

Profits and Gains from Business and Profession

Lesson 6

KEY CONCEPTS

- Business or Profession ■ Speculative Transaction ■ Depreciation ■ Block of Assets ■ Written Down Value 'WDV'
- Deemed Profits ■ Presumptive Taxation

Learning Objectives

To understand the:

- What are the constituent of Business or Profession?
- Which incomes are chargeable under the head PGBP?
- Computation of Taxable Income under the head PGBP?
- Which are admissible/inadmissible expenses while computing the income from business and profession?
- When are certain receipts deemed to be income chargeable to tax under the head PGBP?
- Which are the deductions allowable on actual payment basis?
- Which assesseees are required to compulsorily maintain books of account?
- When is audit of accounts compulsory?
- Who are the assesseees to whom presumptive tax provisions apply?

Lesson Outline

- 'Business' or 'Profession'
- Income Chargeable to Tax under the head Business or Profession
- Speculation Business
- Key Points for consideration
- Computation of Profits from Business or Profession
- Admissible Deductions
- Expenses Restricted/ Disallowed
- Deemed Profits
- Special provision in case of Income of Public Financial Institution
- Special provisions related to Insurance Business
- Compulsory Maintenance of Books of Accounts
- Compulsory Audit of Books of Accounts
- Presumptive Tax provisions to compute Income from eligible Business or Profession
- Special Provision for computing Profit & Gains of Business of Plying Hiring & Leasing Goods Carriages
- Question and Answers
- Case Laws
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

Sections	Income Tax Act, 1961
Section 28	Income chargeable to tax under the head Business or Profession
Section 43(5)	Speculation Transaction
Section 145	Method of Accounting
Section 145A	Method of Accounting in Certain Cases
Section 145B	Taxability of Certain Income
Section 30-37	Admissible Deduction
Section 2(11)	Block of Assets
Section 43(1)	Actual Cost
Section 43(6)	Written Down Value (WDV)
Section 40A	Expenses Disallowed
Section 43B	Disallowance of unpaid Statutory Liability
Section 43A	Changes in Rate of Exchange
Section 41	Deemed Profits
Section 43CA	Transfer of Immovable Property
Section 43D	Special provision in case of Income of Public Financial Institutions
Section 44AE	Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages
Section 44	Special provisions related to Insurance Business
Section 44AA	Compulsory maintenance of Books of Account
Section 44AB	Compulsory Audit of Books of Account
Section 44AD	Special provision for computing profits and gains of business on Presumptive Basis
Section 44ADA	Presumptive Taxation for Professionals
Rules	Income Tax Rules, 1962
Rule 5	Conditions for Allowability of Depreciation
Rule 6ABBA	Prescribed Electronic Modes

'BUSINESS' OR 'PROFESSION'

The concept of business pre-supposes the carrying on of any activity for profit. The definition of term '**business**' given in the Act does not make it essential for any taxpayer to carry on his activities constituting business for a considerable length of time.

The term 'Business, has been defined in Section 2(13) of the Income-tax Act to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

The definition of business given in Section 2(13) being an inclusive definition and not being exhaustive, is wide enough to cover every case of transaction entered into with the idea of earning income.

Example: If a person purchases a piece of land, gets it surveyed, lays down a scheme of development, divides it into a number of building plots and sells some of the plots from time to time, he would be chargeable to tax not only on the notional profits made on individual sale of plots but also on the surplus, if any, remaining after the sale of all plots and after the venture had come to an end.

According to the generally accepted principles, the meaning of the term '**profession**' involves the concept of an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator.

The term 'Profession' has not been defined in the Act. The term profession includes vocation [Section 2(36)]

For instance, an auditor carrying on his practice, the lawyer or a doctor, a painter, an actor, an architect or sculptor, would be persons carrying on a profession and not a business.

The common feature in the case of both profession as well as business is that the object of carrying them out is to derive income and to make profit.

Vocation simply means any type of activity in which a person is engaged and he earns his livelihood from such activity. Any gain or receipt arising out of vocation is certainly taxable under business and profession.

Example: Writing of articles in the magazines is also vocation. Vocation also refers to any work performed on the strength of one's natural ability for that work. Regularity and profit motive are not necessary for an activity to be called a vocation.

The distinction between business, profession and vocation is not however material because income from all these activities is taxable under the same head.

INCOME CHARGEABLE TO TAX UNDER THE HEAD BUSINESS OR PROFESSION [SECTION 28]

The scope of income chargeable under this head is covered by Section 28 of the Act which lays down the following:

(i)	Profits and gains of any Business or Profession: The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.
(ii)	Compensation: Any compensation received or receivable by any person; 1. For managing the whole or substantially the whole of the affairs of an Indian company or affairs in India of any other company or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto.

	2. For holding an agency in India for any part of the activities relating to the business of any other person or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto. 3. 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. 4. 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 derived by a trade, professional or similar association from specific services performed for its members: Income derived by any trade, professional or similar association from specific services performed for its members. This is an exception to the general principle of mutuality that no one can make profit out of himself. Therefore any surplus arising to the mutual associations such as Labour Welfare Association, Chamber of Commerce etc. by performing specific services to its members is deemed as income earned as carrying on business in respect of these services and accordingly chargeable to tax.
(iv)	Export Incentives: Profits on sale of a Import entitlement licence granted under the Imports (Control) Order. Cash assistance (by whatever name called) received or receivable against export under any schemes of the government of India. Any custom duty or excise duty drawback repaid or repayable to any person against export under the Customs and Central excise Duties Drawback Rules, 1971. Any profit on the transfer of the Duty Entitlement Pass Book Scheme or Duty Free Replenishment Certificate being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.
(v)	<i>The value of any benefit or perquisite arising from business or the exercise of a profession, whether convertible into money or not; or in cash or in kind or partly in cash and partly in kind</i>
(vi)	Value of any benefit or Perquisite: The value of any benefit or perquisite, whether convertible into money or not or in cash or in kind or partly in cash and partly in kind arising from business or the exercise of any profession. For example, value of a rent free accommodation secured by an assessee from a company in consideration of his professional services to the company will be assessable in the hands of the assessee.
(vii)	Any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm to the extent not been allowed to be deducted under section 40(b). For example: A firm pays interest to a partner at 18% simple interest p.a. The allowable rate of interest is 12% p.a. Hence the excess 6% 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. The interest taxable in the hands of the partner shall be 12% only.
(viii)	Any sum, whether received or receivable, in cash or kind, under an agreement for – (a) not carrying out any activity in relation to any business or profession, provided it is not taxable as capital gains. For example: Non-compete Fees. (b) 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.

(ix)	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 business income.
(x)	Fair market value of inventory as on the date of Conversion: The fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset determined in the prescribed manner, would be chargeable to tax as business income
(xi)	Any sum received from transfer or destruction of any Capital Asset: Any sum received or receivable, in cash or in kind, on account of transferred, demolished, discarded or destroyed of any capital asset (other than land or goodwill or financial instrument) whose cost has been allowed as a deduction under section 35AD.

Note: It is hereby clarified that 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 shall be chargeable under the head “Income from house property”.

SPECULATION BUSINESS

Section 43(5) defines the expression “speculative transaction” as “a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips”. 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 as per the Explanation to Section 73, this deeming provision does not apply to the following companies:

- (a) Where a company whose gross total income consists mainly of income which is chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources”, or
- (b) A company, the principal business of which is:
 - (i) the business of trading in shares or
 - (ii) banking business 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, the income from such business is not treated as income from speculative business.

Forms of transactions specifically excluded from the scope of speculative transactions

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

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 fluctuations; or

A **contract entered into by a member of a forward market** or a stock exchange in the course of any transaction which is in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as such member.

An eligible transaction (transaction carried out electronically through SEBI registered stock broker or sub broker or intermediary) in respect of **trading in derivatives** referred to in Clause (aa) of Section 2 of the Securities Contracts (Regulation) Act, 1956 carried out in a recognized stock exchange.

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 recognized association and chargeable to commodities transaction tax. In case of agricultural commodity derivatives the requirements of chargeability of commodities transaction tax shall not apply.

KEY POINTS FOR CONSIDERATION

The provisions of the Income-tax Act contained in Sections 28 to 44D regulate the method of computing income from business. The income from business to which a person is chargeable under this head represents not the gross receipts from the business but the profits and gains derived from there.

Method of Accounting

Income earned in cash or in kind

Continuation of Business or Profession

Ownership of Business is not necessary for Taxability

Business may be Legal or Illegal

Profit motive is not the sole consideration for taxability

Computation of income separately for each business

Method of Accounting [Section 145]

Income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting has not been regularly followed by the assessee,

or where the income has not been computed in accordance with the Income Computation and Disclosure Standards (ICDS) as notified, the Assessing Officer may make a best judgement assessment as provided in section 144 of the Income tax Act, 1961.

The Central Government vide Notification No. 87/2016 dated 29.09.2016 has notified Income Computation and Disclosure Standards (ICDS) to be applicable with effect from 1st April, 2017 onwards for the purpose of computation of income under the head “Profits and gains of business or profession” and “Income from other sources” and not for maintaining books of accounts. Some key features of ICDS are as under:

- (i) ICDS applies to all tax payers except Individual and HUF who are not covered under the tax audit provisions under section 44AB.
- (ii) ICDS applies only to tax payers following mercantile system of accounting.
- (iii) In case of conflict between the provisions of the Income Tax Act or Income Tax Rules and the ICDS, the provisions of the Act or the Rules shall prevail to that extent.
- (iv) In case of conflict between the judicial pronouncements/ judgements and the ICDS, the provisions of the ICDS shall prevail to that extent.
- (v) ICDS shall apply irrespective of the accounting standards adopted by companies, i.e., either Accounting Standards or Ind-AS.
- (vi) The provisions of ICDS shall not apply for computation of MAT. However it shall apply for computation of AMT as AMT is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act.
- (vii) ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. For example, for computing presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.

Method of Accounting in Certain Cases [Section 145A]

For the purpose of determining the income chargeable under the head “Profits and gains of business or profession”

- (i) the valuation of inventory shall be made at lower of actual cost or net realisable value computed in accordance with ICDS.
- (ii) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.
- (iii) the inventory being securities not listed on a recognised stock exchange, or listed but not quoted on a recognised stock exchange, shall be valued at actual cost as initially recognised in accordance with the ICDS.
- (iv) the inventory being securities listed and quoted on a recognised stock exchange, shall be valued at lower of actual cost or net realisable value in accordance with the ICDS.

Provided that the inventory being securities held by a scheduled bank or public financial institution shall be valued in accordance with the ICDS after taking into account the extant guidelines issued by the Reserve Bank of India in this regard. The comparison of actual cost and net realisable value of securities shall be made category-wise.

Taxability of Certain Income [Section 145B]

Notwithstanding anything to the contrary contained in section 145, the interest received by an assessee on any compensation or on enhanced compensation, shall be deemed to be the income of the previous year in which it is received.

Any claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

Subsidy or grant from Government as referred in definition of income under section 2(24) of the Act, shall be deemed to be the income of the previous year in which it is received, if not charged to income-tax in any earlier previous year.

Income earned in Cash or in Kind

The income that is chargeable to tax under this head may be realised by the assessee in cash or kind. In cases where the profit is realised in any other form than cash, the market value of the commodity received as income should be taken to be the quantum of income chargeable to tax. Even in cases where an assessee is in receipt of money from his clients or other persons who are under no obligation to make such payment, the assessee would still be chargeable to tax if these monies were received by him in the ordinary course of business or profession. For instance, any amount paid to a Company Secretary by a person who has not been his client but who has been benefited by his professional service to another, would be assessable as the Company Secretary's income from profession.

The person carrying on the business or profession would be chargeable to tax under this head regardless of the fact that the profits or gains made by him ultimately go to the benefit of some other person or to the business community or public body as a whole. In other words, the subsequent application of the money derived by way of income from business is immaterial for the purpose of assessment of the businessman.

Continuation of Business or Profession

The chargeability to tax under Section 28 is based primarily upon the condition that the assessee must have carried on a business or profession at any time during the accounting year, though not necessarily throughout the accounting year.

But there may be a few cases (e.g., deemed profits taxable under Section 41) where even if no business is carried on during the accounting year, the assessee would still be chargeable to tax.

Ownership of Business is not necessary for Taxability

In order to be taxable in respect of the income of a business, it is not essential that the business must be carried on by the same person who is the owner thereof. Even if the owner authorises some other person to carry on the business on his behalf or the owner is deprived by the court under certain circumstances of the right to carry on his own business, the owner will still be taxable under this head.

Similarly, it is not only the legal ownership but also the beneficial ownership that has to be considered. In this connection it has to be kept in view, as to who is the actual recipient of the income which is going to be taxed.

For example, where a business is acquired for the benefit of a company which is going to be incorporated and the promoters carry on the business and earn profits during the period prior to the incorporation, if the company accepts the action of the promoters and receives from them the past profits made prior to its incorporation, the company shall be assessable under this section in respect of such profits although before the incorporation of the company the promoters were the legal owners of this business yet as the company was the beneficial owner (as it has actually received the profits) of the business, it will be assessable on these profits.

Business may be Legal or Illegal

While profit motive is indicative of the fact that the adventure of an assessee is in the nature of trade and consequently constitutes a business, it is immaterial whether the business is legal or illegal. In other words, the taxability of the income from business does not in any way depend upon or is affected by the taint of illegality in the income or the sources. Income derived from illegal activities is as much chargeable to tax as income from other operations. The fact that the person who carried on the illegal activities is punishable under the appropriate law, does not exclude him from the liability to income-tax.

Even the benefits/deductions under the Act are not denied mere on the grounds of illegibility of business. As per the Supreme Court Judgement in the case of Dr. T.A. Qureshi, the loss arising on account of confiscation of heroin (drugs) is a business loss even it is illegal business. Such loss can be set-off against the profits of legal business.

Profit Motive is not the Sole Consideration for Taxability

There may be assessee who carry on business without the primary object of making profits (e.g., a co-operative society which tries to cater to the needs of its members without the object of making maximum profits). Even in such cases, if profits arise from the business carried on by the assessee and such profits are incidental to the business, the assessee would still be taxable. Therefore, profit motive is not the only test of determining the taxability of income from any activity constituting business or profession.

Computation of Income Separately for each Business

A taxpayer is entitled to carry on as many number of businesses as he possibly can, both in his own name and in the name of others. The profits and gains of all businesses or professions would be assessable under this head. But the profit of each business must be computed separately from one another and the deductions and allowance permissible to each business must be allowed against the income derived there from. The income chargeable under this head is the aggregate of the net result of the various business or businesses or profession(s) carried on during the accounting year. Thus, the loss arising from one business would be set off against income from another business falling under the same head and the net result after such set off would alone be assessable income under this head.

Business Income not taxable under the head “Business or Profession”

In the following cases, income though in the nature of profits and gains of business or profession is not taxable under section 28, under the head “Profits and gains of business or profession”:

1. *Rental income in the case of Dealer in Property:*

Rent of house property is taxable under section 22 under the head “Income from house property”, even if property constitutes stock-in-trade of recipient of rent or the recipient of rent is engaged in the business of letting properties on rent.

Explanation 3 shall be inserted to section 28 by the Finance (No. 2) Act, 2024, w.e.f. 1-4-2025:

It is hereby clarified that 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 shall be chargeable under the head “Income from house property”.

2. *Dividend on Shares in the case of a Dealer-in-Shares:*

Dividends on shares are taxable under section 56(2)(i), under the head “Income from Other Sources in case of a dealer-in-shares”, even if they are derived from shares held as stock-in-trade or the recipient of dividends is a dealer-in-shares.

3. *Winnings from Lotteries, races etc.*

Winnings from lotteries, races, etc., are taxable under the head “Income from other sources” etc. even if such income is derived through regular business activity.

COMPUTATION OF PROFITS FORM BUSINESS OR PROFESSION [SECTION 29]

The profits and gains of business or profession are computed in accordance with the provisions contained in Sections 30 to 43D. Sections 30 to 36 contain those specific deductions which are expressly allowed while Section 37(1) extends the allowance to items of business expenditure not covered by sections 30 to 36 which are otherwise allowable according to accepted commercial practices, while computing profits of business or profession. Section 40 provides those expenses which are allowed on the basis of general commercial principles while computing profits of business or profession. It is necessary to know those principles before studying the deductions expressly allowed while computing profits of business or profession.

General Commercial Principles

- Profits should be computed according to the method of accounting regularly employed by the assessee, provided that actual profit can be ascertained by this method, whether on receipt basis or accrual basis.
- Only those expenses and losses are allowed as deductions which were incurred or sustained during the relevant previous year and related to business.
- These losses and expenses should be incidental to the operation of the business. For example, embezzlement by an employee during the course of business is a loss incidental to the business.
- If a business has been discontinued before the commencement of the previous year, it's expenses cannot be allowed as deduction against the income of any other running business of the assessee.
- There are some essential expenses, though neither expressly allowed nor disallowed, but are deductible while computing the profits of business or profession on the basis of general commercial principles provided that these are not expenses or losses of a capital nature or personal nature.
- Any expenditure incurred in consideration of commercial expediency is allowed as deduction.
- Deduction can be made from the income of that business only for which the expenses were incurred. The expenses of one business cannot be charged against the income of any other business.

COMPUTATION OF INCOME UNDER THE HEAD “PROFITS AND GAINS FROM BUSINESS OR PROFESSION”

Net Profit as per Profit and Loss Account	xxx
Add : Inadmissible expenses debited to profit and loss account	xxx
Add : Deemed incomes not credited to profit and loss account	xxx
Less : Deductible expenses not debited to profit and loss account	(xxx)
Less : Incomes chargeable under other heads credited to Profit & Loss A/c	(xxx)
Income under the head Business or Profession	xxxx

ADMISSIBLE DEDUCTIONS

1. Rent, rates, repairs and insurance for buildings [Section 30]
2. Repairs and insurance for Plant & Machinery, Furniture [Section 31]
3. Depreciation [Section 32]
4. Tea/Coffee/Rubber Development Account [Section 33AB]
5. Site restoration fund [Section 33ABA]
6. Scientific Research [Section 35]
7. Amortization of Spectrum fees [Section 35ABA]
8. Expenditure on telecom licence [Section 35ABB]
9. Expenditure of capital nature incurred in respect of specified business [Section 35AD]
10. Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes [Section 35CCA]
11. Expenditure on Agricultural extension project [Section 35CCC]
12. Expenditure on skill development project [Section 35CCD]
13. Amortization of Preliminary Expenses [Section 35D]
14. Amortization of Expenditure in the case of Voluntary Retirement Scheme [Section 35DDA]
15. Other Deductions [Section 36]
16. Other Expenses [Section 37]

Rent, Rates, Taxes, Repairs and Insurance for Buildings [Section 30]

This section allows the deduction in respect of rent, rates, taxes, repairs and insurance for buildings that are used by the assessee for the purpose of his business / profession.

- **Property partly used:** If the property is partly used, the deduction will be proportionate to the use.
- **Part of the property is sub-let:** In case part of the property is sub-let, the differential, i.e., rent paid minus rent recovered would be allowable as deduction.
- **Occupation by owner himself:** No notional rent is allowable for owned properties. In cases where a firm carries on a business in the premises owned by one of its partners the rent payable to the partner would be an allowable deduction to the extent it is reasonable and is not excessive since the firm and the partners are separate entities.
- **Repair of the premises:** Repairs undertaken, whether as a owner / tenant/lessee, licensee/mortgage with possession, are allowed.
- **Expenses Deduction:** Municipal taxes, rates, insurance incurred by the assessee for the property is also allowed.

Deduction of expenses on the basis of usage:

Section 38 of the Act provides for the allowance of the proportionate amount of the expenses where the assessee uses the premises partly for his business or professional purposes and partly for other purposes the deduction allowable under this section is a sum proportionate to that part of the expenses which are attributable to the premises used for business or professional purposes. If the assessee is the owner of the building which is used for business or professional purposes, no deduction would be available in respect of the notional rent which would otherwise have been payable. But depreciation under Section 32 would be available in respect of such buildings.

Where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deductions under Section 30, Section 31 and Section 32 shall be restricted to a fair proportionate part thereof which the Assessing Officer may determine, having regard to the user of such building, machinery, plant or furniture for the purposes of the business or profession.

Repairs and Insurance for Plant & Machinery, Furniture [Section 31]

This section allows deduction in respect of expenses on current repairs and insurance of Plant & Machinery, & furniture used for business / profession.

- **Usage of the Asset:** Allowable in full, even if used for part of the year.
- **Repairs:** Current repairs deduction is allowed. The term repair will include renewal or renovation of an asset but not its replacement or reconstruction. However, capital nature isn't allowed.
- **Insurance Premium:** Insurance premium paid to insure the assets against risks of losses owing to damage / destruction, provided that the assets are used for business / profession are allowed, only if these premiums are paid / payable during the Previous Year.

Note: The assessee is entitled for deduction in respect of repairs and insurance of these assets only if these assets have been actually used for the purpose of the business of the assessee during the accounting year the profits of which are subjected to tax. Thus, if the assets are used in some business, income of which is not chargeable to tax, the assessee cannot claim deduction in respect of these expenses against the income from some other business, the profits of which are taxable.

Depreciation [Section 32]

This section allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets. *The deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.* The deduction towards depreciation is very essential to arrive at the income of the assessee and also to amortise the capital cost of the amount invested in buildings, machinery, plant and furniture.

The provisions for allowing depreciation are contained in Section 32 and are regulated under Rule 5 of the Income- tax Rules. The rates of depreciation are also provided in the Income-tax Rules. Assets should have been owned and used by the assessee for the purpose of his business / profession during the Previous Year irrespective they are wholly owned by the assessee or not.

