CHAPTER 1. INTRODUCTION & CHARGEABILITY

THE INCOME TAX ACT 1961

INTRODUCTION

1. As per Article 265 of the constitution, no law can be made to impose duties & taxes unless the constitution gives the power.

2. In the VII Schedule to the constitution, it is segregated into the following 3 lists:
   a. **UNION LIST:**
      This covers revenue as well as non-revenue matters from Entry 1 to Entry 96 as specific entries and Entry 97 to impose taxes & duties on those matters which are not enumerated in the above 96 entries. The right to make the Income Tax Act comes from Entry 82 which states that IT can be imposed by Central Government on any income except agricultural income. The above entries include both revenue as well as non-revenue matters. As far as the IT is considered, it is a revenue matter and therefore it should first be laid down in the lower house, i.e., Lok Sabha & then the Upper House, i.e., Rajya Sabha.

   b. **STATE LIST:**
      This covers the matters related to State Government i.e Stamp Duty etc. The state list does not have any residuary entry, therefore, any new taxes or duties which has to be imposed must be imposed through Entry 97 given in Union list Eg: STT, CTT, Health & Education Cess, etc. Further these will be imposed through a relevant Finance Act.

   c. **CONCURRENT LIST:**
      This covers matters related to both Governments, Eg: Octroi duty (Now after GST not relevant), a revenue matter & education a non-revenue matter.

3. Once the power has been established through the constitution, the Act can be made by the government through Parliamentary process. An Act always comes below the Constitution & it is divided into Chapter numbers (23 CHAPTERS) and sections (298).

4. The rules made by the Central Government will follow the Act and therefore the Rules can never override the Act but should be consistent with it. The power to make rules under IT Act is given in Section 295.

THE INCOME TAX ACT 1961

(1) The first section of every Act is Short Title, Extent & Applicability & Commencement. The Income Tax is effective from 1st April 1962.

As per Section 1, this Act is applicable to whole of India including the state of J & K. As per Sec 2(25A), India include landmass. Further, it also includes territorial waters of India up to 12 Nautical Miles (12NM). Further it also includes air space above its landmass & territorial waters. Further, it also extends to the EEZ of India up to 200NM. The Central Government notifies the activities to be conducted in EEZ.
The charging Sec of Income Tax law is given under Sec 4 which reads as follows:

“Total Income of a Person for a P.Y. is charged or assessed to tax in the next following A.Y.”

The event of computation is always done in A.Y. by the assessee himself known as “Self-Assessment”.

Income Tax = Total Income (x) Tax Rates.

For tax rates we have two sources:

- Relevant Finance Act. {Person Based Rates}
- Income Tax Act itself. {For certain Special Incomes u/s 110 to 115BBG}

The Income Tax Act is generally made with reference to A.Y. The relevant Finance Act for P.Y 2020-2021 will be Finance Act 2020 i.e. which was passed last year if an assessee stands in A.Y and see back. Therefore, the assessee has to stand in A.Y. and see which Finance Bill was passed last year. Therefore, most of the amendments are made with reference to A.Y.

Therefore, in FA 2020 if an amendment states that it is applicable with the effect from 01.04.21 it means that it is applicable from A.Y. 21 – 22 i.e. P.Y. 20 – 21. Further, if some amendments in FA 2020 states that it is applicable retrospectively w.e.f 01.04.12 then it means it is applicable from A.Y 12 – 13 i.e. P.Y. 11 – 12.

WHAT IS THE DEFINITION OF THE TERM TOTAL INCOME?

The term “TOTAL INCOME” is defined u/s 2(45) which means Income referred in section 5 & computed in the manner laid down in this Act.

SECTION 5: - SCOPE OF TOTAL INCOME

For Resident & Ordinary Resident world income is taxable whereas for Non-Residents only those incomes are taxable in India which are accrued or deemed to accrue or arise in India or which are received in India.

Once this is established, that total income comes within the purview of Sec 5 then, it has to be computed in the manner laid down in this Act.

SEC 14: DIVIDES THE INCOME INTO 5 HEADS AS FOLLOWS:

- Income from Salary (Sec 15 to Sec 17)
- Income from House property (Sec 22 to 27)
- Income from B & P (Sec 28 to 44DB)
- Capital Gains (Sec 45 to 55A)
- Income from Other Sources (Sec 56 to 59)
- Clubbing Provisions (Sec 60 to 65)
- Set off & Carry forward (Sec 70 to 80)
• Deductions under Chapter VIA (80C to 80U)

(11) WHAT DO YOU MEAN BY THE TERM ‘INCOME’?

The term income in general terminology means something which is a real income, which is regular in nature and it is derived from a definite source. This theory is called as ‘Real Income Theory’ which was the base to draft Income Tax Act, 1961:

• Salary is an income because it is derived from a source i.e. Employment.
• Rental is an income because it is derived from a source i.e. House property.
• Profits and Gains is an income because it is derived from a source i.e. Business or Profession.
• Interest, Dividend & CG is an income because it is derived from a source i.e. Investment.

Therefore, we can conclude lottery winnings, crosswords, puzzles, gifts, non-compete fees, etc. are not income in the real sense as they are not regular in nature and therefore to expand the base of Income Tax, the Central Government slowly & gradually started amending the definition of Income given u/s 2(24) to incorporate Capital Receipts or Artificial Incomes instead of increasing the rates of Income Tax.

“Today the definition of Income has in all 31 clauses”.

CLASSIFICATION OF INCOMES: -

Classifying the Income under the correct head is of utmost importance, because wrong classification would amount to wrong computation and would lead to further tax liabilities.

Following incomes will always be charged under their respective head as they have a SPECIFIC CHARGE under the ACT.

• Lottery, winnings, crosswords, puzzles, etc.
• Gifts.
• Dividends whether accrued to investor or dealer.
• Rent from House Property.

JUDICIAL PRONOUNCEMENTS

In CHENNAI PROPERTIES AND INVESTMENTS LTD. V. CIT (2015), the Supreme Court observed that holding of the properties and earning income by letting out of these properties is the main objective of the company. Further, in the return of income filed by the company and accepted by the Assessing Officer, the entire income of the company comprised of income from letting out of such properties. The Supreme Court, accordingly, held that such income was taxable as business income. Likewise, in Rayala Corporation (P) Ltd. v. Asst. CIT (2016) 386 ITR 500, the Supreme Court noted that the assessee was engaged only in the business of renting its properties and earning rental income therefrom and accordingly, held that such income was taxable as business income. In this case, however, on account of lack
of sufficient material to prove that substantial income of the assessee was from letting out of property, the Supreme Court held that the rental income has to be assessed as “Income from house property”.

**Following incomes are chargeable based on COMPARATIVE CHARGE:**
- Interest will be chargeable under IFOS if not classified under PGBP.
- If Jewellery is held as capital Asset and it is sold then it will be chargeable under the head capital Gains, whereas if a jewellery is sold by a jeweller, then it would be considered as Income from PGBP.

### SECTION 28: CHARGING SECTION

The following incomes shall be chargeable to tax under the head "Profits and gains of business or profession":

(i) The profit and gains of any business or profession, which was carried on by the assessee at any time during the previous year. *(Refer Compendium for detail analysis)*

(ii) Profits on sale of a license granted under Imports (Control) Order under a scheme of exports. *(To be done later)*

(iii) Cash assistance received or receivable against exports under any scheme of Government. *(To be done later)*

(iv) Any duty of customs or excise repaid or repayable as drawback against exports under scheme of Government. *(To be done later)*

(v) Any profit on the transfer of the Duty Entitlement Passbook Scheme, being the Duty Remission Scheme under the export and import policy. *(To be done later)*

(vi) The value of any benefit or perquisite, whether convertible into money or not, arising from any business or profession. *(To be done later)*

(vii) any sum, whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business or Profession. *(To be done later)*

### AMENDMENT MADE BY FINANCE ACT 2018

Any compensation due (or received) by any person (by whatever name called) at or in connection with the termination (or the modification of the terms and conditions) of any contract relating to his business, shall be chargeable to tax under the head "Profits and gains of business or profession".

### SECTION 29: HOW TO COMPUTE INCOME FROM PROFITS AND GAINS OF BUSINESS OR PROFESSION

The income under the head "Profits and gains of business or profession" shall be computed in accordance with the provisions contained in sections 30 to 43D.
CHAPTER 2. DEPRECIATION

SECTION 32(1)(ii): DEPRECIATION

- In respect of-
  (i) buildings, machinery, plant or furniture, being tangible assets;
  (ii) know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets

- owned wholly or partly by the assessee
- and used for the purposes of the business or profession
- depreciation shall be allowed
- on the written down value
- of the block of assets
- at the prescribed percentage.

WHAT DOES THE TERM OWNERSHIP MEANS FOR THE PURPOSE OF DEPRECIATION?

1. Beneficial Owner is Relevant Rather Than Legal Owner:
   Mysore Minerals Ltd (Supreme Court)
   In this case, the Supreme Court held that depreciation is allowable to the assessee on the buildings whose possession has been acquired by the assessee and which were used by him for the purposes of his business or profession, even though such buildings were not transferred in the name of the assessee. Registration of name under the Registration Act is not determinative of ownership. What has to be seen is the beneficial ownership. Therefore, if the assessee has taken the possession of a building in pursuance of an agreement to sell, then he is deemed as the owner of the building for claiming depreciation even if the building is not registered in his name.

MEANING OF USE:
WHAT DOES THE TERM ‘USE’ MEAN FOR THE PURPOSE OF DEPRECIATION?

The term ‘use’ means both active as well as passive use. (i.e. ready for use).

Use includes passive use in certain circumstances: One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. Courts have held that, in certain circumstances, an asset can be said to be in use even when it is “kept ready for use”.

For example, stand by equipment and fire extinguishers can be capitalized if they are ‘ready for use’. Likewise, machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, has to be capitalised. Hence, in
such cases, the term “use” embraces both active use and passive use. However, such passive use should also be for business purposes.

**CIT V. CHENNAI PETROLEUM CORPORATION LTD. (MADRAS)**

Can depreciation under section 32 be allowed on the plant and machinery which is ready for use but could not be put to use at any time during the previous year due to some extraneous reason, for example, paucity of raw material?

The assessee claimed depreciation on the gas sweetening plant, which was built during the relevant previous year and was not used in that year on account of non-availability of raw material i.e., sour gas.

**High Court's observations:**

The High Court held that so long as the business was a going one and the machinery got ready for use but could not be put to use due to certain extraneous circumstances, depreciation under section 32 would be allowable.

**High Court's decision:**

The High Court confirmed the majority decision of the Tribunal holding that, in this case, the machinery was entitled to depreciation since the business was a going concern and the machinery, being ready for use, could not be actually put to use due to an extraneous reason, namely, raw material paucity.

**Sec 2(11): BLOCK OF ASSETS:**

Block of Assets means a group of assets falling within a class of assets comprising:

(a) tangible assets, being buildings, machinery, plant or furniture;

(b) intangible assets, being know-how, patents, copy-rights, trade marks, licences, franchises or any other business or commercial rights of similar nature in respect of which the same percentage of depreciation is prescribed.

**KEY POINTS:**

1. Normal depreciation shall be allowed even if actual cost of the asset is less than Rs. 5,000.

2. "Know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto.)

Therefore, there will be separate blocks of assets for:

i) Buildings

ii) Plant and machinery

iii) Furniture

iv) Intangible assets

3. Temple inside factory will form part of the factory building and is eligible for depreciation. Management expenses of temple are deductible under section 37(1) as revenue expenditure.
4. It may be noted that revaluation of assets does not have any impact under the Income-
tax Act. What is relevant for the purposes of calculating depreciation under the Income-
tax Act is the actual cost. Revaluation of asset should be ignored.

5. It may be noted that depreciation on asset partially owned by the assessee shall be
allowed to him to the extent of his share in asset.

6. **CBDT Circular**
   Irrespective of accounting treatment prescribed by the Accounting Standard, the lessor
   shall be entitled to claim depreciation on leased assets whether the lease is an operating
   lease or a financial lease.

7. **Is the assessee entitled to depreciation on the value of goodwill considering it
   as an asset within the meaning of Explanation 3(b) to Section 32(1)?**

   **CIT V. SMIFS SECURITIES LTD. (2012) (SC)**

   **Facts of the case:** In this case, the assessee has paid an excess consideration over
   the value of net assets of the amalgamating company acquired by it, which is treated
   as goodwill, since the extra consideration was paid towards the reputation which the
   amalgamating company was enjoying in order to retain its existing clientele. The
   assessee had claimed depreciation on the said goodwill. However, the Assessing
   Officer contended that the goodwill is not an asset falling under Explanation 3 to
   section 32(1) and therefore, is not eligible for depreciation.

   **Supreme Court’s Observations:** On this issue, the Supreme Court observed that
   Explanation 3 to section 32(1) states that the expression 'asset' shall mean an
   intangible asset, being know-how, patents, copyrights, trademarks, licences,
   franchises or any other business or commercial rights of similar nature.

   **Supreme Court’s Decision:** A reading of the words 'any other business or
   commercial rights of similar nature' in Explanation 3(b) indicates that goodwill
   would fall under the said expression. In the process of amalgamation, the
   amalgamated company had acquired a capital right in the form of goodwill because
   of which the market worth of the amalgamated company stood increased.
   Therefore, it was held that 'Goodwill' is an asset under Explanation 3(b) to section
   32(1) and depreciation thereon is allowable under the said section.

8. **Can depreciation on leased vehicles be denied to the lessor on the ground that
   the vehicles are registered in the name of the lessee and that the lessor is not
   the actual user of the vehicles?**

   **I.C.D.S. Ltd. v. CIT (2013) (SC)**

   **Facts of the case:** The assessee is a non-banking finance company engaged, *inter
   alia*, in the business of leasing and hire purchase. The assessee purchased vehicles
directly from the manufacturers and as a part of its business, leased out these
vehicles to its customers, after which the physical possession of the vehicles was
with the lessee. Further, the lessees were registered as the owners of the vehicles in the certificate of registration issued under the Motor Vehicles Act, 1988. The assessee-lesser claimed depreciation on such vehicles.

The Assessing Officer disallowed the depreciation claim on the ground that the assessee’s use of these vehicles was only by way of leasing out the vehicles to others and not as actual user of the vehicles in the business of running them on hire and secondly, the vehicles were registered in the name of the lessee and not the assessee-lesser. Therefore, according to the Assessing Officer, the assessee had merely financed the purchase of these assets and was neither the owner nor the user of these assets.

**High Court's view:** The High Court was also of the view that the assessee could not be treated as the owner of the vehicles, since the vehicles were not registered in the name of the assessee and the assessee had only financed the transaction. Therefore, the High Court held that the assessee was not entitled to claim depreciation.

**Supreme Court’s Observations:** The Supreme Court observed that section 32 imposes a twin requirement of “ownership” and “usage for business” as conditions for claim of depreciation thereunder. The Apex Court further observed that as far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.

The Supreme Court further noted that section 2(30) of the Motor Vehicle Act, 1988, is a deeming provision which creates a legal fiction of ownership in favour of the lessee only for that Act, not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the legal title of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988. If the lessee was in fact the legal owner, he would have claimed depreciation on the vehicles which was not the case.

