

UNIT – 3: PROFITS AND GAINS OF BUSINESS OR PROFESSION

LEARNING OUTCOMES

After studying this unit, you would be able to-

- ◆ **comprehend** the meaning of “business” and “profession” and the scope of income chargeable to tax under this head;
- ◆ **comprehend** the meaning of speculative transaction and the tax treatment of loss incurred in speculation business;
- ◆ **identify** the expenditures/payments which are admissible as deduction, **comprehend** the conditions to be satisfied to avail such deductions, the limits, if any, specified in respect thereof;
- ◆ **compute** the deductions available while computing business income applying the relevant provisions under default tax regime under section 115BAC;
- ◆ **compute** the deductions available while computing business income applying the relevant provisions under normal provisions of the Act;
- ◆ **identify** the expenditures/payments which are not admissible as deduction;
- ◆ **identify** the deductions allowable only on actual payment;
- ◆ **examine** when certain receipts are deemed to be income chargeable to tax under this head;
- ◆ **identify** the assessee who is required to compulsorily maintain books of account and get them audited;
- ◆ **apply** the presumptive tax provisions under the Act to compute income from eligible business or profession;
- ◆ **compute** the business income by applying the charging and deeming provisions and allowing permissible deductions;
- ◆ **compute** the business income in cases where income is partly agricultural and partly business in nature.

Proforma for computation of income under the head "Profits and gains of business or profession" under default tax regime under section 115BAC

Particulars	Amount (₹)	Amount (₹)
Net profit as per statement of profit and loss		A
Add: Expenses debited to statement of profit and loss but not allowable		
Depreciation as per books of account	xxx	
Income-tax [disallowed u/s 40(a)(ii)]	xxx	
30% of sum payable to residents on which tax is not deducted at source or has not been remitted on or before the due date u/s 139(1), after deduction, disallowed under section 40(a)(ia) [The same is allowable in the year in which the tax is deducted and remitted]	xxx	
Any expenditure incurred, in respect of which payment is made for goods, services or facilities to a related person, to the extent the same is excessive or unreasonable, in the opinion of the A.O, having regard to its FMV [disallowed u/s 40A(2)]	xxx	
Any expenditure incurred in respect of which payment or aggregate of payments to a person exceeding ₹ 10,000 in a single day is made otherwise than by way of A/c payee cheque/bank draft/ use of ECS through bank A/c or through such other prescribed electronic mode (debit card, credit card, Net banking, RTGS, NEFT, IMPS, BHIM Aadhar Pay) [disallowed u/s 40A(3)]	xxx	
Certain sums payable by the assessee which have not been paid during the relevant P.Y. in which the liability was incurred on or before the due date for filing return u/s 139(1) in respect of that P.Y. [disallowed u/s 43B]	xxx	
Sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of MSME Development Act, 2006 [disallowed u/s 43B]	xxx	
Personal expenses [not allowable as per section 37]	xxx	

Capital expenditure [not allowable as per section 37]	xxx	
Repairs of capital nature [not allowable as per Sections 30 & 31]	xxx	
Amortization of preliminary expenditure u/s 35D/ expenditure incurred under voluntary retirement scheme u/s 35DDA [4/5th of such expenditure to be added back]	xxx	
Family planning expenses not allowable in the case of a person other than a company	xxx	
Fine or penalty paid for infringement or breach of law [However, penalty in the nature of damages for delay in completion of a contract, being compensatory in nature, is allowable]	xxx	
All expenses related to income which is not taxable under this head e.g. municipal taxes in respect of residential house property	xxx	
Any sum paid by the assessee as an employer by way of contribution to pension scheme u/s 80CCD exceeding 14% of the salary of the employee	xxx	B
(A + B)		C
Less: Expenditure allowable as deduction but not debited to statement of profit and loss		
Depreciation computed as per Rule 5 of Income-tax Rules, 1962	xxx	
30% of expenditure disallowed in an earlier P.Y. due to non-deduction of tax at source/ non-remittance before due date u/s 139(1) of that year, allowed this year on remittance (This item of adjustment is generally given under "Additional information" in the question)	xxx	
Amount disallowed in an earlier P.Y. as per section 43B, due to non-payment on or before due date u/s 139(1), allowed as deduction in this year on actual payment (This item of adjustment is generally given under "Additional information" in the question)	xxx	D
(C - D)		E

Less: Income credited in statement of profit and loss but not taxable/taxable under any other head		
• Dividend income	xxx	
• Agricultural income exempt under section 10(1)	xxx	
• Interest on securities/savings bank account/FD taxable under the head "Income from other sources"	xxx	
• Profit on sale of capital asset taxable under the head "Capital Gains"	xxx	
• Rent from house property taxable under the head "Income from house property"	xxx	
• Winnings from lotteries, horse races, games etc. taxable under the head "Income from other sources"	xxx	
• Gifts exempt or taxable under the head "Income from other sources"	xxx	
• Income-tax refund not taxable	xxx	
• Interest on income-tax refund taxable under the head "Income from other sources"	xxx	F
(E - F)		G
Add: Income chargeable under this head/Deemed Income [If the same is given as additional information and has not already been credited to Statement of Profit & Loss]		
• Salary, remuneration, interest received by a partner from the firm, to the extent the same is deductible in the hands of the firm as per section 40(b)	xxx	
• Bad debt allowed as deduction u/s 36(1)(vii) in an earlier P.Y., now recovered [deemed as income u/s 41(4)]	xxx	
• Remission or cessation of a trading liability [deemed as income u/s 41(1)]	xxx	H
Profits and gains from business or profession (G + H)		I

Proforma for computation of income under the head “Profits and gains of business or profession” under optional tax regime taking business income computed under default tax regime under section 115BAC as the starting point

Particulars	Amount (₹)	Amount (₹)
Profits and gains from business or profession as per section 115BAC		A
Less: Expenditure allowable as deduction		
Additional depreciation@20% of actual cost of new P & M acquired by an assessee engaged in the business of manufacture or production of any article or thing or generation, transmission or distribution of power (10% of actual cost, if put to use for less than 180 days in the year of acquisition) [Balance additional depreciation can be claimed in the next year i.e., P.Y.2025-26]	xxx	
Balance additional depreciation @10% of actual cost of P & M acquired and installed during the P.Y. 2023-24 and put to use for less than 180 days in that year	xxx	B
Profits and gains from business or profession as per normal provisions of the Act (A – B)		C

Note - An assessee carrying on specified business and exercising the option to shift out of the default tax regime provided under section 115BAC(1A), is eligible for deduction u/s 35AD in respect of capital expenditure (other than land, goodwill and financial instruments) incurred for such business, subject to fulfillment of specified conditions. However, if he pays tax under default tax regime under section 115BAC, he would **not** be eligible for deduction u/s 35AD.

The table in the next page depicts the allowability of deduction for expenditure incurred for in-house scientific research related to the business of the assessee and contribution to outsiders for scientific research/social science/statistical research under the default tax regime and optional tax regime.

Deduction for expenditure incurred for in-house scientific research related to business and contribution to outsiders for scientific research/social science/statistical research

Under the default tax regime u/s 115BAC		Under the optional tax regime as per the normal provisions of the Act					
Nature of Expenditure/ contribution for scientific research/social science/ statistical research	Allowability of deduction	Treatment while computing income under the head "PGBP"		Allowability of deduction	Treatment while computing income under the head "PGBP"		
		If debited to Profit & Loss A/c	If given as additional information				
		I. In house research expenditure on scientific research related to assessee's business					
35(1)(i)	Revenue expenditure	Allowable as deduction	No adjustment required, since it is already debited to profit and loss A/c	To be deducted while computing income under the head "PGBP"	Allowable as deduction	No adjustment required, since it is already debited to profit and loss A/c	To be deducted while computing income under the head "PGBP"
35(1)(iv) r.w.s. 35(2)	Any capital expenditure (other than cost of acquisition of land)						

Nature of Expenditure/ contribution for scientific research/social science/statistical research	Under the default tax regime u/s 115BAC		Under the optional tax regime as per the normal provisions of the Act				
	Allowability of deduction	Treatment while computing income under the head “PGBP”		Allowability of deduction	Treatment while computing income under the head “PGBP”		
		If debited to Profit & Loss A/c	If given as additional information				
II. Contribution to outsiders							
35(1)(ii)	Notified approved research association/university/college/other institution for scientific research	Not allowable as deduction	To be added back while computing income under the “PGBP”	No adjustment required	Allowable as deduction	No adjustment required, since it is already debited to profit and loss A/c	To be deducted while computing income under the head “PGBP”
35(1)(iia)	Approved notified Company for scientific research						
35(1)(iii)	Notified approved research association/university/college/other institution for research in social science or statistical research						
35(2AA)	Approved Laboratory/ National University/ IIT/specified person to be used for scientific research undertaken under an approved programme						



3.1 MEANING OF 'BUSINESS' AND 'PROFESSION'

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.

Business	Profession
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".	The term " profession " has not been defined in the Act. It means an occupation requiring some degree of learning. The term 'profession' includes vocation as well [Section 2(36)].



- *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.*
- *It is, however, 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 (except in case of tax audit and presumptive income provisions, where the rates and threshold limits are different for business and profession).*
- *Business necessarily means a continuous exercise of an activity with a profit motive; nevertheless, profit from a single venture in the nature of trade may also be treated as business.*

Meaning of 'Profits'

- (i) **Profits in cash or in kind:** 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.
- (ii) **Capital receipts:** Capital receipts are not generally to be taken into account while computing profits under this head.
- (iii) **Voluntary receipts:** 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) **Income from distinct businesses:** 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 businesses carried on by the assessee.
- (vi) **Computation of profits:** 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. The charge is not on the gross receipts but on the profits and gains.
- (vii) **Legality of income:** 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. Thus, income tax is not restricted in its application to lawful business only.

However, expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law would not be allowable as deduction while computing profits of such business.

3.2 METHOD OF ACCOUNTING

Under section 145(1), income chargeable under the heads "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee.

However, as per section 145B, certain income would be taxable in the following manner:

- (i) interest received by an assessee on compensation or on enhanced compensation, shall be deemed to be the income of the year in which it is received [Such income is taxable under the head "Income from other sources"]
- (ii) income referred to in section 2(24)(xviii) i.e., assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Under section 145(2), the Central Government is empowered to notify in the Official Gazette from time to time, income computation and disclosure standards (ICDSs) to be followed by any class of assessee or in respect of any class of income.

Accordingly, the Central Government has, vide Notification No. S.O.3079(E) dated 29.9.2016, notified ten ICDSs to be applicable from A.Y.2017-18.

The notified ICDSs have to be followed by all assessee (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources".

The ten notified ICDSs are:

- | | | |
|-----------|---|--|
| ICDS I | : | Accounting Policies |
| ICDS II | : | Valuation of Inventories |
| ICDS III | : | Construction Contracts |
| ICDS IV | : | Revenue Recognition |
| ICDS V | : | Tangible Fixed Assets |
| ICDS VI | : | The Effects of Changes in Foreign Exchange Rates |
| ICDS VII | : | Government Grants |
| ICDS VIII | : | Securities |
| ICDS IX | : | Borrowing Costs |
| ICDS X | : | Provisions, Contingent Liabilities and Contingent Assets |

Note: ICDSs would be dealt with in detail at Final Level.

3.3 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 from business or profession:** Income arising to any person by way of profits and gains from the business or profession carried on by him at any time during the previous year.

If an assessee is engaged in the business of letting out of residential houses, the income generated from letting out of a residential house or a part of the house by the owner shall not be chargeable under the head "Profits and gains of business or profession" and would be chargeable under the head "Income from house property".

- (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 companyat 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 in 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;
- (d) any person, by whatever name called, at or in connection with the termination or modification of the terms and conditions, of any contract relating to his business.

- (iii) **Income from specific services performed for its members by a trade, professional or business:** 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 definitely or directly be related to these services.

- (iv) **Incentives received or receivable by assessee carrying on export business:**

- (a) **Profit on sale of import entitlements:** Profits on sale of a licence granted under the Imports (Control) Order, 1955¹ made under the Imports and Exports (Control) Act, 1947².
- (b) **Cash assistance against exports under any scheme of Govt:** Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.
- (c) **Customs duty or excise re-paid or repayable as drawback:** Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971³.
- (d) **Profit on transfer of Duty Entitlement Pass Book Scheme or Duty Free Replenishment Certificate:** Any profit on the transfer of the Duty Entitlement Pass Book Scheme⁴ or Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and

¹ Now Foreign Trade (Exemption from application of Rules in certain cases) Order, 1993

² Now Foreign Trade (Development and Regulation) Act, 1992

³ Now Customs and Central Excise Duties Drawback Rules, 2017

⁴ The pre-export DEPB scheme was abolished with effect from 1 April 2000. After several extensions through the years, the post-export scheme was phased out on 30 September 2011 and thereafter DEPB items were incorporated into the Duty Drawback Schedule with effect from 1 October 2011

import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

- (v) **Value of any benefit or perquisite:** The value of any benefit or perquisite arising from business or the exercise of any profession, whether –
- convertible into money or not or
 - in cash or in kind or partly in cash and partly in kind.

Example:

If a company provides rent free residential accommodation to a lawyer in consideration of professional services rendered by him to the company, the value of such accommodation would be assessable in the hands of the said lawyer as his income under the head "Profits and gains or business or profession".

- (vi) **Sum due to, or received by, a partner of a firm:** 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.

Example:

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.

Exemption of share income of a partner [Section 10(2A)]

Section 10(2A) exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

- (vii) **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 profession; or

However, the following sums received or receivable would not be chargeable to tax under the head "profits and gains from business or profession":

- (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 or profession, 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.
- (b) for not sharing 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.
- (viii) Any sum received under a Keyman insurance policy:** Any sum received by the assessee, as an employer, under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business.
- (ix) Fair market value of inventory on its conversion/treatment as capital asset:** Fair market value of inventory on the date of its conversion or treatment as capital asset, determined in the prescribed manner, would be chargeable to tax as business income.
- (x) Sum received on account of capital asset referred under section 35AD:** Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD) being demolished, destroyed, discarded or transferred.

3.4 SPECULATION BUSINESS

Explanation 2 to section 28 specifically provides that where an assessee carries on speculation 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 speculation business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from profits and gains of business and profession from any other business.

Meaning of Speculative Transaction

“Speculative transaction” means a transaction in which a contract for the purchase or sales 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 [Section 43(5)].

Where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does **not** apply to the following companies –

- (1) A company whose gross total income consists of mainly income chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources”;
- (2) A company, the principal business of which is –
 - (i) the business of trading in shares; or
 - (ii) the business of banking; or
 - (iii) the granting of loans and advances.

Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business. [*Explanation* to section 73]

Transactions not deemed to be speculative transactions

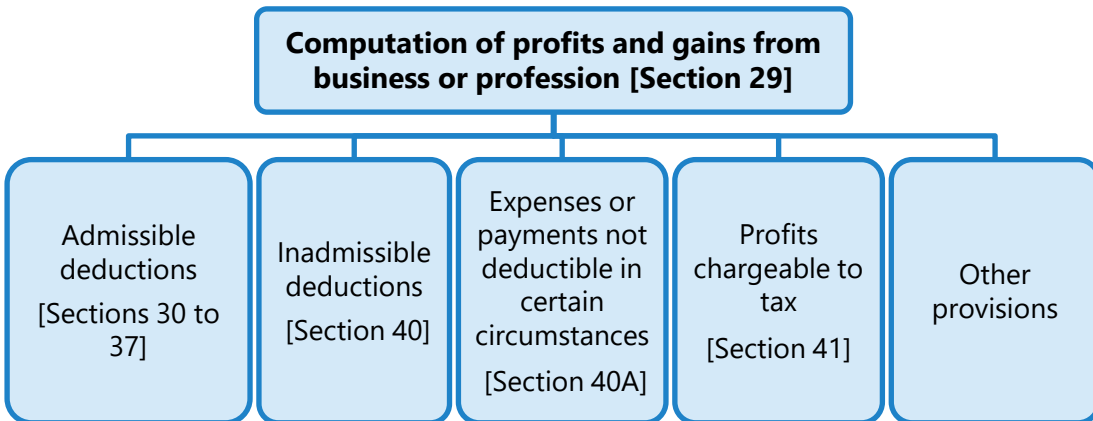
The following forms of transactions shall not be deemed to be speculative transaction:

- (i) **Hedging contract in respect of raw materials or merchandise:** 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) **Hedging contract in respect of stocks and shares:** 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) **Forward contract:** 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) **Trading in derivatives:** An eligible transaction (transaction carried out electronically through SEBI registered stockbroker or sub broker or intermediary) carried out in respect of trading in derivatives in a recognized stock exchange.
- (v) **Trading in commodity derivatives:** An eligible transaction (transaction carried out electronically through a member or intermediary registered under the bye-laws, rules and regulations of the recognized stock exchange) in respect of trading in commodity derivatives carried out in a recognised stock exchange, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013.

However, the requirement of chargeability of commodities transaction tax is **not** applicable in respect of trading in agricultural commodity derivatives.

3.5 COMPUTATION OF PROFITS AND GAINS FROM BUSINESS OR PROFESSION [SECTION 29]

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.



3.6 ADMISSIBLE DEDUCTIONS [SECTIONS 30 TO 37]

(i) Rent, rates, taxes, 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 purposes of his business or profession.

- **Where the premises are occupied by the assessee as a tenant**, the rent paid for such premises and the amount paid on account of cost of repairs, if the assessee has undertaken to bear such repairs to the premises.

- **Occupation of premises by the assessee being 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.
- **Repairs of the premises:** Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where
 - ♦ the assessee is the owner of the building or
 - ♦ 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.
- **Cost of repairs and current repairs of capital nature not to be allowed as deduction [Explanation to section 30]:** Amount paid on account of the 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, shall not include any capital nature expenditure. In other words, cost of repairs and current repairs other than of capital nature is allowed as deduction while computing business income.
- **Other expenses:** 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.
- **Premises used partly for business and partly for other purposes:** 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 [Section 38(1)].

(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.

- **Usage of the asset for business:** 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 active as well as passive use. However, insurance and repair charges of assets which are owned by the assessee but 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.

- **Repairs exclude replacement or reconstruction:** The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction.



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).

- **Insurance premium:** The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions:
 - ✓ The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.
 - ✓ The assets must be used by the assessee for the purposes of his business or profession during the accounting year.
 - ✓ 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 endure to the benefit of someone other than the owner.

- **Current repairs of capital nature not to be allowed [Explanation to section 31]:** Amount paid on account of current repairs of machinery, plant or furniture shall not include any capital nature expenditure. In other words, current repairs other than of capital nature expenditure is allowed as deduction in the computation of income under the head "profits and gains of business or profession".

(iii) Depreciation [Section 32]

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

Explanation 5 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) Conditions to be satisfied for allowance of depreciation:** 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, not being goodwill of a business or profession.
- ✓ 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 ships, books, vehicles, scientific apparatus and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.
- ✓ 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.
- ✓ The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of machinery and building includes a part of the building.
- ✓ 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 - 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%** 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 or profession 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 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, stand by equipment and fire extinguishers can be capitalized if they are ‘ready for use’.

Likewise, machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, has to be capitalised. Hence, in such cases, the term “use” embraces both active use and passive use. However, such passive use should also be for business purposes.

- (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.



In this connection, students may note that 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) Computation of Depreciation Allowance - Depreciation allowance will be calculated on the following basis:

- (i) **Power generation undertakings:** 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 IA 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) **Block of assets:** 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: A "block of assets" is defined in section 2(11), 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, not being goodwill of a business or profession, 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 or Machinery acquired:** In case of an assessee exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and paying tax as per the optional tax regime under the regular provisions of the Act, additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power at the rate of **20%** of the actual cost of such machinery or plant.

Asset put to use for less than 180 days: Additional depreciation **@10%** (i.e., 50% of additional depreciation of 20%) to be allowed, where the plant or machinery is put to use for less than 180 days during the previous year in which such asset is acquired.

Further, the balance additional depreciation@10% (i.e., remaining 50% of the additional depreciation of 20%) on new plant or machinery acquired and used for less than 180 days, which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year if the assessee exercises the option of shifting out of the default tax regime provided u/s 115BAC(1A) in the immediately succeeding previous year.

Plant and Machinery not qualifying for additional depreciation

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.

Eligibility for grant of additional depreciation under section 32(1)(iia) in the case of an assessee engaged in printing or printing and publishing [Circular No. 15/2016, dated 19-5-2016]

An assessee, engaged in the business of manufacture or production of an article or thing, is eligible to claim additional depreciation under section 32(1)(iia) in addition to the normal depreciation under section 32(1).

The CBDT has, vide this Circular, clarified that the business of printing or printing and publishing amounts to manufacture or production of an article or thing and is, therefore, eligible for additional depreciation under section 32(1)(iia).



Additional depreciation would be allowed to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). It is not allowable when the assessee pays concessional rates of tax under the default tax regime u/s 115BAC.

- (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 (other than the previous year in which it is first brought into use) the depreciation amount 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, 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.

Meaning of certain term

Term	Meaning
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.

