

## CHAPTER - III

### COMPUTATION OF INCOME FROM BUSINESS AND PROFESSION

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## C H A P T E R - I I I

### COMPUTATION OF INCOME FROM BUSINESS OR PROFESSION

#### 3.1 Definition of Head ( Section 28 )

Under Sections 28 to 44 of the income tax act 1961, Profits and Gains of business or profession form part of total income of an assessee. This head is the most important source of tax collection for the Government. The certain terms and their meanings are given below :

#### Business :

Business simply means any economic activity carried on for earning profits. Sec.2(3) defines the term 'Business' as "any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture". This definition covers every fact of an occupation carried on by a person with a view to earning profit. Production of goods from raw-material, buying and selling of goods to make profits and producing services to others are different forms of business. Profits arising therefrom is chargeable to tax under the head "profits and gains of business or profession".

#### Profession :

The word 'profession' implies possessed attainments in special knowledge and 'special knowledge' means which can

acquired only after patient study and application. According to Sec. 2(36) profession includes vocations for instance - Tax Experts, Cost Accountants, Chartered Accountants, Lawyers, Engineers, Surgeon, Author etc. are professionals. The term vocation means a way of living for which one has special fitness. Vocation means any type of activity in which a person is engaged and he earns his livelihood from such activity. The practice of a religion may also amount to vocation. Any gain or receipt arising out of vocation is certainly taxable under this head of income.

### 3.2 Chargiability (under Section 28) :

The following are the incomes which are chargeable to income tax under the head 'Profit & Gains of Business or Profession'

#### (1) Business or Professional Income [Sec.28(i)] -

Business or professional income [Sec.28(i)] means the profits and gains of any business or profession which was carried on by the assessee whether in India or out-side India during the previous year are assessed under this head. Whether the assessee was carried out business or profession throughout the year or part of the year, whether he himself was carried or it carried through manager, agent, servant, whether revenue profits are casual and non-recurring that is

not question. The profits and gains derived from business or profession by the assessee are liable for tax.

(2) Compensation [Section 28(ii)] -

Any compensation or other payment due to or received by the following persons is assessable as business income :

- (a) Any person, managing the whole or substantially the whole of affairs of an Indian Company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto.
- (b) Any person managing the whole or substantially the whole of the affairs in India of any other company, at or connection with the termination of his office or the modification of the terms & conditions relating thereto.
- (c) Any person holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto.
- (d) Any person; for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property.

(3) Income of a trade or professional association -  
[Sec. 28(iii)]

Income derived by a trade, professional or similar association from specific service performed for its members, only is considered to be business income and taxed accordingly. Sec. 28(iii) further says that income arising from specific services by the association to its members is taxed only and income not arising from specific purpose is outside the purview of this clause e.g. entrance fees, members periodical subscription etc. are not taxable.

(4) Speculation Business -

If an assessee carries on a speculative transaction of such a nature as to constitute a business, such business should be deemed distinct and separate from any other business. According to Section 43(5) 'Speculative transaction' means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares is periodically or ultimately settled, otherwise than by the actual delivery or transfer of commodity or scrips (shares). Hedging business is not considered as speculative business because such transactions are made to set off the effect of future price fluctuations. If the transaction is settled by difference is paid then it speculative transaction and if it is settled by actual

delivery of the product, it will not be speculative transaction. The net result of speculative business is calculated by setting off the loss of one speculative transaction against profits of another speculative transaction in the same previous year.

(5) Value of benefit of perquisite [Sec 28(iv)] -

The value of any benefit or perquisite, whether convertible in to money or not arising from business or the exercise of a profession, is chargeable under this head. As the benefit and perquisites received by an employee fall and are taxed under the head 'Salaries'. Similarly benefits and perquisites arising from business or exercise of profession are taxed under the head Profit & Gains of business or profession.

(6) Profit earned from an illegal business -

The income tax law does not make any difference whether it is legal or illegal business. If assessee earns any income from illegal business it is computed in the ordinary manner and chargeable tax along with income earned from legal business.

Computation of Income :

While computing income under the head "Profits and Gains of Business or Profession" the following principles must be kept in mind. Because, these principles were the basis of so many court decisions.

(1) Business or Profession carried on by the Assessee :

Under Sec. 28, it is the person, carrying on a business or profession is chargeable to tax. It is immaterial whether the assessee himself doing the business or through the manager, agent etc. The important point is that the business should have been carried on by the assessee at any time during previous year and Assessee should have right to carry on the business. In case a person is deprived of the right to carry on the business, the same person cannot be chargeable to tax under this head since he cannot be regarded as 'carrying on' the business. Guardians for minors or receivers or trustees may be assessed under this section in respect of profit of the business carried on by them.

(2) Business or Profession should be carried on during the previous year -

Income from business or profession is chargeable to tax under this head only, if the business or profession is carried on by the assessee at any time during the previous

year. It is not essential that the business or profession should be carried on throughout the previous year or up to the end of the previous year.

- (3) Income of previous year is taxable during the following Assessment Year -

Income of business or profession carried on by the assessee during the previous year is chargeable to tax in the next following Assessment Year.

- (4) Tax incidence arises in respect of all business or profession -

Profits and gains of different businesses and professions carried on by the assessee are not chargeable to tax separately. The net result of each business or profession separately calculated and loss of one business is set off against the profit of another business while aggregation of total income under this head.

