

CHAPTER 08

PGBP

Meaning of "Business & Profession" Business [Sec 2(13)]

✚ Business includes any Trade, Commerce, Manufacture or any adventure.

✚ **Adventure:** Doing an activity for first time without knowing its outcome.

Profession

✚ The term "Profession" has not been defined in the act.

✚ In general sense, it means an occupation requiring some degree of learning.

✚ The term 'Profession' includes Vocation also [Section 2(36)].

Ex: Painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect & even an astrologer are persons who can be said to be carrying on a profession.

Note: For the purpose of Income tax, it is immaterial whether a person is carrying on a 'Business' or 'Profession' or 'vocation'.

Meaning of "Profit"**Cash or Kind**

✚ Profits may be realized in money or in money's worth (cash or in kind-FMV).

Capital Receipt

✚ Capital receipts are generally not taxable u/h PGBP bec these is separate chapter CG.

Voluntary Receipts

✚ Voluntary Payment received in the course of a business/profession would be treated as income in the hands of the Recipient.

Ex: 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.

Purpose

✚ Purpose for which the profits earned in business/profession are use is immaterial.

Legality

✚ Even the profit earned from illegal source is taxable.

Distinct Businesses

✚ Tax is chargeable on the Aggregate profits of all the business carried on by the assessee.

Computation of Profits

✚ Tax is levied on the 'profits & gains' & not on gross receipts i.e. after deducting losses & expenses.

Charging Section (Sec.28)

1. Profits & Gains of any business or profession carried on at any time during PY by the assessee.

- Capital Receipt → Not Taxable. (Subject to certain exceptions)
- Capital Loss → Not Deductible.

2. Compensation for Loss of Office.

Any compensation or other payment due to or received by any person in relation to Termination or Modification of terms & conditions, of any contract relating to his business.

3. Income of Trade/Professional Association from Specific Activities for its Members.

- This is an exception to "Principle of Mutuality" since association & its members are treated a Same Person. [Ex: Chambers of commerce, stock brokers' associations etc]
- As a result, association performing specific services for its members is deemed to be carrying on business i.r.o these services & Income arising from such specific activities is Taxable.

4. Export Incentives.

- (a) Profit on sale of import entitlements license.
- (b) Cash assistance against exports under any scheme of Government of India.
- (c) Customs duty or excise re-paid or repayable as duty drawback / cash compensatory support
- (d) Profit on transfer of Duty Entitlement Passbook Scheme/Duty-Free Replenishment Certificate.

5. Remuneration / Commission / Interest to Partners in partnership firm.

Is taxable in the hands of Partner (as PGBP) to the extent it is deductible to firm.

Ex: The allowable rate of interest is 12% p.a. u/s 40(b). Now if a firm pays interest to a partner at 15% p.a, excess 3% paid will be disallowed to firm u/s 40(b). Thus 12% which is allowed as deduction to the firm u/s 40(b) shall be taxed in the hands of partner (as PGBP).

Excess interest of 3% which has been disallowed to the firm u/s 40(b) will not be taxed in the hands of the partner again.

6. Amount received for Non-Competence Fees are taxable [even if they are capital receipts]. Any sum received under an agreement,
 - For not carrying out any activity in relation to any business or profession.
 - Not to share any know-how, patent, copyright, trade mark likely to assist in the manufacture or processing of goods or provision for services etc.
7. Keyman Insurance Policy (including Bonus) is taxable in the hands of employer if maturity Amount is Received by Employer. If received by Employee = Perquisite.
8. FMV of Inventory (SIT) on the date of its conversion into capital asset would be taxable as business income.
9. Value of Benefit arising from Business/Profession. (Whether Convertible into Money or not). (There should be Nexus between the business & the benefits received).
10. Sum received or receivable on demolition, destruction or transfer of any Capital Asset (Except Land/GW/Fin Inst), whole cost of which was allowed as deduction u/s 35AD.
11. Any Gift / Perquisite / Benefits/ arising out of business & profession.
12. Discontinued Business (Sec 176): A situation where the income is earned after discontinuance of business/ profession. Income from discontinued business is also taxable.
13. Any income earned by the owner from renting out a residential house or a portion thereof shall be taxed under "Income from House Property" and not under "Profits and Gains from Business or Profession (PGBP)."

Speculation Business

- ✚ 'Speculative transaction' means a transaction in which a contract for purchase or sales of any commodity (including stocks & shares) is periodically/ultimately settled otherwise than by the Actual delivery or transfer of the commodity/Scripts [section 43(5)].
 - ✚ Deeming provision: Where any part of the business of a company consists of purchase & sale of the shares of other companies, such company is deemed to be carrying on speculation business to the extent of such business of the purchase & sale of such shares.
- However, this Deeming Provision does not apply to the following companies: .

1. A company whose GTI consists of mainly income taxable u/h IFOS, HP, Capital gains.

2. A company whose principal business is:

(i) Trading in shares;

(ii) Banking;

(iii) Granting of loans & advances.

✚ Profits/Losses resulting from Speculative Transaction must be treated as separate & distinct from other profits & gains of business & profession because Loss from Speculative Business can be set off only against Profit of Speculative Business & no other business (Section 73).

Transactions not Deemed to be Speculative Transactions (Read Once)

1. 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.

2. Hedging contract in respect of Stocks & Shares: A contract in respect of Stocks & Shares entered into by a dealer/investor to guard against loss in his holdings of stocks & shares.

3. 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

4. Trading in Derivatives: Eligible transaction carried RSE.

5. Trading in Commodity Derivatives: Eligible transaction in respect of trading in commodity derivatives carried out in a recognized association, which is chargeable to CTT.

Relevance of Method of Accounting [Sec 145(1)]

✚ Income chargeable u/h 'PGBP' or 'IFOS' shall be computed in accordance with the method of accounting regularly followed by the Assessee.

✚ If Assessee follows Mercantile System of Accounting → Income will be taxed on "Due" basis.

✚ If Assessee follows Cash basis of Accounting → Income will be taxed on "Receipt" basis.

A. Specific Deductions [Sec 30 - 36]

✚ We know that Profit = Receipts - Expenditures.

- Section 30 - 36 gives the list of the expenditures which are allowed as deductions while calculating income under this head.

Rent, Rates, Taxes, Repairs & Insurance for Building [Sec 30]

| Expenditure | Conditions |
|-------------------|--|
| Rent | Paid by the Tenant for Building occupied by him for his business. |
| Revenue Repairs | Done by Owner/Tenant. [Capital Repairs are not covered Here] |
| Rates & Taxes | Land Revenue, Local Rates & Municipal Tax [Section 43B will Apply] Allowed to both i.e Owner / Tenant. |
| Insurance Premium | Paid by the owner. Allowed to both i.e Owner / Tenant. |

Points to remember

- Premises used partly for Business & partly for other purposes: Proportionate Expenditure of the premises used for Business will be allowed as a deduction.
- Deduction in case of Subletting of rented premises = Rent paid - Rent recovered from sub-tenant.
- No Deduction for Notional Rent: If the owner uses his own premises for his business, No Notional Rent shall be allowed as deduction. But if firm runs its business in the premises owned by one of its partners, rent payable to the partner will be an allowable deduction to the extent it is reasonable & is not excessive.
- Cesses, Rates & Taxes levied by a Foreign Government → Allowed as deduction.

Repairs & Insurance of Plant, Machinery & Furniture [Sec 31]

| NATURE OF EXPENDITURE | CONDITIONS |
|-----------------------|--|
| Revenue Repairs | Done by Owner & Tenant. |
| Insurance Premium | Paid by Owner. Allowed to both i.e Owner / Tenant. |

Points to Remember:

- Insurance & Repair charges of the Assets which have been discarded (though owned by the assessee) or have not been used for the business during the PY → Not Allowed as Deduction.

2. To Claim Deduction u/s 31 → Asset must be used (atleast for 1 day) for assessee's business.

3. Repairs include Renewal or Renovation of an asset but not its Replacement or Reconstruction.

Depreciation [Sec 32]

1. Only WDV Method of charging depreciation is recognized under the Act. However, Power Generation units have option to claim depreciation on SLM.

2. Depreciation is to be claimed on the BLOCK OF ASSETS & Not on Individual Asset.

3. Claiming Depreciation is Mandatory. Assessee does not have any option to not claim it.

Conditions for Claiming Depreciation.

1. Ownership of Asset

Assessee must be the owner of the asset (fully or partly owned).

Registered ownership is not necessary (It can be a beneficial ownership).

Hire Purchase → Hire purchaser is entitled to claim depreciation as he gets substantial rights when contract is made.

To claim depreciation on building, ownership of land on which building is constructed is not necessary. Land may be lease-hold.

