

Marudhar Kesari Jain College for Women, Vaniyambadi
PG Department of Commerce (CA)
E- Notes on Income Tax Law and Practice – 1
Paper Code : CECP55C

UNIT-V

INCOME FROM BUSINESS/PROFESSION

Business is an activity of purchase and sell of goods with the intention of making profit. Profession is an occupation requiring intellectual skill. E.g. Doctor, Lawyer etc. Vocation is an activity, which requires a special skill, which is used to earn income. e.g. Painter, Singer etc. For income tax purpose there is no difference between business income, profession income and vocation income.

Section 2 (13) : Business

Business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Explanation: -

Thus business is any activity carried out with the intention to earn profit, whether such an activity is continuous or temporary is immaterial.

In determining whether a particular transaction is an adventure in the nature of trade or not, total impression and effect of all relevant facts and circumstances of the transaction have to be seen. To bring a transaction within the term “business”, the transaction must be a “trade” or in the nature of “trade”. Hence everything depends upon the facts and circumstances of the case.

E.g. A person making investment of surplus funds in shares or debentures cannot be deemed to be carrying on the business of trading in shares although occasionally he may be selling “some” shares or debentures and making gains thereon.

METHODS OF COMPUTING TAXABLE INCOME

1. Gross Sales or Gross fees as the case may be are to be taken as the base if Receipt and Payment A/c or cash Book is given. From this Gross income expenses which are specifically allowed by the income tax act are deducted to arrive at taxable income.
2. If profit & loss a/c or income & expenditure a/c is given Net Profit or (Surplus) is taken as the base and then following adjustments are made: -
 - 1) Expenses, which are debited, to profit & loss a/c, but disallowed by the Income Tax Act and either fully or partially are added back.
 - 2) Expenses, which are not debited, to profit & loss a/c but which are allowed by the Income Tax Act are deducted.
 - 3) Income that is credited to profit & loss a/c but not taxable at all or taxable under some different head is to be deducted.
 - 4) Income that is not credited to profit & loss a/c, but which is chargeable to tax as business income is to be added.

BASIS OF CHARGE: SECTION 28

Under Section 28 following are the income chargeable to tax under the head Profits or Gains from Business or profession: -

- 1) Profits and Gains of any business or profession that is carried on by the assessee at any time during the previous year.
- 2) Any compensation or other payment due to or received by an assessee for loss of agency due to termination or modification of terms.
- 3) Income derived by a trade, professional or a similar association for specific services performed for its members.
- 4) Any profit on sale of a license granted under Imports (controls) Order 1955 made under Imports & Exports (control) Act of 1947.
- 5) Any cash assistance (by whatever name called) received or receivable against exports under any scheme of Government of India.
- 6) Any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duty's Drawback Rules 1971.
- 7) Any profit on the transfer of the Duty entitlement pass book scheme under export import policy.
- 8) Any profit on the transfer of the Duty free replenishment certificate under export import policy.
- 9) The value of any benefit or perquisite whether convertible into money or not arising from business or exercise of a profession e.g. A gift received by the lawyer from his client.
- 10) Any interest, salary, bonus, commission or remuneration due to or received by partner of a firm from such firm.
- 11) Sum received or receivable in cash or in kind under an agreement for not carrying out any activity in relation to any business or not sharing any know how, patent, copyright, trade mark, license franchise or any other business or commercial right of similar nature or information or technique likely to assist the manufacture or processing of goods or provision of services.
- 12) Any sum received including bonus under Keyman Insurance Policy.
- 13) Any sum received (or receivable) in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.
- 14) Income from a speculative business.

DEDUCTIONS FOR EXPENSES SPECIFICALLY ALLOWED SECTION 30 TO SECTION 43D

1. Rent, rates, taxes, repairs and insurance of building (Section 30):

- 1) If assessee has occupied the premises as a tenant, rent of the premises and if he has agreed to bear cost of repairs, such cost is allowed as deduction, provided it is not of capital nature.
- 2) If assessee has occupied premises as the owner; repairs, land revenue, local taxes, insurance premium etc. are allowed as deduction. However, no expenditure in form of capital expenditure is allowed.

2. Repairs & Insurance of machinery, Plant & Furniture (Sec.31):

Amount paid on account of repairs and insurance premium against risk of damage in respect of machinery, plant & furniture are allowed as deduction provided they are not of capital nature.

3. Depreciation u/s 32:

Under Section 32 depreciation on assets is allowed as deduction while computing income from business or profession. To claim this deduction following conditions should be satisfied:

- 1) Assessee should be owner of the asset.
- 2) Asset must be used for the business.
- 3) Such use must be in the previous year.

Depreciation is allowed not on individual asset items, but on block of assets under following categories: -

- 1) Buildings
- 2) Plant & Machinery
- 3) Furniture
- 4) Intangible Assets acquired after March 31, 1998 such as know-how, Patents, Trademarks, licenses, franchises or any other business or commercial rights of similar nature.

The term plant includes ships, vehicles, books, scientific apparatus and surgical equipments used for the business but excludes tea bushes or live stock.

If any asset falling in block of assets is acquired during the year and **put to use** during the previous year for **less than 180 days** depreciation on such asset shall be restricted to **50% of the normal depreciation**.

No depreciation is allowed on motor car which is manufactured outside India and acquired on or after 1st March 1975 but before 1st April 2001. However, this restriction does not apply if:

- 1) Assessee carries on a business of running the car on the hire for tourist, or
- 2) If assessee is using the car outside India for his business in another country.

If business is carried on in a building not owned by the assessee but acquired on lease or any other occupancy right and any capital expenditure is incurred by him in respect of this building, such expenditure will be considered as cost of asset as if he is the owner of such property.

A. METHOD OF CALCULATING DEPRECIATION

1. Consider total W.D.V. of assets falling in a particular block of assets at the beginning of the year.
 2. Add cost of assets purchased during the previous year.
 3. Deduct Sale Price (or Scrap value) of asset sold, discarded, demolished or destroyed during the year.
 4. On the balance amount i.e. 1+2-3, calculate depreciation at the given rate. If WDV becomes negative, no depreciation is allowed. If all assets in the block are sold depreciation is not allowed even if block has any balance WDV.
- B.** In the first year if asset acquired is used for less than 180 days depreciation is restricted to 50% of normal depreciation.
- C.** W.e.f. A.Y. 1998-99 an undertaking engaged in generation / distribution of power has an option to claim depreciation on Straight Line Method. Once option is exercised it will apply to all subsequent years.

Additional depreciation

It can be claimed on new plant & machinery acquired after 31st March 2005 by an assessee in the previous year in which it begins manufacturing or producing.

Rate of additional depreciation: 20% of actual cost.

UNABSORBED DEPRECIATION SECTION 32 (2)

If profit for the year is not sufficient to absorb depreciation either fully or partially, unabsorbed depreciation can be deducted from any other head of income. If it still remains unabsorbed it can be carried forward to subsequent assessment years to be adjusted against future taxable income. It can be carried forward for unlimited period.