- (4) **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 which are used mainly for residential purposes except hotels and boarding houses	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below	10%
Block 3.	Buildings acquired on or after 1 st 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	40%
Block 4.	Purely temporary erections such as wooden structures	40%
II	Furniture and Fittings	
Block 1.	Furniture and fittings including electrical fittings ["Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.]	10%
III	Plant & Machinery	
Block 1.	Motor cars other than those used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.03.2020 and put to use on or before 31.03.2020	30%
Block 2.	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 [Other than motor cars mentioned in Block 1 above]	15%

Block 3.	Motors buses, motor lorries, motor taxis used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.03.2020 and put to use on or before 31.03.2020	45%
Block 4.	Motors buses, motor lorries, motor taxis used in the business of running them on hire [Other than mentioned in Block 3 above]	30%
Block 5.	Moulds used in rubber and plastic goods factories	30%
Block 6.	Aeroplanes, Aeroengines	40%
Block 7.	Specified air pollution control equipments, water pollution control equipments, solid waste control equipment and solid waste recycling and resource recovery systems	40%
Block 8.	Plant & Machinery used in semi-conductor industry covering all Integrated Circuits (ICs) (other than mentioned in Block 7 Above)	30%
Block 9.	Life-saving medical equipment	40%
Block 10.	Machinery and plant, acquired and installed on or after the 1 st September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility	40%
Block 11.	Containers made of glass or plastic used as re-fills	40%
Block 12.	Energy Saving Devices (as specified)	40%
Block 13.	Renewable Energy Saving Devices (as specified) including the devices specified in (i) to (iii) below	40%
	(i) Electrically operated vehicles including battery powered or fuel-cell powered vehicles	40%
	(ii) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014	40%
	(iii) Any special devices including electric generators and pumps running on wind energy installed on or after 1.4.2014	40%
Block 14.	Windmills and any specially designed devices running on windmills installed on or before 31.3.2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31.3.2014	15%

Block 15.	Computers including computer software	40%
Block 16.	Books (annual publications or other than annual publications) owned by assessee carrying on a profession	40%
Block 17.	Books owned by assessee carrying on business in running lending libraries	40%
Block 18.	Plant & machinery (General rate)	15%
IV	Ships	
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by Block (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, not being goodwill of a business or profession	25%

Note: Students should refer to Income-tax Rules, 1962 for the detailed classification of assets under Rule 5(1) and the rates applicable thereto.

ILLUSTRATION 1

Mr. X, a proprietor engaged in manufacturing business, furnishes the following particulars:

	Particulars	₹
(1)	Opening balance of plant and machinery as on 1.4.2024 (i.e., WDV as on 31.3.2024 after reducing depreciation for P.Y. 2023-24)	30,00,000
(2)	New plant and machinery purchased and put to use on 8.06.2024	20,00,000
(3)	New plant and machinery acquired and put to use on 15.12.2024	8,00,000
(4)	Computer acquired and installed in the office premises on 2.1.2025	3,00,000

Compute the amount of depreciation and additional depreciation for the A.Y. 2025-26, if Mr. X has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). Assume that all the assets were purchased by way of account payee cheque.

SOLUTION**Computation of depreciation and additional depreciation for A.Y. 2025-26**

Particulars	Plant & Machinery (15%)	Computer (40%)
Normal depreciation		
@15% on ₹ 50,00,000 [See Working Notes 1 & 2]	7,50,000	-
@7.5% (50% of 15%, since put to use for less than 180 days) on ₹ 8,00,000	60,000	-
@20% (50% of 40%, since put to use for less than 180 days) on ₹ 3,00,000	-	60,000
Additional Depreciation		
@20% on ₹ 20,00,000 (new plant and machinery put to use for more than 180 days)	4,00,000	-
@10% (50% of 20%, since put to use for less than 180 days) on ₹ 8,00,000	80,000	-
Total depreciation	12,90,000	60,000

Working Notes:**(1) Computation of written down value of Plant & Machinery**

Particulars	Plant & Machinery (₹)	Computer (₹)
Opening balance as on 1.4.2024	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2024	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2024	8,00,000	-
Computer acquired and installed in the office premises	-	3,00,000
Written down value as on 31.03.2025	58,00,000	3,00,000

(2) Composition of plant and machinery included in the WDV

Particulars	Plant & Machinery (₹)	Computer (₹)
Plant and machinery put to use for 180 days or more [₹ 30,00,000 (WDV) + ₹ 20,00,000 (purchased on 8.6.2024)]	50,00,000	
Plant and machinery put to use for < 180 days	8,00,000	-
Computers put to use for < 180 days	-	3,00,000
	58,00,000	3,00,000

Notes:

- (1) Where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2024 and computer acquired and installed on 02.01.2025, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to ₹ 80,000, being 10% (i.e., 50% of 20%) of ₹ 8 lakh.

Mr. X is eligible for additional depreciation since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

- (2) As per third proviso to section 32(1)(ii), the balance additional depreciation of ₹ 80,000 being 50% of ₹ 1,60,000 (20% of ₹ 8,00,000) would be allowed as deduction in the A.Y.2026-27.
- (3) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia*, in the business of manufacture or production of any article or thing, @20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, *inter alia*, any machinery or plant installed in office premises, residential accommodation or in any guest house.

Accordingly, additional depreciation is not allowable on computer installed in the office premises.

(5) 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.

However, where an assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which 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 or use of electronic clearing system through a bank account or through such other prescribed electronic mode, exceeds ₹ 10,000, such expenditure shall not form part of actual cost of such asset [Second proviso to section 43(1)].

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

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

- (i) Asset used for business after it ceases to be used for scientific research:** 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) [Explanation 1].
- (ii) Inventory converted into capital asset and used for business or profession:** Where inventory is converted or treated as a capital asset and is used for the purpose of business or profession, the fair market value of such inventory as on the date of its conversion into capital asset determined in the prescribed manner, shall be the actual cost of such capital asset to the assessee [Explanation 1A].
- (iii) Asset is acquired by way of gift or inheritance:** Where an asset is acquired by way of gift or inheritance, its actual cost shall be the actual cost to the previous owner minus depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets [Explanation 2].

Further, any expenditure incurred by the assessee such as expenditure on freight, installation etc. of such asset would also be includible in the actual cost.

- (iv) **Second hand asset:** 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 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*].
- (v) **Re-acquisition of asset:** 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 actual cost when he first acquired the asset minus depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets; or
 - (b) the actual price for which the asset is re-acquired by himwhichever is less [*Explanation 4*].
- (vi) **Acquisition of asset previously owned by any person to whom such asset is given on lease, hire or otherwise:** 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*].

Example: 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 with the prior approval of the joint commissioner, 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.

- (vii) Building previously the property of the assessee:** 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*].

ILLUSTRATION 2

A car purchased by Dr. Soman on 10.08.2021 for ₹ 5,25,000 for personal use is brought into professional use on 1.07.2024 by him, when its market value was ₹ 2,50,000.

Compute the actual cost of the car and the amount of depreciation for the A.Y. 2025-26 assuming the rate of depreciation to be 15%.

SOLUTION

As per section 43(1), the expression "actual cost" would mean the actual cost of asset to the assessee.

The purchase price of ₹ 5,25,000 is, therefore, the actual cost of the car to Dr. Soman. Market value (i.e. ₹ 2,50,000) on the date when the asset is brought into professional use is not relevant.

Therefore, amount of depreciation on car as per section 32 for the A.Y.2025-26 would be ₹ 78,750, being ₹ 5,25,000 x 15%.

Note: *Explanation 5 to section 43(1) providing for reduction of notional depreciation from the date of acquisition of asset for personal use to determine actual cost of the asset is applicable only in case of building which is initially acquired for personal use and later brought into professional use. It is not applicable in respect of other assets.*

- (viii) Capitalization of interest paid or payable in connection with acquisition of an asset:** 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.

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, 1961. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counteracting 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*].

- (ix) Amount of duty of excise or additional duty leviable shall be reduced if credit is claimed:** 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, 1944⁵ [Explanation 9].

- (x) **Subsidy or grant or reimbursement:** 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 or grant 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].

- (xi) **Asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India:** 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].

- (xii) **Capital asset on which deduction is allowable under section 35AD:** Explanation 13 to section 43(1) provides 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.

⁵ Now Central Excise Rules, 2002

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 demutualization 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).

- (j) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP as a result of conversion of the such company into LLP (fulfilling the conditions prescribed).

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordance with the provisions of section 35AD(7B) (on account of asset, being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee **as reduced** by the amount of depreciation allowable had the asset been used for the purpose of business, calculated at the rate in force, since the date of its acquisition [Proviso to *Explanation 13* to section 43(1)].

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

- (i) **Assets acquired by the assessee during the previous year:** 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) **Assets acquired before the previous year:** 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*].

- (iii) **In case of any block of assets:** The written down value of any block of assets shall be worked out as under in accordance with section 43(6)(c):

(1) W.D.V. of the block of assets in immediately preceding previous year	xxx
(2) Less: Depreciation actually allowed in respect of that block of assets in said preceding previous year	xxx
Opening balance as on 1st April of the current P.Y.	xxx

Increased by	
(3) Actual cost of assets acquired during the previous year, not being on account of acquisition of goodwill of a business or profession	xxx
(4) Total (1) - (2) + (3)	xxx
Reduced by	
(5) Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year together with scrap value. However, such amount cannot exceed the amount in (4).	xxx
(6) In case of slump sale , actual cost of the asset (-) amount of depreciation that would have been allowable to the assessee for any assessment year as if the asset was the only asset in the block. However, such amount of reduction cannot exceed the WDV.	xxx
(7) W.D.V at the end of the year (on which depreciation is allowable) [(4) – (5) – (6)]	xxx
(8) Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (7) above)	xxx

- (iv) **Depreciation provided in the books of account deemed to be depreciation actually allowed:** 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.
- (v) **Composite Income:** *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.

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.

Example: *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). In this case, ₹ 1 lakh, being the amount of depreciation would be deemed to have been actually allowed.*

Accordingly, the WDV is required to be computed by deducting the full depreciation attributable to composite income i.e., ₹ 1 lakh.

- (vi) **Cases where the Written Down Value reduced to nil:** 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.

(7) 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.

In a case where the assessee is paying tax under default tax regime under section 115BAC and there is a depreciation allowance in respect of a block of asset from an earlier assessment year attributable to additional depreciation u/s 32(1)(iia), which has not been given full effect to prior to A.Y. 2024-25 and which is not allowed to be set-off in the A.Y.2024-25, corresponding adjustment shall be made to the WDV of such block of assets as on 1.4.2023 in the prescribed manner i.e., the WDV as on 1.4.2023 will be increased by the unabsorbed additional depreciation not allowed to be set-off.

Order of set-off

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 forms part of the current year's depreciation, it can be set off against any other head of income except "Salaries".
- 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.

ORDER OF SET-OFF



ILLUSTRATION 3

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2024-25 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2025-26. Assume that all the assets were purchased by way of account payee cheque.

Sl. No.	Description	Date of acquisition	Date when put to use	Amount ₹
1.	Computer including computer software	27 Sept., 24	1 Oct., 24	35,000
2.	Computer UPS	2 Oct., 24	8 Oct., 24	8,500
3.	Computer printer	1 Oct., 24	1 Oct., 24	12,500
4.	Books (other than annual publications are of ₹ 12,000)	1 Apr., 24	1 Apr., 24	13,000
5.	Office furniture (Acquired from a practicing C.A.)	1 Apr., 24	1 Apr., 24	3,00,000
6.	Laptop	26 Sep., 24	8 Oct., 24	43,000

SOLUTION

Computation of depreciation allowable for A.Y.2025-26

Asset	Rate	Depreciation (₹)
Block 1 Furniture [See working note below]	10%	30,000
Block 2 Plant (Computer including computer software, Computer UPS, Laptop, Printers and Books) [See working note below]	40%	34,500
Total depreciation allowable		64,500

Working Note:

Computation of depreciation

Block of Assets	₹
Block 1: Furniture – [Rate of depreciation - 10%]	
Put to use for more than 180 days [₹ 3,00,000@10%]	30,000
Block 2: Plant [Rate of depreciation- 40%]	
(a) Computer including computer software (put to use for more than 180 days) [₹ 35,000 @ 40%]	14,000
(b) Computer UPS (put to use for less than 180 days) [₹ 8,500 @20%] [See note below]	1,700
(c) Computer Printer (put to use for more than 180 days) [₹ 12,500 @40%]	5,000
(d) Laptop (put to use for less than 180 days) [₹ 43,000 @20%] [See note below]	8,600
(e) Books (being annual publications or other than annual publications) (Put to use for more than 180 days) [₹ 13,000 @40%]	5,200
	34,500

Note - 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. 2024-25 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 UPS.

ILLUSTRATION 4

Mr. Gamma, a proprietor started a business of manufacture of tyres and tubes for motor vehicles on 1.1.2024. The manufacturing unit was set up on 1.5.2024. He commenced his manufacturing operations on 1.6.2024. 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.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2025-26. Assume that all the assets were purchased by way of account payee cheque and Mr. Gamma has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

SOLUTION

**Computation of depreciation allowable for the A.Y. 2025-26
in the hands of Mr. Gamma**

Particulars	₹ in crore	
Total cost of plant and machinery	120.00	15.75
Less: Used for Scientific Research (Note 1)	15.00	
	105.00	
Normal Depreciation at 15% on ₹ 105 crore		15.75
Additional Depreciation:		
Cost of plant and machinery	120.00	17.00
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 u/s 35(1)(iv) read with section 35(2)(ia) (Note 2) 15.00	35.00	
	85.00	
Additional Depreciation at 20%		17.00
Depreciation allowable for A.Y.2025-26		32.75

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. Mr. Gamma is entitled to additional depreciation since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). As per section 32(1)(ia), 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) & (iv).

(8) *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.

(9) *Balancing Charge*

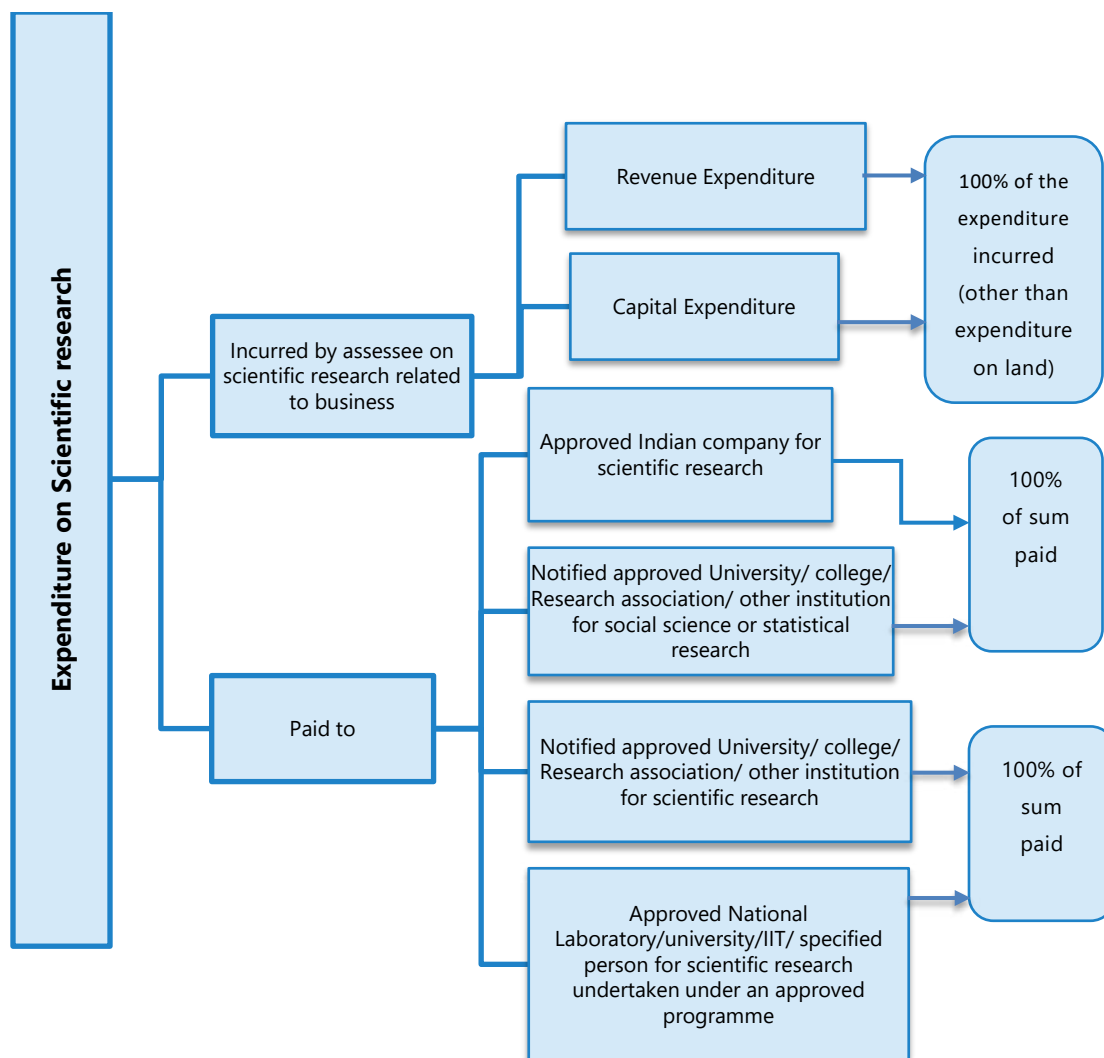
Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the monies payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e. in 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) becomes 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) *Expenditure on Scientific Research [Section 35]*

This section allows a deduction in respect of any expenditure on scientific research (activities for extension of knowledge in the fields of natural or applied science, including agriculture, animal husbandry or fisheries) incurred in relation to the business of the assessee or contribution by the assessee for scientific research or social science or statistical research. However, it does include expenditure incurred in acquisition of rights in or arising out of scientific research.

The deduction allowable under this section is depicted in the diagram below:



(I) Incurred by assessee:

- (i) **Revenue Expenditure:** Any revenue expenditure incurred by the assessee on scientific research **related to his business** would be allowed as deduction in the year in which it was incurred. 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 purchase of 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 [Section 35(1)(i)].

- (ii) **Capital Expenditure:** Any expenditure of a capital nature on scientific research related to the business carried on by the assessee would be deductible in full in the previous year in which it is incurred [Section 35(1)(iv)].

(a) Capital expenditure prior to commencement of business

The *Explanation 1* to section 35(2)(ia) 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 and 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 whether the land is acquired as such or as part of any property.

(b) Carry forward of unabsorbed capital expenditure on scientific research

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 against any head of income other than salaries [Section 35(4)].

(c) Depreciation not admissible

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.

(d) Sale of asset representing expenditure of capital nature on scientific research

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.

Where the asset representing expenditure of a capital nature on scientific research is sold without having been used for other purposes, the provisions of section 41(3) would be attracted. If the proceeds of sale together with the total amount of the deductions made under section 35(1)(iv) 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.

In simple words, since amount of deduction under section 35(1)(iv) is equal to the amount of expenditure, lower of amount of sale proceeds or deduction allowed under section 35(1)(iv) will be charged to tax as income of the business in the previous year in which the asset is sold.



Deduction under section 35(1)(i) and 35(1)(iv) read with section 35(2) would be available to an assessee under both regimes, subject to fulfillment of stipulated conditions.

(II) Amount contributed or paid to:

(i) Notified approved research association, university, college or other institution: A sum equal to any amount paid to –

- a research association which has as its object the undertaking of scientific research or
- to a university, college or other institution to be used for scientific research

provided that such university, college, institution or association is approved for this purpose and notified by the Central Government.
[Section 35(1)(ii)]



Deduction u/s 35(1)(ii) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

- (ii) **Approved Indian company for scientific research:** A sum equal to any amount paid to a company to be used by it for scientific research [Section 35(1)(iia)]

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.



Deduction u/s 35(1)(iia) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

- (iii) **Approved notified research association, university, college or other institution:** A sum equal to 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 to be used for research in a social science or statistical research

provided that they are approved for this purpose and notified by the Central Government [Section 35(1)(iii)].

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 for scientific research or research in a social science or statistical research or to a company for scientific research, 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.



Deduction u/s 35(1)(iii) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

- (iv) **Sum paid to National Laboratory, etc. [Section 35(2AA)]:** Section 35(2AA) 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 approved programmes of scientific research approved by the prescribed authority will be eligible for deduction of the amount so paid.

No other deduction under the Act: No contribution which qualifies for deduction under this clause will be entitled to deduction under any other provision of the Act.

It has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to an approved National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme 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 donee-entities or the programme has been withdrawn.

Term	Meaning
Specified person	A person who is approved by the prescribed authority



Deduction u/s 35(2AA) would be available to an assessee only if he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A).

ILLUSTRATION 5

Mr. A, furnishes the following particulars for the P.Y.2024-25. Compute the deduction allowable under section 35 for A.Y.2025-26, while computing his income under the head "Profits and gains of business or profession", if.