Conditions for Allowability of Depreciation [Rule 5]**(a) Classification of Assets:**

The assets in respect of which depreciation is claimed must be buildings, machinery, plant or furniture.

In addition to these tangible assets intangible assets like know how, patent rights, copy rights, trade marks, licences, franchises or any other business or commercial right of similar nature (not being goodwill of a business or profession) acquired on or after 1.4.1998 are eligible for depreciation. 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' includes ships, books, vehicles, scientific apparatus and surgical equipments used for the purposes of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings. Similarly, the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.

(b) Assets must be owned either wholly or partially:

Depreciation is allowable to the assessee only in respect of those capital assets which are owned by him. In case of a building, the assessee must be owner of the super-structure and not necessarily of the land on which it is constructed. If the assessee is only a tenant of the building but not its owner he is not entitled for allowance in respect of depreciation thereof. Where the land on which the building is constructed has been taken on lease by the assessee, the allowance of depreciation would be admissible only if, according to the lease deed, the assessee is entitled to be the owner of the super-structure. The fact that as part of the terms of the lease deed, the building, after expiry of the lease is to be transferred to the lessor of the land would not affect the allowance for depreciation.

In the case of assets acquired on hire-purchase, e.g., plant and machinery taken on hire, the assessee would not be the owner thereof and consequently would not be entitled for depreciation in respect of the same. But if the plant and machinery had been acquired on instalment basis, the assessee becomes the owner of the assets the moment the purchase or sale is concluded and consequently is entitled to depreciation although a part or whole of the price is payable in future.

(c) Used for the purpose of Business or Profession:

The allowance for depreciation is subject to the condition that the assets on which depreciation is claimed are actually put to use by the assessee for the purposes of his business or profession during the accounting year. The allowance for depreciation, however, is not subject to the condition that the asset in question must be used throughout the relevant accounting year in order to enable the assessee to claim depreciation. Use could also include passive use that means kept ready for use, example – fire extinguishers. In cases where the depreciable asset is used partly for business purposes and partly for other purposes, the deduction towards depreciation allowable under Section 32 would be of a sum proportionate to the depreciation allowance to which the assessee would have otherwise been entitled. It's not just use that's important, it's owned and used that's mandatory, i.e., the assets should be owned and used by the assessee in the Previous Year. If the asset is used for < 180 days, 50% of depreciation is allowable for that previous year. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

- (d) No deduction on sold Assets:** No depreciation is allowable in respect of the depreciable asset if the asset concerned is sold, destroyed, discarded or demolished in the same year in which it was acquired.
- (e) Depreciation is allowed on the Written Down Value (WDV) Method:** Depreciation is computed on the written down value of the Block of the asset as on the last day of the previous year. However in case of the assess engaged in the generation or generation and distribution of power, depreciation may be claimed on the basis of Straight Line Method.
- (f)** Where an assessee incurs any expenditure for acquisition of depreciable asset in respect of which

a payment (or aggregate of payments made to a person in a day), otherwise than by an account payee cheque/draft or use of ECS through a bank account or such other electronic mode as may be prescribed, exceeds Rs. 10,000 such payment shall not be eligible for normal/ additional depreciation. Also such Payment will be ignored for the purpose of computation of Actual Cost of such asset under section 43(1).

- (g) Depreciation is allowable in the hands of the predecessor and successor, in case of succession of a firm, proprietary concern, by a company, or predecessor company and successor LLP, in case of conversion of Pvt. Ltd. Co. to LLP., in case of amalgamation or demerger, and that shall not exceed the depreciation that would have been allowed if the succession, demerger, amalgamation had not taken place and such depreciation shall be apportioned between them proportionate to use.
- (h) **Block of Assets:** The depreciation is provided in respect of “Block of assets”. As per Section 2(11) Block of assets means “a group of assets falling within a class of assets, being tangible assets such as buildings, machinery, plant or furniture and 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”.

There are four classes of the assets which are further categorized into ten Blocks of Assets according to different rates of assets prescribed as under:

S. No.	Class of Asset	Block of Asset
1.	Building	3 blocks (5%, 10% and 40%)
2.	Furniture & Fixture	1 block (10%)
3.	Plant and machinery	5 blocks (15%, 20%, 30%, 40%, 45%)
4.	Intangible Assets	1 block (25%)

(i) **Rates of Depreciation**

I.	Buildings:	Rate
	Residential building other than hotels and boarding houses	5%
	Non residential building, godown, office, factory etc., including hotels and boarding houses	10%
	Temporary erections such as wooden structures	40%
II.	Furniture & Fittings including electrical fittings	10%
III.	Plant & Machinery	
(a)	Plant & Machinery (General)	15%
(b)	Renewable Energy Devices -	
	(i) Being wind mills and any specifically designed devices which run on wind mills	40%
	(ii) Being any special devices including electric generators and pumps running on wind energy	40%

(c)	Motor cars other than those used in a business of running them on hire	15%
(d)	Motor buses, motor lorries, motor vans and motor taxis used in a business of running them on hire	30%
(e)	Books(annual publications or other than annual publications) owned by assessee carrying on a profession	40%
(f)	Books owned by assessee carrying on business in running lending libraries	40%
(g)	Aeroplanes, Aeroengines	40%
(h)	Specified Air Pollution Control Equipments, Water Pollution Control Equipments Solid waste control equipments and solid waste recycling and resource recovery systems	40%
(i)	Computers including computer software	40%
(j)	Ocean-going Ships	20%
(k)	Oil wells	15%
IV. Intangible Assets		
Know-how, patents, copy-rights, trade marks, licences, franchises or any other business or commercial rights of similar nature but not being goodwill of business and profession		25%

Note: As per the landmark judgment of CIT V/s Annamalai Finance Ltd., Madras High Court held that; It is the end use of the specified asset which is relevant for determining the percentage of depreciation. For example in case of business of leasing out vehicle, if lessee is using the vehicle for running them on hire, depreciation shall be allowable at Higher rate of 30% instead of 15% to the lessor.

The allowance under clause (ii) of sub-section (1) of section 32 (related to depreciation on Intangibles) in respect of depreciation of any block of assets shall not exceed forty percent of the written down value of such block of assets in case of -

- (i) a domestic company which has exercised option under sub-section (4) of section 115BA, or under sub-section (5) of section 115BAA, or under sub-section (7) of section 115BAB; or
- (ii) an individual or a Hindu undivided family which has exercised option under sub-section (5) of section 115BAC; or
- (iia) an individual or a Hindu undivided family, or an association of persons (other than a co-operative society) or a body of individuals, whether incorporated or not, or an artificial juridical person referred to in sub-clause (vii) of clause (31) of section 2 whose income is chargeable to tax under sub-section (1A) of section 115BAC; or
- (iii) a co-operative society resident in India which has exercised option under sub-section (5) of section 115BAD; or
- (iv) a co-operative society resident in India which has exercised option under sub-section (5) of section 115BAE;]

Provided also that, where income is chargeable to tax under sub-section (1A) of section 115BAC, the written

down value of the block of asset as on the 1st day of April, 2023 shall be increased by such depreciation which is attributable to clause (iia) of sub-section (1) of section 32 and which is not allowed to be set off under sub-clause (a) of clause (ii) of sub-section (2) of section 115BAC if both the following conditions are satisfied, namely:-

- (i) the assessee has not exercised option under sub-section (5) for any previous year relevant to the assessment year beginning on or before the 1st day of April, 2023; and
- (ii) there is a depreciation allowance in respect of a block of assets which has not been given full effect to prior to the assessment year beginning on the 1st day of April, 2024, and is attributable to the provisions of clause (iia) of sub-section (1) of section 32

Illustration 1:

X Ltd. has a block of assets (P&M), carrying 15% depreciation, WDV on 1st Apr 2025 is INR 75,00,000. It purchased subsequently on 1st Dec. 2025, another machinery for INR 25,00,000 and put to use on the same day. X Ltd. was amalgamated with Y Ltd. effective 1st Feb. 2026.

Solution:

Compute the depreciation allowable for X Ltd. and Y Ltd. for the AY 2026-27.

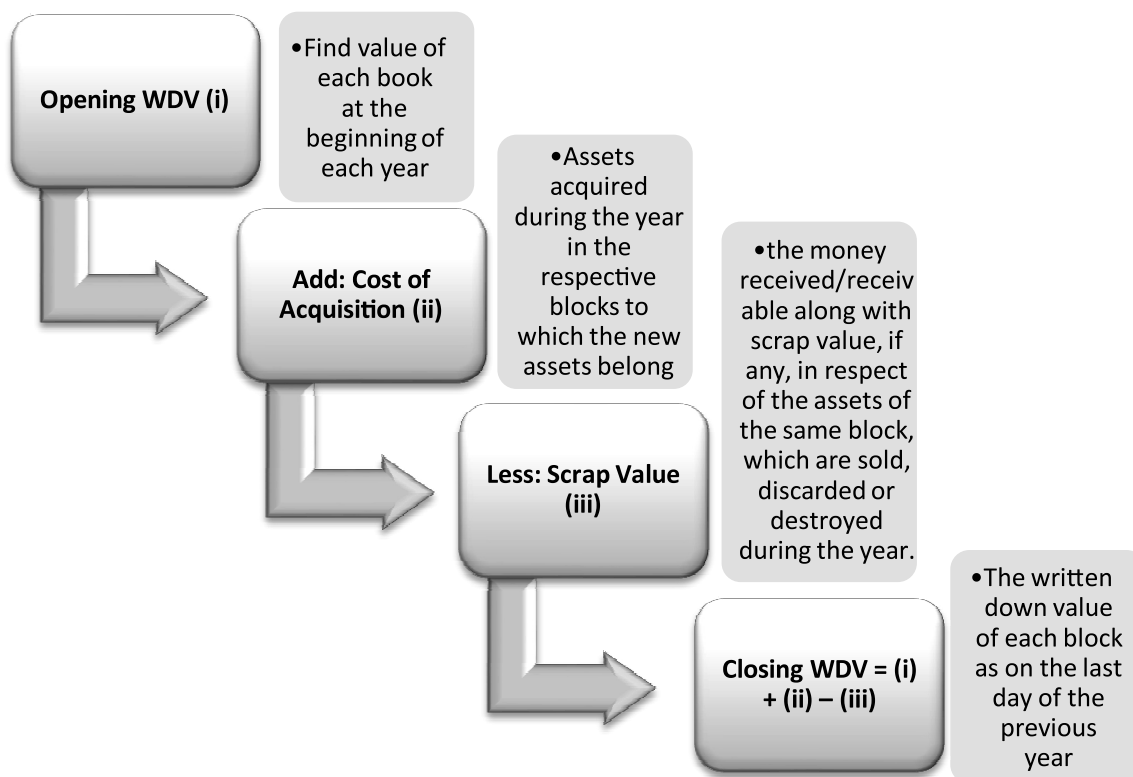
<i>Block</i>	<i>Days</i>	<i>Allowable</i>	<i>Depreciation</i>
75,00,000	365	Full	11,25,000
25,00,000	121	Half	1,87,500

		Total Depreciation	13,12,500
Predecessor	306	On the Opening P&M	9,43,151
Successor	59		1,81,849
Predecessor	62	On the Acquired P&M	96,074
Successor	59		91,426

Notes:

- (1) The depreciation for the asset in existence and used for the whole year is proportionately divided on the basis of the number of days used by the predecessor until amalgamation date and the successor post amalgamation date.
- (2) The depreciation for the asset acquired during the year and used for the remaining part of the year is proportionately divided on the basis of the number of days used by the predecessor until amalgamation date and the successor post amalgamation date, beginning the date of acquisition.

Note: As per the CBDT circular, irrespective of the accounting treatment, the Lessor shall be entitled to claim depreciation on leased assets, whether the lease is an operating lease or a financial lease.

Steps for computing Depreciation:**Illustration 2:**

M Ltd. owns the following assets on 1.4.2025:

Assets	WDV as on 1.4.2025 (₹)	Rates of Depreciation (%)
Building A	10,20,000	10
Building B	5,40,000	10
Building C	6,35,000	10
Machinery C	1,65,000	30
Machinery D	4,000	30
Machinery E	50,000	30
Furniture A	1,10,000	10
Furniture B	8,000	10

The following assets are acquired by the company during the previous year 2025-26:

Asset	Actual Cost ₹	Rate of Depreciation (%)	Date of acquisition
Building D	5,40,000	10	14.5.2025
Machinery F	16,000	30	21.9.2025
Patents	40,000	25	15.4.2025
Technical Know-how	60,000	25	17.5.2025

The following assets are sold by the company during the previous year 2025-26:

Asset	Sale consideration (₹)	Date of Sale
Machinery C	1,10,000	2.9.2025
Machinery E	80,000	28.3.2026

Determine the depreciation for the assessment year 2026-27.

Solution:

Particulars	WDV as on 1.4.2025 (₹)	Additions during the year (₹)	Assets sold during the year (₹)	WDV as on 31.3.2026 (₹)	Depreciation (₹)
Block 1 Building 10%	21,95,000	5,40,000	—	27,35,000	2,73,500
Block 2 Machinery 30%	2,19,000	16,000	1,90,000	45,000	13,500
Block 3 Furniture & Fixtures	1,18,000	—	—	1,18,000	11,800
Block 4 Intangible assets	Nil	1,00,000	—	1,00,000	25,000
Total					323800

Illustration 3:

W.D.V. of the block having two machines namely A & B as on 1.4.2025 is ₹6,00,000. Machine C was acquired on 12.11.2025 for ₹3,00,000 and put to use on the same date. Machine C is sold on 31.3.2026 for ₹4,00,000.

- Compute the depreciation allowable for the assessment year 2026-27.
- What will be the amount of depreciation allowed, if machine 'A' is sold instead of machine 'C'.
- What will be the amount of depreciation allowed if both 'A' and B machines are sold instead of machine C

Solution (a)

<i>Particulars</i>	<i>(₹)</i>
W.D.V. of the block as on 1.4.2025	6,00,000
Addition during the year of Machine C for less than 180 days	3,00,000
	9,00,000
Less: Sale price of machine C sold during the year	(4,00,000)
W.D.V. as on 31.3.2026 for the purpose of charging depreciation	5,00,000
Depreciation on ₹5,00,000 @ 15%	(75,000)
W.D.V. as on 1.4.2026	4,25,000

Full depreciation @ 15% has been charged, as the machine C which was put to use for less than 180 days during the year, ceases to exist on 31.3.2026 and as such depreciation shall not be charged at the rate of 50% of the normal rate. It would have been charged, if the machine other than C had been sold during the year.

(b)

<i>Particulars</i>	<i>Amount</i>	<i>Amount</i>
W.D.V. of the block as on 1.4.2025		6,00,000
Addition during the year of Machine C put to use for less than 180 days		3,00,000
		9,00,000
Less : Sale price of machine A sold during the year		4,00,000
		5,00,000
Depreciation @ 7.5% on ₹3,00,000	22,500	
@ 15% on balance ₹2,00,000	30,000	52,500
W.D.V. as on 1.4.2026		4,47,500

(c)

<i>Particulars</i>	<i>Amount</i>	<i>Amount</i>
W.D.V. of the block as on 1.4.2025		6,00,000
Addition during the year of Machine C put to use for less than 180 days		3,00,000
		9,00,000
Less : Sale price of machine A & B sold during the year		4,00,000
		5,00,000
Depreciation* @ 7.5% on ₹3,00,000	22,500	
@ 15% on balance ₹2,00,000	30,000	52,500
W.D.V. as on 1.4.2026		4,47,500

* Although only one asset 'C' is left in the block whose cost is ₹ 3,00,000, still depreciation will be allowed on the balance amount of ₹2,00,000 @ 15% as the block has not ceased to exist.

Actual Cost [Section 43(1)]

The actual cost of an asset to the assessee is normally the amount of capital expenditure incurred in respect of the acquisition, installation, etc., of the asset and also the other expenses, if any, incurred by him to make the asset ready for the purpose of its use in the business.

The expression 'actual cost' has been defined in Section 43(1) of the Act to mean that 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. For instance, if an assessee gets a subsidy from the Government for the purchase of a particular item of machinery, the actual cost of the machinery to the assessee would be total of the purchase price and the expenses in regard to installation etc. minus the subsidy received from the Government.

It is important to note that where, an assessee, in acquisition of an asset, makes payment(s) in a day otherwise than by an a/c payee cheque drawn on a bank/ account payee demand draft / ECS / or such other electronic modes as may be prescribed, which is > INR 10000, such expenditure would not be a part of the actual cost of such asset.

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].

The provisions of Section 43(1) of the Act clarify that the actual cost of depreciable asset should be determined in the following circumstances as indicated below:

- **Asset used for scientific research initially and then used for Business:** If an asset was first used for scientific research and then used for business later, the actual cost would be the initial cost incurred in acquiring the asset minus the deduction already claimed under section 35(1)(iv).
- **Asset acquired as a gift / inheritance:** If the asset is acquired as a gift / inheritance, the actual cost is the WDV of the previous owner.
- **Re-acquisition of Asset:** If an asset was once in use, then transferred and later re-acquired, the actual cost would be the WDV at the time of transfer OR the price of re-acquisition, whichever is lower.

For Instance, if 'X' transfers his machinery on 1.1.2026 to 'Y' for a sum of Rs. 6.00 lakhs while the actual cost of the asset and the written down value thereof on that day to 'X' are Rs. 3.00 lakhs and Rs. 1.00 lakh respectively, it may be inferred that the transfer by 'X' to 'Y' is made with idea to enable 'Y' to claim depreciation on Rs. 6.00 Lakhs while the market value of the asset on the date of sale by 'X' to 'Y' may be Rs. 4.00 lakhs only. In such a case, the Assessing Officer would be entitled to allow depreciation to 'Y' on the basis of the cost which may be determined by him to be Rs. 4.00 lakhs instead of Rs. 6.00 lakhs as claimed by 'Y'.

- **Asset is transferred from a holding co. to a subsidiary co. or vice-versa** If an asset is transferred from a holding co. to a subsidiary co. or vice-versa, then subject to specified conditions, the transaction wouldn't be a transfer of a capital asset and hence, the actual cost to the transferee company shall be taken to be the same as it would have been used by the transferor company had it continued to hold it for the purposes of business / profession, and similar approach to be adopted for amalgamation / demerger.
- **Interest paid or payable in connection with acquisition of an Asset:** Any amount of interest paid / payable as interest in connection with the acquisition of an asset, and relatable to period after the asset is put to use, shall not be included in the actual cost of the asset.

- **Subsidy or grant or reimbursement by the Central Government or a State Government or any authority established under any law or by any other person :**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.
- **Asset acquired by a non-resident outside India:** Where an asset which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his business or profession, the actual cost of the asset to the assessee shall be the actual cost 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.
- **Capital Asset acquired under scheme for Corporatisation:** Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization.
- Capital Asset on which deduction has been allowed or allowable u/s 35AD shall be treated as nil:
- **Actual cost of inventory converted into capital asset, if used for business,** shall be the Fair Market Value.

Note: Interest paid before the commencement of the production on amounts borrowed by the assessee for acquisition and installation of the plant and machinery shall form part of the actual cost u/s 43(1), as decided by the Supreme Court in *Challapalli Sugars Limited Vs CIT*.

Illustration 4

Ashwani borrowed a sum of ₹30,00,000 on 1.4.2023 @ 12% p.a. to construct the building for the purpose of her business. The construction of house property is completed on 30.6.2025 and put to use immediately. The loan is still outstanding. Cost of construction of building is ₹60 lakh. Calculate the actual cost of building which shall be eligible for depreciation.

Solution:

Particulars	Amount
Cost of construction	₹ 60,00,000
Add: Interest from 1.4.2023 to 30.6.2025 ($₹30,00,000 \times 12/100 \times 27/12$)	8,10,000
Total actual cost eligible for depreciation	68,10,000

Note: Interest payable after 30.6.2025 shall be allowed as revenue expenditure.

Written Down Value (WDV) [Section 43(6)]

- **Asset acquired during previous year:** In case of acquisition of assets during the Previous Year, the actual cost becomes the WDV.
- **Asset acquired before previous year:** In case of assets acquired before the Previous Year, the WDV = Actual Cost to the Assessee Less Depreciation c/f if any.
- **Asset transfer from holding company to subsidiary, or vice-versa:** In case of transfer of assets from holding company to subsidiary, or vice-versa, or from an amalgamating company to an amalgamated company, then the actual cost of assets in the books of the transferee company would be the WDV of the block of assets, as in the books of transferor company for the immediately preceding Previous Year, minus, the allowable depreciation during the Current Year.
- **WDV in case successor is LLP:** In case of a successor LLP, the WDV in the books of the LLP would be the WDV in the books of the predecessor company on the date of such conversion.
- **The WDV of the following assets may be reduced to NIL:**
 - (a) the moneys receivable by the assessee in respect of the assets sold, together with the scrap value if any is > than the current WDV of the assets at the beginning of the year as increased by the actual cost of any new asset acquired, OR
 - (b) where the entire block of assets is sold during the year.

Unabsorbed Depreciation

- It's the depreciation that couldn't be consumed fully, that is, the profits were not sufficient to absorb it.
- Can be carried forward indefinitely. The current year depreciation and the brought forward business losses get priority in the set off over the unabsorbed depreciation, in that order.

Depreciation on Straight Line Basis

In the case of Power Units [Section 2(1)(i)] (optional to power generating units) from the assessment year 1998-99, an undertaking engaged in generation or generation and distribution of power can claim depreciation on straight line basis on the actual cost of individual asset. But the aggregate depreciation cannot exceed the actual cost. Alternatively, such undertaking can claim depreciation, at its option, according to written down value method like any other assessee. The option for this purpose shall be exercised before the due date of furnishing return of income. Once this option is exercised, it shall be final and shall apply to all the subsequent years.