- (5) Speculation Business -

The speculation business of the assessee is kept separate. If there is profit - it will be taxed alongwith other business income. But if there is speculation loss - it can be set off against profits of speculation business only and not against profits of any other business.

- (6) Profit on sale of assets on the winding up of a business -

The profit arising from some of the assets after winding up a business is not taxable but the profit on the sale of stock in trade is taxable. If the entire business sold in one lot for a single unapportioned consideration and the assets include stock in trade, the profit in the sale of stock in trade is not separable. In such a case the entire profit on sale of the business will not be taxable under this head.

- (7) Legal ownership and Beneficial ownership -

Under Section 28, it is not only legal ownership is considered but also the beneficial ownership is also considered. The income is taxable in the hands of a person to whom it is actually accrues.

- (8) Tax is levied only on the real profits of previous year and not on anticipated profits -

Anticipated profits or potential profits or losses which may occur in future, are not considered for arriving at taxable income of previous year. This rule however, not applicable in respect of stock in trade. It may be valued on basis of cost or market value whichever is less.

### 3.3 Deductions :

Section 29 of Income-Tax Act provide deductions and allowances laid down by Sections 30 to 37 while computing profits and or gains of a business or profession. There are numerous types of expenses varying from business to business and according to the nature of business unit. Under these section an effort is made to enlist every type of expense. However, it is not the final list. Any other expenditure which is not covered under Section 30 to 37 can be allowed as deduction provided it is (a) incidental to business or profession, (b) not a capital expenditure, (c) not a personal expenditure, (d) there is no express or implied prohibition under the Act against its deduction while computing taxable income.

Basic Principles Governing Admissibility of deduction under Sections 30 to 44 D :

- ( 1) Any expenditure incurred in consideration of commercial expediency and on the basis of the principles of ordinary commercial trading is allowed as deduction.
- ( 2) Commercial expediency simply means the expenditure made by prudent man for the purpose of his business, in the best interest of his business or any other expenditure incurred totally, and exclusively for the purpose of the business.

- ( 3) Any other expenditure which was incurred in the carrying of the business or profession and is incidental to such business or profession.
- ( 4) Only those expenses are allowed which are not prohibited express or implied.
- ( 5) In the case of a new business, accounting year commences on the date when the business is set up. Expenditure incurred prior to setting up cannot be allowed as it falls outside the accounting year. So deductions are made regarding those expenses only which are incurred in the relevant accounting year. Each accounting year is separate and distinct one.
- ( 6) Deductions are to be made from the business for which the expenses were made. In case of more than one business, the expenses of one cannot be charged from the other in any case.
- ( 7) The expenditure of a business which was discontinued before the commencement of the accounting year cannot be charged from the existing business. A general rule in such cases is that the expenses of a dead business become capital loss.
- ( 8) In case of a single transaction all the expenses are allowed whether incurred in that accounting year or earlier to that.

- ( 9) A partner is allowed a deduction from his share of income from the firms profits such expenses which he might have incurred in earning this partnership. profit.
- (10) Only expenses are allowed to be deducted while the loss of any type is not allowed without considering its nature.
- (11) Capital expenditure is not allowed.
- (12) Expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time but putting aside of money which may become expenditure. on the happening of an event is not expenditure.
- (13) Deduction will be allowed in case of only those expenses which have been incurred for the purposes of the assessee's own business.
- (14) Any amount previously allowed as deduction, if the same is recovered, it will be taxable in the year in which it is so recovered.
- (15) The onus of proof that a particular expenditure is permissible as a deduction falls upon the assessee.

3.4 Deductions Chart

Items of Deductions

Sections

Amount of Deductions

Sec. 30

(1) Rent, Rates, Taxes, Repairs & Insurance in the case of Building premises where assessee is carrying his business or profession  
 a) Rent

\* Full amount of Rent is admissible in case the building premises is taken on Rent. If building premises belongs to one of the partners Rent paid to partner is admissible for deduction and in case the assessee owns business premises, no deduction is allowed.

b) Repairs

\* If the assessee is tenant and the agreement of Rent provides the tenant will bear the cost of repairs then such amount is admissible and the assessee is owner of the premises, the amount spent by him for repairs is also allowable as deduction.

c) Local Taxes

\* In case the assessee is owner of building and he paid land revenue, local rates and municipal taxes, in respect of premises are allowed and in case if the assessee is tenant and according to contract of rent he is supposed to pay these expenses, are also allowed.

d) Insurance Premium

\* Any amount of insurance premium paid against the risk of damage or destruction on premises is allowable.

(2) Repairs and Insurance of machinery plant and furniture

Sec. 31

\* The amount paid on account of current repairs and the amount of premium paid in respect of insurance against the risk of damage or destruction in respect of machinery, plant, furniture used for the purposes of business or profession is available for deduction. Only these should not be a capital nature.

(3) Depreciation

Sec. 32

Deduction of depreciation is allowed at the prescribed out of the profits of previous year. It was allowed on actual cost basis in case of ships and on written down value basis in case of other Assets. Block of Assets have been divided in to four groups.