The Apex Court observed that as long as the assessee-lesser has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –

- The assessee is the exclusive owner of the vehicle at all points of time;
- The assessee is empowered to repossess the vehicle, in case the lessee committed a default;
- At the end of the lease period, the lessee was obliged to return the vehicle to the assessee;
- The assessee had a right of inspection of the vehicle at all times.

It can be seen that the proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee.

**Supreme Court’s Decision:** The Supreme Court, therefore, held that assessee was entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32, namely, ownership of the vehicles and its usage in the course of business.
9. **Extracts from “Income Computation and Disclosure Standard V relating to Tangible Fixed Assets”**

Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets. Details of such jointly owned tangible fixed assets shall be indicated separately in the tangible fixed assets register.

### RULE 5(1): RATES OF DEPRECIATION

#### PART A  TANGIBLE ASSETS

<table>
<thead>
<tr>
<th>I</th>
<th>Buildings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Block 1</td>
<td>Buildings which are used mainly for residential purposes except hotels and boarding houses 5%</td>
</tr>
<tr>
<td>Block 2</td>
<td>Buildings which are not used mainly for residential purposes and not covered by Block (1) above and (3) below 10%</td>
</tr>
<tr>
<td>Block 3</td>
<td>Buildings acquired on or after 1st September, 2002 for installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities 40%</td>
</tr>
<tr>
<td>Block 4</td>
<td>Purely temporary erections such as wooden structures 40%</td>
</tr>
</tbody>
</table>

#### II  Furniture and Fittings

| I       | Furniture and fittings including electrical fittings "Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc. 10% |

#### III  Plant & Machinery

<table>
<thead>
<tr>
<th>I</th>
<th>Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990 15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Block 2</td>
<td>Motor cars other than those used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.3.2020 and put to use on or before 31.3.2020 30%</td>
</tr>
<tr>
<td>Block 3</td>
<td>Motors buses, motor lorries, motor taxis used in the business of running them on hire 30%</td>
</tr>
<tr>
<td>Block 4</td>
<td>Moulds used in rubber and plastic goods factories 30%</td>
</tr>
<tr>
<td>Block 5</td>
<td>Specified air pollution control equipments, water pollution control equipments, solid waste control equipment and solidwaste recycling 40%</td>
</tr>
<tr>
<td>Block 6</td>
<td>Plant &amp; Machinery used in semi-conductor industry covering all Integrated Circuits (ICs) 30%</td>
</tr>
<tr>
<td>Block 7.</td>
<td>Life saving medical equipments</td>
</tr>
<tr>
<td>---------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td>Block 8.</td>
<td>Machinery and plant, acquired and installed on or after the 1st day of September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility</td>
</tr>
<tr>
<td>Block 9.</td>
<td>Oil wells</td>
</tr>
<tr>
<td>Block 10.</td>
<td>Renewable Energy Saving Devices (as specified)</td>
</tr>
<tr>
<td>(i)</td>
<td>Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014</td>
</tr>
<tr>
<td>(ii)</td>
<td>Any special devices including electric generators and pumps running on wind energy installed on or after 1.4.2014 would be eligible for depreciation</td>
</tr>
<tr>
<td>(iii)</td>
<td>Windmills and any specially designed devices running on windmills installed on or before 31.3.2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31.3.2014</td>
</tr>
<tr>
<td>Block 11.</td>
<td>Computers including computer software</td>
</tr>
<tr>
<td>Block 12.</td>
<td>Books (annual publications or other than annual publications) owned by assessees carrying on a profession</td>
</tr>
<tr>
<td>Block 13.</td>
<td>Books owned by assessees carrying on business in running lending libraries</td>
</tr>
<tr>
<td>Block 14.</td>
<td>Plant &amp; machinery (General rate)</td>
</tr>
<tr>
<td>IV</td>
<td>Ships</td>
</tr>
<tr>
<td>Block 1.</td>
<td>Ocean-going ships</td>
</tr>
<tr>
<td>Block 2.</td>
<td>Vessels ordinarily operating on inland waters not covered by Block 3 below</td>
</tr>
<tr>
<td>Block 3.</td>
<td>Speed boats operating on inland water</td>
</tr>
<tr>
<td><strong>PART B INTANGIBLE ASSETS</strong></td>
<td></td>
</tr>
<tr>
<td>Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature</td>
<td>25%</td>
</tr>
</tbody>
</table>

**SECTION 43(3): DEFINITION OF "PLANT"**

Section 43(3) defines "Plant" to include ships, vehicles, books, scientific apparatus, and surgical equipment used for the purposes of the business or profession but does not include tea bushes or livestock OR BUILDINGS OR FURNITURE AND FITTINGS. [The words in bold and capital letters have been added by Finance Act, 2003] Therefore, as per the amendment made by Finance Act, 2003 specially designed building such as hospital, cinema hall, theatre, shall not be treated as plant and machinery but shall be treated as buildings. Similarly, furniture and fittings specially designed for a hotel, cinema hall, hospital shall not be treated as plant and machinery but shall be treated as furniture and fittings.
EXPLANATION 1 TO SECTION 32(1): DEEMED BUILDING

Where the business or profession of the assessee is carried on in a building not owned by him but in respect of which he holds a lease or any other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or by way of renovation or extension or improvement to the building, then such capital expenditure will be treated as the building owned by the assessee.

Illustration:
Mr X is a tenant in a building in which he carries on his business. On 31.12.2018 he incurred an expenditure of Rs. 4 lakhs on constructing a room to be used as office. On 29.11.2020, he vacated the building and receives from landlord:

| Case I | Rs. 2,40,000 |
| Case II | Rs. 5,00,000 |
| Answer: Block of building (10%) | |
| Deemed Building as per Explanation 1 to Section 32(1) | Rs 4,00,000 |
| Less: Depreciation @ 5% for the Assessment Year 2019-2020 | Rs 20,000 |
| Opening WDV as on 01.04.2019 | Rs 3,80,000 |
| Less: Depreciation @ 10% for Assessment Year 2020-2021 | Rs 38,000 |
| Opening WDV as on 01.04.2020 | Rs 3,42,000 |

- WDV of the block shall be Nil since, the block ceases to exist on the transfer of the deemed building.
- Section 50 is attracted since block ceases to exist on the transfer of deemed building.

Assessment Year 2021-2022

Capital Gains - Case I

| Compensation from landlord | Rs. 2,40,000 |
| Less: Opening WDV as on 01.04.2020 | Rs 3,42,000 |
| Short Term Capital Gain/Loss | (-) Rs 1,02,000 |

Capital Gains - Case II

| Compensation from landlord | Rs. 5,00,000 |
| Less: Opening WDV as on 01.04.2020 | Rs 3,42,000 |
| Short Term Capital Gain | Rs. 1,58,000 |

EXPLANATION 5 TO SECTION 32(1): MANDATORY TO CLAIM DEPRECIATION

It is mandatory for the assessee to claim depreciation. Depreciation shall be allowed to the assessee whether or not the assessee has claimed deduction in respect of depreciation in computing his total income. Therefore, in computing the profits and gains of business or profession for any previous year, the deduction of depreciation under section 32 shall be mandatory.
NO DEPRECIATION WHERE ACTUAL COST ALLOWED AS DEDUCTION UNDER SECTION 42

No depreciation shall be allowed in respect of any plant or machinery if the actual cost thereof is allowed as deduction in one or more years under an agreement under section 42.

PROVISO TO SECTION 32(1): 50% DEPRECIATION WHEN ASSET IS PUT TO USE FOR LESS THAN 180 DAYS

Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days in that previous year, then the deduction of depreciation in respect of such asset shall be restricted to fifty percent of the depreciation allowable. This is applicable for depreciation under sections 32(1)(i), 32(1)(ii) and 32(1)(iia).

Illustration:
Asset is purchased on 10.02.2020 for Rs. 3,00,000. Depreciation is allowable @ 15%. Asset is installed and put to use on 25.12.2020.

Assessment Year 2020-2021
No depreciation shall be allowed since the asset is put to use on 25.12.2020.

Assessment Year 2021-2022
Restriction of 50% of depreciation applies only in the year in which the asset is purchased or acquired; therefore, normal depreciation @ 15% shall be allowed.
Hence, Depreciation on asset for Assessment Year 2021-2022 = 15% of Rs.3,00,000 = Rs. 45,000

WHEN DEPRECIATION CAN BE CLAIMED?

(1) The block of asset must be positive on the last day.  AND  (2) The Block must not cease to exist on last day.

Example:
a. Ideal Situation to claim depreciation

<table>
<thead>
<tr>
<th>Opening WDV</th>
<th>Qty</th>
<th>Nil</th>
<th>PY 2020 – 21</th>
</tr>
</thead>
<tbody>
<tr>
<td>(+) Purchase (01.04.20)</td>
<td>2</td>
<td>200,000</td>
<td>Furniture Rate = 10%</td>
</tr>
<tr>
<td>(-) Sold (NIL)</td>
<td>(-)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>WDV before depreciation</td>
<td>2</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>(-) Depreciation (20 – 21)</td>
<td>(20,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cl. WDV after depreciation</td>
<td>1,80,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Case I: No depreciation (2020 – 21)

<table>
<thead>
<tr>
<th>Opening WDV</th>
<th>Qty</th>
<th>Nil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase (+)</td>
<td>2</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Sold (-)</td>
<td>(1)</td>
<td>(3,00,000)</td>
</tr>
<tr>
<td>Cl. WDV before depreciation</td>
<td>1</td>
<td>(1,00,000)</td>
</tr>
</tbody>
</table>

- Cannot claim dep & Sec. 50, i.e. STCG will be applicable {Refer Book 2}

### Case II: No depreciation (2020 – 21)

<table>
<thead>
<tr>
<th>Opening WDV</th>
<th>Qty</th>
<th>Nil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase (+)</td>
<td>2</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Sold (-)</td>
<td>(2)</td>
<td>(1,00,000)</td>
</tr>
<tr>
<td>Cl. WDV before depreciation</td>
<td>0</td>
<td>100000</td>
</tr>
</tbody>
</table>

- Cannot claim depreciation & Sec. 50, i.e. STCG will be applicable {Refer Book 2}

**PROVISO TO SECTION 32(1): DEPRECIATION IN CASE OF SUCCESSION, AMALGAMATION AND DEMERGER**

The aggregate deduction, in respect of depreciation of:

(a) buildings, machinery, plant or furniture, being tangible assets or
(b) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets allowable to:

(i) the predecessor and the successor in case of succession referred to in section 47(xiii) or section 47(xiib) or section 47(xiv) or section 170, or
(ii) the amalgamating company and the amalgamated company in the case of amalgamation, or
(iii) the demerged company and the resulting company in case of demerger as the case may be,

shall not exceed in any previous year, the deduction calculated at the prescribed rates as if the succession or the amalgamation or the demerger had not taken place. Such deduction shall be apportioned between the predecessor and the successor, or the amalgamating company and the amalgamated company, or the demerged company and the resulting company, as the case may be, in the ratio of the number of days for which the assets were used by them.

**SECTION 32(1)(iia): ADDITIONAL DEPRECIATION**

In the case of any new machinery or plant
- other than ships and aircraft
- which has been acquired and installed
- by an assessee
- engaged in the business of manufacture or production of any article or thing
- OR IN THE BUSINESS OF GENERATION, TRANSMISSION OR DISTRIBUTION OF POWER
- a further sum equal to 20% of the actual cost of such machinery or plant
- shall be allowed as deduction under section 32(1)(ii).

- Provided that where an assessee,
- sets up an undertaking or enterprise
- for manufacture or production of any article or thing
- on or after the 1st day of April, 2015 in any backward area notified by the Central Government in this behalf,
- in the State of Andhra Pradesh or in the State of Bihar or in the State of Telangana or in the State of West Bengal; and
- acquires and installs any new machinery or plant (other than ships and aircraft)
- for the purposes of the said undertaking or enterprise
- during the period beginning on the 1st day of April, 2015 and ending before the 1st day of April, 2020 in the said backward area.
- then, the provisions of clause (iia) shall have effect, as if for the words "twenty per cent", the words "thirty-five per cent" had been substituted.

Provided further that no deduction shall be allowed in respect of—
(a) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person; or
(b) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house; or
(c) any office appliances or road transport vehicles; or
(d) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains of Business or Profession" of any one previous year.

Provided also that where an asset referred to in clause (iia) or the first proviso to clause (iia), as the case may be, is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than 180 days in that previous year, and the additional depreciation in respect of such asset is restricted to 50% of the amount calculated at the percentage prescribed for an asset under clause (iia) for that previous year, then, the deduction for the balance 50% of the amount calculated at the percentage prescribed for such asset under clause (iia) shall be allowed in the immediately succeeding previous year in respect of such asset.

SECTION 32 OF THE INCOME-TAX ACT, 1961 - DEPRECIATION - ADDITIONAL DEPRECIATION UNDER SECTION 32(1)(iia) FOR ASSESSEES ENGAGED IN BUSINESS OF MANUFACTURE OR PRODUCTION OF AN ARTICLE OR THING
CIRCULAR NO.15/2015, DATED 19-5-2016

An assessee, engaged in the business of manufacture or production of an article or thing, is eligible to claim additional depreciation under clause (iia) of sub-section (1) of section 32 of the Income- tax Act, 1961 (hereinafter referred to as the Act) in addition to the depreciation allowance under sub-section (1) of section 32 of the Act.
Whether or not an assessee engaged in printing or printing and publishing is eligible for grant of additional depreciation under clause (iia) of sub-section (1) of section 32 of the Act, has been a contentious issue. In other words, whether printing or printing and publishing amounts to manufacture or production of article or thing has been contested in legal forums.

The Board has accepted the position that printing or printing and publishing amounts to manufacture or production of an article or thing.

It is, therefore, a settled position that the business of printing or printing and publishing amounts to manufacture or production of an article or thing and is accordingly eligible for additional depreciation under section 32(1)(iia) of the Act.

### SECTION 43(6): WRITTEN DOWN VALUE

Up to Assessment Year 1987-88, the concept of individual asset was relevant and depreciation was allowed on each asset. From Assessment Year 1988-89, the concept of Block of assets has been introduced.

The written down value of the block of assets shall be calculated as under:

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>W.D.V. of the block at the beginning of Previous Year</td>
<td></td>
</tr>
<tr>
<td>Add:</td>
<td>Actual Cost of the assets falling within this block acquired during the Previous Year</td>
</tr>
<tr>
<td>Less:</td>
<td>Moneys payable in respect of assets falling in this block which are sold, discarded, demolished or destroyed during the Previous Year and the amount of scrap value</td>
</tr>
<tr>
<td>Less:</td>
<td>Actual cost of the assets falling within that block transferred by way of slump sale referred to in section 50B as reduced by:</td>
</tr>
<tr>
<td></td>
<td>(i) depreciation actually allowed upto assessment year 1987-88 in respect of the asset transferred.</td>
</tr>
<tr>
<td></td>
<td>(ii) depreciation that would have been allowable for assessment year 1988-89 and future assessment years as if the asset was the only asset in the block of assets. [Section 43(6)(c)(i)(C)]</td>
</tr>
<tr>
<td></td>
<td>W.D.V. of block for the Assessment Year</td>
</tr>
</tbody>
</table>

However, the above reduction i.e. under section 43(6)(c)(i)(C) shall be limited to the written down value of Block of assets. [See After Slump sale under Capital Gains]

**KEY POINTS:**

1. The reduction of moneys payable shall only be to the extent that W.D.V. becomes NIL.
2. Moneys payable means the sale price of the asset and includes any insurance, salvage or compensation payable in respect of the asset.
3. Any allowance in respect of any depreciation carried forward under section 32(2) shall be deemed to be "depreciation actually allowed".
4. Where section 50 is not attracted, then expenditure incurred wholly and exclusively in connection with transfer of asset e.g., commission paid to the broker for selling the asset, shall not be adjusted from the WDV of the block of assets. The gross sale price of the asset shall be deducted from the WDV of the Block of assets. Such expenditure on transfer of asset is allowable as revenue expenditure under section 37(1).
5. Can "moneys payable" in respect of a building sold by the assessee (which has to be reduced from the opening written down value of the block of assets for calculating depreciation) be construed as the fair market value of the asset instead of the actual sale price?

