii) an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank computed in the manner prescribed by the CBDT.

(b) A scheduled bank or a non-scheduled bank referred to in (a) above or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government. It is also provided that this deduction shall not be allowed unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

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**Scheduled Bank**: It refers to the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the Reserve Bank of India Act, 1935.

**Non-Scheduled Bank**: This refers to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 which is not a scheduled bank.

**Rural branch**: This means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

(c) **Foreign Banks**: In the case of foreign banks the deduction will be an amount not exceeding 5% of the total income (computed before making any deduction under this clause and Chapter VI-A).

(d) A public financial institution, a State Financial Corporation and a State Industrial Investment Corporation will be entitled to a deduction in respect of provision for bad and doubtful debts made out of profits. The maximum amount to be allowed as a deduction will be limited to 5% of its total income before making any deduction in respect of the provision for bad and doubtful debt or in respect of any deduction in Chapter VI-A.

"Public Financial Institution" shall have the meaning assigned to it in section 4A of the Companies Act, 1956.

"State Financial Corporation" means a financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951.

"State Industrial Investment Corporation" means a Government company within the meaning of Section 617 of the Companies Act, 1956 engaged in the business of providing long-term finance for industrial projects and eligible for deduction under clause (viii) of this sub-section.

Co-operative bank, primary agricultural credit society and primary co-operative agricultural and rural development bank have the same meanings assigned in Explanation to section 80P(4).

**(13) Special deduction to Specified Entities engaged in eligible business [Section 36(1)(viii)]**

(a) This section provides deduction in respect of any special reserve created and maintained by a specified entity.

(b) The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head “Profits and gains of business or profession” carried to such reserve account.

(c) The eligible business for different entities specified are given in the table below –

<table>
<thead>
<tr>
<th>Specified entity</th>
<th>Eligible business</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Financial Corporation specified in section 4A of the Companies Act, 1956</td>
<td>Business of providing long-term finance for -</td>
</tr>
</tbody>
</table>

2 Section 2(72) of the Companies Act, 2013
Profits and Gains of Business or Profession 6.64

| Financial corporation which is a public sector company | (i) industrial or agricultural development or (ii) development of infrastructure facility in India; or (iii) development of housing in India. |
| Banking company | |
| Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank) | |

2. A housing finance company

Business of providing long-term finance for the construction or purchase of houses in India for residential purposes.

3. Any other financial corporation including a public company

Business of providing long-term finance for development of infrastructure facility in India.

(d) However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

(e) Infrastructure facility has been defined to mean -

(a) (1) an infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-I.A i.e.

(i) a road including toll road, a bridge or a rail system;

(ii) a highway project including housing or other activities being an integral part of the highway project;

(iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and

(iv) a port, airport, inland waterway or inland port or a navigational channel in the sea

(2) any other public facility of a similar nature as may be notified by the CBDT in this behalf in the Official Gazette and which fulfils the prescribed conditions;

(b) an undertaking referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (4) of section 80-I.A (i.e. an undertaking providing telecommunication services, an undertaking developing, developing and operating, maintaining and operating an industrial park or SEZ notified by the Central Government, an undertaking generating, distributing or transmitting power); and

(c) an undertaking referred to in sub-section (10) of section 80-I.B i.e. an undertaking developing and building housing projects approved by a local authority.
Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility [Notification No.187/2006 dated 20.7.2006]: Rule 6ABAA specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of subsection (1) of section 36. The conditions specified therein are -

(a) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;

(b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the Explanation to section 80-IA(4)(i);

(c) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.

Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii) [Notification No. 188/2006, dated 20.7.2006]

The following public facilities have been notified by the CBDT as infrastructure facility for purposes of section 36(1)(viii)-

(1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962

(2) Mass Rapid Transit system

(3) Light Rail Transit system

(4) Expressways

(5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers

(6) Bus and truck terminals

(7) Subways

(8) Road dividers

(9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system

(10) Multilevel Computerised Car Parking.

Deduction in respect of income from long-term finance for development of infrastructure facilities - The deduction will now be available also to approved financial corporations providing long-term finance for development of infrastructure facilities in India. For this purpose, the expression “infrastructure facility” shall have the meaning assigned to it in section 80-IA.

(14) Expenses on family planning [Section 36(1)(ix)] - Any expenditure of revenue nature bona fide incurred by a company for the purpose of promoting family planning amongst its
employees will be allowed as a deduction in computing the company’s business income; where, the expenditure is of a capital nature, one-fifth of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years. This deduction is allowable only to companies and not to other assesses. The assessee would be entitled to carry forward and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation. The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(15) Deduction for expenditure incurred by entities established under any Central, State or Provincial Act [Section 36(1)(xii)]

Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if –

(a) it is constituted or established by a Central, State or Provincial Act;

(b) such corporation or body corporate is notified by the Central Government in the Official Gazette for this purpose having regard to the objects and purposes of the Act;

(c) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted and established.

Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii).

(16) Deduction in respect of banking cash transaction tax [Section 36(1)(xiii)]

(a) The Finance Act, 2005 had, through Chapter VII, introduced a tax called banking cash transaction tax, as an anti tax-evasion measure, in respect of every taxable banking transaction entered into on or after 1.6.2005.

(b) Section 36(1)(xiii) provides for deduction of any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him.

Note – Banking Cash Transaction Tax is not chargeable in respect of any taxable banking transaction entered into on or after 1.4.2009.

(17) Deduction of contribution by a public financial institution to Credit guarantee fund trust for small industries [Section 36(1)(xiv)]

(i) Section 36(1)(xiv) provides for deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries notified by the Central Government in the Official Gazette.

(ii) Public financial institution has the meaning assigned to it in section 4A of the Companies Act, 1956.
(18) Deduction of securities transaction tax paid [Section 36(1)(xv)]: The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head ‘Profits and gains of business or profession’. Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

(19) Deduction for commodities transaction tax paid in respect of taxable commodities transactions [Section 36(1)(xvi)]

(a) The Finance Act, 2013 has introduced a new tax called Commodities Transaction Tax (CTT) to be levied on taxable commodities transactions entered into in a recognised association, vide Chapter VII of the Finance Act, 2013.

(b) For this purpose, a ‘taxable commodities transaction’ means a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.

(c) CTT is to be levied at 0.01% on sale of commodity derivative from the date on which Chapter VII of the Finance Bill, 2013 comes into force by way of notification in the Official Gazette by the Central Government. CTT is to be paid by the seller.

(d) A “commodity derivative” means –

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

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

(i) of such underlying goods; or

(ii) of related services and rights, such as warehousing and freight; or

(iii) with reference to weather and similar events and activities having a bearing on the commodity sector.

(e) Consequently, new clause (xvi) has been inserted in section 36(1) to provide that an amount equal to the CTT paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head “Profits and gains of business or profession”.

(xix) Residuary Expenses [Section 37]

(1) Revenue expenditure incurred for purposes of carrying on the business, profession or vocation - This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. (These are allowable under section 29 as losses incidental to the business). The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.
(2) **Conditions for allowance** - The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section:

(a) The expenditure should not be of the nature described in sections 30 to 36.

(b) It should have been incurred by the assessee in the accounting year.

(c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.

(d) It must have been incurred after the business was set up.

(e) It should not be in the nature of any personal expenses of the assessee.

(f) It should have been laid out or expended wholly and exclusively for the purposes of such business.

(g) It should not be in the nature of capital expenditure. (The principles to be followed for distinguishing capital expenditure from revenue are discussed below.)

(h) The expenditure should not have been incurred by the assessee for any purpose which is an offence or is prohibited by law.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. Therefore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

(3) For determining whether an expenditure is of the nature contemplated by the foregoing provisions of law the following tests should be applied:

(i) ‘**Character as a trader**’: The expenditure should be incurred by the assessee in his character as a trader.

(ii) ‘**Voluntarily expended on grounds of commercial expediency**’ : A sum of money expended, not out of necessity but with a view to getting a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for purposes of the trade [Atherton v British Insulated and Helsby Ltd. 10 LTC. 115 (H.L.)].

(iii) ‘**Direct concern and direct purpose**’: In order to ascertain whether the expenditure has been incurred wholly and exclusively for the purpose of the business one must look to the direct concern and direct purpose for which the money is laid out and not the remote or indirect result which may possibly motivate or flow from the expenditure.