Note: If Tenant has incurred any Capital Expenditure on construction, renovation, extension of the building taken on lease/rent, he can take depreciation on such capital expenditure.

2. Asset must be used by the assessee for his business/profession during relevant PY

- Asset must be put to use at any time during the previous year. - Even if the asset is used for a single day during the year, full depreciation shall be allowed Except for first year of use of asset.

- Use of Asset in 1st year of Asset: Asset must be used for atleast 180 days to get full depreciation. If it is used for less than 180 days in 1st year, only 50% of the allowable depreciation can be claimed.

Ex: If Assessee acquires the asset in PY 2023-24 on 1 Dec 2023, only 50% of the allowable depreciation can be claimed by the Assessee in PY 2023-24. However, from PY 2024-25, full dep can be claimed even if the asset has been used even for a single day in PY 2024-25.

However, if asset is acquired in PY 2023-24 & it is not put to use in PY 2023-24, no depreciation can be claimed for PY 2023-24. Now PY 2024-25 cannot be said to be the first year of asset. Thus 100% depreciation will be allowed in PY 2024-25.

Note: In case of Partition of HUF, Dissolution of Firm, Conversion of firm into Company, no asset is acquired by the successor & thus condition of 180 days is Not Applicable.

✚ Use includes "Passive use" [Asset is said to be in use even when it is "kept ready for use"].

Some Other Points:

1. Asset used Partly for Business & partly for Personal purposes → Depreciation proportionate to the business is allowed as deduction u/s 32 & should be deducted from WDV.
2. Asset used Partly for Business & partly for Agricultural purposes → Depreciation proportionate to the business shall be allowed as deduction u/s 32, but 100% depreciation should be subtracted from WDV.

Note: Allowability of Depreciation in case of Letting of assets on hire.

| | |
|--|--|
| If Letting of Assets on Hire is the business of the assessee. | Depreciation on such let out assets is allowed to the assessee u/s 32. |
| If Letting of assets on Hire is NOT the business of the assessee. | Depreciation on such let out assets is allowed u/s 57(ii). |

3. Asset must fall under the eligible class of Asset
 - (a) **Class A: Tangible assets.** It included building, machinery, plant or furniture.
 - (b) **Class B: Intangible assets.** It includes know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature etc.
4. No dep on Goodwill Even if purchased / otherwise from AY 2021-2022.

Concept of "Block of Assets"

Meaning: Group of assets falling within **Same Class** & having **Same Rate** of Depreciation.

Points to be considered while forming block of asset:

Building includes Roads, bridges & tubewells attached to the building or forming part of it.

Machinery Asset which is directly connected with Production/Manufacture/ processing.

Furniture Asset used for Convenience & Decoration.

Plant Any Asset not falling under any other classification, but which are Essential to carry out the business.

Includes: Ships, vehicles, books, scientific apparatus & surgical used for business.

Excludes: Tea bushes or livestock etc.; animal, human body or stock-in-trade; Buildings.

However, Theatre buildings, hospital buildings & hotel buildings though specially equipped for business are still buildings & cannot be treated as plant.

Points to Remember:

- ✚ Assets Ineligible for depreciation [Land/Personal assets] will not form part of any block.
- ✚ While calculating Depreciation on Building, Cost of Land is to be Excluded.
- ✚ Reduction of goodwill from block of asset to be considered as transfer w.e.f. 01/04/2021.

A. Steps to Determine Block of Asset:

1. Classify assets into (i) Tangible Assets & (ii) Intangible Assets.
2. All the Tangible Assets shall further be classified into (a) Building, (b) Plant & Machinery & (c) Furniture
3. Group the classified assets in each category separately on the basis of Rate of depreciation.
4. Assets having same rate of depreciation should be grouped together.

B. Steps to Calculate Depreciation: [V. IMP]

1. Find Closing WDV of each block for PY. [Opening WDV + Additions during year - Sale Value].
2. Bifurcate Closing WDV of each block into two categories: (i) WDV of the assets used for less than 180 days during PY (ii) Balance WDV. [Note that it is not always equals to WDV of Assets used for > 180 days]
3. Apply Rate of depreciation on (i) Assets used for less than 180 days. [50% Rate Depreciation]
4. Apply Rate of depreciation on (ii) Balance WDV. [100% depreciation (as per the rates)].

Rates of Depreciation

| | Nature of Asset | (%) |
|---|--|-----|
| I | Building | |
| | <u>Block 1:</u> Residential Building except hotels & boarding houses | 5 |

| | | |
|-----|---|----|
| | <u>Block 2:</u> Buildings which are not used mainly for residential purposes & not covered by Block (1) above & (3) below (Office, factory, Godowns & other buildings) | 10 |
| | <u>Block 3:</u> Building used for installing P&M of Water supply project / Water treatment system. It should be used for the business of providing Infrastructure facilities. | 40 |
| | <u>Block 4:</u> Any temporary or wooden structures. | 40 |
| II | Furniture - Any furniture & fittings including electrical fittings. | 10 |
| III | Plant & Machinery | |
| | <u>Block 1:</u> Motor cars (Except cars used in business of running them on hire) & EPABX, Mobile Phone | 15 |
| | <u>Block 2:</u> Buses, lorries & taxies used in the business of hire | 30 |
| | <u>Block 3:</u> Moulds used in rubber & plastics goods factory | 30 |
| | <u>Block 4:</u> Aeroplanes & Aeroengines, Computer (Incl. UPS, Software) | 40 |
| | <u>Block 5:</u> Pollution control equipments (air/water); Solid waste control equipment etc. | 40 |
| | <u>Block 6:</u> P&M used in semi-conductor industry covering all Integrated Circuits | 30 |
| | <u>Block 7:</u> Lifesaving medical equipment. | 40 |
| | <u>Block 8:</u> P&M in Water supply project/Water treatment system. It should be used for the business of providing Infrastructure facilities. | 40 |
| | <u>Block 9:</u> Oil wells, Books (Incl. Annual Publication) | 40 |
| | <u>Block 10:</u> Renewable Energy Saving Devices (Incl. E-Vehicle) | |
| | (i) Windmills & devices which run on windmills (including electric generators & pumps) installed on or after 1.4.2014. | 40 |
| | (ii) Windmills & devices which run on windmills (including electric generators & pumps) installed before 1.4.2014. | 15 |

Increased ROD for certain Assets [Rule 5(2)]

Any New P&M installed to Manufacture or Produce any Article or thing by using any technology or other know-how developed in:

- (a) Laboratory owned or financed by the government or
- (b) Laboratory owned by a public sector company or a University/recognized institution shall be treated as a part of the block of assets qualifying for depreciation @ 40%.

Note: if all assets has been sold / destroyed / discarded & there is still remains balance in the block = +ve balance then STCL & -ve balance then STCG u/s 50.

Additional Depreciation [Sec 32(1)(ia)]

Eligibility: The Assessee must be engaged in the business of:

- (a) Manufacturing or production of any article or thing, or
- (b) Generation, transmission or Distribution of Power

Benefits: Additional depreciation is available @ prescribed rates to the eligible assesseees for Investment in New Plant & Machinery. [No Land & Building or OLD P&M]

Ineligible Investments.

1. Ships & Aircrafts
2. Any second-hand P&M (Indian or Imported)
3. Any P&M installed in office premises, residential house or guest house.
4. Any other office appliances (Incl. Computer & Computer S/W).
5. Road transport vehicles.
6. Any P&M whose whole of Actual cost has been allowed as deduction.

Additional Dep Rate: 20% of Actual cost of new P&M.

If Assets put to use for less than 180 days in 1st PY:

✚ 1st PY = Restricted to 50% (i.e. 10%)

✚ Next PY = Remaining 50% that was disallowed in the 1st PY

- Additional depreciation will be over & above normal depreciation allowed.
- It should be reduced from WDV of the asset.

✚ Forklift Truck used in factory eligible for additional depreciation.

✚ Circular No. 15/2016: Printing or Printing & Publishing amounts to manufacture & thus an Assessee engaged in such business is eligible for Additional Depreciation u/s 32(1)(ia).

Note: Additional depreciation is not available to the power generating assessee who claims depreciation on SLM basis. Because Additional depreciation is available only in those cases where normal depreciation is claimed u/s 32(1)ii on the WDV of block of assets.

Depreciation on SLM Basis [Sec 32(1)(i)]

Applicability For Undertakings engaged in **Generation, transmission, Distribution of Power.**

Time to Exercise: **Before DD of Filing ROI u/s 139(1)** relevant to the PY in which they begin to generate power. **The option once exercised shall be Final.**

Option of SLM → **Tangible Assets only.**

For Intangible Assets, only WDV method shall be applicable. Such undertakings can charge depreciation on tangible assets individually, i.e. SLM or WDV whichever is beneficial for assessee.