PROBLEMS

1. Find out WDV on block of assets for depreciation purpose under Income Tax Act for assessment year 2016-17. Also find out amount of depreciation
 - i)
 - 1) WDV on 1st April 2015 ` 35,000
 - 2) Purchase of assets during the year
 - a. On 5th April, 2015 ` 13,000
 - b. On 30th Sept. 2015 ` 10,000
 - 3) On 7th March 2016, one asset WDV of which at the beginning of the year was ` 7,000 was sold for ` 5,000.
 - 4) Rate of depreciation: 10%

- ii) 1) Block of asset-Plant & Machinery.
 2) W.D.V. on 1st April 2015 ` 8,000.
 3) Purchases of a new machine on 1st September 2015 ` 6,000.
 4) One machine W.D.V. of which at the beginning was ` 7,000 was sold for ` 16,000.
 5) Rate of depreciation 15%.
- iii) 1) Block of asset-Plant & Machinery 2) W.D.V. on 1st April 2015 ` 50,000.
 3) Machines purchased during the year
 (a) On 15th May 2015 ` 20,000
 (b) On 18th Oct 2015 ` 4,000
 4) Rate of depreciation 10%
- iv) 1) W.D.V. as on 1st April 2015 ` 60,000
 2) Purchases on 30th March 2016 ` 10,000
 3) Sales W.D.V. ` 8,000, Selling Price ` 5,000.
 4) Rate of depreciation 15%.
 5) Block of Assets: Furniture
- v) If selling price is ` 62,000 in case (iv) find the amount of depreciation.
- vi) WDV on 1.4.2015 ` 16,000
 All assets sold for ` 4,000
 Rate of depreciation 10%
- vii) Following assets were acquired for a new business. Form block of assets & calculate depreciation:

Particulars	Rate of Depreciation	Cost()
1. Building	5%	60,00,000
2. Machinery	20%	2,00,000
3. Machinery	40%	3,00,000
4. Machinery	50%	1,00,000

Investment Allowance for investment in new plant and machinery [U/s 32AC]

This deduction is allowed for A.Y. 2014-15 & 2015-16 only to a Company engaged in manufacture and invests more than ` 100 crores in new plant and machinery during the period between 1st April 2013 & 31st March 2015. This deduction is allowed in addition to normal and additional depreciation.

Actual Deduction: a. In A.Y. 2014-15 15% of actual cost of new assets acquired and installed in the previous year 2013-14

b. In A.Y. 2014-15 15% of actual cost of new assets acquired from 1st April 2013 to 31st March 2015 as reduced by deduction allowed in A.Y.2014-15.

U/s 32AC(1) Investment Allowance is available if the aggregate amount of actual cost of new asset acquired and installed by the company during any previous year exceeds ` 25 crore. This is applicable from A.Y. 2015-16 to 2017-18.

If asset on which this deduction is claimed is transferred within 5 years from the date of installation then the amount that was allowed as deduction shall be treated as business income in the year in which it is transferred.

Expenditure on Scientific Research [U/S 35]

Scientific Research means any activities for the expansion of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. The following expenditure on scientific research is allowed as deduction:

- a)** Revenue expenditure incurred for scientific research related to assessee's business will be fully allowed. This may be the payment of any salary to the persons engaged in scientific research or purchase of materials for use in such scientific research.
 - b)** Capital expenditure incurred on scientific research related to assessee's business, will be allowed in full, however purchase of land is not allowed. No depreciation is allowed u/s 32 in respect of such asset during the previous year and subsequent year.
 - c)** Contribution made to approved scientific research association or college or university or other approved institutions for scientific research and to approved university, college or institution for the use of scientific research is allowed. Above may or may not be related to assessee's business & a weighted deduction of 1.75 times of amounts paid is allowed as a deduction.
 - d)** Contribution made to approved university, college or institution for research in social science or statistical research is allowed. Above may or may not be related to assessee's business & a weighted deduction of 1.25 times of amounts paid is allowed as a deduction.
 - e)** Any sum paid to a "National laboratory" or I.I.T. or a university or a specified person approved by prescribed authority, to be used for scientific research under an approved program, will be allowed deduction of 2 times of the amount so paid [Sec. 35(2AA)].
 - f)** In case of a company engaged in manufacture or production of any drugs pharmaceuticals, electronic equipments, computers, tele-communication equipments, chemicals or any other article or thing notified by the board, incurs any expenditure on scientific research (excluding the cost of land and building) or in-house research and development facility as approved by the prescribe authority, a weighted deduction of 2 times of such expenditure shall be allowed. The weighted deduction which was allowed in respect of such expenditure u/s 35(AB) will not be considered for any deduction under any other provision of this Act. This weighted deduction is allowed subject to the condition that the research and development facility is approved by the prescribed authority and the company has entered into an agreement of cooperation and for audit of the accounts maintained for this purpose. The prescribed authority shall submit the report of the approval of the said facility to the director General in such form and within such time as may be prescribed. This sub- section is amended to allow the said deduction in respect of expenditure incurred upto 31st Day of March 2012.
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4. Deduction u/s. 36 & 37:

- 1. Insurance:** Section 36(1) (i)- Premium paid to cover the risk of damage or destruction of stocks, stores, cattle and on health of employees under the approved scheme.
- 2. Insurance Premium paid by Federal milk co-op. society on the lives of cattle owned by the members of a Primary Milk Co-op, Society affiliated to it.** Section 36(1) (ia)
- 3. Premia for insurance on health of employees in accordance with scheme framed by GIC & approved by Central Government or any other insurer & approved by the Insurance Regulatory & Development Authority (only if paid by cheque)** Section 36(1) (ib).
- 4. Bonus or commission paid to Employees:** Section 36(1) (ii): It is allowed as deduction so far as they are not paid as profit or dividend.
- 5. Interest on borrowed capital:** Section 36(1) (iii): - It is allowed as deduction. However, interest paid by firm to its partners is allowed subject to provisions of Sections 40(b).
- 6. Discount on zero coupon bonds** is deductible by issuing Company on pro rata Basis Sec.36(1)(iii a)
- 7. Contribution to recognised Provident fund or an approved super annuation fund:** Section 36(1)(iv). Any sum paid by the assessee as an employer by way of contribution towards pension scheme.
- 8. Contribution to Pension Scheme:** Section 36(1)(iv a) Any contribution by an employer by way of contribution towards a pension scheme for an employee up to 10% of salary shall be allowed as deduction.
- 9. Contribution to approved Gratuity Fund** Section 36(1)(v): - Amount contributed to the fund which is for the exclusive benefit of the employees will be allowed as deduction.
- 10. Contributions received from employees (when deposited)** Section 36(1)(va): - Any contribution received from employees towards any funds for the welfare of the employees e.g. P.F. will be allowed as deduction when such contribution is credited to employees a/c on or before the due date. It is allowed as deduction not because it is an expenditure of the assessee. In fact, it is not at all an expenditure of the assessee. But when this amount is deducted from salary of employees, it is treated as an income under section 2(24)(x). Therefore, deduction is allowed when payment is made by the due date.
- 11. Animals used for the business:** Section 36 (1) (vi): - Deduction is allowed when animals have died or have become permanently useless. Amount of deduction will be difference between actual cost of the animals and amount realised if any in respect of carcasses of the animals.

Deduction is allowed only if animals are used for the purpose of business but not as stock in trade.