(iv) ‘**Purpose of the assessee’s own business**’ : The expenditure should be primarily incurred for the assessee’s own business. Notwithstanding this proposition so long as the expenditure is for the whole and exclusive purpose of the assessee’s trade the mere fact that the expenditure incidentally obtains some advantage to the assessee in some
6.69 Income Tax

classic character other than that of a trader, would not detract the effect of the finding that the expenditure was wholly and exclusively incurred for purpose of the assessee's business.

(v) ‘Unremunerative expenditure’ : The expenditure need not be incurred solely for the purpose of earning profit in the year of account. For example, the cost of repairs or advertisement or expenses on a foreign tour by the managing directors would be deductible even though the income therefrom would be earned in future years.

(vi) ‘Treatment in assessee’s accounts’ : The way in which an item of expenditure is treated in the assessee’s accounts is not a conclusive evidence against or in favour of the assessee.

Payment out of profits and payments ascertained by reference to profits : When a trader makes a payment which is computed in relation to profits the question that arises is: Does the payment represent a mere division of profit with another person or is it an item of expenditure the amount of which is ascertained by reference to the profits? The payment would be allowable in the second case but not in the first.

(4) Distinction between capital and revenue expenditure: The line of demarcation between capital and revenue expenditure is very thin and the ultimate conclusion on the nature of the expenditure is always a mixed question of law and fact. In deciding whether an expenditure is of a revenue or a capital nature, one must take into consideration the nature and ordinary course of the business of the assessee and the object for which the expenditure had been incurred.

Whether a particular item of expenditure is incurred for the purpose of the business or not must be viewed in the larger context of business necessity and expediency. For this purpose, one must look not to the documents but also the surrounding circumstances so as to arrive at a decision as to what exactly is the real nature of the transaction from the commercial point of view.

It is often very difficult to lay down a test of a comprehensive nature which would be of universal application. Different tests have to be applied from the business point of view and then conclusions must be arrived at on the question whether, on a fair consideration of the whole situation as evident from the facts, the expenditure in question incurred in a particular case is of revenue nature or of a capital nature. The following broad principles have been evolved by the decisions of the various courts from time to time. These principles are neither exhaustive nor are they intended to be. They would serve only as guidelines to decide any problem arising in regard to the determination of the capital or revenue of a particular item [Hylam Ltd. v CIT [1913] 87 ITR 310 (A.P.)].

(i) If the expenditure is for the initial outlay or for acquiring or bringing into existence any asset or advantage of an enduring benefit to the business of the assessee or for extension of the business which is already in existence or for substantial replacement of any existing business asset it must be treated as capital expenditure. The Supreme Court has reiterated the above principle in CIT v. Jalan Trading Co. (P) Ltd. [1985] 23 Taxman (SC).

(ii) If, however, the expenditure, although incurred for the purpose of the business that too for acquiring an asset or advantage, is for running the business or for working out that asset with a view to producing profits, it would be a revenue expenditure. The expenditure incurred for the purpose of carrying on the business undertaking would be of
a revenue nature. The expenditure which has to be incurred by an assessee in the ordinary course of his business, to enable him to carry on his trading operations is normally to be considered to be of a revenue nature. The expenditure by the assessee cannot be considered to be capital in nature merely because of the fact that the amount involved is large. The quantum of the expenditure cannot go to affect or alter the real nature and character of expenditure.

(iii) In cases where the outgoing of money spent by the assessee is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process of operations and not for the acquisition of any asset of a permanent character the possession of which is a condition precedent to the running of the business, then such an item of payment would constitute an expenditure of a revenue nature.

(iv) Any special knowledge, technical know-how or patent or trade mark constitutes an asset and if such an asset is acquired on payment for its use and exploitation for a limited period in the business and the acquisition is not of an asset or advantage of an enduring nature and at the end of the stipulated period the asset or advantage reverts back intact to the giver of the special knowledge or the owner of the patent, trade mark or copyright, it would constitute an expenditure of a revenue nature. In this context, it may be noted that a payment made to ward off competition in business to a rival would constitute a capital expenditure if the object of making that payment is to derive an advantage by eliminating competition over some length of time. The same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any point of time. How long the period of contemplated advantage or the benefit should be in order to constitute benefit of an enduring nature would depend upon the facts and circumstances of each individual case. Although enduring benefit need not be of an everlasting character, it should not be so transitory and ephemeral that it may be terminated at any time at the volition of any of the parties to the contract.

(v) In cases of acquisition of a capital asset, it is immaterial whether the price for it is paid by the assessee once and for all in lumpsum or periodically and also whether it is paid out of capital or income or is linked with the total sales or the turnover of the business. In such a case, the expenditure or outgoing would constitute payment of a capital nature although it may indirectly be linked to or is paid out of revenue profit or sales.

(vi) In cases where the amount paid for acquisition of an asset of an enduring nature is settled, by the mere fact that the amount so settled is chalked out into various small amounts or periodical instalments the capital nature of the transaction or expenditure would not in any way be affected nor the fact that the payment is made in instalments or in small amounts would in any way alter the nature of the expenditure from capital to revenue. In other words, the magnitude of the payment and its periodicity would not be deciding factors for determining the capital or revenue nature of any particular payment.

(vii) A lumpsum amount paid for liquidating recurring claims would generally be of a revenue nature; it would not cease to be a revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. In such a case it is the intention and the object for which the assets are acquired that determine the nature of the expenditure incurred over it, and not the mode and the manner in which the payment
is made nor is it in any way related to or determined by the source of such payment.

(viii) If the expenditure in question is recurring and is incurred by the assessee during the ordinary course of the business or manufacture, it would normally constitute a revenue expenditure.

(ix) An asset or advantage of an enduring nature resulting in capital expenditure does not mean that such an asset should last forever; if the capital asset is, by its very nature, a short lived one, the expenditure incurred over it does not on that account cease to be a capital expenditure.

(x) It is nowhere stipulated in the law that if a benefit of enduring nature is obtained, the expenditure for securing it must be treated as a capital expenditure. If the advantage or the benefit acquired by the assessee is to get stock-in-trade of a business it would constitute a revenue; but if what is acquired by the assessee is not the advantage of getting his current or trading assets directly but of something which requires to be processed before it is converted into stock-in-trade, the expenditure incurred over it would constitute a capital expenditure.

(xi) Further, an item of disbursement may be regarded as capital expenditure when it is referable to fixed capital or a capital asset; it is a revenue expenditure when it is referable to circulating capital or stock in trade. Expenditure which relates to the framework of the taxpayer's business is a capital expenditure. Expenditure incurred for the termination of trading relationship in order to avoid losses occurring in future though that relationship, whether pecuniary loss or commercial inconvenience, is a revenue expenditure. Expenditure incurred for the initial starting of the business before its setting up for substantial expansion and also expenditure incurred after the discontinuance of the business would be of a capital nature.

The capital or revenue character of a particular item must be decided from the facts and circumstances of each case and must be based upon the principles of law applicable to those facts. The fact that a particular transaction is treated by the parties as capital or revenue in nature or is called a sale, instead of being an agreement to use or let out the particular asset would not convert the capital or revenue character of the transaction. Similarly, the entries made by the parties concerned in their books of account or other documents would not always be indicative or conclusive, as to what the real nature of the transaction is based upon the above principles, the capital or revenue character of a particular expenditure will have to be decided in every case.

**Instances of revenue expenditure:** Payment made for the use of goodwill, use of quota rights or in the case of a hotel or restaurant business the cost of table linen, crockery, pots is of a revenue expenditure. The cost of dredging carried on by a harbor authority for the purpose of keeping the channels clear for shipping is also of revenue expenditure. Expenditure incurred by a surgeon or businessman on a study tour abroad to acquire knowledge of the latest techniques would be on revenue account.

**Circular No.6/2007 dated 11.10.2007** clarifies the issue of allowability of the claim of harvesting and transportation expenses incurred by the 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.
The issue of allowability of such expenses in the case of co-operative sugar mills has been examined by the CBDT. These expenses are incurred by the Sugar Mills for ensuring an adequate and sustained supply of freshly cut sugarcane that is an essential input for the continuous running of such Mills. These expenses are, therefore, incurred for commercial expediency and are prima facie wholly and exclusively for the purpose of business. Such expenses are, therefore, allowable in the computation of the income of the co-operative sugar mills.

**Instances of capital expenditure:** Expenditure on improvement to property as distinguished from mere repairs or that which is incurred by a company in raising loans or issuing debentures for capital outlay would be capital expenditure if they are incurred before the business is set up. Legal expenses incurred in connection with the mortgages of the premises belonging to the assessee in which the assessee carries on his business are also capital expenditure.

