CHAPTER 5. GENERAL DEDUCTION U/S 37(1)

Treatment of Losses under Income Tax Act:-


One has to keep in view the general commercial principles while determining real & true profits of a business or profession.

There may be loss which is not admissible loss under any of the provisions of the Act and yet such losses should be allowed in order to determine true and real profits of assessee & it is the duty of every person who has anything to do with taxing business people to understand what are the principles of commercial accounting.

Unless one understands the principle of commercial accounting, it is absolutely difficult to make a proper assessment.

Trading losses which are incidental to the operations of the business must be allowed even if it is not specially coded anywhere in the Act.

As capital receipts are not chargeable to tax, therefore even capital Losses can’t be allowed as deduction. [CIT v/s Mysore Sugar Co. Ltd].

Following are the some of the instances which are deductible as losses:-

a. Loss of stock by fire.

b. Loss of stock by Ravages of Ants.

c. Loss of cash by theft.

d. Loss of stock by Act of God.

e. Loss on Account of foreign exchange.

f. Loss due to embezzlement by employee.

SECTION 37(1): GENERAL CLAUSE FOR DEDUCTIONS

Any expenditure other than specifically mentioned in the preceding paragraphs (i.e. sections 30 to 36) shall be allowed as deduction provided the following conditions are satisfied:

1. it is not in the nature of capital expenditure;
2. it is not in the nature of personal expenses of the assessee; and
3. it is laid out wholly and exclusively for the purposes of the business or profession of the assessee.

EXPLANATION 1 TO SECTION 37(1): ILLEGAL PAYMENTS

"For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure."
The above amendment will result in disallowance of claims made by certain assesses in respect of payments on account of protection money, extortion, hafta, bribes, etc as business expenditure. It is well decided that unlawful expenditure is not allowable expenditure in computation of income.

EXPLANATION 2 TO SECTION 37(1): CORPORATE SOCIAL RESPONSIBILITY EXPENSES

Disallowance of CSR expenditure [Explanation 2 to Section 37(1)]

(i) Section 135 of the Companies Act, 2013 read with Schedule VII thereto and Companies (Corporate Social Responsibility) Rules, 2014 are the special provisions under the new company law regime imposing mandatory CSR obligations.

<table>
<thead>
<tr>
<th>Mandatory CSR obligations under section 135:</th>
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<tr>
<td>➢ Every company, listed or unlisted, private or public, having a -</td>
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<td>- net worth of Rs. 500 crores or more [Net worth criterion]; or</td>
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<tr>
<td>- turnover of Rs. 1,000 crores or more [Turnover criterion]; or</td>
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<tr>
<td>- a net profit of Rs. 5 crores or more [Net Profit criterion]</td>
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<td>during any financial year to constitute a CSR Committee of the Board;</td>
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<td>➢ CSR Committee has to formulate CSR policy and the same has to be approved by the Board;</td>
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<td>➢ Such company to undertake CSR activities as per the CSR Policy;</td>
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<tr>
<td>➢ Such company to spend in every financial year, at least 2% of its average net profits made in the immediately three preceding financial years, on the CSR activities specified in Schedule VII to the Companies Act, 2013.</td>
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(ii) As per Rule 4 of the Companies (CSR) Rules, 2014, the following expenditure are not considered as CSR activity for the purpose of section 135:

- Expenditure on activities undertaken in pursuance of normal course of business;
- Expenditure on CSR activities undertaken outside India;
- Expenditure which is exclusively for the benefit of the employees of the company or their families; and
- Contributions to political parties.

(iii) Under section 37(1) of the Income-tax Act, 1961, only expenditure, not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. The issue under consideration is whether CSR expenditure is allowable as deduction under section 37.

(iv) It has now been clarified that for the purposes of section 37(1), any expenditure incurred by an assesse on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37.

(v) The rationale behind the disallowance is that CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business.

(vi) However, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be
allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.

CIRCULAR NO. 5/2012, DATED 1-8-2012

Section 37(1) of the Income Tax Act, 1961 - Allowability of Business Expenditure - Inadmissibility of expenses incurred in providing freebees to Medical Practitioner by pharmaceutical and allied health sector Industry

1. It has been brought to the notice of the Board that some pharmaceutical and allied health sector Industries are providing freebees (freebies) to medical practitioners and their professional associations in violation of the regulations issued by Medical Council of India (the 'Council') which is a regulatory body constituted under the Medical Council Act, 1956.

2. The council in exercise of its statutory powers amended the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 (the regulations) on 10-12-2009 imposing a prohibition on the medical practitioner and their professional associations from taking any Gift, Travel facility, Hospitality, Cash or monetary grant from the pharmaceutical and allied health sector Industries.

3. Section 37(1) of Income Tax Act provides for deduction of any revenue expenditure (other than those failing under sections 30 to 36) from the business Income if such expense is laid out/expended wholly or exclusively for the purpose of business or profession. However, the Explanation appended to this sub-section denies claim of any such expense, if the same has been incurred for a purpose which is either an offence or prohibited by law.

Thus, the claim of any expense incurred in providing above mentioned or similar freebees in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 shall be inadmissible under section 37(1) of the Income Tax Act being an expense prohibited by the law. This disallowance shall be made in the hands of such pharmaceutical or allied health sector Industries or other assessee which has provided aforesaid freebees and claimed it as a deductible expense in its accounts against income.

4. It is also clarified that the sum equivalent to value of freebees enjoyed by the aforesaid medical practitioner or professional associations is also taxable business income or income from other sources as the case may be depending on the facts of each case. The Assessing Officers of such medical practitioner or professional associations should examine the same and take an appropriate action.

This may be brought to the notice of all the officers of the charge for necessary action.

TREATMENT OF EXPENDITURE ON KEYMAN INSURANCE POLICY:

CBDT Circular no. 762/1998 dated 18.02.1998 clarifies that the premium paid on the Keyman Insurance Policy is allowable as business expenditure.

Taking into account the Explanation to Section 10(10D) and the CBDT Circular no. 762 dated 18.02.1998, Courts have held that a Keyman Insurance Policy is not confined to a policy taken for an employee but also extends to an insurance policy taken with respect to the life of another person who is connected in any manner whatsoever with the business of the subscriber (assessee).

The High Court of Punjab and Haryana has, in the case of M/s. Ramesh Steels, ITA No. 437 of 2015, vide judgement dated 2.2.2016, reiterating the above view, held that, “the said policy when obtained to secure the life of a partner to safeguard the firm against a
disruption of the business is equally for the benefit of the partnership business which may be effected as a result of premature death of a partner. Thus, the premium on the Keyman Insurance Policy of partner of the firm is wholly and exclusively for the purpose of business and is allowable as ‘business expenditure’.

In view of the above, the CBDT has clarified that in case of a firm, premium paid by the firm on the Keyman Insurance Policy of a partner, to safeguard the firm against a disruption of the business, is an admissible expenditure under section 37 of the Act.

### ILLUSTRATIONS ON SECTION 37(1)

1. Penalties imposed for infraction of law are not deductible. *Haji Aziz & Abdul Shakoor Bros. v. CIT (SC)*

2. **DR. T.A. QURESHI VS. CIT (SUPREME COURT)**
   
   **Loss of illegal business shall be allowed to set-off from profits of legal business.**

   **FACTS OF THE CASE:**
   
   Subsequent to the recovery and seizure of huge quantity of heroin drugs from the assessees-doctor's possession, he filed return claiming that since the heroin seized from him formed part of stock-in-trade, hence, its loss on account of seizure was an allowable deduction while computing his Profits and Gains from Business & Profession. The Assessing Officer, however, disallowed the assessees's said claim.

   **HELD:**
   
   On an appeal to the Supreme Court, the Supreme Court held that, no doubt, the assessees had contended that he was only earning income from his medical profession and was not doing any illegal activity of manufacturing or selling of heroin. However, the finding of fact of the Tribunal in its order was that the assessees was engaged in manufacture and selling of heroin.

   The Tribunal held that the heroin seized was the assessees's stock-in-trade, it was implicit that the Tribunal reiterated the view that the assessees was doing the business of manufacture and sale of heroin.

   In order of Tribunal there was a finding of fact to the effect that the heroin formed part of stock in trade of the assessees. In view of said finding, the Tribunal allowed the assessees's claim of deducting the loss of 5 kg of heroin whose value was assessed by the Tribunal at Rs. 2 lakhs as a business loss. The view taken by the Tribunal was to be sustained.

   The Explanation to section 37 has really nothing to do with the instant case as it was not a case of a business expenditure, but of business loss. Business losses are allowable on ordinary commercial principles in computing profits. Once it was found that the heroin seized form part of stock-in-trade of the assessees, it followed that the seizure and confiscation of such stock-in-trade had to be allowed as a business loss. Loss of stock-in-trade has to be considered as a trading loss.

   
   Where goods have been confiscated by custom authorities in a foreign country due to certain statutory violation, can the same be treated as a loss of stock-in-trade, and claimed as deduction’

   The High Court held that the **loss arising on confiscation of pharmaceutical drugs is a business loss**, based on the Supreme Court's decision in Dr. T. A. Qureshi's case.
4. **Any Penalty/interest paid under Direct Taxes laws is not deductible.**
   (a) Expenditure incurred due to failure to deduct TDS is not allowable as a business expense.

   **Indian Aluminium Co. Ltd. v. CIT (SC)**
   Assessee paid foreign collaborators fees without deducting TDS. Then he paid TDS to government. Subsequently the assessee failed to recover TDS from the collaborator and w/off the same in books. Held it cannot be treated as business expenditure under section 37(1), since the amount is paid for the default in deducting TDS under the Income-tax Act. It cannot be claimed as bad debt under section 36(1)(vii) as the conditions of bad debt are not satisfied.

   (b) Interest paid in respect of delayed payment of income-tax is not deductible.

5. **Penalty/penal interest under Sales Tax Act.**
   (a) Interest paid by the assessee to Sales Tax Department on arrears of sales tax is an admissible deduction.
   (b) Penalty levied under the Central Sales Tax Act is not deductible.

6. Demurrage paid to port authorities in connection with release of confiscated goods is not a fine paid for infraction of law and is thus allowable as business expense.

7. **Delayed payments to P.F.**
   Interest paid under employees Provident Fund & Misc. Provisions Act, 1952 is allowable if it is compensatory and not penal.

8. **Penalty/ Damages paid for breach of contract.**
   (a) Penalty paid by assessee contractor for non-completion of contract within stipulated time is allowable.
   **Reason:** Delay in completion of contract work is incidental to the business of contracts. Therefore, the liability to compensation is contractual and is not in the nature of penalty.
   (b) Penalty for failure to supply goods under a contract are allowable.

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<th>SECTION 37(2B): PAYMENTS MADE TO POLITICAL PARTY</th>
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<tr>
<td>Notwithstanding anything contained in section 37(1), no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract pamphlet or the like published by a political party.</td>
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<th>KEY POINTS:</th>
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<tr>
<td>1. Donations to political party and electoral trust are disallowed since such donation can not be said to be expenditure incurred for the purposes of business or profession.</td>
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<tr>
<td>2. However, donations to political party and electoral trust are allowed as deduction under section 80GGB and 80GGC of the Income Tax Act.</td>
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</table>

The CBDT has, vide this Circular, clarified the tax treatment of expenditure incurred on development and construction of infrastructural facilities like roads/highways on Build-Operate-Transfer (BOT) basis with right to collect toll - whether the same is entitled to depreciation under section 32(1)(ii) or can be amortized by treating it as an allowable business expenditure under the relevant provisions of the Income-tax Act, 1961.

Generally, the BOT basis projects are entered into between the developer and the government or the notified authority, on the following terms:

(i) In such projects, the developer, in terms of concessionaire agreement with Government or its agencies, is required to construct, develop and maintain the infrastructural facility of roads/highways which, inter alia, includes laying of road, bridges, highways, approach roads, culverts, public amenities etc. at its own cost and its utilization thereof for a specified period.

(ii) The possession of land is handed over to the assessee (i.e., the developer) by the Government/notified authority for the purpose of construction of the project without any actual transfer of ownership. The assessee, therefore, has only a right to develop and maintain such asset. It also enjoys the benefits arising from the use of asset through collection of toll for a specified period, without having actual ownership over such asset. Therefore, the rights in the land remain vested with the Government/notified agencies.

(iii) Since the assessee does not hold any rights in the project except recovery of toll fee to recoup the expenditure incurred, it cannot be treated as an owner of the property, either wholly or partly, for purposes of allowability of depreciation under section 32(1)(ii). Thus, claim of depreciation on toll ways is not allowable due to non-fulfillment of ownership criteria in such cases.

(iv) Where the assessee incurs expenditure on a project for development of roads/highways, it is entitled to recover cost incurred towards development of such facility (comprising of construction cost and other pre-operative expenses) during construction period. Further, expenditure incurred by the assessee on such BOT projects brings to it an enduring benefit in the form of right to collect the toll during the period of agreement.

The Supreme Court, in Madras Industrial Investment Corporation Ltd. vs. CIT 225 ITR 802, allowed the spreading over of liability over a number of years on the ground that there was continuing benefit to the company over a period. Therefore, analogously, expenditure incurred on an infrastructure project for development of roads/highways under BOT agreement may be treated as having been made/ incurred for the purposes of business or profession of the assessee and same shall be allowed to be spread during the tenure of concessionaire agreement.

In view of the above, the CBDT, in exercise of the powers conferred under section 119, clarifies that the cost of construction on development of infrastructure facility, being roads/highways under BOT projects, may be amortized and claimed as allowable business expenditure under the Act in the following manner:

(i) The amortization allowable may be computed at the rate which ensures that the whole of the cost incurred in creation of infrastructural facility of road/highway is amortised evenly over the period of concessionaire agreement after excluding the time taken for creation of such facility.
Where an assessee has claimed any deduction out of initial cost of development of infrastructure facility of roads/highways under BOT projects in earlier years, the total deduction so claimed for the assessment years prior to assessment year under consideration may be deducted from the initial cost of infrastructure facility of roads/highways and the cost so reduced shall be amortised equally over the remaining period of toll concessionaire agreement.

The clarification given in this Circular is applicable only to those infrastructure projects for development of road/highways on BOT basis where ownership is not vested with the assessee under the concessionaire agreement.

FROM THE JUDICIARY

1. **KERALA ROAD LINES (SUPREME COURT)**
   The assessee has entered into an agreement for purchase of land with buildings thereon. The buildings standing on the land were demolished and the income from the sale of scrap material was treated as business income. The assessee had to pay certain interest on delayed payment for the purchase price and it claimed the same as revenue expenditure. The Assessing Officer disallowed the claim of the assessee on the ground that the payment of interest on the purchase of property was in the nature of a capital expenditure and not a revenue expenditure.