Where an assessee incurs any expenditure for acquisition of any asset 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/ account payee bank draft or use of ECS through a bank account or such other electronic mode as may be prescribed, exceeds Rs. 10,000, such Payment shall be ignored for the purpose of computation of Actual Cost of such asset.

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].

Terminal Depreciation

If any asset, on which depreciation is claimed on basis of SLM, is sold and the amount by which money payable together with scrap value, fall short of WDV of such asset, depreciation shall be allowed equal to such deficiency in the year of sale.

Illustration 5:

An electricity company which was charging depreciation on straight line method and whose actual cost of the asset was ₹6,00,000 and written down value ₹5,50,000 sold the said asset during 2025-26 after 2 years. What will be the tax treatment if the asset is sold for:

(i) ₹ 4,50,000 (ii) 5,80,000 (iii) ₹ 7,00,000

Solution

(i) ₹ 4,50,000 - ₹ 5,50,000 = ₹ 1,00,000 will be allowed as terminal depreciation in the previous year 2025-26.

(ii) ₹ 5,80,000 - ₹ 5,50,000 = ₹ 30,000 shall be balancing charge and taxable as business income as per section 41(2).

(iii) ₹ 7,00,000 - 5,50,000 = ₹ 50,000 shall be balancing charge and hence taxable as business income ₹ 7,00,000 - 6,00,000 = ₹ 1,00,000 shall be short-term capital gain.

Balancing Charge [Section 41(2)]

If any asset, on which depreciation is claimed on basis of SLM, asset is sold and the amount by which moneys payable together with scrap value, exceeds WDV of such asset, then the least of the following shall be taxable under the head PGBP.

- (i) difference between the actual cost and WDV.
- (ii) difference between aggregate of moneys payable and WDV.

Additional Depreciation [Section 32(1)(iia)]

The additional depreciation is available to assessee engaged in the business of manufacture or production of any article or thing or engaged in the business of generation, transmission or distribution of power at the rate of 20% of actual cost of eligible new machinery or plant (other than ships and aircrafts acquired and installed after 31/3/05).

Additional Depreciation shall not be allowed if –

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

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

any office appliances or road transport vehicles; or

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

Note:

1. Where asset is purchased and put to use in business in the same previous year for less than 180 days then additional depreciation is allowed at 50% of rate of additional depreciation and balance 50% of additional depreciation in immediately succeeding financial year.
2. *If an assessee taxed under section 115BAC / 115BAD he / it will not be entitled to claim deduction of additional depreciation.*

Calculation of Written Down Value of a Block of Asset [Section 43(6)]

WDV of block of assets shall be computed as follows -

Aggregate of Written Down Value of all the assets falling within that block of assets as at the beginning of the previous year	XXX
Add: Actual cost of any asset falling within that block not being increase on account of acquisition of goodwill of a business or profession , acquired during the previous year	XXX
Less: Moneys payable (including scrap) in respect of any asset falling within that block which is sold, discarded, demolished or destroyed during the previous year, to the extent it does not exceed the sum of the above two.	XXX
WDV at the end of the year	XXX
Less: Depreciation at block rate	XXX
Depreciated value of the block at the end of year	XXX

It means if the net consideration of an asset out of the block is less than the balance, there would be no capital gain. If the net consideration of an asset is more than the balance (the value of all assets in the block) the excess shall be deemed to be short term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance, the loss shall be deemed to be short term capital loss.

Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India, 1992, the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.

For Example:

Depreciable assets on 1.4.2024 on which the depreciation is available at the same rate of 25%.

Asset A	3,00,000
Asset B	5,00,000
Asset C	7,00,000
Total	15,00,000
Less : [Depreciation @ 25% of 15,00,000]	(3,75,000)
(i) Written down value on 1.4.2025 of block of assets	11,25,000
Add : Cost of Asset purchased during 2025-26	6,00,000
(ii) Balance	17,25,000

	Asset B sold during year 2025-26	(6,75,000)
(iii)	Balance	10,50,000
	Less: Depreciation for 2025-26 @ 25% of Rs. 10,50,000	(2,62,500)

Written down value of all assets on 1.4.2026 = 7,87,500

Illustration 6:

Mr. Mohan, engaged in the business of generation of power, furnishes the following details for FY 2025-26. He has opted for WDV method, you are required to compute the allowable depreciation for FY 2025-26.

The Opening Block as on 22nd April, 2025 was INR 950,000 (15% block). He acquired second hand machinery for INR 250,000 on 30th Nov'25 . He also acquired Power Generation Machinery on 1st Aug 2025 for INR 10,00,000. He invested in an AC for Office for INR 200,000 on 9th Sep'25 and a pollution control equipment for INR 250000 on 30th Jun' 25. He bought additional power generation machinery for INR 500,000 on 1st Feb' 26 . Also, he sold assets valued INR 400,000 for INR 350,000 during the year.

Solution:

Particulars	INR	Block	Date	Particulars	INR	Block	Date
Opening WDV	9,50,000	15%		Air Pollution Control Equipment	2,50,000	40%	30th Jun, 25
Acq. Second hand	2,50,000	15%	30th Nov'25				
Power Generation Machinery	10,00,000	15%	1st Aug'25				
AC for Office	2,00,000	15%	9th Sep'25				
Power Generation Machinery	5,00,000	15%	1st Feb'26				
Sale Value	3,50,000						
Depreciation							
On the ones put to use for < 180 day	18,750						
	37,500						

On the Remaining Block, which comes to INR 18,00,000	2,70,000			On the Pollution Control Equipment	1,00,000		
Depreciation allowable	3,26,250						
Addl Depreciation allowable on Power Generation Machinery @ 20	2,00,000			Addl Depreciation allowable on the Poll Control Equipment @	50,000		
Power Generation Machinery @ 20% which was used for < 180 days	50,000						
Total Depreciation Allowable	5,76,250			Total Depreciation Allowable	1,50,000		

Notes:

- The cells highlighted denote the ones which were put to use for < 180 days.
- Power generation equipment, pollution control equipment can enjoy additional depreciation.
- No depreciation is allowable on second hand machinery or office appliances like AC.

Tea/Coffee/Rubber Development Account [Section 33AB]

Section 33AB is applicable to an assessee carrying on the business of growing and manufacturing tea or coffee or rubber in India. For claiming the deduction u/s 33AB the assessee has to satisfy the following conditions:

- an assessee, carrying on business of growing and manufacturing tea or coffee or rubber in India
- Any amount deposited with the National Bank or in an account maintained by the assessee with the Bank in accordance with and for the purposes specified in a scheme approved in this behalf by the Tea Board of India or the Coffee Board of India or the Rubber Board;
- assessee's whose accounts have been audited and the assessee furnishes along with his return of income the report of such audit in the prescribed form and duly signed and verified by such accountant. In cases where the accounts of the tax payer are required to be audited under any other law, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return along with a further report in the form prescribed for the purposes of this provision.

Deduction:

- (a) a sum equal to the amount or the aggregate of the amounts so deposited; or
- (b) Forty per cent of the profits of such business (computed under the head “Profits and gains of business or profession” before making any deduction under Section 33AB), whichever is less.

Note:

1. The audit report is to be furnished at least one month prior to the due date for furnishing the return of income under section 139(1).
2. If an assessee taxed under section 115BAC / 115BAD he/ it will not be entitled to claim deduction on account of Tea/ Coffee/Rubber development account.

Withdrawal of Amount

There is a restriction on the withdrawal of the amount standing in the credit of such Special account of the assessee, i.e., the withdrawal must be made either: (i) for the purposes specified in the scheme, or, in the following circumstances: (a) closure of business; (b) death of an assessee; (c) partition of a H.U.F.; (d) dissolution of a firm; (e) liquidation of a company.

Consequences in case of closure of Business

Withdrawal of any amount in the event of: (a) closure of business or; (b) dissolution of a firm, the whole of such amount shall be deemed to be the profits and gains of business or profession of that previous year and chargeable to income-tax as if the business had not closed, or, the firm not dissolved and taxable in that previous year.

Conversely, where any amount standing to the credit of the assessee in the special account or in the Tea Deposit Account is utilised by the assessee for the purposes of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed as a revenue deduction in computing the income chargeable under the head “Profits and gains of business or profession”.

Non-utilisation of any amount released by the National Bank, for being utilised by the assessee for the purposes of a business, in accordance with the scheme, renders the whole or part of the amount not utilised, as the case may be, deemed as profits and gains of business and, accordingly, chargeable to income-tax as income of that previous year. The exceptions to this provision are, when the amount is not utilised in the cases of: (i) death of an assessee; (ii) partition of a Hindu undivided family; (iii) liquidation of a company.

In cases where the asset acquired in accordance with the scheme or deposit scheme is sold or otherwise transferred in any previous year by the assessee to any person, at any time before the expiry of eight years from the end of the previous year in which it was acquired, such part of the cost of the asset as is relatable to the deduction already allowed is deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and charged to income-tax accordingly.

Exception to the Provision:

- (i) the asset is sold or otherwise transferred by the assessee to Government, local authority, corporation established by or under a Central, State or Provincial Act or a Government company as defined in the Companies Act; or
- (ii) Where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm only where;

- (i) all the properties of the firm relating to business or profession immediately before the succession become the properties of the company;
- (ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and
- (iii) all the shareholders of the company were partners of the firm immediately before the succession.
 - (a) “Coffee Board” means the Coffee Board constituted under Section 4 of the Coffee Act, 1942;
 - (aa) “National Bank” means the National Bank for Agriculture and Rural Development established under Section 3 of the National Bank for Agriculture and Rural Development Act, 1981;
 - (ab) “Rubber Board” means the Rubber Board constituted under Sub-section (1) of Section 4 of the Rubber Board Act, 1947;
 - (b) “Tea Board” means the Tea Board established under Section 4 of the Tea Act, 1953.

Computation of Business income in cases where income is partly Agriculture and partly Business

Taxability in case of composite income for manufacturing and performing other processes of Rubber; tea and Coffee is summarized as under:

S. No.	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
1	Income from the manufacture of rubber by the seller in India	35%	65%
2	Income from sale of coffee ● grown and cured by the seller in India ● grown, cured, roasted and ground by the seller in India	25% 40%	75% 60%
3	Income from the manufacture of tea by the seller in India	40%	60%

Site Restoration Fund [Section 33ABA]

- The taxpayer is engaged in the business of the prospecting for, or extraction or production of, petroleum or natural gas or both in India.
- The Central Government has entered into an agreement with the taxpayer for such business.
- The assessee deposit with SBI any amount in an account maintained by the assessee with that bank in a scheme approved by the Government of India in the Ministry of Petroleum and Natural Gas; or deposit any amount in an account opened by the assessee in accordance with, and for the purposes specified in, a scheme framed by the Ministry of Petroleum and Natural Gas.
- The aforesaid amount shall be deposited before the end of the previous year.
- The accounts of the taxpayer should be audited by an accountant as defined in the explanation below Sub-section (2) of Section 288 and the report of the auditor is filed along with the return of the relevant assessment year. Further, in case where the accounts of the taxpayer are required to be audited under

any other law, e.g., under the Companies Act, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return along with a further report in the form prescribed for the purposes of the provision.

Amount of Deduction: Lower of the following

- (a) a sum equal to amounts deposited as mentioned above; or
- (b) 20% of the profit of such business computed under the head “Profits and gains of business or profession” before making any deduction under Section 33ABA and before adjusting brought forward business loss under Section 72.

Note:

- 1. Where any deduction is claimed under this section, no deduction shall be allowed in respect of such amount in any other previous year.
- 2. Where a deduction is claimed and allowed under this section, to a firm, association of persons or body of individuals, no deduction shall be allowed to any partner of the firm or the member of the association or body in respect of the same deposit.
- 3. If an assessee taxed under section 115BAC / 115BAD he/it will not be entitled to claim deduction on account of Site Restoration fund.

The amount standing to the credit of such special account or site restoration account may be withdrawn only for the purpose specified in the scheme or deposit scheme. If the amount released by SBI or the amount withdrawn from site restoration account in a year is not utilized in the same previous year for the purpose for which it is released, the amount not so utilized will be treated as taxable profits of that year and taxed accordingly.

Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in Section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year. Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee is no longer in existence, the above provisions shall apply as if the business is in existence in that previous year.

There is an overriding condition that the deduction under this provision cannot be claimed in relation to amounts utilized for the purpose of any machinery or plant to be installed in any office premises or residential accommodation including guest house; any office appliance, other than computers; any other plant or machinery which either is installed in an undertaking producing low priority items specified in the Eleventh Schedule in the Act or is an item of plant or machinery entitled to 100 per cent write off by way of depreciation or for any other reason in any one year.

The deduction allowed under this provision will be withdrawn if the asset acquired in accordance with the scheme is sold or otherwise transferred within 8 years from the end of the previous year in which it is acquired. For this purpose, the cost of the asset relatable to the deduction allowed will be treated as taxable business profits of the year in which the asset is sold or otherwise transferred.

The deduction allowed earlier will, however, not be withdrawn in cases where the asset is transferred within 8 years period to Government, local authority statutory corporation or Government company.

It will also not be withdrawn where the transfer takes place in connection with succession of a firm by a company. For this purpose it is necessary that:

- (a) the scheme continues to apply to the company in the manner applicable to the firm;
- (b) the successor company takes over all the assets and liabilities of the firm; and
- (c) all the shareholders of the company were partners of the firm before the succession.

Scientific Research [Section 35]

The term scientific research connotes and implies activities for the extension and advancement of knowledge, in the fields of natural or applied science, including, agriculture, animal husbandries and fisheries.

A) Deduction of expenditure incurred on research carried on by Assessee Himself

In case the expenditure is made by the assessee himself, then irrespective of whether the expenditure is revenue or capital in nature, 100% of the expenditure would be allowable. **However, it is prudent to note that if the expenditure is towards acquisition of land, that would not be allowable.**

Revenue Expenditure: Any revenue expenditure incurred by the assessee within 3 years immediately preceding the commencement of business, for which research is conducted, by way of salary to research personnel engaged in such research, or material inputs for such research, will be allowed as a deduction in the year in which such business is commenced. However, such expenditure would be limited to the amount certified by the prescribed authority.

Capital Expenditure: Any capital expenditure incurred by the assessee, within 3 years immediately preceding the commencement of the business would be deemed to have been incurred in the year in which the business was commenced and will therefore rank for deduction in the year of commencement of business, in full

In case such expenditure cannot be absorbed by business profits in any year, such deficiency can be carried forward indefinitely until it is fully absorbed / consumed

B) Deduction of expenditure incurred on research carried on by Third Party

In case the research is conducted by a third party, and the payment is made by the assessee for conducting the research, the allowability is as under:

- a) In case the amount is **paid to a company for scientific research**, 100% of such expenditure is allowable. This deduction is allowable only if the company is an Indian company and has as its main object, scientific research and development.
- b) In case the amount is paid to a **university, college or research association for social science or statistical research**, 100% of such expenditure is allowable. The deduction is allowable only if the payment is to an approved institution and such deduction cannot be denied later, subsequent to such payments, merely on the grounds, that the approval so granted to the institution is withdrawn.
- c) In case the amount is paid to a **National Laboratory / IIT**, 100% of the expenditure can be claimed as a deduction. A National Laboratory is a scientific laboratory functioning at the national level, under the ambit of Indian Council of Agricultural OR Medical OR Scientific Research, the Defence Research and Development Organisation (DRDO), the Department of Atomic Energy / Bio-technology are included.

- d) In case the amount is paid to a **university, college or research association for scientific research**, 100% of such expenditure is allowable. The payments made to such institutions would be allowable irrespective of whether such research is related to the assessee's business or not and irrespective of whether the expenditure is revenue or capital in nature.
- e) Where a company is engaged in the business of **bio-technology or in the business of manufacture or production of any article / thing, not being one which is specified in the eleventh schedule**, incurs any expenditure on scientific research, OR in-house research & development facility as may be approved by the prescribed authority, a weighted deduction of 100% is allowable in the Previous Year.

No deduction is allowable in case of any expenditure that is towards acquisition of land.

Expenditure in case of drugs and pharmaceuticals shall include the expenditure of clinical drug trial, obtaining approvals from any state regulatory authority, and filing an application under the Patents Act, 1970.

Provided that every notification on account of payment to outside agencies under section 35(1)(ii), (iia), (iii) in respect of the research association, university, college or other institution, issued on or before the date on which Section 35(1) has come into force, shall be deemed to have been withdrawn unless such outside agency makes an intimation in such form and manner, as may be prescribed, to the prescribed income-tax authority by 31.08.2020 and subject to such intimation the notification shall be valid for a period of five consecutive assessment years beginning with the assessment year commencing on or after the 1st day of April, 2021.

Provided further these outside agencies (Donee) under section 35(1)(ii), (iia), (iii) are not entitled to deduction under section 35(1) unless they prepare and deliver the Statement of donation receipts by Donee to cross check claim of donation by Donor for such period as may be prescribed to the said prescribed income-tax authority in such form, verified in such manner and within such time, as may be prescribed. And furnishes a certificate to the donor, specifying the amount of donation within such time from the date of receipt of sum.

Note: Any failure by the Donee in preparing and delivering the Statement of donation to the Income Tax Authority or in furnishing certificate to the donor within the time prescribed shall attract fee @ Rs. 200 for every day during which the failure continues under section 234G along with the penalty for a sum not less than Rs. 10,000 which may be extended to Rs. 1,00,000 under section 271K.

Summary		
Section	Expenditure Incurred for / Payment made	Deduction
35(1)(i)	Revenue Expenditure incurred on scientific research related to assessee's business	100%
35(1)(ii)	Research Association for Scientific Research	100 %
35(1)(iia)	Paid to Company for Scientific Research	100%
35(1)(iii)	Research Association for Social Science OR Statistical Research	100%
35(1)(iv)	Capital Expenditure (except land acquisition)	100%
35(2AA)	National Laboratory / IIT for scientific research undertaken under an approved Programme	100 %
35(2AB)	Expenditure incurred by a company engaged in Bio-technology	100 %

Note: If an assessee taxed under section 115BAC/115BAD he / it will not be entitled to claim deduction on account of payment to outside agencies for Scientific Research under section 35(1)(ii), (iia), (iii) and 35(2AA). [As Amended by Finance Act, 2020]

Illustration 7:

Binod furnishes the following particulars for PY 2025-26. You are required to arrive at the deduction allowable u/s 35 for AY 2026-27, while computing the Income under the head “Profits / Gains from Business/ Profession”.

1. Amount paid to M/s ABC Ltd., a company registered in India, which has as it's main object, scientific research and development, as approved by the prescribed authority INR 600,000
2. Amount Paid to IIT Mumbai, for an approved scientific research programme INR 375,000
3. Revenue Expenditure on In-house R&D facility as approved by prescribed authority INR 450,000
4. Capital Expenditure on In-house R&D facility as approved by prescribed authority INR 12,00,000. This includes cost of Land INR 450,000
5. Amount paid to Indian Institute of Science, Bangalore, for Scientific Research INR 10,00,000

Solution:

<i>Expenditure</i>	<i>INR</i>	<i>Allowable Section</i>	<i>Deduction</i>
Amount paid to M/s ABC Ltd., a company registered in India, which has as it's main object, scientific research and development, as approved by the prescribed authority	6,00,000	100% 35(1)(iia)	6,00,000
Amount Paid to IIT Mumbai, for an approved scientific research programme	3,75,000	100 % 35(2AA)	3,75,000
Revenue Expenditure on In-house R&D facility as approved by prescribed authority	4,50,000	100% 35(1)(i)	4,50,000
Capital Expenditure on In-house R&D facility as approved by prescribed authority	7,50,000	100% 35(1)(iv)	7,50,000
Amount paid to Indian Institute of Science, Bangalore for Scientific Research	10,00,000	100 % 35(1)(ii)	10,00,000
Total	31,75,000		31,75,000

Amortization of Spectrum Fees for Purchase of Spectrum [Section 35ABA]

New section 35ABA is inserted to provide amortization of amount paid on the acquisition of any right to use spectrum for telecommunication services by paying spectrum fees. The section provides:

- i. Any capital expenditure incurred and actually paid by the assessee on acquisition of any right to use spectrum for Telecom services by paying spectrum fee will be allowed as deduction in equal instalments.

Deduction will start from the year in which payment is made (or the year of commencement of business, whichever is later) and ending with the year in which spectrum comes to an end, irrespective of the previous year in which liability for expenditure was incurred according to the method of accounting regularly followed by assessee or payable in such manner as may be prescribed.

- ii. Where the spectrum is transferred and the proceeds of transfer are less than the expenditure remaining unallowed, a deduction equal to the expenditure remaining unallowed as reduced by the proceeds of transfer, shall be allowed in the year of transfer of spectrum.
- iii. If spectrum is transferred and proceeds of transfer exceed the amount of expenditure remaining unallowed, the excess amount (to the extent it does not exceed deduction claimed u/s 35ABA) shall be chargeable to tax as profits and gains of business in the previous year in which such spectrum has been transferred.
- iv. Unallowed expenditure in a case where a part of spectrum is transferred would be amortised.
- v. Where the deduction has been claimed and granted to the assessee in accordance with the provisions of this section and, subsequently, there is failure to comply with any of the provisions of this section, then the deduction shall be deemed to have been wrongly allowed. In such case, the assessing officer can re-compute the total income of the assessee for the previous year (in which deduction was claimed) and make necessary rectification. Such rectification can be made within 4 years from the end of the previous year in which failure takes place.
- vi. Under the scheme of amalgamation, if the amalgamating company sells or transfers the spectrum to an amalgamated company, being an Indian company, then the provisions of this section shall apply the amalgamated company as they would have applied to the amalgamating company if later had not transferred the spectrum. Similar rule will be applicable in case of demerger.