(5) **Advertisements in souvenirs of political parties:** Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply notwithstanding anything to the contrary contained in section 37(1). In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business. Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

(6) **Explanation to section 37(1)** - This *Explanation* provides that any expenditure incurred by the assessee for any purpose which is an offence or is prohibited by law shall not be allowed as a deduction or allowance.

*Inadmissibility of expenses incurred in providing freebees to medical practitioner by pharmaceutical and allied health sector industry [Circular No. 5/2012 dated 1-8-2012]*

Section 37(1) provides for deduction of any revenue expenditure (other than those falling under sections 30 to 36) from the business income if such expense is laid out or expended wholly or exclusively for the purpose of business or profession. However, the Explanation below section 37(1) denies claim of any such expenses, if the same has been incurred for a purpose which is either an offence or prohibited by law.

The CBDT, considering the fact that the claim of any expense incurred in providing freebees to medical practitioner is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has clarified that the expenditure so incurred shall be inadmissible under section 37(1) of the Income-tax Act, 1961, being an expense prohibited by the law. The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebees and claimed it as a deductible expense in its accounts against income.

This circular has also clarified that a sum equivalent to value of freebees enjoyed by the
aforesaid medical practitioner or professional associations is also taxable as business income or income from other sources, as the case may be, depending on the facts of each case.

**Illustration 11**

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2014 is ₹15,25,890 after debiting the following items:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Purchase price of raw material used for the purpose of in-house research and development</td>
<td>1,80,000</td>
</tr>
<tr>
<td>2.</td>
<td>Purchase price of asset used for in-house research and development wrongly debited to profit and loss account:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1) Land</td>
<td>5,00,000</td>
</tr>
<tr>
<td></td>
<td>(2) Building</td>
<td>3,00,000</td>
</tr>
<tr>
<td>3.</td>
<td>Expenditure incurred on notified agricultural extension project</td>
<td>1,50,000</td>
</tr>
<tr>
<td>4.</td>
<td>Expenditure on notified skill development project:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(1) Purchase of land</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td>(2) Expenditure on training for skill development</td>
<td>2,50,000</td>
</tr>
<tr>
<td>5.</td>
<td>Expenditure incurred on advertisement in the souvenir published by a political party</td>
<td>75,000</td>
</tr>
</tbody>
</table>

Compute the income under the head “Profits and gains of business or profession” for the A.Y. 2014-15 of Isac Ltd.

**Answer**

**Computation of income under the head “Profits and gains of business or profession” for the A.Y. 2014-15**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>15,25,890</td>
</tr>
<tr>
<td>Add: Items debited to profit and loss account, but to be disallowed</td>
<td></td>
</tr>
<tr>
<td>Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)</td>
<td>-</td>
</tr>
<tr>
<td>Expenditure incurred on notified agricultural extension project (to be treated separately)</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>---------</td>
</tr>
<tr>
<td>Expenditure incurred on notified skill development project -</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Expenditure on training for skill development (to be treated separately)</td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)</td>
<td>75,000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Purchase price of raw material used for in-house research and development qualifies for 200% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 100% is allowed.</td>
<td>1,80,000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.</td>
<td>2,25,000</td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
</tr>
<tr>
<td>Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.</td>
<td>3,75,000</td>
</tr>
<tr>
<td><strong>Profit and gains from business</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>19,20,890</td>
</tr>
</tbody>
</table>

**Note:** The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head “Profit and Gains of Business or Profession” but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

### 3.6 Inadmissible Deductions [Section 40]

By dividing the assessees into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows:

(i) **Section 40(a)** - In the case of any assessee, the following expenses are not deductible:

1. Any interest (not being interest on loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable, -
   
   (a) outside India;
   
   (b) in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source under Chapter XlIB and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under section 200(1). It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under section 200(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

   (2) **Section 40(a)(ia)** provides that interest, commission, brokerage, rent, royalty, fees for technical/professional services payable to a resident or amounts payable (for carrying out any
work contract) to a resident contractor/sub-contractor, on which tax is deductible at source, shall be disallowed if –

(i) such tax has not been deducted; or

(ii) such tax, after deduction, has not been paid on or before the due date specified in section 139(1).

In case the tax is deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

If, for instance, tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2013-14, the same has to be paid by 31st July/30th September 2014, as the case may be. Otherwise, the expenditure would be disallowed in computing the income for A.Y.2014-15. If the tax deducted during the P.Y.2013-14 has been paid after 31st July/30th September, 2014, the same would be allowed as deduction in the year of payment.

Section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

Consequently, in cases where such person responsible for deducting tax is not deemed to be an assessee-in-default on account of payment of taxes to the resident payee, it shall be deemed that the payer has deducted and paid the tax on such sum on the date of furnishing return of income by the resident payee.

Since the date of furnishing the return of income by the resident payee is taken to be the date on which the payer has deducted tax at source and paid the same, the expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. Such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the resident payee, since tax is deemed to have been deducted and paid by the payer in that year.

(3) any sum paid on account of tax or cess levied on profits on the basis of or in proportion to the profits and gains of any business or profession;

(a) Any sum paid outside India (on account of any rate or tax levied) which is eligible for tax relief under section 90 or deduction from the income-tax payable under section 91 is not allowable and is deemed to have never been allowable as a deduction under section 40(a).
(b) However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with the provisions of section 90 or section 91, as the case may be.

(c) Any sum paid outside India (on account of any rate or tax levied) and eligible for relief under section 90A will not be allowed as a deduction.

(4) any sum paid on account of wealth tax.

For the purpose of this disallowance the expression ‘wealth-tax’ means the wealth-tax chargeable under Wealth-tax Act, 1957, or any tax of similar nature or character chargeable under any law in any country outside India or any tax chargeable under such law with reference to the value of the assets of, or the capital employed in a business or profession carried on by the assessee, whether or not the debts of business or profession are allowed as a deduction in computing the amount with reference to which such tax is charged, but does not include any tax chargeable with reference to the value of any particular asset of the business or profession.

(5) (i) any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, etc., which is levied exclusively on, or

(ii) any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government (SG)

A State Government undertaking includes –

(a) A corporation established by or under any Act of the SG

(b) A company in which more than 50% of the paid-up equity share capital is held by the SG

(c) A company in which more than 50% of the paid-up equity share capital is held singly or jointly by (a) or (b)

(d) A company or corporation in which the SG has the right to appoint the majority of directors or to control the management or policy decisions

(e) An authority, a board or an institution or a body established or constituted by or under any Act of the SG or owned or controlled by the SG

(6) any sum which is chargeable under the head ‘Salaries’ if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.
(7) any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head ‘Salaries’.

(8) Tax paid on perquisites on behalf of employees is not deductible- In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee. Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

(ii) Section 40(b) - In the case of any firm assessable as such or a limited liability partnership (LLP) the following amounts shall not be deducted in computing the income from business of any firm/LLP:

(1) Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term ‘remuneration’ is applied to denote payments in the nature of salary, bonus, commission);

(2) Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed;

(3) It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in sub-clause (iii) of section 40(b), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto. Consequently, if, for instance, a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, but effective from April 1, the firm would get deduction for the remuneration paid to its working partners from July 1 and onwards, but not for the period from April 1 to June 30. In other words, it will not be possible to give retrospective effect to oral agreements entered into vis a vis such remuneration prior to putting the same in a written partnership deed.

(4) Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.

(5) Any remuneration paid to a partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.
Illustration 12
A firm has paid ₹7,50,000 as remuneration to its partners for the P.Y.2013-14, in accordance with its partnership deed, and it has a book profit of ₹10 lakh. What is the remuneration allowable as deduction?

Answer
The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>On first ₹3 lakh of book profit [₹3,00,000 × 90%]</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On balance ₹7 lakh of book profit [₹7,00,000 × 60%]</td>
<td>4,20,000</td>
</tr>
</tbody>
</table>

6,90,000

The excess amount of ₹60,000 (i.e., ₹7,50,000 – ₹6,90,000) would be disallowed as per section 40(b)(v).

There are four Explanations to section 40(b):

Explanation 1 provides that where an individual is a partner in a firm in a representative capacity:
(i) interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause.
(ii) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause.

Explanation 2 provides that where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person.

Explanation 3 defines the term “book profit”. It means the net profit as shown in the P & L A/c for the relevant previous year computed in accordance with the provisions for computing income from profits and gains.

The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.