- (i) he is paying tax under default tax regime under section 115BAC
- (ii) he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)

	Particulars	₹
1.	Amount paid to notified approved Indian Institute of Science, Bangalore, for scientific research	1,00,000
2.	Amount paid to IIT, Delhi for an approved scientific research programme	2,50,000

3.	Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority	4,00,000
4.	Expenditure incurred on in-house scientific research and development facility as approved by the prescribed authority related to his business	
(a)	Revenue expenditure on scientific research	3,00,000
(b)	Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research	7,50,000

SOLUTION

(i) If Mr. A is paying tax under default tax regime under section 115BAC

Computation of deduction under section 35 for the A.Y.2025-26

Particulars	₹	Section	Allowability	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science, Bangalore	1,00,000	35(1)(ii)	Not allowable under default tax regime	Nil
IIT, Delhi	2,50,000	35(2AA)		Nil
X Ltd.	4,00,000	35(1)(iia)		Nil
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(1)(i)	Allowable under default tax regime	3,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(1)(iv) read with 35(2)(ia)		2,50,000
Deduction allowable under section 35				5,50,000

- (ii) If Mr. A has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A)

Computation of deduction under section 35 for the A.Y.2025-26

Particulars	₹	Section	% of deduction	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	100%	1,00,000
IIT, Delhi	2,50,000	35(2AA)	100%	2,50,000
X Ltd.	4,00,000	35(1)(ia)	100%	4,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(1)(i)	100%	3,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(1)(iv) read with 35(2)(ia)	100%	2,50,000
Deduction allowable under section 35				13,00,000

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

- (1) **List of specified businesses:** 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.

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 notified scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government.
- 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;
- setting up and operating a warehousing facility for storage of sugar;
- laying and operating a slurry pipeline for the transportation of iron ore;
- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines;
- developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility.

(2) Deduction for Capital Expenditure: 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 to the assessee opting for deduction under section 35AD.

➡ However, expenditure incurred on acquisition of any **land, goodwill or financial instrument** would **not** be eligible for deduction.

➡ Further, any expenditure in respect of which payment or aggregate of payment made to a person of an amount exceeding **₹ 10,000 in a day** otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode would not be eligible for deduction. The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [Notification No. 8/2020 dated 29.01.2020]



In case of an individual/HUF/AoP/BoI carrying on specified business, deduction u/s 35AD would be available only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A). If such assessee is paying concessional rates of tax under the default tax regime u/s 115BAC, deduction u/s 35AD would not be available.

A company would not be eligible for deduction under section 35AD, if it opts for the special provisions of section 115BAA/115BAB.

- (3) Expenditure prior to commencement of operation:** 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.

The amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

- (4) Conditions to be fulfilled:** For claiming deduction under section 35AD, the specified business should fulfill the following conditions –

(i)	it should not be set up by splitting up, or the reconstruction, of a business already in existence;
(ii)	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 such specified 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, at any time prior to the date of its installation by the assessee, used in India;
- (b) the plant or machinery was imported into India from a foreign Country; and
- (c) no deduction on account of depreciation in respect of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.

- (5) **No deduction under section 10AA or Chapter VI-A under the heading "C - Deductions in respect of certain incomes":** 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" or section 10AA 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" or section 10AA for the same or any other year and vice versa.

- (6) **No deduction allowable under the Act in respect of expenditure for which deduction allowed under this section:** 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, if the deduction has been claimed or opted by him and allowed to him under section 35AD.

(7) Date of Commencement of specified businesses:

S. No.	Specified business	Date of commencement of operations
1.	Laying and operating a cross country natural gas pipeline network for distribution, including storage facilities being an integral part of such network	on or after 1 st April, 2007
2.	(a) building and operating anywhere in India, a hotel of two-star or above category as specified by the Central Government (b) building and operating a hospital with at least 100 beds for patients (c) notified scheme for slum redevelopment or rehabilitation housing projects	on or after 1 st April, 2010
3.	(a) notified scheme for affordable housing projects and (b) production of fertilizer in a new plant or in a newly installed capacity in an existing plant	on or after 1 st April, 2011
4.	(a) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, (b) bee-keeping and production of honey and beeswax and (c) setting up and operating a warehousing facility for storage of sugar	on or after 1 st April, 2012
5.	(a) laying and operating a slurry pipeline for the transportation of iron ore or (b) setting up and operating a semi-conductor wafer fabrication manufacturing unit	on or after 1 st April, 2014
6.	developing or operating and maintaining or developing, operating and maintaining, any infrastructure facility	on or after 1 st April, 2017

7.	In any other case, namely, setting and operating- (a) "cold-chain" facilities for specified products or (b) warehousing facilities for storing agricultural produce	on or after 1 st April, 2009
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(8) Meaning of certain terms

Term	Meaning
Cold chain facility	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.
Associated person	In relation to the assessee means a person— (i) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee; (ii) who holds, directly or indirectly, shares carrying not less than 26% of the voting power in the capital of the assessee; (iii) 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 (iv) who guarantees not less than 10% of the total borrowings of the assessee.
Infrastructure facility	(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. (iv) A port, airport, inland waterway, inland port or navigational channel in the sea.

(9) Set-off or carry forward and set-off of loss from specified business:

The loss of an assessee claiming deduction u/s 35AD in respect of a specified business can be set-off against the profit of another specified business u/s 73A, irrespective of whether the latter is eligible for deduction u/s 35AD.

Example: A assessee, exercising the option of shifting out of the default tax regime provided under section 115BAC(1A), 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 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 6

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2024. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2024 to March, 2024 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2023. The cost of land included in the above figures is ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. During the P.Y. 2024-25, he 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.2025-26 and the loss to be carried forward, assuming that Mr. A is exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and has fulfilled all the conditions specified under section 35AD and wants to claim 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 for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2025-26 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively. Also, assume in respect of expenditure incurred, the payments are made by account payee cheque or use of ECS through bank account.

SOLUTION**Computation of profits and gains of business or profession for A.Y.2025-26**

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32	
10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	3
Income chargeable under "Profits and gains from business or profession"	28

Computation of income/loss from specified business under section 35AD

Particulars		Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction u/s 35AD)	16	14	30
	Less: Deduction under section 35AD			
(B)	Capital expenditure incurred prior to 1.4.2024 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2024 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y. 2024-25	20	15	35
(D)	Total capital expenditure (B + C)	50	35	85
(E)	Deduction under section 35AD			
	100% of capital expenditure (food grains/ sugar)	50	35	85
	Total deduction u/s 35AD for A.Y.2025-26	50	35	85
(F)	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)	(34)	(21)	(55)

Notes:

- (i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2025-26 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 1.4.2012 or on or after 1.4.2009, respectively.
- (ii) 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.
- (iii) 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.2024-25.
- (iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 55 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.

ILLUSTRATION 7

Mr. Suraj, a proprietor, commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2024. He incurred capital expenditure of ₹ 50 lakh during the period January, 2024 to March, 2024 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2024. Further, during the P.Y. 2024-25, he 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.2025-26, assuming that he has fulfilled all the conditions specified under section 35AD and opted for claiming deduction under section 35AD; and he has not claimed any deduction under Chapter VI-A under the heading "C – Deductions in respect of certain incomes". He has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2025-26 is ₹ 25 lakhs. Assume that he also has another

existing business of running a four-star hotel in Coimbatore, which commenced operations fifteen years back, the profits from which are ₹ 120 lakhs for the A.Y. 2025-26. Also, assume that payments for capital expenditure were made by net banking.

SOLUTION

Computation of profits and gains of business or profession for A.Y. 2025-26

Particulars	₹
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)	25 lakh
Less: Deduction under section 35AD	
Capital expenditure incurred during the P.Y.2024-25 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakh – ₹ 150 lakh	50 lakh
Capital expenditure incurred prior to 1.4.2024 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2024	50 lakh
Total deduction under section 35AD for A.Y.2025-26	100 lakh
Loss from the specified business of new hotel in Madurai	(75 lakh)
Profit from the existing business of running a hotel in Coimbatore	120 lakh
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A	45 lakh

(10) Other conditions contained under section 35AD

S. No.	Particulars	Condition
1.	Audit of accounts	The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant P.Y. 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.
2.	Asset to be used for specified business for eight years	Section 35AD(7A) provides that any asset in respect of which a deduction is claimed and allowed u/s 35AD shall be used only for the specified business for a period of eight years beginning with the previous

		year in which such asset is acquired or constructed.
3.	(i) Asset demolished, destroyed, discarded or transferred for which a deduction has been allowed	If any asset on which a deduction u/s 35AD has been claimed and allowed, is demolished, destroyed, discarded or transferred, the sum received or receivable for the same is chargeable to tax u/s 28(vii). This does not take into account a case where asset on which deduction u/s 35AD has been claimed is used for any purpose other than the specified business by way of a mode other than that specified above.
	(ii) Asset used for any other business other than specified business during 8 years	As per section 35AD(7B), if asset is used for any purpose other than the specified business during 8 years beginning with the previous year in which such asset is acquired, the total amount of deduction so claimed and allowed in any previous year(s) in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed u/s 35AD, shall be deemed to be income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used. In such a case, as per the proviso to <i>Explanation 13</i> to Section 43(1), the actual cost of such asset for the assessee shall be the actual cost as reduced by amount of depreciation would have been allowable had the asset been used for the purpose of business since the date of its acquisition.

ILLUSTRATION 8

Mr. Arnav is a proprietor having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non-specified business of operating a warehousing facility for storage of edible oil.

Unit A commenced operations on 1.4.2023 and it claimed deduction of ₹ 100 lakhs incurred on purchase of two buildings for ₹ 50 lakhs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y.2024-25. However, in February, 2025, Unit A transferred one of its buildings to Unit B.

Examine the tax implications of such transfer in the hands of Mr. Arnab.

SOLUTION

Since the capital asset, in respect of which deduction of ₹ 50 lakhs was claimed u/s 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2024-25, the deeming provision u/s 35AD(7B) is attracted during the A.Y.2025-26.

Particulars	₹
Deduction allowed u/s 35AD for A.Y.2024-25	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2024-25 [10% of ₹ 50 lakhs]	5,00,000
Deemed income under section 35AD(7B)	45,00,000

Mr. Arnab, however, by virtue of *proviso to Explanation 13 to section 43(1)*, can claim depreciation u/s 32 on the building in Unit B for A.Y.2025-26. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

Particulars	₹
Actual cost to the assessee	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2024-25 [10% of ₹ 50 lakhs]	5,00,000
Actual cost in the hands of Mr. Arnab in respect of building in its Unit B	45,00,000

(vi) Amortisation of Preliminary Expenses [Section 35D]

(1) Nature of expenditure: 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) Applicable: This section applies

- only to Indian companies and resident non-corporate assesseees;
- 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 - expenses incurred till the new unit commences production or operation.

(3) Amount eligible for deduction: 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:

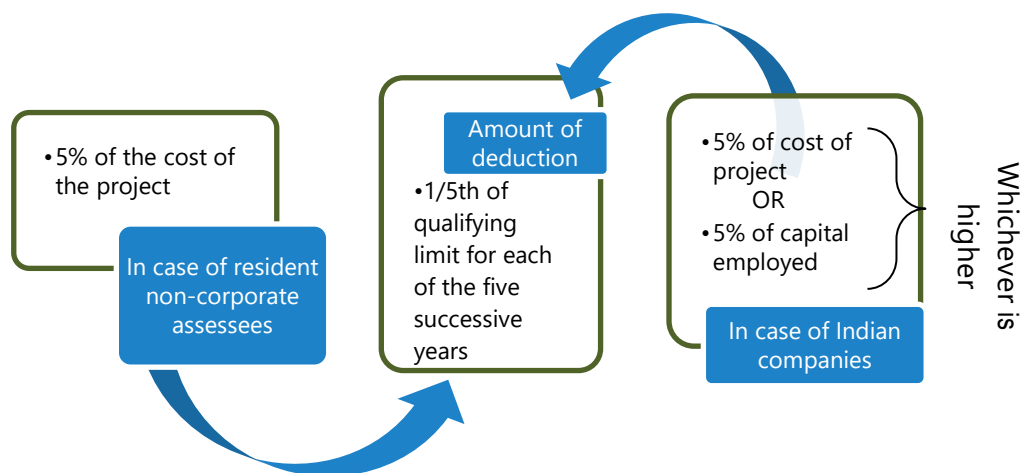
- (i) Expenditure in connection with—
 - (a) the preparation of feasibility report
 - (b) the preparation of project report;
 - (c) conducting market survey or any other survey necessary for the business of the assessee;
 - (d) engineering services relating to the assessee's business;

The assessee has to furnish a statement containing the particulars of above expenditure within prescribed period to the prescribed income-tax authority in the prescribed form and manner.

Accordingly, Rule 6ABBB prescribes that the statement containing particulars of above specified expenditure is required to be furnished one month prior to the due date for furnishing the return of income as specified under section 139(1).

- (ii) 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.
- (iii) **Where the assessee is a company,** in addition to the above, expenditure incurred –
 - (a) by way of legal charges for drafting the Memorandum and Articles of Association of the company;
 - (b) on printing the Memorandum and Articles of Association;

- (c) by way of fees for registering the company under the Companies Act; 1956⁶,
 - (d) 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
 - (iv) 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.
- (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, 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.



(6) Meaning of certain terms:

Terms	Meaning
Cost of the project	(i) 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

⁶ Now Companies Act, 2013

	books of the assessee as on the last day of the previous year in which the business of the assessee commences; (ii) Expenses incurred for 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, in so far as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.
Capital employed in the business of the company	(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 previous year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation in so far 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.

- (7) Audit of accounts:** 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 before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1); and the assessee has, by that date, furnished for the first year in 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.

Particulars	Due date of filing of return	Specified Date
Assessees (other than a company) subject to tax audit	31 st October of the relevant A.Y. For A.Y.2025-26, on or before 31 st October, 2025	30 th September of the relevant A.Y. For A.Y.2025-26, on or before 30 th September, 2025

- (8) **No other deduction under any provision of the Act:** 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.

(vii) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA]:

- (1) **Nature of expenditure:** 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) **Amount of deduction:** 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) **No deduction under any other provision of the Act:** No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(viii) 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 used for 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) 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.

(3) 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.

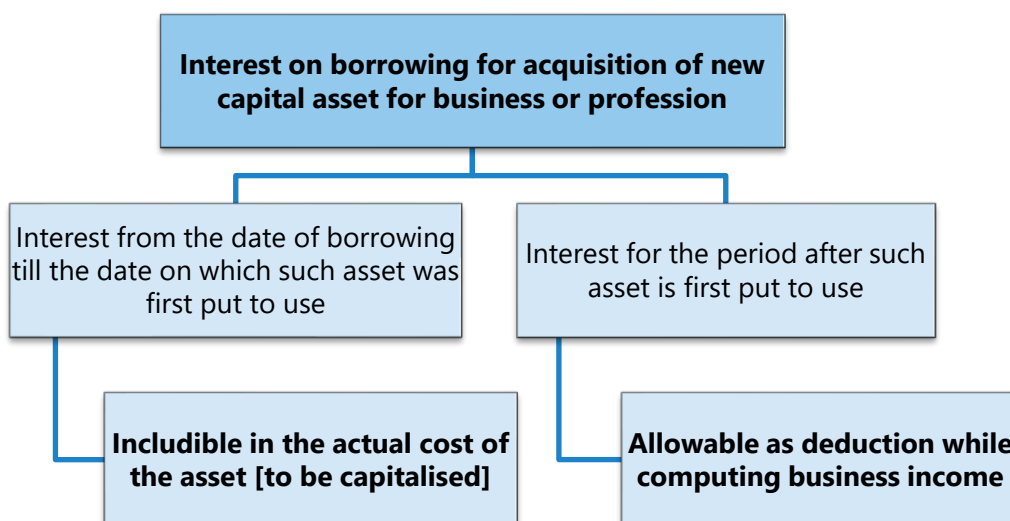
(4) Interest on borrowed capital [Section 36(1)(iii)] - Deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

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.

As per proviso to section 36(1)(iii), deduction in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset (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 shall not be allowed.

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, therefore, be capitalised.



- (5) **Discount on Zero Coupon Bonds (ZCBs) [Section 36(1)(iiia)]** - Section 36(1)(iiia) 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.

Term	Meaning
Discount	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.
Period of life of the bond	The period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

- (6) **Contributions to provident and other funds [Section 36(1)(iv) and (v)]** - Contribution to the employees' recognised provident fund/approved superannuation fund is allowable subject to the limits laid down for the purpose of recognizing the provident fund or approving superannuation fund.

Contribution to an approved gratuity fund is allowable subject to the condition that the gratuity fund should be for exclusive benefit of the employees under an irrevocable trust.

(7) 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, deduction would be restricted to **14% 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.

(8) Amount received by an assessee-employer as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date under the relevant Act, Rule etc. – Section 36(1)(va) and section 57(ia) 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.

Due date

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.

Note - It is clarified that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis on or before due date of filing of return of income for relevant assessment year, does not apply and would deemed never to be applied on employee's contribution received by employer towards any welfare fund of such

employee. In effect, the extended time upto due date of filing of return for is not available for credit of employees contribution towards any welfare fund received by the employer.

(9) 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.

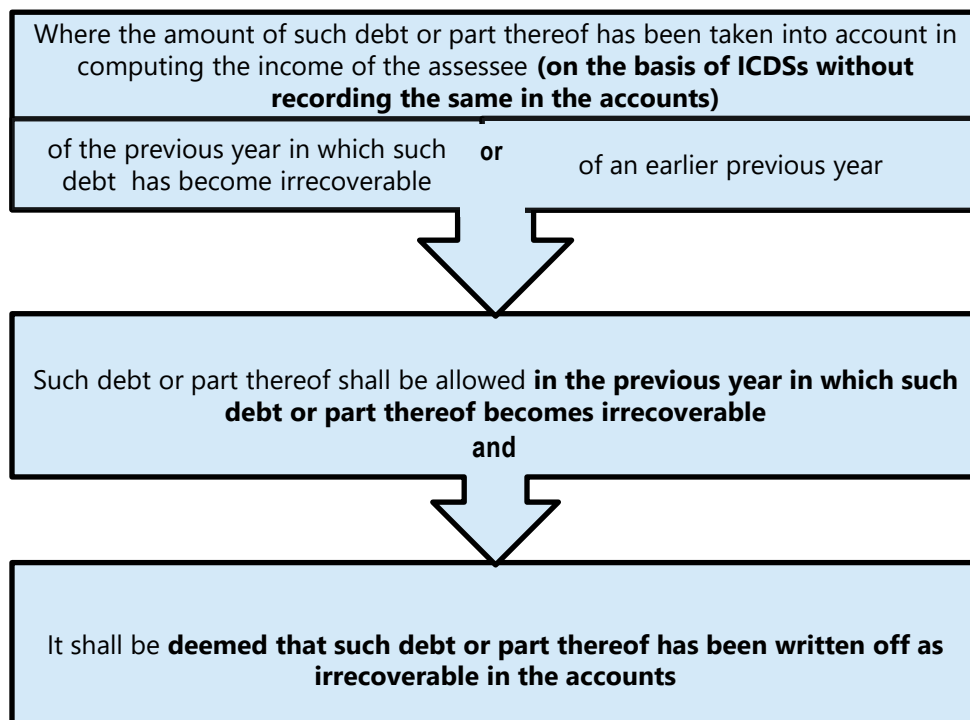
I. Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs⁷ to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable [Section 36(1)(vii)]

- (i) Under section 36(1)(vii), deduction is allowed in respect of the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year.
- (ii) Therefore, write off in the books of account is an essential condition for claim of bad debts under section 36(1)(vii).
- (iii) Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable.

If a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDSs, has become irrecoverable, it can still be claimed as bad debt under section 36(1)(vii) since **it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the second proviso to section 36(1)(vii)**. This is because some ICDSs

⁷ Income Computation Disclosure Standards (ICDSs) will be discussed at Final level.

require recognition of income at an earlier point of time (prior to the point of time such income is recognised in the books of account). Consequently, if the whole or part of such income recognised at an earlier point of time for tax purposes becomes irrecoverable, it can be claimed as bad debts on account of the second proviso to section 36(1)(vii).



II. **Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery**

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.

(10) Expenses on family planning by a company [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 assessees.
- 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.



*An individual carrying on business or profession will **not** be allowed deduction of expenses incurred on promoting family planning amongst its employees.*

(11) 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.

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

- (a) Section 36(1)(xvi) provides 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".
- (b) A 'taxable commodities transaction' means a transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities, traded in recognised stock exchange.
- (c) **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.

(ix) 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. 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**.
- (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) Expenditure incurred on Keyman insurance policy: *CBDT Circular no. 762/1998 dated 18.02.1998* clarifies that the premium paid on the Keyman Insurance Policy is allowable as business expenditure.

The Punjab and Haryana High Court held that, "the Keyman Insurance Policy when obtained to secure the life of a partner to safeguard the firm against a disruption of the business is equally for the benefit of the partnership

business which may be effected as a result of premature death of a partner. Thus, the premium on the Keyman Insurance Policy of partner of the firm is wholly and exclusively for the purpose of business and is allowable as business expenditure”.

The CBDT accepted the view of the High Court, accordingly, vide *Circular no. 38/2016* has clarified that, in case of a firm, premium paid by the firm on the Keyman Insurance Policy of a partner, to safeguard the firm against a disruption of the business, is an admissible expenditure under section 37.