   Held, that the sale proceeds of the scrap material after demolishing the structures standing on the land was treated as business income of the assessee. If that was so, payment of interest which was the contractual obligation, would also be a business expenditure. Once the revenue had accepted the sale proceeds of the scrap material of structures standing on land as business income, then, correspondingly, the assessee would be entitled to claim the amount of interest paid as revenue expenditure.

2. **Is Circular No. 5/2012 dated 01.08.2012 disallowing the expenditure incurred on freebies provided by pharmaceutical companies to medical practitioners, in line with Explanation to section 37(1), which disallows expenditure which is prohibited by law?**

   **CONFEDERATION OF INDIAN PHARMACEUTICAL INDUSTRY (H.P.)**

   **High Court’s Observations:** On this issue, the Himachal Pradesh High Court observed that as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries. This is a statutory regulation in the interest of the patients and the public, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

   The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, *vide Circular No.5/2012 dated 1.8.2012*, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has
provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

**High Court’s Decision:** The High Court opined that the contention of the assessee that the above mentioned Circular goes beyond section 37(1) was not acceptable. As per **Explanation** to section 37(1), it is clear that any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession. The sum and substance of the circular is also the same. Therefore, the circular is totally in line with the **Explanation** to section 37(1).

However, if the assessee satisfies the assessing authority that the expenditure incurred is not in violation of the regulations framed by the Medical Council then it may legitimately claim a deduction, but it is for the assessee to satisfy the Assessing Officer that the expense is not in violation of the Medical Council Regulations.

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

**CIT V. KAP SCAN AND DIAGNOSTIC CENTRE P. LTD. (2012) (P&H)**

**High Court’s Observations:** On the above mentioned issue, the Punjab and Haryana High Court observed that the argument of the assessee that giving commission to the private doctors for referring the patients for various medical tests was a trade practice which could not be termed to be illegal and therefore, the same cannot be disallowed under section 37(1), is not acceptable. Applying the rationale and considering the purpose of **Explanation** to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. The assessee cannot take a plea that businessmen are entitled to conduct their business even contrary to law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have pernicious consequences to the society as a whole.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

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

4. **CIT vs. Khemchand Motilal Jain, Tobacco Products (P.) Ltd. (Madhya Pradesh)**

Assessee-company was engaged in manufacturing and sale of bidis. The wholetime director of assessee-company, had gone on business tour for purchase of tendu leaves where he was kidnapped for ransom by a dacoit. Police was unsuccessful to recover 'S' from clutches of dacoits and, ultimately, assessee had to pay ransom money for release
of its director. Amount of ransom money paid by assessee is allowed as business expenditure.

5. Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, be allowed as business expenditure under section 31, by treating it as current repairs considering heart as plant and machinery, or under section 37, by treating it as expenditure incurred wholly and exclusively for the purpose of business or profession?

SHANTI BHUSHAN V. CIT (2011) 336 ITR 26 (DELHI)

Facts of the case: In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the heart should be treated as plant as it is used for the purpose of his professional work. He substantiated his contention by stating that after his heart surgery, his gross receipts from profession increased manifold. Hence, the expenditure on the heart surgery should be allowed as business expenditure either under section 31 as current repairs to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession. The department argued that the said expenditure was personal in nature and was not incurred wholly and exclusively for the purpose of business or profession, and therefore, the same should not be allowed as business expenditure.

High Court’s Observations: On this issue, the Delhi High Court observed that a healthy and functional human heart is necessary for a human being irrespective of the vocation or profession he is attached with. Expenses incurred to repair an impaired heart would thus add to the longevity and efficiency of a human being which would be reflected in every activity he does, including professional activity. It cannot be said that the heart is used as an exclusive tool for the purpose of professional activity by the assessee. Further, the High Court held that:

(i) To allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee’s balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would face difficulty in arriving at the cost of acquisition of such an asset for showing in his books of account.

Though the definition of “plant” as per the provisions of section 43(3) is inclusive in nature, such plant must have been used as a business tool which is not true in case of heart. Therefore, the heart cannot be said to be plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

(ii) According to the provisions of section 37, inter alia, the said expenditure must be incurred wholly and exclusively for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work.

High Court’s Decision: There is, therefore, no direct nexus between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable. Hence, the heart surgery expenses shall not be allowed as a business
6. Can expenditure incurred on alteration of a dam to ensure adequate supply of water for the smelter plant owned by the assessee be allowed as revenue expenditure?

**CIT V. HINDUSTAN ZINC LTD. (2010) 322 ITR 478 (RAJ.)**

**Facts of the case:** The assessee company owned a super smelter plant which requires large quantity of water for its day-to-day operation, in the absence of which it would not be able to function. The assessee, therefore, incurred expenditure for alteration of the dam (constructed by the State Government) to ensure sharing of the water with the State Government without having any right or ownership in the dam or water. The assessee’s share of water is also determined by the State Government. The assessee claimed the expenditure as deduction under section 37, which was disallowed by the Assessing Officer on the ground that it was of capital nature.

**Tribunal view:** The Tribunal, however, was of the view that since the object and effect of the expenditure incurred by the assessee is to facilitate its trade operation and enable the management to conduct business more efficiently and profitably, the expenditure is revenue in nature and hence, allowable as deduction.

**High Court’s Observations & Decision:** The High Court observed that the expenditure incurred by the assessee for commercial expediency relates to carrying on of business. The expenditure is of such nature which a prudent businessman may incur for the purpose of his business. The operational expenses incurred by the assessee solely intended for the furtherance of the enterprise can by no means be treated as expenditure of capital nature.

7. Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?

**MILLENNIA DEVELOPERS (P) LTD. V. DCIT (2010) 322 ITR 401 (KARN.)**

**Facts of the case:** The assessee, a private limited company carrying on business activity as a developer and builder, claimed the amount paid by way of regularization fee for the deviations made while constructing a structure and for violating the plan sanctioned in terms of the building bye-laws, approved by the municipal authorities as per the provisions of the Karnataka Municipal Corporations Act, 1976. The assessee’s claim was disallowed by the Assessing Officer and the disallowance was confirmed by the Tribunal.

**High Court’s Observations and Decision:** The High Court observed that as per the provisions of the Karnataka Municipal Corporations Act, 1976, the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under section 37. Merely describing the payment as a compounding fee would not alter the character of the payment.

**Note** – In this case, it is the actual character of the payment and not its nomenclature that has determined the disallowance of such expenditure as deduction. The principle of substance over form has been applied in disallowing an expenditure in the nature of penalty, though the same has been described as regularization fee/compounding fee.
8. Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?

**CIT V. NEELAVATHI & OTHERS (2010) (KARN)**

**Facts of the case:** The assessee running cinema theatres claimed deduction of the sum paid to the local police and local gundas towards maintenance of the theatre. The same was disallowed by the Assessing Officer.

**High Court’s Observations:** On this issue, the High Court observed that if any payment is made towards the security of the business of the assessee, such amount is allowable as deduction, as the amount is spent for maintenance of peace and law and order in the business premises of the assessee i.e., cinema theatres in this case. However, the amount claimed by the assessee, in the instant case, was towards payment made to the police and gundas.

Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.

**High Court’s Decision:** If the assessee had incurred expenditure for the purpose of security, the same would have been allowed as deduction. However, in the instant case, since the payment has been made to the police and gundas to keep them away from the business premises, such a payment is illegal and hence, not allowable as deduction.

9. Can advance given to employees and security deposit paid to the landlord, which became irrecoverable, be allowed as a business loss?

**CIT V. TRIVENI ENGG. & INDUSTRIES LTD. (2012) 343 ITR 245 (DELHI)**

On the above mentioned issue, the Delhi High Court held that advances to employees were given by the amalgamating company in the ordinary course of business by way of temporary financial accommodation to be recovered out of the salary paid to the employees. Therefore, such advances given to persons who had been employed by the assessee company which have become irrecoverable would be treated as business loss.

However, as regards the allowability of non-recoverable security deposit given to the landlord for obtaining lease of premises for purposes of business, the High Court observed that the security deposits were refundable and therefore, were not in the form of rent. They were given for securing the premises on rent. The assessee had obtained a right to use the property, i.e., tenancy right, which is a capital asset. Therefore, it is not allowable as business loss.

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

**CIT V. ORIENT CERAMICS AND INDUSTRIES LTD. (2013) (DELHI)**

**High Court’s Observations:** On this issue, the Delhi High Court noted the following observations of the Punjab and Haryana High Court in *CIT v. Liberty*
Group Marketing Division [2009] 315 ITR 125, while holding that such expenditure was revenue in nature -

(i) The expenditure incurred by the assessee on glow sign boards does not bring into existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital.
(ii) The glow sign board is not an asset of permanent nature. It has a short life.
(iii) The materials used in the glow sign boards decay with the effect of weather. Therefore, it requires frequent replacement. Consequently, the assessee has to incur expenditure on glow sign boards regularly in almost each year.
(iv) The assessee incurred expenditure on the glow sign boards with the object of facilitating the business operation and not with the object of acquiring asset of enduring nature.

High Court's Decision: The Delhi High Court concurred with the above observations of the P & H High Court and held that such expenditure on glow sign boards displayed at dealer outlets was revenue in nature.

11. Is interest income from share application money deposited in bank eligible for set-off against public issue expenses or should such interest be subject to tax under the head ‘Income from Other Sources’?

CIT V. SREE RAMA MULTI TECH LTD. [2018] (SC)

Issue: The issue under consideration is whether the interest income from share application money is taxable under the head ‘Income from Other Sources’ or can the same be set-off against public issue expenses.

Supreme Court’s Observations:
1. The Supreme Court observed that the assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed.
2. The interest earned was inextricably linked with the requirement of raising share capital.
3. Any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as “Income from Other Sources”. Here, the share application money was deposited with the bank not to make additional income but to comply with the statute.
4. The interest accrued on such deposit is merely incidental. Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized. Accordingly, the accrued interest is not liable to be taxed as “Income from Other Sources”; the same is eligible to be set-off against public issue expenses.

Supreme Court’s Decision: The Supreme Court concurred with the High Court’s view that the interest accrued on deposit of share application money with bank is eligible for set off against the public issue expenses; such interest is, hence, not taxable as “Income from Other Sources”.

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CHAPTER 6. DISALLOWANCES

AS PER SEC 40A(1) THE FOLLOWING DISALLOWANCES SHALL BE MADE NOTWITHSTANDING ANYTHING CONTAINED IN ANY OTHER PROVISION OF THE INCOME-TAX ACT:

SECTION 40A(2): PAYMENTS TO SPECIFIED PERSONS NOT DEDUCTIBLE UNDER CERTAIN CIRCUMSTANCES

Sub-section (2) of section 40A provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a specified person (See column (2) of Table below) so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he shall have due regard to:

(a) the fair market value of the goods, service of facilities for which the payment is made; or
(b) the legitimate needs of the business or profession carried on by the assessee; or
(c) the benefit derived by or accruing to the assessee from such a payment.

<table>
<thead>
<tr>
<th>Assessee</th>
<th>Specified Person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Individual</td>
<td></td>
</tr>
<tr>
<td>1. Any relative of the individual assessee</td>
<td></td>
</tr>
<tr>
<td>2. Any person who carries on a business or profession, if</td>
<td></td>
</tr>
<tr>
<td>• the individual has a substantial interest in the business of that person or</td>
<td></td>
</tr>
<tr>
<td>• any relative of the individual has a substantial interest in the business of that person</td>
<td></td>
</tr>
<tr>
<td>Company, Firm, HUF or AOP</td>
<td></td>
</tr>
<tr>
<td>1. Any director, partner of the firm or member of the family or association or any relative of such director, partner or member or</td>
<td></td>
</tr>
<tr>
<td>2. Any person who carries on a business or profession, in which the Company/Firm/HUF/AOP or director of the company, partner of the firm or member of the family or association or any relative of such director, partner or member has substantial interest</td>
<td></td>
</tr>
<tr>
<td>All assessees</td>
<td>The following are specified persons:</td>
</tr>
<tr>
<td>Person who has substantial interest in the assessee’s business</td>
<td>Other related persons of such person, who has a substantial interest in the assessee’s business</td>
</tr>
<tr>
<td>Any individual</td>
<td>• Any relative of such individual</td>
</tr>
<tr>
<td>Company / AOP / Firm / HUF</td>
<td>• Any director of such company, partner of such firm or the member of such family or association or</td>
</tr>
</tbody>
</table>
Relative in relation to an Individual means the spouse, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].

**Substantial interest in a business or profession**

A person shall be deemed to have a substantial interest in a business or profession if -

- in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and

- in any other case, such person is, at any time during the previous year, beneficially entitled to not less than 20% of the profits of such business or profession.

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**SECTION 40A(3) & (3A): PAYMENTS MADE OTHERWISE THAN BY ACCOUNT PAYEE CHEQUE OR ACCOUNT PAYEE BANK DRAFT OR OTHER MODE**

According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft or use of electronic system through bank account or such other electronic mode as may be prescribed exceeds Rs. 10,000, such expenditure shall not be allowed as a deduction.

(Underlined and bold words are amended by Finance Act (No.2) 2019)

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income.

**Example:**

If, in respect of an expenditure of Rs. 32,000 incurred by X Ltd., 4 cash payments of Rs. 8,000 are made on a particular day to one Mr. Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of Rs. 32,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr. Y exceeds Rs. 10,000.
Cash Payment made in excess of Rs. 10,000 deemed to be the income of the subsequent year, if an expenditure has been allowed as deduction in any previous year on due basis:

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or such other electronic mode as may be prescribed, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds Rs. 10,000 [Section 40A(3A)].

(Underlined and bold words are amended by Finance Act (No.2) 2019)

Rule 6ABBA:
The following shall be the other electronic modes for the purposes of clause (d) of first proviso to section 13A, clause (f) of sub-section (8) of section 35AD, sub-section (3), sub-section (3A), proviso to sub-section (3A) and sub-section (4) of section 40A, second proviso to clause (1) of Section 43, sub-section (4) of section 43CA, proviso to sub-section (1) of section 44AD, second proviso to sub-section (1) of section 50C, second proviso to sub-clause (b) of clause (x) of sub-section (2) of section 56, clause (b) of first proviso of clause (i) of Explanation to section 80JJAA, section 269SS, section 269ST and section 269T, namely:-

(a) Credit Card;
(b) Debit Card;
(c) Net Banking;
(d) IMPS (Immediate Payment Service);
(e) UPI (Unified Payment Interface);
(f) RTGS (Real Time Gross Settlement);
(g) NEFT (National Electronic Funds Transfer); and
(h) BHIM (Bharat Interface for Money) Aadhar Pay;

Increase in limit of cash payment, where payment made to transport operator:

This limit of Rs. 10,000 has been raised to Rs. 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to Rs. 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or such other electronic mode as may be prescribed. In all other cases, the limit would continue to be Rs. 10,000.