Where, in a previous year, any deduction has been claimed and granted to the assessee under sub-section (1), and, subsequently, there is failure to comply with any of the provisions of this section, then, -

- (a) the deduction shall be deemed to have been wrongly allowed;
- (b) the Assessing Officer may, notwithstanding anything contained in this Act, re-compute the total income of the assessee for the said previous year and make the necessary rectification;
- (c) the provisions of section 154 shall, so far as may be, apply and the period of four years specified in subsection (7) of that section being reckoned from the end of the previous year in which the failure to comply with the provisions of this section takes place.

Expenditure on Telecom Licence [Section 35ABB]

Deduction of Capital Expenditure: Where any capital expenditure is incurred by the assessee for acquiring any right to operate telecommunications services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal instalments over the period for which the licence remains in force, subject to the following:

- (a) **Fees paid before commencement of business:** If the fee is paid for acquiring any right to operate telecommunications services before the commencement of such business, the deduction shall be allowed for the previous years beginning with the previous year in which such business is commenced.
- (b) **Fees paid after commencement of business:** If the fee is paid for acquiring such rights after the commencement of such business the deduction shall be allowed for the previous years beginning with the previous year in which the license fee is actually paid (irrespective of the previous year in which the liability for the expenditure is incurred).

Profit/Loss on Sale –

- **Transfer of License:** Where the licence is transferred and proceeds of transfer (sale proceeds) are less than the amount of expenditure incurred remaining unallowed:
 - (i) Whole License transferred: Where whole of the licence is transferred in a previous year. Deduction as given below shall be allowed in the previous year in which the licence is transferred.
Expenditure remaining unallowed less sale proceeds.
 - (ii) Part of the license transferred: Where part of the licence is transferred in a previous year. Deduction as given below shall be allowed in the balance number of relevant previous years.
(expenditure remaining unallowed less sale proceeds) divided by balance number of relevant previous years, i.e., the previous years not expired at the beginning of the year of transfer.
- Where the licence is transferred and the proceeds of transfer (sale proceeds) exceed the amount of expenditure incurred remaining unallowed.
Sale proceeds less expenditure remaining unallowed subject to deductions already allowed shall be chargeable to income tax as profits and gains of the business in the previous year in which licence is transferred. Consequently, no further deduction in the previous year in which licence is transferred or in any subsequent previous years is allowed.
Where licence is transferred in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.
- **Transfer in scheme of Amalgamation:** Where under a scheme of amalgamation a telecom licence is transferred by the amalgamating company to the amalgamated company (being an Indian company), then deduction will not be available under this section to the amalgamating company, instead the provisions of this Section (35ABB) will continue to apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.
- **Transfer in case of Demerger:** Similarly in a scheme of demerger a telecom licence is transferred by the demerged company to the resulting company, then deduction will not be available to the demerged company and will instead apply to the resulting company as they would have applied to the demerged company if the latter had not transferred the licence.

Further where a deduction for any previous year is claimed and allowed under Section 35ABB, then no deduction under Section 32(1) shall be allowed for the same or any subsequent previous year.

Expenditure of capital nature incurred in respect of Specified Business [Section 35AD]

An assessee shall (if he opts) be allowed a deduction of capital nature expenditure incurred for any specified business carried on by him during the previous year in which such expenditure is incurred by him. This section talks about investment linked incentives for specified businesses as under:

- A) Setting up & operating cold chain facilities for specified products (date of commencement of operation on or after 01/04/2009)
- B) Setting up & operating warehousing facilities for agricultural produce (date of commencement of operation on or after 01/04/2009)
- C) 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 (date of commencement of operation of natural gas is on or after 01/04/2007)

- D) Building and operating a 2-star hotel or above, anywhere in India (date of commencement of operation on or after 01/04/2010)
- E) Building and operating a hospital with at least > 100 beds for patients, anywhere in India (date of commencement of operation on or after 01/04/2010)
- F) Developing & building a housing project under a notified scheme for slum redevelopment or rehabilitation (date of commencement of operation on or after 01/04/2010 / affordable housing (date of commencement of operation on or after 01/04/2011), framed by central government or state government)
- G) Developing & building a housing project under a notified scheme for affordable housing framed by the central government or state government
- H) Production of fertilizers in India (date of commencement of operation on or after 01/04/2011)
- I) Setting up and operating an Inland Container Depot OR a Container Freight Station, under Customs Act, 1962 (date of commencement of operation on or after 01/04/2012)
- J) Bee-keeping and production of honey and beeswax (date of commencement of operation on or after 01/04/2012)
- K) Setting up and operating a warehousing facility for storage of sugar (date of commencement of operation on or after 01/04/2012)
- L) Laying and operating a slurry pipeline for transportation of iron-ore (date of commencement of operation on or after 01/04/2014)
- M) Setting up and operating a semi-conductor wafer fabrication manufacturing unit, if such unit is notified by the board in accordance with the prescribed guidelines; (date of commencement of operation on or after 01/04/2014)
- N) Developing / Maintaining & Operating / Developing & Maintaining & Operating a new infrastructure facility in India. (date of commencement of operation on or after 01/04/2017)

Capital Expenditure Deduction: 100% of the capital expenditure incurred during the Previous Year, wholly and exclusively for the above businesses would be allowable as a deduction.

Expenditure incurred prior to commencement of business: The expenditure incurred prior to the commencement of the business, would be allowed as a deduction in the year of commencement of business, and should also be capitalised in the books of the assessee on the commencement of operations.

Set off of Losses: The loss from specified businesses can be set off only against profits of specified businesses but can be carried forward indefinitely for set off against one or more specified businesses.

Period of Deduction: The above deduction is allowable only if accounts of the assessee are audited by a Chartered Accountant and that any asset in respect of which the deduction is claimed, can be used only for the specified businesses for a period of 8 years beginning with the PY in which the asset was acquired / constructed.

Exceptions

- Expenditure on acquisition of any land, financial instrument OR goodwill will not be allowed as a deduction.
- Any expenditure where the aggregate of payments made to a person exceeding INR 10,000 per day, otherwise than by account payee cheque drawn on a bank / account payee DD / ECS / or such other electronic modes as prescribed under Rule 6ABBA would not be eligible for a 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 also be available of shifting out of the default tax regime provided u/s 115BAC(1A). A company would not be eligible for deduction u/s 35AD if it opts for the special provisions of section 115BAA/115BAB.
- No deduction in respect of the expenditure under section 35AD(1) shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year, if the deduction has been claimed or opted by the assessee and allowed to him under this section.

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 eight years beginning with the previous year in which such asset is acquired or constructed.

If any asset on which a deduction under section 35AD has been allowed, is used for any purpose other than the specified business, the total amount of deduction so claimed and allowed in one or more previous years 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 under section 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.

Example: Suppose a company purchased plant and machinery for Rs. 2 crores for a specified business, and claimed deduction under section 35AD. However, the very next year the plant and machinery purchased was put to use for unspecified business.

In this case, since the machinery has been used for unspecified business, the deduction claimed under section 35AD will be disallowed. However, the amount of deduction to be disallowed will be reduced by the depreciation allowable in accordance with the provisions of section 32.

Deduction claimed under section 35AD on a capital asset:	Rs. 2,00,00,000
Depreciation eligible will be @15%:	Rs. 30,00,000
Profit chargeable to tax in accordance with the sub-section (7B) of section 35AD:	Rs.1,70,00,000

Illustration 8:

Kiara Ltd. constructed a building and started operating a hotel of 3 star category w.e.f. 1.4.2025. The company incurred the following expenditure in this connection.

1.	Capital expenditure (including cost of land ₹ 70 lakhs) incurred during December, 2025 to March 2026 which were capitalized in the books of account 31.3.2025	₹ 1,30,00,000
2.	Capital expenditure incurred during previous year 2025-26 (it includes ₹ 40 lakhs paid for Goodwill)	₹ 1,40,00,000

Compute the deduction available under section 35AD in the assessment year 2026-27.

Solution:

Particulars	₹ Amount
Capital expenditure incurred before commencement but capitalized in books of account	1,30,00,000
Less: Cost of land not eligible for deduction under section 35 AD	(70,00,000)
	60,00,000
Capital expenditure incurred during previous year 2025-26 exclusive of value of goodwill	1,00,00,000
Deduction allowable under section 35AD	1,60,00,000

Illustration 9:

ABC Ltd commenced operations of the Business of a new Four-Star Hotel in Chennai on 01.04.2025. The Company incurred Capital Expenditure of ₹ 40 Lakhs during the period January, 2025 to March, 2025 exclusively for the above Business, and capitalised the same in its Books of Account as on April, 2025. Further, during the Previous Year 2025-2026, it incurred Capital Expenditure of ₹ 2.5 Crores (out of which ₹ 1 Crore was for Acquisition of Land) exclusively for the above Business.

Compute the Income under the heading Profits and Gains of Business or Profession for the Assessment Year 2026-27, assuming that ABC Ltd has fulfilled all the conditions specified for claim of deduction u/s 35AD and has not claimed any deduction under Chapter VI-A under the heading "C- Deductions in respect of certain incomes". The Profits from the Business of running this Hotel (before claiming deduction u/s 35AD), for the Assessment Year 2026-27 is ₹ 80 Lakhs.

Assume that the Company also has another existing Business of running a Four-Star Hotel in Kanpur, which commenced Operations 6 years back, the Profits from which was ₹ 130 Lakhs for the AY 2026-27 .

Solution:

Assessee: ABC Ltd Previous Year: 2025-2026 Assessment Year: 2026-2027

Computation of Deduction u/s 35AD

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

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

Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes [Section 35CCA]

Any sum paid to a rural development fund set up and notified by the Central Government and to the National Urban Poverty Eradication Fund similarly set up and notified qualifies for deduction on fulfilment of certain conditions.

Expenditure on Agricultural extension project [Section 35CCC]

Where an **assessee incurs** any expenditure on agricultural extension project notified by the Board then, there shall be allowed a deduction of a sum equal to 100 % of such expenditure.

Note: The deduction under section 35CCC would not be allowed if the assessee has opted to pay tax u/s 115BAC(1A).

Expenditure on skill development project [Section 35CCD]

Where a **company incurs** any expenditure (**not being expenditure in the nature of cost of any land or building**) on any skill development project notified by the Board then, there shall be allowed a deduction of a sum equal to 100% of such expenditure.

Amortization of Preliminary Expenses [Section 35D]

Eligible Assessee: Under Section 35D, **Indian companies and other non-corporate taxpayers resident in India** would be entitled to amortisation of certain preliminary expenses incurred by them for the establishment of business concerns or the expansion of the business of existing concerns.

Expenditure incurred prior or after commencement of business: The expenditure which qualifies for amortisation should have been incurred by the assessee before the commencement of his business. If, however, the expenditure is incurred after the commencement of business, it is essential that the expenditure should be in connection with the extension or expansion of the undertaking of the assessee or in connection with the setting up of a new unit by the assessee.

Eligible Deduction: The amount qualifying for amortisation would be allowable as a deduction in **five equal instalments** beginning with the previous year in which the business of the assessee actually commences or the previous year in which the extension of the present undertaking is completed or the new unit commences production or operation, as the case may be.

The following expenses incurred by the assessee, qualify for amortisation under this section as preliminary expenses:

- (i) Expenses in connection with the preparation of feasibility report or project report;
- (ii) Expenses for conducting market survey or any other survey necessary for the purpose of the business of the assessee;
- (iii) expenditure for getting engineering services related to the business of the assessee;

Provided that the assessee shall furnish a statement containing the particulars of expenditure specified in point (i) to (iii) within such period, to such income-tax authority, in such form and manner, as may be prescribed;

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 return of income as specified under section 139(1)

- (iv) expenses by way of legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;

- (v) in the case of a company
 - (a) expenses by way of legal charges for drafting the Memorandum and Articles of Association of the Company;
 - (b) expenses for printing the Memorandum and Articles of Association;
 - (c) expenses by way of fees for registration of the company under Companies Act; and
 - (d) expenditure incurred in connection with issue for public subscription of shares or debentures of the company, being underwriting commission, brokerage and the charges of drafting, typing, printing and advertisement of the prospectus; and
- (vi) such other items of expenses not covered by the list specified above which the Central Board of Direct Taxes may prescribe for the purpose of amortisation under this section.

Amount Qualifying for Deduction:

The maximum aggregate amount of the qualifying expenses that can be amortised has been fixed at

- 5% of the cost of the project in case of assessee **other than Indian company**
- In the case of an Indian company, at the option of the company,
 - 5% of the capital employed in the business of the company, or Cost of Project.

whichever is higher. The excess, if any, of the qualifying expenses shall be ignored.

Expenses incurred before commencement of Business: For the purpose of amortisation, the expression “**Cost of the Project**” in relation to the expenses incurred before the commencement of the business means the actual cost of the fixed assets being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of land and buildings, which are shown in the books of accounts of the assessee as on the last day of the accounting year in which the business of the assessee actually commences.

Expenses incurred after commencement of Business: Where the expenses are incurred after the commencement of business either in connection with the extension of the present undertaking or in connection with the setting up of a new unit, the cost of the project should be taken to mean the actual cost of the fixed assets, being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of the land and building which are shown in the books of the assessee as on the last day of the previous year in which extension of the undertaking is completed or the new unit commences production or operations, as the case may be, to the extent to which such fixed assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit of the assessee.

Note: The audit report is to be furnished at least one month prior to the due date for furnishing the return of income under section 139(1).

In the case of company, the “**capital employed**” in the business means where preliminary expenses have been incurred before the commencement of the business, the **aggregate of the issued share capital, debentures and long- term borrowings** as on the last day of the accounting year in which the business of the company has actually commenced. In cases where the expenditure has been incurred after the commencement of the business, the capital employed in the business of the company should be taken to be the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the

new unit commences production or operation, to the extent to which the capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or setting up of the new unit of the company.

The expression “**long-term borrowings**” to be included as part of the capital employed in the business of the company should be taken to mean:

- (i) any moneys borrowed by the company from the Government or the Industrial Finance Corporation of India or Industrial Credit and Investment Corporation of India or any other financial institution which is eligible for deduction under Section 36(1)(vii) of the Act or any banking institution; or
- (ii) any moneys borrowed or debt incurred by the company in a foreign country in respect of the purchases outside India of capital plant and machinery where the terms of the borrowing provide for repayment of the money borrowed or debt incurred over a period of not less than seven years.

The allowance towards amortisation of preliminary expenses is subject to the condition that the accounts of the assessee for the year or years in which the preliminary expenses are incurred have been audited by a Chartered Accountant or other accountant specified in Section 288(2) of the Act and, in addition, the assessee furnishes along with his return of income for the first year in which the deduction is claimed, the report of audit in the prescribed form, duly signed and verified by the auditor and setting out such other particulars as have been prescribed by the Board for this purpose.

Note: The **audit report** is to be furnished **at least one month prior to the due** date for furnishing the return of income under section 139(1).

In cases of amalgamation as defined in Section 2(1B) of the Act, where the undertaking of an Indian Company has been transferred before the expiry of ten years, the amalgamating company would not be entitled to the allowance towards amortisation of preliminary expenses in the year in which the amalgamation takes place. But the amalgamated company would be entitled to the allowance for the remaining period over which the allowance under this section is available. The total period over which the amortisation is allowable should not exceed ten years or five years as the case may be in the case of both the amalgamating company and the amalgamated company. The allowance under this section would not be denied, in cases of amalgamation, to the amalgamated company merely because the expenditure has not actually been incurred by the amalgamated company. Similarly, in case of demerger where an undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the said period of 10 years or 5 years (as the case may be), to another company in a scheme of demerger no deduction shall be admissible to the demerged company in the year in which the demerger takes place. The resulting company would be entitled to claim deduction for the balance period under this section. In other words, the deduction for the balance period will be available to resulting company as it would have been available to demerged company, if the demerger had not taken place. In cases where preliminary expenses qualify for amortisation under Section 35D and the allowance claimed by the assessee in this regard is allowed in any assessment year, these expenses would not qualify for any allowance or deduction in respect of any other assessment year or even in the same year under any other provision of the Income-tax Act, 1961.

Illustration 10:

- (a) Compute the deduction allowable under section 35D on the basis of the following information submitted.

Preliminary expenses incurred	₹ 2,20,000
Cost of project	₹ 50,00,000

- (b) What will be your answer if the above preliminary expenses have been incurred by Ruchira Ltd. & the capital employed is ₹ 60,00,000.

Solution

(a) Cost of project	₹ 50,00,000
5% of cost of project	₹ 2,50,000
Actual expenditure incurred	₹ 2,20,000
Deduction allowed shall be limited to	₹ 2,20,000

Deduction allowed shall be ₹ 2,20,000/5 = ₹ 44,000 for a period of 5 years starting from the previous year in which business has commenced.

(b) Actual preliminary expenditure incurred	₹ 2,20,000
5% of cost of project	₹ 2,50,000
Capital employed	₹ 60,00,000
5% of capital employed	₹ 3,00,000

Maximum deduction to be allowed shall be restricted to ₹ 2,20,000 Deduction allowable for 5 years — ₹ 2,20,000/5 = ₹ 44,000 every year

Amortisation of Expenditure in the case of Voluntary Retirement Scheme [Section 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.

Other Deductions [Section 36]

The other deductions allowable while computing the income from business/professions are as follows:

Type & Section	Deductions
Insurance Premia paid u/s 36(1)(i)	Premia paid on insurance policy to cover risk of damage/ destruction to stock/ stores of the business or profession.
Insurance Premia paid u/s 36(1)(ia)	Premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society
Premia paid by employer for health insurance of employees u/s 36 (1) (ib)	Premia paid by employer by any mode other than by cash , on health insurance of it's employees, in accordance with the scheme framed by GIC of India, or approved by the IRDA.
Bonus & Commission u/s 36 (1)(ii)	Deductible in full as long as the bonus / commission shall not be payable to them as profits / dividends, if it had not been paid as bonus/ commission.

<i>Type & Section</i>	<i>Deductions</i>
Interest on Borrowed Capital u/s 36(1)(iii)	Deduction allowed for any interest paid in respect of capital borrowed for business. In case the capital is borrowed for acquiring an asset, the interest is capitalised from the date of borrowing until the date when the asset is put to use. Post the “put to use” date, it cannot be capitalised anymore and then such interest becomes an allowable deduction.
Discount on Zero Coupon Bonds u/s 36(1)(iiia)	Difference between the issue and the redemption values, as these are issued at a discount and redeemed at par. Available to Infra. Companies/ funds / Scheduled Banks, starting from the date of issue of the bond, ending with the maturity / redemption.
Contribution to Provident & Other funds u/s 36(1)(iv) & (v)	Allowable if the fund is settled upon a trust, it should be recognised / approved, and the contributions should be periodic, and as long as the fund is for the benefit of the employees.
Employer's contribution to the a/c of the employee under a pension scheme referred to in Section 80CCD [Section 36(1)(va)]	Deduction is restricted to 14% of salary of employee in PY. Salary, here, would include only Basic & DA (if the terms of employment provide).
Employee's Contribution to Welfare Funds [Section 36(1)(va)]	Deemed as business income of the employer assessee and will be allowed as a deduction only if the employee contributions have been credited to the employees' account by the assessee in the fund, on or before the due date under the respective welfare acts.
Bad Debts u/s 36(1)(vii) & 36(2)	Allowable if the debts written off as irrecoverable in the accounts of the assessee pertain to the business / profession carried on during the PY and as long as the debt was considered in the income for the PY in which it was earned. If on the final settlement, the amount recovered on any debt falls short of the total debt minus the debt allowed, the deficiency will be allowed as a deduction in the year of recovery and if the amount so recovered is more than the amount due after the allowance has been made, the excess will be chargeable to tax.
Special reserve created and maintained by a specified entity [Section 36(1)(viii)]	An amount not exceeding twenty per cent of the profits derived from eligible business computed under the head “Profits and gains of business or profession” (before making any deduction under this clause) carried to such reserve account: Provided that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid up share capital and of the general reserves of the specified entity, no allowance under this clause shall be made in respect of such excess.

<i>Type & Section</i>	<i>Deductions</i>
Expenses on family planning [Section 36(1)(ix)]	If the expenditure is capital in nature, allowable in five equal instalments beginning the PY in which it was incurred and if revenue in nature, it shall be fully allowable in the PY in which it was incurred. The deduction is allowable to corporate assessees only.
Banking cash transaction tax [Section 36(1)(xiii)]	Any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him
Securities Transaction Tax Paid [Section 36(1)(xv)]	Allowable in respect of transactions entered in the course of business, as long as the income from the taxable securities' transactions, in respect of which it was incurred, is included under the heads "Profits / Gains from Business / Profession"
Commodities Transaction Tax paid [Section 36(1) (xvi)]	Allowable in respect of transactions entered in the course of business, as long as the income from the taxable commodities' transactions, in respect of which it was incurred, is included under the heads "Profits / Gains from Business / Profession" For this purpose, 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.

Other Expenses [Section 37]

Section 37(1) of the Income-tax Act provides for allowance in respect of any other item of expenditure not covered by any of the provisions contained in Sections 30 to 36 discussed above and is limited to the amount actually expended during the Previous Year. This deduction is subject to the following conditions:

Conditions:

Expenditure should not be covered u/s 30-36

Expenditure should be incurred by the assessee in the PY

Expenditure should be incurred wholly and exclusively for the purpose of business/profession

Expenditure should not be personal in nature

Expenditure should not be capital in nature

Expenditure is not incurred for any purpose which is an offence or prohibited by law illegal/immoral purpose

Explanation 3 to section 37(1)- It is clarified that the expression “expenditure incurred by assessee for any purpose which is an offence or which is prohibited by law in shall include and 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 to settle proceedings initiated in relation to contravention under such law as may be notified by Central Government in the Official Gazette in this behalf.