Explanation 4 defines a working partner. Accordingly, it means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

(iii) Section 40(ba) - Association of persons or body of individuals: Any payment of interest, salary, commission, bonus or remuneration made by an association of persons or body of individuals to its members will also not be allowed as a deduction in computing the income of the association or body.

There are three Explanations to section 40(ba):

Explanation 1 - Where interest is paid by an AOP or BOI to a member who has paid interest to
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the AOP/BOI, the amount of interest to be disallowed under clause (ba) shall be limited to the net amount of interest paid by AOP/BOI to the partner.

Explanation 2 - Where an individual is a member in an AOP/BOI on behalf of another person, interest paid by AOP/BOI shall not be taken into account for the purposes of clause (ba). But, interest paid to or received from each person in his representative capacity shall be taken into account.

Explanation 3 - Where an individual is a member in his individual capacity, interest paid to him in his representative capacity shall not be taken into account.

6.7 Expenses or payments not deductible in certain circumstances [Section 40A]

(i) Payments to relatives and associates - Sub-section (2) of section 40A provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or to an associate concern so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he 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.

The word “relative” as defined in the section 2(41) means, in relation to individual, the spouse, brother or sister of any lineal ascendant or descendant of that individual. Whether the assessee is a firm, H.U.F. or an association of persons the relationship will have to be reckoned for the purpose, with reference to the partners of the firm and the members of the family or association. Similarly, where the assessee is a company the relationship will have to be reckoned with reference to the directors or persons having substantial interest in the company.

The related person as mentioned in section 40A(2) includes, inter alia, a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member. Further, the related person in relation to a company shall include any other company carrying on business or profession in which the first mentioned company has substantial interest.

A person shall be deemed to have a substantial interest in a business or profession if:

- in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and
- in any other case such person is, at any time during the previous year, beneficially entitled to not less than 20% the profits of such business or profession.

No adjustment to expenditure under section 40A(2) if the transaction is a specified domestic transaction which is carried out at arm’s length price
No disallowance on account of any expenditure in respect of payment which has been made or is to be made to a related person, being excessive or unreasonable having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in section 92BA, if such transaction is at arm’s length price i.e., no adjustment shall be made under section 40A(2) in relation to the specified domestic transaction in case the same is carried out at arm’s length price even though the arm’s length price so determined may be at variance with the fair market value.

Note - For details regarding the meaning of specified domestic transaction, please refer to Chapter 16 on Transfer Pricing.

(ii) Cash payments in excess of ₹ 20,000 - According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeds ₹ 20,000, such expenditure shall not be allowed as a deduction.

For example if, in respect of an expenditure of ₹ 60,000 incurred by X Ltd., 4 cash payments of ₹ 15,000 are made on a particular day to one Mr.Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of ₹ 60,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr.Y exceeds ₹ 20,000.

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds ₹ 20,000 [Section 40A(3A)].

This limit of ₹ 20,000 has been raised to ₹ 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to ₹ 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft. In all other cases, the limit would continue to be ₹ 20,000.

However, no disallowance would be made in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income. It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding ₹ 20,000 at a time are required to be made by account payee cheques or drafts as interest is a deductible expenditure. This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, this requirement does not apply to advance payment.
made by the commission agent to the party concerned against supply of goods. However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft apply equally to payments made for goods purchased on credit.

Rule 6DD provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft. As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

(a) where the payment is made to
   (i) the Reserve Bank of India or any banking company;
   (ii) the State Bank of India or any subsidiary bank;
   (iii) any co-operative bank or land mortgage bank;
   (iv) any primary agricultural credit society or any primary credit society;
   (v) the Life Insurance Corporation of India;

(b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;

(c) where the payment is made by
   (i) any letter of credit arrangements through a bank;
   (ii) a mail or telegraphic transfer through a bank;
   (iii) a book adjustment from any account in a bank to any other account in that or any other bank;
   (iv) a bill of exchange made payable only to a bank;
   (v) the use of electronic clearing system through a bank account;
   (vi) a credit card;
   (vii) a debit card.

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of -
   (i) agricultural or forest produce; or
   (ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
(iii) fish or fish products; or
(iv) the products of horticulture or apiculture,
to the cultivator, grower or producer of such articles, produce or products;

Note -
(i) The expression ‘fish or fish products’ (iii) above would include ‘other marine
products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.’.
(ii) The ‘producers’ of fish or fish products for the purpose of rule 6DD(e) would include,
besides the fishermen, any headman of fishermen, who sorts the catch of fish
brought by fishermen from the sea, at the sea shore itself and then sells the fish or
fish products to traders, exporters etc.

However, 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’ of these goods
and is only a trader, broker or any other middleman, by whatever name called.

(f) where the payment is made for the purchase of the products manufactured or processed
without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not
served by any bank, to any person who ordinarily resides, or is carrying on any business,
profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such
employee, on or in connection with the retirement, retrenchment, resignation, discharge
or death of such employee, on account of gratuity, retrenchment compensation or similar
terminal benefit and the aggregate of such sums payable to the employee or his heir
does not exceed fifty thousand rupees;

(i) where the payment is made by an assessee by way of salary to his employee after
deducting the income-tax from salary in accordance with the provisions of section 192 of
the Act, and when such employee -

(i) is temporarily posted for a continuous period of fifteen days or more in a place other
than his normal place of duty or on a ship; and

(ii) does not maintain any account in any bank at such place or ship;

(j) where the payment was required to be made on a day on which the banks were closed
either on account of holiday or strike;

(k) where the payment is made by any person to his agent who is required to make payment
in cash for goods or services on behalf of such person;

(l) where the payment is made by an authorised dealer or a money changer against
purchase of foreign currency or travellers cheques in the normal course of his business.

(iii) Disallowance of provision for gratuity - Section 40A(7) provides that no deduction
would be allowable to any taxpayer carrying on any business or profession in respect of any
provision (whether called as provision or by any other names) made by him towards the
payment of gratuity to his employers on their retirement or on the termination of their employment for any reason. The reason for this disallowance is that, under section 36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business. A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer. This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made under section 40A(7) in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee’s retirement, death, termination of service etc.

(iv) Contributions by employers to funds, trust etc. [Sections 40A(9) to (11)] - These sub-sections have been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees. Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose. However, where such sum is paid in respect of funds covered by sections 36(1)(iv), 36(1)(iva) and 36(1)(v) or any other law, then the deduction will not be denied.

(v) Deduction in respect of Head Office expenses, in the case of non-residents - Section 44C restricts the scope of deduction available to non-resident taxpayers in the matter of allowance of head office expenses in computing their taxable income from the business carried on in India. These restrictions would have the effect of overriding anything to the contrary contained in the provisions for allowance of expenses and other deductions contained in sections 28 to 43A of the Income-tax Act, 1961. This provision prescribes the limits up to which the deduction could be allowed in computing profits and gains from any business carried on by the non-resident in India and apply to the expenses in the matter of head office expenses.

For the purpose of those restrictions and the consequent disallowance, the expression ‘head office expenditure’ must be taken to mean executive and general administration expenses incurred by the assessee outside India including also the expenditure incurred in respect of the following items viz.,
(i) rent, rates, taxes, repairs or insurance in respect of any premises outside India used for the purpose of the business or profession;

(ii) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other persons employed in, or managing the affairs of any office in India;

(iii) travelling expenses incurred in respect of any employee or other person who is employed in or who is looking after the management of the affairs of any office outside India; and

(iv) such other matter connected with executive and general administration of the business as may be prescribed by the CBDT from time to time.

The limits prescribed are the following:

(i) an amount equal to 5% of the adjusted total income of the assessee; or

(ii) an amount of so much of the expenditure in the nature of head office expenses (explained above), which are incurred by the assessee, as is attributable to the business or profession of the assessee in India.

The limit upto which the deduction is permissible to the assessee is the lesser of the aforesaid two amounts and consequently, the basis for allowance would be the lower of the above two items. If, however the actual amount on account of head office expenses claimed by the assessee is less than the limits specified above, the deduction admissible would be confined to the amount of actual expenditure incurred by the assessee.

For the purpose of determining the amount of deduction admissible to the assessee, the expression ‘adjusted total income’ used in item (i) above must be taken to mean the total income of the assessee computed in accordance with the provisions of the Income-tax Act before giving effect to the following items of allowance on deduction viz.,—

(a) depreciation allowance under section 32(2);

(b) capital expenditure on family planning incurred by companies admissible as a deduction under section 36(ix);

(c) any brought-forward business loss qualifying for set off against business income in accordance with the provisions of section 72(1);

(d) any brought-forward loss in regard to any speculation business qualifying for set off against income from speculation under section 73(3);

(e) any loss computed under the head ‘Capital gains’ and brought forward from earlier assessment year qualifying for set-off under section 74(1); and

(f) any loss attributable to the casual item of income assessable under section 56 qualifying for set-off in accordance with the provisions of section 74A(3).