(Underlined and bold words are amended by Finance Act (No.2) 2019)
Cases and circumstances in which a payment or aggregate of payments exceeding ten thousand rupees may be made to a person in a day, otherwise than by an account payee cheque/ account payee bank draft/ use of ECS through a bank account [Rule 6DD]:

As per this rule, no disallowance under section 40A(3) shall be made and no payment shall be deemed to be the profits and gains of business or profession under section 40A(3A) where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or such other electronic mode as may be prescribed, exceeds ten thousand rupees in the cases and circumstances specified hereunder, namely:

(i) **Loan transactions:** It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding Rs.10,000 at a time are required to be made by account payee cheques or drafts or electronic clearing system or such other electronic mode as may be prescribed, as interest is a deductible expenditure.

(ii) **Payment made by commission agents:** This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods. However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft or electronic clearing system or such other electronic mode as may be prescribed, apply equally to payments made for goods purchased on credit.

Cases and circumstances in which a payment or aggregate of payments exceeding ten thousand rupees may be made to a person in a day, otherwise than by an account payee cheque [Rule 6DD]:

As per this rule, no disallowance under section 40A(3) shall be made and no payment shall be deemed to be the profits and gains of business or profession under section 40A(3A) where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or such other electronic mode as may be prescribed, exceeds ten thousand rupees in the cases and circumstances specified hereunder, namely:

(a) where the payment is made to

(i) the Reserve Bank of India or any banking company;
(ii) the State Bank of India or any subsidiary bank;
(iii) any co-operative bank or land mortgage bank;
(iv) any primary agricultural credit society or any primary credit society;
(v) the Life Insurance Corporation of India;

(b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;
Disallowances

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(c) where the payment is made by

(i) any letter of credit arrangements through a bank;
(ii) a mail or telegraphic transfer through a bank;
(iii) a book adjustment from any account in a bank to any other account in that or any other bank;
(iv) a bill of exchange made payable only to a bank;
(v) a credit card;
(vi) a debit card.

(d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

(e) where the payment is made for the purchase of -

(i) agricultural or forest produce; or
(ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
(iii) fish or fish products; or
(iv) the products of horticulture or apiculture,
to the cultivator, grower or producer of such articles, produce or products;

Note -
(i) The expression ‘fish or fish products’ (iii) above would include ‘other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.’.
(ii) The ‘producers’ of fish or fish products for the purpose of Rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a ‘producer’ of these goods and is only a trader, broker or any other middleman, by whatever name called.

(f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

(g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

(h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;

(i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -

(i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and
(ii) does not maintain any account in any bank at such place or ship;

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(j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
(k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
(l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travelers cheques in the normal course of his business.

SECTION 40A(7): EMPLOYER'S CONTRIBUTION TO GRATUITY FUND
No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of employment.

(Refer Compendium for example)

SECTION 40A(9): EMPLOYER'S CONTRIBUTION TO UNAPPROVED GRATUITY FUND, UNRECOGNIZED PROVIDENT FUND OR UNAPPROVED SUPERANNUATION FUND IS DISALLOWED
No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society or any institution except where such sum is required to be paid under any law in force or where such sum is paid for an approved gratuity fund, recognised provident fund or approved superannuation fund or pension scheme referred to in section 80 CCD.

AMOUNT SPECIFICALLY NOT DEDUCTIBLE UNDER SECTION 40

NOTWITHSTANDING ANYTHING CONTAINED IN SECTION 30 TO 38, NO DEDUCTION SHALL BE ALLOWED IN RESPECT OF THE FOLLOWING:

SECTION 40(a)(i): NON-COMPLIANCE OF PROVISIONS OF TDS WHERE PAYMENT IS MADE TO NON-RESIDENT
Any interest, royalty, fees for technical services or other sum chargeable under this Act, which is payable, -
(a) outside India;
(b) in India to a non-resident, not being a company or to a foreign company,
on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date of filing of return specified under section 139(1).
It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date of filing of return under section 139(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

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

(Added by Finance Act (No. 2), 2019)

Clarification regarding disallowance of ‘other sum chargeable’ under section 40(a)(i)

[Circular No. 3/2015, dated 12-02-2015]

If there has been a failure in deduction or in payment of tax deducted in respect of any interest, royalty, fees for technical services or other sum chargeable under the Act either payable in India to non-corporate non-resident or a foreign company or payable outside India, then, disallowance of the related expenditure/ payment is attracted under section 40(a)(i) while computing income chargeable under the head “Profits and gains of business or profession”.

The interpretation of the term ‘other sum chargeable’ in section 195 has been clarified in this circular i.e. whether this term refers to the whole sum being remitted or only the portion representing the sum chargeable to income-tax under the Act.

In its Instruction No. 2/2014, dated 26.02.2014, the CBDT has clarified that the Assessing Officer shall determine the appropriate portion of the sum chargeable to tax as mentioned in section 195(1), to ascertain the tax liability on which the deductor shall be deemed to be an assessee in default under section 201, in cases where no application is filed by the deductor for determining the sum so chargeable under section 195(2).

In this circular, the CBDT has, in exercise of its powers under section 119, clarified that for the purpose of making disallowance of ‘other sum chargeable’ under section 40(a)(i), the appropriate portion of the sum which is chargeable to tax shall form the basis of disallowance. Further, the appropriate portion shall be the same as determined by the Assessing Officer having jurisdiction for the purpose of section 195(1). Also, where the determination of ‘other sum chargeable’ has been made under sub-section (2), (3) or (7) of section 195 of the Act, such a determination will form the basis for disallowance, if any, under section 40(a)(i).

Illustration :

<table>
<thead>
<tr>
<th>Date on which TDS should have been deducted</th>
<th>Actual Date of Deduction</th>
<th>Time limit as per section 200(1)for depositing TDS</th>
<th>Date of payment of TDS</th>
<th>Previous year in which deductible</th>
</tr>
</thead>
<tbody>
<tr>
<td>26.06.2020</td>
<td>26.06.2020</td>
<td>07.07.2020</td>
<td>31.03.2021</td>
<td>2020-21</td>
</tr>
<tr>
<td>31.03.2021</td>
<td>31.03.2021</td>
<td>30.04.2021</td>
<td>30.06.2021</td>
<td>2020-21</td>
</tr>
<tr>
<td>16.05.2020</td>
<td>16.05.2020</td>
<td>07.06.2020</td>
<td>Not deposited</td>
<td>2021-22</td>
</tr>
</tbody>
</table>
SECTION 40(a)(ia): NON-COMPLIANCE OF PROVISION OF TDS WHERE PAYMENT IS MADE TO A RESIDENT

Section 40(a)(ia) provides that 30% of any sum payable to a resident, on which tax is deductible at source under Chapter XVII-B, shall be disallowed if –

(i) such tax has not been deducted; or

(ii) such tax, after deduction, has not been paid on or before the due date specified in section 139(1).

If in respect of such sum, tax has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), 30% of such sum shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

For instance, tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2020-21, the same has to be paid by 31st July/ 30th September 2021, as the case may be. Otherwise, 30% of royalty paid would be disallowed in computing the income for A.Y. 2021-22.

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

(Second Proviso added by Finance Act, 2012)

ANALYSIS OF AMENDMENT IN SECTION 40(a)(ia) BY FINANCE ACT, 2012 AND IN SECTION 40(a)(i) BY FINANCE ACT (NO. 2) 2019:

1. Section 201(1) provides that if an assessee:

   (a) fails to deduct TDS; or

   (b) after deduction, fails to pay the TDS, then he shall be deemed to be an assessee in default under section 220 & 221. Consequently, he is liable to pay:

      (i) Penalty under section 221 which can be up to the amount of TDS not deducted/not paid.

      (ii) Interest under section 220 @ 1% p.m. from the date the tax was deductible / payable till the date of passing of an order under section 201.

2. It is well established law laid down by various courts that the deductor shall be treated as an assessee in default only if:

   • Deductor has failed to deduct TDS; and
   • Deductee has also failed to pay the tax directly.

Therefore, deductor cannot be treated as an assessee in default where deductor has failed to deduct TDS but deductee has paid the tax directly.
The Finance Act, 2012/2019 seeks to incorporate the above provisions in section 201(1) by inserting Proviso in section 201(1).

3. The amendments are for resident or Non resident deductee.
4. The amendment to section 201(1) i.e. First proviso to section 201(1) provides as under:
   - If the deductor fails to deduct the whole or any part of tax in accordance with the Chapter of TDS.
   - on the sum paid to a resident or Non resident; or
   - on the sum credited to the account of a resident or Non resident,
   - then such deductor shall not be deemed to be an assessee in default in respect of such TDS if:
     • the resident or Non resident payee has furnished his return of income under section 139.
     • the resident or Non resident payee has taken into account such sum for computing income in such return of income; and
     • the resident or Non resident payee has paid the tax due on income declared by him in such return of income.

The deductor has to furnish a certificate to this effect from a Chartered Accountant in the prescribed form. (Rule 31ACB and Form 26A)

5. The amendment also provides that deductor shall have to pay interest under section 201(1A) @ 1% per month or part of the month from the date the tax was so deductible to the date of furnishing of return of income by the resident or Non resident payee. The interest shall be levied on the amount of TDS not deducted / short deducted by the deductor.

6. Section 40(a)(ia)/40(a)(i) has been amended by Finance Act, 2012/2019 to provide that:
   - where assessee has failed to deduct TDS in accordance with Chapter of TDS
   - and he is not treated as an assessee in default under the first proviso to section 201(1)
   - then, for the purpose of section 40(a)(ia)/40(a)(i)
   - it shall be deemed that the assessee has deducted and paid the tax on such sum
   - on the date of furnishing of return of income by the resident or Non Resident payee
   - and deduction of such expenditure shall be allowed accordingly.

**ILLUSTRATON**
A company A Ltd. whose due date of filing of return is 30th September pays the following sums without deduction of TDS:

(i) Rs 2,00,000 to Mr. X, a resident, as rent (Due date of filing of return for Mr. X is 31st July)
(ii) Rs 5,00,000 to Y Ltd., a resident company, as professional fees (Due date of filing of return for Y Ltd. is 30th Nov.)

The above sums were paid on 1st July, 2020 without deduction of TDS.
For previous year 31.03.2021, X and Y Ltd have included the above sums in their respective return of income and have paid tax thereon. Returns have been filed by X and Y Ltd. on 31st August, 2021 and 30th Nov, 2021 respectively.

Company A Ltd has taken certificate from Chartered Accountant to the above effect. Now following are the consequences:

(i) Company A Ltd. shall not be treated as an assessee in default for payment of Rs. 2,00,000 made to Mr. X without deducting TDS. Company A Ltd. shall pay interest @ 1% p.m. from 1st July, 2020 to 31st August, 2021 on TDS of Rs. 20,000. The expenditure of Rs. 2,00,000 shall be allowed to company A Ltd. in previous years 31.03.2021 as per provision of section 40(a)(ia).

(ii) Company A Ltd. shall not be treated as an assessee in default for payment of Rs. 5,00,000 to Y Ltd. without deducting TDS. Company A Ltd shall pay interest @ 1% p.m. from 1st July, 2020 to 30th Nov, 2021 on TDS of Rs. 50,000. 30% of expenditure of Rs. 5,00,000 shall be allowed to Company A Ltd. in previous year 31.03.2022 as per provisions of section 40(a)(ia). 30% of the said expenditure shall be disallowed in previous 31.03.2021 since deduction and payment of TDS is deemed to be made on 30.11.2021 i.e. after the due date 30.09.2021 of company A Ltd.

Whether section 40(a)(ia) is attracted when amount is not ‘payable’ to a sub-contractor but has been actually paid?

PALAM GAS SERVICE V. CIT [2017] (SC)

Facts of the case: The assessee, Palam Gas Service, is engaged in the business of purchase and sale of LPG cylinders. The assessee had arranged for the transportation to be done through three sub-contractors within the meaning of section 194C. During the relevant assessment year, when the assessee made freight payments of Rs.20,97,689 to the sub-contractors, it did not deduct tax at source. The Assessing Officer disallowed the freight expenses as per section 40(a)(ia) on account of failure to deduct tax. The assessee contended that section 40(a)(ia) did not apply as the amount was not ‘payable’ but had been actually paid.

Issue: Whether the provisions of Section 40(a)(ia) would be attracted when the amount is not 'payable' to a sub-contractor but has been actually paid? Would the obligation to deduct tax depend on the method of accounting followed by an assessee?

Supreme Court’s Observations: The Supreme Court noted the difference in opinion amongst the various High Courts. On the one hand, the High Courts of Punjab & Haryana, Madras, Calcutta and Gujarat held that Section 40(a)(ia) extended to amounts actually paid. The Allahabad High Court had, however, held otherwise. The Supreme Court agreed with the observations of the majority High Courts and held that section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. Accordingly, the judgment of the Allahabad High Court in CIT v. Vector Shipping Services (P.) Ltd. [2013] 357 ITR 642 stands overruled.

The Supreme Court reaffirmed that the obligation to deduct tax at source is mandatory and applicable irrespective of the method of accounting adopted. If the assessee follows the mercantile system of accounting, then, the moment amount was credited to the

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account of the payee on accrual of liability, tax was required to be deducted at source. If the assessee follows cash system of accounting, then, tax is required to be deducted at source at the time of making payment.

**Supreme Court’s Decision:** The Supreme Court, accordingly, upheld the decision of the majority High Courts that section 40(a)(ia) would be attracted for failure to deduct tax in both cases i.e., when the amount is payable or when the amount is paid, as the case may be, depending on the system of accounting followed by the assessee.

**SECTION 40(a)(ii): INCOME TAX**

1. Income-tax payable under Income-tax Act is not deductible. Even the income-tax paid under the tax laws of a foreign country is not allowable as deduction. For such tax, relief can be claimed under section 90 or section 90A or section 91, as the case may be.

2. Service tax/GST is allowable as deduction under section 37(1), subject to section 43B.

**SECTION 40(a)(ia): WEALTH TAX**

Any sum paid on account of wealth tax chargeable under the Wealth tax Act, 1957 or similar statute outside India.

**KEY POINT:**

Valuation fees paid for valuation of assets does not represent wealth tax and is allowable as deduction.

**SECTION 40(a)(iia): FEE OR CHARGES PAID BY STATE GOVERNMENT UNDERTAKING**

Any amount—

(A) paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or

(B) which is appropriated, directly or indirectly, from,

a State Government undertaking by the State Government.

**ANALYSIS**

State Government undertakings are liable to Income Tax. If they pay dividends to the State Government then, such dividend is not deductible as an expense and such dividend is also liable to Dividend Distribution Tax. State Governments instead of taking dividends, started taking out money from these undertakings in form of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, which were exclusive levies on such undertakings. This was done so that such payments were allowed as deduction and State Government gets the money without any payment of dividend distribution tax by such undertakings.