- 12. Bad debts:** Section 36(1)(vii) and Section 36(2): - Deduction is allowed on this account if debts have arisen out of business transaction. It is the responsibility of the assessee to prove to the satisfaction of income tax officer that such debts are irrecoverable.
- 13. Expenditure for promoting family planning:** Section 36(1)(ix): - Only a company can claim this deduction. Any expenditure incurred by a company to promote family planning among its employees is allowed as deduction fully, provided it is revenue expenditure. Any capital expenditure on this account is allowed as deduction in 5 equal instalments. If profit is not sufficient to absorb this expenditure it can be carried forward to be set off in future. No depreciation can be claimed under section 32 on capital assets used for promoting family planning and allowed as deduction under section 36(1)(ix).
- 14.** Any amount of banking cash transaction tax paid during the year. 36(1)(xiii)
- 14. General Expenditure for the purpose of business or profession Section 37:** - Any other expenditure not covered by section 30 to 36 which is of revenue nature will be allowed as deduction provided it is incurred exclusively for the purpose of business or profession. e. g
 1. Embezzlement of cash.
 2. Expenses on local festival such as Diwali, Muhurta etc.
 3. Cash shortage found in the business at the end of the day.
 4. Entertainment Expenses
 5. Advertisement Expenses
 6. Travelling Expenses
 7. Guest House Expenses.
 8. Lawful expenses related to illegal business.
 9. Premium on redemption of debentures
 10. Discount on issue of debentures (on pro rata basis)

Expenses Not Deductible Under Section 37

1. Donations
2. Charities
3. Gifts to relatives
4. Income tax
5. Wealth tax
6. Advance income tax
7. Fines and penalties for breach of any laws.
8. Personal Drawings
9. Salary to owner
10. Interest on proprietors capital
11. Capital expenditure

12. Purchase of an assets
13. Extension of building
14. Personal expenditure
15. Household expenses.
16. Drawings
17. Education expenses of children
18. Residential telephone bill
19. Residential electricity bill
20. Residential maintenance
21. Amount transferred to reserve
22. Personal Hotel expenses
23. R.D.D. But deduction is allowed for actual bad debts
24. Personal motor expenses
25. L.I.C. on own life.
26. Any Investments
27. Any expenses related to let out house property.
28. Expenditure on Advertisement (Section 37(2B)): It is allowed as deduction. However, as per Section 37 (2B), any expenditure incurred by an assessee on the advertisement in any souvenir, brochure, pamphlet etc. published by a political party will not be allowed as deduction.
29. In case of all assessee Section 40(a): Interest, royalty, fees for technical services or any other sum chargeable to tax payable outside India without deducting tax at source & where there is no person to be treated as an agent of person receiving this amount.
30. Salary paid outside India without deducting tax at source
31. Any contribution to PF or any other Fund, if there is no arrangement for TDS from any payment to be made from such Fund if it is taxable under the head Salaries.
32. Expenditure on Corporate Social Responsibility.(W.e.f A.Y. 2016-17)

5. Deductions under section 40:

Deduction to firm / AOP on certain appropriations: -

1. In case of partnership firm **Section 40(b)**: - Payment of salary, bonus, commission or remuneration to partner of the firm, by the firm is allowed as deduction only to the following extent: -
 1. Loss or profit up to ` 3,00,000 - ` 1,50,000 or 90% of book profit which ever is more
 2. On the balance - 60% of book profit
2. In case of A.O.P. Section 40(ba): Any payment of Interest, Salary, bonus, commission or remuneration made by A.O.P. or B.O.I. to the member thereof shall not be allowed as deduction.

3. Interest to partners – Interest on capital of partners is allowed as deduction provided it is authorized by the partnership deed & rate of interest does not exceed 12% p.a.
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EXPENSES OR PAYMENTS NOT DEDUCTIBLE IN CERTAIN CASES UNDER SECTION 40 A

1. Payments to certain persons which are unreasonable or excessive under Section 40A(2).

Payments made by assessee to following persons :-

- (a) Who is relative of assessee, if assessee is an individual i.e. spouse, brother, sister or any lineal ascendant & descendant
- (b) Who is director, partner, member or their relatives, if assessee is a company or a firm or AOP or HUF
- (c) Any person who is having substantial interest in business or profession of the assessee. i.e. a person who is beneficial owner of at least 20% of equity capital or entitled to 20% profit.

If any payment is made by assessee on any account to above mentioned persons & if in the opinion of assessing officer such payment is excessive or unreasonable then to the extent it is unreasonable will be disallowed.

2. Payments exceeding `20,000 made otherwise than by a crossed cheque or a draft Section 40A(3) & 40A (4):- If assessee incurs any expenditure exceeding ` 20,000 otherwise than by a crossed cheque or a draft it shall be disallowed to the extent of 100%.

Where the assessee incurs any expenditure 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, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.

If expenses are incurred in earlier years and remained outstanding in that year but deduction was allowed on accrual basis and if actual payment (exceeding ` 20,000) is made in the next year in cash it will be considered as if expenditure allowed earlier as deduction was wrong & necessary amount will be added to income of year in which it is paid.

However, Rule 6DD provides for exceptional or unavoidable circumstances where payments exceeding ` 20,000 are to be made in cash. Taking into consideration genuineness of such transaction they will be allowed as deduction.

With effect from October 1, 2009, the monetary limit of ` 20,000 under section 40A(3) has been raised to ` 35,000 in the case of payment made for plying, hiring or leasing goods carriages. For other payments, the limit of ` 20,000 will continue.

For the purpose of this Section even payment for purchase of goods is considered as expenses.

3. Provision made for payment of gratuity under section 40 A (7)

- a) Subject to the provisions of clauses (b), no deduction shall be allowed in respect of any provision (whether called as such or by any other name) made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.
- b) Nothing in clause (a) shall apply in relation to any provision made by the assessee for the purpose of 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.

4. Contributions made by employer to non-statutory funds under section 40A(9) & 40A (10): - Any contribution mentioned above shall not be allowed as deduction. This provision does not apply to contributions to recognised PF, approved gratuity & super annuation fund etc.

6. Deduction under section 43:

Disallowance of unpaid statutory liability (Section 43B): - This section is applicable only if books are maintained on accrual basis. In the following cases, deduction otherwise allowable under the Income-tax Act will not be allowed unless the amounts are actually paid by the due date for filing return of income. If these liabilities are disallowed under section 43B in the year of provision, they will be allowed in succeeding year or years when actually paid: -

- 1) Tax, duty, cess or fees, under any law (e.g. Sales-tax, Excise duty, etc.)
- 2) Employer's contribution to provident fund or super annuation fund or gratuity fund or any other fund for the welfare of the employees.
- 3) Bonus or commission for services rendered payable to employees referred to in section (1) (ii) & sum due in lieu of leave balance.
- 4) Interest on any loan or borrowing from any public financial institutions or a State Financial Corporation or a State Industrial Investment Corporation, in accordance with the terms and conditions of loan/borrowing agreement.
- 5) Interest on any term loan from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan.

It should be noted that these payments will not be allowed as deduction on accrual basis if not paid by the due date of filing return of income even if books are kept on mercantile basis.

Computation of Business Profits:

Business Profit should be calculated through profit & Loss Account. In Profit & Loss Account there are some expenses which are partly allowed or disallowed under Income Tax Act. On the Credit side of Profit & Loss A/c there are some Income which are tax free or not taxable under the head Business/Profession.