CIT v. Cable Corporation of India Ltd. (Bom.)
The written down value of the asset falling within that block of assets at the beginning of the previous year has to be adjusted by the amount for which the asset is actually sold and not by its fair market value.

SECTION 43(1): ACTUAL COST

Actual Cost means the actual cost of the asset to the assessee, reduced by that portion of the cost which has been directly or indirectly met by any other person or authority. However, where an assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or such other electronic mode as may be prescribed, exceeds Rs. 10,000, such expenditure shall not form part of actual cost of such asset [Proviso to section 43(1)] {To be done later after sec 40A(3)}. (Underlined and bold words are amended by Finance Act (No.2) 2019)

KEY POINTS:
1. In Challapali Sugar Mills Ltd (SC), it was held that the interest paid before the commencement of production on the amounts borrowed by the assessee for the acquisition and installation of plant and machinery, buildings, furniture and fixture forms part of the actual cost.
2. Explanation 8 to section 43(1) provides that where any interest is paid or is payable as interest in connection with the acquisition of an asset, so much of the amount as is relatable to any period after such asset is first put to use shall not be included in the actual cost of the asset.
3. Salaries, expenses of guest house maintained for erection staff, travelling, vehicle and general expenses pertaining to setting up of the plant forms part of the actual cost.
4. Expenses on test runs of machinery prior to production are part of the actual cost of plant & machinery.

5. EXTRACTS FROM ICDS-V RELATING TO TANGIBLE FIXED ASSET
   (a) Administration and other general overhead expenses are to be excluded from the cost of tangible fixed assets if they do not relate to a specific tangible fixed asset. Expenses which are specifically attributable to construction of a project or to the acquisition of a tangible fixed asset or bringing it to its working condition, shall be included as a part of the cost of the project or as a part of the cost of the tangible fixed asset.
   (b) The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, shall be capitalised. The expenditure incurred after the plant has begun commercial production, that is production intended for sale or captive consumption, shall be treated as revenue expenditure.
6. Section 36(1)(iii) provides that while computing the income under the head P/G/B/P, deduction shall be allowed for the amount of interest paid in respect of capital borrowed for the purposes of business or profession. The Finance Act, 2003 has added the following proviso to section 36(1)(iii) w.e.f. Assessment Year 2004-05:

"Provided that the amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction."

---

**EXTRACTS FROM “INCOME COMPUTATION AND DISCLOSURE STANDARD – 9 RELATING TO BORROWING COSTS”**

**Borrowing Costs Eligible for Capitalisation**

1. To the extent the funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.

2. To the extent the funds are borrowed generally and utilised for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely:

\[ A \times \frac{B}{C} \]

Where

- **A** = borrowing costs incurred during the previous year except on borrowings directly relatable to specific purposes;
- **B** = (i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;
  (ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day or both on the first day and the last day of previous year, half of the cost of qualifying asset;
  (iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be, other than those qualifying assets which are directly funded out of specific borrowings; or
- **C** = the average of the amount of total asset as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than those assets which are directly funded out of specific borrowings;

**Commencement of Capitalisation**

3. The capitalisation of borrowing costs shall commence:
   (a) in a case referred to in paragraph 5, from the date on which funds were borrowed;
   (b) in a case referred to in paragraph 6, from the date on which funds were utilised.
**Cessation of Capitalisation**

4. Capitalisation of borrowing costs shall cease:
   (a) in case of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, when such asset is first put to use;
   (b) ------

**EXPLANATIONS TO SECTION 43(1): DETERMINATION OF ACTUAL COST IN SPECIAL CASES**

<table>
<thead>
<tr>
<th>EXPL. TO SEC. 43(1)</th>
<th>MODE OF ACQUISITION</th>
<th>ACTUAL COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Asset acquired for scientific research subsequently brought into business use</td>
<td>NIL <em>(To be done with Sec 35)</em></td>
</tr>
<tr>
<td>2</td>
<td>Asset acquired by way of gift or inheritance</td>
<td>Actual Cost to the previous owner minus depreciation actually to him.</td>
</tr>
</tbody>
</table>

**Eg :-** Mr. X acquired a machinery on 02/02/2016 for Rs. 1,00,000. Rate = 15%. Mr. X gifted this to Mr. Y on 31/12/2020. WDV of Block of Asset of Mr. X and Mr. Y on 01/04/2020 is Rs. 5,00,000 and Rs. 3,00,000 respectively. Determine Actual cost in the hands of Mr. Y.

**Ans.**

<table>
<thead>
<tr>
<th>Actual Cost to Mr. X</th>
<th>1,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Depreciation actually allowed</td>
<td>(7,500)</td>
</tr>
<tr>
<td>P.Y. 2015 – 2016 @ 7.5%</td>
<td>(13,875)</td>
</tr>
<tr>
<td>P.Y. 2017 – 2018 @ 15%</td>
<td>(11,794)</td>
</tr>
<tr>
<td>P.Y. 2018 – 2019 @ 15%</td>
<td>(10,025)</td>
</tr>
<tr>
<td>P.Y. 2019 – 2020 @ 15%</td>
<td>(8,521)</td>
</tr>
<tr>
<td><strong>Actual cost to Mr. Y.</strong></td>
<td><strong>48,285</strong></td>
</tr>
</tbody>
</table>

**Eg :- Mr. X**

| 1. Op WDV as on 01.04.2020 of block (15%) | 10,00,000 |
| 2. PGBP before depreciation | 4,00,000 |
| 3. B/F Loss under head Capital Gains | (1,20,00,000) |

Mr. X sells the entire Block for Rs. 1,30,00,000.
### Mr. X files a return:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. PGBP</td>
<td>4,00,000</td>
</tr>
<tr>
<td>2. Short term Capital Gain</td>
<td>1,20,00,000</td>
</tr>
<tr>
<td>(-) Short term Capital Loss</td>
<td>(1,20,00,000)</td>
</tr>
<tr>
<td>Mr. X’s total income</td>
<td>4,00,000</td>
</tr>
</tbody>
</table>

### Relevant information of Mr. Y:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PGBP before depreciation</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Op WDV (15%) on 01.04.2020</td>
<td>20,00,000</td>
</tr>
</tbody>
</table>

### Mr. Y files a return

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PGBP income</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Less: Dep @ 15% on (1,30,00,000 + 20,00,000)</td>
<td>(22,50,000)</td>
</tr>
<tr>
<td>Total Income of Y</td>
<td>27,50,000</td>
</tr>
</tbody>
</table>

### After Explanation 3 to Sec. 43(1)

Now the A.O. invokes explanation 3 and he determines that the FMV of the asset transferred for Rs.1,30,00,000 is Rs 15,00,000

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PGBP</td>
<td>50,00,000</td>
</tr>
<tr>
<td>(-) Depo @ 15% [15,00,000 + 20,00,000]</td>
<td>(5,25,000)</td>
</tr>
<tr>
<td>Total Income of Y</td>
<td>44,75,000</td>
</tr>
</tbody>
</table>

Note: The Sale consideration of X will not change because of Explanation 3.

### Example:

Eg:- Mr. A acquired an asset on 01.01.2015 for Rs 1,00,000 and the asset was taken to the Block on which dep @ 15%. Mr. A sold the asset to Mr. B on 01.01.2017 for Rs 1,50,000 and Mr. B sold the asset to Mr. C on 01.01.2018 for Rs 200,000. Mr. C sells the asset to Mr. A on 01.01.21 for Rs 450,000. Determine “Actual cost” to Mr. A.

**Ans.** Expln 4 of Sec 43(1) will be attracted in the hands of Mr.A. Actual cost will be lower of:-

(i) Actual price for which asset is reacquired     Rs. 4,50,000

(ii) Actual cost to Mr. A when he first acquired the Asset     Rs.1,00,000

(-) Less : Dep :- P.Y 2014 – 2015 @ 7.5%     7,500

P.Y. 2015 – 2016 @ 15%     13,875 (Rs 21,375)

Actual Cost     Rs 78,625
Depreciation

| 5 | Building used for private purpose subsequently brought into business use. | The cost of purchase or construction of the building as reduced by the notional depreciation calculated at the depreciation rate applicable to the year of conversion in to business use. |

Eg:
Mr. X purchased a building on 01.01.2017 for personal residence for Rs 10,00,000. The building is now a factory building on 01.01.2021 when its FMV is Rs 800,000. Assume that depn rate on building was 7.5% up to A.Y. 2017 – 18 and depn rate building from A.Y. 2018 – 19 is 10%.

Ans. As per expln 5 to 43(1), the actual cost of building to Mr. X

| Actual Cost | 10,00,000 |
| (-) Depn for P.Y 16 – 17 @ 5% | (50,000) |
| Depn for P.Y. 17 – 18 @ 10% | (95,000) |
| Depn for P.Y. 18 – 19 @ 10% | (85,500) |
| Depn for P.Y. 19 – 20 @ 10% | (76,950) |
| Actual cost for P.Y. 2020 – 21 | 6,92,550 |

Note for Plant & Machinery & Furniture:

6 & Exp. 2 to section 43(6) Asset transferred by a holding Co. to its subsidiary Co. or by a Subsidiary Co., to holding Co. if the following two conditions are satisfied: -

i) Shares of the subsidiary Co. should be wholly owned by the holding co. or its nominees,

ii) The transferee co. should be an Indian company.

Note: If transferor company was not claiming depreciation since it was not used for its business, then the actual cost to the transferee company shall be the actual cost to the transferor Company.

WDV on 1st day of FY to the transferor company will be adopted as the actual cost to the transferee company.

(To be done with Capital Gains)

7 & Exp. 2 to section 43(6) Transfer of asset in a scheme of amalgamation by amalgamating company to amalgamated Indian company.

Note: If amalgamating Company was

WDV to the amalgamating company on 1st day of FY of amalgamation will be adopted as the actual cost to the amalgamated company.
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Depreciation</strong></td>
<td><strong>AJ Education NeXt</strong></td>
</tr>
<tr>
<td>not claiming depreciation since it was not used for its business, then actual cost to the amalgamated company shall be the actual cost to the amalgamating company.</td>
<td><em>(To be done with Capital Gains)</em></td>
</tr>
<tr>
<td>7A</td>
<td>Asset transferred by a demerged company to the resulting Indian company.</td>
</tr>
<tr>
<td></td>
<td>Actual cost shall be the written down value in the hands of the demerged company on the 1st day of FY of demerger. <em>(To be done with Capital Gains)</em></td>
</tr>
<tr>
<td>8</td>
<td>Asset acquired out of borrowed funds <em>(Do along with CSM &amp; proviso to sec 36(1)(iii))</em></td>
</tr>
<tr>
<td></td>
<td>Interest on loan borrowed relating to the period after the asset is first put to use shall never form part of actual cost. <em>(To be done with Capital Gains)</em></td>
</tr>
<tr>
<td>9</td>
<td>Asset acquired subject to levy of excise duty or customs duty in respect of which CENVAT credit is availed.</td>
</tr>
<tr>
<td></td>
<td>So much of the duty in respect in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944 shall not form part of the actual cost.</td>
</tr>
</tbody>
</table>

**Eg:**

<table>
<thead>
<tr>
<th><strong>Machinery :-</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BSP</td>
<td>10,00,000</td>
</tr>
<tr>
<td>(+) GST @ 10%</td>
<td>1,00,000 → Input Credit</td>
</tr>
<tr>
<td></td>
<td>11,00,000 is Availed.</td>
</tr>
</tbody>
</table>

**Note :-** The Actual cost in this case will be amount excluding the Input Credit.

<table>
<thead>
<tr>
<th>10</th>
<th>A portion of the cost of an asset acquired is met directly or indirectly by Government or any statutory authority or any other person in the form of a subsidy or grant or reimbursement.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>So much of the cost as is relatable to such subsidy or grant or reimbursement shall not form part of the actual cost.</td>
</tr>
<tr>
<td></td>
<td>If subsidy is not directly relatable to the asset acquired, but subsidy is with reference to the assets then the subsidy shall be proportionately reduced from the actual cost of the assets with reference to which subsidy has been granted.</td>
</tr>
</tbody>
</table>
### Eg:-
Say if an assessee wants to acquire an asset of Rs 100 Cr & central govt. is reimbursing Rs 30 Cr. directly in respect of that asset then actual cost would be Rs 100 Cr - Rs 30 Cr. = Rs 70 Cr.

- However, if the subsidy is not directly related to asset, but is in reference to many assets, then it must be proportionately reduced.

**Eg:** If an assessee is acquiring a pool of assets of Rs 120 Cr. which includes 3 assets:

1. **Building** Rs 60
2. **P & M** Rs 40
3. **Furniture** Rs 20

The Central Govt. is reimbursing 30% of entire cost.

The actual cost of every asset will be as follows:

1. **Building** = 60(-) 18 = 42
2. **P & M** = 40(-) (12) = 28
3. **Furniture** = 20 (-) 6 = 14

<table>
<thead>
<tr>
<th>11</th>
<th>Asset brought into India by a Non-resident assessee or a foreign company for use in his business or profession.</th>
<th>Actual cost as reduced by the amount of depreciation calculated at the rate in force as if the asset was used in India since the date of acquisition.</th>
</tr>
</thead>
</table>

**Eg:-** Mr. A a non-resident purchased a computer in U.S.A on **01.01.2016** for Rs 10,00,000. It was used for his business outside India. On **01.01.21,** he starts a business in India and computer is brought in India on that day when its FMV is Rs 200,000.