In order to levy tax on such withdrawals by State Governments from such undertakings, the amendment has been bought by Finance Act, 2013, wherein any exclusive payments in form of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge to State Government by such undertakings has been specifically disallowed.
Disallowances

It may be noted that disallowance will be attracted if:

(i) Levy is by State Government. No disallowance shall be attracted if levy is by Central Government.

(ii) It should be exclusive on the State Government undertakings. If levy is non-exclusive, i.e., applicable to others also, disallowance shall not be attracted.

SECTION 40(a)(ii): TDS ON SALARY PAYABLE OUTSIDE INDIA OR TO A NON-RESIDENT

Any sum which is chargeable under the head ‘Salaries’ if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

SECTION 40(a)(iv): EMPLOYER'S CONTRIBUTION TOWARDS PROVIDENT FUND OR ANY OTHER FUND

Any payment to a provident fund or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to secure that the tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head "Salaries". (To be discussed later)

SECTION 40(a)(v): PAYMENT OF TAX ON BEHALF OF EMPLOYEE

In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee. Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

SECTION 43B: CERTAIN DEDUCTIONS ALLOWED ON ACTUAL PAYMENT

Notwithstanding anything contained in any other provisions of the Income Tax Act, a deduction otherwise allowable under the Act in respect of -

(a) any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or

(b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of the employees, or (To be discussed later)

(c) any bonus or commission payable to the employees, or

(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

(da) any sum payable by the assessee as interest on any loan or borrowing from a deposit taking NBFC or systematically important non-deposit taking NBFC, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or (See Note Below)
(e) any sum payable by the assessee as interest on any LOAN OR ADVANCE from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advance. {"Scheduled bank" includes a cooperative bank}.

(f) any sum payable by the assessee as an employer in lieu of any leave to the credit of his employee, (i.e. provision for leave encashment)

(g) any sum payable by the assessee to the Indian Railways for the use of railway assets.

shall be allowed as deduction only in the previous year in which such sum is actually paid by him. This is irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting employed by him.

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**Systemically important non-deposit taking NBFC** – It means a non-banking financial company (NBFC) which is not accepting or holding public deposits and is having total assets of not less than Rs. 500 crores as per the last audited balance sheet and is registered with RBI under the provisions of the Reserve Bank of India Act.

**Deposit taking NBFC** - “Deposit taking NBFC” means a non-banking financial company which is accepting or holding public deposits and is registered with RBI under the provisions of the Reserve Bank of India Act.

Further where deduction i.r.o of clause (da) is already claimed on accrual basis till PY 2018-2019, then no deduction shall be allowed on actual payment if paid in PY 2019-2020 or subsequent years. {Explanation 3AA to Sec 43B}

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**KEY POINTS:**

1. The provisions of section 43B shall not apply in relation to any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under section 139(1) in respect of the previous year in which liability to pay such sum was incurred by the assessee.

2. **Conversion of interest into a loan or borrowing or advance or payable in other manner**

   *Explanation 3C, 3CA & 3D* clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d), (da) and (e) above, is converted into a loan or borrowing or advance, the interest so converted and not “actually paid” shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment.

   The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No.7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.
Illustration:

**Case I: INCLUSIVE ACCOUNTING:**
Following entries have been made in the books of account of the assessee:

1. Bank A/c Dr. 2,00,000
   To Sales 2,00,000

2. Sales Tax Dr. 10,000
   To Sales Tax Payable 10,000

<table>
<thead>
<tr>
<th>Profit and Loss Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax</td>
</tr>
<tr>
<td>Net Profit</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Assume that sales tax payable has not been paid till due date of filing of return of income.

**Computation of Total Income**

- Net Profit as per P&L A/c 1,90,000
- Sales Tax disallowed u/s 43B 10,000
- **Total Income** 2,00,000

**Case II: EXCLUSIVE ACCOUNTING**

If in the above case, following entry is passed in the books of account of the assessee:

<table>
<thead>
<tr>
<th>Bank A/c</th>
<th>Dr.</th>
<th>2,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Sales</td>
<td>1,90,000</td>
<td></td>
</tr>
<tr>
<td>To Sales Tax Payable</td>
<td>10,000</td>
<td></td>
</tr>
</tbody>
</table>

- As per Supreme Court in **CHOWRINGEE SALES BUREAU**, sales tax should be routed through Profit and Loss Account. It is the duty of the Assessing Officer to route sales tax through Profit and Loss Account.

**Therefore, Computation of Total Income in Case II:**

<table>
<thead>
<tr>
<th>Net Profit as per P&amp;L A/c</th>
<th>1,90,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax disallowed u/s 43B</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>2,00,000</strong></td>
</tr>
</tbody>
</table>
CONTRARY DECISIONS OF SEVERAL HIGH COURT’S

COMMISSIONER OF INCOME-TAX VS. AIMIL LTD. (DELHI HIGH COURT)

Employees' contribution towards provident fund and ESI would qualify for deduction even if paid after due date prescribed under Provident Fund Act/ESI Act but before due date of filing of return.

Delhi High Court held that section 2(24) enumerates different components of income. It, inter alia, stipulates that income includes any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948, or any other fund for the welfare of such employees. It is clear from the above that as soon as employees' contribution towards provident fund or ESI is received by the assessee-employer by way of deduction or otherwise from the salary/wages of the employees, it will be treated as 'income' at the hands of the assessee. It clearly follows therefrom that if the assessee does not deposit this contribution with provident fund/ESI authorities, it will be taxed as income in the hands of theassessee. However, on making deposit with the concerned authorities, the assessee becomes entitled to deduction under the provisions of section 36(1)(va). Section 43B(b), however, stipulates that such deduction would be permissible only on actual payment. This is the scheme of the Act for making an assessee entitled to get deduction from income insofar as employees' contribution is concerned.

If the employees' contribution is not deposited by the due date prescribed under the relevant Acts and is deposited late, the employer not only pays interest on delayed payment but can incur penalties also, for which specific provisions are made in the Provident Fund Act as well as in the ESI Act. Therefore, the Act permits the employer to make the deposit with some delay, subject to the aforesaid consequences. Insofar as the Income-tax Act is concerned, the assessee can get the benefit if the actual payment is made before due date of filing of return under section 139(1).

CIT V. KICHHA SUGAR CO. LTD. (UTTARAKHAND)

Can the amount of employees' contribution towards provident fund, deducted and credited to the employee's PF account by the employer-assessee after the "due date" under the EPF & Miscellaneous Provisions Act, 1952, but before the due date of filing return of income under the Income-tax Act, 1961, be allowed as deduction while computing business income of the employer-assessee?

The High Court observed that the "due date" referred to in section 36(1)(va) must be read in conjunction with the "due date" referred to in the first proviso to section 43B. A combined reading of both the sections would make it clear that the due date referred to in section 36(1)(va) is the due date as mentioned in section 43B i.e., the due date of filing of return of income.

Therefore, any amount of employees' contribution paid by the employer-assessee to the provident fund authorities after the due date under the Employees Provident Fund & Miscellaneous Provisions Act, 1952 (EPF & MP Act) but before the due date of filing the return for the previous year, shall be allowable as deduction in the hands of the employer-assessee.

ALTERNATE VIEW:

Can employees contribution to Provident Fund and Employee’s State Insurance be allowed as deduction where the assessee-employer had not remitted the same on or before the “due date” under the relevant Act but remitted the same on or before the due date for filing of return of income under section 139(1)?
**CIT V. GUJARAT STATE ROAD TRANSPORT CORPN (2014) (GUJ)**

**Facts of the case:** The assessee collected employees’ contribution to Provident Fund and ESI which were remitted, after the due date under the relevant Acts but before the ‘due date’ for filing the return specified in section 139(1). The assessing authority held that the amount collected by way of employees’ contribution to PF and ESI are income under section 2(24)(x) and their remittance is governed by section 36(1)(va). The time limit prescribed for remitting the contribution is the ‘due date’ prescribed under the Provident Funds Act, Employees’ State Insurance Act, rule, order or notification issued thereunder or under any standing order, award, contract or service or otherwise.

**Issue:** The issue under consideration is whether extended time limit upto the due date of filing the return contained in section 43B would be available in respect of remittances which are governed by section 36(1)(va).

**High Court’s Observations:** The High Court noted that section 43B(b) pertaining to employer’s contribution cannot be applied with respect to employees’ contribution which is governed by section 36(1)(va). So far as the employee’s contribution is concerned, the Explanation to section 36(1)(va) continues to remain in the statute and there is no provision for applying the extended time limit provided under section 43B for remittance of employee’s contribution. The amount of employee’s contribution to PF and ESI is an income upon recovery from salary and its remittance within the ‘due date’ as specified in Explanation to section 36(1)(va) makes it eligible for deduction. Employees’ contribution recovered by the employer is not eligible for extended time limit upto the due date of filing of return, which is available under section 43B in the case of employer’s own contribution.

**High Court’s Decision:** The High Court, accordingly, held that the delayed remittance of employees’ contribution beyond the ‘due date’ prescribed in section 36(1)(va), is not deductible while computing the business income, even though such remittance has been made before the due date of filing of return of income under section 139(1).

**Note:** A contrary view was expressed by Uttrakhand High Court in the case of CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351 holding that the employees' contribution to provident fund, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer- assessee with the provident fund authority on or before the due date of filing the return for the relevant previous year.

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CHAPTER 7. RECOVERY OF EXPENDITURE & REMISSION AND CESSATION OF TRADING LIABILITY

SEE COMPENDIUM FOR THE DISCUSSION

KEY POINT:
"Successor in business" means -

(i) Where there has been an amalgamation of a company with another company, the amalgamated company.

(ii) Where a firm carrying on business or profession is succeeded by another firm, the other firm.

(iii) Where the first mentioned person is succeeded by any other person in the business or profession, the other person.

(iv) Where there has been a demerger, the resulting company.

1. SECTION 41(1) APPLIES TO TRADING LIABILITIES ONLY
The assessee took a personal loan from Mr. A of Rs. 1,00,000. Subsequently the assessee and Mr. A decided that the loan need not be repaid and therefore the assessee wrote off the loan to the credit of profit and loss account. Held that section 41(1) is attracted when there is a remission or cessation of trading liability. In the present case, the loan is not a trading liability and therefore section 41(1) is not attracted. Section 56(2)(vii) shall be attracted if assessee is an individual or HUF and the loan so waived shall be taxable in his hands as Income from other sources.

However, Supreme Court in the case of T.V. Sundaram lyenger & Sons held that where the assessee transfers unclaimed advances from the trade parties to Profit & Loss Account, then the assessee has become richer by the amount transferred to Profit & Loss Account. The said amount is not taxable under section 41(1) but shall be taxable under section 28. Supreme Court held that such amounts though not allowed as deduction earlier and transferred to Profit & Loss Account would constitute trading receipts taxable under section 28. Therefore, on the basis of this Supreme Court judgement if trade advances are written off to the credit of Profit & Loss account, then although section 41(1) is not attracted but the said sum shall be taxable under section 28.

2. POLYFLEX INDIA (P) LTD. v. CIT (SC)
The assessee company paid excise duty on certain goods in the year 1986 and was allowed as deduction. The assessee challenged the levy of excise duty and the High Court on 01.01.2008 decided in favour of the assessee and held that excise duty was not payable by it. The excise duty was refunded to the assessee on 20.01.2008. The Department filed a SLP in Supreme Court against the order of High Court and the SLP was still pending in Supreme Court. The Assessing Officer invoked section 41(1) in Assessment Year 2008-09 and taxed the excise duty refunded in Assessment Year 2008-09. The assessee contented that there was no remission/ cessation of trading liability within the meaning of section 41(1) so long as the issue was pending determination by Supreme Court.
Section 41(1) is attracted if in the assessment of any year an allowance or deduction has been made in respect of any loss, expenditure or trading liability and subsequently the assessee:

(i) has obtained any amount in respect of such loss or expenditure, or
(ii) obtained any benefit in respect of such trading liability by way of remission or cessation thereof.

If either of the above two happens, the deeming section 41(1) comes into play. The Supreme Court held that no doubt the remission or cessation of trading liability takes place only if the matter is not pending in any litigation and has been finally decided in favour of the assessee. If the matter of remission/cessation of liability is pending before any Court, then it will not amount to remission or cessation of trading liability.

The Supreme Court held that in the present case, the question was not of remission or cessation of the trading liability since there was no trading liability as the assessee has already paid the excise duty. As per Supreme court, in the present case the first part of section 41(1) is attracted namely:

(iii) has obtained any amount in respect of such loss or expenditure.

As per Supreme Court, section 41(1) is a deeming fiction and it comes into play as soon as the assessee receives any amount in respect of such loss or expenditure. It is irrelevant that such receipt has been disputed by the Department in future appeal. The deeming fiction of section 41(1) comes into play as soon as the amount is received and therefore in the present case, the Assessing Officer was justified in invoking section 41(1) in Assessment Year 2008-09.

3. **ROLLATAINERS LTD. V. CIT (DEL)**

Can the provisions of section 41(1) be invoked both in respect of waiver of working capital loan utilized for day-to-day business operations and in respect of waiver of term loan taken for purchasing a capital asset?

The provisions of section 41(1) are attracted in respect of waiver of the working capital loan utilized for day-to-day business operations, since it amounted to remission of a trading liability. However, in the case of waiver of term loan for purchasing capital assets, the provisions of section 41(1) are not attracted since it cannot be treated as remission or cessation of a trading liability.

4. **CIT V. SOFTWORKS COMPUTERS P. LTD. (BOM.)**

Can waiver of loan or advance taken for the purpose of relocation of office premises be treated as a revenue receipt liable to tax?

The Bombay High Court held that since the advance taken by the assessee-company was utilized by it for the purpose of relocating its office premises i.e., for acquisition of a capital asset, namely, a new office, the waiver of the same cannot be said to be waiver or remission of trading liability to attract taxability under the Act.

**Waiver of such advance, being capital in nature, is not taxable under the Act.**

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SECTION 14A: EXPENDITURE INCURRED IN RELATION TO INCOME NOT INCLUDIBLE IN TOTAL INCOME

(1) For the purposes of computing the total income under Chapter IV (i.e. the five heads of income), no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of total income under the Income-tax Act.

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income.

RULE 8D: METHOD FOR DETERMINING AMOUNT OF EXPENDITURE IN RELATION TO INCOME NOT INCLUDIBLE IN TOTAL INCOME

(1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with -
   (a) the correctness of the claim of expenditure made by the assessee; or
   (b) the claim made by the assessee that no expenditure has been incurred in relation to income which does not form part of the total income under the Act, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of sub-rule (2).