Newly acquired assets put to use < 180 days → Depreciation is allowable at **50% of ROD**; Remaining 50% will be allowed in next AY.

Sale in Year of First Use = Profit/Loss arising shall be treated as **STCG/STCL.**

Transfer of Depreciable Assets by Power Sector Units

| SN | Conditions | Treatment |
|----|----------------------------|---|
| 1 | Sale Price < WDV | Terminal Depreciation = WDV – Sale price. It shall be Deductible u/s 32. |
| 2 | Sale Price > WDV but < COA | Balancing Charge (Profit) = Sale Price – WDV. It shall be Taxable u/s 41(2). |
| 3 | Sale Price > COA / WDV | Balancing Charge (Profit) = COA – WDV. It shall be Taxable as PGBP u/s 41(2). & Sale price - COA taxable capital gain u/s 50A. |

Depreciation in Case of Amalgamation/Demerger of Company, Succession of Firm & Other Business Re-Organisation

- (i) Amalgamation of companies,
- (ii) Demerger of companies,
- (iii) Conversion of proprietary / partnership firm into a company (public / private)
- (iv) Conversion of private limited / unlisted public company into LLP firm.

- These are the cases of **Change in ownership**.
- In such cases, **depreciation shall be calculated on the assumption that no change in ownership has taken place.**
- Then the amount of **depreciation so calculated shall be apportioned between predecessor & successor in the ratio of number of days for which the asset is USED by them.**
- Note:** Consideration for which the assets are transferred to the resulting company is irrelevant for calculation of depreciation. Students should not get confused by such amount given in question.
- Note:** When the asset was put to use during the year = total time period commences on the day when asset was put to use & end on 31st march of PY.

Determination of Actual Cost [Sec 43(1)]

| Cost of Acquisition/Construction of Asset | | ₹ |
|---|------------|-----|
| Less: | | |
| (a) Taxes & Duties in respect of which CENVAT credit is Allowed | XXX | |
| (b) Subsidy or Grant received by any Authority (Directly/Indirectly) | XXX | XXX |
| (c) Amt received on product sale during trial run. | XXX | |
| Add: | | |
| (a) Interest on loan borrowed payable upto date of commencement of production / asset first put to use. | XXX XXX | |
| (b) Expenses incurred for acquiring Asset [Freight, Insurance, loading, unloading] | XXX | |
| (c) Expenses incurred in connection with the Instalment of Asset. { Making support structure } | XXX | XXX |
| (d) FOREX Fluctuations arising in respect of asset acquired from abroad [Sec 43A] | | |
| ACTUAL COST for the purpose of computing Depreciation | | XXX |

Note: Any Expenditure for Acquisition of any Asset for which the aggregate payments made to a person in a day, otherwise than by A/c Payee Cheque or A/c Payee Draft or Electronic

clearing system exceeds ₹ 10,000, such expenditure shall not be included in Cost of asset.

8 Modes = Dr / Cr Card, Net Banking, NEFT, RTGS, IMPS, UPI, AADHAR based BHIM Pay.

'Actual Cost' in Special Cases [Explanation to Section 43(1)]

| SN | Cases | Actual Cost |
|----|--|--|
| 1 | Scientific Asset/Specified business Asset u/s 35AD brought into business. | Actual cost = Nil because deduction allowed u/s 35. |
| 2 | Conversion of SIT into Capital asset & used into business | FMV of Capital Asset on the date of conversion. |
| 3 | Asset acquired by Gift, Will or Inheritance | WDV to the previous owner. |
| 4 | Second Hand Asset (Intention to claim higher depreciation) | If AO is satisfied that main purpose was to claiming higher depreciation on enhanced cost, he may, with the previous approval of JCIT, determine the Actual Cost having regard to all the circumstances of the case. |
| 5 | Re-acquisition of asset used for Business/profession earlier. | (a) WDV at the time of original transfer or (b) Cost of re-acquisition [whichever is Lower] |
| 6 | Sale & Leaseback transactions (Assets previously used by transferor for his B/P are acquired by transferee & let out or hired or leased to the transferor) | WDV of the previous owner i.e. Lessee. |
| 7 | Building (now brought into business) which was used for non-business purpose earlier. <u>Note:</u> Only Applicable for Building. | Actual cost of building - Notional Depreciation @ current rate on that date. <u>Note:</u> Other assets should be recorded @ original COA. |
| 8 | Transfer by holding company to its WOS or vice versa | Actual cost of the asset = Same Cost/WDV as it would have been if |

| | | |
|----|--|--|
| 9 | Transfer in scheme of Amalgamation to Indian amalgamated company | the transferor company had continued to hold the asset. |
| 10 | Transfer in scheme of Demerger to Indian resulting company | |
| 11 | Subsidy on capital investment | Specific Subsidy: Deducted from Actual COA. General subsidy: Proportionate Subsidy relating to the asset shall be deducted from COA. |
| 12 | Asset acquired outside India by NR & brought to India & used for the purpose of his business/profession. | Actual cost - depreciation calculated @ rate in force that would have been allowable had the asset been used in India since the date of acquisition. |

Written Down Value [Sec 43(6)]

✚ Asset acquired during PY: Actual Cost

✚ Asset acquired before PY: Actual Cost - Depreciation Actually Allowed.

Cases When No Depreciation is Allowed

| | |
|------------------------------------|--|
| WDV is Zero but Block is not Empty | No Depreciation & STCG u/s 50(1) will arise. |
| Block is empty but WDV is not Zero | No Depreciation & STCG u/s 50(2) will arise. |

Unabsorbed Depreciation [Sec 32(2)]

- Where depreciation is not fully deductible u/h 'PGBP' because of absence or inadequacy of profits, it is deductible from other heads of Income for the same AY.
- If depreciation is still unabsorbed, it can be c/f to subsequent AY without any time limit.
- In the subsequent years, unabsorbed depreciation can be set off against any income whether chargeable under the head PGBP or under any other head of income. { other than salary & casual Income }
- In the matter of set off, the following priority is followed in the subsequent years (i) Current year Depreciation (ii) Brought Forward Business Loss (iii) Unabsorbed Depreciation.

Note: Set off will be allowed even if the said business to which it related has been discontinued.

Expenditure on Scientific Research [Sec 35]

A. Scientific Research Carried on by Assessee [Related to business]

Revenue Expenditure [Sec 35(1)(i)] - [100 % Deduction]

| | |
|---|--|
| Pre-commencement Period Expenditure. {Only to the extent it has been certified by prescribed authority.} | Only following expenditures will be allowed as deduction: (i) Salary (excluding perquisites) to research personnel. (ii) Purchase of Materials used in scientific research. [only of 3 years prior to Commencement] |
| Post-commencement Period Expenditure | Any Revenue Expenditure incurred allowed. |

Capital Expenditure [SEC 35(1)(iv) & 35(2)] - [100 % Deduction]

| | |
|--------------------------------------|--|
| Pre-commencement Period Expenditure | Any Capital Expenditure incurred will be allowed as deduction (Except Cost of Land). [only of 3 years prior to Commencement] |
| Post-commencement Period Expenditure | Any Capital Expenditure incurred will be allowed as deduction (Except Cost of Land). |

Note : If Land & Building purchased then deduction allowed only for building.

Note : Donation shall be disallowed unless such research association files the statements of donation.

Expenditure on In-House Research by Company Assessee [Sec 35(2AB)]

| | |
|-------------------|--|
| Assessee | Company only |
| Eligible Business | Bio-technology or any business of manufacture/production of any articles or thing, not being an article or thing specified in the list of the Eleventh schedule. |
| Expenditure | Capital & Revenue Expenditure [Excluding Cost of Land & Building] |
| Deductions | 100% of Capital & Revenue [Except cost of Land & Building] |

Note: For Company → Pre-commencement expenditure & cost of Building is not allowed as deduction u/s 35(2AB). Thus, company will not be able to claim 100% depreciation on them. But they are allowed as deduction @ 100% u/s 35(1)(iv) & 35(2). Hence, company will be entitled to claim 100% deduction on Pre-commencement expenditure & cost of Building u/s 35(1) (iv) & (2).

Points to Remember:

- ✚ Deduction of Pre-commencement expenditure shall be allowed in the year of commencement of business to the extent certified by the prescribed authority.
- ✚ Assessee must incur the expenditure on scientific research. Actual payment is not compulsory.
- ✚ Assessee is not eligible for deduction by mere transfer of asset from business purpose to scientific research purpose [i.e Merely by transfer entry in books of accounts].
- ✚ No depreciation u/s 32 will be allowed on any capital asset whose cost has been allowed as deduction u/s 35.
- ✚ It is not necessary that the capital asset must be complete in all respect & used for scientific purpose in the PY itself. It is also irrelevant that construction of building is not completed the building has not been used in PY.
- ✚ No deductions u/s 35(2AB) shall be allowed to company accepting donations u/s 35(1)(iia).
- ✚ UNABSORBED CAPITAL EXPENDITURE ON SCIENTIFIC RESEARCH: Treated same as unabsorbed depreciation (can be carried forward for infinite years without any time limit).