Thus, the total income of the assessee computed for the relevant accounting year must be first ascertained before giving effect to the provisions for the aforesaid allowance and 5% thereof would be treated as the limit upto which head office expenses would be admissible as a deduction in computing the business income of the non-resident for income-tax purposes.
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However, in cases where the adjusted total income of the assessee, 5% of which is to be taken as the basis for determining the first of the qualifying limits, happens to be a loss, the proviso to section 44C authorises the limit of 5% to be taken with reference to the average adjusted total income. For this purpose the expression 'average adjusted total income' would mean —

(i) in cases where the total income of the assessee is assessable for each of the three assessment years immediately preceding the relevant assessment year - one-third of the aggregate amount of the adjusted total income of the previous years relevant to the aforesaid three assessment years.

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

(iii) in cases where the total income of the assessee becomes assessable only for one of the three assessment years aforesaid - the amount of adjusted total incomes in respect of the previous year relevant to the assessment year.

The aforesaid provisions of restricting allowances on account of deduction in respect of head office expenditure would apply in the case of all non-resident taxpayers whose income from business or profession is chargeable to income-tax under section 28 of the Income-tax Act. The provisions for disallowance of the excess of the expenditure over the least of the limits mentioned above would apply even if the expenditure is such that it does not attract the provisions for disallowance contained in any other section of the Income-tax Act.

6.8 Profits chargeable to tax [Section 41]

This section enumerates certain receipts which are deemed to be income under the head "Business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises. The particulars of such receipts are given below:

(i) Section 41(1) - Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

Successor in business:

(i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.
(ii) Where a firm carrying on a business or profession is succeeded by another firm the successor will be the other firm.

(iii) In any other case, where one person is succeeded by any other person in that business or profession the other person will be the successor.

(iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

(ii) Balancing charge, etc. - The provisions of section 41(2) relating to balancing charge, of section 41(3) relating to assets acquired for scientific research and of section 41(4) dealing with recovery of bad debts have been dealt with earlier under the respective items.

(iii) Section 41(4A) - The withdrawal from special reserve created and maintained under section 36(1)(viii) will be deemed to be profits and gains of business and charged accordingly in the year of withdrawal. Even if the business is closed, it will be deemed to be in existence for this purpose. This also applies to section 41(5).

Brought forward losses of defunct business - In cases where a receipt is deemed under this section to be profit of a business under this section relating to a business that had ceased to exist and there is an unabsorbed loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this section. This sub-section thus constitutes an exception to the rule that if a business has ceased to exist, any loss relating to it cannot be carried forward and set off against any income from any source.

6.9 Special provisions for deduction in case of business for prospecting etc. for mineral oil [Section 42]

This section has been enacted to permit an assessee to claim an allowance which may on general principles be inadmissible, e.g., allowance in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial expenditure incurred on the setting up of a profit-earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract or arrangements entered into by the Central Government for prospecting for, or the extraction or production of mineral oils.

Allowable expenses: The allowance permissible under this section shall be in relation to (i) the expenditure by way of in fructuous or abortive exploration expenses in respect of an area surrendered prior to the beginning of commercial production by the assessee; (ii) after the beginning of commercial production, the expenditure incurred by the assessee, whether before or after such commercial production in respect of drilling or exploration activities in services in respect of physical assets used in that connection (except those assets which qualify for depreciation allowance under section 32); and (iii) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding years as may be specified in the agreement.

Amount of deduction: The sum of those allowances should be computed and deduction
should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation in the business of the Central Government for the prospecting or exploration of mineral oil. It has been specifically provided that the other provisions of the Act are being deemed, for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of the agreement. It may be noted that allowances in this regard are made in lieu of or in addition to the other allowances permissible under the Act, depending upon the terms of the agreement.

Subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, in accordance with the aforesaid agreement, various situations would arise. The tax treatment in respect of those situations are as follows:

(1) Where the proceeds of the transfer so far as they consist of capital sums are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of transfer, shall be allowed in respect of the previous year in which such business or interest is transferred.

(2) Where such proceeds exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred in connection with the business or to obtain interest therein and the amount of such expenditure remaining unallowed, shall be chargeable to income-tax as profits and gains of the business in the previous year in which the business or interest therein, whether wholly or partly, had been transferred.

However, in a case where the provisions of this clause do not apply, the deduction to be allowed for expenditure incurred remaining unallowed shall be arrived at by subtracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed.

Explanation - Where the business or interest in such business is transferred in a previous year in which such business carried on by the assessee is no longer in existence, the provisions of this clause shall apply as if the business is in existence in that previous year.

(3) Where such proceeds are not less than the amount of the expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the business or interest in such business is transferred or in respect of any subsequent year or years.

Special provisions in case of amalgamation/demerger: Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the business to the amalgamated company (being an Indian company), the provisions of this sub-section—

(i) shall not apply in the case of the amalgamating company and

(ii) shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamated company if the latter had not transferred the business or interest in the business.

The section provides for similar provisions in the case of demerger where the resulting company, being an Indian company, shall claim the production under the said section.
6.10 Changes in the rate of exchange of currency [Section 43A]

The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee at the time of making the payment, the following values may be changed accordingly with respect to the increase or decrease in such liability:

(i) the actual cost of the asset under section 43(1)
(ii) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)
(iii) the amount of capital expenditure on acquisition of patents or copyrights under section 35A
(iv) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)
(v) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

The section further clarifies that where any adjustment has already been made under the erstwhile section 43A to the amount of capital expenditure or cost of acquisition of an asset on account of increase or decrease in liability due to exchange rate fluctuation, it should be verified that the amount of such adjustment is equal to the change in the liability at the time of making payment.

In this context,

(a) “rate of exchange” means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;

(b) “foreign currency” and “Indian currency” have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999.

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 this section.

Where the assessee has entered into a contract with an authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

6.11 Certain Deductions to be Only on Actual Payment [Section 43B]

The following sums are allowed as deduction only on the basis of actual payment within the time limits specified in section 43B.

(a) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.
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(b) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.

c) Bonus or Commission for services rendered payable to employees.

d) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation.

e) Interest on any loan or advance from a scheduled bank on actual payment basis.

(f) Any sum paid by the assessee as an employer in lieu of earned leave of his employee.

The above sums can be paid by the assessee on or before the due date for furnishing the return of income under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

For the purposes of clause (a), “any sum payable” means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law. For example, an assessee may collect sales tax from customers during the month of March, 2013. However, in respect of such collections he may have to discharge the liability only within say 10th April, 2013 under the sales tax law. The explanation covers this type of liability also. Consequently, if an assessee following accrual method of accounting has created a provision in respect of such a liability the same is not deductible unless remitted within the due date specified in this section.

For this purpose, scheduled bank has the meaning assigned to it in clause (iii) of the Explanation to section 11(5), that is, the State Bank of India (SBI), a subsidiary of SBI, a nationalised bank or any other bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

"State Industrial Investment Corporation" means a Government company within the meaning of section 617 of the Companies Act, 1956, engaged in providing long-term finance for industrial projects and eligible for deduction under section 36(1)(iii).

Explanation 3B provides that where a deduction in respect of earned leave encashment paid to any employee is allowed in computing the business income of the employer for the previous year in which the liability to pay was incurred (applicable for previous year 2000-2001 or any earlier year), no deduction shall be allowed in respect of such sum in the previous year in which the sum is actually paid.

Explanation 3C & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d) and (e) above, is converted into a loan or borrowing or advance, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in Circular No. 7/2006 dated 17.7.2006. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be
Illustration 13

Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation and Indian Bank and has not paid interest as detailed hereunder:

<table>
<thead>
<tr>
<th></th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Andhra Pradesh State Financial Corporation (P.Y. 2012-13 &amp; 2013-14)</td>
<td>15,00,000</td>
</tr>
<tr>
<td>(ii) Indian Bank (P.Y. 2013-14)</td>
<td>30,00,000</td>
</tr>
<tr>
<td></td>
<td>45,00,000</td>
</tr>
</tbody>
</table>

Both Andhra Pradesh State Financial Corporation and Indian Bank, while restructuring the loan facilities of Hari during the year 2013-14, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2014, Hari paid 5 installments to Andhra Pradesh State Financial Corporation and 3 installments to Indian Bank.