Group I - Buildings % of Depreciation allowed

- a) Ordinary residential Buildings 5 %
- b) Factory Buildings 10 %
- c) Hotel Buildings or small residential houses 20 %
- d) Temporary Structure 100 %

Group II - Furniture

- a) General Rate 10 %
- bb) Furniture of hotel, school, libraries etc. 15 %

Group - III Plant & Machinery

- a) General Rate, including cars & scooters 33.33 %
- b) Lorries, Buses, Taxes etc. and water, air, pollution control equipment 50 %
- c) Energy saving devices or solar energy equipment etc. 100 %



<u>Item of Deduction</u>	<u>Section</u>	<u>Amount of Deduction</u>
(7) Expenditure incurred in the field of scientific Research	Sec. 35	<p>Under Section 35 Revenue expenditure and capital expenditure in respect of Scientific Research are allowed as deductions while computing income of business or profession.</p> <p>a) Revenue Expenditure - [35(1)] Any expenditure of revenue nature incurred on Scientific Research related to the business of assessee. Any salary paid to personnel in Scientific Research and on purchase of materials used in such scientific research during the period of 3 years immediately preceding the commencement of business will be deemed to have been expended in the previous year in which business is commenced. This expenditure must be incurred by assessee himself.</p> <p>ii) Any sum paid to an approved scientific research institution or to an approved University, College or to a public limited company institution to be used for scientific research related to assessee's business.</p> <p>iii) Any sum paid to a university, college, other institution to be used for research in social science or statistical research related to class of business, carried on by a university, college, institution which is for the time being approved for the purpose of this clause by the prescribed authority.</p> <p>b) Capital Expenditure</p> <p>i) Capital expenditure incurred before 1st April, 1967 : If any expenditure was made for scientific research before 1st April, 1967 such expenditure was divided in to five equal installments and first installment was charged to the year as its expenditure and the remaining in four installments to the succeeding previous years.</p> <p>ii) Capital expenditure incurred after 31st March, 1967 : If any expenditure incurred of capital nature on scientific research after 31st March, 1967 the whole of such expenditure shall be allowed as deduction in the same previous year.</p>
(8) Expenditure incurred on the acquisition of patents rights or copy rights.	Sec. 35 A	* The expenditure on acquisition of Patent and Copy Rights (after 28 Feb., 1966) is divided in to fourteen equal installments and every year one instalment is allowed as deduction beginning with the previous year in which such expenditure is incurred.
(9) Expenditure on know-how	Sec. 35 AB	* When technical know-how is acquired in any previous year the lump-sum consideration paid shall be allowed to be deducted in six equal instalments commencing from the previous year in which such consideration is paid.
(10) Contribution to an association carrying out any programme of rural development	Sec. 35 CCA	* Any expenditure incurred by any assessee during the previous year by way of payment of any amount to an association of institution, which is engaged in carrying out any programme of rural-development approved by prescribed authority or in training of persons for implementing programmes of rural development.

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|------|--|------------------------|---|
| (11) | Contribution to an association carrying out any programme of conservation of natural resources | Sec. 35 CCB            | * Where an assessee incurs any expenditure by way of payment to an association or institution which has its object of under-taking any programme of conservation of natural resources and such association or institution is carrying on such project on which amount so received is spent, a deduction equal to amount so paid shall be allowed. Only such institution to which such amount is paid must be approved for the time being by prescribed authority and such approval shall not be granted ordinarily for more than 3 years.   |
| (12) | A-rticulation of certain preliminary expenses  | Sec. 35 D              | * Amount of preliminary expenses is divided into ten instalments and the assessee shall be allowed a deduction of an amount equal to one instalment for each of the ten successive previous years beginning with previous year in which business commences or extension work is completed or new industrial unit commences production as the case may be. The maximum amount eligible for deduction as preliminary expenses shall not exceed 2.5 % of the cost of project or in case of company assessee at the option of the company, the amount of deduction will be the amount, equal to 2.5 % of capital employed in the business of the company. |
| (13) | Expenditure on prospecting etc. for certain minerals   | Sec. 35 E              | * An assessee who is resident in India is engaged in any operation relating to prospecting for, extraction or production of any mineral and incurs any expenditure after 31 March, 1970, the assessee shall in accordance with and subject to the provisions of this Section, be allowed for each of relevant previous years a deduction of an amount equal to one-tenth (1/10) of the amount of such expenditure.  |
| (14) | Insurance premium for stock, cattle, employees   | Sec. 36(i), (ia), (ib) | * The amount of any insurance premium paid against destruction of stock or stores used for the purpose of business or profession and any premium paid by a federal milk co-operative society to keep in force an insurance on the life of cattle owned by member of cooperative society being a primary society engaged in supplying milk raised by its members to federal milk co-operative society and any premium paid by assessee as an employer to keep in force an insurance on the health of his employees under the scheme framed in this behalf by GIC and Approved by Central Government is allowed as deduction.                           |
| (15) | Bonus or Commission  | Sec. 36(ii)            | Any amount paid to an employee in addition to salary as bonus or commission for services rendered is allowable.   |
| (16) | Salary paid to blind or handicapped persons  | Sec. 36(ia)            | A deduction of a sum equal to $1\frac{1}{2}$ times of the amount of expenditure incurred on payment of any salary to an employee, who is blind or handicapped at the end of previous year, is allowed.  |
| (17) | Interest on borrowed Capital   | Sec. 36(iii)           | Any interest paid on borrowed capital used for business/profession of the assessee is allowable.  |
| (18) | Contribution to provident and superannuation Fund  | Sec. 36(iv)(a)         | Any amount paid by an assessee as an employer by way of contribution towards a recognised provident fund, an approved superannuation fund, subject to limits prescribed is allowed as deduction.  |