B. Contribution Made by Assessee to Outsider [Related to Business or Not]

| Purpose | Sec | Contribution to whom | Deduction |
|---------------------|------------|--|-----------|
| Scientific Research | 35(2AA) | National laboratory/ National university/ IITs/ IIMs | 100% |
| | 35 (1)(ii) | Approved Research association / University / College / Other institution | 100% |
| | 35(1)(iia) | Company Registered in India having scientific research as its main business objective. | 100% |

| | | | |
|--------------------------------|------------|--|------|
| | | Note: The recipient company cannot claim weighted deduction u/s 35(2AB) but can claim 100% deduction. | |
| Social or statistical Research | 35(1)(iii) | Approved Research association / University / College / Other institution | 100% |

Note: Deduction of contribution made shall not be denied merely on the ground that the approval granted to such institutions was withdrawn after payment of such sum by the assessee to them.

Note: if assessee is not carrying any business / profession, such donation are allowed as deduction u/s 80 GGA {100%}.

Note: Receiver of donation can utilize the donation for the prescribed research. There is no condition that such research should be related to business of assessee.

Note: Unabsorbed research capital exp. can be setoff & C/f same as unabsorbed Dep.

Sale of Scientific Asset [Sec 41(3)].

Assessee may use scientific research asset for his other business purpose after completion of scientific research. [Conversion of scientific research asset into normal business asset]
OR

Assessee may sell scientific research asset without using it for another purpose after completion of scientific research. In both cases, tax liability could arise.

1. Asset is sold after using it for Business / Transfer to any other business :

- Cost of Acquisition = Nil (Since whole of the cost has been allowed as deduction)
- No Depreciation will be allowed on such asset when it is used for other business.
- The asset shall be added to the existing block of assets of the other business.

2. Asset is sold without using it for business:

- PGBP Taxable Amount = Lower of (i) Sale Price or (ii) Deduction allowed u/s 35.
- Capital Gain = Excess of Sale price over cost of acquisition.

Investment in Specified Business [Sec 35AD]

✚ Only Capital Expenditures are covered u/s 35AD [Other than Land/GW/Financial Instrument]. This section is optional to assessee.

Nature of Specified Business

1. Setting up & operating a Cold chain facility.
2. Warehousing facility for storage of agricultural produce.
3. Warehousing facility for storage of sugar
4. Production of Fertilizer
5. Hospital (at least 100 Beds)
6. Cross country pipeline for petroleum or crude oil, natural gas
7. Hotel (2 Star & above) + if outsourced the hotel operation to any other person.
8. Slum Re-development Housing
9. Affordable Housing project.
10. Bee-keeping & production of honey & bees wax
11. Setting up & operation ICDs (inland container depot) or CFS (container freight station)
12. Laying & Operating Slurry Pipeline for the transportation of iron ore.
13. Setting & operating Semiconductor Wafer Fabrication Manufacturing unit
14. Developing or maintaining & operating or developing, maintaining & operating a new infrastructure facility. (Toll Road, Highway, Bridge, Water treatment system, port, airport)

Permissible Expenditure for Deduction

| | |
|-------------------------------|--|
| 1. Prior Period Expenses | If Capitalized in the books of accounts. |
| 2. Post commencement expenses | Any Capital Expenditure incurred during the PY. Except on Land, Goodwill, Financial Instrument. |

Note: Any Expenditure for Acquisition of any Asset for which the aggregate payments made to a person in a day, otherwise than by A/c Payee Cheque or A/c Payee Draft or Electronic clearing system exceeds ₹ 10,000 would not be eligible for deduction.

Terms & Conditions:

1. It is NOT set up by Splitting up or reconstruction of a business already in existence.
2. It is NOT set up by transfer of Second-hand Plant & Machinery.

Exceptions:

(a) Imported P&M will be treated as new for this section &

(b) Used P&M upto 20% of Total value of P&M shall be allowed under this section.

3. No Deduction under any other section: If deduction is claimed and allowed under section 35AD, the assessee shall not be allowed any deduction in respect of the specified business under the provisions of Chapter VIA under sections 80HH to 80RRB or under section 10AA for the same or any other assessment year. (i.e 10AA, 80IA, 80IAB, 80IB, 80IC, 80ID, 80IE, 80JJA, 80JJAA, 80QQB, 80RRB) in any PY or u/s 35 AD in any other PY.)

4. Use of Asset till 8 years for Specified Business only: Where such asset is used for any purpose other than specified business during 8 years, following amount shall be deemed to be the income (PGBP) of the assessee of the PY in which the asset is used for Non-Specified purpose. { For example: T/f to Non-Specified Business.}

PGBP Income = Total Deduction Claimed & Allowed in one or more PYs - Depreciation u/s 32 allowable as if no deduction was allowed u/s 35AD

Exception: If the company becomes a sick within 8 years, this provision will not be applicable.

Note: Sale of asset for which deduction claimed u/s 35AD to be treated as PGBP income.

Note: Set-off & C/F of losses

Intra Head Adjustments = Only losses U/s 35AD to U/s 35AD allowed.

Inter Head Adjustments = Not allowed losses U/s 35AD to any other head.

Carry forward = Indefinitely but only set-off against U/s 35AD in future years.

Expenditure on Agricultural Extension Project [Sec 35CCC]

✚ Deduction = 100% of such expenditure [Except cost of Land or Building]

✚ Eligible Assessee: Any Assessee.

✚ Project shall have prior approval of ministry of Agriculture, GOI.

Contribution for Rural Development Programmes [Sec 35CCA]

✚ Any sum paid to the following is eligible for 100 % Deduction u/s 35CCA

- Associations to be used for carrying out rural development;
- Associations which trains people for implementation of rural development programme;

National Fund for rural development & National Urban Poverty Education Fund.

Note: if assessee is not carrying any business / profession, such donation are allowed as deduction u/s 80 GGA {100%}.

Expenditure on Skill Development Project [Sec 35CCD]

- ✚ Amount of Deduction: 100% of such expenditure. [Except cost of Land or Building]
- ✚ Eligible Assessee → Company.
- ✚ It should be incurred on Public Private Partnership Project for skill development in manufacturing sector.

Amortization of Preliminary Expenditure [Sec 35D]

Assessee

- (a) Indian Company or
- (b) Any other person Resident in India. { Ind / HUF / Firm etc.} i.e not available to a foreign company or NR.

Eligible Expenditure

- (a) In case of New companies → Expenses for setting up any business. {Before Comm}
 - (b) In case of Existing companies → Exp for Expansion of Business / setting up new unit.
- ✚ Expenditure on Preparation of feasibility report, Project report, conducting market survey or engineering services relating to the business.
 - ✚ Legal charges for drafting any agreement relating to the business.

Accordingly, the CBDT has, vide this notification, inserted Rule 6ABBB to prescribe that the statement containing particulars of above specified expenditure is required to be furnished one month prior to the due date for furnishing the ROI as per section 139(1).

Related to Company

- ✚ Legal charges for drafting the MOA & AOA of the company.
- ✚ Printing charges of the MOA & AOA of the company.
- ✚ Registration fees of the company.
- ✚ Expenditure on public issue of shares/debenture, underwriting commission, brokerage & charges for drafting, & advertising prospectus.

Maximum Limit

- | | | |
|----|----------------|---|
| 1. | Indian Company | Higher of 5% of [Cost of Project OR Capital Employed] |
| 2. | Any other | Assessee 5% of Cost of Project. |

Qualifying Expenditure

- | | |
|----|-------------------------------------|
| 1. | Eligible Expenditure incurred or |
| 2. | Maximum Limit (whichever is Lower). |

Deduction 1/5th of the Qualifying expenditure in 5 successive PYs.

Audit **COMPULSORY AUDIT** for the years in which expenditure is incurred.

Meaning of Cost of Project → Actual cost of Fixed assets [L & B, P & M, F & F etc];

Meaning of Capital Employed → Aggregate of Issued share capital, Debentures, borrowings; (for both as on the last day of PY in which business is commenced).

Note: If Indian Co. is amalgamated with another Indian Co. before expiry of 10 years → Above provisions will apply to amalgamated Co. as if the amalgamation had not taken place.

Amortization of Compensation Paid Under VRS [Sec 35DDA]

Eligible Assessee = Any Assessee.

Eligible Expenditure = Payment of any sum to Employee for his voluntary retirement (VRS)

Deduction

- ✚ 1/5th of Expenditure shall be deductible for 5 succeeding PYs.
- ✚ Each Part Payment of VRS is deductible in 5 Instalments.
- ✚ 1st Instalment is deductible in the PY in which such sum is Actually Paid.