CBDT Notification No. 38/2025 : The following four laws are notified:

- Securities and Exchange Board of India Act, 1992
 - Securities Contracts (Regulation) Act, 1956
 - Depositories Act, 1996
 - Competition Act, 2002
- (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.

For eg: Expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry. These expenses are in violation of the provisions of Indian medical council Regulations. Hence such expenditure are 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.

Note:

1. Corporate Social Responsibility (CSR) expenditure is not construed to have been incurred for the purposes of business / profession and hence will be disallowed, and will be allowed aptly under the relevant Sections 30- 36.
2. Any advertisement expenditure in souvenirs of political parties, representing contributions for political purposes, would be disallowed.

Some of the examples of allowable expenses under Section 37(1) are as under:

- (i) Expenditure incurred on raising loans or issuing debentures but not on issuing share capital.
- (ii) Legal expenses incurred:
 - (a) to avoid a business liability, e.g., for alleged breach of a trading contract;
 - (b) to defend the assessee's title to his assets, e.g., land, building, etc.;
 - (c) to secure the termination of a disadvantageous trading relationship, e.g., removal of an undesirable employee;
 - (d) by a director of a company in defending a suit brought to challenge the validity of his election to the directorship;
 - (e) to protect the capital asset of the business which has already been acquired;
 - (f) by a company in resisting a winding up petition by some shareholders;
 - (g) for defending monopoly rights;
 - (h) incurred in restraining another company from using assessee's trade mark.

However, the expenses incurred in criminal proceedings are not allowable. Legal expenses relating to acquisition of capital asset for a business are capital expenses and as such, not allowable.

In this connection the Supreme Court held that-where litigation expenses are incurred by the assessee for the purpose of creating, curing or completing his title to the capital, then the expenses incurred must be considered as capital expenditure. But if the litigation expenses are incurred to protect the business of the assessee, they must be considered as a revenue expenditure. [*Dalmia Jain & Co. v. C.I.T. (1971) 81 ITR p. 754 (S.C.)*].

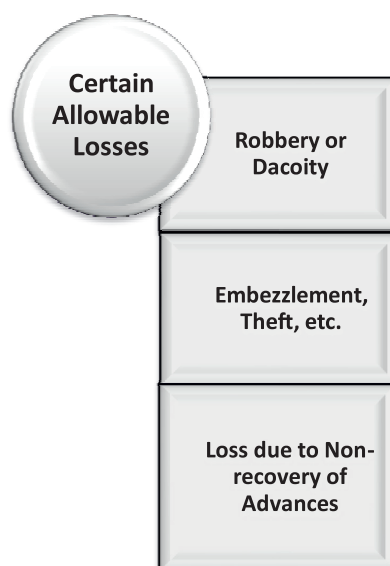
Expenditure for prosecuting civil proceedings is deductible provided the expenditure was laid out for the purpose of the business wholly and exclusively i.e. to promote the interest of the business. [*Sree Meenakshi Mills v. C.I.T. (1976) 63 ITR, p. 207 (S.C.)*]

- (iii) Bonus to employees under an industrial award.
- (iv) Expenses for the installation of new telephone.
- (v) Sales tax is an admissible deduction but not estate duty.
- (vi) Interest on unpaid purchase price of goods or capital assets.
- (vii) Expenditure incurred to oppose nationalization or to prevent extinction of business. However, the donations given for the political parties or for political cause are not admissible deductions under Section 37.
- (viii) Subscriptions given are allowed if their payment is compulsory or commercially expedient and of benefit to the payer.
- (ix) Expenses incurred on the occasion of festival or customary days are allowed up to a reasonable amount keeping in view the size of the business and subject to the satisfaction of the Assessing Officer that the expenses are not expenses of personal, social or religious nature.
- (x) Recurring expenses incurred on imparting basic training to apprentices under the Apprentices Act, 1961 is deductible.
- (xi) Initial expenditure on the first installation of fluorescent tube lights is treated as Capital expenditure and hence not deductible but all subsequent expenditure for replacement of tubes is treated as revenue expenditure and hence deductible.
- (xii) Loss through embezzlement by an employee is deductible.
- (xiii) Professional tax paid by a person carrying on business or trade is allowed as deduction.
- (xiv) Annual listing fee paid to stock exchange is allowed as deduction.
- (xv) Expenses incurred on Civil defence measures as specified by the Board, even when there is no emergency, is deductible.
- (xvi) Brokerage paid for raising loan to finance business.
- (xvii) Stamp and registration charges for the purpose of entering into agreement for obtaining overdraft facilities.
- (xviii) Security deposited with postal authorities for telex connection deductible as business expenditure. However, when the amount is returned by postal authorities, when the telex connection is finally closed, the refund shall be treated as an income of the assessee of the year in which the amount is refunded.
- (xix) Compensation payable as a result of negligence in carrying on a business or termination of an employee, director or agent.

- (xx) Compensation to an employee for injury sustained or accident met with while on duty.
- (xxi) Royalty paid for mining, patents or copyrights.
- (xxii) Insurance premiums: Premium for insurance of building, plant, machinery, furniture, stock or stores are allowable under specific sections, e.g., premium paid by a businessman under a policy insuring its employees or experts against death or injury, or insuring the employer against liability for compensation in respect of accidents to its workmen or against loss of trading licence.
- (xxiii) Penalty paid by the assessee for saving from confiscation of the goods which he has purchased from a third- party without knowing that they had been illegally imported.
- (xxiv) Pension, gratuity or other voluntary payment made to the employees are deductible but a gratuity paid to a single employee when it was not the practice of the business was treated as disallowable expense. In the same way voluntary pensions and lump sum payments made by a company to its employees on its winding up were not allowed.
- (xxv) *Bona fide* expenditure of a revenue nature incurred for the welfare of employees on its winding up was not allowed.
- (xxvi) Excessive price paid out of extra commercial considerations shall be disallowed.
- (xxvii) Sum paid by the assessee as a surety when it is not part of his business shall be disallowed.
- (xxviii) Presents given to employees by way of gift and not as perquisites for services rendered, shall be disallowed.

Certain Allowable Losses

Losses which are directly incidental to the business or profession of the assessee are allowable. Following are some examples of such losses:



1. Robbery or Dacoity: Loss caused by robbery or dacoity is not deductible. But, if it is incidental to business it will be allowed as a deduction and this depends upon the specific circumstances and conditions. For example, if cash is sent for disbursement at different centers by a sugar factory in rural area, it is incidental to business and is, therefore, allowed. Any loss due to robbery in a bank will be allowed as the bank is under an obligation to maintain some cash outside the storeroom for payments.

2. Embezzlement, Theft, etc.: The loss of money due to embezzlement by an employee handling the funds of the business while discharging his official duties is allowed as deduction. It is deductible when discovered. When an employee goes to bank to deposit the cash or takes cash with him for disbursement and he takes away the money for his own use, even then, the loss is allowable. Theft by a cashier, who is incharge of cash is also an allowable loss. A theft committed either by an employee or by someone else by breaking open into the business premises after office hours, is also allowable.

3. Loss due to Non-recovery of Advances: If it is the practice in a business to give advance money to the suppliers and if the supplier neither supplies the order nor refunds the advance money, the loss sustained by the assessee is incidental to business and is, therefore, allowable.

Section 37(2B) : Payment made to Political Party: Any expenditure on advertisement in any souvenir, brochure, tract pamphlet or the like published by any political party, whether it is registered with the election commission of India or not, shall not be allowed as deduction.

EXPENSES DISALLOWED [SECTION 40]

The following expenses shall not be deducted in computing the income chargeable under the head “profits and gains of business or profession:

- **Interest, royalty, fees for technical services payable outside India or in India to a Non-Resident:** Under **Section 40(a)(i)**, deduction is not allowed in respect of any interest, royalty, fees for technical services or other sum chargeable under the Income-tax Act, which is payable outside India or in India to a non-resident non-corporate or to a foreign company and on which tax has not been deducted or after deduction, has not been paid on or before the due date of filing return specified in subsection (1) of section 139.

Provided that where in respect of any such sum, tax has been deducted in any subsequent year or has been deducted in the previous year but paid after the due date of filing return specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso.

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.

- **TDS not deducted on any sum payable to a Resident: Under section 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 specified in sub-section (1) of section 139.

Provided that where in respect of any 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 sub-section (1) of section 139, 30% of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso.

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

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.

Levy not deducted for a specified service on which equalisation levy is deductible with respect to sum payable to a Non-Resident: Under section 40(a)(ib), Any sum payable to a non-resident on which levy is deductible and such levy has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139.

Provided that where in respect of any such sum, levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such levy has been paid.

- **Rate or Tax Paid on Profits: Under Section 40(a)(ii),** any sum paid by the assessee on account of any tax* or rate levied on profits on the basis of or in proportion to the profits and gains of any business or profession, would be disallowed in full. For example, income-tax, foreign income-tax.

**Tax shall include and shall be deemed to have always included any surcharge or cess, by whatever name called, on such tax.*

Explanation 1 to sub-clause (ii) of clause (a) of Section 40 clarifies that any sum paid outside India and eligible for relief of tax under Section 90 or deduction from the Income Tax payable under Section 91 is not allowable and deemed to have never been allowable as a deduction under Section 40 of the Income Tax Act. However, the tax payers will continue to be eligible for tax credit in respect of Income Tax paid in a foreign country in accordance with the provisions of Section 90 or Section 91 as the case may be.

Explanation 2 provides that any sum paid outside India and eligible for relief of tax under new Section 90A will not be allowed as a deduction in computation of profit and gains from business or professions.

Under section 40(a)(iib), any amount paid by way of fee, charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government, shall not be allowed as deduction for the purposes of computation of income of such undertakings under the head “Profits and gains of business or profession”.

A State Government undertaking includes –

- (a) A corporation established by or under any Act of the State Government;

- (b) A company in which more than 50% of the paid up equity share capital is held by the State Government;
- (c) A company in which more than 50% of the paid up equity share capital is held singly or jointly by (a) or (b);
- (d) A company or corporation in which the State Government has the right to appoint the majority of directors or to control the management or policy decisions.

An authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.

- **Salaries [Section 40a(iii)]:** Any payment 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 thereon under Chapter XVIIIB of the Act.
- **Payment to Provident Funds etc. [Section 40a(iv)]:** Any payment to a Provident Fund or other fund established for the benefit of employees of the assessee would be disallowed in cases where the assessee (employer) has not made effective arrangements to secure deduction of tax at source from any payment made from the fund which are chargeable to tax under the head “salaries” in the hands of the employees.
- **Payment of tax on non-monetary perquisites [Section 40a(v)]:** In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee.

Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

- **Payment to Partners:** The provision of Section 40(b) in the case of a firm which is assessable as such or LLP the following amounts shall not be deducted in computing the business / profession income of the Firm/ LLP:
 - (a) **Payment to Non- working partner:** Any payment of salary, bonus, commission or remuneration to non- working partner.
 - (b) **Remuneration paid to a working partner not authorized by Deed:** Remuneration paid to a working partner or interest paid to any partner which is not authorised by or not in accordance with the terms of the partnership deed.
 - (c) **Any remuneration paid to a working partner or interest paid to any partner** which is authorised by or is in accordance with the terms of the partnership deed but which relates to any period falling prior to the date of such partnership deed.
 - (d) **Interest paid in excess of 12%:** any interest which is paid in accordance with the terms of the partnership deed and relates to any period falling after the date of such partnership deed but which is in excess of simple interest @ 12% p.a.
 - (e) any remuneration to a working partner which is authorised by and is in accordance with the terms of the partnership deed and in relation to any period falling after the date of partnership deed is an allowable deduction subject however, to the condition that the maximum amount of such payment made to all the partners during the previous year should not exceed the limits given below:

<i>Quantum of Book Profit</i>	<i>Amount</i>
(a) Up to Rs. 6,00,000 of book profit or in case of a loss	Rs. 3,00,000 or 90% of the Book profit, whichever is more
(b) on the balance of book profit	60% of book profit

“Working Partner”, means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

“Book Profit” means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in chapter IV-D (i.e., Sections 28 to 44D) as increased by the aggregate amount of remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.

For Example: A firm has paid Rs. 8 lakhs as remuneration to its partners for the P.Y. 2025-26, in accordance with its partnership deed, and it has a book profit of Rs. 10 lakh. Now the allowable remuneration calculated as per the limits specified in section 40(b):

On first Rs.6 lakh of book profit [Rs. 6,00,000 × 90%] = Rs. 5,40,000

On balance Rs. 4 lakh of book profit [Rs. 4,00,000 × 60%] = Rs. 2,40,000

Total = Rs. 7,80,000

So the excess amount of Rs. 20,000 (i.e., Rs.8,00,000 – Rs. 7,80,00) would be disallowed as per section 40(b)

- **Payment by AOPs / BOIs [Section 40(ba)]:** In the case of an association of persons or body of individuals (other than a company or a Co-operative Society or a society registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India) any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such association or body to its member shall not be allowed as a deduction in computing the income of such association or body.

As per explanation 1 to clause (ba) of Section 40 of the Income-tax Act, where interest is paid by the association or body to any member thereof, who has also paid interest to the association or body, the disallowance shall be restricted to the amount paid by the association or body to the member, after deducting therefrom the amount paid by the member to the association or body.

EXPENSES RESTRICTED [SECTION 40A]

- (1) Payment to Relatives or Associates [Section 40A(2)]:** (1) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person specified below and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable, having due regard to the
- fair market value of the goods, services 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 him therefrom,

so much of the expenditure as is considered to be excessive or unreasonable must be disallowed in computing the assessee's income from business or profession. However the amount so disallowed

would be taxable as income in the hands of the recipient. **This section applies to expenditure only.** It is not attracted when assessee makes a sale to specified person at a price lower than its Fair Market Value.

Domestic Transfer pricing provisions of arm length pricing shall not be applied to any expenditure in respect of which payment is made to a related party covered by section 40A(2) of the Income-tax Act.

The specified persons, the payments to whom may fall for disallowance under this section are the following:

Assessee	Specified Person
An Individual	a. any relative of the individual assessee b. any person who carries on a business or profession, if individual assessee or any of his relative has a substantial interest in the business of that person
Company, firm, association of persons or H.U.F	a. any director of the company, partner of the firm, member of the association or family, or any relative of such director, partner or member or b. 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 c. 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 Assessee	a. Any Person who has a substantial interest in the business or profession of the assessee or any relative of such Person b. Other related persons of such person, who has a substantial interest in the assessee's business like ● 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

Note:

- a. **Substantial interest in a Business or Profession means-** (i) in cases where the business or profession is carried on by a company, if such person is the beneficial owner at any time during the relevant accounting year of equity shares carrying not less than 20% of the total voting power, and (ii) in other cases, if such person is at any time during the accounting year, beneficially entitled to not less than 20% of the profits of such business or profession.
- b. **Relative in relation to an Individual** means the spouse, brother or sister or any lineal ascendant or descendant of that individual.

- (2) **Payments exceeding Rs. 10,000 [Section 40A(3)]:** Where the assessee incurs any expenditure (while computing income under the heads Profit & Gains from Business and Profession and Income from Other sources) 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 system through bank account or through such other electronic modes as prescribed under Rule 6ABBA exceeds Rs. 10,000 (ten thousand rupees), no deduction shall be allowed in respect of such expenditure. Payments in exceeding of Rs.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.

Prescribed Electronic Modes [Rule 6ABBA]

(a) Credit Card; (b) Debit Card; (c) Net Banking; (d) IMPS (Immediate Payment Service); (e) UPI (Unified Payment Interface); (f) RTGS (Real Time Gross Settlement); (g) NEFT (National Electronic Funds Transfer); and (h) BHIM (Bharat Interface for Money) Aadhar Pay. **[As Amended by Finance Act, 2020]**

Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profit and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds ten thousand rupees:

Provided that no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3) and this sub-section 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 such other electronic modes as may be prescribed, exceeds ten thousand rupees, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Provided further that in the case of payment made **for plying, hiring or leasing goods carriages, the amount shall not exceed Rs. 35,000 (thirty-five thousand rupees)** instead of ten thousand rupees.

- a) **Transaction of Loan:** It does not apply to loan transactions because advancing of loans or repayment of the principal amount of loans does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding Rs. 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.
- b) **Payment made by commission agents:** This requirement does not apply to payment made by commission's agents for goods received by them for sale on commission or consignment basis because such 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.

Under **Rule 6DD** of the Income-tax Rules, the following categories of payments are exempt for the purposes of this requirement. Consequently, the provisions of Section 40A (3) do not apply to the following cases and circumstances:

- (i) Payments which are made to the Reserve Bank of India, State Bank of India or other banking institutions, including co-operative banks and land mortgage banks, primary credit societies, Life Insurance Corporation of India, Unit Trust of India and certain specified institute providing Industrial Finance.

- (ii) Payments, which under the contracts entered into prior to 1.4.1969 have to be made only in legal tender.
- (iii) Payments made to the Central or State Governments which under the Rules framed by the Government are required to be made in legal tender.
- (iv) Payments in villages and towns having no banking facility, to persons ordinarily residing or carrying on business or profession in such villages or towns.
- (v) Payments by means of book adjustment by the assessee in the account of the payee against money due to the assessee for any goods supplied or services rendered by him to the payee.
- (vi) Payments made by any Letter of Credit arrangement through bank, a mail or telegraphic transfer through bank, a book adjustment from any account in a bank to any other account in that or any other bank and a bill of exchange made payable only to a bank.
- (vii) Payments of terminal benefits made to an employee of an assessee such as gratuity, retrenchment compensation, etc. not exceeding Rs. 50,000.
- (viii) Payments made to cultivators, growers or producers for the purchase of agricultural or forest produce, animal husbandry products including hides and skins, products of dairy or poultry farming, products of horticulture or fish, products of cottage industry run without the aid of power.
- (ix) Where the payment is made to an employee temporarily but for a minimum period of fifteen days in a place other than his normal place of duty or on a ship provided tax has been deducted at source in terms of Section 192 of the Act and provided further that such employee has no bank account at such place of temporary posting or ship.
- (x) Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike.
- (xi) Where payment is made to an agent who in turn is required to make payment in cash for goods or services on behalf of the assessee.
- (xii) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

Where an expense payable has been allowed in the assessment for any year in respect of any liability incurred by the assessee and in any subsequent year the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or such other electronic modes as prescribed under Rule 6ABBA, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day exceeding INR 10,000.

Will the provision of section 40A(3) be attracted in the following cases:

Questions	Answers A.Y. 2026-27
(a) Ashni purchases goods worth ₹ 60,000 from Ruchira against one bill but makes payment of ₹ 18,000, 18,000, 12,000 & 12,000 at different times on the same date.	Section 40A(3) shall be applicable and ₹ 60,000 shall be disallowed
(b) Ashni makes a payment of ₹ 50,000 as donation by cheque to National Defence Fund.	Section 40A(3) shall not be applicable. As donation is not allowable as deduction under section 30 to 37 but allowable under section 80G from GTI

Questions	Answers A.Y. 2026-27
(c) Kiara makes a purchase of goods of ₹ 80,000 and makes payment of ₹ 65,000 by account payee cheque and ₹ 15,000 in cash.	Section 40A(3) will be applicable as the payment in cash exceeds ₹ 10,000. Hence, ₹ 15,000 shall be disallowed.
(d) Sarika, a dealer of machines purchases a machine for ₹ 1,50,000 and makes the payment by bearer cheque.	Entire ₹ 1,50,000 shall be disallowed as payment is not by account payee cheque
(e) Nitin pays a salary of ₹ 12,000 by bearer cheque to an employee.	₹ 12,000 shall be disallowed as the payment exceeds ₹ 10,000 and it has been made by a bearer cheque.
(f) Sachin purchases goods in cash from his brother for ₹ 60,000, whose market value is ₹ 55,000.	₹ 5,000 will be disallowed under section 40A(2) and ₹ 55,000 shall be disallowed under section 40A(3)
(g) Pooja purchases goods in cash for ₹ 40,000 from Nitin, a villager and makes payment to Nitin in his village where no banking facility is available.	No. As per rule 6DD, it is permissible.
(o) Big B makes a payment in cash amounting to ₹ 35,000 to a transporter on 5.11.2025.	Nothing shall be disallowed as payment is made to a transporter which can be made otherwise than by an account payee cheque upto ₹ 35,000.

- (3) Provision for Gratuity [Section 40A(7)]:** No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason. However, any provision made by the assessee for the payment of a sum by way of any contribution towards an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during the previous year shall be allowed.

Where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of 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 of gratuity to any employee shall not be allowed as a deduction in computing the income of the assessee of the previous year in which the sum is so paid.

- (4) Restriction on contribution by employers to non-statutory funds [Sections 40A(9), (10) and (11)]:** With a view to discouraging creation of irrevocable or discretionary trusts funds, companies, associations of persons, societies, etc. the Finance Act, 1984 has provided that no deduction shall be allowed in the computation of taxable profits in respect of any sums paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid by the assessee as an employer or contributed (within the limits laid down under the relevant provisions) to a recognised provident fund or an approved gratuity fund or an approved superannuation fund or for the purposes of and to the extent required by or under any other law.

Disallowance of unpaid Statutory Liability [Section 43B]

Under the income-tax law, a person carrying on a business or profession can maintain account for his income either on cash or mercantile basis. The latter, however, have to reckon with the restrictions contained in Section 43B of the Income-tax Act. This section cuts into the freedom of a business to claim certain specified expenses

on due basis. The section has broadly divided the targeted expenses into two, i.e., according to section 43B even if an assessee maintains books on mercantile system even then the following sums are allowed as deduction only on the basis of actual payment within the time limits specified in section 43B. In the first category are:

- (a) Any sum payable by way of **taxes, duties, cess or fees**, by whatever name called under any law for the time being in force, or;
- (b) **Bonus and commission** for services rendered payable to employees;
- (c) **Interest on any loan or borrowing** from such class of non-banking financial companies as may be notified by the Central Government in the Official Gazette in this behalf in accordance with the terms and conditions of the agreement governing such loan or borrowing.