Balance as per P & L A/c (+) Profit

(-) Loss Amount

Add Expenses claimed but not allowed under the Act

1. All Provisions & Reserves (Provision for Bad Debt/Depreciation/Income)
2. All Taxes (Except Income Tax, Wealth Tax etc.) except sales Tax,Excise
3. Duty,& Local Taxes of premises used for business.
4. All Charities & Donations
5. All personal Expenses
6. Any type of Fine / Penalty
7. Speculative Losses
8. All Capital Losses
9. Any Difference in Profit & Loss Account
10. Previous year Expenses
11. Rent paid to self
12. All expenses related to other head of Income
13. Payments made to the partner (in terms of salary,commission or any other way.)
14. All capital expenses except scientific research
15. Loss by theft
16. Expenses on Illegal Business
17. Rent for Residential portion
18. Interest on Income tax, TDS etc

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Paper Code : BECP 55C

UNIT-V

PROBLEM NO: 1

Computation of depreciation allowable in the hands of Gamma Ltd. for the A.Y. 2017 - 18.

Particulars		Rs. in crore	
Total cost of plant and machinery		120.00	
Less: Used for Scientific Research (Note 1)		<u>15.00</u>	
		<u>105.00</u>	15.75
Normal Depreciation at 15% on Rs.105 crore			
Additional Depreciation:			
Cost of plant and machinery		120.00	
Less: Second hand plant and machinery (Note 2)	20.00		
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia)	<u>15.00</u>	<u>35.00</u>	
		85.00	
Additional Depreciation at 20%			<u>17.00</u>
Depreciation allowable for A.Y.2017-18			<u>32.75</u>

Note:

1. As per section 35(2)(iv) no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, **since deduction is allowable under section 35 in respect of such capital expenditure.**
2. As per section 32(1)(ia) additional depreciation is allowable in the case of **any new machinery or plant** acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing, at the **rate of 20% of the actual cost of such machinery or plant.**

PROBLEM NO: 2

Computation of depreciation allowable for A.Y.2017-18

	Asset	Rate	Depreciation
Block 1	Furniture	10%	30,000
Block 2	Plant (Computer, computer software, laptop, printer & books)	60%	44,550
Block 3	Plant (Books)	100%	12,000
	Total depreciation allowable		86,550

1. Computation of depreciation

Block of Assets	Rs.
Block 1: Furniture – rate 10%	
Put to use for more than 180 days [Rs.3,00,000@10%]	30,000
Block 2: Plant – rate 60%	
a) Computer (put to use for more than 180 days) [Rs.35,000 @ 60%]	21,000
b) Computer printer (put to use for more than 180 days)(12,500 @ 60%)	7,500
c) Laptop (put to use for less than 180 days) [Rs. 43,000 @ 30%]	12,900
d) Computer Software (put to use for less than 180 days) [Rs.8,500@ 30%]	2,550
e) Books (other than annual publications) (Put to use for more than 180 days) [Rs.1,000 @ 60%]	<u>600</u>
Block 3: Plant – Rate 100%	44,550
Books (being annual publications) put to use for more than 180 days 12,000 @ 100%]	12,000

PROBLEM NO: 3

Computation of depreciation in the case of transfer of business:

Depreciation is to be calculated as if there is no succession	Rs.
WDV as on 1st April	3,00,000
Add : Additions made before succession	<u>1,20,000</u>
	4,20,000
Less : Sale consideration of the asset sold	<u>Nil</u>
	<u>4,20,000</u>
Depreciation @ 15%	63,000

Allocation of depreciation between sole proprietary concern and the successor company:

The depreciation of Rs. 63,000 is to be allocated in the ratio of number of days the assets were used by the sole proprietary concern and the company.

Ex-sole proprietary concern:

1st April to 31st August = 153 days Rs. 63,000 x 153 / 365 = **Rs. 26,408 Successor**

company:

Rs. 63,000 - Rs. 26,408 = **Rs. 36,592** (i.e. Rs. 63,000 x 212 / 365)

The depreciation of Rs. 12,000 [50% of 15% on Rs. 1,60,000] in respect of asset purchased by the successor company on 1st January is fully allowable in the hands of the successor company.

Note: Since it has not been specified that the company is a manufacturing company or a company engaged in the generation or generation and distribution of power, additional depreciation has not been provided for.

PROBLEM NO: 4

Tax treatment of depreciation and unabsorbed business loss of a private company on its conversion into a LLP

1. Depreciation: The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Fifth proviso to Section 32(1)]

Therefore, depreciation has to be first calculated as if the conversion had not taken place and then apportioned between the company and the LLP in the ratio of the number of days for which the assets were used by them.

		Rs.		Rs.
Block I	Machinery	3,30,000	15%	49,500
Block II	Patents	3,00,000	25%	75,000
				1,24,500

1. Allocation of depreciation: Depreciation on machinery and patents have to be apportioned between the company and the LLP in the ratio of the number of days for which the **assets were used by them**. Since patents were acquired only on 1.6.2016, it could have been used by the company for 214 days only. Therefore, the depreciation on assets has to be allocated between the company and LLP as follows –

Asset	Total depreciation for the year	Company		LLP	
		No. of days of usage	Depreciation	No. of days of usage	Depreciation
Machinery	49,500	275	44,485	31	5,015
Patents	75,000	214	65,510	31	9,490
	1,24,500		1,09,995		14,505

Therefore, depreciation to be allowed in the hands of the company is Rs.1,09,995 and depreciation to be allowed in the hands of the LLP is Rs. 14,505.

2. Unabsorbed business loss to be carried forward by the LLP:

Particulars	Amount (Rs.)
Profits of the company before depreciation 8,00,000	8,00,000
Less: Current year depreciation 1,09,995	<u>1,09,995</u>
Business income of the company after depreciation 6,90,005	6,90,005
Brought forward business loss 9,00,000	<u>9,00,000</u>
Unabsorbed business loss as on 31.12.2016 to be carried forward by the LLP	<u>2,09,995</u>

The LLP would be allowed to carry forward and set-off the unabsorbed business loss and unabsorbed depreciation of the predecessor company [Section 72A(6A)].

3. Actual cost of assets to the LLP

- i) The actual cost of the block of assets in case of the LLP shall be the WDV of the block of assets as in the case of the company on the date of conversion. The WDV as on 1.1.2017 for Machinery and Patents are Rs. 2,85,515 and Rs. 2,34,490, respectively, which would be the actual cost in the case of the LLP.

WDV of Machinery as on 1.1.2017 = Rs. 3,30,000 – Rs. 44,485 = Rs. 2,85,515 WDV

of Patents as on 1.1.2017 = Rs. 3,00,000 – Rs. 65,510 = Rs. 2,34,490

- ii) Land is not a depreciable asset. The cost of acquisition of land to the LLP would be the cost for which the company acquired it, as increased by the cost of improvement. In respect of the building, deduction had been allowed in the earlier year under section 35AD.

Hence, there is no question of depreciation during the current year. The actual cost of the building to the LLP would be Nil.