Note: In case of any Business Re-organization → Deduction shall be allowed to resulting company (organisation) for Remaining years.

Miscellaneous Deductions [Sec 36(1)]**Insurance Premium Paid On: Sec 36(1)(i)**

Stocks or stores against risk of damage or destruction.

- (ia) Lives of Cattles owned by members & paid by primary milk co-operative society.
- (ib) Health of Employees → Paid by the employer [Any mode other than Cash] & KIP paid by employer.

Bonus or Commission [Sec 43B will Apply] : Sec 36(1)(ii)

Bonus/commission PAID to the Employees by the employer. [not payable as profit or dividend]

Note: Amount 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 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.

Interest on Borrowed Capital for Business: Sec 36(1)(iii)

Interest for the period **after** the asset is put to use is allowed as **deduction**.

Note: Interest payable for the period **before** the asset is put to use → **Capitalized** & added to COA of Asset & thus not deductible u/s 36(1)(iii).

Points to Remember:

- ✚ Interest on own capital is → Not deductible.
- ✚ Guaranteed interest paid to shareholders on paid-up capital → Not Deductible.
- ✚ Interest paid on money borrowed for payment of dividends → Deductible.
- ✚ Interest paid on money borrowed for payment of Tax → Not Deductible.
- ✚ Interest paid by a firm to partners → Deductible;
- ✚ Interest paid by AOP to its members → Not Deductible.

Amortization of Exp. on Zero Coupon Bond by Issuing Co.: Sec 36(1)(iiia)

A Amortization of Discount on a Zero-Coupon Bond is deductible over the life of such bond.

Tax Treatment in the hands of Issuing Company

- ✚ Discount (Amount payable on Maturity - Issue Price) on ZCB is deductible on Pro rata basis.
Pro rata basis: Over the life (Calendar months) of ZCB { Days ≥ 15 = 1 Month}
- ✚ No TDS u/s 194A by the payer company.

Tax Treatment in the hands of Investor

- ✚ Maturity or redemption of ZCB will amount to transfer u/s 2(47)(iva).

Employer's Contribution: Sec 36(1)(iv)/(v)

RPF or Approved SF, Subject to section 43B.

- (iva) Pension scheme to the extent of Lower of:

Actual Contribution or ~~10%~~ 14% of salary (Basic + DA(R)) of the employee in PY.

Approved Gratuity Fund subject to Section 43B.

Employee's Contribution: Sec 36(1)(va)

Employee's contribution towards RPF/SF/ESIC, if deposited by the employer before DD.

Note: EE's contribution is first included in total income of the employer. Then deduction is given under this section if the sum received is deposited on or before due date of relevant fund. In effect extended time u/s 43B not applicable here i.e due date of filing of ITR.

Animal Allowance

✚ An Allowance for dead/Permanently useless animals which were used in the business.

✚ Amount of Deduction = Purchase Price of animals - Sum realized on sale of death body.

✚ When Allowed: PY in which animal dies or becomes permanently useless for business.

Bad Debts (Excluding Provisions for Bad Debt) : Sec 36(1)(vii)

Conditions:

✚ Debt (Sale) must be incidental to the business.

✚ Such debt must be charged as income in computing the income if the assessee of any PY

✚ Must be written off in books of accounts.

✚ Debt may be money lent in the ordinary course of banking or money lending business

Second Proviso inserted by FA, 2015: If whole or part of Debt has been included in the income of PY in which it becomes irrevocable or earlier PYs without recording the same in the books of accounts; such Debt amount shall be allowed in PY in which, it becomes irrevocable and it shall be deemed that such amount has been written off in A/cs

Other points:

1. In case of succession → Successor is entitled to claim the deduction when a debt originally due to the predecessor is written off as bad debt by the successor in his books of accounts.

2. Recovery of Bad debts is taxable as PGBP income in the PY of recovery. [sec 41(4)]

3. Bad debts for discontinued business = Disallowed.

Expenses on Family Planning: Sec 36(1)(ix)

✚ Any expenditure incurred by the company (Indian / foreign) for promoting family planning amongst employees will be allowed as deduction in the hands of company.

Amount of Deduction will be as follows:

- ✚ Revenue Expenditure: Fully allowed in the PY in which it is incurred.
 - ✚ Capital Expenditure: 1/5th of the expenditure allowed in 5 PY's.
- Note: Treatment of Unabsorbed family planning expenditure is same as treatment of unabsorbed depreciation.
- (xv) Securities Transaction Tax [STT] paid by the assessee is deductible if the income arising from such a taxable securities transaction is included u/h "PGBP" i.e not held as investment.
- (xvi) Commodity Transaction Tax [CTT] paid by the assessee is deductible if the income arising from a taxable commodities transaction is included u/h "PGBP" i.e not held as investment.

Marked to market loss : Sec 36(1)(xviii)

MTM loss: - As per ICDS - Allowed

Others - Not Allowed

General Deductions [Sec 37]

- ✚ Section 30-36 provides for **Specific deductions** in respect of certain expenditures.
- ✚ But still there can be **Certain Expenditures** which might not get covered in Section 30-36.
- ✚ Thus **Section 37** provides for **General deductions**.
- ✚ **Only Business Expenditure is Allowable u/s 37.**
- ✚ Deduction u/s 37 is limited only to the amount actually expended & does not extend to a reserve created against a contingent liability.
- ✚ Business losses such as those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc is allowable u/s 29 as losses incidental to the business.

Conditions for Allowance U/S 37:

Such expenditure shall

1. Not covered in Sec 30 to 36.
2. **Not a capital expenditure** (Only revenue expenditure is deductible u/s 37).
3. Incurred during the PY & It must have been incurred after the business was set up.
4. Incurred wholly & exclusively for business (**Personal Expenditure is NOT deductible**).
5. Legal Purpose only: Expenditure should not be for any purpose which is an offence or prohibited by law.

Example of expenditure: - Salary, telephone, festival exp., advertisement.

Points to Remember:

1. There should be Nexus between Expenses & business.
2. Exclusive benefit may or may not be derived by the assessee. Section 37 requires that the expenditure should be wholly & exclusively incurred for purpose of the business. AO cannot question the necessity of the expenditure in allowing the deduction for such expense which was incurred for the purpose of the business but was unnecessary.
3. Expenditure For = IPO, FPO, Right Shares = **Capital Exp = Not Allowed**
= Buy Back of Shares, Bonus Share, Debenture or Loan = **Revenue Exp = Not Allowed**

Some Important Decisions based on Case Laws:

| Particulars | Deduction u/s 37(1) |
|--|---|
| Penalties imposed for Infraction of Laws | Not Allowed |
| Penalty paid for failure to deduct TDS | Not Allowed |
| Any interest or penalty paid under Direct tax laws | Not Allowed |
| Interest paid to Sales tax Department on Arrears of Sales tax | Allowed |
| Penalty levied under CST Act. | Not Allowed |
| Demurrage paid to port authorities for releasing confiscated goods. | Allowed as it is not a fine. |
| Interest paid under Employees PF & Misc. provision Act, 1952. | Allowed |
| Penalty paid by the assessee (contractor) for non-completion of contract within stipulated time. | Allowed as it is not a fine paid for infraction of law. |

Some Important Circulars:

1. Expenditure on keyman insurance policy: Premium paid allowable as business expenditure.
2. Expenditure incurred on CSR: Not deemed to be incurred for Business & thus not deductible.
3. Expenses incurred in providing freebees to medical practitioner: violation of the provisions of Indian Medical Council Regulations, 2002. Thus, freebees enjoyed is also taxable as business income or IFOS.

Amendments Introduced by FA 2022 in General Deduction (Sec 37)

- ✚ Expenditure for any offence or prohibited purpose - **Not allowable.**
- Scope of expenditure for any offence or prohibited purpose [Explanation 3]
- Such expenditure shall include the expenditure incurred by an assessee,
1. For any purpose which is an offence under, or which is prohibited by, any law for the time being in force, in India or outside India; or
 2. 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 guideline, as the case may be, for the time being in force, governing the conduct of such person; or
 3. To compound an offence under any law for the time being in force, in India or outside India.
 4. **To settle proceeding initiated in relation to contravention under such law as may be notified by the central Govt.**

Contribution to Political Parties [Sec 37(2B)]

- ✚ Any expenditure on advertisement in any souvenir, brochure, tract, pamphlet published by Political parties is **not deductible.**
- ✚ However, it can be claimed as deduction u/s 80GGB & 80GGC as "Donations to PP".

Section 38(2)

Where any building, machinery, plant or furniture is not exclusively used for the purposes of the business/profession, deductions shall be restricted to a proportionate use thereof.