Hari claimed the entire interest of ₹ 45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.

Solution

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to Andhra Pradesh State Financial Corporation (APSFC) and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y. 2014-15 shall be calculated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Interest outstanding</th>
<th>Number of Installments</th>
<th>Amount per installment</th>
<th>Installments paid</th>
<th>Interest allowable (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>APSFC</td>
<td>15 lakh</td>
<td>60</td>
<td>25,000</td>
<td>5</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Indian Bank</td>
<td>30 lakh</td>
<td>60</td>
<td>50,000</td>
<td>3</td>
<td>1,50,000</td>
</tr>
<tr>
<td><strong>Total amount eligible for deduction</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>2,75,000</strong></td>
</tr>
</tbody>
</table>
6.12 Special Provision for Computation of Cost of Acquisition of Certain Assets [Section 43C]

(i) Where an asset acquired under a scheme of amalgamation is sold by an amalgamated company as its stock-in-trade then in computing the profits and gains derived from sale of such stock-in-trade the cost of acquisition of stock-in-trade to the amalgamated company shall be the cost of acquisition of such stock-in-trade or the asset to the amalgamating company as increased by the cost if any of any improvement thereto and the expenditure incurred wholly and exclusively in connection with such a transfer.

(ii) The provisions of section 43C will thus apply to the following cases of revaluation:

(a) When the stock-in-trade of the amalgamating company is taken over at reduced price by the amalgamated company under the scheme of amalgamation.

(b) Where a capital asset of the amalgamating company is taken over as stock-in-trade by the amalgamated company after revaluation under the scheme of amalgamation.

(iii) The situation referred to at (b) above will in turn cover three situations:

(1) When the capital asset is converted to stock-in-trade by the amalgamating company with revaluation and the revalued asset is taken over by the amalgamated company under the scheme of amalgamation.

(2) Where the capital asset is taken over as stock-in-trade by the amalgamated company at renewed price at the time of amalgamation.

(3) Where the capital asset of the amalgamating company is taken over by the amalgamated company as a capital asset and has been converted into stock-in-trade and revalued.

(iv) In a case referred to above, where the revaluation and conversion of capital asset into stock-in-trade takes place in the hands of the amalgamated company the provisions of section 45(2) will apply. So in such a case the provision of section 43C will not apply. This has been done with a view to ensure that a taxpayer does not face double taxation in respect of the same transaction. However when the stock-in-trade referred to in item (i) as well as at (a) and (b) above are sold, the provisions of section 43C will apply.

(v) A similar provision in section 43C has also been made to cover cases where the asset sold as stock-in-trade has been acquired by the assessee either by way of full or partial partition of HUF or under a gift or will or an irrevocable trust and such asset is sold as stock-in-trade.

6.13 Stamp Duty Value of land and building to be taken as the full value of consideration in respect of transfer, even if the same are held by the transferor as stock-in-trade [New Section 43CA]

(i) At present, the provisions of section 50C require adoption of stamp duty value of land or building or both, which are held as a capital asset, if the same are transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer.
(ii) However, such provisions are not applicable in case of transfer of immovable property, held by the transferor as stock-in-trade.

(iii) Therefore, as an anti-avoidance measure, new section 43CA has been inserted to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head “Profits and gains of business of profession”.

(iv) Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not the same, the stamp duty value may be taken as on the date of the agreement for transfer instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by any mode other than cash on or before the date of the agreement.

(v) The Assessing Officer may refer the valuation of the asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957 in the following cases -

1) Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and

2) the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court.

(vi) Where the value ascertained by the Valuation Officer exceeds the value adopted or assessed or assessable by the Stamp Valuation Authority, the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer.

The term “assessable” covers transfers executed through power of attorney. The term ‘assessable’ has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.
### Illustration 14

<table>
<thead>
<tr>
<th>Case</th>
<th>Date of transfer of land / building held as stock-in-trade</th>
<th>Actual consideration</th>
<th>Stamp duty value on the date of agreement</th>
<th>Stamp duty value on the date of registration</th>
<th>Full value of consideration</th>
<th>Remark</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>31/1/2013</td>
<td>100</td>
<td>120 (31/7/2012)</td>
<td>210 (31/1/2013)</td>
<td>100</td>
<td>Section 43CA is not applicable since the date of transfer is before 1/4/2013</td>
</tr>
<tr>
<td>2</td>
<td>1/5/2013</td>
<td>100</td>
<td>120 (1/9/2012)</td>
<td>210 (1/5/2013)</td>
<td>120</td>
<td>Stamp duty value on the date of agreement to be adopted as full value of consideration.</td>
</tr>
<tr>
<td>3</td>
<td>1/5/2013</td>
<td>100</td>
<td>120 (1/9/2012)</td>
<td>210 (1/5/2013)</td>
<td>210</td>
<td>Stamp duty value on the date of registration to be adopted as full value of consideration.</td>
</tr>
<tr>
<td>4</td>
<td>31/3/2014</td>
<td>100</td>
<td>120 (1/5/2013)</td>
<td>210 (31/3/2014)</td>
<td>210</td>
<td>Stamp duty value of the date of registration would be the full value of consideration.</td>
</tr>
</tbody>
</table>

### 6.14 Special Provision in case of income of Public Financial Institutions [Section 43D]

(i) In the case of a public financial institution or a scheduled bank or a State financial corporation or a State industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts, as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institutions for
that year or in the previous year in which it is actually received by them, whichever is earlier. This provision is now applicable to co-operative banks also [Sub-clause (a)].

(ii) In the case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debts shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous in which it is actually received by it, whichever is earlier. [Sub-clause (b)].

6.15 Insurance Business [Section 44]
The profits and gains of any business of insurance, including any such business carried on by a mutual insurance company or by a co-operative society, shall be computed in accordance with the rules contained in the First Schedule of the Income-tax Act, 1961. This is notwithstanding anything to the contrary contained in the provisions of the Income-tax Act, 1961 relating to computation of income chargeable under the head “Income from house property”, “Capital gains” or “Income from other sources” or in section 199 or in sections 28 to 43B.

6.16 Special provisions in the case of certain associations [Section 44A]
This is a provision calculated to encourage the development activities carried on by the trade, professional and other associations other than those whose incomes are already exempted under section 10(23A). This section provides that where the expenditure incurred by an association solely for purposes of protection or advancement of the common interest of its members exceeds the amount collected by the association from the members whether by way of subscription or otherwise, the resulting deficiency shall be allowed as a deduction in computing the income of the association assessable under the head “profits and gains of business or profession”; if there is no such income, then, it will be allowed as a deduction in computing the income under any other head. However, only an amount up to 50% of total taxable income of the association can be set off against the deficiency aforementioned. In computing the taxable income of the association, effect must first be given to the allowances or losses brought forward under any other section of the Act. This section applies only to such associations which do not distribute their income amongst their members except in the form of grants to affiliated associations.

6.17 Compulsory maintenance of accounts [Section 44AA]
This section provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the Central Board of Direct Taxes in the Official Gazette must statutorily maintain such books of accounts and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The persons carrying on these professions are statutorily obliged to maintain the prescribed books of account and other documents regardless of the quantum of their
income and also regardless of the question whether the profession was set up prior to or after the coming into force of this new provision.

The professions notified so far are as follows:

The profession of authorised representative; the profession of film artiste (actor, camera man, director, music director, art director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of Company Secretary; and information technology professionals.

Every taxpayer carrying on any business or profession (other than the professions specified above) must maintain the books of account prescribed by the Central Board of Direct Taxes in the following circumstances:

(a) in cases where the income from the business or profession exceeds ₹ 1,20,000 or the total sales turnover or gross receipts, as the case may be, in the business or profession exceed ₹ 10,00,000 in any one of three years immediately preceding the accounting year; or

(b) in cases where the business or profession is newly set up in any previous year, if his income from business or profession is likely to exceed ₹ 1,20,000 or his total sales turnover or gross receipts, as the case may be, in the business or profession are likely to exceed ₹ 10,00,000 during the previous year;

(c) in cases where profits and gains from the business are calculated on a presumptive basis under section 44AE or 44BB or 44BBB and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.

(d) in cases where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the basic exemption limit during such previous year.

In such cases, compulsory tax audit would also become necessary.

The Central Board of Direct Taxes has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to prescribe by rules the books of account and other documents including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and the place at which they must be kept and maintained. Further, the Central Board of Direct Taxes has also been empowered to prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44A.