**Ans.** The Actual cost of the computer for **A.Y. 21 – 22** shall be as under

| Actual cost | 10,00,000 |
| (-) Dep A.Y. 16 – 17 @ 30% | (3,00,000) |
| (-) Dep A.Y. 17 – 18 @ 60% | (4,20,000) |
| (-) Dep A.Y. 18 – 19 @ 40% | (1,12,000) |
| (-) Dep A.Y. 19 – 20 @ 40% | (67,200) |
| (-) Dep A.Y. 20 – 21 @ 40% | (40,320) |

**Actual cost for A.Y. 21 – 22** 60,480

<table>
<thead>
<tr>
<th>12</th>
<th>Any capital asset acquired under a scheme of corporatisation of a recognised stock exchange in India, approved by SEBI.</th>
<th>The amount, which would have been regarded as actual cost, had there been no such corporatisation shall be deemed to be the actual cost. <strong>(To be done with Capital Gains)</strong></th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>13</th>
<th>Actual cost of capital asset has been allowed as deduction under section 35AD and capital asset is transferred by way of transactions referred to in section 47.</th>
<th>The actual cost of such asset to the transferee shall be NIL. <strong>(To be done with sec 35AD)</strong></th>
</tr>
</thead>
</table>
EXPLANATION 7 TO SECTION 43(6)

For the purposes of this clause, where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession", for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head "Profits and gains of business or profession" and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act. (Inserted by Finance Act, 2009)

ANALYSIS OF EXPLANATION 7 TO SECTION 43(6)

Explanation 7 to section 43(6) has been introduced by Finance Act, 2009 to nullify the judgement of Commissioner of Income-Tax vs. Doom Dooma India Ltd. (Supreme Court) [2009]

1. In this case, the assessee company was engaged in the business of growing and manufacturing tea in India. During the previous year, the income was computed as under:

<table>
<thead>
<tr>
<th>Composite income from growing &amp; manufacturing tea in India before depreciation</th>
<th>3000 Lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Depreciation on actual cost of assets of Rs.1000 Lakh @ 15%</td>
<td>150 Lakh</td>
</tr>
<tr>
<td>Total Income</td>
<td>2850 Lakh</td>
</tr>
</tbody>
</table>

2. Out of which 60% is agricultural income and 40% of 2850 Lakh i.e., 1140 Lakh is taxable business income.

3. The question before the Supreme Court was whether in cases where Rule 8 applies and income which is brought to tax as 'business income' is only 40% of composite income, only 40% of depreciation allowed at prescribed rate is required to be taken into account for computing WDV of Block of Assets because that is depreciation 'actually allowed'.

4. Supreme Court held that in case where Rule 8 applies, the income which is brought to tax as 'business income' is only 40 per cent of the composite income and, consequently, proportionate depreciation is required to be taken into account because that is the depreciation 'actually allowed'. Therefore, WDV of block of asset shall be taken as Rs. 940 Lakh.

5. As per the Supreme Court, the WDV of block of assets for the next year shall be:

<table>
<thead>
<tr>
<th>Actual Cost</th>
<th>1000 Lakh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Depreciation</td>
<td>60 Lakh</td>
</tr>
<tr>
<td>WDV</td>
<td>940 Lakh</td>
</tr>
</tbody>
</table>
6. After the insertion of Explanation 7 to section 43(6), the WDV of block of assets for the next year shall be:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual Cost</td>
<td>1000 Lakh</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>150 Lakh</td>
</tr>
<tr>
<td>WDV</td>
<td>850 Lakh</td>
</tr>
</tbody>
</table>

**SECTION 32(2): SET-OFF AND CARRYFORWARD OF UNABSORBED DEPRECIATION**

1. The current year depreciation for any assessment year shall be set off:
   (i) against the profits and gains of any business or profession carried on by the assessee assessable for that assessment year and
   (ii) the balance if any, against the income under any head EXCEPT SALARIES assessable for that assessment year. (It can be set-off against income under the head Capital Gains, Income from other sources, House property EXCEPT Salaries.)

2. Depreciation to the extent not set off shall be carried forward to the next assessment year and set off against:
   (i) profits and gains of any business or profession carried on by the assessee and
   (ii) the balance if any against the income under any head EXCEPT SALARIES. (It can be set-off against income under the head Capital Gains, Income from other sources, Income from House Property EXCEPT Salaries.)

3. The unabsorbed depreciation can be carried forward indefinitely.

4. **Priority of set-off**
   (i) Current Year Depreciation.
   (ii) Brought forward Business Losses.
   (iii) Brought forward Depreciation.

5. Set-off and carry forward of depreciation is not governed by section 80 but by section 32(2). Therefore, unabsorbed depreciation can be carried forward and set-off, even if the return is filed after the time prescribed under section 139(1).

**KEY POINT:**
Depreciation can be carried forward only if the assessee is the same, i.e., the assessee who claimed depreciation and the assessee who wants to carry forward the depreciation must be the same. Exception to this rule is section 72A/72AA/72AB where depreciation can be carried forward even when the assessee has changed in the following situations:
- Firm succeeded by a Company {Section 47(xiii)}
- Proprietorship Concern succeeded by a company {Section 47(xiv)}
- Unlisted Company succeeded by LLP {Section 47(xiiiib)}
- Amalgamation
- Demerger
- Amalgamation referred to in section 72AA
- Amalgamation and Demerger of Co-operative Bank referred to in section 72AB.

2.20
1. **Leased Assets**

A lessee of a plant or machinery is not entitled to claim depreciation thereon as he does not own the plant. A lessor can, however, claim depreciation on the assets leased out by him if he is engaged in the business of leasing out the assets.

Section 57 provides that if the lessor is not in the business of leasing, then lease income is taxable as "Income from Other Sources" and depreciation computed as per section 32 shall be allowed.

2. **Assets acquired on Hire Purchase**

Where the terms of the hire purchase agreement provide that the hired asset shall eventually become the property of the hirer or give the hirer an option to purchase the asset, the transaction would be governed by CBDT Circular No. 9 of 1943. Accordingly, the periodical payments made by the hirer would be broken into interest charges (to be allowed as deduction to the hirer) and payment on account of capital cost of the asset. Depreciation is allowed to the hirer on the initial value of the asset, i.e., the amount for which the hired item would have been sold for cash at the date of agreement.

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**SECTION 38(2): ASSETS NOT EXCLUSIVELY USED FOR BUSINESS PROFESSION**

Where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, then the deduction under section 30 (repairs & insurance premium of the building), deduction under section 31 (repairs and insurance premium of machinery, plant and furniture) and the deduction under section 32 shall be restricted to a fair proportionate part thereof which the Assessing Officer may determine having regard to the use of such building, machinery, plant or furniture for the purposes of business or profession.

**SUBSIDIES (INSERTED BY FINANCE ACT 2015)**

**SECTION 2(24) (xviii) : DEFINITION OF INCOME INCLUDES SUBSIDY AND GRANTS**

Income includes

- assistance in the form of
- a subsidy or
- grant or
- cash incentive or
- duty drawback or
- waiver or
- concession or
- reimbursement (by whatever name called)
- by the Central Government or
- a State Government or
- any authority
- or body
- or agency
- in cash or kind
(a) the subsidy or grant or reimbursement which is taken into account for
determination of the actual cost of the asset in accordance with the provisions
of Explanation 10 to section 43(1); or

(b) the subsidy or grant by the Central Government for the purpose of the
corpus of a trust or institution established by the Central Government or a
State Government, as the case may be.

(Added by Finance Act, 2016)

**SUBSIDIES**

- If subsidy is for acquiring an asset, it shall be deducted from actual cost of asset as per
  Explanation 10 to section 43(1).
- If subsidy is with reference to the assets, it shall be deducted from actual cost of the
  assets as per Proviso to Explanation 10 to Section 43(1).
- If loan taken for acquisition of an asset is waived, then such loan waived shall be
  income now as per section 2(24)(xviii).
- Any other subsidy / waiver of loan/ grant from Government / any authority / body / agency will be taxable as income as Profits and Gains of Business or Profession or Income from other sources.

**PRESS RELEASE DATED 5TH MAY 2015:**
The amended definition of income shall not apply to the LPG subsidy or any other welfare
subsidy received by an individual in his personal capacity and not in connection with the
business or profession carried on by him.”.

**INCOME COMPUTATION AND DISCLOSURE STANDARD VII RELATING TO
GOVERNMENT GRANTS**

**Preamble**
This Income Computation and Disclosure Standard is applicable for computation of income
chargeable under the head “Profits and gains of business or profession” or “Income from
other sources” and not for the purpose of maintenance of books of account.
In case of conflict between the provisions of the Income Tax Act, 1961 (‘the Act’) and this
Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that
extent.

**Scope**
1. This Income Computation and Disclosure Standard deals with the treatment of
   Government grants. The Government grants are sometimes called by other names such
   as subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements,
   etc.
2. This Income Computation and Disclosure Standard does not deal with :-
   (a) Government assistance other than in the form of Government grants; and
   (b) Government participation in the ownership of the enterprise.
Definitions

3(1). The following terms are used in the Income Computation and Disclosure Standard with the meanings specified:

(a) “Government” refers to the Central Government, State Governments, agencies and similar bodies, whether local, national or international.

(b) “Government grants” are assistance by Government in cash or kind to a person for past or future compliance with certain conditions. They exclude those forms of Government assistance which cannot have a value placed upon them and the transactions with Government which cannot be distinguished from the normal trading transactions of the person.

3(2). Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to the in the Act.

Recognition of Government Grants

4(1). Government grants should not be recognised until there is reasonable assurance that (i) the person shall comply with the conditions attached to them, and (ii) the grants shall be received.

4(2). Recognition of Government grant shall not be postponed beyond the date of actual receipt.

Treatment of Government Grants

5. Where the Government grant relates to a depreciable fixed asset or assets of a person, the grant shall be deducted from the actual cost of the asset or asset concerned or from the written down value of block of assets to which concerned asset or assets belonged to.

6. Where the Government grant relates to a non-depreciable asset or assets of a person requiring fulfilment of certain obligations, the grant shall be recognised as income over the same period over which the cost of meeting such obligations is charged to income.

7. Where the Government grant is of such a nature that it cannot be directly relatable to the asset acquired, so such of the amount which bears to the total Government grant, the same proportion as such asset bears to all the assets in respect of or with reference to which the Government grant is so received, shall be deducted from the actual cost of the asset or shall be reduced from the written down value of block of assets to which the asset or assets belonged to.

8. The Government grant that is receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs, shall be recognised as income of the period in which it is receivable.
9. The Government grants other than covered by paragraph 5, 6, 7, and 8 shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate.

10. The Government grants in the form of non-monetary assets, given at a concessional rate, shall be accounted for on the basis of their acquisition cost.

Refund of Government Grants

11. The amount, refundable in respect of a Government grant referred to in paragraph 6, 8 and 9 shall be applied first against any unamortised deferred credit remaining in respect of the Government grant. To the extent that amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount shall be charged to profit and loss statement.

12. The amount refundable in respect of a Government grant related to a depreciable fixed asset or assets shall be recorded by increasing the actual cost or written down value of block of assets by the amount refundable. Where the actual cost of the asset is increased, depreciation on the revised actual cost or written down value shall be provided prospectively at the prescribed rate.

Transitional Provisions

13. All the Government grants which meet the recognition criteria of para 4 on or after 1st day of April, 2015 shall be recognised for the previous year commencing on or after 1st day of April, 2015 in accordance with the provisions of this standard after taking into account the amount, if any, of the said Government grant recognised for any previous year ending on or before 31st day of March, 2015.

Disclosures

14. Following disclosure shall be made in respect of Government grants, namely:-
   (a) nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year;
   (b) nature and extent of Government grants recognised during the previous year as income;
   (c) nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons thereof; and
   (d) nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

DEPRECIATION FOR POWER GENERATING UNDERTAKINGS

Assessees in the business of generation or generation and distribution of power, have the option to claim depreciation on

1. Straight Line method on each asset or
2. Written down value method on block of assets (This we have already done earlier.)
SECTION 32(1)(i): DEPRECIATION FOR POWER GENERATING UNDERTAKINGS

Section 32(1)(i) provides that an assessee in the business of generation or generation and distribution of power will be allowed depreciation

- in respect of
- building, machinery, plant or furniture being tangible assets;
- know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets
- owned wholly or partly by the assessee, and used for the purposes of business, at the prescribed rates on actual cost of each asset on straight line method of depreciation.

KEY NOTES:
1. Where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than 180 days in that previous year, the depreciation allowance in respect of such asset shall be restricted to 50% of the amount calculated at the prescribed percentage.

2. The aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset.

SECTION 32(1)(iii): TERMINAL DEPRECIATION

- In the case of any building, machinery, plant or furniture or intangible asset.
- owned wholly or partly by an undertaking engaged in generation or generation and distribution of power.
- on which depreciation has been claimed and allowed under section 32(1)(i) [Depreciation on straight line method]
- and which is sold, discarded, demolished or destroyed in the previous year (other than the previous year in which it was acquired)
- the amount of depreciation allowed in the previous year in which it is sold, discarded, demolished or destroyed
- shall be equal to
- the amount by which moneys payable in respect of such building, machinery, plant or furniture or intangible asset together with scrap value, if any, fall short of the written down value of such asset; and
- The deduction is allowable only if such deficiency is actually written off in the books of assessee.

KEY NOTES:
1. If the asset is sold in the same previous year in which it was acquired, then there will be short term capital gains on sale of such asset.

2. The expression 'moneys payable' in respect of any building, machinery, plant or furniture or intangible asset includes:
   (i) any insurance, salvage, or compensation moneys payable in respect thereof.
(ii) where the building, machinery, plant or furniture or intangible asset is sold, the price for which it is sold.

SECTION 41(2): BALANCING CHARGE

- where any building, machinery, plant or furniture or intangible asset owned by the assessee in respect of which depreciation is claimed under section 32(1)(i) and which was or has been used for the purpose of business.
- is sold, discarded, demolished or destroyed and
- moneys payable in respect of such building, machinery, plant or furniture or intangible asset together with the scrap value, if any,
- exceeds the written down value
- least of the following shall be charged to Income tax as income of the business in the previous year in which the moneys payable for the building, machinery, plant or furniture or intangible asset became due
  (a) difference between actual cost and written down value.
  (b) difference between aggregate of (moneys payable and scrap value) and written down value.

Further where such moneys payable become due in a previous year in which the business for the purpose of which the building, machinery, plant or furniture or intangible asset was being used is no longer in existence, the provisions of this subsection shall apply as if such business is in existence in the previous year in which the moneys payable became due.

KEY NOTE:
Where the asset is sold in the same previous year in which it was acquired, then section 41(2) shall not be applicable and the profit on sale of asset shall be short term capital gains.

SECTION 50A: SPECIAL PROVISION FOR COST OF ACQUISITION IN CASE OF DEPRECIABLE ASSET

Where the capital asset is an asset in respect of which a deduction on account of depreciation under section 32(1)(i) has been obtained by the assesse in any previous year, the provisions of section 48 and 49 shall apply subject to the modification that the written down value, as defined in section 43(6), of the asset, as adjusted, shall be taken as the cost of acquisition of the asset.

Written down value as adjusted should mean:

Written down value
Add: Income assessed under section 41(2)
Less: Terminal depreciation under section 32(1)(iii)

ANALYSIS
Where an asset on which depreciation has been claimed on SLM basis is sold then,

(i) If Sale Price \(\ll\) WDV of asset, then section 32(1)(iii) shall apply.
WDV of asset - Sale Price = Allowed on Terminal depreciation in year of sale provided the deficiency is w/off in the books of accounts

No Capital Gain shall arise.

(ii) If Sale Price  $>$ WDV of asset, then the least of the following shall be taxable

Under section 41(2) as PGBP income in the year of sale:

(a) Depreciation allowed till date
(b) Sale price-WDV

Capital Gains will be arise under section 50A if Sale Price exceeds Actual cost of the asset.