(2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:—
   (i) the amount of expenditure directly relating to income which does not form part of total income;
   (ii) an amount equal to one percent of the annual average of the monthly averages of the opening and closing balances of the value of investment, income from which does not or shall not form part of total income:

Provided that the amount referred to in clause (i) and clause (ii) shall not exceed the total expenditure claimed by the assessee.
Clarification regarding disallowance of expenses under section 14A in cases where corresponding exempt income has not been earned during the financial year [Circular No. 5/2014, dated 11.2.2014]

Section 14A provides that no deduction shall be allowed in respect of expenditure incurred relating to income which does not form part of total income. A controversy has arisen as to whether disallowance can be made by invoking section 14A even in those cases where no income has been earned by an assessee, which has been claimed as exempt during the financial year.

The CBDT has, through this Circular, clarified that the legislative intent is to allow only that expenditure which is relatable to earning of income. Therefore, it follows that the expenses which are relatable to earning of exempt income have to be considered for disallowance, irrespective of the fact whether such income has been earned during the financial year or not. The above position is clarified by the usage of the term “includible” in the heading to section 14A [Expenditure incurred in relation to income not includible in total income] and Rule 8D [Method for determining amount of expenditure in relation to income not includible in total income], which indicates that it is not necessary that exempt income should necessarily be included in a particular year’s income, for triggering disallowance. Also, the terminology used in section 14A is “income under the Act” and not “income of the year”, which again indicates that it is not material that the assessee should have earned such income during the financial year under consideration.

In effect, section 14A read along with Rule 8D provides for disallowance of expenditure even where the taxpayer has not earned any exempt income in a particular year.

Whether section 14A is applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?

CIT V. KRIBHCO (2012) (DELHI)

The High Court observed that section 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Section 14A is applicable only if an income is not included in the total income as per section 10 of the Income-tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/exemptions provided under Section 10. Section 14A of the Income-tax Act, 1961 ['Act'] provides for disallowance of expenditure in relation to income not "includible" in total income.

SECTION 43D: INTEREST INCOME ON BAD AND DOUBTFUL DEBTS

(i) In the case of
- a public financial institution or
- a scheduled bank or
- a co-operative bank other than primary agricultural credit society or a primary co-operative agricultural and rural development bank or
- a State financial corporation or
- a State industrial investment corporation or
- a deposit taking NBFC or
- a systematically important non-deposit taking NBFC {FA 2019}
the income by way of interest on such categories of bad and doubtful debts, as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institutions etc. for that year or in the previous year in which it is actually received by them, whichever is earlier. [Sub-clause (a)].

(ii) In the case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debts shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous in which it is actually received by it, whichever is earlier. [Sub-clause (b)].

SECTION 44AA: MAINTENANCE OF ACCOUNTS BY CERTAIN PERSONS CARRYING ON PROFESSION OR BUSINESS

(Refer Compendium for the provision)

1. Sec 44AA(1) provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the Central Board of Direct Taxes in the Official Gazette must statutorily maintain such books of accounts and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

Notified professions: The professions notified so far are as the profession of authorised representative; the profession of film artist (actor, camera man, director, music director, art director, dance director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of Company Secretary; and information technology professionals.

SECTION 271A: PENALTY FOR FAILURE TO KEEP OR MAINTAIN BOOKS OF ACCOUNTS, DOCUMENTS, ETC.

If any person fails to keep and maintain any such books of account and other documents as required by section 44AA, in respect of any previous year, then the Assessing Officer or CIT (Appeals) may direct that such person shall pay, by way of penalty, a sum of Rs. 25,000.

SECTION 44AB: AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION

(i) Who are required to get the accounts audited? It is obligatory in the following cases for a person carrying on business or profession to get his accounts audited before the “specified date” by a Chartered Accountant:

(1) if the total sales, turnover or gross receipts in business exceeds Rs.100 lakh in any previous year; or

(2) if the gross receipts in profession exceeds Rs. 50 lakhs in any previous year; or

(3) where the assessee is covered under section 44AE, (44BB or 44BBB) and claims that the profits and gains from business are lower than the profits and
gains computed on a presumptive basis. In such cases, the normal monetary limits for tax audit in respect of business would not apply.

(4) where the assessee is carrying on a notified profession under section 44AA, and he claims that the profits and gains from such profession are lower than the profits and gains computed on a presumptive basis under section 44ADA and his income exceeds the basic exemption limit.

(5) where the assessee is covered under section 44AD(4) and his income exceeds the basic exemption limit.

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**AMENDMENT MADE BY FINANCE ACT 2020**

**Rationalisation of provisions relating to tax audit in certain cases.**

Under section 44AB of the Act, every person carrying on business is required to get his accounts audited, if his total sales, turnover or gross receipts, in business exceed or exceeds one crore rupees in any previous year. In case of a person carrying on profession he is required to get his accounts audited, if his gross receipt in profession exceeds, fifty lakh rupees in any previous year.

In order to reduce compliance burden on small and medium enterprises, it is proposed to increase the threshold limit for a person carrying on business from one crore rupees to five crore rupees in cases where,-

(i) aggregate of all receipts in cash during the previous year does not exceed five per cent of such receipt; and

(ii) aggregate of all payments in cash during the previous year does not exceed five per cent of such payment.

Further, the due date for filing return of income under sub-section (1) of section 139 is proposed to be amended by:-

(A) providing 31st October of the assessment year (as against 30th September) as the due date for an assessee referred to in clause (a) of Explanation 2 of subsection (1) of Section 139 of the Act;

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(ii) **Audit Report:** The person mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith.

(iii) **Accounts audits under other statutes are considered:** In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law.

Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act, 2013. The provision only requires that companies should get their accounts audited under the Companies Act, 2013 before the specified date and in addition to the report required to be given by the
auditor under the Companies Act, 2013 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.

(iv) **Non-applicability:**

1. The requirement of audit under section 44AB does not apply to a person who declares profits and gains on a presumptive basis under section 44AD and his total sales, turnover or gross receipts does not exceed Rs. 2 crores.

2. Further, the requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in (sections 44B and 44BBA).

(v) **Specified date:** "specified date", in relation to the accounts of the assessee of the previous year relevant to an assessment year, means date one month prior to the due date for furnishing the return of income under sub-section (1) of section 139. (FA 2020)

(vi) **Penal provision:** It may be noted that under section 271B, penal action can be taken for not getting the accounts audited and for not filing the audit report by the specified date.

*Note - The Institute has brought out a Guidance Note dealing with the various aspects of tax audit under section 44AB. Students are advised to read the same carefully.*

**SECTION 271B: PENALTY FOR FAILURE TO GET ACCOUNTS AUDITED UNDER SECTION 44AB**

If any person

(i) fails to get his accounts audited under section 44AB in respect of any previous year, or

(ii) fails to furnish a report of such audit by the specified date as defined in section 44AB,

then the Assessing Officer shall direct that such person shall pay, the way of penalty, a sum equal to $\frac{1}{2}$ % of the total sales, turnover or gross receipts in the business, or of the gross receipts in profession, in such previous year, or a sum of Rs. 1,50,000, whichever is less.

**EXPENDITURE ON ISSUE OF SHARES AND DEBENTURES**

1. **PUNJAB STATE INDUSTRIAL DEVELOPMENT CORPORATION LTD. (SUPREME COURT) 1997**

The fees paid to the Registrar of Companies for expansion of authorised capital of the company is directly related to the Capital expenditure incurred by the company and although incidentally that would certainly help in the business of the company and also in profit making, but still it retains the nature of capital expenditure since the expenditure was directly related to the expansion of the capital base of the company. Therefore, the amount paid to ROC as filing fees for enhancement of capital, is not a revenue expenditure and is not deductible.
2. BROOKE BOND INDIA LTD. (SUPREME COURT) 1997

Expenditure incurred by a company in connection with issue of shares with a view to increase its share capital, is directly related to the expansion of capital base of the company and is capital expenditure, even though it may incidentally help in the business of the company and its profit making. The expenditure is not deductible as revenue expenditure and is a capital expenditure which has no tax treatment.

3. CIT V. GENERAL INSURANCE CORPORATION [SUPREME COURT]

Issuance of bonus shares does not result in any inflow of fresh funds or increase in the capital employed; the capital employed remains the same. Issuance of Bonus share by capitalisation of reserves is merely a reallocation of company's fund. If that be so, then it cannot be held that the company has acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and issue of bonus shares will not result in any change in the capital structure of the company. Issue of bonus shares does not result in the expansion of capital base of the company.

Thus, the expenditure incurred in connection with issuance of bonus shares is a revenue expenditure. However, expenditure incurred to increase the authorised capital is a capital expenditure, which is not allowed as deduction.

4. INDIA CEMENTS LIMITED (SUPREME COURT)

As per Supreme Court in India Cements Ltd., any expenditure incurred for raising loans or debentures is fully allowed as deduction. Therefore, expenses on issue of non-convertible as well as convertible bonds/ debentures is allowed as deduction as per Supreme Court in India Cements Ltd.

5. MADRAS INDUSTRIAL INVESTMENT CORPORATION LTD. (SC)

FACTS:

The appellant-company issued debentures in September, 2014, at a discount. The total discount on the issue of Rs. 15 crores amounted to Rs. 30 lakhs. For the assessment year 2015-16, the appellant-company wrote off Rs. 1,25,000 out of the total discount of Rs. 30 lakhs being the proportionate amount of discount for the period of six months ending with 31st March, 2015, taking into account the period of 12 year which was the period of redemption and dividing the discount of Rs. 30 lakhs over the period of 12 years.

DECISION:

When a company issues debenture at a discount, it incurs a liability to pay a larger amount than what it has borrowed. The liability to pay the discounted amount over and above the amount received for the debentures, is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. The amounts so obtained by issue of debentures are used by the company for the purposes of its business. This would, therefore, be expenditure.

Ordinarily, revenue expenditure which is incurred wholly and exclusively for the purpose of business must be allowed in its entirety in the year in which it is incurred. It cannot be spread over a number of years even if the assessee has written it off in his books, over a period of years. However, the facts may justify an assessee who has incurred expenditure in a particular year to spread and claim it over a period of ensuing years. In fact, allowing the entire
Expenditure in one year might give a very distorted picture of the profits of a particular year. Issuing debentures is an instance where, although the assessee has incurred the liability to pay the discount in the year of issue of debentures, the payment is to secure a benefit over a number of years. There is a continuing benefit to the business of the company over the entire period. The liability should, therefore, be spread over the period of the debentures.

The Supreme Court held that the liability to pay the discounted amount over and above the amount received for the debentures was a liability incurred by the company for the purposes of its business in order to generate funds for its business activities. It was, therefore, expenditure. The appellant-company had, in its return, correctly claimed a deduction only in respect of the proportionate part of discount of Rs. 1,25,000 over the relevant accounting period in question. This was also in conformity with the accounting practice of showing the discount in the "discount on debentures account" which was written off over the period of the debentures. The appellant-company was entitled to deduct a sum of Rs. 1,25,000 out of the discount of Rs. 30,00,000 in the relevant assessment year. Balance shall be deducted in the balance number of years.

6. **CIT V. KODAK INDIA LTD. (SUPREME COURT) [2001]**

Expenditure incurred for public issue of shares is capital expenditure. The assessee had acted to increase its share capital because it had been directed by the Reserve Bank of India so to do. This was because it had to reduce its non-residential holding to forty percent. It was submitted that the only way in which the assessee could do business after the Reserve Bank directive was to issue share capital to comply with it. Held that whichever way one looked at it, the object of the assessee was to increase its share capital, whether it did so to continue to do business after the Reserve Bank directive or otherwise. The expenditure incurred for the public issue of shares was capital expenditure.

7. **CIT V. S.M. HOLDING & FINANCE (P.) LTD. (BOM.) [2003]**

Where assessee-company had issued zero-interest unsecured redeemable convertible debentures of Rs. 100 each redeemable after 10 years at a premium of 100%, 10% of the total premium payable by assessee after 10 years was deductible in assessment year in question.

**FACTS OF THE CASE:**

The assessee-company had issued zero-interest unsecured redeemable convertible debentures of Rs. 100 each redeemable after 10 years at a premium of 100%. The assessee claimed that the premium payable by it was Rs. 5,47,50,000 after the expiry of 10 years. However, the assessee claimed deduction of Rs. 54,75,000 per annum. The Assessing Officer added back that figure to the income of the assessee on the ground that the liability was not ascertainable during the accounting year ending 31.03.2013 and that it was a contingent liability.

**HELD:**

Held that in the annual reports of the company and also in the audit reports given by the auditors, it had been certified that zero-interest unsecured redeemable convertible debentures of Rs. 100 each redeemable after 10 years at a premium of 100% had been issued during the assessment year in question. There was no reason to discard this note of the auditor. In view thereof the assessee's claim was to be allowed.
8. CIT V. ITC HOTELS LTD. (KAR.) [2011]

Would the expenditure incurred for issue of convertible debentures be treated as revenue expenditure or capital expenditure?

Held that the expenditure incurred on the issue of debentures shall be treated as revenue expenditure even in case of convertible debentures, i.e. the debentures which had to be converted into shares at a later date.

9. MASCON TECHNICAL SERVICES LTD. V. CIT (2013) (MAD.)

Can share issue expenses incurred by a company be treated as capital in nature, if the public issue could not ultimately materialize on account of non-clearance by SEBI?

**Facts of the case:**
The assessee-company incurred share issue expenses of Rs.35.39 lakh for its proposed public issue, which could not ultimately materialize due to non-clearance by the SEBI. It claimed such expenses as revenue in nature, on the ground that the same was incurred for augmenting its working capital. The claim of the assessee was, however, rejected by the Assessing Officer.

**High Court's Decision:**
The High Court noted that the assessee-company had taken steps to go in for a public issue and incurred share issue expenses for the same. However, it could not go in for the public issue by reason of the orders issued by the SEBI just before the proposed issue. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts. The expenditure, therefore, constitutes a capital expenditure.

**AMENDMENT MADE BY FINANCE ACT 2018:**

**Income from construction and service contracts [Section 43CB]**
The profits and gains arising from a construction contract or a service contract shall be computed on the basis of percentage of completion method (POCM) in accordance with the notified ICDS i.e., ICDS III: Construction Contracts. However, the profits and gains arising from a service contract shall be computed on the basis of

<table>
<thead>
<tr>
<th>Method</th>
<th>Condition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project completion method</td>
<td>If the duration of the contract is not more than 90 days</td>
</tr>
<tr>
<td>Straight line method</td>
<td>If the contract involves indeterminate number of acts over a specific period of time</td>
</tr>
</tbody>
</table>

For the purpose of percentage of completion method, project completion method or straight-line method –

(i) the contract revenue shall include retention money;
(ii) the contract cost shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.
CHAPTER 9. PRESUMPTIVE INCOME

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

1. Notwithstanding anything to the contrary contained in sections 28 to 43C,
   - in case of an eligible assessee
   - engaged in an eligible business
   - a sum equal to 8% of the total turnover or gross receipts of the assessee in the previous year on account of such business,
   - or as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee,
   - shall be deemed to be the income under the head "Profits and gains of Business or Profession".