SectionsItems of Deductions

- | <u>Items of Deductions</u>  | <u>Sections</u> | <u>Amount of Deduction</u>  |
|---|-----------------|---|
| (19) Employers contribution towards the employee's unrecognised provident fund.                             | Sec. 36(iv)(b)  | If employer contributes in the employees unrecognised provident fund is allowed.  |
| (20) Contribution to Gratuity Fund  | Sec. 36(v)      | Any amount paid by the assessee employer by way of contribution towards an approved gratuity fund created by him for exclusive benefit of employees under an irrevocable trust is allowed.  |
| (21) Loss of animals  | Sec. 36(vi)     | If the animals are used in the business or profession of the assessee otherwise than as Stock-in-trade and have died or became permanently useless for such purposes and any loss, suffered due to the death or becoming permanently useless for the Unit will be allowed.  |
| (22) Bad-debts  | Sec. 36(vii)    | Deduction is allowed in respect of bad debts of the business or profession which have actually become irrecoverable in the previous year.   |
| (23) Special Reserve created by financial corporations  | Sec. 36(viii)   | Financial corporation which is engaged in providing long term loans for industrial and agricultural development in India or by a public company formed and registered by India with object of providing Finance for construction of houses in India for residential purposes. The amount not exceeding 40 % of total income is allowed. and in case of other financial corporation 25 % of total income is allowed.   |
| (24) Any expenditure on family planning   | Sec. 36(ix)     | The company assessee are allowed a deduction in respect of the bonafide revenue expenditure incurred by them for the purposes of promoting family planning among its employees.   |
| (25) Entertainment Expenditure  | Sec. 37(2A)     | Expenditure incurred on entertaining the customers of the business or profession in India or outside India is allowable according following slab:<br>1) On first 10 lakhs profits (computed before allowing deduction under investment allowance, development rebate, development allowance, entertainment expenditure) @ 1/2 % of such profits or Rs.5,000/- whichever is higher.<br>2) On next Rs.40 lakhs of profits @ 1/4 %.<br>3) On rest of profits subject to a maximum of Rs.50,000/- in a previous year @ 1/8 %. |
| (26) Expenditure on Advertisement Residential Accommodation, including guest houses and travelling expenses | Sec. 37(3)      | Any expenditure incurred on Advertisement or on maintenance of any residential accommodation including any accommodation in the nature house or in connection with travelling by employee or any other person shall be allowed only to the extent and subject to such conditions if any prescribed from time to time by board of director taxes.  |

Items of Deductions

Sections

Amount of Deduction

- (27) Expenditure of Advertisement  
Sec. 37(3)  
\* Expenditure incurred on advertisement shall be allowable deduction but subject to the rules framed by the board in this connection. Allowable expenditure shall not exceed.  
a) in respect of articles intended for present Rs. 50 on each article.  
b) in respect of any advertisement outside India involving payment in foreign currency, only that amount shall be allowed.
- (28) Residential Accommodation provided to individual employee.  
Sec. 37  
\* If the assessee is other than company, a deduction allowed regarding the expenditure incurred on the maintenance of residential accommodation provided for the use of an individual employee with total emoluments not exceeding Rs.10,000/- will be limited to 20% of salary of each such employee.
- (29) Travelling expenses and employee and other persons  
Sec. 37  
\* Every Business undertaking is required to incur some expenditure on the travelling of its employees and other persons in connection with the business work in India or outside India.  
a) Travelling in India (deduction is limited to aggregate of following)  
i) in respect of travel by rail, road, waterway or air, the expenditure actually incurred.  
b) in respect of other expenditure including hotel expenses or allowances paid  
i) in respect of an employee whose salary is Rs.1,000/- p.m. or more, Rs.150/- per day or part thereof is allowable.  
ii) in respect of any other employee Rs.75/- per day or part is allowable.  
iii) where the stay of such employee is at Bombay, Madras, Calcutta, Delhi the deduction amounts will be Rs.200/- and Rs.100/- respectively regarding (i) and (ii) above items.
- (30) Legal expenses  
Sec. 37  
Legal expenses incurred in respect of business are allowable expenses.
- (31) Expenses incurred of raising loans.  
Sec. 37  
The expenses incurred in connection with the raising of loans, issuing of debentures etc. are allowable for deduction. These expenses include cost of stamps, registration fees, lawyers fees etc.



### 3.5 Eligibility :

#### (1) Rent, Rates, Taxes, Repairs & Insurance for Building Section 30 :

##### (a) Rent :

Rent paid for business premises is allowable deduction.

Eligibility - To allow this deduction, the assessee must satisfy following conditions:

- ( i) If the assessee as tenant occupied premises and used for business or profession. Rent paid to landlord is allowable deduction.
- (ii) If the assessee has partnership business. And business premises belongs to one of its partners the rent paid to the landlord partner is allowed. But if assessee is owner of business premises the assessee cannot be claim deduction because the landlord cannot be tenant also.