STCG = Sale Price - Actual Cost of the asset

FOREIGN EXCHANGE FLUCTUATIONS IN CASE OF IMPORTED ASSETS

SECTION 43A: SPECIAL PROVISION CONSEQUENTIAL TO CHANGES IN RATE OF EXCHANGE OF CURRENCY

(1) The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee at the time of making the payment, the following values may be changed accordingly with respect to the increase or decrease in such liability:

(i) the actual cost of the asset under section 43(1)
(ii) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)
(iii) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)
(iv) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

(2) Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

(3) Where the assessee has entered into a contract with authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.
The adjustments referred in section 43A are as under:

Suppose on 30.6.2014, a foreign currency loan of $1,00,000 is taken and an asset is purchased from a foreign country for $ 1,00,000 on that date. The rate of exchange as on 30.6.2013 is 1$ = Rs. 40. Now on 30.6.2014, the asset shall be recorded as under:

No repayment is made in Previous Year 31.3.2015 and rate of exchange 1$ = Rs. 42 as on 31.3.2015. Hence as per section 43A, no adjustment shall be made in previous year 31.3.2015. Depreciation of Assessment Year 2015-16 shall be Rs. 6,00,000 @ 15%.

(Additional Depreciation under section 32(1)(ia) shall be allowed but the same has not been considered in this question assuming that machinery is an old machinery.)

Now in Previous Year 31.3.2016 the loan of $25,000 is repaid on 30.11.2015 @ 1$ = Rs. 43. Now adjustment as per section 43A shall be:

\[(\text{Rs.} 43 \text{ minus } \text{Rs.} 40) \times 25,000 = 75,000\]

Rs. 75,000 shall be added to the WDV of Rs. 34,00,000 as per Supreme Court in Arvind Mills Ltd., and depreciation shall be allowed in Assessment Year 2016-17 on Rs. 34,75,000 i.e. 15% thereof – Rs. 5,21,250

Now in Previous Year 31.3.2017 the loan of $50,000 is repaid on 31-12-2016 when 1$ = Rs. 39. The adjustment as per section 43A shall be:

\[(\text{Rs.} 39 \text{ minus } \text{Rs.} 40) \times 50,000 = 50,000\]

Therefore, for Assessment Year 2017-18, Rs. 50,000 shall be reduced from WDV of asset as per Supreme Court in Arvind Mills Ltd. Hence, depreciation for Assessment Year 2017-18 shall be allowed on Rs. 29,53,750 – Rs. 50,000 = Rs. 29,03,750 @ 15%.

**TAXATION OF FOREIGN EXCHANGE FLUCTUATION [SECTION 43AA]**

(i) Section 43AA provides that, subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, which shall be computed in accordance with the notified ICDS i.e., ICDS VI: The effects of changes in foreign exchange rates.

(ii) Gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to –

- monetary items and non-monetary items;
- translation of financial statements of foreign operations
- forward exchange contracts;
- foreign currency translation reserves.
INCOME COMPUTATION AND DISCLOSURE STANDARD VI RELATING TO THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Foreign Currency Transactions

Initial Recognition

3(1) A foreign currency transaction shall be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign country at the date of the transaction.

(2) An average rate for a week or a month that approximates the actual rate at the date of the transaction may be used for all transactions in each foreign currency occurring during that period. If the exchange rate fluctuates significantly, the actual rate at the date of the transaction shall be used.

Conversion at Last Date of Previous Year

At last day of each previous year:-

(a) foreign currency monetary items shall be converted into reporting currency by applying the closing rate;

(b) where the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realized from or required to disburse, a foreign currency monetary item owing to restriction on remittances or the closing rate being unrealistic and it is not possible to effect an exchange of currencies at that rate, then the relevant monetary item shall be reported in the reporting currency at the amount which is likely to be realized from or required to disburse such item at the last date of the previous year; and

(c) non–monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.

Recognition of Exchange Differences

(i) In respect of monetary items, exchange differences arising on the settlement thereof or on conversion thereof at last day of the previous year shall be recognised as income or as expense in that previous year.

(ii) In respect of non-monetary items, exchange differences arising on conversion thereof a the last day of the previous year shall not be recognised as income or as expense in that previous year.

Exceptions to Paragraph 3,4 and 5

Notwithstanding anything contained in paragraph 3, 4 and 5, initial recognition, conversion and recognition of exchange difference shall be subject to provisions of section 43A of the Act or Rule 115 of income-tax Rules, 1962, as the case may be.
CHAPTER 3. SPECIFIC DEDUCTIONS.

SECTION 30: RENT, RATES, TAXES, REPAIRS AND INSURANCE FOR BUILDINGS

Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purpose of his business or profession.

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

- **Premises sub-let**: Where the assessee has sublet a part of the premises, the allowance under the section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant.
  The rent payable would be an allowable deduction under this section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner.

- **Occupation of premises by the assessee being the owner**: Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

- **Repairs of the premises**: Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where
  - the assessee is the owner of the building or
  - the assessee is a tenant who has undertaken to bear the cost of repairs to the premises.
  Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.

- **Cost of repairs and current repairs of capital nature not to be allowed**: As per section 30(a), deduction for cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, is allowed but it will not include any expenditure in the nature of capital expenditure.

- **Other expenses**: In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed.
• **Premises used partly for business and partly for other purposes:** Where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction [section 38(1)].

**SECTION 31: REPAIRS AND INSURANCE OF MACHINERY, PLANT AND FURNITURE**

Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession.

• **Usage of the asset:** In order to claim this deduction, the assets must have been used for purposes of the assessee’s own business the profits of which are being taxed. The word ‘used’ has to be read in a wide sense so as to include a passive as well as an active user. Thus, insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction.

Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

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

Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

• **Insurance premium:** The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions:
  ♦ The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.
  ♦ The assets must be used by the assessee for the purposes of his business or profession during the accounting year.
  ♦ The premium should have been actually paid (or payable under the mercantile system of accounting).

The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances.

It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

• **Current repairs of capital nature not to be allowed:** As per section 31, the amount paid on account of current repairs of machinery, plant or furniture is allowed as deduction in the computation of income under the head “profits and gains of

3.2
business or profession” but it will not include any expenditure in the nature of capital expenditure.

**OTHER DEDUCTIONS [SECTION 36]**

This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

1. **Insurance premia paid [Section 36(1)(i)]** - If insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession, the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

2. **Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)]**
   Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.

3. **Premia paid by employer for health insurance of employees [Section 36(1)(ib)]**
   - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by
     - (i) the General Insurance Corporation of India and approved by the Central Government; or
     - (ii) any other insurer and approved by the IRDA.

4. **Bonus and Commission [Section 36(1)(ii)]** - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission.
   - It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits. *(Refer Summary for Example)*

5. **Interest on borrowed capital [Section 36(1)(iii)]** - Deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".
   - Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression ‘for the purposes of business’ is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business.
   - As per proviso to section 36(1)(iii), deduction in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed.
Explanation 8 to section 43(1) clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, therefore, be capitalised.

**Note:** In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under section 40A.

**NOTE 1:**  
**S.A. BUILDERS LTD. VS. COMMISSIONER OF INCOME TAX (APPEALS) (SUPREME COURT)**

**FACTS**

During the assessment proceedings for the assessment years 1991-92 and 1992-93, the Assessing Officer found that the assessee had advanced huge amounts as interest-free loans out of its cash credit account in which there was a huge debit balance. The Assessing Officer disallowed the proportionate interest relating to said amount out of total interest paid to bank, holding that the assessee had diverted its borrowed funds to its sister concern without charging any interest.

**HELD**

The expression 'commercial expediency is an expression of wide import and includes such expenditure as a prudent businessman incurs for the purpose of business. The expenditure may not have been incurred under any legal obligation, yet it is allowable as business expenditure if it was incurred on grounds of commercial expediency. If the money advanced to sister concern was on account of commercial expediency, then the interest on loan shall be allowed as deduction.

It is not in every case that interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be said to be advanced to a sister concern for commercial expediency in many other circumstances. Where holding company, has a deep interest in its subsidiary, and the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the holding company would ordinarily be entitled to deduction of interest on its borrowed loans.

Therefore, interest on loan advanced to sister concern for commercial expediency shall be allowed as deduction.

**NOTE 2 :**  
**East India Pharmaceuticals Works Ltd. (1997) Supreme Court**

Interest on loans taken for payment of income-tax is not an allowable expenditure since payment of income-tax is a personal liability.
NOTE 3:
Guarantee Commission paid to the bank in relation to the bank guarantee given by the assessee to the Income-tax department is an expense related to Income-tax and is thus not allowable as expenditure.

NOTE 4:
Litigation expenses in relation to Income-tax cases are allowable as deduction under section 37(1).

NOTE 5:
Tax audit fees paid is allowable as expenditure under section 37(1).

NOTE 6:
CIT v. Tulip Star Hotels Ltd. (2011) (Del.)
Can a company engaged in the business of owning, running and managing hotels claim interest on borrowed funds, used by it for investing in the equity share capital of a wholly owned subsidiary company, as deduction where the subsidiary company was formed for exercising effective control of new hotels acquired by the parent company under its management?
The High Court held that the assessee was in the business of owning, running and managing hotels. For the effective control of new hotels acquired by the assessee under its management it had invested in a wholly owned subsidiary company. The expenditure incurred was for business purposes and was thus allowable under section 36(1)(iii).
Under section 36(1)(iii), the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession is allowable as deduction. In this case, it has been held that interest paid on capital borrowed for investment in a subsidiary company is allowable as deduction since the subsidiary company was formed to carry on the business of the parent company in a more effective manner.

(6) Discount on Zero Coupon Bonds (ZCBs) [Section 36(1)(iiia)]
The pro rata amount of discount on a zero coupon bond having regard to the period of life of such bond calculated in the manner as may be prescribed.

For the purposes of clause (iiiia) of sub-section (1) of section 36, the pro-rata amount of discount on a zero coupon bond shall be computed in the following manner, namely:

(a) the period of life of the bond shall be converted into number of calendar months and, for this purpose, where the calendar month in which the bond is issued or the bond matures or is redeemed contains a part of a calendar month then, if such part is fifteen days or more than fifteen days, it shall be increased to one calendar month and if such part is less than fifteen days it shall be ignored;

(b) the amount of discount shall be divided by the number of calendar months determined in accordance with clause (a);

(c) where one or more than one calendar month out of calendar months determined in accordance with clause (a) is or are included in a previous year, the amount determined in accordance with clause (b) shall be multiplied by the number of calendar months so
specific deductions

ANALYSIS

Tax treatment in the hands of company issuing such bonds-
(i) Discount is deductible on pro rata basis as stated above.
(ii) Tax will not be deducted at source under section 194A by the payer company.

Tax treatment in the hands of investor-
(i) Maturity/Redemption of zero coupon bonds will amount to transfer under section 2(47)(iva)
(ii) If period of holding is more than 12 months, such bonds would be long-term capital asset under section 2(42A).
(iii) Long Term capital Gains would be taxable at the rate of 10% without indexation under section 112.

Illustration:
Zero coupon bonds are issued by X Ltd. an infrastructure capital company on October 10, 2020. (Issue price: Rs. 85, Face Value as well as amount payable at the time of redemption: Rs. 100) Redemption date: July 9, 2025, Number of bonds subscribed by public: 100,000. These bonds have been notified as zero coupon bonds by notification by the Central Government.

Pro rata deduction available to X Ltd.
Amount of discount offered by X Ltd. [(Rs100 - Rs85) X 1,00,000]: Rs15,00,000 (a)
Period of life of the bond (July 9, 2025 minus October 10, 2020): 57 months (b)

Pro rata deduction for 1 month: Rs.26,316 [(a) / (b)] (c)

Amount deductible in previous year 2020-2021: Rs 1,57,895 [(c) X 6]

Amount deductible in previous year 2021-2022 to 2024-2025: Rs 3,15,789 [(c) X 12]

Amount deductible in previous year 2025-2026: Rs 78,947 [(c) X 3]

(7) Contributions to provident and other funds [Section 36(1)(iv) and (v)] -
Contribution to the employees’ provident and other funds are allowable subject to the following conditions:
(a) The fund should be settled upon a trust.
(b) In case of Provident or superannuation or a Gratuity Fund, it should be one recognised or approved under the Fourth Schedule to the Income-tax Act, 1961.
(c) The amount contributed should be periodic payment and not an adhoc payment to start the fund.
(d) The fund should be for exclusive benefit of the employees.
The nature of the benefit available to the employees from the fund is not material; it may be pension, gratuity or provident fund.
(8) **Employer’s contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]**

(i) Section 36(1)(iva) to provide that the employer’s contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.

(ii) However, deduction would be restricted to 10% of salary of the employee in the previous year.

(iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

(iv) Correspondingly, section 40A(9), which provides for disallowance of any sum paid by an employer towards contribution to any fund or trust has been amended to exclude from the scope of its disallowance, contribution by an employer to the pension scheme referred to in section 80CCD, to the extent to which deduction is allowed under section 36(1)(iva).

(9) **Amount received by assessee as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date**  

Clause (va) of section 36(1) and clause (ia) of section 57 provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee’s account in the relevant fund on or before the due date.

<table>
<thead>
<tr>
<th>Due date</th>
<th>The date by which the assessee is required as an employer to credit such contribution to the employee’s account in the relevant fund under the provisions of any law on term of contract of service or otherwise.</th>
</tr>
</thead>
</table>

As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month.

(10) **Allowance for animals [Section 36(1)(vi)]**

In respect of animals which have been used for the purposes of business otherwise than as stock-in-trade and have died or become permanently useless for such purposes, the difference between the actual cost of the animals to the assessee and the amount, if any, realised in respect of animals or carcasses.

(11) **Actual Bad debts [Section 36(1)(vii)]**

A bad debt shall be allowed as deduction if the following conditions are satisfied:

1. The bad debt should be written off as irrecoverable in the books of account of the assessee for the previous year in which deduction is claimed.

2. The debt should have been taken into account in computing the income of the previous year in which deduction is claimed or any earlier previous year; OR the debt represents the money lend in the ordinary course of business of money lending or banking carried on by the assessee.

Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous
Specific Deductions

year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.

(Added by Finance Act, 2015)

ANALYSIS OF AMENDMENT MADE BY FINANCE ACT, 2015

As per AS – 9 revenue from sale of goods as well as services must be recognized in BOA where there is a reasonable certainty of receiving it.

ICDS IV notified by CBDT on revenue recognition also states that revenue from goods must be recognized when there is reasonable certainty of receiving it [This is the same treatment like AS – 9]. However, revenue from provision of service must be recognized in Income Tax irrespective of its certainty to receive. [This treatment under Income Tax is different from AS-9]

Say if an assessee provides services of Rs. 1,00,000 and there is no certainty in regard of its receipt, then such service will not be recorded in BOA. However, it has to be offered for tax as per ICDS IV.

Now Later on if such debt which are offered in Income Tax but not recorded in BOA becomes bad then assessee must get the deduction of such bad debt u/s 36(1)(vii). However, the technical issue which will arise is that the assessee has to write off that debt in the BOA. This condition cannot be fulfilled by assessee under such circumstances as such debt is not recorded only in the BOA then how the assessee will write off such debt in BOA.

In order to reduce litigation and provide clarity Finance Act 2015 has inserted a proviso to sec 36(1)(vii) which states that “Any income which is offered for tax as per ICDS without recording the same in the BOA, if it becomes bad then it shall be DEEMED that such debt is written off as irrecoverable and deduction will be allowed.

Explanation: For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee, shall not include any provision for bad or doubtful debts made in accounts of the assessee.

There is no requirement to establish that the debt or part thereof has become bad. The essential condition for claiming this deduction is that the debt in respect of which deduction is claimed should have been taken into account in computing the income of the assessee of the previous year in which deduction is claimed or any earlier previous year.