As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in sub-rule (2) in the following cases:

- if his gross receipts exceed ₹ 1,50,000 in all the 3 years immediately preceding the
previous year; or

– if, where the profession has been newly set up in the previous year, his gross receipts are likely to exceed ₹ 1,50,000 in that year.

**Note**: Students may note that professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been specified in the Rule. In other words, they are required to maintain such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

**Sub-rule (2) of Rule 6F**: The following books of account and other documents are required to be maintained.

(i) a cash book;

(ii) a journal, if accounts are maintained on mercantile basis;

(iii) a ledger;

(iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding ₹ 25;

(v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

In case of a person carrying on medical profession, he will be required to maintain the following in addition to the list given above:

(i) a daily case register in Form 3C.

(ii) an inventory under broad heads of the stock of drugs, medicines and other consumable accessories as on the first and last day of the previous year used for his profession.

The above books of account and documents shall be kept and maintained for a minimum of 6 years from the end of the relevant assessment year. However, where the assessment in relation to any assessment year has been reopened under section 147 within the period specified in section 149, all the books of account and other documents which were kept and maintained at the time of reopening the assessment shall continue to be so kept and maintained till the assessment so reopened has been completed.

The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.
6.18 Audit of accounts of certain persons carrying on business or profession [Section 44AB]

(i) It is obligatory in the following cases for a person carrying on business or profession to get his accounts audited before the “specified date” by a Chartered Accountant:

1. if the total sales, turnover or gross receipts in business exceeds ₹ 100 lakh in any previous year; or

2. if the gross receipts in profession exceeds ₹ 25 lakh in any previous year; or

3. where the assessee is covered under section 44AE, 44BB or 44BBB and claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis. In such cases, the normal monetary limits for tax audit in respect of business would not apply.

4. where the assessee is covered under section 44AD, and he claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis and his income exceeds the basic exemption limit.

(ii) The person mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith.

(iii) In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law. Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act, 1956. The provision only requires that companies should get their accounts audited under the Companies Act, 1956 before the specified date and in addition to the report required to be given by the auditor under the Companies Act, 1956 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.

(iv) However, the requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in sections 44B and 44BBA.

(v) The expression “specified date” in relation to the accounts of the previous year or years relevant to any assessment year means the due date for furnishing the return of income under section 139(1). For due date of furnishing return of income, refer section 139(1) in Chapter 10 “Provisions for filing return of income”.

(vi) It may be noted that under section 271B, penal action can be taken for not getting the accounts audited and for not filing the audit report by the specified date. In cases where the audit report has been filed before furnishing of the return, non furnishing of a copy of the audit report or proof of its filing by the specified date along with the return of income will, however, be only a defect under section 139(9) which can be rectified.

Note - The Institute has brought out a Guidance Note dealing with the various aspects of tax audit under section 44AB. Students are advised to read the same carefully.
6.19 Special provisions for computing profits and gains of business on presumptive basis [Section 44AD]

(i) The presumptive taxation scheme under section 44AD covers all small businesses with total turnover/gross receipts of up to ₹ 100 lakh (except the business of plying, hiring and leasing goods carriages covered under section 44AE).

(ii) Resident individuals, HUFs and partnership firms (but not LLPs) would be covered under this scheme.

(iii) The scheme would not apply to an assessee who is availing deductions under section 10AA or deduction under any provisions of Chapter VIA under the heading “C.— Deductions in respect of certain incomes” in the relevant assessment year.

(iv) The presumptive rate of tax would be 8% of total turnover or gross receipts. However, the assessee has the option to declare in his return of income, an amount higher than the presumptive income so calculated, claimed to have been actually earned by him.

(v) All deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed. However, in the case of a firm, salary and interest would be allowed as deduction subject to the conditions and limits prescribed under section 40(b).

(vi) The written down value of any asset of such business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.

(vii) The intention of widening the scope of this scheme is to reduce the compliance and administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessees opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.

(viii) Further, they would also be relieved from the requirement of advance tax payments. It would be sufficient compliance if they pay their tax while filing their return of income before the due date.

(ix) An assessee with turnover of up to ₹ 100 lakh, who shows an income below the presumptive rate prescribed under these provisions, will, in case his total income exceeds the taxable limit, be required to maintain books of accounts under section 44AA and also get them audited under section 44AB.

Thus, merely because an eligible assessee does not opt for presumptive taxation under section 44AD, it would not make him liable to maintain books of account under section 44AA or get the same audited under section 44AB. He will have to comply with these requirements only if his total income exceeds the taxable limit. If his total income does not exceed the taxable limit, the requirement of maintaining books of accounts under section 44AA and having the same audited under section 44AB would not arise.

(x) The following persons are specifically excluded from the applicability of the presumptive
provisions of section 44AD -
(a) a person carrying on profession as referred to in section 44AA(1) i.e., legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board (namely, authorized representatives, film artists, company secretaries and profession of information technology have been notified by the Board for this purpose);
(b) a person earning income in the nature of commission or brokerage; or
(c) a person carrying on any agency business.

6.20 Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages [Section 44AE]
(i) This section provides for estimating business income of an owner of trucks from the plying, hire or leasing of such trucks;
(ii) The scheme applies to persons owning not more than 10 trucks at any time during the previous year;
(iii) The estimated income from each truck in case of a heavy goods vehicle will be deemed to be ₹ 5,000 for every month or part of a month during which the truck is owned by the assessee for the previous year. The assessee can also declare a higher amount in his return of income. In such case, the latter will be considered to be his income;
(iv) In case of a truck, other than a heavy goods vehicle, the estimated income will be deemed to be ₹ 4,500 for every month or part of the month during which such truck is owned by the assessee in the previous year. However, he may also declare a higher income and in such a case, the higher amount will be considered to be his income;
(v) The assessee will be deemed to have been allowed the deductions under sections 30 to 38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.
(vi) The assessee joining the scheme will not be required to maintain books of account under section 44AA and get the accounts audited under section 44AB in respect of such income.

An assessee may claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Illustration 15

An assessee owns a light commercial vehicle for 9 months 15 days, a medium goods vehicle for 9 months and a medium goods vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE.
Solution
His profits and gains from the 3 trucks shall be deemed to be ₹ 4,500 × 10 + ₹ 4,500 × 9 + ₹ 4,500 × 12 = ₹ 1,39,500.

Illustration 16
An assessee owns a heavy goods vehicle for 9 months and 7 days, medium goods vehicle for 9 months and light commercial vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE.

Solution
His profits and gains from the 3 trucks shall be deemed to be ₹ 5,000 × 10 + ₹ 4,500 × 9 + ₹ 4,500 × 12 = ₹ 1,44,500.

6.21 Special provision for computing the profits and gains of shipping business in case of non-residents [Section 44B]

(i) This section provides for computation of the profits and gains of the business of shipping carried on by non-residents to the extent they are chargeable to income-tax in India. According to this, a sum equal to 7½% of the aggregate of the following amounts must be deemed to be the profits and gains of the business of shipping chargeable to tax under the head ‘profits and gains of business or profession’.

(ii) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.

(iii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The total of the above two amounts must be ascertained and 7½% thereof would be calculated and taken as the income from the business chargeable to tax in India. These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act. In other words, the income would be computed on this basis without applying the various provisions contained in sections 28 to 43A. Consequential provisions are also seen in section 172.

For the purposes of sub-section (2), receipts forming the basis of estimates on non-resident shipping lines will include demurrage and handling charges.

6.22 Provisions for computation of taxable income from activities connected with exploration of mineral oils [Section 44BB]

(i) The computation of taxable income of non-resident taxpayer engaged in the business of providing services and facilities in connection with or supplying plant and machinery on hire, used or to be used in the exploration for, and exploitation of mineral oils involves a number of complications.
(ii) As a measure of simplification, section 44BB provides for determination of income of such taxpayer at 10% of the aggregate of certain amounts. The amounts in respect of which the provisions will apply would be the amounts paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supplying plant and machinery for the aforesaid purposes. This amount will also include facilities or supply of plant and machinery. This provision will not, however, apply to any income to which the provisions of section 42, 44D, 44DA, 115A or 293A apply. It may be noted that section 44BB applies only to non-resident assesses.

(iii) Such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under sub-section (2) of section 44AA and get their accounts audited under the provisions of section 44AB of the Act. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

*Note* - If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.

### 6.23 Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Section 44BBA]

Under section 44BBA(1), a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following amounts -

(a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and

(b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

**Illustration 17**

Mr. Tiwari, a non-resident, operates an aircraft between Bangkok and Mumbai. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2014:

(i) ₹ 3 crore in India on account of carriage of passengers from Mumbai.