The existing rate of deemed total income of eight per cent will become six per cent in respect of the amount of such total turnover or gross receipts received by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account or such other electronic mode as may be prescribed during the previous year or before the due date specified in sub-section (1) of section 139 in respect of that previous year. However, the existing rate of deemed profit of 8% referred to in section 44AD of the Act, shall continue to apply in respect of total turnover or gross receipts received in any other mode.

(Underlined and bold words are amended by Finance Act (No.2) 2019)

(i) Eligible business: The presumptive taxation scheme under section 44AD covers all small businesses with total turnover/gross receipts of up to Rs. 200 lakhs (except the business of plying, hiring and leasing goods carriages covered under section 44AE).

(ii) Eligible assessee: Resident individuals, HUFs and partnership firms (but not LLPs) and who has not claimed deduction under any of the section 10AA or deduction under any provisions of Chapter VIA under the heading “C.—Deductions in respect of certain incomes” in the relevant assessment year would be covered under this scheme.

(iii) Presumptive rate of tax: The presumptive rate of tax would be 8% of total turnover or gross receipts. However, the presumptive rate of 6% of total turnover or gross receipts will be applicable in respect of amount which is received
   ♦ by an account payee cheque or
   ♦ by an account payee bank draft or
   ♦ by use of electronic clearing system through a bank account
   ♦ by such other electronic mode as may be prescribed {Finance Act (No. 2)}. 

9.1
during the previous year or on or before the due date of filing of return under section 139(1) in respect of that previous year.

However, the assessee has the option to declare in his return of income, an amount higher than the presumptive income so calculated, claimed to have been actually earned by him.

(2) **No further deduction would be allowed:** All deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed.

(3) **Written down value of the asset:** The WDV of any asset of such business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.

(4) **Relief from maintenance of books of accounts and audit:** The intention of widening the scope of this scheme is to reduce the compliance and administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessees opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.

(5) **Higher threshold for non-audit of accounts for assessees opting for presumptive taxation under section 44AD:** Section 44AB makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed Rs. 1 crore.

However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1), he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed Rs. 2 crores.

(6) **Advance tax:** Further, since the threshold limit of presumptive taxation scheme has been enhanced to Rs. 2 crores, the eligible assessee is now required to pay advance tax by 15th March of the financial year.

(7) **Persons not eligible for presumptive taxation scheme:** The following persons are specifically excluded from the applicability of the presumptive provisions of section 44AD -

(a) a person carrying on profession as referred to in section 44AA(1) ; or
(b) a person earning income in the nature of commission or brokerage; or
(c) a person carrying on any agency business.

(8) **Not eligible to opt for presumptive taxation under this section for 5 assessment years:** Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section and he declares profit for any of the
five consecutive assessment years relevant to the previous year not in accordance with the provisions of sub-section (1), he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of sub-section (1). [Section 44AD(4)].

**Example:**

Let us consider the following particulars relating to a resident individual, Mr. A, being an eligible assessee whose gross receipts do not exceed Rs. 2 crore in any of the assessment years between A.Y. 2021-22 to A.Y. 2023-24.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>A.Y.2021-22</th>
<th>A.Y.2022-23</th>
<th>A.Y.2023-24</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross receipts (Rs.)</td>
<td>1,80,00,000</td>
<td>1,90,00,000</td>
<td>2,00,00,000</td>
</tr>
<tr>
<td>Income offered for taxation (Rs.)</td>
<td>14,40,000</td>
<td>15,20,000</td>
<td>10,00,000</td>
</tr>
<tr>
<td>% of gross receipts</td>
<td>8%</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>Offered income as per presumptive taxation scheme u/s 44AD</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

In the above case, Mr. A, an eligible assessee, opts for presumptive taxation under section 44AD for A.Y. 2021-22 and A.Y. 2022-23 and offers income of Rs. 14.40 lakh and Rs. 15.20 lakh on gross receipts of Rs. 1.80 crore and Rs. 1.90 crore respectively.

However, for A.Y. 2023-24, he offers income of only Rs. 10 lakhs on turnover of Rs. 2 crores, which amounts to 5% of his gross receipts. He maintains books of account under section 44AA and gets the same audited under section 44AB. Since he has not offered income in accordance with the provisions of section 44AD(1) for five consecutive assessment years, after A.Y. 2021-22, he will not be eligible to claim the benefit of section 44AD for next five assessment years succeeding A.Y. 2023-24 i.e., from A.Y. 2024-25 to 2028-29.

(9) **Books of accounts and Audit if sub-section (4) attracted:** An eligible assessee to whom the provisions of sub-section (4) are applicable and whose total income exceeds the basic exemption limit has to maintain books of account under section 44AA and get them audited and furnish a report of such audit under section 44AB. [Section 44AD(5)].

**SECTION 44ADA: SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF PROFESSION ON PRESUMPTIVE BASIS (INSERTED BY FINANCE ACT 2016)**

(1) **Eligible Profession:** The presumptive taxation scheme under section 44ADA for estimating the income of an assessee:

- who is engaged in any profession referred to in section 44AA(1) such as legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette; and
• whose total gross receipts does not exceed Rs. 50 lakhs rupees in a previous year,

(2) **Presumptive rate of tax:** Presumptive rate of tax would be a sum equal to 50% of the total gross receipts, or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the assessee.

(3) **Eligible Assessee**

(4) **No further deduction would be allowed:** Under the scheme, the assessee will be deemed to have been allowed the deductions under section 30 to 38. Accordingly, no further deduction under those sections shall be allowed.

(5) **Written down value of the asset:** The written down value of any asset used for the purpose of the profession of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for the relevant assessment years.

(6) **Relief from maintenance of books of accounts and audit:** The eligible assessee opting for presumptive taxation scheme will not be required to maintain books of account under section 44AA(1) and get the accounts audited under section 44AB in respect of such income.

(7) **Option to claim lower profits:** An assessee may claim that his profits and gains from the aforesaid profession are lower than the profits and gains deemed to be his income under section 44ADA(1); and if such total income exceeds the maximum amount which is not chargeable to income-tax, he has to maintain books of account under section 44AA and get them audited and furnish a report of such audit under section 44AB.

(8) **Advance Tax:** Further, since the presumptive taxation regime has been extended for professionals also, the eligible assessee is now required to pay advance tax by 15th March of the financial year.
SECTION 44AE: SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES

(1) **Eligible business:** This section provides for estimating business income of an owner of goods carriages from the plying, hire or leasing of such goods carriages;

(2) **Eligible assessee:** The scheme applies to persons owning not more than 10 goods vehicles at any time during the previous year;

(3) **Presumptive Income:** The estimated income from each goods vehicle, being a heavy goods vehicle or other than heavy goods vehicle would be

<table>
<thead>
<tr>
<th>Goods Carriage</th>
<th>Presumptive Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Heavy goods vehicle</td>
<td>Rs. 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month during which such vehicle is owned by the assessee for the previous year.</td>
</tr>
<tr>
<td>Other than heavy goods vehicle</td>
<td>Rs. 7,500 for every month or part of a month</td>
</tr>
</tbody>
</table>

The assessee can also declare a higher amount in his return of income. In such case, the latter will be considered to be his income;

(4) **All other deduction deemed to be allowed:** The assessee will be deemed to have been allowed the deductions under sections 30 to 38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.

(5) **Salary and interest to partners is allowed:** Where the assessee is a firm, the salary and interest paid to its partner are allowed to be deducted subject to the conditions and limit specified under section 40(b).

(6) **Not requirement to maintain books of accounts and get the accounts audited:** The assessee joining the scheme will not be required to maintain books of account under section 44AA and get the accounts audited under section 44AB in respect of such income.

(7) **Option to claim lower profits:** An assessee may claim lower profits and gains than the deemed profits and gains subject to the condition that the books of account and other documents are kept and maintained as required under section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.
(8) Meaning of certain terms

<table>
<thead>
<tr>
<th>S. No</th>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>Heavy goods vehicle</td>
<td>any goods carriage, the gross vehicle weight of which exceeds 12,000 kilograms.</td>
</tr>
<tr>
<td>(2)</td>
<td>Gross vehicle weight</td>
<td>total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.</td>
</tr>
<tr>
<td>(3)</td>
<td>Unladen weight</td>
<td>the weight of a vehicle or trailer including all equipment ordinarily used with the vehicle or trailer when working but excluding the weight of driver or attendant and where alternative parts or bodies are used the unladen weight of the vehicle means the weight of the vehicle with the heaviest such alternative body or part.</td>
</tr>
</tbody>
</table>

Special provisions for computing profits and gains on presumptive basis: A summary

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Section 44AD</th>
<th>Section 44ADA</th>
<th>Section 44AE</th>
</tr>
</thead>
</table>
| (1) Eligible Assessee        | Resident individual, HUF or Partnership firm (but not LLP) engaged in eligible business and who has not claimed deduction under section 10AA or Chapter VIA under the heading “C – Deductions in respect of certain incomes” Non-applicability of section 44AD in respect of the following persons:  
- A person carrying on profession specified u/s 44AA(1);  
- A person earning income in the nature of commission or brokerage;  
- A person carrying on any agency business. | Resident assessee engaged in any profession specified u/s 44AA(1),namely, legal, medical, engineering, architectural profession or profession of accountancy or technical consultancy or interior decoration or notified profession (authorized representative, film artist, company secretary, profession of information technology) | An assessee owning not more than 10 goods carriages at any time during the P.Y. |
| (2) Eligible business/profession | Any business, other than business referred to in section 44AE, whose total turnover/ | Any profession specified under section 44AA(1), whose total gross | Business of plying, hiring or leasing goods carriages |
| (3) | Presumptive Income | Presumptive rate/Presumptive income | 8% of total turnover/sales/gross receipts or a sum higher than the aforesaid sum claimed to have been earned by the assessee.  6% of total turnover/gross receipts in respect of the amount of total turnover/sales/gross receipts received by A/c payee cheque/bank draft/ECS during the P.Y. or before due date of filing of return u/s 139(1) in respect of that P.Y. | 50% of total gross receipts of such profession or a sum higher than the aforesaid sum claimed to have been earned by the assessee. For each heavy goods vehicle Rs. 1,000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month and for other than heavy goods vehicle, Rs. 7,500 per month or part of a month during which such vehicle is owned by the assessee or an amount claimed to have been actually earned from such vehicle, whichever is higher. |
| (4) | Non-allowability of deductions while computing presumptive income | Deductions allowable under sections 30 to 38 shall be deemed to have been given full effect to and no further deduction shall be allowed. Even in case of a firm, salary and interest paid to partners is not deductible. | Even in case of a firm, salary and interest paid to partners is not deductible. In case of a firm, salary and interest paid to partners is deductible subject to the conditions and limits in section 40(b) |
| (5) | Written down value of asset | WDV of any asset of an eligible business/profession shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed depreciation for each of the relevant assessment years. |
| (6) | Requirement of maintenance of books of account u/s 44AA and audit u/s 44AB | After declaring profits on presumptive basis u/s 44AD, say, for A.Y.2021-22, non-declaration of profits on presumptive basis for any of the 5 successive A.Y.s thereafter (i.e., from A.Y.2022-23 to) If the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account and other documents u/s 44AA(1) and If the assessee claims his profits to be lower than the profits computed by applying the presumptive rate, he has to maintain books of account u/s 44AA(2) and |
Presumptive Income

| A.Y.2026-27), say, for A.Y. 2023-24, would disentitle the assessee from claiming profits on presumptive basis for five successive AYs subsequent to the AY relevant to the PY of such non-declaration (i.e., from A.Y. 2024-25 to A.Y.2028-29). In such a case, the assessee would have to maintain books of account and other documents u/s 44AA(2) and get his accounts audited u/s 44AB, if his total income > basic exemption limit for that year. | get his accounts audited u/s 44AB, if his total income > basic exemption limit in those years. |

**Note** - If a person is not covered under presumptive tax provisions mentioned above, audit of books of account u/s 44AB is mandatory, if, in a case where he carries on business, his total sales, turnover or gross receipts in business > Rs. 1 crore in that P.Y. and in a case where he carries on profession, his gross receipts in profession > Rs. 50 lakh in that P.Y.
CHAPTER 10. TAXATION OF VARIOUS ENTITIES

TAX RATES APPLICABLE FOR A.Y. 2021-2022

(A) INDIVIDUALS, HINDU UNDIVIDED FAMILIES, AOP'S, BOI'S, ETC.

The rates applicable for the assessment year 2021-22 are as follows:

<table>
<thead>
<tr>
<th>SLAB</th>
<th>Resident Individuals of 60 Years but not more than 80 years at any time during the PY</th>
<th>Resident Individuals of 80 Years and Above at any time during the PY</th>
<th>Other Individuals, HUFs, AOPs, BOIs etc. (R and NR)</th>
<th>Basic Tax Rate (%) of Net Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>S</td>
<td>Up to 3,00,000</td>
<td>Up to 5,00,000</td>
<td>Up to 2,50,000</td>
<td>NIL</td>
</tr>
<tr>
<td>A</td>
<td>3,00,001 to 5,00,000</td>
<td>2,50,001 to 5,00,000</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>5,00,001 to 10,00,000</td>
<td>5,00,001 to 10,00,000</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>S</td>
<td>Above 10,00,000</td>
<td>Above 10,00,000</td>
<td>30%</td>
<td></td>
</tr>
</tbody>
</table>

The rates of surcharge applicable for A.Y.2021-22 are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rate of surcharge on income-tax</th>
<th>Components of total income</th>
<th>Applicable rate of surcharge</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Where the total income (including income under section 111A, 112A &amp; Dividend) &gt; Rs. 50 lakhs but is ≤ Rs. 1 crore</td>
<td>10%</td>
<td>STCG u/s 111A Rs. 10 lakhs; LTCG u/s 112A Rs. 5 lakhs; and Other income Rs. 40 lakhs</td>
<td>Surcharge would be levied @10% on income-tax computed on total income of Rs. 55 lakhs.</td>
</tr>
<tr>
<td>(ii) Where total income (including income under section 111A, 112A &amp; Dividend) &gt; Rs. 1 crore but is ≤ Rs. 2 crores</td>
<td>15%</td>
<td>STCG u/s 111A Rs. 20 lakhs; LTCG u/s 112A Rs. 25 lakhs; and Other income Rs. 80 lakhs</td>
<td>Surcharge would be levied @15% on income-tax computed on total income of Rs. 1.25 crores.</td>
</tr>
<tr>
<td>(iii) Where total income (excluding income under section 111A, 112A &amp; Dividend) &gt; Rs. 2 crore but is ≤ Rs. 5 crore</td>
<td>25%</td>
<td>STCG u/s 111A Rs. 24 lakhs; LTCG u/s 112A Rs. 25 lakhs; and Other income Rs. 3 crores</td>
<td>Surcharge would be levied @15% on income-tax on: STCG of Rs. 24 lakhs chargeable to tax u/s 111A; and LTCG of Rs. 25 lakhs chargeable to tax u/s 112A.</td>
</tr>
<tr>
<td>Payable on the portion of income chargeable to tax under section 111A and 112A</td>
<td>Rate of surcharge on the income-tax payable on the portion of income chargeable to tax under section 111A and 112A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Where total income (excluding income under section 111A, 112A &amp; Dividend) &gt; Rs. 5 crore</td>
<td>37%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(v) Where total income (including income under section 111A, 112A &amp; Dividend) &gt; Rs. 2 crore in cases not covered under (iii) and (iv) above</td>
<td>15%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Surcharge**
  - @25% would be leviable on income-tax computed on other income of Rs. 3 crores included in total income.
  - @15% would be levied on income-tax on:
    - STCG of Rs. 40 lakhs chargeable to tax u/s 111A; and
    - LTCG of Rs. 55 lakhs chargeable to tax u/s 112A.
  - @37% would be leviable on the income-tax leviable on other income included in total income.