- (4) **Explanation 1 to section 37(1)** - This *Explanation* provides that any expenditure incurred by the assessee for any purpose which is an offence or which is prohibited by law shall not be allowed as a deduction or allowance.
- (5) **Explanation 3 to section 37(1)** – It is clarified that the expression “expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law” in (4) above would include and would be deemed to have always included the expenditure incurred by an assessee, -
- (i) for any purpose which is an offence under any law for the time being in force, in India or outside India or which is prohibited by any law for the time being in force, in India or outside India; or
 - (ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guidelines, as the case may be, for the time being in force, governing the conduct of such person; or
 - (iii) to compound an offence under any law for the time being in force, in India or outside India; or
 - (iv) *to settle proceedings initiated in relation to contravention under such law as may be notified by the Central Government in this behalf.*

For eg: expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry are in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations. Hence, such expenditure is considered to be expenses prohibited by the law and not allowed in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies.

(6) Disallowance of CSR expenditure [Explanation 2 to Section 37(1)]

- (i) Section 135 of the Companies Act, 2013 read with Schedule VII thereto and Companies (Corporate Social Responsibility) Rules, 2014 are the special provisions under the company law regime imposing mandatory CSR obligations in respect of companies having net worth/turnover/net profit exceeding specified threshold limits. Such companies have to spend a specified percentage of their average net profits on CSR activities.
- (ii) Under section 37(1), only expenditure, not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. The issue under consideration is whether CSR expenditure is allowable as deduction under section 37.
- (iii) It has been clarified that for the purposes of section 37(1), any expenditure incurred by an assessee on the activities relating to CSR referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37.
- (iv) The rationale behind the disallowance is that CSR expenditure, being an application of income, is **not** incurred wholly and exclusively for the purposes of carrying on business.
- (v) However, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.

(7) 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.



3.7 INADMISSIBLE DEDUCTIONS [SECTION 40]

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

In the case of any assessee, the following expenses are not deductible:

(1) Section 40(a)(i)

Any interest, 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 non-corporate or to a foreign company,

on which tax is deductible at source under Chapter XVIIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date of filing of return specified under section 139(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 after the due date of filing of return under section 139(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such 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,

it would be deemed that the assessee has deducted and paid the tax on such sum on the date on which return of income has been furnished by the payee.

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

(2) Section 40(a)(ia)

Section 40(a)(ia) provides that **30% of any sum payable to a resident**, on which tax is deductible at source under Chapter XVII-B, 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).

If in respect of such sum, tax has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such 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,

it would be deemed that the assessee has deducted and paid the tax on such sum.

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 payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, 30% of such 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. However, 30% of such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

Example: Tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2024-25, the same has to be paid by 31st July/ 31st October, 2025, as the case may be. Otherwise, 30% of royalty paid would be disallowed in computing the income for A.Y.2025-26. If in respect of such royalty, tax deducted during the P.Y.2024-25 has been paid after 31st July/31st October, 2025, 30% of such royalty, disallowed in A.Y.2025-26, would be allowed as deduction in the year of payment, i.e., A.Y.2026-27.

Note - Students are advised to read Chapter 7 on "Advance tax, tax deduction at source and tax collection at source" before solving this illustration.

ILLUSTRATION 9

Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2025 without deduction of tax at source. What would be the consequence of non-deduction of tax at source by Delta Ltd. on these amounts during the financial year 2024-25, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd.?

	Particulars	Amount in ₹
(1)	Salary to its employee, Mr. X (credited and paid in March, 2025)	12,00,000
(2)	Directors' remuneration (credited in March, 2025 and paid in April, 2025)	28,000

Would your answer change if Delta Ltd. has deducted tax on directors' remuneration in April, 2025 at the time of payment and remitted the same in July, 2025?

SOLUTION

Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B would attract disallowance u/s 40(a)(ia).

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible u/s 192 or any sum credited or paid by way of directors' remuneration on which tax is deductible u/s 194J, would attract disallowance@30% u/s 40(a)(ia). Whereas in case of salary, tax has to be deducted u/s 192 at the time of payment, in case of directors' remuneration, tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in both the cases i.e., salary and directors' remuneration, tax is deductible in the P.Y.2024-25, since salary was paid in that year and directors' remuneration was credited in that year. Therefore, the amount to be disallowed u/s 40(a)(ia) while computing business income for A.Y.2025-26 is as follows –

Particulars		Amount paid in ₹	Disallowance u/s 40(a)(ia) @30%
(1)	Salary [tax is deductible under section 192]	12,00,000	3,60,000
(2)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
Disallowance under section 40(a)(ia)			3,68,400

If the tax is deducted on directors' remuneration in the next year i.e., P.Y.2025-26 at the time of payment and remitted to the Government, the amount of ₹ 8,400 would be allowed as deduction while computing the business income of A.Y. 2026-27.

Disallowance of any sum paid to a resident at any time during the previous year without deduction of tax under section 40(a)(ia) [Circular No.10/2013, dated 16.12.2013]

There have been conflicting interpretations by judicial authorities regarding the applicability of provisions of section 40(a)(ia), with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'. Some court rulings have held that the provisions of disallowance under section 40(a)(ia) apply only to the amount which remained

payable at the end of the relevant financial year and would not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source.

Departmental View: The CBDT's view is that the provisions of section 40(a)(ia) would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia), the term "payable" would include "amounts which are paid during the previous year".

ILLUSTRATION 10

During the financial year 2024-25, the following payments/expenditure were made/incurred by Mr. Raja, a resident individual (whose turnover during the year ended 31.3.2024 was ₹ 99 lakhs):

- (i) *Interest of ₹ 45,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;*
- (ii) *₹ 10,00,000 was paid as salary to a resident individual without deduction of tax at source;*
- (iii) *Commission of ₹ 16,000 was paid to Mr. Vidyasagar, a resident, on 2.7.2024 without deduction of tax at source.*

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) assuming that the payees in all the cases mentioned above, have not paid the tax, if any, which was required to be deducted by Mr. Raja?

SOLUTION

Disallowance under section 40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

- (i) The obligation to deduct tax at source from interest paid to a resident arises u/s 194A in the case of an individual, whose total turnover in the immediately preceding P.Y., i.e., P.Y.2023-24 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 1 crore, he is not liable to deduct tax at source. Hence, disallowance u/s 40(a)(ia) is not attracted in this case.

- (ii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee-employer even if the turnover amount does not exceed ₹ 1 crore in the immediately preceding previous year.

Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed.

- (iii) The obligation to deduct tax at source under section 194H from commission paid in excess of ₹ 15,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2023-24 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 1 crore, he is not liable to deduct tax at source u/s 194H. Mr. Raja is not required to deduct tax at source u/s 194M also since the aggregate of such commission to Mr. Vidyasagar does not exceed ₹ 50 lakh during the P.Y. 2024-25. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

(3) Section 40(a)(ii)

Any sum paid on account of any rate or tax levied on profits on the basis of or in proportion to the profits and gains of any business or profession.

It is clarified that the term "tax" would include and would be deemed to have always included any surcharge or cess on such tax. Hence, tax including surcharge and cess would be disallowed while computing business income [*Explanation 3* to section 40(a)(ii)].

(4) Section 40(a)(iii)

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.

(5) Section 40(a)(iv)

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'.

(6) Section 40(a)(v)

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 non-monetary 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.

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 business income

Section 40(b)

- (1) Remuneration to non-working partner** - 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) Remuneration to a working partner not authorized by deed** - 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) Remuneration to a working partner or interest to a partner authorized by deed but relates to an earlier period** - 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 section 40(b)(iii), 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.

Example: If a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, 2024 but effective from April 1, 2024, the firm would get deduction for the remuneration paid to its working partners from July 1, 2024 onwards, but not for the period from April 1 to June 30. 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) **Interest to any partner in excess of 12% p.a.-** 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) **Remuneration to a working partner in excess of prescribed limits -** Any remuneration paid to a working partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

Book Profit	Quantum of deduction
On the first ₹ 6 lakh of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is higher
On the balance of book profit	60% of book profit

- (6) **Meaning of certain terms:**

Term	Meaning
Book Profit	The net profit as shown in the profit and loss account for the relevant previous year computed in accordance with the provisions for computing income from profits and gains [Explanation 3 to section 40(b)]. 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.
Working partner	An individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner [Explanation 4 to section 40(b)]

ILLUSTRATION 11

A firm has paid ₹ 8,50,000 as remuneration to its partners for the P.Y.2024-25, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakhs. What is the remuneration allowable as deduction?

SOLUTION

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

Particulars	₹
On first ₹ 6 lakh of book profit [$₹ 6,00,000 \times 90\%$]	5,40,000
On balance ₹ 4 lakh of book profit [$₹ 4,00,000 \times 60\%$]	2,40,000
	7,80,000

The excess amount of ₹ 70,000 (i.e., ₹ 8,50,000 – ₹ 7,80,000) would be disallowed as per section 40(b)(v).

(7) Explanations to section 40(b)

- (1) 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 1* to section 40(b)]
- (2) 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 2* to section 40(b)].

Note - Presently, there is no provision for deduction of tax at source on payment of salary, remuneration, interest, bonus, or commission to partners by the partnership firm. W.e.f. 1.4.2025, a new section 194T has been introduced by the Finance (No. 2) Act, 2024 which requires partnership firms to deduct tax at source (TDS) @10% on any sum paid to partners, such as salary, remuneration, commission, bonus, or

interest. No deduction is required if the sum or aggregate of such sum does not exceed ₹ 20,000 during the financial year. Please note that the TDS provision under section 194T would be effective from 1.4.2025.

ILLUSTRATION 12

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 17,00,000 before deduction of the following items:

- (1) *Salary of ₹ 40,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).*
- (2) *Depreciation on plant and machinery under section 32 (computed) ₹ 1,50,000.*
- (3) *Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest is ₹ 5,00,000.*

Compute:

- (i) *Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.*
- (ii) *Allowable working partner salary for the A.Y. 2025-26 as per section 40(b).*

SOLUTION

- (i) As per *Explanation 3* to section 40(b), "book profit" shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

Computation of Book Profit of the firm under section 40(b)

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		17,00,000
Less: Depreciation under section 32	1,50,000	
Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (₹ 5,00,000 × 12%)	60,000	2,10,000
Book Profit		14,90,000

- (ii) Salary actually paid to working partners = ₹ 40,000 × 2 × 12 = ₹ 9,60,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits -

On the first ₹ 6,00,000 of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2025-26 in this case would be:

Particulars	₹
On the first ₹ 6,00,000 of book profit [(₹ 3,00,000 or 90% of ₹ 6,00,000) whichever is more]	5,40,000
On the balance of book profit [60% of (₹ 14,90,000 - ₹ 6,00,000)]	5,34,000
Maximum allowable partners' salary	10,74,000

Hence, allowable working partners' salary for the A.Y.2025-26 as per the provisions of section 40(b)(v) is ₹ 9,60,000.



3.8 EXPENSES OR PAYMENT NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES [SECTION 40A]

(i) Payments to relatives and associates

Section 40A(2) provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a specified person [See column (2) of Table below] 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:

- the fair market value of the goods, service or facilities for which the payment is made; or
- the legitimate needs of the business or profession carried on by the assessee; or
- the benefit derived by or accruing to the assessee from such a payment.

Assessee	Specified Person	
(1)	(2)	
Individual	- Any relative of the individual assessee - Any person who carries on a business or profession, if - the individual assessee has a substantial interest in the business of that person or - any relative of the individual assessee has a substantial interest in the business of that person	
Company, Firm, HUF or AOP	- Any director of the company, partner of the firm or member of the family or association or any relative of such director, partner or member or - In case of a company assessee, any individual who has substantial interest in the business or profession of the company or any relative of such individual or - Any person who carries on a business or profession, in which the Company/ Firm/ HUF/ AOP or director of the company, partner of the firm or member of the family or association or any relative of such director, partner or member has substantial interest in the business of that person.	
All assessees	The following are specified persons:	
	Person who has substantial interest in the assessee's business	Other related persons of such person, who has a substantial interest in the assessee's business
	Company/ AOP/ Firm/ HUF	- Any director of such company, partner of such firm or the member of such family or association or - any relative of such director, partner or member or - Any other company carrying on business or profession in which the first mentioned company has a substantial interest

	a director, partner or member	• Company/ Firm/ AOP/ HUF of which he is a director, partner or member or • Any other director/ partner/ member of the such Company/Firm/ AOP/ HUF or • Any relative of such director, partner or member
<i>Relative, in relation to an "individual", means the spouse, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].</i>		
Substantial interest in a business or profession		
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% of the profits of such business or profession.		

(ii) Payments in excess of ₹ 10,000 made otherwise than through prescribed modes

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 or use of electronic system through bank account or through such other prescribed electronic modes exceeds ₹ 10,000, such expenditure shall not be allowed as a deduction.**

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income.

Example: If, in respect of an expenditure of ₹ 32,000 incurred by X Ltd., 4 cash payments of ₹ 8,000 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 ₹ 32,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr. Y exceeds ₹ 10,000.

Payments in excess of ₹ 10,000 made otherwise than through prescribed modes deemed to be the income of the subsequent year, if expenditure has been allowed as deduction in any previous year on due basis:

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 or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay, 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 ₹ 10,000 [Section 40A(3A)].

Increased limit of ₹ 35,000 applicable, where payment is made to transport operator: The limit would be ₹ 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages, otherwise than through prescribed modes. 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 or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay. In all other cases, the limit would continue to be ₹ 10,000.

Cases where disallowances would not be attracted:

- (i) **Loan transactions:** 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 ₹ 10,000 at a time are

required to be made by account payee cheques or drafts or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay as interest is a deductible expenditure.

- (ii) **Payment made by commission agents:** 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 or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay apply equally to payments made for goods purchased on credit.

Cases and circumstances in which a payment or aggregate of payments exceeding ten thousand rupees may be made to a person in a day, otherwise than by an account payee cheque/ account payee bank draft/ use of ECS through a bank account or through such other electronic modes prescribed in Rule 6ABBA [Rule 6DD]:

As per this rule, no disallowance under section 40A(3) shall be made and no payment shall be deemed to be the profits and gains of business or profession under section 40A(3A) 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 or use of electronic clearing system through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and

BHIM (Bharat Interface for Money) Aadhar Pay, exceeds ₹ 10,000 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;
- (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;

Notes -

- (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 ₹ 50,000;
- (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 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;
- (k) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travelers cheques in the normal course of his business.

Note: Where any payment in respect of any expenditure is required to be made by an account payee cheque/account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes in order that such expenditure may not be disallowed as a deduction under section 40A(3), then the payment may be made by such cheque or draft or electronic clearing system or through such other prescribed electronic modes.

No person is allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

This is notwithstanding anything contained in any other law for the time being in force or in any contract.

(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 as per 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.

Further, where any provision for gratuity for any reason has been allowed as a deduction to the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way to gratuity to employee shall not be allowed as deduction to the assessee in the year in which it is paid.

(iv) Contributions by employers to funds, trust etc. [Section 40A(9)]

This sub-section has 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.

ILLUSTRATION 13

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 u/s 36(1)(iva) and disallowance u/s 40A(9)**

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	4,00,000
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	14,00,000
Actual contribution (20% of basic salary i.e., 20% of ₹ 10 lakh)	2,00,000
Less: Permissible deduction under section 36(1)(iva) (14% of basic salary plus dearness pay = 14% of ₹ 14,00,000 = ₹ 1,96,000)	1,96,000
Excess contribution disallowed under section 40A(9)	4,000



3.9 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) Remission or cessation of trading liability [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 or 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, Sale of capital asset used for scientific research, Recovery of a bad debt subsequently etc. [Section 41(2),(3) & (4)]

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) Brought forward losses of defunct business [Section 41(5)]

In cases where a receipt is deemed to be profit of a business under section 41 relating to a business that had ceased to exist and there is an unabsorbed loss, not being a speculation loss, which arose in that business during the previous year in which it had ceased to exist and which has not been set off, it would be set off against income that is chargeable under this section even after the expiry of 8 years.



3.10 CHANGES IN THE RATE OF EXCHANGE OF CURRENCY [SECTION 43A]

- (1) 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, towards the whole or part of the cost of the asset or towards repayment of the whole or a part of the money borrowed by him from any person, directly or indirectly, in any foreign currency specifically for the purpose of acquiring the asset along with the interest, if any, 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 incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)
 - (iv) 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.

- (2) 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.
- (3) Where the assessee has entered into a contract with 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.



3.11 CERTAIN DEDUCTIONS TO BE MADE ONLY ON ACTUAL PAYMENT [SECTION 43B]

The following sums are allowed as deduction only in that previous year in which such sum is actually paid i.e., on actual payment basis.

- (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, or
- (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, or
- (c) **Bonus or Commission** for services rendered payable to employees, or
- (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**, or
- (da) Any sum payable by the assessee as **interest on any loan or borrowing from notified class of non-banking financial companies**, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or
- (e) **Interest on any loan or advance from a scheduled bank or co-operative bank** other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or
- (f) Any sum paid by the assessee as an **employer in lieu of earned leave of his employee**, or
- (g) Any sum payable by the assessee **to the Indian Railways for use of Railway assets**.

For the purpose of claiming deduction of **the sums referred to above in clauses (a) to (g)** in the relevant previous year in which the expenditure is incurred, the above sums have to 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.

Example: An assessee may collect GST from customers during the month of March, 2025. However, in respect of such collections he may have to discharge the liability only within say 20th April, 2025 under the GST 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.

Conversion of interest into a loan or borrowing or debenture or any other instrument

Explanation 3C, 3CA & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d), (e) and (f) above, is converted into a loan or borrowing or advance or debenture or any other instrument by which the liability to pay is deferred to a future date, 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 or debenture or any other instrument by which the liability to pay is deferred to a future date 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 allowed in the previous year in which the converted interest is actually paid.

ILLUSTRATION 14

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 (APSFC) and Indian Bank and has not paid interest as detailed hereunder:

	₹
(i) Andhra Pradesh State Financial Corporation (P.Y. 2023-24 & 2024-25)	15,00,000
(ii) Indian Bank (P.Y. 2024-25)	30,00,000
	45,00,000

Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2024-25, converted the above interest payable by Hari to them as a loan

repayable in 60 equal installments. During the year ended 31.3.2025, Hari paid 5 installments to APSFC 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. Examine 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, *inter alia*, 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 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.2025-26 shall be calculated as follows:

	Interest outstanding	Number of Instalments	Amount per instalment	Instalments paid	Interest allowable (₹)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					2,75,000

Clarification on non-applicability of section 43B on employee's Contribution to welfare funds [Explanation 5 to section 43B]

As per section 2(24)(x), any sum received by an assessee, being an employer from his employee as contribution to any provident fund or superannuation fund or

any fund set up under Employee's State Insurance Act, 1948 or any other fund for the welfare of employees would be considered as the income of an employer.

The deduction in respect of above sum will be allowed to the assessee under section 36(1)(va) only if such sum is credited by the assessee to the employee's account in the relevant fund on or before the due date, being the date specified under the relevant Act, Rule, order or notification issued thereunder.

As per section 43B, 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, would be allowable during any P.Y. if the same has been paid on or before the 'due date' applicable in his case for furnishing the return of income under section 139(1) in respect of that P.Y.

Explanation 5 clarifies that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis (i.e., payment on or before the due date of filing of return of income for relevant assessment year), does not apply and would be deemed never to be applied to employee's contribution received by employer towards any welfare fund. In effect, clause (b) of section 43B covers only employer's contribution to provident fund, superannuation fund, gratuity fund or any other fund for welfare of employees, for remittance of which extended time limit upto due date of filing return u/s 139(1) is available; however, it does not include within its scope, employees' contribution to such funds received by the employer, which has to be credited to the employee's account in the relevant fund on or before the due date specified under the relevant Act, Rule etc. Amount credited after the said due date but on or before the due date under section 139(1) would not be eligible for deduction.

Section 43B [Clause (h)]

Any sum payable by the assessee to a micro or small enterprise beyond the time-limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 would be allowed as deduction only in that previous year in which such sum is actually paid.

Section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises by the buyer on or before the date agreed upon between them in writing i.e., as per the written agreement, which cannot be more than 45 days from the day of acceptance or the day of deemed acceptance of any goods or

services by a buyer from a supplier. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.

If the sum payable by the assessee to a micro or small enterprise is paid as per written agreement (maximum within 45 days) or within 15 days in case of no agreement, the deduction can be claimed on accrual basis if mercantile method of accounting is followed by the assessee.

However, if the sum payable by the assessee to a micro or small enterprise is not paid as per written agreement or within 15 days in case of no agreement, the deduction would be allowed in the previous year in which it is actually paid.

Example: Mr. A has purchased goods of ₹ 10,000 from A & Co., a micro enterprise on 1.3.2025. As per the written agreement between them, the payment has to be made by 5.4.2025. Mr. A follows mercantile method of accounting.

(i) If Mr. A paid the sum on 2.4.2025

Since Mr. A paid the sum on or before 5.4.2025, the deduction would be allowed in P.Y. 2024-25.

(ii) If Mr. A paid the sum on 20.4.2025

Since Mr. A paid the sum beyond the time limit, the deduction would be allowed in the year of actual payment i.e., P.Y. 2025-26.