For example, the assessee gives an advance of Rs. 10,000 for purchase of raw material to Mr. X. Mr. X could not supply the goods as he had become bankrupt and the advance of Rs. 10,000 cannot be recovered from him. The assessee writes off the debt as bad debt.

Here, the second condition that the debt should have been taken into account in computing the income of the previous year in which deduction is claimed or any earlier previous year, is
not satisfied and therefore, the debt cannot be allowed under section 36(1)(vii). However, the same can be claimed under section 37(1) as a trading loss.

**KEY POINTS:**

1. **SECTION 41 (4): BAD DEBT RECOVERY:**
   Where a deduction has been allowed in respect of a bad debt and the bad debt is subsequently recovered, then the amount so recovered shall be deemed to be the income under the head P/G/B/P of the previous year in which the amount is so recovered. This shall apply even if the business or profession is not in existence in the previous year in which recovery is made.
   For example, Rs 1,00,000 is recoverable from a debtor Mr. A. The assessee writes off Rs 40,000 as bad debt in the previous year 31.03.2010. Subsequently, in the previous year 31.03.2016, Rs 70,000 is recovered from Mr. A. Here, Rs 60,000 shall be deemed to have been recovered towards the debt and Rs 10,000 towards the recovery of bad debt of Rs 40,000. Rs 10,000 will be taxable as P/G/B/P under section 41(4) in the previous year 31.03.2016.

2. **P.K.KAIMAL { TO BE DISCUSSED LATER WITH SEC 41(4) }**
   In this case, a firm had claimed and was allowed bad debt of Rs. 1,00,000 in the previous year 31.3.2010. The firm was dissolved and was taken over by a partner Mr. A. The partner Mr. A recovers Rs. 1,00,000 bad debt in the previous year 31.03.2016. Held, that for the applicability of section 41(4), the assessee who claimed the deduction of bad debt and the assessee who recovers the bad debt must be the same. Where a bad debt has been allowed to a firm and the firm makes the recovery thereof, then section 41(4) is attracted in the hands of the firm. But, if the firm is dissolved and the business is continued by an erstwhile partner, then any recovery made by the partner towards bad debt will not attract section 41(4) since the assessee has changed. In the present case, Rs. 1,00,000 is not taxable in the hands of the firm or the partner and the same is a capital receipt in the hands of the partner.

3. **T. VEERABHADRA RAO K.KOTESHWARA RAO (SUPREME COURT)**
   In this case, a firm made a sale to Mr. X of Rs. 1,00,000. The firm was succeeded to by a company and the debtor Mr. X was also transferred to the company. The company writes off the debtor Mr. X of Rs. 1,00,000 and claims deduction of bad debt. The Supreme Court in Veerabhadra Rao held that a successor to a business will be entitled to claim an allowance for bad debt even though the debt did not relate to the business of the assessee but to the business it has succeeded. The court held that even if the relevant debt had been taken into account in computing the income of the predecessor only and had been written off as irrecoverable in the accounts of the successor assessee, the assessee will be entitled to the deduction of bad debt. In the present case Rs. 1 lakh is a deductible as bad debt in the hands of the company.

4. **T.R.F LTD. VS. CIT (SUPREME COURT)**
   After 1.4.1989, it is not necessary for the assessee to establish that the debt, in fact, has become irrecoverable. It is enough if the bad debt is written off as irrecoverable in the accounts of the assessee.

3.9
(12) **Expenses on Family Planning [Section 36(1)(ix)]** - Any expenditure of revenue nature bona fide incurred by a company for the purpose of promoting family planning amongst its employees will be allowed as a deduction in computing the company’s business income;

- Where, the expenditure is of a capital nature, **one-fifth of such expenditure** will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years.
- This deduction is **allowable only to companies** and not to other assessee.
- The assessee would be **entitled to carry forward and set off** the unabsorbed part of the allowance in the same way as unabsorbed depreciation.

The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(13) **Deduction of securities transaction tax paid [Section 36(1)(xv)]**

An amount equal to the securities transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession."

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

An amount equal to the commodities transaction tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

(15) **Amount of expenditure incurred by a co-operative society for purchase of sugarcane at price fixed by the Government allowable as deduction [Section 36(1)(xvii)]**

Section 36(xvii) provides for deduction of expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price equal to or less than the price fixed or approved by the Government.
AMENDMENT MADE BY FINANCE ACT 2018:
Amendment to sections 36 and 40A

The following amendments have been made to sections 36 and 40A (with effect from the assessment year 2017-18)-

• **Section 36(1)** provides for allowing certain deductions in computing income under the head "Profits and gains of business or profession". A new clause (xviii) has been inserted in the said sub-section so as to provide that deduction in respect of any marked to market loss (or other expected loss) shall be allowed. However, deduction is available only if such loss is computed in accordance with ICDS.

• **Section 40A** provides for disallowance of certain expenses or payments while computing income under the head "Profits and gains of business or profession". A new sub-section (13) has been inserted in the said section so as to provide that no deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss except as allowable under section 36(l)(xviii).
CHAPTER 1
CHARGING SEC OF PGBP

(1) **General Chargeability:**
As per **Sec 28(i)** “Profits and gains from business & profession which was carried on by the assessee at any time during the P.Y” is charged under PGBP.
This is the *general chargeability* under the head B & P. Further there are certain special charging Secs as well which do not fulfill the conditions of general chargeability, to widen the scope of taxability.

(2) Whether a particular income will come under the head B & P will be **dependent upon the facts & circumstances** of each case.

(3) The term “Business” is defined u/s 2(13) in an inclusive manner to include trade, commerce, manufacture or any adventure in the nature of trade, commerce, manufacture. However, this *definition does not give any substantial test* to identify whether an activity amounts to business or not. We need to rely on the judgements given by the Court to understand the term Business. Therefore, SC in the case of **Barendra Prasad Ray** has held that “Business implies a systematic and organized activity by applying labour & skill with a dominant intent to earn profits thereon”.

Therefore, earning of profits should be one of the dominant purpose from the activities carried on to constitute it as business.

*On the afore mentioned test the following proposition arises:* -

(1) In case of classification between **CG or PGBP** regular activity and **profit motive** will decide the relevant head.

(2) Between **PGBP & IFOS** if the income is **inextricably** (very closely) linked with the activity of business then it will be classified under PGBP.

**Definition of Profession**

As per **Sec 2(36)** Profession includes ‘Vocation’.
<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>PARTICULARS</th>
<th>RELEVANT HEAD</th>
<th>REMARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>The assessee undertook the activity of plotting, to sell the huge land.</td>
<td>Capital Gains</td>
<td>Suresh Chandra Goel (SC). The activity of plotting was done to ease the process of sale of huge land. When the land is sold in plots, the dominant purpose is to sell the land &amp; exit the market &amp; there is no systematic &amp; organized activity done by the assessee to call it as Business.</td>
</tr>
<tr>
<td>(2)</td>
<td>Where the assessee after buying a huge land constructs a colony on it and then sell it. Whether such activity would be considered as Business?</td>
<td>PGBP</td>
<td>In this case the assessee has undertaken a systematic &amp; organized activity by applying labour &amp; skill &amp; it also amounts to kind of adventure done to fetch better price.</td>
</tr>
<tr>
<td>(3)</td>
<td>Interest income on deposits made in the bank, which has furnished bank guarantee on the behalf of Assessee for a tender.</td>
<td>PGBP</td>
<td>The interest income so earned is not an independent Investing Activity. Such deposits so placed are inextricably linked with the activity of business. Therefore, chargeable under the head B &amp; P.</td>
</tr>
<tr>
<td>(4)</td>
<td>The Assessee let out the P &amp; M during the course of lockout in the factory. Whether the rental income chargeable under</td>
<td>PGBP</td>
<td>Laxmi Silk Mills Ltd (SC) The dominant purpose of the facilities of the business is to generate revenue for its owners. Where the facilities cannot be used by the owner himself on</td>
</tr>
<tr>
<td>IFOS or PGBP?</td>
<td>account of some problems in the Company and therefore it is temporarily let out to generate some revenue, then it would amount to business expediency. Therefore, such income is arising out of business consideration &amp; therefore shall be classified under the head business &amp; profession.</td>
<td></td>
<td></td>
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<tr>
<td>---</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(5) The income earned by hotel industry by letting out the rooms would be classified under which head?</td>
<td>PGBP In case of hotels the income from their activity are in nature of business income, as the dominant purpose is not only let out of rooms, but it is hospitality services.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Chennai Properties & Investment Ltd**

It was held by SC that, if it is written in the MOA that the main object of the company is to acquire & let out immovable property and income from such activity is substantial, then income from such activity shall be taxable under PGBP instead of IFHP.

**Q.** What do you mean by term “PROFITS AND GAINS”?

**Ans.** The profits and gains must be revenue in nature i.e. all revenue receipts are chargeable to tax. Any trading receipt incidental to business will be chargeable under Sec 28(i). Any capital receipt, like damages for not supplying machinery on time will not be taxable, as it is capital receipt.

- Profits & gains may arise from legal or illegal business.
- Profits may arise in cash or kind.
• Profits u/s 28(i) must be Real Profits i.e. not notional, not anticipated i.e. it should not be arrived by applying by deeming fiction. (There are some exceptions eg :- Secs 44AD/44ADA/44AE/44B/44BB/44BBB/44BBA etc)

(4) The term carried on by the assessee means the assessee controls the business and need not do all the activities himself. A non-resident appoints an agent in India, then this agent will carry on the business, but the control of the business is with NR only.

(5) The term anytime during the P.Y.” means business or profession must be conducted at least sometime during the P.Y, if not for the entire year. Further it is not necessary business should be in existence in A.Y.

(6) **Sec 29: How to Compute PGBP Income?**

In accordance with Sec 30 to Sec 43D. But before computing PGBP as per Income Tax Act follow Sec 145.

As per Sec 145(1) every assessee covered under the head B & P or IFOS can maintain BOA on Mercantile or Cash basis regularly followed by the assessee.

As per Sec 145(2) for the purpose of maintaining BOA’s on Mercantile basis, Assessee has to follow Accounting standards notified by the Central Govt. CBDT has notified its own standards known as “INCOME COMPUTATION & DISCLOSURE STANDARDS”. (However only few ICDS have been notified so far)

As per Sec 145(3) if an assessee is found to be not complying with sub sec (1) or (2) then A.O. has the power to invoke Best Judgement Assessment u/s 144 [Refer Assessment Procedure].
### Special Charging Secs

1. **As per Sec 28(va),** any amount received or receivable in cash or kind under an agreement *for not carrying out any activity* in relation to any *business* or *profession* shall be chargeable under the head PGBP.

   ➔ The payer will get the **deduction** of such fees if TDS is deducted @ 10% *u/s 194J.*

2. **As per Sec 28,** value of any *benefit or perquisites* arising from business or profession shall be chargeable under the head PGBP.

### Treatment of Insurance

Any amount received from life insurance policy is **exempt *u/s 10(10D)*** if:

<table>
<thead>
<tr>
<th>(1) If policy is <strong>issued</strong> on or after 01/04/2003 but up to 31/03/2012</th>
<th>Annual <strong>≤ 20%</strong> of Sum Premium (AP) Assured (SA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(2) If policy is issued on or after 01/04/2012 but up to 31/03/2013</td>
<td><strong>AP ≤ 10%</strong> of SA</td>
</tr>
</tbody>
</table>

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**Sec 30 - 37 → Deduction of Expenses & Allowances**

- **Sec 30 - 36**
  - **Specific Deductions**
    - Available to All
      - **Sec 30**
      - **Sec 31**
      - **Sec 32**
      - **Sec 36(1)**
    - Sector wise Deductions
      - 32AD, 35ABB, 35ABA, 35AD,
      - 33AB, 33ABA, 36(1)(viia),
      - 36(1)(viii), 35CCA, 35D, 35DD,
      - 35E, 35DDA, 35CCC, 35CCD.

- **Sec 37**
  - **General Deductions**
    - (+)
    - 2 Explanations
    - (+)
    - Case laws
(3) If policy is issued on or after 01/04/2013

<table>
<thead>
<tr>
<th>Normal</th>
<th>Disability</th>
</tr>
</thead>
<tbody>
<tr>
<td>AP ≤ 10% of SA</td>
<td>u/s 80DDB AP ≤ 15% of SA</td>
</tr>
</tbody>
</table>

If the premium is above the limit, then claim is fully taxable & No deduction under Sec 80C can be allowed.

**Keyman Insurance Policy**

<table>
<thead>
<tr>
<th>1. If received by Employer</th>
<th>2. If received by Employee</th>
<th>3. If received by Nominees of Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxed u/s 28 - PGBP</td>
<td>Taxed u/s 17 - Profits in lieu of Salary</td>
<td>Taxed u/s 56 - IFOS</td>
</tr>
</tbody>
</table>

**Special Charging Sec relating to Export Assesses (Sec 28)**

1. Profit on sale of Import Licence under an import & export scheme shall be chargeable under the head PGBP.
2. Any amount of duty of customs repaid or repayable as drawback shall be chargeable under PGBP.
3. Cash assistance received or receivable against exports under any scheme of government is chargeable under PGBP.

**Special Charging Sec relating to Compensation received in Business**

Any compensation due or received by any person in connection with termination or modification of terms & condition of any contract relating to business shall be chargeable under the head PGBP (Also Refer IFOS) (Finance Act 2018)

**ALL THE BEST**
CHAPTER 2
DEPRECIATION

<table>
<thead>
<tr>
<th>Sec 32 \rightarrow DEPRECIATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sec 32(1)(ii)</td>
</tr>
<tr>
<td>Normal dep under Block Scheme</td>
</tr>
</tbody>
</table>

Sec 32(1)(ii): - Normal Depreciation under Block Scheme

(1) What do you mean by the term “Ownership”?

→ The term "Ownership" is not defined under IT Act. However, the Supreme Court in the landmark judgement of Mysore Minerals Ltd has held that the term ‘owner’ means beneficial owner and not legal owner. Accordingly, registration, title is irrelevant to determine ownership.

(2) Who will claim Depreciation in case of Lease & Hire Purchase Transactions?

In case of lease transactions, depreciation would be claimed by lessor [CBDT Cir. No. 9/2001].

In case of Hire purchase transactions, depreciation would be claimed by Hire purchaser [CBDT Circular of 1943].

ICDS Ltd V/S CIT (SC)

It was held in this case that lessor would be entitled to claim depreciation. The term ‘used’ referred in Sec 32(1)(ii) does not mean that the assessee itself should use the assets. In fact, the term ‘use’ means usage in the course of the business which the assessee is definitely doing. Further the term owner means beneficial owner and one who retained all the rights of ownership. It is irrelevant that the vehicles are in the name of the lessee, as these were mandatory requirements of Motor Vehicle Act 1988.
What do you mean by term "Use" for the purpose of Depreciation?
The term 'use' means both active as well as passive use i.e. ready for use.
It was held in the case of Chennai Petroleum Corp. Ltd. that so long as the business was a going one and the machinery got ready for the use but could not be put to use due to some extraneous reasons [Example shortage of RM] then depreciation would be allowable u/s 32.