PROBLEM NO: 5

Computation of depreciation and additional depreciation for A.Y. 2017-18

Particulars	Plant & Machinery (15%)	Computer (60%)
Normal depreciation:4		
• @ 15% on Rs. 50,00,000 [See Working Notes 1 & 2]	7,50,000	-
• @ 7.5% (50% of 15%, since put to use for less than 180 days) on Rs. 8,00,000	60,000	-
• @ 30% (50% of 60%, since put to use for less than 180 days) on Rs. 3,00,000	-	90,000
Additional Depreciation:		
• @ 20% on Rs. 20,00,000 (new plant and machinery put to use for more than 180 days)	4,00,000	-
• @ 10% (50% of 20%, since put to use for less than 180 days) on Rs. 8,00,000	<u>80,000</u>	<u>-</u>
Total depreciation*	12,90,000	90,000

Working Notes:

(1) Computation of written down value of Plant & Machinery as on 31.03.2017

Particulars	Plant & Machinery	Computer
Written down value as on 1.4.2016	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2016	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2016	8,00,000	-

Computer acquired and installed in the office premises	-	3,00,000
	58,00,000	3,00,000
LESS: depreciation*	12,90,000	90,000
Written down value as on 31.03.2017	45,10,000	2,10,000

(2) Composition of plant and machinery included in the WDV as on 31.3.2017

Particulars	Plant & Machinery	Computer
Plant and machinery put to use for 180 days or more [Rs. 30,00,000 (Opening WDV) + Rs. 20,00,000 (purchased on 8.6.2016)]	50,00,000	-
Plant and machinery put to use for less than 180 days	8,00,000	-
Computers put to use for less than 180 days	-	3,00,000
	58,00,000	3,00,000

Notes:

- As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2016 and computer acquired and installed on 02.01.2017, is restricted to 50% of 15% and 60%, respectively. The additional depreciation on the said plant and machinery is restricted to Rs.80,000, being 10% (i.e., 50% of 20%) of Rs.8 lakh

- As per third proviso to section 32(1)(ii), the balance additional depreciation of Rs.80,000 being 50% of Rs.1,60,000 (20% of Rs.8,00,000) would allowed as deduction in the A.Y.2018-19.
- As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia*, in the business of manufacture or production of any article or thing, @ 20% of the actual cost of such machinery or plant.

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

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

PROBLEM NO: 6

Computation of depreciation allowance under section 32 for the A.Y. 2016 - 17

(Rs. in crore)

Particulars	Plant and Machinery (15%)	Plant and Machinery (60%)
WDV as on 01.04.2015	25.00	-
Add: Plant and Machinery acquired during the year		
- Second hand machinery	12.00	
- New plant and machinery	90.00	
- Air conditioner installed in office	0.15	
Computers acquired during the year	-	0.40
	127.15	0.40
Less: Asset sold during the year	4.00	Nil
Written down value before charging depreciation	123.15	0.40
Less: Depreciation for the P.Y.2015-16 (See Note 1 below)	29.47	0.12
WDV as on 1.4.2016	93.68	0.28

Note 1: Computation of depreciation for the P.Y.2015-16**(Rs. in crore)**

Normal depreciation		
Depreciation@30% on computers put to use for less than 180 days (50% of 60% × 0.40 crore)	-	0.12
Depreciation on plant and machinery (15% block) (40 × 7.5%) + [(123.15-40) × 15%]	15.47	
Additional depreciation		
- New plant and machinery installed on 31.7.2015 (Rs. 50 crore × 20%)	10	
- on 31.10.2015 (Rs. 40 crore × 10%)	4	14.00
Total depreciation	29.47	0.12

Note – For the A.Y.2016-17, the company would be entitled to deduction of Rs. 13.50 crores (i.e., 15% of Rs. 90 crores) under section 32AC(1A) since the investment in new plant and machinery acquired and installed during the year is Rs. 90 crores (i.e., exceeds Rs. 25 crores). Investment in second hand plant and machinery and air-conditioners and computers installed in office would not be eligible for deduction under section 32AC or additional depreciation under section 32(1)(ia).

Computation of depreciation allowance under section 32 for the A.Y. 2017-18**(Rs. in crore)**

Particulars	Plant and Machinery (15%)	Plant and Machinery (60%)
WDV as on 1.4.2016	93.68	0.28
Add: Plant and Machinery acquired during the year	15.00	-
	108.68	0.28
Less: Asset sold during the year	Nil	Nil
Written down value (before charging depreciation)	108.68	0.28
Less: Depreciation for the P.Y.2016-17 @ 15% and 60%, respective	16.30	0.17
Additional depreciation@20% on 15 crore	3.00	
WDV as on 1.4.2017	89.38	0.11

Note - The company would not be eligible for deduction under section 32AC for A.Y. 2017 - 18 since investment in new plant and machinery in that year in the P.Y.2016 - 17 is only Rs. 15 crore (i.e., less than Rs. 25 crore).

PROBLEM NO: 7**Computation of depreciation under section 32 for X Ltd. for A.Y. 2017-18**

Particulars		Rs. in crores
Plant and machinery acquired on 01.06.2016		30.000
Plant and machinery acquired on 01.11.2016		<u>25.000</u>
WDV as on 31.03.2017		55.000
Less: Depreciation @ 15% on Rs. 30 crore	4.500	
Depreciation @ 7.5% (50% of 15%) on Rs. 25 crore	1.875	
Additional Depreciation@35% on Rs. 30 crore	10.500	
Additional Depreciation@17.5% (50% of 35%) on Rs. 20 crore	<u>3.500</u>	<u>20.375</u>
WDV as on 01.04.2017		34.625

Computation of deduction under section 32AC & 32AD for X Ltd. for A.Y. 2017-18

Particulars	Rs. in crores
Deduction under section 32AC(1A) @ 15% on Rs. 50 crore (since investment in new plant and machinery acquired and installed in the previous year 2016-17 by X Ltd., a manufacturing company, exceeds Rs. 25 crore)	7.50
Deduction under section 32AD @ 15% on Rs. 50 crore	<u>7.50</u>
Total benefit	15.00

Yes, the answer would be different, where the manufacturing unit is set up by a firm. The deduction under section 32AC is available only to corporate assessee, and therefore, the deduction of Rs. 7.50 crore under section 32AC would not be available if the manufacturing unit is set up by X & Co., a firm. However, it would be eligible for deduction of Rs. 7.50 crore under section 32AD.

Notes:

- As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 1.11.2016 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

- As per third proviso to section 32(1) (ii), the balance additional depreciation of Rs. 3.5 crore, being 50% of Rs. 7 crore (35% of Rs. 20 crore) would be allowed as deduction in the A.Y.2018-19.
- As per section 32(1)(ia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia*, in the business of manufacture or production of any article or thing. In this case, since new plant and machinery acquired was installed by a manufacturing unit set up in a notified backward area in the State of Telengana, the rate of additional depreciation is 35% of actual cost of new plant and machinery. Since plant and machinery of Rs. 20 crore was put to use for less than 180 days, additional depreciation @ 17.5% (50% of 35%) is allowable as deduction. However, additional depreciation shall not be allowed in respect of second hand plant and machinery of Rs. 5 crore.

Likewise, the benefit available under sections 32AC and 32AD would not be allowed in respect of second hand plant and machinery.

Accordingly, additional depreciation and investment allowance under sections 32AC and 32AD have not been provided on Rs. 5 crore, being the actual cost of second hand plant and machinery acquired and installed in the previous year.