(ii) ₹ 2 crore in India on account of carriage of goods from Mumbai.

(iii) ₹ 1 crore in India on account of carriage of passengers from Bangkok.

(iv) ₹ 2 crore in Bangkok on account of carriage of passengers from Mumbai.

The total expenditure incurred by Mr. Tiwari for the purposes of the business during the year ending 31.3.2014 was ₹ 1.8 crore.
Compute the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2014-15.

Solution

Keeping in view the provisions of section 44BBA, the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder –

| Amount received in India on account of carriage of passengers from Mumbai | ₹ 3,00,00,000 |
| Amount received in India on account of carriage of goods from Mumbai | ₹ 2,00,00,000 |
| Amount received in India on account of carriage of passengers from Bangkok | ₹ 1,00,00,000 |
| Amount received in Bangkok on account of carriage of passengers from Mumbai | ₹ 2,00,00,000 |

Income from business under section 44BBA at 5% of ₹ 8,00,00,000 is ₹ 40,00,000, which is the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2014-15.

6.24 Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) Under this provision in the case of a foreign company engaged in the business of construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf, a sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head ‘profits and gains of business or profession’.

(ii) However, such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under section 44AA(2) and get their accounts audited under the provisions of section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

6.25 Special provisions for computing income by way of royalties etc. in case of non-residents [Section 44DA]

The provisions of this section are as follows -

(i) The income by way of royalty or fees for technical services received from Government or
an Indian concern in pursuance of an agreement made by a non-corporate non-resident or a foreign company with Government or the Indian concern after the 31st March, 2003 in respect of such non-corporate non-resident or a foreign company which carries on business in India, shall be computed on the basis of books of accounts required to be maintained under the Act.

(ii) Such business should be carried on through a permanent establishment, or the assessee should perform professional services from a fixed place of profession in India.

(iii) They should keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA.

(iv) They should get their accounts audited by an accountant as defined in the Explanation below section 288(2) and furnish along with the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

(v) No deduction will be allowed while computing income of such non-resident, of the expenditure which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place and also of any amount paid by the permanent establishment to its head office or any of its offices.

(vi) There have been legal decisions which have expressed contradictory views regarding the scope and applicability of section 44BB vis-à-vis section 44DA on the issue of taxability of fee for technical services relating to the exploration sector.

(vii) In order to reflect the correct legislative intention regarding taxation of income by way of fee for technical services, section 44BB has been amended to exclude the applicability of section 44BB to the income which is covered under section 44DA. A similar amendment has been made in section 44DA to provide that provisions of section 44BB would not be applicable in respect of the income covered under section 44DA.

(viii) Therefore, if the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.

6.26 **Method of computing deduction in the case of business reorganisation of co-operative banks [Section 44DB]**

(i) This section provides the manner in which the deduction under the following sections are to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year –

1. Section 32 (Depreciation);
2. Section 35D (Amortisation of certain preliminary expenses);
3. Section 35DD (Amortisation of expenses in case of amalgamation or demerger);
4. Section 35DDA (Amortisation of expenditure incurred under voluntary retirement scheme).
(ii) Business reorganisation means the reorganisation of business involving the amalgamation or demerger of a co-operative bank.

(iii) Co-operative bank shall have the meaning assigned to it in clause (cci) of section 5 of the Banking Regulation Act, 1949 i.e., a primary co-operative bank or Central Co-operative bank or a State co-operative bank.

(iv) Predecessor co-operative bank means the amalgamating co-operative bank or the demerged co-operative bank, as the case may be.

(v) Successor co-operative bank means the amalgamated co-operative bank or the resulting bank, as the case may be.

(vi) The amount of deduction allowable to the predecessor co-operative bank under the above-mentioned sections has to be determined in accordance with the following formula-

\[ A \times \frac{B}{C} \]

\[ A = \text{the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;} \]

\[ B = \text{the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and} \]

\[ C = \text{the total number of days in the financial year in which the business reorganisation has taken place.} \]

(vii) The amount of deduction allowable to the successor co-operative bank under the above-mentioned sections has to be determined in accordance with the formula -

\[ A \times \frac{B}{C} \]

\[ A = \text{the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;} \]

\[ B = \text{the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and} \]

\[ C = \text{the total number of days in the financial year in which the business reorganisation has taken place.} \]

For example, let us take a case where the deduction allowable under section 32 to the predecessor co-operative bank is, say, `1,20,000 and the business re-organisation took place on 1.11.2013. Then, the deduction allowable to the predecessor co-operative bank under section 32 would be `70,356 i.e., `1,20,000 x 214/365. The deduction allowable to the successor co-operative bank would be `49,644 i.e., `1,20,000 x 151/365.
(viii) In a case where an undertaking of the predecessor co-operative bank entitled to the deduction under sections 35D, 35DD or 35DDA is transferred before the expiry of the period specified therein to a successor co-operative bank on account of business reorganisation, the provisions of section 35D, section 35DD or section 35DDA shall apply to the successor co-operative bank in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.

(ix) Amalgamated co-operative bank means -

1. a co-operative bank with which one or more amalgamating co-operative banks merge; or
2. a co-operative bank formed as a result of merger of two or more amalgamating co-operative banks.

(x) Amalgamating co-operative bank means -

1. a co-operative bank which merges with another co-operative bank; or
2. every co-operative bank merging to form a new co-operative bank.

(xi) Amalgamation means the merger of an amalgamating co-operative bank or banks with an amalgamated co-operative bank, in such a manner that -

1. all the assets and liabilities of the amalgamating co-operative bank or banks immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to the amalgamated co-operative bank) become the assets and liabilities of the amalgamated co-operative bank;
2. the members holding 75% or more voting rights in the amalgamating co-operative bank become members of the amalgamated co-operative bank; and
3. the shareholders holding 75% or more in value of the shares in the amalgamating co-operative bank (other than the shares held by the amalgamated co-operative bank or its nominee or its subsidiary, immediately before the merger) become shareholders of the amalgamated co-operative bank.

(xii) Demerger means the transfer by a demerged co-operative bank of one or more of its undertakings to any resulting co-operative bank, in such manner that -

1. all the assets and liabilities of the undertaking or undertakings immediately before the transfer become the assets and liabilities of the resulting co-operative bank;
2. the assets and the liabilities are transferred to the resulting co-operative bank at values (other than change in the value of assets consequent to their revaluation) appearing in its books of account immediately before the transfer;
3. the resulting co-operative bank issues, in consideration of the transfer, its membership to the members of the demerged co-operative bank on a proportionate basis;
(4) the shareholders holding 75% or more in value of the shares in the demerged co-operative bank (other than shares already held by the resulting bank or its nominee or its subsidiary immediately before the transfer), become shareholders of the resulting co-operative bank, otherwise than as a result of the acquisition of the assets of the demerged co-operative bank or any undertaking thereof by the resulting co-operative bank;

(5) the transfer of the undertaking is on a going concern basis; and

(6) the transfer is in accordance with the conditions specified by the Central Government, by notification in the Official Gazette, having regard to the necessity to ensure that the transfer is for genuine business purposes.

(xiii) Demerged co-operative bank means the co-operative bank whose undertaking is transferred, pursuant to a demerger, to a resulting bank.

(xiv) Resulting co-operative bank means -

(1) one or more co-operative banks to which the undertaking of the demerged co-operative bank is transferred in a demerger; or

(2) any co-operative bank formed as a result of demerger.

Illustration 18


Solution

(i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

\[ A \times \frac{B}{C} \]

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2013, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 30.11.2013, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).
(ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

\[ A \times \frac{B}{C} \]

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2013, in this case) and ending on the last day of the financial year (i.e. 31.3.2014); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

(iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is ₹ 2,40,000 and the business re-organisation took place on 1.12.2013. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be ₹ 1,60,438 i.e., ₹ 2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be ₹ 79,562 i.e., ₹ 2,40,000 x 121/365.

6.27 Computation of business income in cases where income is partly agricultural and partly business in nature

(i) Income from the manufacture of rubber [Rule 7A]

(1) Income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting rubber plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

(ii) Income from the manufacture of coffee [Rule 7B]

(1) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax.

(2) Income derived from the sale of coffee grown cured, roasted and grounded by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as
if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(3) In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in such replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

(iii) Income from the manufacture of tea [Rule 8]

(1) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provision of section 10(31), is not includible in the total income.