<table>
<thead>
<tr>
<th>Sec 2(11): - Block of Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangible Assets</td>
</tr>
<tr>
<td>15% Plant</td>
</tr>
<tr>
<td>15% Machinery</td>
</tr>
<tr>
<td>10% Furniture</td>
</tr>
<tr>
<td>10% Building</td>
</tr>
</tbody>
</table>

@ prescribed rates (Rule 5(1))

- If Assets are used for > 180 days
- If Assets are used for < 180 days

Then dep. @ full Rate  
Then dep. @ half Rate

Proviso to Sec 32(1)

Notes:

1. Residential buildings will be depreciated @ 5% whereas temporary structures will be depreciated at 40%.

2. Motor cars will be depreciated @ 15%, moreover if it is used in business of running them on hire than 30%.

Note: If a Motor Car is purchased & used between 23.08.2019 to 31.03.2020 then the rate of Depreciation would be 30 % for all vehicles. Further if the assessee is engaged in the business of running the Motor Car on Hire, then rate of Depreciation would be 45%. (Press Release on 23.08.2019)
DEPRECIATION

(3) **Computer (including software)** including its peripheral will be depreciated at 40%.
(Refer the discussion of Sec 115A later on in International Taxation)

(4) **Mobile phones and EPBAX** are not computers, hence higher rate of depreciation is not applicable i.e. it will be depreciable at 15%.

(5) **Windmills** will be depreciated at 40%.

(6) **Professional Books** will be depreciated at 40%.

(7) **Ships** will be depreciated at 20%.

(8) **Aircraft** will be depreciated at 40%.

(9) **Pollution Control** Equipment depreciated at 40%.

When Dep rate u/s 32(1) becomes half?

- It becomes half when an asset is **acquired & put to use in that P.Y. for less than 180 days**.
- Therefore, if an asset is acquired in one year, but put to use for less than 180 days in next year, then it won't become half in next year.
- This provision is applicable to dep u/s 32(1)(iia)(i) & not 32(1)(iii).

Is Goodwill an Intangible asset?

- The SC in the case of **Smifs Securities Ltd** has observed that the expression intangible assets includes **other business or commercial rights**. Therefore, the term goodwill will fall under the said expression.

In the process of amalgamation, the amalgamated Company had **acquired a capital right** in the form of goodwill because of which the **market worth** of the amalgamated Company **increases**.

- Therefore, it was held that, goodwill is an intangible asset u/s 32(1) and eligible for deduction @ 25%.

Sec 43(3) Definition of plant

Plant includes ships, vehicles, books, scientific apparatus and surgical equipment’s but does not include tea bushes, livestock or building, furniture and fittings.
### When depreciation can be claimed?

<table>
<thead>
<tr>
<th>Condition</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) The block of asset must be positive on the last day.</td>
<td>AND</td>
</tr>
<tr>
<td></td>
<td>(2) The Block must not cease to exist on last day.</td>
</tr>
</tbody>
</table>

**Note:** Refer Textbook for Illustration, if required.

### Is it mandatory to claim depreciation?

→ **Yes,** as per Explanation 5 to Sec 32(1) it is mandatory to claim depreciation.

### How to arrive at WDV for next year?

→ As per Sec 43(6) WDV means Actual Cost as reduced “depreciation Actually allowed.” However, there are 2 exceptions to this norm as follows:

#### a) Exception 1:
As per Explanation 3 to Sec 43(6) any UAD carried forward u/s 32(2) shall be deemed to be actually allowed in the current year.

Example:

#### b) Exception 2:
In case the Income is partially from Agriculture & Partially from Business, then it is deemed that it is wholly from Business & the entire depreciation is deemed to be allowed for Business. In short reduce entire depreciation from Block.
Sec 32(1)(iia): Additional Depreciation @ 20% acquires & Install & Use New Machinery or Plant

| Manufacture any article or thing | Generation (OR) Generation & Distribution of power or Transmission of Power. |

**Note:**

1. It is **not allowed** in case of P & M which is 2nd Hand or any office premises or residential accommodation, ships, aircrafts, road transport vehicle, any P & M which is already allowed as deduction.

2. Additional depreciation is also subject to 50% proviso if an asset is acquired & put to use in that P.Y. for less than 180 days. However, remaining 50% would be allowable in the immediately next year.

3. Just like normal depreciation additional depreciation is also reduced from the block of asset.

4. Additional Depreciation is one-time benefit for that Plant & Machinery.

**CBDT Circular 15/2015 dated 19/05/2015:**

CBDT has clarified that the printing or printing & publishing amounts to manufacture, therefore eligible for additional depreciation u/s 32(1)(iia).

**Sec 43(1): Meaning of Actual Cost:**

The term Actual Cost means actual cost of asset to the assessee, as reduced by that portion which is met directly or indirectly by any person or authority.

<table>
<thead>
<tr>
<th>DETAILED ANALYSIS:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/04/1995</td>
</tr>
<tr>
<td>10% Loan 100 cr</td>
</tr>
</tbody>
</table>
**DEPRECIATION**

<table>
<thead>
<tr>
<th>Interest 1</th>
<th>Interest 2</th>
<th>Interest 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>[C.S.M]</td>
<td>[36 (1)(iii)]</td>
<td>Proviso to Sec 36(1)(iii)</td>
</tr>
</tbody>
</table>

**Interest 1**

As the SC judgement of **Challapali Sugar Mills Limited**, interest on borrowed Capital till the commencement of business, has to be capitalised to the cost of the asset and then depn can be claimed accordingly on it, by the assessee. This exp cannot be allowed as revenue exp in the year of commencement as it amounts to prior period expenses. Therefore, by applying the principle of C.S.M, we can conclude that till the time the business is not ready, the exp are not incurred for earning revenues but incurred for Fixed assets. Therefore, the term 'actual cost' is wide enough to include all those expenses which are inextricably linked with the asset.

**Interest 2**

In this case, since the business is commenced, and assets are used and therefore interest expense will be allowed as revenue expenditure as per Sec 36(1)(iii).

**Interest 3**

The Company has taken a new loan for construction of another asset. While reading the main provision of Sec 36(1)(iii) interest for such period shall be allowed as revenue expense since the business is commenced. However, proviso to Sec 36(1)(iii) will not allow such interest as revenue exp because it states that any capital borrowed for an asset which is not put to use shall not be allowed as deduction. However, till the time the asset is not put to use, such interest shall be capitalized to the cost of Asset.
DEPRECIATION

Interest 4

This interest will **never form a part of actual cost** as per *Explanation 8 to sec 43(1)*, as the asset is put to use.

This interest cannot be covered in **proviso to sec 36(1)(iii)** as the asset is put to use.

This interest will be **fully allowed as revenue exp** as the borrowed capital is for the purpose of business & profession and the asset is also used. Therefore, it will come in the main provision to *Sec 36(1)(iii).*

**Discussion on Previous Year:**

The term *'previous year'* is defined *u/s 2(34) as 'PY defined u/s 3'.* Since this is the most widely used term in the entire Act, therefore the government has taken the pain of defining separately *u/s 3.*

*Sec 3 defines Previous year as follows:*

For the purpose of this Act a previous year *means a financial year* immediately preceding the *AY.*

**Proviso**

In the case of *business or profession newly set up* in a financial year, the previous year shall be a period *beginning with the date of setting up* of business or profession, *i.e not from 1st April.*

**INCOME COMPUTATION & DISCLOSURE STANDARDS**

**Link of ICDS with & 43(1):**

**ICDS - V → Tangible Fixed Asset**

| Admin and General OH’s expenses are to be excluded from cost, if they do not relate to a specific Tangible Fixed Asset. | Expenses which are specifically attributable to construction of a project on acquisition of T.A. or bringing it to its working condition, shall be included as a part of cost. |
ICDS - V → Tangible Fixed Asset

Expenditure incurred on startup and commissioning of the project, incl. the expn on test runs shall be capitalized.

Exp. incurred after the plant has begun commercial prodn i.e. prodn for sale or captive consumption, shall be treated as revenue expn.

I.C.D.S - IX BORROWING COSTS

If the funds are borrowed specifically for “Qualifying Asset” then the actual borrowing cost incurred during the period for which funds are borrowed for that asset must be Capitalized.

If the funds are borrowed generally for “Qualifying Asset” then Borrowing cost shall be computed in accordance with following formula:

\[ A \times \frac{B}{C} \]

Where:

A = Borrowing costs incurred during the P.Y, except borrowing directly relatable to specific purpose.

B = (i) Average of cost of ‘QA’ as appearing in the B/S on 1st & last day of P.Y (OR):

(ii) in case the Q.A does not appear in B/S on 1st day or both then half of the cost of ‘Q.A’ (OR)

(iii) in case the Q.A does not appear in B/S on last day, then average of cost of Q.A appearing on 1st day and date of put to use

(C) Average of the amount of total assets as appearing in B/S on 1st day and last day

The Capitalization of borrowing cost shall cease in case of the Qualifying Asset, when such Asset is first put to use i.e. it will be available as a revenue expenditure as per Sec 36(1)(iii).
**Explanations to Sec 43(1): Actual Cost in Special Cases**

<table>
<thead>
<tr>
<th>EXPL. TO SEC. 43(1)</th>
<th>MODE OF ACQUISITION</th>
<th>ACTUAL COST</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Asset acquired for scientific research subsequently brought into business use</td>
<td>NIL (To be done with Sec 35)</td>
</tr>
<tr>
<td>2</td>
<td>Asset acquired by way of gift or inheritance</td>
<td>Actual Cost to the previous owner minus depreciation actually allowed to previous owner.</td>
</tr>
<tr>
<td>3</td>
<td>Asset acquired at higher price from any other person using the asset for his business or profession with a view to claim depreciation on enhanced cost and reduce tax liability</td>
<td>Actual cost to be determined by the Assessing Officer with prior approval of Joint Commissioner.</td>
</tr>
<tr>
<td>4</td>
<td>Asset once belonged to the assessee which was used by him for business &amp; is transferred and reacquired by him</td>
<td>The WDV at the time of original transfer or the price paid for acquiring the asset; whichever is less.</td>
</tr>
<tr>
<td>5</td>
<td>Building used for private purposes subsequently brought into business use.</td>
<td>The cost of purchase or construction of the building as reduced by the notional depreciation calculated at the depreciation rate applicable to the year of conversion into business use.</td>
</tr>
<tr>
<td>8</td>
<td>Asset acquired out of borrowed funds (<em>Do along with CSM &amp; proviso to sec 36(1)(iii)</em>)</td>
<td>Interest on loan borrowed relating to the period after the asset is first put to use shall never form part of actual cost.</td>
</tr>
<tr>
<td>9</td>
<td>Asset acquired subject to levy of GST in respect of which input credit is availed.</td>
<td>So much of the GST/Duty in respect in respect of which a claim of credit has been made and...</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>10</td>
<td>A portion of the cost of an asset acquired shall not form part of the actual cost. So much of the cost as is relatable to such subsidy or grant or reimbursement shall not form part of the actual cost. If subsidy is not directly relatable to the asset acquired, but subsidy is with reference to the assets then the subsidy shall be proportionately reduced from the actual cost of the assets with reference to which subsidy has been granted.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Asset brought into India by a Non-resident assessee or a foreign company for use in his business or profession. Actual cost as reduced by the amount of depreciation calculated at the rate in force as if the asset was used in India since the date of acquisition.</td>
<td></td>
</tr>
</tbody>
</table>

Allowed shall not form part of the actual cost.
### DEPRECIATION

#### SUBSIDY AND ITS COMPUTATION UNDER INCOME TAX.
Added by Finance Act 2015
Sec 2(24)(xviii)

**Definition of Income includes Assistance in the form of:**

- a subsidy or
- Grant or
- Cash incentive or
- Duty drawback or
- waiver or
- Concession or
- reimbursement (by whatever name called)
- by C.G (or) S.G (or) any authority (or) body (or) agency; in cash or kind to the assessee

**Exclusion Number -1**

- Other than subsidy or grant or reimbursement referred in Explanation 10 to Sec 43(1)

<table>
<thead>
<tr>
<th>Exclusion Number - 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subsidy or grant by Central Government for the purpose of corpus of a trust or institution established by Central Government or State Government shall not form part of income.</td>
</tr>
<tr>
<td>However, the following are taxable:</td>
</tr>
<tr>
<td>(i) Subsidy or grant by CG for the purpose of corpus of a trust or institution established by Local Authority.</td>
</tr>
<tr>
<td>(ii) Subsidy or grant by SG for the purpose of corpus of a trust or institution established by State Government or Local Authority.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Exclusion Number 3:</th>
</tr>
</thead>
<tbody>
<tr>
<td>LPG subsidy and other welfare subsidies received by individuals are not taxable.</td>
</tr>
</tbody>
</table>

#### CONCLUSION TO BE DRAWN FROM ABOVE AMENDMENT

(i) If subsidy, is for acquiring **Fixed asset then reduce from A/C (Actual cost)** as per Explanation 10 to Sec 43(1).

(ii) **Any other subsidy etc will become taxable under PGBP or IFOS if it is received from C.G (or) S.G (or) any authority (or) body (or) agency. Therefore, if waiver**
of loan is done by a Company then it is still not taxable, and it is a capital receipt and hence not taxable yet.

(A) Income Computation & Disclosure Standard – VII Government Grant Recognition of Government Grant

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Grant should not be recognized until, there is a reasonable assurance</td>
<td>Recognition shall not be postponed beyond the date of actual receipt</td>
</tr>
</tbody>
</table>

That the person shall comply with the conditions attached. AND that grants shall be received.

Treatment of Government Grants

<table>
<thead>
<tr>
<th>Where G/G relates to a Depreciable Asset</th>
<th>Where G/G relates to Non Depreciable Asset</th>
<th>Where G/G Cannot be directly attributed to an Asset</th>
<th>Where G/G is receivable as a compensation</th>
<th>For other than (1)(2)(3)(4)</th>
</tr>
</thead>
</table>
### DEPRECIATION

<table>
<thead>
<tr>
<th>Then, deduct from Actual Cost</th>
<th>Then, G/G shall be recognized as income over the same period during which the cost of obligation is charged to income</th>
<th>Then, deduct proportionately from Actual cost</th>
<th>Shall be recognized as income of the period in which it is receivable.</th>
<th>Shall be recognized as income based on principle of matching concept.</th>
</tr>
</thead>
</table>

**Refund of Government Grants**

<table>
<thead>
<tr>
<th>Refund in case of (2) / (4) &amp; (5)</th>
<th>Refund in case of Depreciable Asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Refundable amount should be first <strong>applied</strong> against unamortized deferred credit remaining.</td>
<td>(a) Refundable Amt shall be recorded by increasing the Actual cost or WDV of the Block.</td>
</tr>
<tr>
<td>(b) <strong>Excess</strong> can be charged to P &amp; L.</td>
<td></td>
</tr>
</tbody>
</table>

**Sec 32(2): Set off and Carry Forward of Unabsorbed Depreciation**

<table>
<thead>
<tr>
<th>Set off against any B &amp; P OR income of any other head except Salaries.</th>
<th>C/F to next years and set off against subsequent year PGBP income (OR) any other income except Salaries.</th>
</tr>
</thead>
</table>

**Time limit = Infinite years i.e. No time limit.**

**Priority of Set off:-**

1. Current year’s depreciation (Explanation 5 to Sec 32(1) mandatory).
2. Brought forward business loss (Because it is subject to 8 year’s time limit).
3. Unabsorbed depreciation {Capital Expenditure of Family Planning & Capital Expenditure of Scientific Research u/s 35(1)(iv)}
Proviso to Sec 32(1): - Depreciation in case of Amalgamation, etc.