Meaning of Micro and Small enterprise

S. No.	Meaning		
Manufacturing enterprises and enterprises rendering services			
(1)	Micro Enterprise		
	Investment in Plant and Machinery or Equipment ≤ ₹ 1 crore	AND	Turnover ≤ ₹ 5 crore
(2)	Small Enterprise		
	Investment in Plant and Machinery or Equipment ≤ ₹ 10 crore	AND	Turnover ≤ ₹ 50 crore



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.



3.12 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 [SECTION 43CA]

- (i) Section 43CA has been inserted as an anti-avoidance measure 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".

However, if the stamp duty value does not exceed **110%** of the consideration received or accruing, then, such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset.

- (ii) 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 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 way of an account payee cheque/account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

- (iii) The Assessing Officer may refer the valuation of the asset to a valuation officer 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.
- (iv) 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**' 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.

Date of transfer of land/ building held as stock-in-trade	Actual consideration	Stamp duty value on the date of agreement	Stamp duty value (SDV) on the date of registration	Full value of consideration	Remark
	₹ in lakhs				
Example:					
1/9/2024	100 (₹ 10 lakhs received by A/c payee cheque on 1/7/2024)	120 (1/7/2024)	130 (1/9/2024)	120	As part of the consideration is received by A/c payee cheque on the date of agreement, Stamp duty value (SDV) on the date of agreement to be adopted as full value of consideration.

					since the SDV exceeds 110% of consideration i.e., ₹ 110 lakhs.
Example:					
1/9/2024	100 (₹ 10 lakhs received by cash on 1/7/2024)	109 (1/7/2024)	130 (1/9/2024)	130	SDV on the date of registration to be adopted as full value of consideration and such SDV exceeds 110% of consideration i.e., ₹ 110 lakhs. Since part of consideration is received by cash on the date of agreement, the SDV on the date of agreement cannot be considered <i>vis-à-vis</i> actual consideration.
Example:					
31/1/2025	100 (₹ 10 lakhs received by A/c payee cheque on 1/7/2024)	109 (1/7/2024)	130 (31/1/2025)	100	Actual sales consideration would be the full value of consideration, since SDV on the date of agreement does not

					exceed 110% of actual consideration. SDV on the date of agreement can be considered <i>vis-à-vis</i> actual consideration, since part of the consideration has been received by account payee cheque on the date of agreement.
Example:					
31/3/2025	100 (Full amount received in cash on the date of registration)	120 (1/5/2024)	130 (31/3/2025)	130	SDV of the date of registration would be the full value of consideration since the SDV exceeds 110% of consideration i.e., ₹ 110 lakhs.



3.13 COMPULSORY MAINTENANCE OF ACCOUNTS [SECTION 44AA]

- (1) **Maintenance of books of account and other documents by notified professions [section 44AA(1)]:** 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 CBDT 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, 1961.

Notified professions: The professions notified so far are as the profession of authorised representative; the profession of film artist (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.

Prescribed books of accounts & other documents: The CBDT 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**.

Rules pertaining to maintenance of books of accounts & other documents:

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 44AA(1).

Prescribed class of persons: 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 Rule 6F(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**.



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.

Prescribed books of accounts and other documents [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.

Place at which books to be kept and maintained: 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.

Period for which the books of account and other documents are required to be kept and maintained by notified professions: 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.

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.

ILLUSTRATION 15

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

Particulars	₹
Financial year 2021-22	1,15,000
Financial year 2022-23	1,80,000
Financial year 2023-24	2,10,000

What is his obligation regarding maintenance of books of accounts for Assessment Year 2025-26 under section 44AA of Income-tax Act, 1961?

SOLUTION

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

As per Rule 6F, a person carrying on a notified profession shall be required to maintain specified books of accounts:

- (i) if his gross receipts in all the three years immediately preceding the relevant previous year has exceeded ₹ 1,50,000; or
- (ii) if it is a new profession which is setup in the relevant previous year, it is likely to exceed ₹ 1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded ₹ 1,50,000 in financial year 2021-22, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him.

Mr. Vinod, however, required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

(2) Maintenance of books of account and other documents by persons carrying on business or profession [other than notified professions referred to in section 44AA(1)] [Section 44AA(2)]

- I. **In case of Individual or HUF:** An Individual or HUF carrying on any business or profession (other than notified professions specified in section

44AA(1)) must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:

- (i) **Existing business or profession:** In cases where the **income** from the existing business or profession **exceeds ₹ 2,50,000 or the total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 25,00,000 in any one of three years immediately preceding** the accounting year; or
 - (ii) **Newly set up business or profession:** 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 ₹ 2,50,000** or his **total sales, turnover or gross receipts**, as the case may be, in the business or profession **are likely to exceed ₹ 25,00,000** during the previous year.
- II. **Person (other than individual or HUF):** Every person (other than individual or HUF) carrying on any business or profession [other than the notified professions referred to in section 44AA(1)] must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:
- (i) **Existing business or profession:** 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
 - (ii) **Newly set up business or profession:** 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;

- III. Showing lower income as compared to income computed on presumptive basis under section 44AE (or section 44BB or section 44BBB)⁸:** Where profits and gains from the business are calculated on a presumptive basis under section 44AE (or section 44BB or section 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.
- IV. Where the provisions of section 44AD(4) are applicable in his case and his income exceeds the basic exemption limit in any previous year:** In cases, where an assessee not eligible to claim the benefit of the provisions of section 44AD(1) for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of 44AD(1) and his income exceeds the basic exemption limit during the previous year.

(2) Penalty for failure to maintain books of account [Section 271A]

If a person fails to keep and maintain any such books of account and other documents as required by section 44AA in respect of any previous year or to retain such books of account and other documents for the specified period, penalty of ₹ 25,000 would be leviable under section 271A.

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

- (i) Requirement of Tax Audit:** It is obligatory for the persons mentioned in column (2) of the table below, carrying on business or profession, to get his accounts audited before the "specified date" by a Chartered Accountant, if the conditions mentioned in the corresponding row of column (3) are satisfied

	Persons	When tax audit is required?
(1)	(2)	(3)
I	In case of a person carrying on business	
(a)	In case of a person carrying on business	If his total sales, turnover or gross receipts in business > ₹ 1 crore in the relevant PY

⁸Section 44BB, 44BBB will be discussed at Final level.

		Note – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44AD(1).
	If in case of such person carrying on business - (i) Aggregate cash receipts in the relevant PY $\leq$ 5% of total receipts (incl. receipts for sales, turnover, gross receipts); and (ii) Aggregate cash payments in the relevant PY $\leq$ 5% of total payments (incl. amount incurred for expenditure)	If his total sales, turnover or gross receipts in business > ₹ 10 crore in the relevant PY
	Note – For this purpose, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.	
(b)	In case of an assessee covered u/s 44AE i.e., an assessee engaged in the business of plying, hiring or leasing goods carriages who owns not more than 10 goods carriages at any time during the P.Y.	If such assessee claims that the profits and gains from business in the relevant P.Y. are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e., ₹ 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and ₹ 7,500 for each vehicle, other than heavy goods vehicle, for every month or part of the month for which the vehicle is owned by the assessee].
(c)	In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts $\leq$ ₹ 200 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2023-24)	If he declares profit for any of the five successive PYs (say, P.Y.2024-25) not in accordance with section 44AD (i.e., he declares profits lower than 8% or 6% of total turnover, sales or gross receipts, as the case may be, in that year), then, he

	In case of an eligible assessee carrying on business, whose aggregate cash receipts in the relevant PY $\leq$ 5% of total turnover or gross receipts and whose total turnover, sales, gross receipts $\leq$ ₹ 300 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2023-24)	cannot opt for section 44AD for five successive PYs after the year of such default (i.e., from P.Y.2025-26 to P.Y.2029-30). For the year of default (i.e., P.Y.2024-25) and five successive previous years (i.e., P.Y.2025-26 to P.Y.2029-30), he has to maintain books of account u/s 44AA and get them audited u/s 44AB, if his income exceeds the basic exemption limit.
II	In case of persons carrying on profession	
(a)	In case of a person carrying on profession	If his gross receipts in profession > ₹ 50 lakh in the relevant PY. Note – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44ADA(1).
(b)	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts $\leq$ ₹ 50 lakhs	If such resident assessee claims that the profits and gains from such profession in the relevant PY are lower than the profits and gains computed on a presumptive basis u/s 44ADA (50% of gross receipts) and his income exceeds the basic exemption limit in that PY.
	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY $\leq$ 5% of total gross receipts and whose gross receipts $\leq$ ₹ 75 lakhs	

- (ii) **Audit Report:** The persons 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) **Accounts audited under other statutes are considered:** 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, 2013. The provision only requires that companies should get their accounts audited under the Companies Act, 2013 before the specified date and in addition to the report required to be given by the auditor under the Companies Act, 2013 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.

- (iv) **Specified date:** The expression “**specified date**” in relation to the accounts of the previous year or years relevant to any assessment year means the date one month prior to the due date for furnishing the return of income under section 139(1).

The due date for filing return of income in case of assessee (other than companies) who are required to get their accounts audited is 31st October of the relevant assessment year. **Hence, the specified date for tax audit would be 30th September of the relevant assessment year⁹.**

- (v) **Penalty for failure to get books of account audited:** If any person fails to get his accounts audited in respect of any previous year or furnish the audit report by the specified date, penalty of lower of (a) and (b) mentioned below would be leviable on such person –

⁹ Except where the assessee has to file transfer pricing report u/s 92E, for whom the due date u/s 139(1) is 30th November of the A.Y.; and hence, the specified date would be 31st October, in such cases. This is, however, not applicable for Intermediate level.

- (a) $\frac{1}{2}\%$ of total sales, turnover or gross receipts, as the case may be, in business or of the gross receipts in profession, in such previous year; or
- (b) ₹ 1,50,000 [Section 271B].



3.15 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS [SECTIONS 44AD/44ADA/44AE]

	Particulars	Section 44AD	Section 44ADA	Section 44AE
(1)	Eligible Assessee	Resident individual, HUF or Partnership firm (but not LLP) engaged in eligible business and who has not claimed deduction under section 10AA or Chapter VIA under "C – Deductions in respect of certain incomes" Non-applicability of section 44AD in respect of the following persons: - A person carrying on profession specified u/s 44AA(1); - A person earning income in the nature of commission or brokerage; - A person carrying on any agency business.	Resident individual or Partnership firm (but not LLP) engaged in any profession specified u/s 44A(1), namely, legal, medical, engineering, architectural profession or profession of accountancy or technical consultancy or interior decoration or notified profession (authorized representative, film artist, company secretary, profession of information technology)	An assessee owning not more than 10 goods carriages at any time during the P.Y.

(2)	Eligible business/ profession	Any business, other than business referred to in section 44AE, whose total turnover/gross receipts in the P.Y. $\leq$ ₹ 200 lakhs in the relevant P.Y.	Any profession specified u/s 44AA(1), whose gross receipts $\leq$ ₹ 50 lakhs in the relevant P.Y.	Business of plying, hiring or leasing goods carriages
		Any business, other than business referred to in section 44AE, whose total turnover/gross receipts in the P.Y. $\leq$ ₹ 300 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY $\leq$ 5% of total turnover or gross receipts.	Any profession specified u/s 44AA(1), whose gross receipts $\leq$ ₹ 75 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY $\leq$ 5% of total gross receipts.	
		In effect, if the turnover of business is $> ₹ 200 \text{ lakhs} \leq ₹ 300 \text{ lakhs}$, the benefit of section 44AD can be availed only if aggregate cash receipts in relevant P.Y. $\leq$ 5% of total turnover or gross receipts.	In effect, if the gross receipts from profession is $> ₹ 50 \text{ lakhs} \leq ₹ 75 \text{ lakhs}$, the benefit of section 44ADA can be availed only if aggregate cash receipts in relevant P.Y. $\leq$ 5% of total gross receipts.	
		Note: For this purpose, the receipt of amount or aggregate of amounts by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the receipt in cash.		

(3)	Presumptive income	8% of total turnover/sales/gross receipts or a sum higher than the aforesaid sum claimed to have been earned by the assessee. 6% of total turnover/gross receipts in respect of the amount of total turnover/sales/gross receipts received by A/c payee cheque/ bank draft/ ECS through a bank account or through such other prescribed electronic modes (credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay) during the P.Y. or before due date of filing of return u/s 139(1) in respect of that P.Y. (or) such higher sum claimed to have been earned by the assessee.	50% of gross receipts of such profession or a sum higher than the aforesaid sum claimed to have been earned by the assessee.	For each heavy goods vehicle ₹ 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month; For each vehicle, other than heavy goods vehicle: ₹ 7,500 per month or part of a month during which such vehicle is owned by the assessee or an amount claimed to have been actually earned from such vehicle, whichever is higher.
(4)	Non-allowability of deductions while computing presumptive income	Deductions allowable under sections 30 to 38 shall be deemed to have been given full effect to and no further deduction shall be allowed		
		Even in case of a firm, salary and interest paid to partners is not deductible.	Even in case of a firm, salary and interest paid to partners is not deductible.	In case of a firm, salary and interest paid to partners is deductible

				subject to the conditions and limits specified in section 40(b)
(5)	Written down value of asset	WDV of any asset of an eligible business/profession shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed depreciation for each of the relevant assessment years		
(6)	Requirement of maintenance of books of account u/s 44AA and audit u/s 44AB	If eligible assessee declares profits and gains in accordance with the provisions of section 44AD, he is not required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if after declaring profits on presumptive basis u/s 44AD, say, for A.Y.2025-26, non-declaration of profits on presumptive basis for any of the 5 successive A.Y.s thereafter (i.e., from A.Y.2026-27 to A.Y.2030-31), say, for A.Y. 2027-28, would disentitle the assessee from claiming profits on presumptive basis for five successive AYs subsequent to the AY relevant to the PY of such non-declaration	If eligible assessee declares profits and gains in accordance with the provisions of section 44ADA, he is not required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account and other documents u/s 44AA(1) and get his accounts audited u/s 44AB, if his total income > basic exemption limit for that year.	If eligible assessee declares profits and gains in accordance with the provisions of section 44AE, he is not required to maintain books of account u/s 44AA or get them audited u/s 44AB. However, if the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account u/s 44AA(2) and get his accounts audited u/s 44AB.

		(i.e., from A.Y.2028-29 to A.Y.2032-33). In such a case, the assessee would have to maintain books of account and other documents u/s 44AA(2) and get his accounts audited u/s 44AB, if his total income exceeds the basic exemption limit in those years.		
(7)	Advance tax obligation	The eligible assessee opting for section 44AD is required to pay advance tax by 15th March of the financial year (F.Y.).	The eligible assessee opting for section 44ADA is required to pay advance tax by 15th March of the F.Y.	The eligible assessee has to pay advance tax in four installments [See Chapter 7 in Module 3 for details].

Meaning of certain terms for the purpose of section 44AE:

S. No	Term	Meaning
(1)	Heavy goods vehicle	any goods carriage, the gross vehicle weight of which exceeds 12,000 kilograms.
(2)	Gross vehicle weight	total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.
(3)	Unladen weight	the weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding the weight of driver or attendant and where alternative parts or bodies are used the unladen weight of the vehicle means the weight of the vehicle with the heaviest such alternative body or part

Example:

Let us consider the following particulars relating to a resident individual, Mr. A, being an eligible assessee carrying on retail trade business whose total turnover do not exceed ₹ 2 crore in any of the previous year relevant to A.Y.2025-26 to A.Y.2027-28-

Particulars	A.Y.2025-26	A.Y.2026-27	A.Y.2027-28
Total turnover (₹)	1,80,00,000	1,90,00,000	2,00,00,000
Amount received through prescribed electronic modes on or before 31 st October of the A.Y.	1,60,00,000	1,45,00,000	1,80,00,000
Income offered for taxation (₹)	11,20,000	12,30,000	10,00,000
% of gross receipts	6% on ₹ 1.60 crore and 8% on ₹ 20 lakhs	6% on ₹ 1.45 crore and 8% on ₹ 45 lakhs	5% on ₹ 2 crore
Offered income as per presumptive taxation scheme u/s 44AD	Yes	Yes	No

In the above case, Mr. A, an eligible assessee, opts for presumptive taxation under section 44AD for A.Y.2025-26 and A.Y.2026-27 and offers income of ₹ 11.20 lakh and ₹ 12.30 lakh on gross receipts of ₹ 1.80 crore and ₹ 1.90 crore, respectively.

However, for A.Y.2027-28, he offers income of only ₹ 10 lakh on turnover of ₹ 2 crore, which amounts to 5% of his gross receipts. He maintains books of account under section 44AA and gets the same audited under section 44AB. Since he has not offered income in accordance with the provisions of section 44AD(1) for five consecutive assessment years, after A.Y. 2025-26, he will not be eligible to claim the benefit of section 44AD for next five assessment years succeeding A.Y.2027-28 i.e., from A.Y.2028-29 to 2032-33.

ILLUSTRATION 16

Mr. Praveen engaged in retail trade, reports a turnover of ₹ 2,98,50,000 for the financial year 2024-25. Amount received in cash during the P.Y. 2024-25 is ₹ 14,00,000 and balance through prescribed electronic modes on or before 31st July 2025. His income from the said business as per books of account is ₹ 15,00,000 computed as per the provisions of Chapter IV-D "Profits and gains from business or Profession" of the Income-tax Act, 1961. Retail trade is the only source of income

for Mr. Praveen. A.Y. 2024-25 was the first year for which he declared his business income in accordance with the provisions of presumptive taxation u/s 44AD.

- (i) Is Mr. Praveen also eligible for presumptive determination of his income chargeable to tax for the assessment year 2025-26?*
- (ii) If so, determine his income from retail trade as per the applicable presumptive provision.*
- (iii) In case Mr. Praveen wants to declare profits as per books of account from retail trade, what are his obligations under the Income-tax Act, 1961?*
- (iii) What is the due date for filing his return of income under both the options?*

SOLUTION

- (i) Yes. Since his cash receipts during the P.Y. does not 5% of the total turnover $(14,00,000/2,98,50,000 \times 100)$ and his total turnover for the F.Y.2024-25 is below ₹ 300 lakhs, he is eligible for presumptive taxation scheme under section 44AD in respect of his retail trade business.
- (ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be ₹ 18,19,000 (₹ 1,12,000, being 8% of ₹ 14,00,000 + ₹ 17,07,000, being 6% of ₹ 2,84,50,000).
- (iii) Mr. Praveen had declared profit for the previous year 2023-24 in accordance with the presumptive provisions and if he wants to declare profits as per books of account which is lower than the presumptive income for any of the five consecutive assessment years i.e., A.Y. 2025-26 to A.Y. 2029-30, he would not be eligible to claim the benefit of presumptive taxation for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance the presumptive provisions i.e. if he declares profits lower than the presumptive income in say P.Y. 2024-25 relevant to A.Y.2025-26, then he would not be eligible to claim the benefit of presumptive taxation for A.Y. 2026-27 to A.Y. 2030-31.

Consequently, Mr. Praveen is required to maintain the books of accounts and get them audited under section 44AB, since his income exceeds the basic exemption limit.

- (iv) In case he declares presumptive income under section 44AD, the due date would be 31st July, 2025.

In case he declares profits as per books of account which is lower than the presumptive income, he is required to get his books of account audited, in

which case the due date for filing of return of income would be 31st October, 2025.

ILLUSTRATION 17

Mr. X commenced the business of operating goods vehicles on 1.4.2024. He purchased the following vehicles during the P.Y.2024-25. Compute his income under section 44AE for A.Y.2025-26.

	Gross Vehicle Weight (in kilograms)	Number	Date of purchase
(1)	7,000	2	10.04.2024
(2)	6,500	1	15.03.2025
(3)	10,000	3	16.07.2024
(4)	11,000	1	02.01.2025
(5)	15,000	2	29.08.2024
(6)	15,000	1	23.02.2025

Would your answer change if the goods vehicles purchased in April, 2024 were put to use only in July, 2024?

SOLUTION

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2024-25, he is eligible to opt for presumptive taxation scheme under section 44AE. ₹ 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

(1)	(2)	(3)	(4)
Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	No. of months × No. of vehicles [(1) × (3)]
For Heavy goods vehicle			
2	29.08.2024	8	16
1	23.02.2025	2	2
			18

For goods vehicle other than heavy goods vehicle			
2	10.4.2024	12	24
1	15.3.2025	1	1
3	16.7.2024	9	27
1	02.1.2025	3	3
			55

The presumptive income of Mr. X under section 44AE for A.Y.2025-26 would be -
 ₹ 6,82,500, i.e., $55 \times ₹ 7,500$, being for other than heavy goods vehicle + $18 \times ₹ 1,000 \times 15$ ton being for heavy goods vehicle.

The answer would remain the same even if the two vehicles purchased in April, 2024 were put to use only in July, 2024, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.