PROBLEM NO: 8

Computation of deduction allowable under section 35

Particulars	Amount (Rs. in lakhs)	% of weighted deduction	Amount of deduction (Rs. in lakhs)
<u>Payment for scientific research</u>			
K Research Ltd.	20	175%	35.00
LMN College	15	175%	26.25
OPQ College	10	Nil	Nil
National Laboratory	8	200%	16.00
<u>In-house research</u>			
Capital expenditure	25	100%	25.00
Revenue expenditure	12	100%	<u>12.00</u>
Deduction allowable under section 35			<u>114.25</u>

K Research Ltd. weighted deduction will be taken as 125%. Then deduction 104.25

Notes:-

- Payment to OPQ College:** Since the note in the question below item (vi) clearly mentions that only K Research Ltd. and LMN College (mentioned in item (i) and (ii), respectively) are approved research institutions, it is a logical conclusion that OPQ College mentioned in item (iii) is not an approved research institution. Therefore, payment to OPQ College would not qualify for deduction under section 35.

- Deduction for in-house research and development:** Only company assessee are entitled to weighted deduction @ 200% under section 35(2AB) in respect of in-house research and development expenditure incurred. However, in this case, the assessee is an individual. Therefore, he would be entitled to deduction @ 100% of the revenue expenditure incurred under section 35(1)(i) and 100% of the capital expenditure incurred under section 35(1)(iv) read with section 35(2), assuming that such expenditure is laid out or expended on scientific research related to his business.

3. **Payment to K Research Ltd. (Alternative Answer):** Any sum paid to a company registered in India which has as its main object scientific research, as is approved by the prescribed authority, qualifies for a weighted deduction of 125% under section 35(1)(ia).

Therefore, it is also possible to take a view that payment of Rs. 20 lakhs to K Research Ltd. qualifies for a weighted deduction of 125% under section 35(1)(ia) since K Research Ltd. is a company. The weighted deduction under section 35(1)(ia) would be Rs. 25 lacs (i.e., 125% of Rs. 20 lacs), in which case, the total deduction under section 35 would be Rs. 104.25 lacs.

4. **Payment to National Laboratory:** The percentage of weighted deduction under section 35(2AA) in respect of amount paid to National Laboratory is 200%.

PROBLEM NO: 9

As per section 35(2AB), where a company engaged in, inter alia, the business of biotechnology incurs any expenditure on scientific research during the current year, it is eligible for claiming weighted deduction of a sum equal to 200% of the eligible expenditure.

Note : The benefit of weighted deduction under this section would be available for expenditure incurred upto 31st March 2017 on in-house research and development facility.

The eligible expenditure and quantum of deduction will be:

- a) Current year capital expenditure (except expenditure in the nature of cost of any land or building) or revenue expenditure incurred for scientific research (weighted deduction @ 200%) under section 35(2AB).
- b) Any expenditure incurred during earlier 3 years immediately preceding the date of commencement of business on payment of salary or purchase of materials, or capital expenditure incurred other than expenditure on acquisition of land [actual expenditure qualifies for deduction under section 35(1)].

1. **The deduction available under section 35 for scientific research**

	Particulars	Rs.
a)	Land	Nil
b)	Building	25,00,000
c)	Revenue expenses of last 3 years	2,20,000
d)	Capital expenditure of last 3 years: Plant and machinery	5,00,000
Expenditure allowable under section 35(1)		32,20,000
	Current year revenue expenditure Rs.1,80,000 [200% of Rs.1,80,000 is allowable under section 35(2AB)]	3,60,000
Total deduction under section 35		35,80,000

2. **Section 41(3) provides that where a capital asset used for scientific research is sold**, without having been used for other purposes, the lower of sale proceeds or the total amount of deduction earlier allowed under section 35 will be considered as income from business of the previous year in which the sale took place.

Therefore, the income chargeable to tax under section 41(3) should be lower of the following:

- a) Sale proceeds i.e. Rs.8,00,000
 - b) Total amount of deduction earlier allowed under section 35 i.e. Rs.5,00,000
Rs.5,00,000 will be deemed to be the income chargeable to tax under section 41(3).
3. The difference between sale proceeds and business income under section 41(3) will be treated as short-term capital gain.

Particulars	Rs.
Sale proceeds of plant and machinery	8,00,000
Less: Business Income as per section 41(3)	<u>5,00,000</u>
Short-term capital gain	<u>3,00,000</u>

PROBLEM NO: 10

As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services, shall be allowed as deduction in equal installments during the number of years for which the licence is in force. Therefore, the year of actual payment is relevant and not the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

1. Rs.3,70,000 paid on 30.03.2016 [P.Y.2015-16]

Unexpired period of licence 10 years

Hence Rs.37,000 [i.e. Rs.3,70,000/10] can be claimed under section 35ABB for period of 10 years commencing from A.Y.2016-17.

2. Rs.11,70,000 paid during year ended 31.03.2017 [P.Y.2016-17]

Unexpired period of license 9 years

Hence, Rs.1,30,000 [i.e. Rs.11,70,000/9] can be claimed under section 35ABB for a period of 9 years commencing from A.Y.2017-18.

3. Amount of deduction u/s 35ABB

Assessment year	Amount (Rs.)
2016-17	37,000
2017-18	37,000 + 1,30,000 = 1,67,000

4. Where deduction under section 35ABB is claimed and allowed, deduction under section 32(1) cannot be allowed for the same previous year or any subsequent previous year.

PROBLEM NO: 11

Since the capital asset, in respect of which deduction of Rs. 50 lacs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2016-17, the deeming provision under section 35AD(7B) is attracted during the A.Y.2017-18.

Particulars	Amount(Rs.)
Deduction allowed under section 35AD for A.Y.2016-17	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2016-17 [10% of Rs. 50 lacs]	5,00,000
Deemed income under section 35AD(7B)	45,00,000

PROBLEM NO: 12

Computation of income under the head “Profit and gains of business or profession” of MNP Ltd. for A.Y.2017 - 18.

Particulars	Rs.	Rs.
Profits from the specified business of new four-star hotel in Chennai (before providing deduction under section 35AD)		80
Less: Deduction under section 35AD		
Capital expenditure incurred during the P.Y. 2016 -17 (excluding the expenditure incurred on acquisition of land) = Rs.250 lakh - Rs.100 lakh (See Notes 1 & 2 below)	150	
Capital expenditure incurred during January 2016 to March 2016 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2016 (See Note 3 below)		
Total deduction under section 35AD for A.Y.2017-18	<u>40</u>	<u>190</u>
Income from the specified business of new hotel in Chennai		(110)
Profit from the existing business of running a four-star hotel in Kanpur (See Note 4 below)		<u>130</u>
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		<u>20L</u>

Notes:

1. According to the provisions of section 35AD, an assessee shall be allowed a deduction in respect of 100% of the capital expenditure incurred wholly and exclusively for the purpose of the specified business
2. The expenditure on acquisition of land, however, does not qualify for deduction under section 35AD.
3. The capital expenditure incurred prior to commencement of specified business shall be allowed as deduction under section 35AD(1) in the year of commencement of specified business, if the same is capitalized in the books of accounts of the assessee on the date of commencement of its operations.
4. As per section 73A, the loss computed under section 35AD in respect of a specified business can be set off against the profit of another specified business. Building and operating a hotel of two-star and above category, anywhere in India, is a specified business, therefore, the loss from the business of new four-star hotel in Chennai can be set-off against the income of the existing four-star hotel in Kanpur.
5. Section 35AD(6A) provides that where the assessee, MNP Ltd., builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, in this case, MNP Ltd. would be eligible to claim investment linked deduction under section 35AD even if it transfers the operation of the Chennai hotel to PQR Ltd.