In case of amalgamation, succession, demerger, compute depreciation as if no amalgamation, succession, demerger has taken place, then apportion such depreciation between amalgamating and amalgamated Co. OR predecessor and successor OR demerged and resulting Co. on the basis of no. of days assets were used by them.

Illustration:
A Ltd has a block of furniture amounting to Rs 1,00,000 on 01.04.2020. Further, A Ltd bought another furniture on 01.07.2020 amounting to Rs 200,000. Further, A Ltd got amalgamated with B Ltd from 4th October 20. Compute dep. as per Sec 32 for A’ltd and B Ltd and also determine the actual cost to be shown in the block of B Ltd.

Ans. Depreciation on Rs. 1,00,000  = 10,000

Depreciation on Rs 2,00,000  = 20,000

<table>
<thead>
<tr>
<th></th>
<th>A Ltd</th>
<th>B Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>10,000</td>
<td>10,000(x)</td>
</tr>
<tr>
<td>(2)</td>
<td>20,000</td>
<td>20,000(x)</td>
</tr>
</tbody>
</table>

Q. What will be the value of Asset to be shown in the books of B Ltd?

- As per Explanation 2 to Sec 43(6) the value of opening WDV will be taken as part of block of B Ltd. i.e. Rs 1,00,000.
- As per Explanation 7 to Sec 43(1) in case of amalgamation the actual cost i.e. Rs 2,00,000 will be forming part of B Ltd block.

Sec 32(1)(i): -SLM Depreciation for Power Generating Assessee

<table>
<thead>
<tr>
<th>Original Cost</th>
<th>1,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Dep for 3 yrs</td>
<td>(30,000)</td>
</tr>
<tr>
<td>W.D.V.</td>
<td>70,000</td>
</tr>
</tbody>
</table>
### DEPRECIATION

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>S.P. = 50,000</td>
<td>(b)</td>
<td>S.P. = 80,000</td>
</tr>
<tr>
<td>Terminal dep u/s 32(1)(iii)</td>
<td>= 20,000</td>
<td>Balancing charge OR Deemed income u/s 41(2) = 10,000</td>
<td>Balancing Charge OR Deemed Income u/s 41(2) = 30,000 [1,00,000 - 70,000]</td>
</tr>
<tr>
<td>COA / Adj WDV = 50,000</td>
<td>Adj. WDV / COA = 80,000</td>
<td>No Cap Gains (70,000 + 10,000)</td>
<td>Adj. WDV / COA = 1,00,000 (70,000 + 30,000)</td>
</tr>
<tr>
<td>No. Cap Gains (70,000 - 20,000)</td>
<td>No Cap Gains (70,000 + 10,000)</td>
<td>CG = 20,000 (120,000 - 20,000)</td>
<td></td>
</tr>
</tbody>
</table>

### SEC 50A: HOW C.G. IS COMPUTED WHEN A POWER GENERATING UNITS Sells AN ASSET?

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale consideration</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td>(-) Cost of Asset = Adj WDV**</td>
<td>(XX)</td>
<td></td>
</tr>
<tr>
<td>Capital Gains</td>
<td>XX</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Adjusted WDV: -

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>WDV</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td>(+) Balancing charge u/s 41(2)</td>
<td>XX</td>
<td></td>
</tr>
<tr>
<td>(-) T/D u/s 32(1)(iii)</td>
<td>(XX)</td>
<td></td>
</tr>
<tr>
<td>Adj WDV = COA</td>
<td>XX</td>
<td></td>
</tr>
</tbody>
</table>

### Additional Depreciation for Power Generating Assessee:

1. **If claimed depreciation as per Sec 32(1)(ii):**
   If the assessee opts for this option, then he is also allowed to claim additional depreciation u/s 32(1)(iia).

2. **Claim depreciation on SLM basis u/s 32(1)(i):**
   If the assessee opts for this option, then he cannot claim additional depreciation u/s 32(1)(iia).
General Note for your Knowledge:

Generally, under the Income Tax Act, no depreciation is allowed in the year of sale, in respect of asset which is sold during the year.

However, there are 2 exceptions under Income Tax Act, where the assessee gets depreciation in the year of sale:

i) Terminal depreciation.

ii) In case of amalgamation, demerger etc.

Sec 43A: - Change in Foreign Exchange Rates

<table>
<thead>
<tr>
<th>Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>When an asset is acquired from outside India</td>
</tr>
<tr>
<td>For that purpose, assessee takes a foreign currency loan OR foreign supplier.</td>
</tr>
</tbody>
</table>

Note: - Make Adjustment in the previous year in which actual payment is made.

ICDS - VI EFFECTS OF CHARGES IN FOREIGN EXCHANGES RATES

<table>
<thead>
<tr>
<th>Initial recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
</tr>
<tr>
<td>Should be recorded as per the rate on the date of transaction.</td>
</tr>
<tr>
<td>(i) If Exchange rate fluctuates significantly then take rate on the date of transaction.</td>
</tr>
</tbody>
</table>

Conversion on last date of Previous Year

<table>
<thead>
<tr>
<th>Monetary limit</th>
<th>Non-Monetary limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Shall be converted based</td>
<td>If closing rate is unrealistic (or) does not reflect</td>
</tr>
<tr>
<td>(2) Shall be recorded as per the rate prevailing on the date of transaction &amp; then</td>
<td></td>
</tr>
</tbody>
</table>
### DEPRECIATION

<table>
<thead>
<tr>
<th>on closing Rate.</th>
<th>reasonable accuracy.</th>
<th>revalue on Closing Date.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Then report at an amount which is likely to be realised or disburse, such item on the last day of P.Y.</td>
<td></td>
</tr>
</tbody>
</table>

**Sec 43A v/s 43AA**

**ALL THE BEST**
CHAPTER 3
SPECIFIC DEDUCTIONS

Sec 30: - Rent, Rates & Taxes, Repairs and Insurance of Building

<table>
<thead>
<tr>
<th>Owner</th>
<th>Tenant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rates, Taxes, Revenue Repairs and Insurance</td>
<td>Rent, Rates, taxes, Revenue Repairs and Insurance</td>
</tr>
<tr>
<td>↓ Capital Repair, then cost of C/R should be added to cost of Building &amp; then claim depreciation on it.</td>
<td>↓ For Capital repair, Tenant will be Deemed owner of the Building and he can also claim depreciation on C/R.</td>
</tr>
</tbody>
</table>

Notes:

1. Rates & Taxes will be allowed on actual payment basis as per Sec 43B.
2. If assessee incurs expenditure on repairs for which he has not undertaken to bear the cost of repairs, whether such expense will be allowed u/s 30? Such deduction will not be allowed u/s 30. However, if such expense is incurred for the purpose of B/P, then it will be allowed u/s 37(1).

Sec 31: - Repairs and Insurance of Plant, Machinery and Furniture

1. Repairs must not be capital in nature.
2. Rent of plant, machinery & Furniture is not deductible here. It is deductible u/s 37(1) subject to conditions mentioned there.

Other Deductions u/s 36(1)

<table>
<thead>
<tr>
<th>(i) Insurance premium paid against risk of destruction or damage of stocks.</th>
<th>(ib) Health Insurance premium paid by employers for employees (other)</th>
<th>(ii) Bonus / Comm. Paid to employees.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>However, where sum represents profits,</td>
</tr>
</tbody>
</table>
SPECIFIC DEDUCTIONS

than cash), then not allowed.

<table>
<thead>
<tr>
<th>SH's</th>
<th>Dividend</th>
<th>Bonus</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (25%)</td>
<td>25,000</td>
<td>-</td>
</tr>
<tr>
<td>B (25%)</td>
<td>25,000</td>
<td>-</td>
</tr>
<tr>
<td>Employee's</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C (25%)</td>
<td>5,000</td>
<td>20,000</td>
</tr>
<tr>
<td>D (25%)</td>
<td>5,000</td>
<td>20,000</td>
</tr>
</tbody>
</table>

Rs 40,000 bonus in the form of dividend can’t be allowed.

Note: Bonus or commission are allowed on actual payment basis as per Sec 43B.

Sec 36(1)(iii): - Interest on Borrowed Capital

| Borrowed money | Money must be used for B & P | Interest is paid or payable. |

(1) The expression ‘capital’ for the purpose of this section means only money and no other assets. Further, there must be an element of refund.

(2) The borrowed capital must be "used for B & P". This term is quite wider as compared to the term for the “purpose of earning profit”. Interest paid on the loans which are used for discharging day-to-day business expenses, for the purpose of acquiring capital assets, for the purpose of discharging dues in relation to business shall be allowed as deduction.

(3) The A.O. has no right to dictate the rate of interest at which capital is borrowed. Depending upon the market conditions, the assessee might pay interest at higher rate, that does not mean assessee is evading tax. What has to be seen is whether the borrowed capital is actually used for the purpose of B or P or not.

(4) Certain Interest payments are subject to Sec 43B.

S.A. BUILDERS (SC)

It was held by SC that expression commercial expediency is of wide import and includes such expenditure as a prudent businessman incurs for the purpose of his business. The IT Authority must put themselves in the shoes of the assessee and
SPECIFIC DEDUCTIONS

see how prudent businessmen would act. If advance is given to the sister concern on account of commercial expediency, then it should be allowed as deduction.

Note:
1. Interest on borrowed capital which is used for the payment of Income Tax is not allowed as deduction. However, if it is to pay GST then it is allowed.

2. What is the meaning of interest?
   → As per Sec 2(28A), interest means interest payable in any manner in respect of any money borrowed or debt incurred & includes any service fee or other charge in respect of money borrowed or debt incurred. {Also Refer Sec 9(1)(v)}

3. Gujarat Guardian Ltd (Delhi HC)
The assessee took a Long-Term loan of 10 years from IDBI, a Public Financial Institution. The said loan was used for the purpose of business. Later on, as a measure of restructuring to reduce the rate of interest, the assessee made a payment of Rs. 10lacs as lumpsum prepayment premium. Whether a complete deduction of 10L will be available in 1 year or in 10 years?

Judgement:
The Delhi HC in the case of Gujarat Guardian Ltd. held that such prepayment premium shall be allowed as deduction in 1 year itself. This is because as per Sec 36(1)(iii) interest on borrowed capital used for business is allowed as deduction. As per Sec 2(28A), the term interest is wide enough to include any other charges like lumpsum prepayment premium.
Further, the loan was taken from a PFI. Thus, the deduction shall be allowed u/s 43B in 1 year itself irrespective of method of Accounting.

<table>
<thead>
<tr>
<th>Sec 36(1)(iii): Discount on Zero Coupon Bonds.</th>
</tr>
</thead>
<tbody>
<tr>
<td>13/09/2020</td>
</tr>
<tr>
<td>Issue Date</td>
</tr>
<tr>
<td>Discount = 10000 x 50 = Rs. 5,00,000</td>
</tr>
</tbody>
</table>

CA AARISH KHAN
SPECIFIC DEDUCTIONS

Redeemable date = 12/09/2025

<table>
<thead>
<tr>
<th>Year</th>
<th>Period</th>
<th>Discount / month</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>21</td>
<td>7m x 8,333</td>
</tr>
<tr>
<td>2021</td>
<td>22</td>
<td>12m x 8,333</td>
</tr>
<tr>
<td>2022</td>
<td>23</td>
<td>12m x 8,333</td>
</tr>
<tr>
<td>2023</td>
<td>24</td>
<td>12m x 8,333</td>
</tr>
<tr>
<td>2024</td>
<td>25</td>
<td>12m x 8,333</td>
</tr>
<tr>
<td>2025</td>
<td>26</td>
<td>5m x 8,333</td>
</tr>
</tbody>
</table>

Note:
If the bonds are issued for 15 days or more by the company, then take it as a complete month.

Sec 36(1)(iv): Employer Contribution to Recognised Provident fund/Superannuation Fund is allowed as deduction {Subject to Sec 43B}.

Sec 36(1)(iva): Employer Contribution to Approved Pension Fund is allowed as deduction {Subject to Sec 43B}.

Sec 36(1)(v): Employer Contribution to Approved Gratuity Fund is allowed as deduction {Subject to Sec 43B}.

Sec 36(1)(va): Employees Contribution to RPF etc is allowed as deduction to employer if paid before the due date of the Relevant Fund

Note: It is pertinent to note that Employees Contribution is considered as Income of Employer as per sec 2(24)(x) when it is deducted from the salary of Employee. Thereafter when it is paid before the funds due date then it is allowed as deduction to Employer. Therefore, it gets nullified. (There are contradictory views on this which will be seen in later part)

Sec 36(1)(vi): Allowance for Animals used for B or P (other than stock in trade)

Deduction = Cost – Sale Value
Note: The **deduction** is available in the **year** in which the animals have become useless or they are dead.

### Sec 36(1)(vii): - Deduction of Actual Bad Debts

<table>
<thead>
<tr>
<th>The Debt must be <strong>written off</strong> as irrecoverable <strong>in BOA</strong> &quot;for the P.Y.&quot;</th>
<th><strong>AND</strong></th>
<th>The debt must be taken into <strong>income</strong> of assessee of year of deduction or earlier P.Y.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td><strong>EXCEPTION:</strong> - Banking and money lending business in relation to their Loan amount</td>
</tr>
</tbody>
</table>

- **T.R.F. Ltd.**
  - It is **not necessary** for the assessee to establish that the debt has become **irrecoverable**. It is enough if it is **w/off** as irrecoverable.
  - For the purpose of this section, Bad Debts **w/off** shall **not include** prov. for doubtful debts. {Also refer Sec 36(1)(viia) later}
  - It was held in the case of **T. Veerbhadr Rao K. Koteshwara Rao** that where the goods, are **sold by predecessor** on credit basis & subsequently, it has become **bad in the hands of successor**, then deduction is **allowed to successor**.

### Amendment made by Finance Act, 2015

In order to reduce litigation and provide clarity Finance Act 2015 has inserted a proviso to sec 36(1)(vii) which states that "Any income which is **offered for tax** as per ICDS without recording the same in the BOA, if it becomes bad then it shall be **DEEMED** that such debt is **written off** as irrecoverable and deduction will be allowed."
**SPECIFIC DEDUCTIONS**

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<table>
<thead>
<tr>
<th><strong>Sec 36(1)(ix):</strong> - Expenditure on promotion of Family Planning amongst Employees only by Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue → Fully Allowed</td>
</tr>
</tbody>
</table>

**Note:** Unabsorbed Capital Expense shall be treated as UAD.

- **36(1)(xv) - STT** *(provided the assessee is trader in securities)* *(In Capital Gains STT is not allowed as deduction as per 7<sup>th</sup> Proviso to Sec 48)*

- **36(1)(xvi) - CTT** *(provided the assessee is trader in commodities)*

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**Sec 36(1)(xvii): Deduction for Cooperative Society:**

Deduction of expenditure incurred by a **co-operative society** engaged in the business of **manufacture of sugar** for purchase of sugarcane at a price equal to or less than the price fixed or approved by the Government.

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**Amendment made by Finance Act 2018:**

As per **Sec 36(1)(xviii),** deduction in respect of **mark to market** loss shall be allowed. However, the deduction is allowed **only if such loss** is computed in accordance with **ICDS.**

Further, as per **Sec 40A(13),** **no deduction** shall be allowed in respect of mark to market loss, if it is **not determined as per Sec 36(1)(xviii).**

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**ALL THE BEST**