##### (b) Repairs :

Expenses incurred to keep building in the workable condition i.e. repairs is admissible expenses. This deduction is allowed in case the

assessee is tenant and in case he is other than tenant also. But only the restriction is that by making repairs value or efficiency of asset must not be increased.

(c) Local Taxes :

Even if the assessee is tenant or owner of premises any sum paid by him in respect of land revenue or municipal taxes, is allowed for deduction. But only thing is that if the assessee is tenant and under contract of rent he is paying rent, then the, that amount is allowable.

(d) Insurance :

Any sum paid by assessee in respect of insurance against risk of damage of premises which is used for business or profession is allowed as expenditure. If the assessee used part of premises for his residential purposes or he had sub-let the premises, the deduction will be limited to that part of the building which is used for the business purposes.

(2) Repairs and Insurance of machinery, Plant and Furniture :

The amount of current repairs, in respect of machinery, plant, furniture and insurance premium paid against the risk of damage of above assets is allowable for deduction on following condition :

- (1) These assets must be used for business purposes.
- (2) These expenses should not be of capital nature.

(3) Investment Allowance Sec. 32(A) :

This new incentive of investment allowance is broadly designed on the lines of the scheme of development rebate. According to Section 32 A(2) the deduction will be allowed in case of the following:

Eligibility -

- (A) A new ship or new air-craft acquired after 31-3-1976 by an assessee engaged in the business of operation of ships or aircraft.
- (B) Any new machinery or plant installed after 31-3-1976 -
  - ( i ) For the purpose of business of generation or distribution of electricity or any other form of power

- (ii) in a small scale industrial undertaking for the purposes of business of manufacture or production, any other articles or things.
- (iii) For the purposes of business construction, manufacture or production of any article or thing not mentioned in the Eleventh Schedule.

The above mentioned provision in (a) and (b) shall not be applicable in relation to

- ( i) a new ship or new aircraft acquired or
- (ii) any new machinery installed after 31-3-1987 but before 1-4-1988.

- (C) Any new machinery or plant installed after the 31st March, 1983 but before 1st April, 1988 for the purposes of business of repairs to ocean-going vessels or other powered craft if the business is carried on by an Indian Company and the business so carried on, is approved for the purposes of this clause by Central Government. This amendment has come in to effect from assessment year 1984-85.
- (D) Air-conditioners installed in factory premises regarding this investment allowance is allowed because it integral part of plant and machinery of factory.

(E) In case of second hand machinery -

Second hand ship, Aircraft, plant and machinery (reconditioned) is also eligible for claim of investment allowance provided following conditions are fulfilled -

(a) Ship or aircraft was not owned by any person resident in India prior to its acquisition.

(b) Plant and Machinery (reconditioned)

( i) was not used in India prior to its installation by the assessee.

( ii) has been imported from out-side India.

(iii) no depreciation had been claimed or is allowable in respect of any period prior to such installation.

Conditions for grant of Investment Allowance

Sec. 32 A(4)

- (1) All particulars prescribed in this behalf have been furnished by the assessee
- (2) 75 % of the investment allowance to be actually allowed to be debited to the profit and loss account of the relevant previous year and credited to investment Allowance Reserve Account. In case

of ship, reserve required to be created shall be 50 % of amount admissible as investment allowance.

- (3) Investment allowance Reserve shall be utilised for the purposes of acquiring a new ship or a new aircraft or a new machinery, or plant before the expiry of a period of 10 years next following the previous year in which investment allowance is admissible.
- (4) Untill the reserve is utilised for further acquisition of new assets, such a reserve shall be eligible to be utilised for the purposes of of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or creation of any asset outside India.
- (5) Under Section 32 A(5), investment allowance allowed earlier shall be deemed to have been wrongly made if, -
  - a) ship, aircraft, machinery or plant is sold or transferred by the assessee to any person before the expiry of 8 years from the year of its acquisition or installation.

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- b) Investment Allowance Reserve is not utilised as provided under points 3 & 4 above.

Above provision is not apply if the above mentioned assets are sold or transferred to Government, a local authority, a corporation or where the sale or transfer is made in connection with the amalgamation or succession.

- (6) In case of amalgamation, the amalgamated company shall step in to the shoes of amalgamating company and shall fulfill the conditions regarding reserve and the amalgamated company shall also enjoy the right to adjust unabsorbed investment allowance of amalgamating company.
- (7) The above mentioned conditions (condition No.6) shall also apply where a firm is succeeded to by a company.

The provision of this sub-section shall apply only where -

- i) whole of the property of the firm relating to the business immediately before the succession becomes the property of the company.

ii) All the liabilities of the firm relating to the business immediately before the succession become the liabilities of the Company.

iii) All the shareholders of the Company were partners of the firm immediately before the succession.

(4) Investment deposit Account Sec. 32 A B

This deduction is allowed from Assessment Year 1988-89 by replacing old scheme of investment allowance. The assessee whose income includes income chargeable to tax under the head profits and gains of business and profession can claim deduction as per prescribed rates on the condition that the business or profession must be eligible under Sec. 32 AB(2). As per this Section any business or profession shall be eligible, excluding -

- a) the business of construction
- b) the business in which manufacture or production of any article or thing specified in Eleventh Schedule is carried on and it is not a small scale industry as per Sec. 32 AB(2).