PROBLEM NO: 13**Computation of profits and gains of business or profession for A.Y.2017-18**

Particulars	Rs.
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
<i>Less:</i> Depreciation under section 32	
10% of Rs.30 lakh, being (Rs.50 lakh - Rs.30 lakh + Rs.10 lakh)	<u>3</u>
Income chargeable under "Profits and gains from business or profession"	<u>28</u>

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

	Particulars	Food Grains	Sugar	Total
A.	Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)	16	14	30
	<i>Less:</i> Deduction under section 35AD			
B.	Capital expenditure incurred prior to 1.4.2016 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2016 (excluding the expenditure incurred on acquisition of land) = Rs.30 lakh (Rs.80 lakh - Rs.50 lakh) and Rs.20 lakh (Rs.60 lakh - Rs.40 lakh)	30	20	50
C.	Capital expenditure incurred during the P.Y.2016-17	<u>20</u>	<u>15</u>	<u>35</u>
D.	Total capital expenditure (B + C)	<u>50</u>	<u>35</u>	<u>85</u>
E.	Deduction under section 35AD			
	150% of capital expenditure (food grains)	75	35	
	100% of capital expenditure (sugar)			
	Total deduction u/s 35AD for A.Y.2017-18	<u>75</u>	<u>35</u>	<u>110</u>
F.	Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)	(59)	(21)	(80)

PROBLEM NO: 16

According to sec.40(a)(ia), where tax has not been deducted or the amount of tax deducted has not been remitted to the credit of central government as per the provisions of tax deduction at source, then, 30% of such expenditure shall be disallowed while computing income under the head "profits and gains from business or profession". Accordingly, in respect of various situations given in question, the following shall be the consequences u/s.40(a)(ia):

S. No.	Nature of payment	Compliance / violation	Tax consequence
a)	Contract payment	Tax not deducted at source	Rs.72,000 shall be disallowed (Rs.2,40,000*30%)
b)	Salary to a resident	Tax not deducted at source	Rs.1,50,000 shall be disallowed (Rs.5,00,000*30%)
c)	Rent	TDS remitted within stipulated time limit.	The assessee has remitted the amount of TDS on 28.09.2017 which is within the time limit for filing return of income. i.e. 30.09.2017. accordingly, no disallowance of expenditure u/s.40(a)(ia) is warranted.
d)	Interest	Tax not deducted at source during financial the year.	Rs.60,000 shall be disallowed in A.Y 2017-18. However, the same shall be allowed as a deduction in AY 2018-19. (Rs.2,00,000*30%)
e)	Professional charges	Delay in remittance of TDS.	Rs.1,50,000 shall be disallowed in A.Y 2017- 18 since the same is not remitted within time limit stipulated u/s 139 (1). However the same shall be allowed as a deduction in AY2018-19 (Rs.5,00,000*30%)
f)	Non-compete fee	Tax not deducted at source	Rs.3,00,000 shall be disallowed (Rs.10,00,000*30%)

PROBLEM NO: 17

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

The assessee is a resident individual, who was not subjected to tax audit during the immediately preceding previous year i.e., P.Y.2015-16 (as his turnover was less than Rs. 100 lakh in that year) and the TDS obligations have to be considered bearing this in mind.

- i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year, i.e., P.Y.2015-16. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2015-16. Hence, disallowance under section 40(a)(ia) is not attracted in this case.
- ii) In the case of interest paid to a non-resident, there is obligation to deduct tax at source under section 195, hence non-deduction of tax at source will attract disallowance under section 40(a)(i).
- iii) The scope of section 40(a)(ia) has been expanded w.e.f. A.Y. 2017-18 to cover all sums in respect of which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. Therefore, disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid with out deduction of tax at source would be disallowed.
- iv) The obligation to deduct tax at source under section 194-H from commission paid in excess of Rs. 5,000 to a resident arises in the case of an individual, only where he was subject to tax audit under section 44AB in the immediately preceding previous year. From the data given, it is clear that he was not subject to tax audit under section 44AB in the P.Y.2015-16. Hence, there is no obligation to deduct tax at source under section 194H during the P.Y. 2016-17. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

PROBLEM NO: 18

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

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

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

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

Note: The Explanatory Memorandum to the Finance (No.2) Bill, 2014, however, clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be allowed as deduction under these sections subject to fulfilment of conditions, if any, specified therein.

Under section 35AC, 100% deduction is allowable in respect of the expenditure incurred on eligible projects/schemes specified under Rule 11K, which includes, inter alia, any project or scheme for construction of school buildings primarily for children belonging to the economically weaker sections of the society, as the Central Government may, by notification in the Official Gazette, specify in this behalf on the recommendation of the National Committee, being a committee constituted by the Central Government, from amongst persons of eminence in public life.

Therefore, if the expenditure of Rs. 5,60,000 on construction of school building is incurred for children belonging to the economically weaker sections of the society and the other conditions mentioned under section 35AC are fulfilled by MN Ltd., it can claim deduction of such expenditure under section 35AC.

- ii) Purchase of building for setting up a warehousing facility for storage of food grains

MN Ltd. would be eligible for investment-linked tax deduction under section 35AD @150% in respect of amount of Rs. 4,50,000 invested in purchase of building for setting up a warehousing facility for storage of food grains which commences operation on or after 1st April, 2012 (P.Y.2016- 17, in this case).

Therefore, the deduction under section 35AD while computing business income would be Rs. 6,75,000.

- iii) Interest on loan paid to Mr. X (a resident) Rs. 50,000 on which tax has not been deducted Rs. 15,000, being 30% of Rs. 50,000, would be disallowed under section 40(a)(ia) while computing the business income of MN Ltd. for non-deduction of tax at source under section 194A on interest of Rs. 50,000 paid by it to Mr. X. The balance Rs. 35,000 would be allowed as deduction under section 36(1)(iii), assuming that the amount was borrowed for the purposes of business.

- iv) Commodities transaction tax of Rs. 20,000 paid on sale of bullion Commodities transaction tax paid in respect of taxable commodities transactions entered into in the course of business during the previous year is allowable as deduction, provided the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

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

PROBLEM NO: 19

- a) **Calculation of Book Profits:**

Particulars	Amount
Net Loss as per P&L A/c	(1,72,000)
Add: Interest to partners	7,100
Other expenses to be disallowed	13,600
Profit as per P.G.B.P	1,51,300

Add: Remuneration to partners	68,000
Book profit	(83,300)

b) Permissible Remuneration in case of losses = 1,50,000 (or) 68,000 which ever is lower=68,000

c) **Income of Partnership Firm:**

Particulars	Amount
Net loss as per P/L A/c	(1,72,000)
Add: Other expenses	13,600
	(1,58,400)
Add: Interest Disallowed [Sec.40(b)]	7,100
Excess remuneration (68,000 – 68,000)	0
Loss	(1,51,300)

PROBLEM NO: 20

Case -1:

Taxable Income of the Partnership Firm

Particulars	Amount
Net Profit as per P&L A/c	1,00,000
Add: Interest Paid in excess [Sec.40 (b)] [1.5L×12%-36K]	18,000
	1,18,000
Add: Excess Remuneration paid [1.8L-allowable remuneration (W.N.1)]	48,000
Taxable Income	1,66,000

W.N.1:

Net Profit as per P & L A/c	1,00,000
Add: Excess interest paid U/s 40(b)	18,000
Add: Remuneration	1,80,000
Book Profit	2,98,000

Remuneration as per Slab system

On Rs.2,98,000 – Rs.1,50,000 (or) 90% of Book Profit which ever is higher.