Central Government has notified following NBFCs

- NBFCs classified in the Middle Layer
 - NBFCs classified in the Top Layer
 - NBFCs classified in the Upper Layer
- (d) **Leave encashment** paid by employer.
 - (e) Any sum payable by employer by way of **contribution to provident fund or super annuation fund or** any other fund for welfare of employees.
 - (f) Any sum payable by the assessee to the **Indian Railways** for use of railway assets.
 - (g) 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.

These expenses (except at point no. g i.e. sum payable by the assessee to a micro or small enterprise) outstanding at the end of the previous year would be allowed as deduction only to the extent they have been actually paid on or before the due date of filing the income-tax return u/s 139(1) failing which they would be allowed in the previous year in which they have been actually paid.

The provisions of this section are applicable only to employer's contribution and are not applicable to employee's contribution for the welfare funds. Hence employer's contribution to various funds is allowed as deduction if the same is paid on or before the due date of filing return under section 139(1). However employee's contribution for the welfare funds is first deemed as income of the assessee (employer) u/s 36(1)(va) and the same is allowed deduction only when such sums are deposited by the assessee to the employee's account in the relevant fund or funds on or before the due date as per the respective welfare acts.

It is hereby clarified that the provisions of this section shall not apply and shall be deemed never to have been applied to a sum received by the assessee from any of his employees to which the provisions of sub-clause (x) of clause (24) of section 2 applies.[Amendment vide Finance Act, 2021]

Note:

Where there is default in the payment of such interest, such interest can be converted in to a loan. Such conversion of the unpaid interest in to loan, by itself, does not constitute the payment, for purposes of Section 43B. This shall be allowed proportionately in the previous year in which the converted interest is actually paid.

A deduction of any sum, being interest payable under this section to any public financial institution or a State financial corporation or a State industrial investment corporation, shall be allowed if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or borrowing or debenture or any other instrument by which the liability to pay is deferred to a future date shall not be deemed to have been actually paid.

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.

Section 43B (h): “any sum payable by the assessee to a MICRO or SMALL enterprise beyond the time limit specified in 15 of the Micro, Small and Medium Enterprises Development Act, 2006,”

The above clause indicated that, in order to be eligible to claim deduction of the sum payable to micro and small enterprises, the payment shall be actually made within the time limit specified in 15 of the Micro, Small and Medium Enterprises Development

Meaning of Micro and Small Enterprise

1. In case of manufacturing enterprises and enterprises rendering services:
 - a) Micro Enterprise means where the investment in plant and machinery or equipment is less than or equal to Rs 1 crore and turnover less than or equal to 5 crore ..
 - b) Small Enterprise means where the investment in plant and machinery or equipment is less than or equal to 10 crore and turnover is less than or equal to 50 crore.

What is the Time Limit specified u/s 15 of the Micro, Small and Medium Enterprises Development Act, 2006 ?

Section 15 of MSME Development Act, 2006 stipulates that “Where any supplier being a micro or small enterprises, supplies any goods or renders any services to any buyer, the buyer shall make payment therefor on or before the date agreed upon between him and the supplier 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 or, where there is no written agreement in this behalf, the payment shall be made before the appointed day i.e within 15 days*:

Provided that in no case the period agreed upon between the supplier and the buyer in writing shall not exceed forty-five days from the day of acceptance or the day of deemed acceptance”

If the sum payable by the assessee to a micro or small enterprise is paid as per written agreement (maximum 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 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.

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.

Illustration 11

During the Financial Year 2025-2026, the following payments / expenditure were made / incurred by Mr. Yuvan Raja, a Resident Individual (whose turnover during the year ended 31.03.2025 was ₹ 54 Lakhs):

1. Interest of ₹ 12,000 and commission Rs.15,000 was paid to Rehman & Co, a Resident Partnership Firm.
2. Interest of ₹ 4,000 was paid as interest to Mr. R.D. Burman, a Non-Resident.
3. ₹ 3,00,000 was paid as salary to a resident individual.
4. He had sold goods worth ₹ 5 Lakhs to Mr. Deva. He gave Mr. Deva a cash discount of ₹ 12,000 later. Commission of ₹ 15,000 was paid to Mr. Vidyasagar on 02.07.2025.

In none of these transactions, tax was deducted at source. Briefly discuss whether any disallowance arises under the provisions of Section 40(a)(i) / 40(a)(ia) of the Income Tax Act, 1961.

Solution:**Assessee: Mr. Yuvan Raja Previous Year: 2025-2026 Assessment Year: 2026-2027**

- 1. Payment of Interest and Commission:** The Assessee is not subject to Tax Audit in the preceding PY since the Turnover of ₹ 54 Lakhs is less than the prescribed limit of u/s 44AB for PY 2024-2025. Therefore the Assessee is **not liable to deduct Tax** for both interest u/s 194A and commission u/s 194H. The amounts of ₹ 12,000 (Interest) and ₹ 15,000 (Commission) are allowable expenditure.
- 2. Interest, Royalty, Fees for Technical Services or other similar sum payable outside India or in India to a Non-Resident not being a Company, or to a Foreign Company,** on which tax has not been paid or deducted at source or after deduction, tax has not been paid before the prescribed time u/s 139(1) will be allowed as a deduction in computing the income of the previous year in which such tax has been paid and not in the previous year to which it relates to. Hence, the interest of ₹ 4,000 paid to Mr. Burman without deduction of tax is **not an allowable expenditure** for the Previous Year 2025-2026. [Note: However, Where an Assessee fails to deduct tax at source but is **not** deemed to be an Assessee in Default u/s 201(1), then it shall be deemed that the Assessee has deducted and paid the tax on such sum, on the date of furnishing of Return of Income by the **Payee.**]
- 3. Salary to a Resident:** TDS on Salaries to Resident Employees in India is also covered u/s 40(a)(ia). So, payment of ₹ 3,00,000 to a Resident Individual on which Tax was not deducted is disallowed to an extent of 30%. However, is allowed in the year of TDS remittance.
- 4. Sale of Goods and Cash Discount** are business transactions and **TDS is not attracted** for these transactions. Therefore the amounts are **not disallowed u/s 40(a)(ia).**

Changes in Rate of Exchange [Section 43A]

As per Section 43A of the Income-tax Act, where an assessee has acquired any asset in any previous year from a country outside India for the purposes of his business or profession and, in consequence of a change in the rate of exchange during any previous year after the acquisition of such asset, there is an increase or reduction in the liability of the assessee as expressed in Indian currency (as compared to the liability existing at the time of acquisition of the asset) at the time of making payment towards the whole or part of the cost of the asset or for payment of the whole or part of the moneys borrowed by him from any person directly or indirectly in any foreign currency specifically for the purpose of acquiring the capital asset. The amount by which the liability of the assessee in terms of Indian Rupees is increased or reduced as a result of change in the rate of exchange of the currency, would be added to or as the case may be deducted from the actual cost of the asset as defined in Section 43(1). Consequently, the amounts of depreciation allowable to assessee in respect of the asset would correspondingly be increased or reduced, as the case may be.

For these purposes, the expression “**rate of exchange**” must be taken to mean the rate of exchange determined or recognised by the Central Government for the conversion of Indian Rupee into foreign currency or *vice-versa*. In cases where the whole or part of the liability in respect of the payment for the cost of the asset or in respect of the money borrowed from a foreign source for acquiring the capital asset is not met by the assessee but directly or indirectly by any other person or authority, the liability so met by the other persons should not be taken into account for the purposes of any adjustment in the actual cost of the asset and consequently the depreciation allowable to the assessee arising from the change in the rate of exchange of the currency.

If, at the time of change in the rate of exchange arising on account of devaluation or otherwise the actual cost of the asset has been fully paid by the assessee and no money remains outstanding in respect of any sum borrowed specifically for the purpose, no adjustment would be permissible to the assessee. The special

provision would, however, apply only in respect of capital expenditure or the value of the capital asset and would not in any way affect the value of the current assets, such as stock-in-trade or other trading assets.

The addition or deduction from the actual cost of the asset on account of change in the rate of exchange in any previous year shall be allowed to be made only on actual payment by the assessee towards the cost of the asset or repayment of the foreign loan or interest, irrespective of the method of accounting adopted by him.

DEEMED PROFITS [SECTION 41]

Section 41 of the Income-tax Act enumerates items of notional income which are deemed to be income from business or profession chargeable to tax. The liability to tax in respect of deemed profits would arise not only during the existence of the business but also after its discontinuance. The items of deemed profits are enlisted below:

- (i) **Remission of Liability or Recoupment of Loss or Expenditure:** Where any allowance or deduction has been made in the assessment for any year in respect of losses, expenditure or trading liability incurred by the assessee and subsequently the assessee or his/its successor in business has obtained, whether in cash or in any other 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 during any subsequent accounting year, the amount so obtained or the value of the benefit so accruing to the assessee or his/its successor in business as the case may be, must be deemed to be the profits and gains of business or profession and must be charged to tax as the income of the assessee or his/its successor in business as the case may be for the year in which the remission or cessation takes place. This tax liability would arise irrespective of the fact whether the business or profession in respect of which the allowance or deduction has been made is being continued to be carried on by the assessee in the year of remission of liability or not. For instance, if sales tax is paid by the assessee in the year 1998-99 and the assessee gets a refund of sales-tax previously paid in the year 1999- 2000, the refund would be taxable as the assessee's income of 1999-2000. But the taxability of any deemed profit on account of remission of liability or recoupment of loss would arise only if the liability in question or the amount of the loss was previously allowed as a deduction in computing the business income of the assessee. For instance, if the income-tax assessment for the year in which the expenditure or loss was claimed was made *ex parte* or was a best judgement assessment and the income was estimated, it cannot be said that the expenditure was actually allowed as a deduction in the assessment. Consequently, if there is a remission of the liability subsequently, the assessee cannot be brought to charge in respect of the same. Unilateral write off of any liability would be taxable as deemed income.
- (ii) Where any building, machinery plant or furniture owned by the assessee and used for the purpose of business for which depreciation under Section 32(1)(i) is claimed, is sold, discarded, demolished or destroyed and the money payable together with scrap value in respect of such assets exceeds the written down value, the excess to the extent of difference between the actual cost and the written down value shall be taxable as business income in the previous year in which the moneys payable become due.

Even if in the year the moneys payable becomes due, the business for which these assets were used is no longer in existence, the provisions of this section shall apply as if the business is in existence in that previous year.

- (iii) **Capital expenditure on Scientific Research:** Where an assessee incurs capital expenditure on scientific research, the entire amount of such expenditure is allowable as a deduction in computing the business income of the assessee in the same year in which the expenditure is incurred. If subsequent to the incurring of the expenditure, the asset representing the capital expenditure is sold, without having been used for other purposes, the assessee would be liable to pay tax on the excess of sale proceeds

together with the deduction allowed earlier over the amount of capital expenditure or the amount of deduction allowed earlier whichever is less.

Further, the assessee is liable to pay tax on the balancing charge even if the assessee's business is not in existence during the previous year in which the money payable in respect of any asset becomes due.

Explanation: For the purpose of Sub-section (3) -

1. "moneys payable in respect of any building, machinery, plant or furniture" includes -
 - (a) any insurance, salvage or compensation moneys payable in respect thereof;
 - (b) where the building, machinery, plant or furniture is sold, the price for which it is sold, so however, that where the actual cost of a motor car is, in accordance with the proviso to clause (1) of Section 43, taken to be twenty-five thousand rupees, the moneys payable in respect of such motor car shall be taken to be a sum which bears to the amount for which the motor car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of twenty-five thousand rupees bears to the actual cost of the motor car to the assessee as it would have been computed before applying the said proviso.
2. "sold" includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian Company.

(iv) Recovery of Bad Debts: Where the assessee claims a deduction in any year in respect of a debt which has become bad or irrecoverable and the Assessing Officer allows a deduction to the extent of the bad debts, if subsequently the assessee recovers either the full amount of the debt which was previously written off as bad or part thereof, the amount so recovered would be chargeable to tax as the business income of the assessee in the year of recovery. But if the amount claimed by the assessee as bad debt was previously disallowed by the Assessing Officer on the ground that it had not actually become bad or it was not written off by the assessee, when the money is recovered, there would be no liability to tax in respect thereof. In cases where the Assessing Officer had allowed only a part thereof as bad, in the subsequent year of recovery, the tax liability under this section must be on the amount of difference between the amount recovered and the bad debt disallowed by the Assessing Officer.

(v) Withdrawal of any amount from special reserve: Where a deduction has been allowed in respect of any special reserve created and maintained under clauses (viii) of Sub-section (1) of Section 36 any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income tax as the income of the previous year in which such amount is withdrawn.

Where any amount is withdrawn from the special reserve in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

(vi) Set off of Losses of a Defunct Business against Deemed Profit : Where the business or profession referred to in this section is no longer in existence and there is income chargeable to tax under points (i), (iv) and (v) given above in respect of that business or profession, any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall as far as may be, be set off against the income chargeable to tax under the sub-section aforesaid.

Transfer of Immovable Property [Section 43CA]

Section 43CA is applicable to transactions of immovable property that section 50C of the Income Tax Act do not cover. Section 43CA 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 or Profession”.

However where the stamp duty value does not exceed 110% of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of computing profits and gains from transfer of such asset.

These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade. 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 by any authority of state government for the purpose of payment of stamp duty in respect of such transfer the value so adopted or assessed or assessable shall for the purpose of computing income under the head “Profits and gains of business or profession” shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

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 and not as on the date of registration for such transfer. However, this exception shall apply only in those cases where amount of consideration or a part thereof for the transfer has been received by way of account payee cheque/account payee bank draft or by use of electronic clearing system 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].

SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS [SECTION 43D]

This section provides that in the case of a public financial institution or a scheduled bank or a state financial corporation or a state industrial investment corporation or a State industrial investment corporation or a *deposit taking non-banking financial company* or a *systemically important non-deposit taking non-banking financial company*, the income by way of interest on such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts shall be chargeable to tax in the previous year in which it is credited to profit and loss account by such institution referred above for that year or in the previous year in which it is actually received by them whichever is earlier.

With a view to improve the viability of leasing finance companies, the section has been amended to provide that in case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debt shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the

previous year in which it is actually received by it, whichever is earlier. The benefit of Section 43D shall also be extended to co-operative banks (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank).

SPECIAL PROVISIONS RELATED TO INSURANCE BUSINESS [SECTION 44]

The profits and gains of any business of insurance must, according to Section 44, be computed in accordance with the rules contained in the First Schedule to the Income-tax Act. For the purpose of the computation, it is immaterial whether the insurance business is carried on by mutual insurance company or by a co-operative society or by any other person. The rules contained in the Schedule would apply notwithstanding anything to the contrary contained in the provisions of the Income-tax Act relating to the computation of income chargeable under the head 'Interest on Securities', 'income from house property', 'capital gains', or 'income from other sources' or under the head 'income from business or profession'.

COMPULSORY MAINTENANCE OF BOOKS OF ACCOUNT [SECTION 44AA]

As per section 44AA(1): Every person carrying on the legal / medical / engineering / architectural profession / accountancy / technical consultancy / interior decoration, or any other profession as notified by the Central Board of Direct Taxes (CBDT), in the Official Gazette, must statutorily maintain such books of account and other documents as may enable the Assessing Officer to compute his total income under the Act.

1. As per Rule 6F, every person carrying legal / medical / engineering / architectural profession / accountancy / technical consultancy / interior decoration, or any other profession as notified by the Central Board of Direct Taxes (CBDT), in the Official Gazette shall keep and maintain the books of account and other documents specified in Rule 6F(2) in the following cases:
 - If the gross receipts exceed Rs 1,50,000 in all the 3 years immediately preceding the previous year; or
 - If the profession has been newly set up in the previous year, his gross receipts are likely to exceed Rs 1,50,000 in that year.
2. An **Individual or HUF** carrying on any business / profession [**other than** notified professions specified in section 44AA(1)], must maintain the books of accounts necessary for computation and assessment,
 - if the income from existing business / profession exceeds INR 250,000 OR the total sales, turnover/ gross receipts as the case may be, in the business or profession exceeds INR 25,00,000 in **any 1 of the 3 years immediately preceding** the accounting year and
 - **if the business / profession is newly set up**, if the income is likely to exceed **Rs. 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 Rs. 25,00,000** during the previous year.
3. Every **person other than an Individual / HUF** carrying on any business / profession **other than notified professions referred to in section 44AA(1)**, must maintain the books of accounts necessary for computation and assessment,
 - If the income from existing business / profession exceeds INR 120,000 OR the total sales, turnover/ gross receipts as the case may be, exceeds INR 10,00,000 in any 1 of the 3 years immediately preceding the accounting year or
 - if the business / profession is newly set up, if the income from business or profession is likely to exceed the thresholds mentioned i.e. Rs. 120,000 OR the total sales, turnover / gross receipts as the case may be, likely to exceed Rs. 10,00,000, during the Previous Year.

4. Where profits and gains from business are deemed to be profits and gains under section 44AE or Section 44BB or Section 44BBB and assessee has claimed his income to be lower than the profits and gains so deemed to be the profits and gains of his business during the previous year or
5. Where the provisions of section 44AD(4) or section 44ADA are applicable to him and his total income exceeds the maximum amount which is not chargeable to income tax.

Under presumptive assessment under sections mentioned above, if assessee claims that his income is lower than that specified under these sections, assessee is required to get his accounts audited by a Chartered Accountant and copy of that report needs to be attached alongwith his return of income. Therefore to get his accounts audited he needs to maintain such books to substantiate his claim and also to enable Chartered Accountant to issue Audit Report to this effect.

The CBDT has the authority under the act to prescribe the books of accounts necessarily to be maintained having regard to the nature of business / profession, including their format and the details to be mentioned therein, and the place where these need to be maintained.

The books of accounts and other documents shall be kept and maintained for a period of 6 years from the end of relevant assessment year. For details students may refer to Rule 6F also for specified books to be maintained.

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

If the person fails to keep / maintain the books of accounts / documents or fails to retain the required books of accounts / documents, then, such person shall be liable to pay the penalty under section 271A to the extent of INR 25,000.

COMPULSORY AUDIT OF BOOKS OF ACCOUNT [SECTION 44AB]

Section 44AB makes it obligatory for a person to get his accounts audited before the “**specified date**” by a “Chartered Accountant”;

An Assessee carrying on Business

Situation A

If the total sales, turnover or gross receipts in **business** in the relevant previous year exceeds INR 1 crore. However, If the following conditions are satisfied then the higher threshold limit of amount exceeding Rs. 10 crore shall be applicable for compulsory Audit by a person carrying on business:

- a. Aggregate cash amounts received including amount received for sales, turnover or gross receipts during the relevant previous year, does not exceed 5% of total receipts (including receipts for sales turnover, gross receipts ; and
- b. Aggregate cash payments made including amount incurred for expenditure, during the relevant previous year does not exceed 5% of the total payments (including amount incurred for expenditure)

For this purpose the payment or receipt, as the case may be, by a cheque drawn on a bank or by bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.

Exception :

- Where a person declares profits and gains for the previous year u/s 44AD and his total sales/ turnover/ gross receipts in business does not exceed Rs 2 crore in the previous year then the provision of tax audit is not applicable

Situation 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 previous year and

If such assessee claims that the profits and gains from business in the relevant previous year are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e. Rs 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and Rs 7500 for each vehicle other than heavy goods vehicle, for every month or part of month for which the vehicle is owned by the assessee].

Situation C:

- a) In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts is not more than Rs 2 crores and who has opted for section 44AD in any earlier previous year (say PY 2023-24)
- b) In case of an eligible assessee carrying on business, whose aggregate cash receipts in the relevant PY does not exceed 5% of the total turnover or gross receipts and whose total turnover, sales or gross receipts does not exceed 3 crores and who has opted for section 44AD in any earlier previous year (say PY 2023-24)

In the above case (a) and (b) if he declares profit for any of the five successive PYs (say PY 2025-26) not in accordance with section 44AD (i.e. he declares profits lower than 8% or 6% of total turnover/ sales/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 PY 2026-27 to 2028-29). For the year of default i.e. PY 2025-26 and five successive PYs (i.e. from PY 2026-27 to 2028-29), 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.

An assessee carrying on Profession

Situation A

If his gross receipts from profession for the relevant previous year exceeds INR 50 lakhs.

Exception: The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on a presumptive basis u/s 44ADA(1).

Situation B

- a) In case of an assessee carrying on notified profession u/s 44AA(1) i.e. legal, medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts does not exceed 50 Lakhs
- b) In case of an assessee carrying on notified profession u/s 44AA(1) i.e. legal, medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY does not exceed 5% of total gross receipts and whose gross receipts does not exceed 75 Lakhs

In the above cases (a) and (b) if such 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.

The provision also casts an obligation on such persons to furnish by the “specified date”, a report of the audit in the prescribed form duly signed and verified by the Chartered Accountant setting forth such particulars as may be prescribed by rules made in this behalf by the Central Board of Direct Taxes.(Form 3CA/3CB/3CD).