3.16 COMPUTATION OF BUSINESS INCOME IN CASES WHERE INCOME IS PARTLY AGRICULTURAL AND PARTLY BUSINESS IN NATURE

Taxability in case of composite income

Rule	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
7A	Income from sale of rubber products derived from rubber plants grown by the seller in India	35%	65%
7B	Income from sale of coffee		
	- grown and cured by the seller in India	25%	75%
	- grown, cured, roasted and grounded by the seller in India	40%	60%
8	Income from sale of tea grown and manufactured by the seller in India	40%	60%

Notes –

- (1) In computing income from sale of tea/sale of rubber/sale of coffee, an allowance shall be made in respect of the cost of planting bushes/rubber plants/coffee plants in replacement of bushes/plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned. 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(30) or 10(31), respectively, is not includible in the total income.
- (2) Section 10(30) provides exemption of subsidy received by an assessee carrying on the business of growing and manufacturing tea in India from or through the Tea Board for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea, subject to fulfillment of specified conditions.
- (3) Section 10(31) provides exemption of subsidy received by an assessee carrying on the business of growing and manufacturing rubber, coffee, cardamom or other notified commodity in India from or through concerned Board for replantation or replacement of rubber plants, coffee plants, cardamom plants or plants for the growing of other notified commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or other notified commodity, subject to fulfillment of specified conditions.

ILLUSTRATION 18

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2025:

S. No.	Particulars	₹
(i)	<i>Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.</i>	3,00,000
(ii)	<i>Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.</i>	1,00,000
(iii)	<i>Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.</i>	2,50,000
(iv)	<i>Income from sale of tea grown and manufactured in Shimla.</i>	4,00,000
(v)	<i>Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.</i>	80,000

You are required to compute the business income and agricultural income of Miss Vivitha for the A.Y. 2025-26.

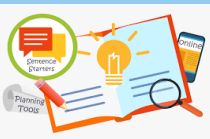
SOLUTION

**Computation of business income and agricultural income of
Ms. Vivitha for the A.Y.2025-26**

Sr. No.	Source of income	Gross (₹)	Business income		Agricultural income
			%	₹	₹
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	1,95,000
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	75,000
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. (See Note 1 below)	2,50,000	100%	2,50,000	-
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	2,40,000
(v)	Saplings and seedlings grown in nursery in India (See Note 2 below)	80,000		Nil	80,000
	Total			5,40,000	5,90,000

Notes:

- Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri Lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.
- Explanation 3* to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land. Therefore, such income would be exempt u/s 10(1).



LET US RECAPITULATE

Method of Accounting [Section 145]

Income chargeable under this head shall be computed in accordance with the method of accounting, either cash or mercantile basis, regularly and consistently employed by the assessee.

Income chargeable under this head [Section 28]

- (i) The profits and gains of any business or profession carried on by the assessee at any time during the previous year. However, any income from letting out of a residential house or a part of the house by the owner shall not be chargeable under the head "Profits and gains of business or profession" and would be chargeable under the head "Income from house property".
- (ii) Any compensation or other payment due to or received by a person, at or in connection with -
 - (a) Termination of his management or modification of the terms and conditions relating thereto, in case the person is managing the whole or substantially the whole of the affairs of an Indian company.
 - (b) Termination of his office or modification of the terms and conditions relating thereto, in case the person is managing the whole or substantially the whole of the affairs in India of any other company.
 - (c) Termination of agency or modification of the terms and conditions relating thereto, in case the person is holding an agency in India for any part of the activities relating to the business of any other person.
 - (d) Vesting in the Government or in any corporation owned and controlled by the Government, under any law for the time being in force, of the management of any property or business.
 - (e) Termination or the modification of the terms and conditions, of any contract relating to his business
- (iii) Income derived by a trade, professional or similar association from specific services performed for its members.
- (iv) In the case of an assessee carrying on export business, the following incentives –
 - (a) Profit on sale of import entitlements;

- (b) Cash assistance against exports under any scheme of GoI;
- (c) Customs duty or excise re-paid or repayable as drawback;
- (d) Profit on transfer of Duty Free Replenishment Certificate.
- (v) The value of any benefit or perquisite arising from business or the exercise of profession, whether
 - (a) convertible into money or not; or
 - (b) in cash or in kind or partly in cash and partly in kind.
- (vi) Any interest, salary, bonus, commission or remuneration due to, or received by, a partner of a firm from such firm (to the extent allowed as deduction in the hands of the firm).
However, the partner's share in the total income of the firm or LLP is exempt from tax [Section 10(2A)].
- (vii) Any sum, received or receivable, in cash or kind under an agreement for –
 - (a) not carrying out any activity in relation to any business or profession; or
 - (b) not sharing any know-how, patent, copyright, trademark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services.
- (viii) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.
- (ix) Fair market value of inventory as on date on which it is converted into or treated as a capital asset.
- (x) Any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, in respect of which the whole of the expenditure had been allowed as deduction under section 35AD.

Computation of income under the head "Profits and gains of business or profession"

As per section 29, the income referred to in section 28 has to be computed in accordance with the provisions contained in sections 30 to 43D.

Admissible Deductions	
Section	Deduction
30	Amount paid on account of rent, rates, taxes, repairs (not including expenditure in the nature of capital expenditure) and insurance for buildings used for the purpose of business or profession. In case the premises are occupied by the assessee as a tenant, the amount of repairs would be allowed as deduction only if he has undertaken to bear the cost of repairs to the premises.
31	Amount paid on account for current repairs and insurance of machinery, plant and furniture used for the purpose of business or profession.
32	Depreciation Depreciation is mandatorily allowable as deduction. Conditions for claiming depreciation - Asset must be used for the purpose of business or profession at any time during the previous year. Note: If the asset is acquired during the previous year and is put to use for less than 180 days during that previous year then, only 50% of the depreciation calculated at the rates prescribed will be allowed. - The asset should be owned (wholly or partly) by the assessee. - The depreciation shall be allowed on the written down value of block of assets at the prescribed rates (except in the case of assets of power generating units, in respect of which depreciation has to be calculated as a percentage of actual cost). As per section 2(11), block of assets means a group of assets falling within a class of assets comprising: - tangible assets, being buildings, machinery, plant or furniture, - intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession; in respect of which, the same rate of depreciation is prescribed.

Written Down Value of Assets (W.D.V.) [Section 43(6)]	
(1) W.D.V. of the block of assets in immediately preceding previous year	xxx
(2) <i>Less:</i> Depreciation actually allowed in respect of that block of assets in said preceding previous year	xxx
Opening balance as on 1st April of the current P.Y.	xxx
Increased by -	
(3) Actual cost of assets acquired during the previous year, not being on account of acquisition of goodwill of a business or profession	xxx
(4) Total (1) - (2) + (3)	xxx
Reduced by -	
(5) Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year together with scrap value. However, such amount cannot exceed the amount in (4).	xxx
(6) In case of slump sale , actual cost of the asset (-) amount of depreciation that would have been allowable to the assessee for any assessment year as if the asset was the only asset in the block. However, such amount of reduction cannot exceed the WDV.	xxx
(7) W.D.V at the end of the year (on which depreciation is allowable) [(4) – (5) – (6)]	xxx
(8) Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (7) above)	xxx
Note – If the actual cost includes cost of asset put to use for less than 180 days in the relevant P.Y. of acquisition, then, depreciation on such cost would be 50% of the prescribed rate.	
32(1)(iia)	In case of an assessee exercising the option of shifting out of the default tax regime provided under section 115BAC(1A), additional depreciation at the rate of 20% of actual cost of plant or machinery acquired and installed by an assessee

	engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power, shall be allowed. If plant and machinery is acquired and put to use for the purpose of business or profession for less than 180 days during the previous year in which it is acquired, additional depreciation will get restricted to 10% of actual cost (i.e., 50% of 20%). The balance additional depreciation@10% of actual cost will be allowed in the immediately succeeding previous year if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A) in the immediately succeeding previous year. However, additional depreciation will not be allowed on the following plant or machinery: • Ships, aircraft, road transport vehicles, office appliances; • Machinery previously used by any other person; • Machinery installed in any office premises, residential accommodation, or guest house; • Machinery in respect of which, the whole of the actual cost is fully allowed as deduction (whether by way of depreciation or otherwise) of any one previous year.
35	Expenditure on Scientific Research <u>Expenditure incurred by assessee [Allowable both under the default tax regime u/s 115BAC and the optional tax regime i.e., normal provisions of the Act]</u> • Any revenue and capital expenditure (other than cost of acquisition of land) on scientific research for in-house research related to its business is allowable as deduction [Section 35(1)(i) & Section 35(1)(iv) read with section 35(2)]. • Deduction is also allowed in respect of payment of salary or purchase of material inputs for such scientific research during 3 years immediately preceding the year of commencement of business. Such expenditure is deemed to have been incurred in the year of commencement of business and is, hence, allowed as deduction in that year [Section 35(1)(i)]. • Capital expenditure incurred during 3 years immediately preceding the year of commencement of the business is also

deemed to have been incurred in the year in which the business commences, and is hence, allowed as deduction in that year **[Section 35(1)(iv) read with section 35(2)]**.

Unabsorbed capital expenditure on scientific research can be carried forward indefinitely for set-off against any income of the assessee other than Salaries.

Contributions to Outsiders [Allowable only if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)]

In case of an assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A) and paying tax as per the optional tax regime under the normal provisions of the Act, contributions made by any assessee to certain specified/ approved institutions shall be entitled to deduction of 100% of contribution made to:

Section	Association/University/Company/College/IIT
35(1)(ii)	Notified approved research association/university/ college/ other institution for scientific research
35(1)(iia)	Approved notified Company for scientific research
35(1)(iii)	Notified approved research association/university/ college/ other institution for research in social science or statistical research
35(2AA)	Approved National Laboratory/ University/ IIT/ specified person to be used for scientific research undertaken under an approved programme

Note – Contribution to outsiders for scientific/ social science/ statistical research is not allowable under the default tax regime u/s 115BAC.

35AD

This section provides for **investment-linked tax deduction** in respect of the following specified businesses commencing operations on or after the dates specified thereto, **if the assessee exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)** -

- setting-up and operating 'cold chain' facilities for specified products (commencing operations on or after 1.4.2009);
- setting-up and operating warehousing facilities for storing agricultural produce (commencing operations on or after 1.4.2009);

- 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 (commencing operations on or after 1.4.2007);
- building and operating a hotel of two-star or above category, anywhere in India (commencing operations on or after 1.4.2010);
- building and operating a hospital, anywhere in India, with at least 100 beds for patients (commencing operations on or after 1.4.2010);
- developing and building a housing project under a notified scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government (commencing operations on or after 1.4.2010);
- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government (commencing operations on or after 1.4.2011);
- production of fertilizer in India (commencing operations on or after 1.4.2011);
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (commencing operations on or after 1.4.2012);
- bee-keeping and production of honey and beeswax (commencing operations on or after 1.4.2012);
- setting up and operating a warehousing facility for storage of sugar (commencing operations on or after 1.4.2012);
- laying and operating a slurry pipeline for transportation of iron-ore (commencing operations on or after 1.4.2014);
- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines (commencing operations on or after 1.4.2014).
- developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility (commencing operations on or after 1.4.2017)

Quantum of deduction - 100% of the capital expenditure (other than expenditure on acquisition of any land, goodwill or financial instrument) incurred during the previous year,

wholly and exclusively for the above specified businesses would be allowed as deduction from the business income of an assessee, if he has opted for the provisions of section 35AD.

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, provided the amount incurred prior to commencement has been **capitalized in the books of account of the assessee on the date of commencement of its operations**.

Payment exceeding ₹ 10,000 to be made through prescribed electronic modes to qualify for deduction u/s 35AD - Any

expenditure in respect of which payment or aggregate of payment made to a person of an amount exceeding ₹ 10,000 in a day otherwise than by account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes would **not** be eligible for deduction.

Non-eligibility for deduction u/s 10AA or Chapter VI-A - An assessee availing investment-linked tax deduction u/s 35AD in respect of any specified business in any assessment year, is not eligible for claiming profit-linked deduction under Chapter VI-A or section 10AA for the same or any other A.Y. in respect of such specified business if the assessee has claimed or opted for section 35AD and deduction thereunder has been allowed to him.

Asset to be used only for specified business for 8 years - Any asset in respect of which a deduction is claimed and allowed under section 35AD shall be **used only for the specified business**, for a period of **8 years** beginning with the previous year in which such asset is acquired or constructed. If such asset is used for any purpose other than the specified business, **the total amount of deduction so claimed and allowed u/s 35AD** in any previous year in respect of such asset, **as reduced by the depreciation** allowable under section 32 as if no deduction had been allowed under section 35AD, shall be **deemed to be the business income of the assessee** of the previous year in which the asset is so used.

Note – *This deduction is not allowable under the default tax regime u/s 115BAC.*

35D	Preliminary expenditure incurred by Indian companies and other resident non-corporate assesseees shall be allowed as deduction over a period of 5 years beginning with the previous year in which business commences or in which extension of the undertaking is completed or the new unit commences operation or production. Examples of Preliminary expenses – expenses on preparation of project report, feasibility report, market survey, engineering services, legal charges for drafting agreement. In case of a Company, preliminary expenses would include, in addition to the above, legal charges for drafting MOA, AOA, printing of MOA and AOA, fee for registration of Co., expenditure in connection with issue of shares or debentures of Co. (i.e. underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus) Qualifying amount - Maximum aggregate amount of the qualifying expenses that can be amortized is 5% of the cost of project (i.e., actual cost of fixed assets in the books of account on the last day of the P.Y.). In case of an Indian company, 5% of the cost of project or at its option, 5% of the capital employed by the company (aggregate of issued share capital, debentures, long-term borrowings as on the last day of the P.Y.), whichever is higher.
35DDA	One-fifth of the expenditure incurred by an assessee-employer in any previous year in the form of payment to any employee in connection with his voluntary retirement in accordance with a scheme of voluntary retirement, shall be allowed as deduction in that previous year and the balance in four equal installments in the immediately four succeeding previous years.
36(1)(iii)	Interest paid in respect of capital borrowed for the purposes of business or profession. However, any interest paid for acquisition of an asset (whether capitalized 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, shall not be allowed as deduction. Such amount of interest would be added to the actual cost of asset.

36(1)(iv)	Any sum paid by the assessee as an employer by way of contribution towards a recognized provident fund or approved superannuation fund.
36(1)(iva)	Any sum paid by the assessee as an employer by way of contribution towards a pension scheme referred to in section 80CCD, to the extent of 14% of salary of any employee. Salary includes dearness allowance, if the terms of employment so provide. Correspondingly, section 40A(9) disallows the sum paid in excess of 14% of the salary of any employee.
36(1)(v)	Any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust.
36(1)(va)	Amount received by assessee-employer as contribution from his employees towards their welfare fund to be allowed as deduction only if such amount is credited by the assessee to the employee's account in the relevant fund on or before due date under the relevant Act/Rule/order/notification . Amount credited after the said due date but on or before the due date under section 139(1) would not be eligible for deduction.
36(1)(vii)	Any bad debts written off as irrecoverable in the accounts of the assessee for the previous year, provided the debt has been taken into account in computing the income of the previous year or any earlier previous year. Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable. If a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDSs, has become irrecoverable, it can still be claimed as bad debts under section 36(1)(vii) since it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the second proviso to section 36(1)(vii). This is because some ICDSs require recognition of income at an earlier point of time (prior to the point of time such income is recognised in the books of account). Consequently, if the whole or part of such income recognised at an earlier point of time for tax purposes becomes irrecoverable, it can be claimed as bad debts on account of the second proviso to section 36(1)(vii).

36(1)(ix)	Any <i>bona fide</i> expenditure incurred by a company for the purpose of promoting family planning amongst its employees. In case the expenditure or part thereof is of capital nature, one-fifth of such expenditure shall be deducted for the previous year in which it was incurred; and the balance in four equal installments in four succeeding previous years. Family planning expenses, whether revenue or capital, is <u>not</u> allowable as deduction for non-corporate assesses, like individuals, HUFs, firms, LLPs.
36(1)(xv)	An amount equal to the securities transaction tax (STT) paid by the assessee in respect of taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession".
36(1)(xvi)	An amount equal to commodities transaction tax (CTT) paid in respect of taxable commodities transactions entered into the course of business during the previous year, 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".
General	
37(1)	An expenditure shall be allowed under section 37, provided: • it is <u>not</u> in the nature of expenditure described under sections 30 to 36; • it is <u>not</u> in the nature of capital expenditure; • it is <u>not</u> a personal expenditure of the assessee; • it is laid out and expended wholly and exclusively for the purpose of business/profession; • it is <u>not</u> incurred for any purpose which is an offence or which is prohibited by law; and • it is <u>not</u> an expenditure incurred by the assessee on CSR activities referred to in section 135 of the Companies Act, 2013. Expenditure incurred for any purpose which is an offence or which is prohibited by law" would include and would be deemed to have always included the expenditure incurred by an assessee, - (i) for any purpose which is an offence under any law for the time being in force, in India or outside India or which is prohibited

	by any law for the time being in force, in India or outside India; or (ii) to provide any benefit or perquisite to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guidelines, as the case may be, for the time being in force, governing the conduct of such person; or (iii) to compound an offence under any law for the time being in force, in India or outside India; or (iv) to settle proceedings initiated in relation to contravention under such law as may be notified by the Central Government in this behalf.
37(2B)	Any expenditure incurred for advertisement in any souvenir, brochure, tract, pamphlet etc. published by a political party is not allowable as deduction.
Amounts not deductible	
Section	Particulars
In the hands of any assessee	
40(a)(i)	Any interest, royalty, fees for technical services or other sum chargeable under the Act, which is payable outside India or in India to a non corporate non-resident or to a foreign company, on which tax deductible at source has not been deducted or after deduction has not been paid on or before the due date specified u/s 139(1). However, if such tax has been deducted in any subsequent year or has been deducted in the previous year but paid in the subsequent year after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such tax is paid.
40(a)(ia)	30% of any sum payable to a resident on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction has not been paid on or before the due date for filing of return of income u/s 139(1). However, if such tax has been deducted in any subsequent year or has been deducted in the previous year but paid in the subsequent year after the due date specified under section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax is paid.

40(a)(ii)	Any sum paid on account of income-tax including surcharge or cess		
40(a)(iii)	Any payment chargeable under the head " Salaries ", if it is payable outside India or to a non-resident, if tax has not been paid thereon nor deducted therefrom		
40(a)(v)	Tax paid by the employer on non-monetary perquisites provided to its employees, which is exempt under section 10(10CC) in the hands of the employee.		
In case of partnership firms or LLPs -			
40(b)	(i)	Salary, bonus, commission or remuneration, by whatever name called, paid to any partner who is not a working partner ;	
	(ii)	Payment of remuneration to a working partner or interest to any partner, which is not – • authorized by the partnership deed; or • in accordance with the terms of the partnership deed.	
	(iii)	Payment of remuneration to a working partner or interest to any partner authorized by and in accordance with the terms of the partnership deed, but relates to a period falling prior to the date of such partnership and is not authorized by the earlier partnership deed.	
	(iv)	Payment of interest to any partner authorised by and in accordance with the terms of the partnership deed and falling after the date of the partnership deed to the extent of the excess of the amount calculated at 12% simple interest per annum .	
	(v)	Payment of remuneration to a working partner which is authorized by and in accordance with the partnership deed to the extent the aggregate of such payment to working partners exceed the following limits -	
	(a)	On the first ₹ 6,00,000 of the book-profit or in case of a loss	₹ 3,00,000 or 90% of the book-profit, whichever is more.
	(b)	On the balance of book-profit	60%

Meaning of Book profit:

Book profit 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 partners of the firm if the same has been deducted while computing net profit.

Expenses or payments not deductible in certain circumstances

Section	Particulars												
40A(2)	Any expenditure incurred in respect of which a payment is made to a related person or entity, to the extent it is considered excessive or unreasonable by the Assessing Officer. Few examples of related persons are as under: <table border="1"> <thead> <tr> <th>Assessee</th><th>Related Person</th></tr> </thead> <tbody> <tr> <td>Individual</td><td>Any relative of the individual (husband or wife, brother or sister, any lineal ascendant or descendant of the individual)</td></tr> <tr> <td>Firm</td><td>Any partner of the firm or relative of such partner</td></tr> <tr> <td>HUF or AOP</td><td>Any member of the AOP or HUF or any relative of such member</td></tr> <tr> <td>Company</td><td>Director of the company or any relative of the director</td></tr> <tr> <td>Any assessee</td><td>Any individual who has a substantial interest (20% or more voting power or beneficial entitlement to 20% of profits) in the business or profession of the assessee; or A relative of such individual.</td></tr> </tbody> </table>	Assessee	Related Person	Individual	Any relative of the individual (husband or wife, brother or sister, any lineal ascendant or descendant of the individual)	Firm	Any partner of the firm or relative of such partner	HUF or AOP	Any member of the AOP or HUF or any relative of such member	Company	Director of the company or any relative of the director	Any assessee	Any individual who has a substantial interest (20% or more voting power or beneficial entitlement to 20% of profits) in the business or profession of the assessee; or A relative of such individual.
Assessee	Related Person												
Individual	Any relative of the individual (husband or wife, brother or sister, any lineal ascendant or descendant of the individual)												
Firm	Any partner of the firm or relative of such partner												
HUF or AOP	Any member of the AOP or HUF or any relative of such member												
Company	Director of the company or any relative of the director												
Any assessee	Any individual who has a substantial interest (20% or more voting power or beneficial entitlement to 20% of profits) in the business or profession of the assessee; or A relative of such individual.												
40A(3)	Any expenditure, in respect of which a payment or aggregate of payments made to a person in a single day otherwise than by account payee cheque or account payee bank draft or ECS through bank account or through such other prescribed electronic modes exceeds ₹ 10,000. In case of payments made to transport operator for plying, hiring or leasing goods carriages, an enhanced limit of ₹ 35,000 shall apply. If the payment/payments exceed this limit, the entire expenditure would be disallowed.												