- c) The business of leasing or hiring of machinery or plant to an industrial undertaking other than a small scale industry, or construction, or manufacture or production of article or thing mentioned in 11th Schedule.

No deduction is allowed u/s 32 AB in following cases -

- i) If any amount is utilised for purchase of plant and machinery installed in office premises, residential houses, or a guest house.
- ii) Any office appliance is purchased (except computers).
- iii) Any road transport vehicles are purchased.
- iv) Any amount utilised for the purchase of any machinery, plant, the whole of the actual cost has been allowed to be debited to Profit and Loss Account.

(5) Depreciation Section 32

The assessee can claim deduction for depreciation out of profits and gains of business or profession carried on by him during relevant previous year or from income from other sources in case of assets let out for a certain period of time and letting is not the regular business of assessee at a prescribed rates by

fulfilling following conditions, laid down in law or Income Tax Rules 1962 or as per case decisions.

- 1) Depreciation is allowed only on capital assets namely buildings, machinery, plant, furniture.
- 2) On Block of Assets prescribed percentage of depreciation is allowed from assessment year 1988-89.
- 3) Assets must be owned by the assessee.
- 4) Assets must actually used for the business in the previous year.
- 5) The deduction of depreciation will not be allowed if the assets are sold during the year.
- 6) Full particulars of the asset on which depreciation is to be charged, must be furnished to the Assessing Officer.
- 7) Depreciation is allowed either on the basis of actual cost or written down value of asset.
- 8) Plant & Machinery costing not more than Rs.5,000/- shall be allowed as deduction.
- 9) The manufacturing company can claim depreciation on cost of technical know-how. Because it is considered 'plant' within the meaning of Sec.32.

- 10) No depreciation is allowed on the cars manufactured outside India imported in India after 28-2-1975, Depreciation is allowed in prescribed rates if that car is used for hire to tourists.
- 11) Depreciation of Books : The term 'plant' as defined under Sec.43(3) includes Books and general rate of depreciation is 33.33 % and if the cost of Book is below Rs.5,000/- then whole cost is allowed as depreciation.

(6) Expenditure incurred in the Field of Scientific  
+Research Section 35

Expenditure of revenue nature made on scientific research activities is allowable on following conditions,

- a) This expenditure must be made by assessee himself.
- b) Any sum paid to approved association, college, university, company to be used for scientific research related to assessee's business.
- c) Any sum paid to University, college, company or institution which carried the research work that institution must be for the time being approved by the prescribed authority.

(7) Expenditure incurred on the acquisition of Patent Rights and Copy Rights (Sec 35 A)

Deduction available if assessee spent any expenditure on acquiring the above item on following conditions -

- i) Whole expenditure is divided into fourteen equal installments and every year one installment is allowed as deduction begins with the previous year in which such expenditure is incurred.
- ii) If expenditure is incurred before the commencement of the business, the fourteen previous years are counted beginning with the previous year in which the business commences.
- iii) When the period of 14 years have elapsed since the acquisition of the right, the full capital expenditure shall be allowed in one installment only in the year in which expenditure is incurred.

(8) Expenditure on Know-how (Sec. 35 AB)

Expenditure on know-how is allowed as below -

- 1) If the technical know-how acquired by assessee was developed in Indian laboratory, university, college

or any institution referred in Sec. 32 A, the expenditure made shall be written off in three equal instalments.

- 2) If any expenditure made to acquire technical know-how which is not as stated above shall allowed for deduction in six equal instalments commencing from the previous year in which such expenditure is made.

(9) Rural Development Allowance ( Sec. 35 CC)

The assessee can claim deduction for above item if he made any expenditure on rural development on following conditions -

- 1) The assessee must be company or co-operative society.
- 2) The expenditure must be made after 30th June, 1977 on rural development programme.

(10) Contribution to an association carrying out any programme of rural development (Sec 35 CC A)

If assessee contributes any amount to an association which is carrying rural development programme is available for deduction on following conditions.

- i) The assessee had obtained the approval of the prescribed authority in respect of such programme before 1 March, 1983.
- ii) Such programme involves work by way of construction of any building or other structure whether use as dispensary, school, training or welfare centre, workshop, or any other purpose or the laying of any road or the construction or boring of a well or tube-well or the installation of any plant and machinery and such work has commenced before the 1st March, 1983.
- iii) The expenditure on such programme is incurred in a case where the approval of the prescribed authority in respect of such programme has been granted for a specified period before the expiry of that period and any other case before 1st March, 1984.
- iv) The assessee furnishes, along with the return of income for the assessment year for which the deduction is claimed, a statement of such expenditure in the prescribed form duly signed and verified by chartered accountant and setting fourth such particulars as may be prescribed.



- (11) Contribution to an association carrying out any programme of conservation of natural resources (Sec. 35 CCB)

Deduction is available equal to amount paid by assessee if -

- 1) The association or institution to which such amount is paid must be approved for the time-being by the prescribed authority.
- 2) Such approval shall not be granted ordinarily for more than 3 years.

- (12) Amortisation of certain preliminary expenses (Sec. 35 D).