- **Surcharge**
  - @15% would be levied on income-tax on total income of Rs. 2.25 crore.

⇒ **Health & Education Cess:** @ 4% leviable on {tax plus surcharge}

⇒ **Rebate u/s 87A:** In case of Resident Individual, whose income does not exceed Rs.5,00,000, there shall be allowed a rebate of –
  (a) 100% of the Income Tax; or
  (b) Rs. 12,500

  Whichever is less from the amount of Income Tax.

*Note: The above tax rate is one of the options for Individual’s & HUF’s. The second option is given in sec 115BAC which is introduced by Finance Act 2020. We shall see sec 115BAC later on with illustrations on it.*
ILLUSTRATION 1:
The profit as per P & L account of an AOP is Rs. 5,80,000. The salaries and interest paid to the members are as under:

<table>
<thead>
<tr>
<th>Members</th>
<th>Salaries</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>20,000</td>
<td>Nil</td>
</tr>
<tr>
<td>B</td>
<td>30,000</td>
<td>10,000</td>
</tr>
<tr>
<td>C</td>
<td>10,000</td>
<td>20,000</td>
</tr>
</tbody>
</table>

Expenses of Rs. 40,000 debited in Profits Loss Account are disallowable under section 43B. Mr. A, Mr. B & Mr. C are the members and the following data is given:

<table>
<thead>
<tr>
<th>Members</th>
<th>Other Incomes</th>
<th>Share in AOP</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2,40,000</td>
<td>20%</td>
</tr>
<tr>
<td>B</td>
<td>2,30,000</td>
<td>30%</td>
</tr>
<tr>
<td>C</td>
<td>2,20,000</td>
<td>50%</td>
</tr>
</tbody>
</table>

ANSWER:
Since the total income of all the members excluding the share of income of AOP is below taxable limit and none of the member is assessable at a rate higher than Maximum marginal rate, the tax shall be levied on the AOP at the normal rates applicable to an individual, as per section 167B.

**Total Income of AOP**

<table>
<thead>
<tr>
<th>Profit as per P&amp;L Account</th>
<th></th>
<th>5,80,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Add: Expenses disallowed under section 43B</td>
<td></td>
<td>40,000</td>
</tr>
<tr>
<td>Add: Salaries &amp; Interest disallowed under section 40(ba)</td>
<td></td>
<td>90,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td></td>
<td><strong>7,10,000</strong></td>
</tr>
</tbody>
</table>

Tax thereon | 54,500

**Add: Health & education cess @ 4%** | 2,180

**Total Tax payable** | **56,680**

**Income to be allocated to the members in profit sharing ratio**

<table>
<thead>
<tr>
<th>Taxable Income of AOP/ BOI</th>
<th>7,10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less: Salaries &amp; Interest paid to members</td>
<td>90,000</td>
</tr>
<tr>
<td>Amount to be allocated to members in profit sharing ratio</td>
<td><strong>6,20,000</strong></td>
</tr>
</tbody>
</table>

**ALLOCATION OF TOTAL INCOME OF AOP TO MEMBERS AS PER SECTION 67A**

<table>
<thead>
<tr>
<th>Mr. A</th>
<th>Mr. B</th>
<th>Mr. C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs. 6,20,000 in Profit sharing ratio</td>
<td>1,24,000</td>
<td>1,86,000</td>
</tr>
<tr>
<td>Add: Salary</td>
<td>20,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Add: Interest</td>
<td>NIL</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Income from AOP assessable under the head P/G/B/P</strong></td>
<td>1,44,000</td>
<td>2,26,000</td>
</tr>
</tbody>
</table>

**TOTAL INCOME OF MEMBERS**
### Share in income of AOP

<table>
<thead>
<tr>
<th>Share in income of AOP</th>
<th>1,44,000</th>
<th>2,26,000</th>
<th>3,40,000</th>
</tr>
</thead>
</table>

### Other Incomes

<table>
<thead>
<tr>
<th>Other Incomes</th>
<th>2,40,000</th>
<th>2,30,000</th>
<th>2,20,000</th>
</tr>
</thead>
</table>

### Total Income

<table>
<thead>
<tr>
<th>Total Income</th>
<th>3,84,000</th>
<th>4,56,000</th>
<th>5,60,000</th>
</tr>
</thead>
</table>

### Tax

<table>
<thead>
<tr>
<th>Tax</th>
</tr>
</thead>
</table>

#### Less: Rebate under section 86

<table>
<thead>
<tr>
<th>Less: Rebate under section 86</th>
</tr>
</thead>
</table>

#### Less: Rebate under section 87A

<table>
<thead>
<tr>
<th>Less: Rebate under section 87A</th>
</tr>
</thead>
</table>

#### TAX PAYABLE

<table>
<thead>
<tr>
<th>Add: Health &amp; Education Cess @ 4%</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL TAX PAYABLE</td>
</tr>
<tr>
<td>ROUND OFF</td>
</tr>
</tbody>
</table>

### ILLUSTRATION 2:

Total Income of AOP is = Rs. 80,000

<table>
<thead>
<tr>
<th>Members</th>
<th>Other Incomes</th>
<th>Share in AOP</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Individual)</td>
<td>140,000</td>
<td>50%</td>
</tr>
<tr>
<td>B (Individual)</td>
<td>80,000</td>
<td>30%</td>
</tr>
<tr>
<td>C (Foreign Co.)</td>
<td>90,000</td>
<td>20%</td>
</tr>
</tbody>
</table>

#### ANSWER:

Since, C is assessable at a rate higher than maximum marginal rate, i.e. _________%, tax on the income of AOP shall be leviable as under:

(i) on the share of C @ _________%

(ii) on balance income @ _________%

### TOTAL INCOME OF AOP Rs. 80,000

<table>
<thead>
<tr>
<th>Tax thereon</th>
<th>Rs. 16,000</th>
<th>@ %</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>- On Rs.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>Rs.</td>
</tr>
<tr>
<td>Round off</td>
<td></td>
<td></td>
<td>Rs.</td>
</tr>
</tbody>
</table>

The share of income from AOP shall not be included while computing the total income of the members.

### TOTAL INCOME OF MEMBERS

<table>
<thead>
<tr>
<th></th>
<th>Mr. A</th>
<th>Mr. B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>140,000</td>
<td>80,000</td>
<td>90,000</td>
</tr>
<tr>
<td>TAX PAYABLE</td>
<td>NIL</td>
<td>NIL</td>
<td></td>
</tr>
</tbody>
</table>
ILLUSTRATION 3:
Total Income of AOP is = Rs. 1,00,000

<table>
<thead>
<tr>
<th>Members</th>
<th>Other Incomes</th>
<th>Share in AOP</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Individual)</td>
<td>2,90,000</td>
<td>50%</td>
</tr>
<tr>
<td>B (Individual)</td>
<td>1,00,000</td>
<td>50%</td>
</tr>
</tbody>
</table>

ANSWER:
Since the income of Mr. A, excluding his share of income from the AOP is more than the maximum amount not chargeable to tax and none of the members of the AOP is assessable at a rate higher than the maximum marginal rate, tax shall be levied on the AOP at the maximum marginal rate, i.e. ___________%.

TOTAL INCOME OF AOP = Rs. 1,00,000
Tax thereon @ _______%

The share of income from AOP shall not be included while computing the total income of the members.

<table>
<thead>
<tr>
<th>TOTAL INCOME OF MEMBERS</th>
<th>Mr. A</th>
<th>Mr. B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>2,90,000</td>
<td>1,00,000</td>
</tr>
<tr>
<td>TAX PAYABLE</td>
<td>NIL</td>
<td>NIL</td>
</tr>
</tbody>
</table>

ILLUSTRATION 4:
Total Income of AOP is = Rs. 60,000

<table>
<thead>
<tr>
<th>Members</th>
<th>Other Incomes</th>
<th>Share in AOP</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (Individual)</td>
<td>90,000</td>
<td>40%</td>
</tr>
<tr>
<td>B (Individual)</td>
<td>80,000</td>
<td>10%</td>
</tr>
<tr>
<td>C (Indian Co.)</td>
<td>Nil</td>
<td>20%</td>
</tr>
<tr>
<td>D (Foreign Co.)</td>
<td>Nil</td>
<td>30%</td>
</tr>
</tbody>
</table>

ANSWER:
Since D is assessable at a rate higher than the marginal rate, tax on the total income of the AOP shall be levied as under:

(i) on the share of A&B @ _______%
(ii) on the share of C @ _______%
(iii) on the share of D @ _______%

Total Income of AOP = Rs. 60,000
Tax thereon
- on Rs. 30,000 @ _______%
- on Rs. 12,000 @ _______%
- on Rs. 18,000 @ _______%

TOTAL TAX PAYABLE
ROUND OFF
The share of income from AOP shall not be included in the total income of the members.

**TOTAL INCOME OF MEMBERS**

<table>
<thead>
<tr>
<th></th>
<th>Mr. A</th>
<th>Mr. B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Income</td>
<td>Rs. 90,000</td>
<td>Rs. 80,000</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Tax thereon</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

**TAXATION OF FIRMS**

**SECTION 184: ASSESSMENT AS A FIRM**

A firm shall be assessed as a firm for the purposes of the Act if:

(i) the partnership is evidenced by an instrument, and

(ii) the individual shares of the partners are specified in the instrument.

**OTHER CONDITIONS:**

(a) A certified copy of the instrument of partnership referred above should accompany the return of income of the previous year relevant to assessment year in respect of which assessment as a firm is first sought.

(b) The copy of instrument of partnership shall be certified in writing by all the partners not being minors, or, where the return is made after the dissolution of the firm, by all persons (not being minors) who were partners in the firm immediately before its dissolution and by the legal representative of any such partner who is deceased.

(c) Where the firm is assessed as such for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the assessment as a firm was first sought.

(d) Where any change in constitution had taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year.

(e) Notwithstanding anything contained in any other provisions of this Act, where, in respect of any assessment year, there is on the part of a firm any such failure as is mentioned in section 144, the firm shall be so assessed that no deduction by way of any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such firm to any partner of such firm shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession" and such interest, salary bonus, commission or remuneration shall not be chargeable to income-tax under section 28(v) in the hands of partners. [Section 184(5)]

**SECTION 185: ASSESSMENT WHEN SECTION 184 NOT COMPLIED WITH**

Notwithstanding anything contained in any other provision of this Act, where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be so assessed that no deduction by way of any payment of interest, salary, bonus, commission or remuneration by whatever name called, made by such firm to any partner of such firm shall...
Taxation of various entities

be allowed in computing the income chargeable under the head "Profits and gains of business or profession" and such interest, salary, bonus, commission or remuneration shall not be chargeable to income-tax under section 28(v) in the hands of the partners.

**CAN SALARY AND INTEREST PAID TO PARTNERS BE DISALLOWED EVEN IF CONDITIONS OF 40(b) ARE SATISFIED**

In the following cases, the salary and interest paid by a firm to its partners shall be disallowed even if the conditions of section 40(b) are satisfied.

1. **Where Section 184(5) applies:** If there is a failure on part of the firm as referred to in section 144, then salary and interest paid by the firm to its partners shall be disallowed. Such salary and interest shall not be taxable in hands of the partners.

2. **Where Section 185 applies:** Where a firm does not comply with the technical requirements of section 184, then the salary and interest paid by the firm to its partners shall be disallowed. Such salary and interest shall not be taxable in hands of partner.

**SECTION 187: CHANGE IN CONSTITUTION OF FIRM**

Where at the time of making an assessment under section 143 or section 144 or section 147 or section 153A it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment.

**KEY NOTE:**

(a) if one or more partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change, continue as partner or partners after the change or

(b) Where all the partners continue with a change in the respective shares or in the shares of some of them.

However, nothing in clause (a) shall apply where the firm is dissolved on the death of any of its partners.

**Illustration:**

In the partnership firm M/s ABCD, Mr. A, Mr. B, Mr. C and Mr. D were partners during the previous year ended 31.03.2021. Mr. D retires on 30.04.2021. Therefore, if the Assessing Officer makes an assessment under section 143(3) on the firm for the previous year ended 31.03.2021 on 31.12.2021, he shall make the assessment on the reconstituted firm M/s ABC. However as per section 188A, all the partners namely Mr. A, Mr. B, Mr. C and Mr. D shall be liable for the taxes, interest and penalty of the firm for Assessment Year 2021-2022.

**SECTION 188: SUCCESSION OF ONE FIRM BY ANOTHER FIRM**

Where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate assessment shall be made on the predecessor firm and the successor firm. The predecessor firm shall be assessed in respect of the income of the previous year in which succession took place up to the date of succession. The successor firm shall be assessed in respect of the income of the previous year after the date of succession.
Illustrations:

1. From the firm M/s ABC, Mr. C retires on 30.06.2020 → Section 187 shall apply. Assessment for previous year 31.03.2021 shall be made on the reconstituted firm M/s AB. However, the liabilities of the partners shall be governed by section 188A.

2. From the firm M/s ABC, Mr. A, Mr. B and Mr. C retire on 30.06.2020 and Mr. D, Mr. E and Mr. F are admitted → Section 188 shall apply. Separate assessment shall be made on M/s ABC for the period 01.04.2020 to 30.06.2020 and on M/s DEF for the period 01.07.2020 to 31.03.2021.

3. M/s ABC becomes M/s DBC on 30.06.2020. M/s DBC becomes M/s DEC on 30.09.2020. M/s DEC becomes M/s DEF on 31.12.2020. → This is a case of change in constitution of the firm and section 187 shall apply. Assessment for the previous year ended 31.03.2021 shall be made on the reconstituted firm M/s DEF. However, the liabilities of the partners shall be governed by section 188A.

4. In firm M/s ABC, Mr. B dies on 30.06.2020 and the partnership deed is silent about the death of the partner. → This will result in dissolution of firm and section 187 shall not apply. Section 189 shall apply.