	However, disallowance would not be attracted if the cases and circumstances in which payment is made otherwise than by way of an account payee cheque or bank draft are covered in Rule 6DD. Few Examples of exceptions covered in Rule 6DD: Payment to RBI, SBI, Co-operative banks Payment made to Government, which according to its Rules, has to be made in legal tender Payment for purchase of agricultural produce, forest produce, fish and fish products, productions of horticulture or apiculture to the cultivator, grower or producer of such produce or products.
40A(3A)	Where an expenditure has been allowed as deduction on accrual basis in any previous year, and payment is made in a subsequent previous year otherwise than by account payee cheque or account payee bank draft or ECS through bank account or through such other prescribed electronic modes and such payment (or aggregate of payments made to a person in a day is made in a subsequent previous year) is in excess of the limits of ₹ 10,000/ ₹ 35,000 specified above, the payment/aggregate of payments so made shall be deemed as profits and gains of the business or profession and charged to tax as income of the subsequent previous year. However, the deeming provision will not apply in the cases and circumstances covered in Rule 6DD.
40A(7)	Provision for payment of gratuity to employees. However, disallowance would not be attracted if provision is made for contribution to approved gratuity fund or for payment of gratuity that has become payable during the year.
Profits chargeable to tax [Section 41]	
41(1)	Where deduction was allowed in respect of loss, expenditure or trading liability for any year and subsequently, during any previous year, the assessee or successor of the business has obtained any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained or the value of benefit accrued shall be deemed to be income of the P.Y. in which such benefit was obtained.
41(3)	Amount realized on transfer of an asset used for scientific research without being used for other purposes is taxable as business income in the year of sale to the extent of lower of deduction allowed under section 35(1)(iv) and sale proceeds

41(4)	Any amount recovered by the assessee against bad debt earlier allowed as deduction shall be taxed as income in the year in which it is received.
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Certain Deductions to be allowed only on Actual Payment [Section 43B]

In respect of the following sums payable by an assessee during the P.Y., deduction is allowable **only if the sum is actually paid on or before the due date of filing of return u/s 139(1)** for the said P.Y. Otherwise, the same would be allowed only in the year in which the sum is actually paid.

- (i) **Tax, duty, cess or fee**, under any law for the time being in force; or
- (ii) Contribution to any **provident fund or superannuation fund or gratuity fund** or any other fund for the welfare of employees; or
- (iii) **Bonus or commission** for services rendered by employees, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission; or
- (iv) **Interest on any loan or borrowing** from any **public financial institution or a State Financial Corporation or a State Industrial Investment Corporation**, in accordance with the terms and conditions of the agreement governing such loan or borrowing; or
- (v) **Interest on any loan or borrowing from notified class of non-banking financial companies**, in accordance with the terms and conditions of the agreement governing such loan or borrowing
- (vi) **Interest on any loan or advance from a scheduled bank or co-operative bank** other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank in accordance with the terms and conditions of the agreement governing such loan or advances; or
- (vii) **Payment in lieu of any leave at the credit of his employee.**
- (viii) Any sum payable to the **Indian Railways for use of Railway assets.**

However, any sum payable by the assessee to a micro or small enterprise beyond the time-limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 would be allowed as deduction only in the P.Y. in which the sum is actually paid.

Section 15 of the of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises on or before the date as per the written agreement, which cannot be more than 45 days. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.

If the sum is paid within the said period, deduction would be allowed in the

year of accrual. If it is paid after the said period, then, deduction would be allowed only in the year of actual payment, even if it is paid on or before the due date of filing return of income u/s 139(1).

Other Provisions

Section	Particulars	
43CA	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 or profession". However, if the stamp duty value does not exceed 110% of the actual consideration received or accruing then, such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset. 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 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 way of an account payee cheque/ account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.	
44AB	Mandatory audit of accounts of certain persons	
	Category of person	Condition for applicability of section 44AB
(1)	(2)	(3)
I	In case of a person carrying on business	
(a)	In case of a person carrying on business	If his total sales, turnover or gross receipts in business > ₹ 1 crore in the relevant PY. Note – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44AD(1).
	If in case of such person carrying on business –	If his total sales, turnover or gross receipts in business > ₹ 10 crore in the relevant PY

	(i) Aggregate cash receipts in the relevant PY $\leq$ 5% of total receipts (incl. receipts for sales, turnover, gross receipts); and (ii) Aggregate cash payments in the relevant PY $\leq$ 5% of total payments (incl. amount incurred for expenditure)	
	Note – For this purpose, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.	
(b)	In case of an assessee covered u/s 44AE i.e., an assessee engaged in the business of plying, hiring or leasing goods carriages who owns not more than 10 goods carriages at any time during the P.Y.	If such assessee claims that the profits and gains from business in the relevant P.Y. are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e., ₹ 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and ₹ 7,500 for each vehicle, other than heavy goods vehicle, for every month or part of the month for which the vehicle is owned by the assessee].
(c)	In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts $\leq$ ₹ 200 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2023-24)	If he declares profit for any of the five successive PYs (say, P.Y.2024-25) not in accordance with section 44AD (i.e., he declares profits lower than 8% or 6% of total turnover, sales or gross receipts, as the case may be, in that year), then, he cannot opt for section 44AD for five successive PYs after the year of such default (i.e., from P.Y.2025-26 to P.Y.2029-30). For the year of default (i.e., P.Y. 2024-25) and five successive previous years (i.e., P.Y.2025-26 to P.Y.2029-30), he
	In case of an eligible assessee carrying on business, whose	

	aggregate cash receipts in the relevant PY $\leq$ 5% of total turnover or gross receipts and whose total turnover, sales, gross receipts $\leq$ ₹ 300 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y.2023-24)	has to maintain books of account u/s 44AA and get them audited u/s 44AB, if his income exceeds the basic exemption limit.
II	In case of persons carrying on profession	
(a)	In case of a person carrying on profession	If his gross receipts in profession $>$ ₹ 50 lakh in the relevant PY Note – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44ADA(1).
(b)	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts $\leq$ ₹ 50 lakhs.	If such resident assessee claims that the profits and gains from such profession in the relevant PY are lower than the profits and gains computed on a presumptive basis u/s 44ADA (50% of gross receipts) and his income exceeds the basic exemption limit in that PY.
	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal medical, engineering, accountancy, architecture, interior	

	decoration, technical consultancy, whose aggregate cash receipts in the relevant PY $\leq$ 5% of total gross receipts and whose gross receipts $\leq$ ₹ 75 lakhs.	
Presumptive Income provisions		
Section	Particulars	Deemed profits and gains
44AD	Any individual, HUF or firm who is a resident (other than LLP) who has not claimed deduction under section 10AA or Chapter VI-A under the heading "C – Deductions in respect of certain incomes" engaged in any business (except the business of plying, hiring or leasing goods carriages referred to in section 44AE) and whose total turnover or gross receipts in the previous year does not exceed ₹ 2 crore. If aggregate cash receipts in the relevant PY $\leq$ 5% of total turnover or gross receipts of the assessee, higher turnover threshold of ₹ 3 crore would be applicable. <u>Non-applicability of section 44AD</u> This section will not apply to –	8% of gross receipts or total turnover or such higher sum claimed to have been earned by him However, the presumptive income would be 6% (instead of 8%) of total turnover or sales, in respect of amount which is received • by an account payee cheque or • by an account payee bank draft or • by use of electronic clearing system through a bank account or • through such other prescribed electronic modes during the previous year or before the due date of filing of return u/s 139(1) in respect of that previous year.

	(i) a person carrying on specified professions referred to in section 44AA(1), (ii) a person earning income in the nature of commission or brokerage; (iii) a person carrying on agency business.	
44ADA	An assessee, being an individual or a partnership firm (other than LLP) resident in India, who is engaged – in any profession referred to in section 44AA(1) such as 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 in the Official Gazette; and whose total gross receipts does not exceed ₹ 50 lakhs in a previous year. If aggregate cash receipts in the relevant PY $\leq$ 5% of total turnover or gross receipts of the assessee,	50% of the gross receipts or such higher sum claimed to have been earned by him.

	a higher gross receipts threshold of ₹ 75 lakhs would be applicable.	
44AE	Any assessee who owns not more than ten goods carriages at any time during the previous year and who is engaged in the business of plying, hiring and leasing goods carriages .	For each heavy goods vehicle, ₹ 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month during which the vehicle is owned by the assessee. For each vehicle, other than heavy goods vehicle, ₹ 7,500 per month or part of a month during which such vehicle is owned by the assessee (or) an amount claimed to have been actually earned from such vehicle, whichever is higher.

Taxability in case of composite income

In cases where income is derived from the sale of rubber manufactured or processed from rubber plants grown by the seller in India, coffee grown and cured/grown, cured, roasted and grounded by the seller in India, or tea grown and manufactured by the seller in India, the income shall be computed as if it were income derived from business, and a specified percentage of such income, as given in the table below, shall be deemed to be income liable to tax -

Rule	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
7A	Income from sale of rubber products derived from rubber plants grown by the seller in India	35%	65%
7B	Income from sale of coffee		
	- grown and cured by the seller in India	25%	75%
	- grown, cured, roasted and grounded by the seller in India	40%	60%
8	Income from sale of tea grown and manufactured by the seller in India	40%	60%



TEST YOUR KNOWLEDGE

1. Mr. Venus., engaged in manufacture of pesticides, furnishes the following particulars relating to its manufacturing unit at Chennai, for the year ending 31-3-2025:

	(₹ in lakhs)
WDV of Plant and Machinery on 31.3.2024	30.00
Depreciation including additional depreciation for P.Y. 2023-24	4.75
New machinery purchased on 1-9-2024	10.00
New machinery purchased on 1-12-2024	8.00
Computer purchased on 3-1-2025	4.00

Additional information:

- All assets were purchased by A/c payee cheque.
- All assets were put to use immediately.
- New machinery purchased on 1-12-2024 and computer have been installed in the office.
- During the year ended 31-3-2024, a new machinery had been purchased on 31-10-2023, for ₹ 10 lakhs. Additional depreciation, besides normal depreciation, had been claimed thereon.
- Depreciation rate for machinery may be taken as 15%.
- The assessee has no brought forward business loss or unabsorbed depreciation as on 1.4.2024.

Compute the depreciation available to the assessee as per the provisions of the Income-tax Act, 1961 and the WDV of different blocks of assets as on 31-3-2025 if -

- he exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)
- he pays tax under the default tax regime under section 115BAC.

2. Mr. Abhimanyu is engaged in the business of generation and distribution of electric power. He opts to claim depreciation on written down value for income-tax purposes. From the following details, compute the depreciation allowable as per the provisions of the Income-tax Act, 1961 for the A.Y. 2025-26, assuming he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A):

	Particulars	(₹ in lakhs)
(i)	WDV of block as on 31.3.2024 (15% rate)	50.00
(ii)	Depreciation for P.Y. 2023-24	7.50
(iii)	New machinery purchased on 12-10-2024	10.00
(iv)	Machinery imported from Colombo on 12-4-2024. This machine had been used only in Colombo earlier and the assessee is the first user in India.	9.00
(v)	New computer installed in generation wing unit on 15-7-2024	2.00

All assets were purchased by A/c payee cheque.

3. Examine with reasons, the allowability of the following expenses incurred by Mr. Manav, a wholesale dealer of commodities, under the Income-tax Act, 1961 while computing profit and gains from business or profession for the A.Y. 2025-26 if he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) -
- Construction of school building in compliance with CSR activities amounting to ₹ 5,60,000.
 - Purchase of building for the purpose of specified business of setting up and operating a warehousing facility for storage of food grains amounting to ₹ 4,50,000.
 - Interest on loan paid to Mr. X (a resident) ₹ 50,000 on which tax has not been deducted. The sales for the P.Y. 2023-24 was ₹ 202 lakhs. Mr. X has not paid the tax, if any, on such interest.
 - Commodities transaction tax paid ₹ 20,000 on sale of bullion.

4. *Examine with reasons, for the following sub-divisions, whether the following statements are true or false having regard to the provisions of the Income-tax Act, 1961:*
- (i) *For a dealer in shares and securities, securities transaction tax paid in a recognized stock exchange is permissible business expenditure.*
 - (ii) *Where a person follows mercantile system of accounting, an expenditure of ₹ 25,000 has been allowed on accrual basis and in a later year, in respect of the said expenditure, assessee makes the payment of ₹ 25,000 through a crossed cheque, ₹ 25,000 can be the profits and gains of business under section 40A(3A) in the year of payment.*
 - (iii) *It is mandatory to provide for depreciation under section 32 of the Income-tax Act, 1961, while computing income under the head "Profits and Gains from Business and Profession".*
 - (iv) *The mediclaim premium paid to GIC by Mr. Lomesh for his employees, by an account payee cheque on 27.12.2024 is a deductible expenditure under section 36.*
 - (v) *Under section 35DDA, amortization of expenditure incurred under eligible Voluntary Retirement Scheme at the time of retirement alone, can be done.*
 - (vi) *An individual engaged in trading activities and exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) can claim additional depreciation under section 32(1)(iia) in respect of new plant acquired and installed in the trading concern, where the increase in value of such plant as compared to the approved base year is more than 10%.*
5. *Examine, with reasons, the allowability of the following expenses under the Income-tax Act, 1961 while computing income from business or profession for the A.Y. 2025-26:*
- (i) *Provision made on the basis of actuarial valuation for payment of gratuity ₹ 5,00,000. However, no payment on account of gratuity was made before due date of filing return.*

- (ii) Purchase of oil seeds of ₹ 50,000 in cash from a farmer on a banking day.
 - (iii) Tax on non-monetary perquisite provided to an employee ₹ 20,000.
 - (iv) Payment of ₹ 50,000 by using credit card for fire insurance.
 - (v) Salary payment of ₹ 10,00,000 to Mr. X outside India by a company without deduction of tax assuming Mr. X has not paid tax on such salary income.
 - (vi) Payment made in cash ₹ 30,000 to a transporter in a day for carriage of goods.
6. Examine with reasons, whether the following statements are true or false, with regard to the provisions of the Income-tax Act, 1961:
- (a) Payment made in respect of a business expenditure incurred on 16th February, 2025 for ₹ 25,000 through a crossed cheque is hit by the provisions of section 40A(3).
 - (b)
 - (i) It is a condition precedent to write off in the books of account, the amount due from debtor to claim deduction for bad debt.
 - (ii) Failure to deduct tax at source in accordance with the provisions of Chapter XVII-B, inter alia, from the amounts payable to a non-resident as rent or royalty, will result in disallowance while computing the business income where the non-resident payee has not paid the tax due on such income.
7. Mr. Sivam, a retail trader of Cochin gives the following Trading and Profit and Loss Account for the year ended 31st March, 2025:

Trading and Profit and Loss Account for the year ended 31.03.2025

Particulars	₹	Particulars	₹
To Opening stock	90,000	By Sales	1,12,11,500
To Purchases	1,10,04,000	By Closing stock	1,86,100
To Gross Profit	3,03,600		-
	1,13,97,600		1,13,97,600
To Salary	60,000	By Gross profit b/d	3,03,600
To Rent and rates	36,000	By Income from UTI	2,400

To Interest on loan	15,000		
To Depreciation	1,05,000		
To Printing & stationery	23,200		
To Postage & telegram	1,640		
To Loss on sale of shares (Short-term)	8,100		
To Other general expenses	7,060		
To Net Profit	50,000		
	3,06,000		3,06,000

Additional Information:

- (i) It was found that some stocks were omitted to be included in both the Opening and Closing Stock, the values of which were:

Opening stock ₹ 9,000

Closing stock ₹ 18,000

- (ii) Salary includes ₹ 10,000 paid to his brother, which is unreasonable to the extent of ₹ 2,000.
- (iii) The whole amount of printing and stationery was paid in cash by way of one-time payment to Mr. Ramesh.
- (iv) The depreciation provided in the Profit and Loss Account ₹ 1,05,000 was based on the following information:
- The opening balance of plant and machinery (i.e., the written down value as on 31.3.2024 minus depreciation for P.Y. 2023-24) is ₹ 4,20,000. A new plant falling under the same block of depreciation was bought on 01.7.2024 for ₹ 70,000. Two old plants were sold on 1.10.2024 for ₹ 50,000.
- (v) Rent and rates includes GST liability of ₹ 3,400 paid on 7.4.2025.
- (vi) Other general expenses include ₹ 2,000 paid as donation to a Public Charitable Trust.

You are required to compute the profits and gains of Mr. Sivam under presumptive taxation u/s 44AD and profits and gains as per the regular provisions of the Act assuming he has exercised the option of shifting out of

the default tax regime provided under section 115BAC(1A). Assume that the whole of the amount of turnover received by account payee cheque or use of electronic clearing system through bank account during the previous year.

8. Mr. Sukhvinder is engaged in the business of plying goods carriages. On 1st April, 2024, he owns 10 trucks (out of which 6 are heavy goods vehicles, the gross vehicle weight of such goods vehicle is 15,000 kg each). On 2nd May, 2024, he sold one of the heavy goods vehicles and purchased a light goods vehicle on 6th May, 2024. This new vehicle could, however, be put to use only on 15th June, 2024.

Compute the total income of Mr. Sukhvinder for the A.Y. 2025-26, taking note of the following data:

Particulars	₹	₹
Freight charges collected		12,70,000
Less: Operational expenses	6,25,000	
Depreciation as per section 32	1,85,000	
Other office expenses	15,000	8,25,000
Net Profit		4,45,000
Other business and non-business income		70,000

9. Mr. Raju, a manufacturer at Chennai, gives the following Manufacturing, Trading and Profit & Loss Account for the year ended 31.03.2025:

**Manufacturing, Trading and Profit & Loss Account
for the year ended 31.03.2025**

Particulars	₹	Particulars	₹
To Opening Stock	71,000	By Sales	2,32,00,000
To Purchase of Raw Materials	2,16,99,000	By Closing stock	2,00,000
To Manufacturing Wages & Expenses	5,70,000		
To Gross Profit	10,60,000		
	2,34,00,000		2,34,00,000
To Administrative charges	3,26,000	By Gross Profit	10,60,000

To SGST penalty	5,000	By Dividend from domestic companies	15,000
To GST paid	1,10,000	By Income from agriculture (net)	1,80,000
To General Expenses	54,000		
To Interest to Bank (On machinery term loan)	60,000		
To Depreciation	2,00,000		
To Net Profit	5,00,000		
	12,55,000		12,55,000

Following are the further information relating to the financial year 2024-25:

- Administrative charges include ₹ 46,000 paid as commission to brother of the assessee. The commission amount at the market rate is ₹ 36,000.
- The assessee paid ₹ 33,000 in cash to a transport carrier on 29.12.2024. This amount is included in manufacturing expenses. (Assume that the provisions relating to TDS are not applicable to this payment)
- A sum of ₹ 4,000 per month was paid as salary to a staff throughout the year and this has not been recorded in the books of account.
- Bank term loan interest actually paid upto 31.03.2025 was ₹ 20,000 and the balance was paid in November 2025.
- Housing loan principal repaid during the year was ₹ 50,000 and it relates to residential property acquired by him in P.Y. 2023-24 for self-occupation. Interest on housing loan was ₹ 23,000. Housing loan was taken from Canara Bank. These amounts were not dealt with in the profit and loss account given above.
- Depreciation allowable under the Act is to be computed on the basis of following information:

Plant & Machinery (Depreciation rate@15%)	₹
WDV as on 31.03.2024 minus Depreciation for P.Y. 2023-24	11,90,000
Additions during the year (used for more than 180 days)	2,00,000
Total additions during the year	4,00,000

Compute the total income of Mr. Raju for the A.Y. 2025-26 assuming he pays tax under default tax regime.

Note: Ignore application of section 14A for disallowance of expenditures in respect of any exempt income.

10. Mr. Tenzingh is engaged in composite business of growing and curing (further processing) coffee in Coorg, Karnataka. The whole of coffee grown in his plantation is cured. Relevant information pertaining to the year ended 31.3.2025 are given below:

Particulars	₹
Opening balance of car (only asset in the block) as on 1.4.2024 (i.e. WDV as on 31.3.2024 (-) depreciation for P.Y. 2023-24)	3,00,000
Opening balance of machinery as on 1.4.2024 (i.e., WDV as on 31.3.2024 (-) depreciation for P.Y. 2023-24)	15,00,000
Expenses incurred for growing coffee	3,10,000
Expenditure for curing coffee	3,00,000
Sale value of cured coffee	22,00,000

Besides being used for agricultural operations, the car is also used for personal use; disallowance for personal use may be taken at 20%. The expenses incurred for car running and maintenance are ₹ 50,000. The machines were used in coffee curing business operations.