Note: Specified Date is one month prior to the due date for filing Return of Income u/s 139(1) which shall be as under:

S. No.	Type of Assessee	Due Date u/s 44AB for furnishing Tax Audit report	Due Date u/s 139(1) for furnishing Return of Income
1.	Where the assessee is required to furnish a report of a CA u/s 92E relating to international transaction or specified domestic transaction (Transfer Pricing cases)	31st October of the relevant Assessment Year	30th November of the relevant Assessment Year
2.	Any other case	30th September of the relevant Assessment Year	31st October of the relevant Assessment Year

Penalty for Non-Compliance of the Tax Audit Under Section 44AB

Persons or individuals who fails to get their accounts audited or fails to furnish the audit report by the specified date, penalty of lower (a) or (b) mentioned below would be leviable on such person-

- 0.5% 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
- 1,50,000 [Section 271B]

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS [SECTION 44AD]

A) Assessee on which section applicable

The provisions of this section shall be applicable to

- resident Individual,
- resident HUF,
- resident partnership Firm (excluding LLP)

carrying on eligible business **except** the business of plying, hiring or leasing goods carriages referred to in section 44AE and who has not claimed deduction u/s 10AA or chapter VIA under "C- Deductions in respect of certain incomes".

Persons not eligible for Presumptive Taxation Scheme: The following persons are specifically excluded from the applicability of the presumptive provisions of section 44AD -

- a person carrying on profession as referred to in section 44AA(1), i.e., legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board
- a person earning income in the nature of commission or brokerage; or
- a person carrying on any agency business.

B) Business on which section is applicable:

Case 1

Any business other than business referred to in section 44AE whose total turnover or gross receipts in the relevant previous year does not exceed 2 Crores.

Case 2

In case of an assessee carrying on business other than business referred to in section 44AE, whose total turnover or gross receipts in the previous year does not exceed 3 crores in the relevant PY if the aggregate cash receipts in the relevant PY does not exceed 5% of the total turnover or gross receipts

In effect if the turnover of business exceeds 2 crores but does not exceed 3 crores the benefit of section 44AD can be availed only if aggregate cash receipts in relevant PY does not exceed 5% of total turnover or gross receipts.

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.

- **Income to be computed on Presumptive Basis:**

A sum equal to 8% of the total turnover or gross receipts of the assessee in the previous year shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

Presumptive income u/s 44AD shall be calculated @ 6% instead of 8% in respect of those portions of turnover/ sales/gross receipts if following conditions are satisfied:

- a) Turnover / sales / gross receipts is received by an account payee cheque / bank draft / ECS through a bank account or such other modes as prescribed under Rule 6ABBA (*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*).
 - b) The above payment is received during the previous year or before the due date of submission of return u/s 139(1) in the assessment year.
- **No deduction shall be allowed to the assessee under sections 30 to 38 and the salary and interest paid to the partners shall not be allowed for deduction subject to the conditions and limits specified in section 40(b).**
 - The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.
 - The intent of this section is to reduce administrative and compliance burden on small businesses, and relieve them from the requirement of maintenance of books of accounts. Therefore, people opting for taxation on presumptive basis are not required to maintain books of account u/s 44AA or get them audited u/s 44AB. Assessee to maintain accounts and get them audited, if he claims the profits to be less than 6% or 8% (as applicable) of the gross receipts.

An assessee opting for section 44AD is required to pay advance tax by 15th March, every FY.

Illustration 12

In the example below, the assessee has opted for presumptive taxation in AY 2022-23 and 2023-24 but in AY 2025-26, since his computed gains from business were lower than the presumptive, he didn't opt for it. Hence for 5 AY's subsequent to that year, i.e., from AY 2025-26 to AY 2029-30, he will not be able to opt for presumptive basis u/s 44AD.

ASSESSMENT YEAR			
Particulars	2022-23	2023-24	2025-26
Gross Receipts	1,80,00,000	1,90,00,000	2,00,00,000
Presumptive Opted	Yes	Yes	No
Tax Rate	8%	8%	Not Applicable
Deemed Income for Taxation	14,40,000	15,20,000	10,00,000
Books of Accounts & Audit	No	No	Yes

PRESUMPTIVE TAXATION FOR PROFESSIONALS [SECTION 44ADA]

Assessee on which section applicable

- Resident Individual,
- Resident Partnership Firm (excluding LLP)

who is engaged in any profession specified u/s 44AA(1) namely legal / medical / engineering / architectural / accountancy / technical consultancy / interior decoration, or any other profession as notified by the Central Board of Direct Taxes (CBDT), in the Official Gazette

Profession on which section is applicable:

- In case of an assessee carrying on notified profession u/s 44AA(1) i.e legal, medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts does not exceed 50 Lakhs in the relevant PY.
- In case of an assessee carrying on notified profession u/s 44AA(1) i.e legal, medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY does not exceed 5% of total gross receipts and whose gross receipts does not exceed 75 lakhs in the relevant previous year.

In effect if the gross receipts from profession exceeds 50 Lakhs but does not exceed 75 Lakhs the benefit of section 44ADA can be availed only if aggregate cash receipts in relevant PY does not exceed 5% of total gross receipts.

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.

Income to be computed on Presumptive Basis

50% of gross receipts of such profession or a sum higher than the aforesaid sum claimed to have been earned by the assessee.

No deduction shall be allowed to the assessee under sections 30 to 38 and the salary and interest paid to the partners shall not be allowed for deduction subject to the conditions and limits specified in section 40(b).

The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

Assessee to maintain accounts and get them audited if he claims profits to be less than 50% of the Gross Receipts. An assessee opting for section 44ADA is required to pay advance tax by 15th March, every FY.

BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES [SECTION 44AE]

This section provides a presumptive basis of taxation for estimating business income from plying, hiring or leasing goods carriages, so long as the assessee does not own > 10 goods carriages at any time during the relevant previous year.

The current presumptive income scheme is applicable to all classes of goods carriages being less than 10 in number, irrespective of their tonnage capacity. Hence with amendment by Finance Act, 2018 the presumptive income shall be as under:

- (i) In case of heavy goods vehicle (the gross vehicle weight of which exceeds 12,000 kilograms), the presumptive income would be deemed to be an amount equal to Rs. 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 heavy goods vehicle is owned by the assessee in the previous year or an amount claimed to have been actually earned from such vehicle, whichever is higher.
- (ii) The vehicles other than heavy goods vehicle will continue to be taxed at as per the existing rates of Rs. 7,500 for every month or part of a month during which the goods carriage is owned by the assessee in the previous year or an amount claimed to have been actually earned from such goods carriage, whichever is higher.

An assessee may claim lower income than the presumptive income as specified under this section, if he keeps and maintains such books of account under section 44AA and gets his accounts audited and furnishes a report of such audit as required under section 44AB.

An assessee, who is in possession of a goods carriage, whether taken on hire purchase or on instalments and for which the whole or part of the amount payable is still due, shall be deemed to be the owner of such goods carriage.

The expression “heavy goods vehicle” means any goods carriage, the gross vehicle weight of which exceeds 12000 kilograms.

No deduction shall be allowed to the assessee under sections 30 to 38 and the salary and interest paid to the partners shall be allowed for deduction subject to the conditions and limits specified in section 40(b).

The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.

The intent of this section is to reduce administrative and compliance burden on small businesses, and relieve them from the requirement of maintenance of books of accounts. Therefore, people opting for taxation on presumptive basis are not required to maintain books of account u/s 44AA or get them audited u/s 44AB.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF OPERATION OF CRUISE SHIPS IN CASE OF NON-RESIDENTS [SECTION 44BBC]

- (1) Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of cruise ships subject to such conditions as may be prescribed, a sum equal to twenty per cent of the aggregate of the amounts specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.
- (2) The amounts referred to in sub-section (1) shall be the following:
 - (a) the amount paid or payable to the assessee or to any person on his behalf on account of the carriage of passengers; and
 - (b) the amount received or deemed to be received by or on behalf of the assessee on account of the carriage of passengers.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF NON-RESIDENTS ENGAGED IN BUSINESS OF PROVIDING SERVICES OR TECHNOLOGY FOR SETTING UP AN ELECTRONICS MANUFACTURING FACILITY OR IN CONNECTION WITH MANUFACTURING OR PRODUCING ELECTRONIC GOODS, ARTICLE OR THING IN INDIA [SECTION 44BBD]

- (1) Notwithstanding anything to the contrary contained in sections 28 to 43A, where an assessee, being a non-resident, engaged in the business of providing services or technology in India, for the purposes of setting up an electronics manufacturing facility or in connection with manufacturing or producing electronic goods, article or thing in India—
 - (a) to a resident company which is establishing or operating electronics manufacturing facility or a connected facility for manufacturing or producing electronic goods, article or thing in India, under a scheme notified by the Central Government in the Ministry of Electronics and Information Technology; and
 - (b) the resident company satisfies the conditions prescribed in this behalf, a sum equal to twenty-five per cent of the aggregate of the amounts specified in sub-section(2) shall be deemed to be the profits and gains of such business of the non-resident assessee chargeable to tax under the head “Profits and gains of business or profession”.
- (2) The amounts referred to in sub-section (1) shall be the following: —
 - (a) the amount paid or payable to the non-resident assessee or to any person on his behalf on account of providing services or technology; and
 - (b) the amount received or deemed to be received by the non-resident assessee or on behalf of non-resident assessee on account of providing services or technology: Provided that the provisions of section 44DA or section 115A shall not apply in respect of the amounts referred to in this sub-section.
- (3) Notwithstanding anything in sub-section (2) of section 32 and sub-section (1) of section 72, where a non-resident assessee declares profits and gains of business for any previous year under sub-section (1), no set off of unabsorbed depreciation and brought forward loss shall be allowed to the assessee for such previous year.

QUESTIONS AND ANSWERS

CASE 1

Ms. Priya is engaged in the business of generation and distribution of power and opts the WDV method for claiming Depreciation. She has an opening block of INR 50,00,000. She acquired new machinery for INR 25,00,000 on 15th Nov 2025. She also imported a new machinery from Zurich for INR 10,00,000 on 14th Apr 2025. This machine was used there earlier and she is the first user in India. Additionally, she bought computers for INR 500,000 on 9th Sep 2025.

You are required to compute the allowable depreciation under Income Tax Act, 1961 for AY 2026-27.

Answer

<i>Items</i>	<i>Date</i>	<i>INR</i>	<i>Category</i>	<i>Rate</i>	<i>Depreciation</i>
Opening WDV	1st Apr 2025	50,00,000	Full	15%	7,50,000
New Machinery	15th Nov 2025	25,00,000	Half	15%	1,87,500
Imported Machinery	14th Apr 2025	10,00,000	Full	15%	1,50,000
Computers	9th Sep 2025	5,00,000	Full	40%	2,00,000
Total Depreciation					12,87,500
Addl Depreciation					
New Machinery		25,00,000	Half	20%	2,50,000
Computers		5,00,000	Full	20%	1,00,000
Additional Depreciation					3,50,000
Annual Depreciation					16,37,500

Note: The machinery that was imported was first used therein at Zurich, earlier, before being imported into India and hence no depreciation will be allowed on the same.

CASE 2

Examine whether the following expenses incurred by Ms. Priyanka, a dealer in Securities, will be allowable?

- Expenses on CSR Activities INR 750,000
- Setting up a cold chain facility for specified products, INR 10,00,000
- Interest on loan paid to Mr. Shyam, INR 100,000 on which no TDS was affected. Her sales for the PY was INR 5 Crores
- Securities Transaction Tax paid INR 50,000

Answer:

- Expenses on CSR activities are not allowable as a deduction u/s 37 and hence the entire INR 750,000 would be disallowed

- (b) This is a specified business for which she can claim 100% deduction u/s 35AD, hence entire INR 10,00,000 will be allowable
- (c) The turnover of Ms. Priyanka exceeds the threshold of INR 100,00,000 and hence she was required to deduct tax at source. Since she didn't, 30% of the interest, i.e., 30% of INR 100,000, that is INR 30,000 would be disallowed u/s 40(a)(ia) and the balance INR 70,000 would be allowable for the assessee u/s 36(1)(iii)
- (d) Securities Transaction Tax of INR 50,000 would be an allowable expense, assuming that income from such source, has been included under the head "Profits / Gains from Business / Profession".

CASE 3

Mr. Kundan Lal, a trader at Kolkata, submits the P&L as under, for FY 2025-26:

Profit & Loss Account for Year Ended 31st March, 2026			
Particulars	INR	Particulars	INR
To Opening Stock	1,00,000	By Sales	1,25,00,000
To Purchases	1,20,00,000	By Closing Stock	2,00,000
To Gross Profit	6,00,000		
Total	1,27,00,000	Total	1,27,00,000
To Rent, Rates, Taxes	1,08,000	By Gross Profit	6,00,000
To Salaries	1,25,000	By Interest Income	5,000
To Interest on loan	25,000		
To Depreciation	2,25,000		
To Printing & Stationery	25,000		
To Postage & Telegram	1,750		
To Loss on Sale of Shares (Short Term)	12,190		
To General Expenses	17,060		
To Net Profit	66,000		
Total	6,05,000	Total	6,05,000

Additional Information:

- a) Closing Stock & Opening Stock was under-valued by 10%
- b) Salary includes INR 20,000 paid to a relative which was considered unreasonable
- c) The whole amount of Printing & Stationery was paid in Cash at one go
- d) WDV of the Plant & Machinery on 1st April, 2025 was INR 12,00,000. Additions of INR 5,00,000 were made on 1st June 2025 and on 1st Oct 2025, Machinery was sold for INR 12,57,993
- e) Rent & Rates included GST Liability for Mar' 26, of INR 27,000, duly paid within 7th April 2026

- f) A general expenses includes donation of INR 12,000 was made to a public charitable trust during the year.

You are required to:

- Calculate the Profits / Gains from Business Profession
- Advise whether he should opt for the Presumptive scheme u/s 44AD

You can assume that the entire amount of turnover was received by account payee cheque.

Answer:

Computation of Business Income for PY 2025-26

	<i>Particulars</i>	<i>INR</i>
	Net Profit	66,000
<i>Add:</i>	Under Valuation Closing Stock	22,222
	Salary (Relative)	20,000
	Printing & Stationery (Cash > 10,000)	25,000
	Depreciation	2,25,000
	Donation	12,000
	Loss on Sale of Shares	12,190
		3,82,412
<i>Less:</i>	Under Valuation of Opening Stock	(11,111)
	Allowable Depreciation	(66,301)
	Interest Income	(5,000)
	Profits / Gains from Business / Profession	3,00,000
	Under Presumptive Taxation	7,50,000

Since the tax liability on presumptive basis, i.e., 6% of Gross Receipts (INR 125,00,000 *6%) = INR 750,000 is higher than the computed Profits / Gains from Business Profession, he shouldn't adopt for presumptive basis. However, since his turnover is > INR 1 Crore, audit u/s 44AB would be mandatory, if he doesn't adopt presumptive basis.

Notes:

- Under-valued closing stock added to Profits $[(100/90 \times 200,000) - 2,00,000]$
- Under-valued opening stock reduced $[(100/90 \times 100,000) - 1,00,000]$
- Salary to relative, to the extent considered reasonable, added back
- Since the cash payment was > INR 10,000, entire amount disallowed u/s 40 A (3)

e) Depreciation added back and allowed as under:

<i>Particulars</i>	<i>INR</i>
Opening WDV	12,00,000
Additions	5,00,000
Disposals	12,57,993
Closing WDV	4,42,007
Depreciation @ 15%	66,301

f) Since the unpaid GST Liability was paid before the due date and before the date of filing return of income u/s 139(1), it is allowable.

CASE 4

Net profit as per profit and loss account of X is Rs. 6,86,000 for the year ending 31st March, 2026. The following information is noted from his accounts:

- (a) Advertisement expenditure debited to profit and loss account include the following:
- Expenditure incurred outside India: Rs. 46,000 (permitted by RBI);
 - Articles presented by way of advertisement (60 articles cost of each being Rs. 900; and 36 articles cost of each being Rs. 1,700);
 - Rs 16,000 being cost of advertisement which appeared in a newspaper owned by a political party;
 - Rs. 11,400 being capital expenditure on advertisement;
 - Rs. 12,000 paid in cash; and
 - Rs. 7,000 paid to a concern in which X has substantial interest (amount is excessive to the extent of Rs. 1,400).
- (b) Out of salary to employees of Rs. 8,70,000 debited to the profit and loss account:
- Rs. 40,000 is employees' contribution to recognised provident fund, Rs. 37,500 of which is credited in the employees' account in the relevant fund before the 'due date';
 - Rs. 46,000 is bonus which is paid on 13th November, 2026;
 - Rs. 36,000 is commission which is paid on 1st December, 2026;
 - Rs. 20,000 is allowance to workers which is paid on 10th December, 2026;
 - Rs. 40,000 is paid outside India in respect of which tax is not deducted at source;
 - Rs. 6,000 being capital expenditure for promoting family planning amongst employees; and
 - Rs. 40,000 being entertainment allowance given to employees;
 - Entertainment expenditure debited to profit and loss account is Rs. 9,000. Determine the net income of X for the assessment year 2026-27.

Answer:**Calculation of Net Income of X for Assessment Year 2026-27**

<i>Particular</i>	<i>Amount</i>
Net Profit as per Profit and Loss Account	6,86,000
<i>Add: Inadmissible items:</i>	
Cash paid for advertisement expenses (Note 3)	12000
Cost of advertisement which appeared in a newspaper owned by a political party	16000
Excessive amount paid to a concern in which X has substantial interest	1400
Employee contribution to recognised provident fund (to the extent not credited in the employees' account in the relevant fund before the 'due date')	2500
Bonus being paid to employees after the 'due date' of filing the return	46000
Commission being paid to employees after the 'due date' of filing the return	36000
Salary paid outside India in respect of which tax is not deducted at source	40000
Capital expenditure for promoting family planning amongst employees (allowed only to a corporate assessee)	6000
Capital expenditure on Advertisements	11400
Net Income	8,57,300

Notes:

1. Restrictions on advertisement and entertainment abolished.
2. With the abolition of Section 37(3), which inter alia governed the deductibility of advertising expenses, advertising too has come within the fold of the omnibus Section 37(1) which specifically frowns on capital expenditure. The Himachal Pradesh High Court verdict in Mohan Meakin Breweries Ltd. v. CIT (1979) 118 ITR 101 allowing capital expenditure on advertising therefore has ceased to have the force of law as it was rendered in the context of Section 37(3).
3. Advertisement expenses of Rs. 12,000 (i.e., exceeding the limit of Rs. 10,000) is paid in cash, hence disallowed under section 40A(3).
4. The 'due date' for filing return where the assessee is a person (other than a company) who is required to get his accounts audited under the Income-tax Act or any other law is 31st October; and where the assessee is a person deriving income from business and who is not required to get his accounts audited, the 'due date' is 31st July. Under the provisions of Section 43B of the Act - Bonus Rs. 46,000 paid on 13th Nov., 2026 and Commission Rs. 36,000 paid on 1st Dec., 2026 are not admissible since the payments are made after the above mentioned 'due date'.
5. Allowance to workers which is paid on 10th December, 2026 is admissible on 'due basis'.

PRACTICE QUESTIONS

Question 1: Mr. Anil is the owner of a business. Following is his P & L A/c for year ended on 31.03.2026

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Business charges	5,110	Gross profit	50,870
Rent, rates and taxes	2,900	Interest on Govt. Securities (Gross)	5,350
Sundry expenses	7,050	Rent from property	5,400
House hold expenses	1,880		
Provision for bad debts	1,200		
Loss on sale of motor car (used for private purpose)	1,800		
Insurance premium (including life insurance of Rs. 1790 of Mr. Anil)	2,880		
Interest on bank loan	1,380		
Provision for Depreciation	6,400		
Net profit	31,020		
Total	61,620	Total	61,620

Additional information:

- (i) Bad debts written off during the year – Rs. 650
- (ii) Admissible depreciation as per Income tax rules – Rs.1,600
- (iii) The assessee is running his business in a rented property, half of which is used by him for his own residence. Rent of Rs. 2,400 in respect of entire house is included in rent, rate and taxes. The balance of Rs. 500 is on municipal tax paid for property given on rent.
- (iv) Compute the Gross total Income of Mr. Anil for the assessment year 2026-27. Not covered u/s 115BAC

Solution:

Computation of Gross Total Income	Amount (Rs.)	Amount (Rs.)
Income from House Property		
Rent received	5,400	
Less: Municipal taxes	(500)	
	4,900	
Less: Statutory deduction @ 30%	(1,470)	3,430
Profit and gains from Business or Profession		
Profit as per P & L Account		31,020

Computation of Gross Total Income	Amount (Rs.)	Amount (Rs.)
<i>Add:</i> Inadmissible expenses		
Rent	1,200	
Household expenses	1,880	
Provision for bad debts	1,200	
Loss on sale of car	1,800	
Life insurance premium	1,790	
Provision for depreciation	6,400	
M. Taxes for let out house property	500	14,770
		45,790
Less Expenses allowed but not debited to P & L A/c		
Bad debts	650	
Depreciation	1,600	(2,250)
		43,540
<i>Less:</i> Incomes not taxable under this head but credited to P&L A/c.		
Interest on Govt. Securities	5,350	
Rent from Property	5,400	(10,750)
Income from Business		32,790
Income from Other Sources		
Interest on Govt. securities		5,350
Gross Total Income (3,430 + 32,790 + 5,350)		41,570

Question 2: Mr. Sahil furnishes the following particulars of his income for the A/Y 2026-27. Not covered u/s 115BAC

Profit and Loss Account for the year ending 31.03.2026			
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Office expenses	12,400	By Gross Profit	2,98,000
To General expenses	12,000	By Sundry Receipts	19,000
To Legal Expenses	8,000	By Custom Duties recovered back from Govt. (earlier not allowed as deduction)	15,300

To Depreciation on Machinery	11,000	By bad debts recovered (earlier allowed as deduction)	3,000
To staff Salary	21,000	By Gift from son	40,000
To Bonus to staff	15,000		
To Contribution to approved gratuity fund	16,000		
To Outstanding liability for Custom Duties	18,000		
To Audit Fees	21,000		
To Net Profit	2,40,900		
Total	3,75,300	Total	3,75,300

Other information:

- Bonus to employees according to the Payment of Bonus Act 1965, comes to Rs. 4,200.
- Depreciation on machinery shown in the profit and loss account is calculated according to the income tax provisions.
- General expense includes payment of Rs. 9,000 to an approved educational institute for the purpose of carrying on scientific research in natural science. The research is, however now related to the business of the assessee.
- During the previous year Mr. Sahil also made a capital expenditure of Rs. 5,000 for the purpose of carrying on scientific research related to his business. This expenditure is however not recorded in the profit and loss account.
- Outstanding liability in respect of custom duty amounting to Rs. 10,500 was paid on 10.04.2026, Rs. 1,000 on 10.05.2026, Rs. 2,000 on 30.06.2026, Rs. 1,000 on 10.07.2026 and Rs. 3,500 is still outstanding. The return is furnished on 31.07.2026
- No tax has been deducted at source on the audit fees of Rs. 21,000

Determine the taxable income of Mr. Sahil for the assessment year 2026-27 assuming he, annually deposits Rs. 10,000 in a public provident fund account and his turnover for FY 2025-26 was Rs. 30,00,000.