Expenditure incurred in this respect before the commencement of the business or after the commencement or in connection with the extension of its industrial undertaking or in connection with its setting up a new industrial unit will be available for deduction if the following conditions are satisfied.

- 1) It is allowed only in case of an Indian Company or a person other than company resident in India.
- 2) The expenditure must be incurred after 31st March, 1970.

- 3) Whole expenditure is divided in to Ten equal instalments and the assessee shall be allowed a deduction of an amount equal to one instalment for each of the ten successive previous years beginning with the previous year in which business commences or extension of work is completed or the new industrial unit commences production as the case may be.
- 4) The maximum amount eligible for deduction as preliminary expenses shall not exceed  $2\frac{1}{2}$  % of the 'cost of project' or in case of company assessee at the option of the Company, the amount of deduction will be the amount, equal to  $2\frac{1}{2}$  % of 'Capital employed in the business of the Company'.

(13) Expenditure on prospecting etc. for certain minerals  
(Sec. 35 E)

This deduction is available on the following conditions

- i) Assessee must be an Indian resident and he must have been engaged in any operation relating to prospecting for, extraction or production of any mineral.
- ii) The expenditure must be made after 31st March, 1970 is allowed but it does not include -

expenses incurred on the acquisition of the site of mineral or group of associated minerals, and expenses incurred on the acquisition of the deposits of the minerals and expenses of capital nature incurred in respect of any building, machinery, plant or furniture.

iii) Deduction is allowed for each of the relevant previous years of an amount equal to one-tenth of the amount of such expenditure. If the profits of assessee are insufficient to absorb the full amount of the instalment, the amount of the instalment up to available profits will be allowed and the balance will be carried forward and added in next previous years instalment and so on for succeeding previous year, but no part of any instalment can be carried forward beyond the tenth previous year.

(14) Insurance premium

Premium paid is allowed on condition that Insurance must be against risk of damage or destruction of stocks and stores.

(15) Insurance premium for cattle

Any insurance premium paid by a federal milk cooperative society on the life of cattle owned by a

member of a co-operative society, which is primary society engaged in supplying milk raised by its members to federal milk co-operative society is allowed.

(16) Insurance premium for employees

Under any Scheme of GIC which is approved by Central Government premium by employer paid to keep in force an insurance on the health of his employees is allowed.

(17) Bonus or Commission

If employer paid any commission or bonus to employee's that is allowed on following conditions that, it should be reasonable with reference to

- a) the pay of the employee and conditions of his service.
- b) the profit of the business or profession for the previous year in question.
- c) the general practice or local practice in similar business or profession.
- d) the assessee should not pay the bonus or commission with a view to reduce the taxable profits.

(18) Salary paid to Blind and Handicapped persons

This deduction is available if -

- i) Employee is totally blind or
- ii) Employee is subject to or suffers from a permanent physical disability (other than blindness) which has the effect of reducing substantially his capacity to engage in gainful employment or occupation.
- iii) Employer has to produce before Assessing Officer at the end of first previous year in respect of each such employee, a medical certificate from registered medical practitioner regarding blindness or physical disability of such employee.

(19) Interest on Borrowed Capital

This is allowed when -

- i) The borrowed capital is used in the business or profession by the assessee.
- ii) Assessee must pay interest Actually.

(20) Employer's contribution towards the employee's unrecognised provident fund.

This is allowed as deduction provided -

- i) The fund has been constituted on the basis of irrevocable trust.

- ii) Employer may not be able to withdraw his contribution out of the fund.
- iii) The fund deed has a provision to deduct tax at source whenever any amount is withdrawn out of this fund.

(21) Contribution to Gratuity Fund :

Contribution made by Assessee towards this fund is allowed if he satisfied following conditions -

- 1) Assessee employer must make contribution towards an approved gratuity fund.
- 2) This fund must be used for exclusive benefit of employees under an irrevocable trust.

(22) Employees contribution to funds :

Any amount received by employer from his employees as their contribution to any provident fund, superannuation fund or any fund set up under E.S.I. Act 1948 or any other fund, is available for deduction if such amount is credited to the employee's Account in relevant fund on or before due date.

(23) Loss of animals :

This is allowed if -

- i) The animals are used in the business or profession.
- ii) Animals are died or become permanently useless for such purposes and any loss suffered due to the death or becoming permanently useless for the unit.

(24) Bad-debts :

This deduction is allowed in respect of the debt of the debt of the business or profession which have actually become irrecoverable in the previous year. To allow allowance regarding bad debts following conditions which are laid down under Act u/s 36(2) must be fulfilled.

- a) The debt or loan should be in respect of business or profession of the assessee and relates to the relevant accounting year
- b) The deduction shall be allowed in respect of only those debts which have been taken in to account in computing the income of the assessee of the previous year or of an earlier previous year ~~of~~ should represent money lent in the ordinary course of business of banking or money lending.

- c) The debt or loan or part thereof, a deduction about which is claimed as bad debts, must have become actually bad in the accounting year.
- d) The deduction will be allowed in respect of only those bad debts which have been written-off in the books of accounts of the assessee in the previous year in which the deduction is so claimed.

(25) Special Reserve Created by a financial corporation :

This deduction is allowed on the following conditions -

- i) The financial corporations of public company it must be engaged in providing long term finances for industrial and agricultural development in India.
- ii) Above mentioned purpose must be approved by Central Government.