Specific Disallowances

Section 40(a)(i): Interest, Royalty, FTS Or Any Other Sum to NR

Payable out of India (to any person) or Payable in India (to any NR or Foreign Company)

| | |
|---------------------------------------|---|
| Conditions for Disallowance | (i) Tax is not deducted before the end of the PY. OR (ii) Tax is deducted but not paid before due date of filing ROI u/s 139(1). |
| Consequences | 100 % of such amount paid/payable is disallowed in that PY |
| Deduction or Payment in Subsequent PY | (i) Where tax has been deducted in any subsequent PY OR (ii) has been deducted during the PY but paid after the Due date; |

then 100% of such sum shall be allowed as deduction in computing the income of PY in which such tax has been paid (PY of Payment of tax to government).

Most Important point to be noted;

(i) Tax should be deducted before the end of PY (i.e before 31st march of the relevant PY)

AND

(ii) Such deducted tax should be paid to govt. before due date of filing ROI u/s 139(1).

Both the conditions should be satisfied together to get deduction in the relevant PY.

There may exist a situation when tax is deducted after 31st march of the relevant PY but such tax is paid to government before due date of filing ROI. In such case, amount paid shall be disallowed in the relevant PY since tax has not been deducted before 31st march.

However, it will be allowed as deduction in the next PY.

Payments to Resident (on which TDS Applicable) [Sec 40(a)(ia)]

| | |
|---------------------------------------|---|
| Conditions for disallowance | (i) Such tax is not deducted before the end of PY OR (ii) Tax is deducted but not paid before Due Date of ROI u/s 139(1) |
| Consequences | 30% of such amt. paid/ payable is disallowed as deduction in that PY. |
| Deduction or payment in Subsequent PY | (i) Where tax has been deducted in any subsequent PY OR (ii) has been deducted during the PY but paid after the said DD, 30% of such sum shall be allowed as deduction in computing the income of the PY in which such tax has been paid. |

Payment of Tax by Payee of such sum [Sec 201]

✚ If Tax on such income has been paid by the payee by showing such sum as his income in his ROI, then it shall be deemed that Assessee has deducted & paid tax & thus No disallowance under this section. In addition of above a certificate is required from CA by Payer.

✚ Deemed Date of TDS & Payment of tax → Date of filing ROI by the payee.

Since date of filing ROI by resident payee is deemed to be the date on which the payer has deducted & paid tax → 100% / 30% of such expenditure/payment shall be disallowed u/s 40(a)(ia) in the year in which the said expenditure is incurred.

However, 100% / 30% of such expenditure will be allowed as deduction in the subsequent year in which ROI is furnished by the resident payee.

Salary Paid Outside India / to Non-Resident [Sec 40(a)(iii)]

Payment of Salary on which tax has been **neither deducted** before the end of PY nor paid to Govt. upto due date of TDS payment (7th of next month)

- Payable out of India (to any person), or
- In India (to any NR).

Tax Paid by Employer on Non-Monetary Perquisites [Sec 40(a)(v)]

Tax paid on non-monetary perquisites by the employer → **Not Deductible to Employer.**

Such tax will be **exempt** in the hands of employee - [Sec 10(10CC)]

Income Tax Paid (Include Surcharge & HEC)

On business income is not deductible - Section 40(a)(ii)/(iia)

Payment Made by State Govt. undertaking to state govt. of royalty or any other sum [SECTION 40(a)(iib)]

Not allowed as deduction.

Disallowance in Case of Partnership Firm / LLP [Sec 40(b)]

A. Remuneration to Partner [Salary/Bonus/Commission/by whatever name]

Following payments to partners are **disallowed** in the hands of Partnership firm:

1. Remuneration to Non- Working Partner.
2. Remuneration to Working Partner if:
 - (a) Not Authorized by Partnership deed.
 - (b) Not in Accordance with T&C of partnership deed.
 - (c) For the period prior to the date of agreement.
 - (d) Exceeding the limit given below ↓

| Book Profit | Amount of Remuneration |
|---|--|
| Book Loss OR Upto ₹ 3 Lacs ₹ 6 Lacs of Book Profit | ₹ 1.5 Lacs ₹ 3 Lacs OR 90% of Book Profit |
| | [Higher] |
| On the balance of Book Profit [Above 6 Lacs] | 60% of the Book Profit |

Meaning of Book Profit

Net Profit under PGBP

(-) Current year + B/f unabsorbed Depreciation

(+) Remuneration (if Dr to P&L A/c)

Note: Share of Profit received by a partner exempt in the hands of partner U/s 10(2A).

B. Interest Paid to Partners

Interest paid to partners is **disallowed** in following cases:

- (a) Not Authorized by Partnership deed
- (b) For the period prior to the date of Partnership Deed.
- (c) At a Rate Exceeding 12% p.a.

Explanation:

- I. Where an Individual is a Partner in the Firm in Representative Capacity.
 - Interest paid by firm to such individual in Individual capacity shall NOT be considered.
 - Interest paid by firm to such individual in Representative capacity shall be considered.
- II. Where an Individual is a Partner in the Firm in Individual Capacity
 - Interest paid by firm to such individual on behalf of any other person is not considered.

Remuneration Paid by AOP/BOI to its Member [Sec 40(ba)]

✚ Salary, Bonus, Commission paid by AOP/BOI to its Member → Not Deductible.

Disallowance of Payment Made to Specified Persons/Relatives in Excess of Fair Market Value [Sec 40A(2)]

Payment made to relative in excess of fair value - not deductible: if the

✚ Payment made to specified persons and

✚ The assessing officer is of opinion that such expenditure is excessive or unreasonable, So much of excessive or unreasonable will be disallowed.

Meaning of specified persons:

Applicability:

- (a) Payment for any Expenditure is made to a related person / person having substantial interest in the business AND
- (b) Such payment is considered to be excessive or unreasonable by AO.
- Disallowance: Expenditure to the extent it is Excessive or unreasonable to the FMV is Disallowed.

Meaning of Relatives:

| Payer | Payments made to/received by (Payee) |
|--------------------|--|
| Individual | (i) Relative; (ii) Person in whose business; individual or his relative has a substantial interest. |
| Company | (i) Director of the company & their relatives (ii) Person in whose business; Company, Director or his relative has substantial interest. (iii) Relative of such Director/Partner/Member or any other Company carrying on business or profession in which the first mentioned Company has substantial interest. |
| Firm | (i) Partner & their relatives; (ii) Any Person in whose business; firm, partner or their relatives has substantial interest. |
| AOP | (i) Member & their relatives; (ii) Any Person in whose business; AOP, Member & their relatives has substantial interest. |
| HUF | (i) Member & their relatives; (ii) Person in whose business; HUF, Member & their relatives has substantial interest. |
| Any other Assessee | (i) Individual who has a substantial interest in the Assessee's business/profession, or relatives of such individual, or |

- (ii) Company/ firm/ AOP/ HUF/ having substantial interest in the assessee's business or profession, or any director/ partner/ Member of such company/ firm/ AOP/ HUF, or any relative of such director/ Partner/ Member.

Relative Means: Spouse, Father, Mother, Brother, Sister, lineal descendants, or lineal ascendants of individual.

Payment in Cash [Other than A/c Payee Cheque Etc] [Sec 40A(3)]

Conditions for Disallowance u/s 40A(3)

1. Assessee incurs any revenue expenditure exceeding ₹ 10,000 which is deductible u/h PGBP.
2. **A Payment** or **Aggregate of Payments** made to **A Person** in **A Day** for an Expenditure exceeds ₹ 10,000 [₹ 35,000 in case of payment made for Plying, Hiring, Leasing Goods Carriages].
3. Above Payment is made otherwise than by A/c payee cheque/draft/Internet Banking. Then → **NO DEDUCTION** shall be allowed for such expenditure.
Ex: If for an expenditure of ₹ 32,000 incurred by X Ltd, 4 cash payments of ₹ 8,000 each are made on a particular day to Mr. Y as: (1) Morning at 10 AM; (2) @ 12 Noon; (3) @ 3 PM & (4) @ 6 PM, Entire expenditure of ₹ 32,000 would be disallowed u/s 40A(3), since Aggregate cash payments made during a day to Mr. Y > ₹ 10,000.

Points to Remember:

1. If any expenditure has been allowed as deduction in any earlier PY on accrual basis (if assessee is following accrual basis) & payment for such expenditure has been made in any subsequent PY exceeding ₹ 10,000/35,000 in cash to a person in a day, then such payment shall be deemed to be the income of the PY in which payment is made.
2. Repayment of Loans → Sec 40A(3) doesn't Apply.

But it applies to interest payments since interest is a deductible expenditure.