Remuneration = Rs.2,68,200

Remuneration as per Partnership Deed (60,000 + 72,000) or as per Sec.40 (b) (2,68,200) which ever is lower

Allowable Remuneration = 1,32,000

Taxable Income of Partners

Particulars	A	B	C	D
Share of profits (Exempted U/s.10 (2A))	--	--	--	--
Interest (To the extent it is allowed as deduction)	--	--	--	18,000
Remuneration	--	60,000	72,000	--
Taxable Income	--	60,000	72,000	18,000

Case - 2:

a)

Taxable Income of the Partnership Firm

Particulars	Amount
Net Profit as per P&L A/c	1,00,000
Add: Interest Paid in excess – U/s 40 (b)	36,000
	1,36,000

Add: Remuneration	1,80,000
Taxable Income	3,16,000

b) Nothing is allowed as expenditure in the hands of partnership firm, no income is taxable in the hand of partners.

PROBLEM NO: 21

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

Particulars	Rs.
On first Rs. 3 lakh of book profit [Rs. 3,00,000 × 90%]	2,70,000
On balance Rs. 7 lakh of book profit [Rs. 7,00,000 × 60%]	4,20,000
	6,90,000

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

PROBLEM NO: 22

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

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

Accordingly, the amount of interest eligible for deduction for the A.Y.2017-18 shall be calculated as follows:

	Interest Outstanding	Number of Installments	Amount per installment	Installments Paid	Interest Allowable (Rs.)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					2,75,000

Actual Income = 25000

PROBLEM NO: 23

Computation of Taxable Income of X & Co. for the A.Y.2017-18

Particulars	Amount
<u>PGBP</u>	
Construction business (Note-1) – 25,000	
Other business – 1,90,000	2,15,000
<u>Capital Gains</u>	
Long term Capital Gains	40,000
Gross total income	2,55,000
Less: Chapter VI – A Deductions (Sec.80G)	5,000
Net taxable income	2,50,000

Calculation of Presumptive income

Gross Presumptive income (37,80,000×8%)	3,02,400
Less: Interest & salary to partners	60,000
Taxable presumptive Income	2,42,400

Note - 1: Since the actual income of the Assessee is less than the presumptive income. Assessee can declare the actual income as taxable income by satisfying following two conditions:

- i) Maintaining books of accounts U/s.44AA
- ii) By getting them audited U/s.44AB

PROBLEM NO: 24

Computation of Taxable Income of X Ltd for the A.Y.2017-18

Particulars	Amount
Business Income (W.N.1)	45,000
Other Income	70,000
Gross Total Income	1,15,000
Less: Chapter VI A Deductions	-
Net taxable income	1,15,000

W.N.1:

Calculation of Presumptive Income as per Sec.44 AE

Type of Vehicle	Duration	No. of Months	Income
9 – Heavy good vehicles	1-4-16 to 31-3-17	12	(9x12x7500)8,10,000
1 – Heavy good vehicle	1-4-16 to 2-5-16	2	(1x2x7500)15,000
1 – Light good vehicle	6-5-16 to 31-3-17	11	(1x11x7500)82,500
			9,07,500

Actual Income = Rs.45,000

Conclusion: Since the actual income is less than the presumptive income, assessee can declare actual income as taxable income subject to the satisfaction of the following two conditions:

- a) Maintaining Books of accounts U/s.44 AA
- b) By getting them audited U/s 44 AB

PROBLEM NO: 25

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2016-17, he is eligible to opt for presumptive taxation scheme under section 44AE. Rs. 7,500 per month or part of month for which each goods carriage is owned by him would be deemed as his profits and gains from such goods carriage.

(1)	(2)	(3)	(4)
Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	No. of months × No. of vehicles [(1) × (3)]
2	10.04.2016	12	24
1	15.03.2017	1	1
3	16.07.2016	9	27
1	2.01.2017	3	3
2	29.08.2016	8	16
1	23.02.2017	2	2
10	TOTAL		73

Therefore, presumptive income of Mr. X under section 44AE for A. Y.2017-18 is **Rs. 5,47,500**, being 73 × Rs. 7,500.

The answer would remain the same even if the two vehicles purchased in April, 2016 were put to use only in July, 2016, since the presumptive income of Rs. 7,500 per month has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

PROBLEM NO: 26

Under section 44BBA, in case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to 5% of the aggregate of the following amounts shall be deemed to be his business income:

- a) The amount paid or payable, whether in or out of India, to the assessee on account of carriage of passengers, goods etc. from any place in India; and
- b) The amount received or deemed to be received in India by the assessee on account of carriage of passengers, goods etc. from any place outside India.

Hence, the income of Mr. B.A. Patel chargeable to tax in India under the head "Profits and Gains of business or profession" is determined as under:

Particulars	Rs.
For carrying passengers from Ahmedabad	50,00,000
For carrying passengers from London, amount received in India	75,00,000
For carrying goods from Ahmedabad	25,00,000
Total	1,50,00,000

Hence, income from business computed on presumptive basis as per section 44BBA is Rs. 7,50,000, being 5% of Rs. 1,50,00,000.

Note: No deduction is allowable in respect of any expenditure incurred for the purpose of the business.

PROBLEM NO: 27

Computation of Taxable Income of Mr.D for the A.Y.2017-18

Net profit as per P&L A/c	25,500
(+) Expenses to be disallowed	
Excess salary paid	3,100
Reserve for bad debts	10,000
Interest on D's capital	3,000
Expenditure on acquisition of patents	28,000
Depreciation in excess (10,000-9,500)	500
Provision for income tax (Sec.40(a))	4,000
(-) Allowable expenses	
Depreciation on patents (28K×25%×1/2)	3,500
Outstanding sales tax liability (Note-1)	5,000
Taxable Income	65,600

Assumption: Assumed that assessee as satisfied the conditions as given in Sec.36(1) for the allowability of deduction towards bad debts

Note-1: As per Sec. 43B to get deduction towards the taxes for the P.Y 2015-16 will be allowed only if the payment was made before 31-07-16. Since the payment was not made with in the due date the same will be allowed as deduction in the year of actual payment 2016-17.

Note – 2: The cut off date for payment of customs duty is 31st July, 2016. Since the amount was made within the cut off date it should have been allowed as deduction for the previous year 2015-16. So, it will not be allowed as deduction again in 2016-17 (i.e., year of payment)

PROBLEM NO: 28

Calculation of Taxable Income

Profit as per P&L A/c	5,45,000
(+) <u>Expenses to be Disallowed</u>	
Sales Tax (50,000-44,000) (Note-1)	6,000
(-) <u>Expenses to be allowed</u>	
Bonus (Note-2)	15,000
Customs duty	25,000
Leave salary	45,000
Taxable income from PGBP	4,66,000