3.6 Chart showing Computation of Profits and Gains of Business or Profession

COMPUTATION OF BUSINESS PROFITS

<u>Balance</u> as per Profit & Loss A/c - Profit(+)	Amount
Loss (-)	Rs.
(I) Add : Expenses claimed but not allowed under the Act.	
(i) All provisions & reserves except creation of reserve by financial corporations U/s 36.	-
(ii) All taxes except sale-tax, excise duty and local taxes of premises used for business.	-
(iii) Rent paid to self	-
(iv) All capital expenses	-
(v) All capital losses	-
(vi) All charities and donations	-
(vii) All expenses related to other heads of income	-
(viii) Cultivation expenses	-
(ix) Any interest on capital unless the amount is borrowed	-
(x) All personal expenses	-
(xi) Any depreciation which is in excess of permitted limits	-
(xii) Gifts and presents	-
(xiii) Any type of fine or penalty	-
(xiv) Any payment to partner (in case of firm)	-
(xv) Any salary or interest payable outside India unless is paid according to the law	-

(xvi)	Past losses	-	
(xvii)	Any expenditure which is not incurred according to the provision of law	-	
(xviii)	Salary paid to self or any other member of family for casual help	-	<u>(+)</u>
	Total of these items is added in the profit or is adjusted out of the loss.		(A)
(II)	Deduct out of (A) any expenditure which is allowable under the act, but has not been debited to Profit & Loss A/c.	-	
(i)	Actual Bad-debts	-	
(ii)	Depreciation	-	
(iii)	Any other expenditure incurred according to provisions of law	-	<u>(-)</u>
			(B)
(III)	Deduct out of amount arrived at (B) any income which is either exempt or not taxable under this head		
(a)	Income exempted from tax		
(i)	Post office savings bank interest		
(ii)	Agricultural receipts		
(iii)	Gifts from relatives		
(iv)	Income tax refund		
(v)	Bad-debts received (disallowed earlier)		

- (b) Income taxable under other heads
  - (i) Part-time salary
  - (ii) Interest on securities
  - (iii) Rent from house property
  - (iv) Capital receipts
  - (v) Dividend, Bank interest, winning from lotteries, race etc.

Total of these is deducted from (B) above and we get taxable profit from the business

Add :

Income from any other business (legal or illegal) to get income taxable under the head Profits & Gains of Business or Profession.

## COMPUTATION OF PROFESSIONAL INCOME

Professionals usually prepares Income and Expenditure Account of Receipts and Payments Account. They will not prepare Profit & Loss Account.

The following charts can help a person to compute the Professional income of certain professionals.

(1) Chart showing computation of Income of Medical Practitioner or Doctor.

Professional Receipts :

1) Consultation Fees	-
2) Operation Fees	-
3) Visiting Fees	-
4) Sale of Medicines	-
5) Gift from patients	-
6) Value of any perquisite received	-
7) Examiners fees	-
8) Any other professional receipt	-
Total Receipts	- <hr style="width: 100px; margin-left: auto; margin-right: 0;"/>

Less : Professional Expenses

1) Dispensary expenses	-
2) Cost of Medicines	-
3) Depreciation on Surgical instruments and X-ray Machines etc.	-
4) Cost of equipment (below Rs.5000/-)	-
5) Motor car expenses, depreciation relating to professional work	-

- |  |   |
|--|---|
| 6) Expenditure incurred to increase professional knowledge | - |
| 7) Any other expenditure incurred during the year          | - |

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Professional  
Income

(2) Professional Income of Chartered Accountant

Professional Receipts

- |                                 |   |
|---------------------------------|---|
| 1) Audit Fees                   | - |
| 2) Income from Accountancy work | - |
| 3) Institute Fees               | - |
| 4) Examiner's Fees              | - |
| 5) Gifts from clients           | - |
| 6) Consultancy services         | - |
| 7) Other receipts               | - |

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Less : Professional expenditure

- |   |   |
|---|---|
| 1) Office expenses  | - |
| 2) Institute Expenses   | - |
| 3) Cost of books  | - |
| 4) Motor car expenses relating to professional work                                     | - |
| 5) Membership fees  | - |
| 6) Depreciation on office equipment, car etc.<br>(if full cost is less than Rs.5,000/-) | - |

- |  |   |
|--|---|
| 7) Any other expenditure incurred to increase professional knowledge | - |
| 8) Stipend to trainees   | - |
| 9) Subscriptions   | - |

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Professional Income

(3) Income of Lawyer or Advocate

Professional Receipts

- |                          |   |
|--------------------------|---|
| 1) Practicing Fees       | - |
| 2) Special Commission    | - |
| 3) Presents from clients | - |
| 4) Examiners Fees        | - |

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Less : Professional expenditure

- |   |   |
|---|---|
| 1) Office expenses  | - |
| 2) Salary of staff, if any  | - |
| 3) Cost of books & equipments<br>(if its cost is less than 5,000/-) | - |
| 4) Depreciation<br>(if its cost is less than 5,000/-)               | - |
| 5) Expenses incurred to increase professional knowledge             | - |
| 6) Subscription   | - |
| 7) Purchase of stamp-paper or court fee                             | - |
| 8) Travelling expenses  | - |

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Professional Income