Compute the income arising from the above activities for the A.Y. 2025-26.

ANSWERS

1. **Computation of written down value of block of assets of Venus Ltd. as on 31.3.2025**

Particulars	Plant & Machinery (₹ in lakhs)	Computer (₹ in lakhs)
Written down value (as on 31.3.2024)	30.00	Nil
Less: Depreciation including additional depreciation for P.Y. 2023-24	4.75	-
Opening balance as on 1.4.2024	25.25	

Add: Actual cost of new assets acquired during the year		
New machinery purchased on 1.9.2024	10.00	-
New machinery purchased on 1.12.2024	8.00	-
Computer purchased on 3.1.2025	-	4.00
	43.25	4.00
Less: Assets sold/discarded/destroyed during the year	Nil	Nil
Written Down Value (as on 31.03.2025)	43.25	4.00

(i) **If Mr. Venus exercises the option of shifting out of the default tax regime provided under section 115BAC(1A)**

In this case, since his income would be computed under the optional tax regime as per the normal provisions of the Act, he would be entitled for normal depreciation and additional depreciation, subject to fulfilment of conditions.

Computation of depreciation for A.Y. 2025-26

	Particulars	Plant & Machinery (₹ in lakhs)	Computer (₹ in lakhs)
I.	Assets put to use for more than 180 days, eligible for 100% depreciation calculated applying the eligible rate of normal depreciation and additional depreciation		
	<u>Normal Depreciation</u>		
	- WDV of plant and machinery (₹ 25.25 lakhs x 15%)	3.79	-
	- New Machinery purchased on 1.9.2024 (₹ 10 lakhs x 15%)	1.50	-
	(A)	5.29	-
	<u>Additional Depreciation</u>		
	New Machinery purchased on 1.9.2024 (₹ 10 lakhs x 20%)	2.00	-
	Balance additional depreciation in respect of new machinery purchased on 31.10.2023 and put to use for less	1.00	-

II.	than 180 days in the P.Y. 2023-24 (₹ 10 lakhs x 20% x 50%)		
	(B)	3.00	
	Assets put to use for less than 180 days, eligible for 50% depreciation calculated applying the eligible rate of normal depreciation and additional depreciation, if any		
	<u>Normal Depreciation</u>		
	New machinery purchased on 1.12.2024 [₹ 8 lakhs x 7.5% (i.e., 50% of 15%)]	0.60	-
	Computer purchased on 3.1.2024 [₹ 4 lakhs x 20% (50% of 40%)]	-	0.80
	(C)	0.60	0.80
	Total Depreciation (A+B+C)	8.89	0.80

Notes:

- (1) As per section 32(1)(ia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005, by an assessee engaged, *inter alia*, in 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 office appliances or road transport vehicles;
- (ii) any machinery or plant installed in, *inter alia*, office premises.

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

- (i) Machinery purchased on 1.12.2024, installed in office and
 - (ii) Computer purchased on 3.1.2025, installed in office.
- (2) Balance additional depreciation@10% on new plant or machinery acquired and put to use for less than 180 days in the year of acquisition which has not been allowed in that year, shall be allowed in the immediately succeeding previous year.

Hence, in this case, the balance additional depreciation@10% (i.e., ₹ 1 lakhs, being 10% of ₹ 10 lakhs) in respect of new machinery which had been purchased during the previous year 2023-24 and put to use for less than 180 days in that year can be claimed in P.Y. 2024-25 being immediately succeeding previous year.

(i) If Mr. Venus pays tax under default tax regime under section 115BAC

In this case, under the default tax regime as per section 115BAC, he would be entitled only for normal depreciation but not additional depreciation.

Computation of depreciation for A.Y. 2025-26

	Particulars	Plant & Machinery (₹ in lakhs)	Computer (₹ in lakhs)
I.	Assets put to use for more than 180 days, eligible for 100% depreciation calculated applying the eligible rate of normal depreciation <u>Normal Depreciation</u>		
	- WDV of plant and machinery (₹ 25.25 lakhs x 15%)	3.79	-
	- New Machinery purchased on 1.9.2024 (₹ 10 lakhs x 15%)	1.50	-
	(A)	5.29	-
II.	Assets put to use for less than 180 days, eligible for 50% depreciation calculated applying the eligible rate of normal depreciation <u>Normal Depreciation</u>		
	New machinery purchased on 1.12.2024 [₹ 8 lakhs x 7.5% (i.e., 50% of 15%)]	0.60	-
	Computer purchased on 3.1.2023 [₹ 4 lakhs x 20% (50% of 40%)]	-	0.80
	(C)	0.60	0.80
	Total Depreciation (A+B+C)	5.89	0.80

2. **Computation of depreciation under section 32 for A.Y.2025-26**

Particulars	₹	₹
Normal Depreciation		
Depreciation@15% on ₹ 51,50,000, being machinery put to use for more than 180 days [WDV as on 31.3.2024 of ₹ 50,00,000 – Depreciation for P.Y. 2023-24 of ₹ 7,50,000+ Purchase cost of imported machinery of ₹ 9,00,000]	7,72,500	
Depreciation@7.5% on ₹ 10,00,000, being new machinery put to use for less than 180 days	75,000	
	8,47,500	
Depreciation@40% on computers purchased ₹ 2,00,000	80,000	9,27,500
Additional Depreciation (Refer Note below)		
Additional Depreciation@10% of ₹ 10,00,000 [being actual cost of new machinery purchased on 12-10-2024]	1,00,000	
Additional Depreciation@20% on new computer installed in generation wing of the unit [20% of ₹ 2,00,000]	40,000	1,40,000
Depreciation on Plant and Machinery		10,67,500

Note:-

Mr. Abhimanyu is eligible for additional depreciation since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). The benefit of additional depreciation is available to new plant and machinery acquired and installed in power sector undertakings. Accordingly, additional depreciation is allowable in the case of any new machinery or plant acquired and installed by an assessee engaged, *inter alia*, in the business of generation, transmission or distribution of power, at the rate of 20% of the actual cost of such machinery or plant.

Therefore, new computer installed in generation wing units eligible for additional depreciation@20%.

Since the new machinery was purchased only on 12.10.2024, it was put to use for less than 180 days during the previous year, and hence, only 10%

(i.e., 50% of 20%) is allowable as additional depreciation in the A.Y.2025-26. The balance additional depreciation would be allowed in the next year.

However, additional depreciation shall not be allowed in respect of, *inter alia*, any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person. Therefore, additional depreciation is not allowable in respect of imported machinery, since it was used in Colombo, before its installation by the assessee.

3. Allowability of the expenses incurred by Mr. Manav, a wholesale dealer in commodities, while computing profits and gains from business or profession

(i) Construction of school building in compliance with CSR activities

Under section 37(1), only expenditure not being in the nature of capital expenditure or personal expense and not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing business income.

However, any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall **not** be allowed as deduction under section 37.

Accordingly, the amount of ₹ 5,60,000 incurred by Mr. Manav, towards construction of school building in compliance with CSR activities shall **not** be allowed as deduction under section 37.

(ii) Purchase of building for setting up and operating a warehousing facility for storage of food grains

Mr. Manav, would be eligible for investment-linked tax deduction under section 35AD, since he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A). The deduction u/s 35AD would be 100% of ₹ 4,50,000, being the amount invested in purchase of building for setting up and operating a warehousing facility for storage of food grains which commences operation on or after 1st April, 2009 (P.Y.2024-25, in this case).

Therefore, the deduction under section 35AD while computing business income of such specified business would be ₹ 4,50,000, if Mr. Manav opts for section 35AD.

(iii) Interest on loan paid to Mr. X (a resident) ₹ 50,000 on which tax has not been deducted

As per section 194A, Mr. Manav, being an individual is required to deduct tax at source on the amount of interest on loan paid to Mr. X, since his turnover during the previous year 2023-24 exceeds ₹ 100 lakhs.

Therefore, ₹ 15,000, being 30% of ₹ 50,000, would be disallowed under section 40(a)(ia) while computing the business income of Mr. Manav for non-deduction of tax at source under section 194A on interest of ₹ 50,000 paid by it to Mr. X.

The balance ₹ 35,000 would be allowed as deduction under section 36(1)(iii), assuming that the amount was borrowed for the purposes of business.

(iv) Commodities transaction tax of ₹ 20,000 paid on sale of bullion

Commodities transaction tax paid in respect of taxable commodities transactions entered into in the course of business during the previous year is allowable as deduction, provided the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

Taking that income from this commodities transaction is included while computing the business income of Mr. Manav, the commodity transaction tax of ₹ 20,000 paid is allowable as deduction under section 36(1)(xvi).

- 4. (i) True:** Section 36(1)(xv) allows a deduction of the amount of securities transaction tax paid by the assessee in respect of taxable securities transactions entered into in the course of business during the previous year as deduction from the business income of a dealer in shares and securities.
- (ii) True:** As per section 40A(3A), in the 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 exceeding ₹ 10,000 has been made in the subsequent year otherwise

than by an account payee cheque or an account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay, then, the payment so made shall be deemed to be the income of the subsequent year in which such payment has been made.

- (iii) **True:** According to the *Explanation 5* to section 32(1), allowance of depreciation is mandatory. Therefore, depreciation has to be provided mandatorily while calculating income from business/ profession whether or not the assessee has claimed the same while computing his total income.
- (iv) **True:** Section 36(1)(ib) provides deduction in respect of premium paid by an employer to keep in force an insurance on the health of his employees under a scheme framed in this behalf by GIC or any other insurer. The medical insurance premium can be paid by any mode other than cash, to be eligible for deduction under section 36(1)(ib).
- (v) **False:** Expenditure incurred in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, will be entitled to deduction in 5 equal annual installments beginning from the year in which each payment is made to the employee.
- (vi) **False:** Additional depreciation can be claimed only in respect of eligible plant and machinery acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or transmission or distribution of power.

In this case, the individual is engaged in trading activities and the new plant has been acquired and installed in a trading concern. Hence, he will not be entitled to claim additional depreciation under section 32(1)(iia), even though he has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A).

5. (i) **Not allowable as deduction:** As per section 40A(7), no deduction is allowed in computing business income in respect of any provision made by the assessee in his books of account for the payment of gratuity to his employees except in the following two cases:

- (1) where any provision is made for the purpose of payment of sum by way of contribution towards an approved gratuity fund; or
- (2) where any provision is made for the purpose of making any payment on account of gratuity that has become payable during the previous year.

Therefore, in the present case, the provision made on the basis of actuarial valuation for payment of gratuity has to be disallowed under section 40A(7), since, no payment has been actually made on account of gratuity.

Note: It is assumed that such provision is not for the purpose of contribution towards an approved gratuity fund.

- (ii) **Allowable as deduction:** As per Rule 6DD, in case the payment is made for purchase of agricultural produce directly to the cultivator, grower or producer of such agricultural produce, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds ₹ 10,000.

Therefore, in the given case, disallowance under section 40A(3) is not attracted since, cash payment for purchase of oil seeds is made directly to the farmer.

- (iii) **Not allowable as deduction:** Income-tax of ₹ 20,000 paid by the employer in respect of non-monetary perquisites provided to its employees is exempt in the hands of the employee under section 10(10CC).

As per section 40(a)(v), such income-tax paid by the employer is not deductible while computing business income.

- (iv) **Allowable as deduction:** Payment for fire insurance is allowable as deduction under section 36(1). Since payment is made by credit card, which is a prescribed electronic mode, disallowance under section 40A(3) is not attracted in this case.

- (v) **Not allowable as deduction:** Disallowance under section 40(a)(iii) is attracted in respect of salary payment of ₹ 10,00,000 outside India by a company without deduction of tax at source.

- (vi) **Allowable as deduction:** The limit for attracting disallowance under section 40A(3) for payment otherwise than by way of account payee cheque or account payee bank draft or use of ECS through a bank account or through such other prescribed electronic mode is ₹ 35,000 in case of payment made for plying, hiring or leasing goods carriage. Therefore, in the present case, disallowance under section 40A(3) is not attracted for payment of ₹ 30,000 made in cash to a transporter for carriage of goods.
6. (a) **True:** In order to escape the disallowance specified in section 40A(3), payment in respect of the business expenditure ought to have been made through an account payee cheque. Payment through a crossed cheque will attract disallowance under section 40A(3).
- (b) (i) **True:** It is mandatory to write off the amount due from a debtor as not receivable in the books of account, in order to claim the same as bad debt under section 36(1)(vii). However, where the debt has been taken into account in computing the income of the assessee on the basis of ICDSs notified under section 145(2), without recording the same in the accounts, then, such debt shall be allowed in the previous year in which such debt becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the said purpose.
- (ii) **True:** Section 40(a)(i) provides that failure to deduct tax at source from, *inter alia*, rent or royalty payable to a non-resident, in accordance with the provisions of Chapter XVII-B, will result in disallowance of such expenditure, where the non-resident payee has not paid the tax due on such income.

7. **Computation of business income of Mr. Sivam for the A.Y. 2025-26**

Particulars	₹	₹
Net Profit as per profit and loss account		50,000
Add: Inadmissible expenses/ losses		
Under valuation of closing stock	18,000	

Salary paid to brother – unreasonable [Section 40A(2)]	2,000	
Printing and stationery - whole amount of printing & stationery paid in cash would be disallowed, since such amount exceeds ₹ 10,000 [Section 40A(3)]	23,200	
Depreciation (considered separately)	1,05,000	
Short term capital loss on shares	8,100	
Donation to public charitable trust	2,000	1,58,300
		2,08,300
Less: Items to be deducted:		
Under valuation of opening stock	9,000	
Income from UTI [Chargeable under the head "Income from Other Sources"]	2,400	11,400
Business income before depreciation		1,96,900
Less: Depreciation (See Note 1)		66,000
		1,30,900

Computation of business income as per section 44AD:

As per section 44AD, where the amount of turnover is received, *inter alia*, by way of account payee cheque or use of electronic clearing system through bank account or through such other prescribed electronic modes, the presumptive business income would be 6% of turnover, i.e., ₹ 1,12,11,500 x 6 /100 = ₹ 6,72,690

Notes:

1. Calculation of depreciation

Particulars	₹
Opening balance of plant & machinery as on 1.4.2024 (i.e. WDV as on 31.3.2024 (-) depreciation for P.Y. 2023-24)	4,20,000
Add: Cost of new plant & machinery	70,000
	4,90,000
Less: Sale proceeds of assets sold	50,000
WDV of the block of plant & machinery as on 31.3.2025	4,40,000

Depreciation@15%

66,000

No additional depreciation is allowable as the assessee is not engaged in manufacture or production of any article.

2. Since GST liability has been paid before the due date of filing return of income under section 139(1), the same is deductible.
8. Section 44AE would apply in the case of Mr. Sukhvinder since he is engaged in the business of plying goods carriages and owns not more than ten goods carriages at any time during the previous year.

Section 44AE provides for computation of business income of such assesses on a presumptive basis. The income shall be deemed to be ₹ 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by the assessee in the previous year or such higher sum as declared by the assessee in his return of income.

Mr. Sukhvinder's business income calculated applying the provisions of section 44AE is ₹ 13,72,500 (**See Notes 1 & 2 below**) and his total income would be ₹ 14,42,500.

However, as per section 44AE(7), Mr. Sukhvinder may claim lower profits and gains if he keeps and maintains proper books of account as per section 44AA and gets the same audited and furnishes a report of such audit as required under section 44AB. If he does so, then his income for tax purposes from goods carriages would be ₹ 4,45,000 instead of ₹ 13,72,500 and his total income would be ₹ 5,15,000.

Notes:

1. Computation of total income of Mr. Sukhvinder for A.Y. 2025-26

Particulars	Presumptive income ₹	Where books are maintained ₹
Income from business of plying goods carriages [See Note 2 Below]	13,72,500	4,45,000
Other business and non-business income	70,000	70,000
Total Income	14,42,500	5,15,000

2. Calculation of presumptive income as per section 44AE

Type of carriage	No. of months	Rate per ton per month/ per month	Ton	Amount ₹
(1)	(2)		(3)	(4)
<u>Heavy goods vehicle</u>				
1 goods carriage upto 1 st May	2	1,000	15 (15,000/1,000)	30,000
5 goods carriage held throughout the year	12	1,000	15 (15,000/1,000)	9,00,000
<u>Goods vehicle other than heavy goods vehicle</u>				
1 goods carriage from 6 th May	11	7,500	-	82,500
4 goods carriage held throughout the year	12	7,500	-	3,60,000
Total				13,72,500

9. Computation of total income of Mr. Raju for the A.Y. 2025-26

Particulars	₹	₹
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,000
Add: Excess commission paid to brother disallowed under section 40A(2)	10,000	
Disallowance under section 40A(3) is not attracted since the limit for one time cash payment is ₹ 35,000 in respect of payment to transport operators. Therefore, amount of ₹ 33,000 paid in cash to a transport carrier is allowable as deduction.	Nil	

Bank term loan interest paid after the due date of filing of return under section 139(1) – disallowed as per section 43B	40,000	
State GST penalty paid disallowed [See Note 2 below]	5,000	
Depreciation debited to profit and loss account	2,00,000	2,55,000
		7,55,000
Less: Dividend from domestic companies [Chargeable to tax under the head “Income from Other Sources”]	15,000	
Income from agriculture [Exempt under section 10(1)]	1,80,000	
Salary paid to staff not recorded in the books (Assumed it was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same would be allowable as deduction while computing profits and gains of business and profession) [See Note 1 below]	48,000	
Depreciation under the Income-tax Act, 1961 (As per working note)	2,23,500	4,66,500
		2,88,500
Income from house property		
Annual value of self-occupied property	Nil	
Less: Deduction u/s 24(b) – interest on housing loan [Not allowable, since Mr. Raju is paying tax as per default tax regime]	Nil	Nil
Income from Other Sources		
Dividend from domestic companies		15,000
Gross Total Income		3,03,500
Less: Deduction u/s 80C [Not allowable, since Mr. Raju is paying tax as per default tax regime]		Nil
Total Income		3,03,500

Working Note:**Computation of depreciation under the Income-tax Act, 1961**

Particulars	₹
Depreciation@15% on ₹ 13.90 lakhs (WDV as on 31.3.2024 less depreciation for P.Y. 2023-24 i.e., ₹ 11.90 lakh plus assets purchased during the year and used for more than 180 days ₹ 2 lakh)	2,08,500
Depreciation @7.5% on ₹ 2 lakh (Assets used for < 180 days)	15,000
	2,23,500

Since Mr. Raju is paying tax as per default tax regime, additional depreciation u/s 32(1)(ia) would not be available to him.

Notes (Alternate views):

1. It is also possible to take a view that the salary paid to staff not recorded in the books is in the nature of unexplained expenditure and hence, would be deemed to be income as per section 69C and would be taxable @ 60% under section 115BBE. In such a case, no deduction allowable in respect of such expenditure.
2. Where the imposition of penalty is not for delay in payment of sales tax or VAT or GST but for contravention of provisions of the Sales Tax Act or VAT Act or GST Law, the levy is not compensatory and therefore, not deductible. However, if the levy is compensatory in nature, it would be fully allowable. Where it is a composite levy, the portion which is compensatory is allowable and that portion which is penal is to be disallowed.

Since the question only mentions "GST penalty paid" and the reason for levy of penalty is not given, it has been assumed that the levy is not compensatory and therefore, not deductible. It is, however, possible to assume that such levy is compensatory in nature and hence, allowable as deduction. In such a case, the total income would be ₹ 3,94,500.

10. Where an assessee is engaged in the composite business of growing and curing of coffee, the income will be segregated between agricultural income and business income, as per Rule 7B of the Income-tax Rules, 1962.

As per the above Rule, income derived from 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. The balance 75% will be treated as agricultural income.

Particulars	₹	₹
Sale value of cured coffee		22,00,000
Less: Expenses for growing coffee	3,10,000	
Car expenses (80% of ₹ 50,000)	40,000	
Depreciation on car (80% of 15% of ₹ 3,00,000) [See Computation below]	36,000	
Total cost of agricultural operations	3,86,000	
Expenditure on coffee curing 3,00,000 operations		
Add: Depreciation on machinery 2,25,000 (15% of ₹ 15,00,000) [See Computation below]		
Total cost of the curing operations	5,25,000	
Total cost of composite operations		9,11,000
Total profits from composite activities		12,89,000
Business income (25% of above)		3,22,250
Agricultural income (75% of above)		9,66,750

Computation of depreciation for P.Y. 2024-25

Particulars	₹	₹
Car		
Opening balance as on 1.4.2024 (i.e., WDV as on 31.3.2024 (-) depreciation for P.Y.2023-24)		3,00,000
Depreciation thereon at 15%	45,000	
Less: Disallowance @20% for personal use	9,000	
Depreciation actually allowed		36,000

Machinery		
Opening balance as on 1.4.2024 (i.e., WDV as on 31.3.2024 (-) depreciation for P.Y.2023-24)		15,00,000
Depreciation @ 15% for P.Y. 2024-25		2,25,000

Explanation 7 to section 43(6) 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 (and not just 25%) 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.