Exceptions: [In these cases, Rule 6DD, **NO Disallowance even if amount paid > ₹ 10,000**]

1. Payment made to Banks (including Private & Co-operative Bank, Credit Societies, UTI & LIC.)
2. Payment made to Govt when such payment is required to be made in legal tender.

3. Payment through Banking System.
4. Payment by Book entry (Adjustments against any liability incurred).
5. Payments made to the Cultivator, Grower or Producer of agricultural, forest, animal husbandry or dairy or poultry, fish, horticulture, apiculture products.
6. Payment to the producers of goods in cottage industry without the aid of power.
7. Payment made at the place which on the date of payments is not served by bank.
8. Any terminal benefits [Ex: Retirement benefit etc.] \leq ₹ 50,000.
9. Payment to Employees on temporary posting for continuous period of 15 days or more if such payment is made after TDS & such employee does not maintain any bank A/c at such place.
10. Payment made on a day on which Banks were closed due to holiday or strike.
11. Payments made by any person to his commission agent who is required to make payment in cash for goods or services on behalf of such person.
12. Payment made by Authorized Dealer or Money changer against purchase of Foreign currency or Traveller's cheque in the normal course of his business.

Provision for Gratuity to Employees [Sec 40A(7)]

✚ Any Provision made for payment of gratuity which is Not yet due → Not Deductible.

Exceptions:

1. Contribution towards Approved Gratuity Fund.
2. Provision for Gratuity that has become Due & Payable during PY by virtue of Employee's Retirement, Death, Termination of service etc.

Contribution by Employer to Unrecognized PF [Sec 40A(9)]

✚ Contribution to Any Fund which is not required by Law (Non-Statutory) is not allowed as deduction.

Deemed Profit & Their Treatment [Sec 41]

Recovery Against Any Deduction [Sec 41(1)]

✚ Deduction of any Loss, Expenditure or Trading Liability was allowed in any earlier year; &

✚ During the current PY, the assessee has obtained:

- Refund of such expenditure OR

- Some Benefits in respect of such Trading liability. (Remission/Cessation of such liability; then

Such refunded expenditure or remitted/ceased liability shall be deemed to be the income of the Assessee.

✚ Year of Taxability → PY in which Amount is Recovered OR Liability is Remitted.

Examples:

1. ₹ 1,50,000 is paid as sales tax by X during PY 2023-24 & same is allowed as deduction. Mr. X claims a refund of ₹ 10,000 on 16/06/2025 from sales tax department after getting a favourable verdict from Delhi High Court. ₹ 10,000 is taxable for the PY 2025-26.
2. Suppose before the verdict of Delhi High Court, X dies & the business is continued by his son Y who gets a refund of ₹ 10,000 from the sales tax department, ₹ 10,000 is taxable as business income of Y.
3. An assessee is allowed deduction for PY 2023-24 in respect of ₹ 42,000 misappropriated by his cashier. In PY 2025-26 ₹ 8,000 (out of the sum so misappropriated) is recovered by the assessee. ₹ 8,000 is chargeable to tax as business income for PY 2025-26.

Balancing Charge [Sec 41(2)]

✚ Balancing Charge on assets on which depreciation is charged on SLM basis, in case of power generating/distributing undertakings.

✚ Year of Taxability: Year of transfer/sale.

Difference between WDV of asset & sale price is taxable u/h PGBP as balancing charge.

Sale of Asset Used for Scientific Research [Sec 41(3)]

✚ PGBP Taxable Amount = LOWER OF (1) OR (2).

(a) Deduction Allowed U/s 35(1)(iv) OR

(b) Sale Proceeds.

{if sale price > cost then capital gain also arise}

✚ Year of Taxability: Year of transfer/sale.

Recovery of Bad Debt Allowed as Deduction U/S 36(1)(vii) [Sec 41(4)]

✚ Year of Taxability: Year of Recovery.

Adjustment of Loss [Sec 41(5)]

- ✚ Generally, loss from business cannot be c/f after 8 years.
- ✚ However, loss suffered in the year of Discontinuance (only) can be set off against any income taxable u/s 41(1), (3), (4), (4A) [Above deemed Incomes].

Expenditures Deductible on Payment Basis Only [Sec 43B]

- ✚ Conditions for Applicability of 43B: Assessee following Mercantile Basis of Accounting only. Following Expenses (which are deductible in normal circumstances) are deductible in the relevant PY only if they are paid before due date of filing ROI of such PY u/s 139(1).
1. Tax, Duty, Cess or Fee (by whatever name called) levied under any law.
 2. Employer's Contribution to any PF/SF/Gratuity Fund or any recognized welfare fund.
 3. Bonus, Comm., leave salary to EEs [Arrears of salary & other benefits → not covered in 43B].
 4. Interest on any Loan or borrowing from any PFI/State Financial Corp/State Industrial Investment Corp.
 5. Interest on any Loan or advances from a Scheduled Bank (including co-operative bank).
 6. Sum payable by the employer in lieu of any Leave standing at the credit of his employee.
 7. Interest payable on any loan or borrowing from notified class of non-banking financial companies, in accordance with the T&C of the agreement governing such loan or borrowing.
 8. Any sum Payable to Indian Railways for the use of Railways Assets.
 9. Conversion of interest payable into debenture or any other instrument not be deemed to paid.

Points to Remember:

- ✚ Conversion of unpaid interest into Fresh Loan/Deb by Bank /FI → If unpaid Interest is converted into Loan/Advances, it shall not be deemed to be paid & thus no deduction shall be allowed. Deduction allowed in the year of such converted interest paid.
- ✚ Conversion of unpaid Sales tax into Loan by State Government → If unpaid sales tax is converted into loan by State Government, it shall be deemed to have been paid & thus deduction shall be allowed.

| | |
|--|---|
| Deposit taking NBFC | NBFC which is accepting or holding public deposits & is registered with RBI. |
| Systemically Important Non-Deposit taking NBFC | NBFC which is not accepting or holding public deposits & having total assets \geq ₹ 500 crore as per last audited balance sheet & is registered with RBI. |

Amendments introduced through Budget 2023

Any sum payable by the assessee to Micro or Small enterprises beyond the time limit of MSME Act 2006 would be allowed as deduction only in that PY in which such sum is actually paid.

- If there is written agreement (which can not be more than 45 days) = On or before agreed date between them in writing.
- If there is no such written agreement = Payment within 15 days.

Example: Mr Joy has purchased goods of Rs. 15,000 from PK & Co. a micro enterprise on 05/03/2024. As per the written agreement payment has to be made by 08/04/2024. Mr. Joy follow the mercantile method of accounting.

Case 1 = If Mr Joy paid the sum on 06/04/2024: since Mr. Joy paid the sum on or before 08/04/2024 the deduction shall be allowed in PY 2023-24.

Case 2 = If Mr Joy paid the sum on 14/04/2024: since Mr. Joy paid the sum beyond 08/04/2024 the deduction shall be allowed in PY 2024-25.

Micro Enterprises

- In case of Manufacture or production of goods pertain to specified industries

Where investment in P&M \leq 25 Lakhs.

- In case of providing or rendering service

Where investment in equipment \leq 10 Lakhs.

Small Enterprises

- In case of Manufacture or production of goods pertain to specified industries

Where investment in P&M exceed 25 Lakhs But doesn't 5 Crore.

- In case of providing or rendering service

Where investment in equipment exceeds 10 Lakhs doesn't 2 Crore.

Note: For calculating investment in P&M, the cost of pollution control, R&D, Industrial safety devices and such notified item shall be excluded.

Adjustment in COA of Asset Due to Change in Forex Rate [Sec 43A]

If any business asset is acquired/Loan is taken in Foreign Currency;

At the time of payment, there is a change in Foreign Exchange rates (as compared to the rates on the date of loan), Such difference [Increase/decrease in liability] shall be adjusted to the cost of acquisition of Asset to the extent of amount paid.

Such Increased/Decreased cost shall be taken into consideration for all purposes of Tax.

Note: Consider Profit/loss only on principal amount paid during PY & Ignore loss/profit on outstanding amount.

FVC I.R.O TRANSFER OF L&B HELD AS SIT [SEC 43CA] → To be Studied with Sec 50C u/h 'Capital Gains'.

Compulsory Maintenance of Books of Accounts [Sec 44AA]

Specified Professions

| | |
|--|--|
| Gross Receipt > ₹ 1,50,000 in All of the last 3 PYs. | Books prescribed u/r 6F. |
| Gross Receipt ≤ 1,50,000 in Any of the last 3 PYs. | Such books of account & documents which enable AO to compute their taxable income. |

Specified Profession: Specified Profession include persons carrying on Legal, Medical, Engineering, Architectural, Accountancy, Technical consultancy or Interior Decoration or any other NOTIFIED profession by CBDT.

Notified Profession: Authorised representatives, film artists, company secretaries & Information Technology.