Solution: Computation of Business Income of Mr. Sahil for the Assessment Year 2026-27

Profit and Gains from Business or Profession	Amount (Rs.)	Amount (Rs.)
Net profit as per P & L A/c		2,40,900
Add:		
Outstanding for custom duty	3,500	3,500
		2,44,400
Less:		

Profit and Gains from Business or Profession	Amount (Rs.)	Amount (Rs.)
Custom duties recovered back	15,300	
Gift from son	40,000	
Capital expending on scientific research	5,000	(60,300)
Income from Business		1,84,100
Less: Deduction u/s 80C		10,000
Taxable income		1,74,100

Question 3: State with reason whether the following expenses are admissible a deduction while computing income from business or profession:

- (i) Stock in trade was lost in fire, amounting to Rs. 12,000 and was debited to profit and loss Account.
- (ii) Amount spent on successful suit filed against a person for infringing trade mark of assessee Rs. 10,000
- (iii) Interest paid to bank Rs. 15,000 in connection with overdraft obtained for paying dividend
- (iv) Entertainment expenses of Rs. 28,000 incurred during the previous year.
- (v) Capital expenditure of Rs. 1,00,000 has been incurred towards promotion of family planning amongst employees of ABC Ltd.
- (vi) Rs. 20,000 were spent in the previous year in connection with statutory income tax proceedings.
- (vii) Rs. 3,000 spent in connection with installation of a new telephone connection.
- (vii) Traveling expenses of a Director of ABC Ltd. Rs. 20,000 incurred on a tour to U.S.A in connection with the negotiation of purchase of a new machinery.
- (viii) Compensation paid to the widow and children of deceased employees of the factory on the order of labour Court

Solution:

- (i) Loss of stock in trade by fire is deduction from profit and gains of business or profession
- (ii) Amount spent on a suit field for infringing the trade mark of Rs. 10,000 is fully admissible because it is a commercial expediency for security or registration of trade mark.
- (iii) Interest of Rs. 15,000 paid to bank for overdraft for payment of dividend is allowed.
- (iv) Entertainment expenditure is covered under section 37(1) hence fully allowed.
- (v) Expenditure on promotion of family planning incurred by a company amongst its employees is allowed but if it is of capital nature then $\frac{1}{5}^{\text{th}}$ of the amount spent is allowed in the previous year in which it is incurred and balance in four equal installments in next four previous years. In this case Rs. 20,000 is allowed in the current previous year and balance in next four previous year (Rs. 20,000 each year)
- (vi) Amount spent on income tax is allowed as legal charges. Hence Rs. 20,000 is deductibles.
- (vii) Rs. 3,000 is allowed as deduction which is incurred for installation of a new telephone connection.
- (viii) Traveling expenses of a director are fully allowed because the tour was for business purposes. It may also be treated as part of the cost of new machine, if the assessee so desires.

- (ix) Compensation paid to the widow & children of deceased employee as per order of court are fully allowed.

Question 4: Mr. Vinod carries on his own business. For the year ending 31.03.2026, his Trading/Profit & loss account was as follows:

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Opening stock	20,000	Sales	2,89,000
Purchases	1,09,000	Closing stock	52,000
Salaries	6,000	Interest on Jay Co. Ltd	
Rent	11,000	Debentures	2,000
Bonus	3,000	Dividend from UTI	2,000
Printing & Postage and stationery	4,000	Discount received	12,000
Miscellaneous expenses	4,000	Race winning (Gross)	12,000
Advertisement expense	22,000		
Drawings	12,000		
LIC Premium	5,000		
Car expenses:			
Driver's Salary	6,000		
Petrol & repair	12,000		
Property tax	4,000		
Medical expense of son with Disability at Apollo hospital	3,000		
Cost of NSC (VIII series)	3,000		
Net Profit	1,45,000		
Total	3,69,000	Total	3,69,000

Other information:

- Advertisement expenses included cost of 20 gift packs of Rs. 1100 each presented to esteemed customers on occasion of Diwali.
- Assume: Taxes deducted at source on dividends and debentures are 'Nil'
- The car was used both for business and personal purposes. 2/3rd is for business purposes.
- The property tax of Rs. 4,000 was in respect of his self occupied house whose rental value is Rs. 18,000.

Compute GTI and TI of Mr. Vinod for assessment year 2026-27 showing the incomes under various heads. Not covered u/s 115BAC

Solution:**Computation of Total Income of Mr. Vinod for the Assessment year 2026-27**

Particulars	Amount (Rs.)	Amount (Rs.)	Amount (Rs.)
Profit and Gains from Business or Profession			
Net profit as per P & L A/c		1,45,000	
<i>Add:</i> Expenses/ Payments not admissible			
Drawings	12,000		
LIC premium	5,000		
Car expenses			
Driver salary (1/3)	2,000		
Petrol (1/3)	4,000		
Property tax	4,000		
Medical expenses	3,000		
Cost of NSC	3,000	33,000	
		1,78,000	
<i>Less:</i> Incomes which are not taxable under this head			
Interest on debentures	2,000		
Dividend from U.T.I	2,000		
Horse race income	12,000	(16,000)	
Income from business			1,62,000
Income from other sources			
Interest	2,000		
Dividend from U.T.I.	2,000		
Horse race income	12,000		16,000
Gross Total Income			1,78,000
<i>Less:</i> Deduction under Chapter VIA			
U/s 80C (LIC: Rs. 5,000 + NSC: Rs. 3,000)		8,000	
U/s 80DD		75,000	(83,000)
Taxable Income			95,000

Question 5: X furnishes the following particulars for the previous year relevant to A/Y 2026-27.

Profit and Loss A/c for the year ending 31.03.2026

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To salary to staff	22,000	By gross profit	2,50,000
To entertainment expenses	13,000		
To general expenses	11,000		
To bad debts	4,500		
To reserve for bad debts	10,000		
To advertising expenses	7,000		
To interest on X capital A/c	3,000		
To acquisition of patent's rights	28,000		
To telephone expenses	12,000		
To depreciation	10,000		
To provision or Income Tax	4,000		
To Net Profit	1,25,500		
Total	2,50,000	Total	2,50,000

Other information:

- i. Salary to staff includes salary paid to a relative which is unreasonable to the extent of Rs. 3,100.
- ii. Provision for income tax is excessive to the extent of Rs. 3,000
- iii. Depreciation according to the income tax provision comes to Rs. 9,500
- iv. During the previous year 2025-26 the following payment were made and the same have not been debited to profit and loss account of 2025-26.
 - a. Rs. 3,000 paid on 10.06.2025 on account of outstanding customs duty of the previous year 2024-2025 and
 - b. Rs. 5,000 paid on 15.06.2026 on account of outstanding custom duty of the previous year 2025-2026
- v. Patents were acquired on 04.11.2025

Find out the taxable income of X for the AY 2026-27. Due date of filling return of income of assessment year 2025-26 and 2026-27 is 31st July of the relevant AY. Covered u/s 115BAC

Solution:**Computation of Taxable Income of X for the Assessment year 2026-27**

Particulars	Amount (Rs.)	Amount (Rs.)
Profit and gains from business or profession		
Net profit as per P & L A/c		1,25,500
Add: Expenses / payments not admissible		
Salary to a relative	3,100	
Depreciation (in excess of Income – tax provision)	500	
Provision for Income – tax (full amount)	4,000	
Interest on X capital A/c	3,000	
Reserve for bad debts	10,000	
Expenditure on acquisition of patent rights	28,000	48,600
		1,74,100
Less: Custom duty for assessment year 2025-26	5,000	
Depreciation on patent rights 12.5 % of Rs. 28,000	3,500	(8,500)
Income from business / Gross total income		1,65,600

CASE LAW

1.	2010	<i>Vijaya Bank v. Commissioner of Income Tax</i>	<i>Supreme Court</i>
----	------	--	----------------------

“Actual write off” of individual debtor’s account is not necessary under 36(1)(vii) Bad Debt, of the Income-tax Act, 1961

Decision: On a question before the Hon’ble Supreme Court whether it is imperative for assessee-bank to close individual account of each of its debtors in its books for claiming deduction under section 36(1)(vii) of the Income-tax Act, the Supreme Court referring to its judgement in *Southern Technologies Limited v. Joint CIT9* held that in order to understand the term “write-off” one has to see how the write off has been effected. If an assessee debits an amount of doubtful debtors to profit and loss account and credits the asset account (i.e., sundry debtors) it would constitute an actual write off of a debt.

On the contrary, if the amount is credited to “current liabilities and provisions”, then it would be a provision. In the latter case the assessee would not be entitled to the deduction after 1-4-1989. It was also held that the assessing officer was empowered to tax the subsequent repayment, if any, under section 41(1) of the Income-tax Act.

Reference may also be made to the Supreme Court decision in *TRF Limited vs CIT10* wherein it was held that bad debts need not be proven to be irrecoverable under section 36(1)(vii). It is sufficient if they are written off.

2.	2010	<i>Commissioner of Income-tax v. Smt. Sita Devi Juneja</i>	<i>Punjab and Haryana High Court</i>
----	------	--	--------------------------------------

Remission of a liability under section 41(1) of the Income Tax Act, 1961

Decision: The High Court held that merely because liability was outstanding for the last six years, it could not be presumed that the said liability had ceased to exist. It was also conceded that there was no Bilateral Act between the assessee and the creditors, which indicated that the said liability had ceased to exist. In absence of any bilateral act, the said liability could not have been treated as ceased. In view of these facts, the Commissioner (Appeals) as well as the Tribunal had rightly come to the conclusion that the Assessing Officer had wrongly invoked the Explanation I to section 41(1) and made the aforesaid addition on the basis of presumptions, conjectures and surmises. It had been further found that the Assessing Officer had failed to show that in any earlier year allowance of deduction had been in respect of any trading liability incurred by the assessee. It was also not proved that any benefit was obtained by the assessee concerning such a trading liability by way of remission or cessation thereof during the concerned year. Thus, there did not accrue any benefit to the assessee which could be deemed to be the profit or gain of the assessee's business, which would otherwise not be the assessee's income. It had been further found as a fact that the assessee had filed the copies of accounts of sundry creditors signed by the concerned creditors.

3.	2014	<i>CIT v. K and Co.</i>	<i>Delhi High Court</i>
----	------	-------------------------	-------------------------

Is interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable as business income?

Decision: The High Court held that the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".

4.	2015	<i>Additional CIT v. Dharmpur Sugar Mill (P) Ltd</i>	<i>Allahabad High Court</i>
----	------	--	-----------------------------

Is expenditure incurred for construction of transmission lines by the assessee for supply of power to UPPCL by the assessee deductible as revenue expenditure?

Decision: Following the principle of law laid down by the Supreme Court in Empire Jute Mills' case, the Allahabad High Court, in this case, held that the expenditure which was incurred by the assessee in the laying of transmission lines was clearly on the revenue account. The transmission lines, upon erection, vested absolutely in UPPCL. The expenditure which was incurred by the assessee was for aiding efficient conduct of its business since the assessee had to supply electricity to its sole consumer UPPCL. This was not an advantage of a capital nature.

5.	2013	<i>CIT v. Orient Ceramics and Industries Ltd.</i>	<i>Delhi High Court</i>
----	------	---	-------------------------

What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?

Decision: The Delhi High Court held that such expenditure on glow sign boards displayed at dealer outlets was revenue in nature.

6.	2011	<i>CIT v. ITC Hotels Ltd.</i>	<i>Karnataka High Court</i>
----	------	-------------------------------	-----------------------------

Would the expenditure incurred on issue and collection of convertible debentures be treated as revenue expenditure or capital expenditure?

Decision: The Karnataka High Court held that the expenditure incurred on the issue and collection of debentures shall be treated as revenue expenditure even in case of convertible debentures, i.e., the debentures which had to be converted into shares at a later date.

7.	2012	<i>CIT v. Kap Scan and Diagnostic Centre P. Ltd.</i>	<i>Punjab and Haryana High Court</i>
----	------	--	--------------------------------------

Can the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure under section 37 or would it be treated as illegal and against public policy to attract disallowance?

Decision: The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy and should be discouraged. Thus, the High Court held that commission paid to doctors for referring patients for diagnosis is not allowable as a business expenditure.

8.	2015	<i>CIT v. KLN Agrotechs (P) Ltd</i>	<i>Karnataka High Court</i>
----	------	-------------------------------------	-----------------------------

Where the lump sum amount paid as One Time Settlement (OTS), without bifurcation of interest and principal, has been offered to tax under section 41(1), can the assessee claim benefit of deduction of interest (interest paid plus interest waived) under section 43B?

Decision: The High Court concurred with the Tribunal's view that if out of the total sum of INR 256.54 lakhs which has been offered and subjected to tax by the assessee in its return, the amount of unpaid interest of INR 193.96 lakhs is deducted then the waived principal sum would come to 62.58 lakhs (i.e., INR 441.30 lakhs minus 378.72 lakhs), which is the amount which ought to have been taxed under section 41(1). Based on the above reasoning, the HC held that either the interest amount has to be allowed as deduction under section 43B or the sum offered for tax (as waived by the bank) has to be reduced by the amount of interest. In either case, the effective amount which is subjected to tax, would come to the same.

9.	2016	<i>Shasun Chemicals & Drugs Ltd v. CIT</i>	<i>Supreme Court</i>
----	------	--	----------------------

In a case where payment of bonus due to employees is paid to a trust and such amount is subsequently paid to the employees before the stipulated due date, would the same be allowable under section 36(1)(ii) while computing business income?

Decision: The Apex Court held that section 36(1) contains various kinds of expenses which are allowable as deduction while computing the business income. The amount paid by way of bonus is one such expenditure which is allowable as deduction under section 36(1)(ii).

It also held that the embargo contained in section 43B(b) or section 40A(9) does not come in the way of the assessee's claim, since the bonus was ultimately paid to the employees before the due date as per the statutory requirement. Therefore, the payment in respect of bonus is allowable as deduction, as there is no dispute that the amount was paid by the assessee to its employees before the due date by which such payment is supposed to be made in order to claim deduction under section 36(1)(ii).

Note: In this case, the Supreme Court has held that the bonus was allowable as deduction under section 36(1) (ii), even though it was initially remitted to the trust created for this purpose, from which the payment was ultimately made to the employees before the due date. The Supreme Court has applied the concept of “substance over form” in allowing the deduction of bonus paid under section 36(1)(ii) by considering that the payment of bonus was ultimately made to employees before the stipulated due date. Applying the same concept, the intermittent process of creation of trust for remittance of bonus and subsequent payment therefrom to the employees, which formed the basis of disallowance of bonus by the Assessing Officer on the basis of the provisions of section 40A(9) has been ignored. However, had the payment to employees not been made before the stipulated due date, deduction under section 36(1)(ii) would not be allowable merely because the amount was remitted to the trust before the stipulated due date. It may be noted that as date of file of return of income under section 139(1) is a pre-requisite for claiming deduction under section 36(1)(ii).

Gains of Business or Profession”. It is an admitted fact in the instant case that the assessee company has only one business and that is of leasing its property and earning rent there from. Thus, even on the factual aspect, we do not find any substance in what has been submitted by the learned counsel appearing for the Revenue”.

“The judgment relied upon by the learned counsel appearing for the assessee squarely covers the facts of the case involved in the appeals. The business of the company is to lease its property and to earn rent and therefore, the income so earned should be treated as its business income”.

10.	2016	<i>M/s. Rayala Corporation Pvt. Ltd vs. Assistant Commissioner of Income Tax</i>	<i>Supreme Court</i>
-----	------	--	----------------------

Income from Rent out Business is ‘Profits & gains of business’ not ‘Income from House property

Decision: In a recent case between M/s. Rayala Corporation Pvt. Ltd vs. Assistant Commissioner of Income Tax, the Supreme Court of India has declared that, Income which arises from Rent out business should be taxed under the Head “Profits and gains of business or profession” not ‘Income from House property’.

The appellant-assessee, a private limited company, is having house property, which has been rented and the assessee is receiving income from the said property by way of rent.

The division bench comprising of Justice Anil R Dave and Justice L Nageshwar Rao has relied the case *Chennai Properties and Investments Ltd. v. Commissioner of Income Tax [2015] 373 ITR 673 (SC)* that if an assessee is having his house property and by way of business he is giving the property on rent and if he is receiving rent from the said property as his business income, the said income, even if in the nature of rent, should be treated as “Business Income” because the assessee is having a business of renting his property and the rent which he receives is in the nature of his business income.

While setting aside the Madras High Court Judgment, the division bench of Supreme Court observed that, “the rent should be the main source of income or the purpose for which the company is incorporated should be to earn income from rent, so as to make the rental income to be the income taxable under the head “Profits and Gains of Business or Profession”. It is an admitted fact in the instant case that the assessee company has only one business and that is of leasing its property and earning rent there from. Thus, even on the factual aspect, we do not find any substance in what has been submitted by the learned counsel appearing for the Revenue”

“The judgment relied upon by the learned counsel appearing for the assessee squarely covers the facts of the case involved in the appeals. The business of the company is to lease its property and to earn rent and therefore, the income so earned should be treated as its business income”.

11.	2018	CIT v. Mahindra and Mahindra Ltd.	Supreme Court
Where the waiver is in respect of loan taken for purchase of plant and machinery and tooling equipment, would the same be subject to tax in the hands of the recipient by virtue of the provisions contained in either section 28(iv) or section 41(1)? Decision: The assessee, Mahindra and Mahindra is advanced with a loan for procurement of capital assets, namely, plant, machinery and tooling equipment from a foreign Company K. Later on, AMC took over K and agreed to waive the principal amount of loan advanced by K to the assessee-company. This was communicated to the assessee-company which filed its return showing Rs. 57,74,064 as cessation of its liability towards AMC. The Income-tax Officer concluded that the waiver of the loan amount represented income and held that the sum of Rs. 57,74,064 was taxable under section 28(iv) as a perquisite. The alternate argument of the revenue authorities was that the sum would be taxable under section 41(1) as a waiver of a trading liability. The Supreme Court observed that for applicability of section 28(iv), income must arise from business or profession and the benefit received has to be in non-monetary form. The amount of Rs. 57,74,064, being a cash receipt, therefore, does not fall under section 28(iv). For being covered under section 41(1), the assessee-company should have claimed an allowance or deduction in any assessment for any year in respect of a trading liability incurred by the assessee. In this case, the loan was taken for procurement of capital assets, namely, plant, machinery and tooling equipment. The purchase amount had not been debited to the trading account or to the profit and loss account in any of the assessment years. Hence, waiver of such loan would not tantamount to cessation of a trading liability.			

LESSON ROUND-UP

- Sections 28 to 44D contain the provisions for computation of Income from Business and Profession. Section 28 defines the scope of income which can be taxed under this head.
- Section 29 specifies the method of computation of income under the business or profession.
- Expenses/allowances expressly allowed by the Act are listed under sections 28 to 37, whereas sections 40 and 40A enumerate those expenses which are expressly disallowed and 43B expenses to be made on actual payment basis, while computing taxable income under this head.
- Section 44AA provides for maintenance of accounts by the assessee carrying on business or profession.
- Mandatory tax audit of accounts of the persons carrying on business or profession is prescribed in section 44AB.
- Computation of profit from business and profession on presumptive basis are covered under sections 44AD, 44ADA and 44AE.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.)

Multiple Choice Questions “MCQs”

- Preliminary Expenses u/s 35D, qualifying so would be deductible in equal installments
 - Five
 - Seven

c) Ten

d) One

Answer : (a)

2. The rate of depreciation specified for intangible assets is?

a) 25%

b) 30%

c) 40%

d) 15%

Answer : (a)

3. Salary, Bonus etc. under section 40(b) is allowed to:

a) Working partner

b) Non-working partner

c) All the partners

d) None of the partners

Answer : (a)

LIST OF FURTHER READINGS

- **Direct Taxes Law and Practice**

Author : Dr. Vinod K. Singhania & Dr. Kapil Singhania

Publisher : Taxmann

- **Direct Taxes Ready Reckoner with Tax Planning**

Author : Dr. Girish Ahuja & Dr. Ravi Gupta

Publisher : Wolters Kluwer

OTHER REFERENCES (INCLUDING WEBSITES AND VIDEO LINKS)

- **Income Tax Act, 1961:** <https://www.incometaxIndia.gov.in/Pages/acts/income-tax-act.aspx>
- **Income Tax Rules, 1962:** <https://www.incometaxIndia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
- **Circulars:** <https://www.incometaxIndia.gov.in/Pages/communications/circulars.aspx>
- **Notifications:** <https://www.incometaxIndia.gov.in/Pages/communications/notifications.aspx>