1. INDIVIDUAL/HUF carrying **Business** or **Non-Specified Profession**:
 - Income > ₹ 2,50,000 OR Sale, T/O or GR > 25,00,000 in ANY ONE of the last 3 PY.
2. OTHER THAN INDIVIDUAL/HUF carrying **Business** or **Non - Specified Profession**:
 - Income > 1,20,000 OR Sales, T/O or GR > 10,00,000 in ANY ONE of the last 3 PY.
3. Person showing Lower Income than Income computed on Presumptive basis u/s 44AE.
4. If Sec 44AD(4) is applicable to him & his income exceeds BEL in any of those PY:
 - If Any assessee is NOT Eligible to claim the benefit of the provisions of Sec. 44AD(1) for 5 AYS subsequent to the PY in which the profit has not been declared on presumptive basis as per 44AD(1) & his Income exceeds BEL during the PY.
5. Person showing Lower Income than Income computed on Presumptive basis u/s 44ADA & Income exceed BEL.

Some Other Provisions: [Read once]

- (i) Place at which books are to be kept & maintained:
 - 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 & documents may be kept & maintained at the respective places.
- (ii) Minimum period of maintenance of books of account & other documents:
 - Minimum of 6 years from the end of the relevant AY.
- (iii) Books of accounts & documents prescribed in Rule 6F:
 - (a) Cash book; Ledgers
 - (b) Journal, if accounts are maintained on mercantile basis;
 - (c) Carbon copies of Bills & Receipts issued (serially numbered) for Amount > ₹ 25;
 - (d) Original Bills & Receipts issued to the person in respect of expenditure incurred by the person, or where such bills & receipts are not issued, payment voucher prepared & signed by the person, provided the amount < ₹ 50. Where the cash book contains adequate particulars, the preparation & signing of payment voucher is not required.

Books also include in **electronic form** or digital form.

(iv) If no books of account maintain = Penalty 25,000.

Additional requirement in case of person carrying on Medical Profession:

- (a) Daily case registers in Forms 3C.
 (b) Inventory under broad heads of the stock of drugs, medicines & other consumable accessories as on the First & last day of the PY used for his profession.

Compulsory Audit of Books of Accounts [Sec 44AB]

| Different Taxpayer | Circumstances when audit is compulsory |
|-------------------------------------|--|
| Business Person | If Total Sale, Turnover or Gross Receipt for PY > ₹ 1 Crore. ** |
| Professionals | If his Gross Receipts for PY > ₹ 50 Lacs. |
| Person covered u/s 44AE | If such person claims that his income is LOWER than Income computed on Presumptive basis. (Such Audit have nothing to do with their turnover) |
| Person covered u/s 44AD & Sec 44ADA | If such person claims that his income is LOWER than Income computed on Presumptive basis & his Income Exceeds BEL. |
| Person covered u/s 44AD(4) | If his Income Exceeds BEL. |

** Requirement of Compulsory Audit u/s 44AB does not apply to a person who declared profit u/s 44AD on presumptive basis & his Total Sales, Turnover, or Gross Receipts \leq ₹ 2 Crores.

** T/o limit is 10 Crore if cash received/payment does not exceed 5% of total receipt/ pay.

Note: Penalty if Tax Audit not done: - Lower of (a) 0.5% of Turnover or (b) 1,50,000.

Presumptive Income of Eligible Business [Sec 44AD]

Eligible Assessee

- ✚ Resident Individual/HUF/Partnership Firm (not being a LLP & AOP, BOI, Company) &
- ✚ Assessee has not claimed deduction u/s 10AA, 80IA - 80RRB in relevant AY.
- ✚ Eligible Business: Any business (other than Negative Listed).
- ✚ Turnover in the PY of such business does not exceed ₹ 2 Crores / ₹ 3 Crores if at least 95% receipt have been received through banking channel.

Negative list

The provisions of Sec. 44AD are NOT applicable to:

- (a) Person carrying on specified profession as referred in Sec. 44AA(1),
- (b) Person earning income in the nature of Commission or brokerage, or
- (c) Person carrying on any Agency business.
- (d) Business of plying, hiring, or leasing goods carriages specified u/s 44AE.

Income → 8% of Turnover.



However, Income = 6% of Turnover/GR for amount received by A/c Payee cheque / draft / Net Banking during PY or before DD of Filing ROI u/s 139(1)



Deductions → No Deduction u/s 30 - 38 shall be available.



Maintenance of Books → Not required.



Audit → Not required.

**Chapter VI-A Deductions**

U/s 80C to 80U shall be available to the Assessee. But 10AA, 80IA to 80RRB not allowed.



Advance Tax → 1 installment on/before 15th March.

**Depreciation**

Depreciation for subsequent PY when he ceases to be eligible assessee for section 44AD → WDV of the Assets shall be computed, as if Depreciation had been allowed in earlier year.



Business Loss → Losses can be carry forward.



Partners remuneration → Partners remuneration u/s 40(b) not allowed.

QUESTION: Can Assessee declare Lower Income?

ANSWER: YES, but

1. He will have to maintain books of accounts. &
2. If the declared income exceeds BEL, he will have to get his books of accounts audited.

SECTION 44AD(4):

If an eligible assessee declares profit for any PY as per 44AD on presumptive basis & he does not declare profit on presumptive basis as per section 44AD(1) for any of the next 5 consecutive PY, he becomes ineligible to claim the benefit of presumptive income as per 44AD(1) for next 5 AYS subsequent to PY in which profit has not been declared as per 44AD.

Presumptive Income of Eligible Professionals [Sec 44ADA]

Eligible Assessee

- ✚ Resident Person (Ind, Partnership Firm, not LLP) engaged Legal, Medical, Engineering, Architectural, Accountancy, Technical consultancy or Interior Decoration or any other NOTIFIED profession. Authorised representatives, film artists, company secretaries & Information Technology have been notified for this purpose till date.
- ✚ Gross Receipt does not exceed 50 Lacs / 75 Lacs if at least 95% receipt have been received through banking channel.
- ✚ Income → 50% of Gross Receipt. However, Assessee can declare Higher Income.
- No Deduction → No Deduction u/s 30 - 38 shall be available.
- ✚ Maintenance of Books → Not required.
- ✚ Audit → Not required.
- ✚ Chapter VI-A Deductions → Deduction u/s 80C to 80U shall be available to the Assessee
- ✚ Advance Tax → @ 1% PM for March in 1 installment on/before 15th March.
- ✚ Depreciation
- Depreciation for subsequent PY when he ceases to be eligible assessee for section 44ADA → WDV of the Assets shall be computed, as if Depreciation had been allowed in earlier year.
- ✚ Business Loss → Losses can be carry forward.
- ✚ Partners remuneration → Partners remuneration u/s 40(b) not allowed.

QUESTION: Can Assessee declare Lower Income?

ANSWER: YES, but

1. He will have to maintain books of accounts &
2. If the declared income exceeds BEL, he will have to get his books of accounts Audited.

Presumptive Income of Transport Assessee [Sec 44AE]

Eligible Assessee

- ✚ Persons carrying on business of plying, hiring, & leasing goods carriages & not owning more than 10 Goods Carriages at any time during the PY.

Income

| | |
|----------------------|--|
| Heavy Goods Vehicles | ₹ 1,000 per ton of gross vehicle weight or unladen weight for every month or part of it. |
|----------------------|--|

| | |
|---------------------------|--|
| Other than Heavy Vehicles | ₹ 7,500 for every month or part of it. [Note: irrespective of the weight] |
|---------------------------|--|

Only for the period during which vehicle is owned by Assessee in the PY.

✚ No Deduction

No Deduction u/s 30 - 38 shall be available.

However, Salary & Interest paid by firm to partner → Deductible.

✚ Maintenance of Books & Audit → Not required.

✚ Chapter VI-A Deductions → Deduction u/s 80C to 80U shall be available to the Assessee.

✚ Advance Tax → 1 installment on/before 15th March.

✚ Depreciation → Depreciation for subsequent PY when he ceases to be eligible assessee for section 44AE → WDV of the Assets shall be computed, as if Depreciation had been allowed in earlier year.

✚ Business Loss: Losses can be carry forward.

✚ Partners remuneration: Partners remuneration u/s 40(b) are allowed.

✚ Advance Tax: Not Mandatory

QUESTION: Can Assessee declare Lower Income?

ANSWER: YES, but

1. He will have to maintain books of accounts &
2. If the declared income exceeds BEL, he will have to get his books of accounts audited.

Meaning of Some terms:

| | |
|----------------------|--|
| Heavy Vehicle | Any goods carriage whose gross vehicle weight > 12,000 kgs. |
| Gross vehicle weight | Total weight of the vehicle & load certified & registered by the authority. |
| Unladen weight | Weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding (i) Weight of driver/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. |