5. In firm M/s ABC, Mr. B dies on 30.06.2020 and the partnership deed provides that the firm shall continue on the death of any partner. → This is a change in the constitution of the firm and section 187 shall apply. The assessment for previous year ended 31.03.2021 shall be made on firm M/s AC. However, the liabilities of the partners/legal heirs shall be governed by section 188A.

6. From firm M/s AB, Mr. A retires → This is a case of dissolution of firm to which section 189 shall apply.

7. Firm M/s ABC is converted into a private limited company → This is a case of dissolution of firm to which section 189 shall apply.

SECTION 188A: JOINT & SEVERAL LIABILITY OF PARTNERS FOR TAX PAYABLE BY FIRM

Every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant.

Illustration 1:
A partnership firm consisted of partners A, B, C & D during the previous year ended on 31st March, 2015. Partner D retired on 2nd April, 2015. The cases of the firm for assessment years 2015-2016 to 2019-2020 are reopened under section 147 on 1.1.2021. Now, the taxes, penalty and interest for assessment years 2015-2016 and 2016-2017 can be recovered either from the firm or from A or B or C or D or from any of them jointly. The taxes, penalty and interest of
assessment years 2017-2018 to 2019-2020 can be recovered either from the firm or from A or B or C or any of them jointly.

Illustration 2:
Mr. A was a partner in the firm M/s. XYZ only for a month in the previous year 31st March, 2021. Mr. A along with other partners and the firm is jointly and severally liable for the taxes, interest and penalty of the firm for the previous year 31st March, 2021. If Assessing Officer is unable to recover the taxes, interest and penalty from the firm for the said year, then he can recover the taxes, penalty and interest of the firm for the said year from Mr. A.

SECTION 189: FIRM DISSOLVED OR BUSINESS DISCONTINUED

1. Every person who was at the time of such discontinuance or dissolution a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or any other sum payable under the Act."

Illustration:
A partnership firm formed on 1.4.2009 consisted of partners P, Q, R & S up to 31st March, 2013. Partner P retired on 15th April, 2013 and Mr. X was taken in as a partner on that date. Mr. Q retired on 15th May, 2017. Mr. R retired on 31st December, 2019 and on that date Mr. Y was taken in as partner. The firm is dissolved on 4th January, 2021.

Now, Mr. P, Q, R & S are jointly and severally liable for the taxes, interest and penalty of the firm from assessment year 2010-2011 to assessment year 2014-2015. Mr. X is also jointly and severally along with Mr. P, Q, R & S liable for the taxes, interest and penalty of the firm for assessment year 2014-2015. Mr. X, Q, R & S are jointly and severally liable for the taxes, interest and penalty of the firm for assessment years 2015-2016 to 2018-2019. Mr. X, R & S are jointly severally liable for the taxes, interest and penalty of the firm for assessment years 2019-2020 and 2020-2021. Mr. Y is also liable jointly and severally with Mr. X, R & S for assessment year 2020-2021. Mr. X, Mr. Y and Mr. S are jointly severally liable for the taxes, interest and penalty of the firm for Assessment Year 2021-2022. (Provisions of section 188A)

Mr. X, Y & S are the partners at the time of dissolution and therefore they are jointly and severally liable for the taxes, interest and penalty of firm from assessment year 2010-2011 to assessment year 2021-2022 as per the provision of section 189. They are liable along with the persons referred to in section 188A.

TAXATION OF FIRMS AND ITS PARTNERS: PROVISIONS IN BRIEF

1. Income of the partnership firm is assessed at a flat tax rate of 30% (+ 12% surcharge where total income exceeds Rs. 1 crore + 4% Health & education cess. LTCG are taxed under section 112/112A and STGG are taxed under section 111A.

2. Shares of partners in the total income of the firm is EXEMPT in the hands of partners under section 10(2A).

3. Remuneration and interest paid to the partners is allowed as deduction to the firm subject to the limits and conditions specified in section 40(b).
4. Remuneration and interest received by the partners shall be taxed in their hands as P/G/B/P under section 28(v). However, salaries and interest which have not been allowed under section 40(b) or section 184(5) or section 185 shall not be added to the income of the partners under section 28(v).

5. Losses of the firm shall be carried forward by the firm and shall not be allocated to the partners.

### SECTION 40(b): PAYMENT OF INTEREST, SALARY, BONUS, COMMISSION OR REMUNERATION MADE BY FIRM TO ITS PARTNERS

Interest and remuneration paid to the partners by a firm are not deductible. However, the interest and remuneration paid to partners by a firm are deductible if all the following conditions are satisfied:

(i) Payment of salary, bonus, commission or remuneration, by whatever name called (hereinafter referred as remuneration) is to a working partner. If it is paid to a non-working partner, the same shall be disallowed. **Explanation: Working Partner** means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

(ii) The payment of remuneration to a working partner and payment of interest to any partner should be authorised by and should be in accordance with the terms of the partnership deed.

### CBDT CIRCULAR

It has been observed that the assesses are incorporating the following kind of clause in the partnership deed:

“The amount of remuneration to the working partner will be as mutually agreed upon between partners at the end of the year”.

The Assessing Officers are now disallowing the deduction on the basis of such clauses for the reason that they neither specify the amount of remuneration to each partner nor lay down the manner of quantifying the remuneration.

In cases where neither the amount of remuneration has been quantified nor even the limit of total remuneration has been specified but the same has been left to be determined by the partners at the end of the year, the remuneration to the partners will not be allowed as deduction in computation of firm's income. **The remuneration shall be admissible only if the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.**

(iii) The payment of remuneration and interest should relate to a period falling after the date of partnership deed. That means, the partnership deed should not provide for payment of remuneration and interest from retrospective effect (i.e. any earlier period prior to the date of partnership deed).

**Illustration 1:**
The partners entered into a partnership agreement on 1.4.2020 and no salary was provided in the deed. On 31.1.2021, the partners entered into an agreement to amend
the above deed with retrospective effect from 1.4.2020 to provide a salary of Rs. 3,000 each per month to each partner.

**Answer:**
Salary paid to partners for the period 01.04.2020 to 31.01.2021 shall not be allowed as a deduction to the firm.
Salary paid to partners for the period 01.02.2021 to 31.03.2021 shall be allowed as a deduction to the firm, subject to the limit specified under section 40(b).

**Illustration 2:**
A & B enters into partnership on 1.4.2020. The partnership deed provides salary of Rs. 3000 per month to A and Rs. 4000 per month to B. On 1.7.2020, an agreement is entered to amend the above deed retrospectively from 1.4.2020 and provide salary of Rs. 6,000 per month to A and Rs. 7,000 per month to B.

**Answer:**
For the period 01.04.2020 to 30.06.2020, salary paid to A & B shall be allowed as a deduction to the firm to the tune of Rs. 3,000 per month to A and Rs. 4,000 per month to B. Thereafter, the enhanced salary paid shall be allowed as deduction. But, the above deduction shall be limited to the amount specified under section 40(b).

(iv) The payment of interest to a partner should not exceed the amount calculated at the rate of 12% per annum simple interest (any amount in excess will be disallowed).

**NOVEL DISTRIBUTING ENTERPRISES [2001] (KER.)**
Where interest paid to partners on current account was not authorised under partnership deed, in view of the provisions in section 40(b)(iv) impugned interest was rightly disallowed, notwithstanding fact that assessee-firm had recorded said transaction in its books of account and partners had included said amount in their return of income and paid tax thereon.

The petitioner-firm claimed deduction of interest paid to the partners both in respect of capital account and also the current account. The Assessing Officer disallowed the claim in respect of interest on current account on the ground that the partnership deed did not authorise it. The petitioner took up the matter in revision before the Commissioner under section 264 but the same was rejected.

Held that clause 10 of the partnership deed which dealt with payment of interest stated that the net profit or loss after making 12% interest on the capital contribution of the partners, for each year, shall be shared. Since the petitioners had no case that interest related to the capital contribution, the said amount could not be allowed as a deduction in view of the provisions of sub-clause (iv) of clause (b) of section 40. The fact that the assessee-firm had paid interest on current account and recorded it in the books of account and further that the partners had included the said amount in their individual returns and paid tax would not alter the situation. The authorities could act only in accordance with the provisions of section 40(b). In the instant case, the CIT had rejected the claim for deduction of interest paid on current account only because there was no provision in the partnership deed enabling such payment. The disallowance was justified.
(v) The payment of remuneration should not exceed the following amounts (Any amount in excess will be disallowed).

<table>
<thead>
<tr>
<th>(a)</th>
<th>On the first Rs. 3,00,000 of book profit or in case of a loss</th>
<th>Rs.1,50,000 or at the rate of 90% of the book profit, whichever is more</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b)</td>
<td>On the balance of book profits.</td>
<td>At the rate of 60%</td>
</tr>
</tbody>
</table>

Explanation: "Book Profit" means the net profit as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in sections 28 to 44D as increased by the aggregate of the remuneration paid or payable to all partners of the firm if such amount has been deducted while computing the net profit.

**Analysis of Section 40(b)**

The following aspects may be noted while computing book profits:

(i) Only the income under the head P/G/B/P is to be taken,
(ii) Current year and brought forward depreciation is to be deducted. (Section 32)
(iii) Brought Forward Business Losses will not be deducted. (Section 72)
(iv) Chapter VI-A deductions are also not to be deducted,
(v) Remuneration is to be added back if it is debited to Profit & Loss Account,
(vi) Interest paid to the partners to the extent it is deductible shall not be added back.

**CONDITIONS FOR ALLOWABILITY OF REMUNERATION AND INTEREST PAID BY THE FIRM TO ITS PARTNERS**

<table>
<thead>
<tr>
<th>Allowability of Remuneration</th>
<th>Allowability of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. To a working partner.</td>
<td>1. To a working/ non-working partner.</td>
</tr>
<tr>
<td>2. To an individual only.</td>
<td>2. To any partner.</td>
</tr>
<tr>
<td>3. Should be authorised by partnership deed.</td>
<td>3. Should be authorised by partnership deed.</td>
</tr>
<tr>
<td>4. In the partnership deed:</td>
<td>4. Rate of interest should be specified in the partnership deed.</td>
</tr>
<tr>
<td>- either specify the amount of remuneration payable to each partner, or</td>
<td></td>
</tr>
<tr>
<td>- lay down the manner of quantification of remuneration to each partner.</td>
<td></td>
</tr>
<tr>
<td>5. Remuneration should not be retrospective.</td>
<td>5. Interest should not be retrospective.</td>
</tr>
</tbody>
</table>

**KEY NOTES:**

1. If a firm pays interest to a partner and the partner pays interest to the firm on his drawings, then the interest shall not be netted off. The interest received by the firm from the partners on their drawings is taxable in the hands of the firm as income under the head Profits & Gains of Business or Profession. The interest paid by the firm to the partners is allowable as per section 40(b).
2. Interest paid by the firm to its partners on their fixed capital account, current capital account and loan account is allowable as deduction to the firm provided the partnership deed specifically authorizes the payment of interest on fixed capital account, current capital account and loan account. If the partnership deed authorizes the payment of interest on fixed capital account, then interest on current capital account and loan account shall not be allowed as deduction to the firm.

### EXPLANATION 1 TO SECTION 40(b)

Where an individual is a partner in a firm on behalf of or for the benefit, of any other person (partner in a representative capacity), then

- **(a)** Interest paid by the firm to such individual otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of section 40(b).

- **(b)** Interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of section 40(b).

**Illustration:**

Mr. X is a partner in a firm on behalf of his HUF i.e. partner in a representative capacity. Mr. X has given a loan to the firm out of his self acquired funds and the firm pays interest of Rs. 10,000 to Mr. X. The firm also pays interest of Rs. 15,000 to Mr. X on the capital of HUF.

In this case section 40(b) will not be applicable to the interest payment of Rs. 10,000. Rs. 10,000 interest is allowable under section 36(1)(iii) subject to section 40A(2). The interest payment of Rs. 15,000 is however subjected to the provisions of section 40(b).

### EXPLANATION 2 TO SECTION 40(b)

Where an individual is a partner in a firm otherwise than as partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of section 40(b), if such interest is received by him on behalf, or for the benefit of any other person.

**Illustration:**

Mr. X is a partner in a firm in his individual capacity. He is also the karta of a HUF. The firm pays interest of Rs. 10,000 to Mr. X on the loan given by HUF to the firm. The firm also pays Rs. 15,000 to Mr. X on his capital in the firm.

In this case, section 40(b) will not be applicable to the interest of Rs. 10,000. The said interest is deductible under section 36(1)(iii) subject to the provisions of section 40A(2). The interest payment of Rs. 15,000 will however be subjected to the provisions of section 40(b).

### SECTION 28(v): PROFITS AND GAINS OF BUSINESS OR PROFESSION

Any interest, salary, bonus, commission or remuneration due to or received by a partner of a firm from such firm shall be assessable under the head P/G/B/P.

**Provided** that where any interest, salary, bonus, commission or remuneration has not been allowed to be deducted under section 40(b), the amount not so allowed to be deducted shall not be added to the income of the partners.
WHETHER REMUNERATION PAID TO THE PARTNER CAN BE DISALLOWED UNDER SECTION 40A(2)

Can remuneration paid to working partners as per the partnership deed be considered as unreasonable and excessive for attracting disallowance under section 40A(2)(a) even though the same is within the statutory limit prescribed under section 40(b)(v)?

CIT V. GREAT CITY MANUFACTURING CO. (2013) (ALL)

Facts of the case: In this case, the Assessing Officer contended that the remuneration paid by the firm to its working partners was highly excessive and unreasonable, on the ground that the remuneration to partners (Rs. 39.31 lakh) was many times more than the total payment of salary to all the employees (Rs. 4.87 lakh). Therefore, he disallowed the excessive portion of the remuneration to partners by invoking the provisions of section 40A(2)(a).

High Court’s Observations: On this issue, the High Court observed that section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. If the remuneration paid is within the ceiling limit provided under section 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.

The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of remuneration to the working partners and the remuneration is within the limits prescribed under section 40(b)(v). If these conditions are complied with, then the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive.

High Court’s Decision: The Allahabad High Court, therefore, held that the question of disallowance of remuneration under section 40A(2)(a) does not arise in this case, since the Tribunal has found that all the three conditions mentioned above have been satisfied. Hence, the remuneration paid to working partners within the limits specified under section 40(b)(v) cannot be disallowed by invoking the provisions of section 40A(2)(a).

SECTION 10(2A): INCOME EXEMPT FROM TAX

In case of a partner of a firm, his share in the total income of the firm shall not be included in the total income of the partner.

KEY NOTES:
The share of a partner in the total income of the firm shall be computed as under:

Total Income of the firm X Share of profits of the firm as per the partnership deed
Profits of the firm as per partnership deed.
SECTION 10(2A) OF THE INCOME-TAX ACT, 1961 - FIRM - SHARE OF PROFITS TO PARTNER OF FIRM - CLARIFICATION ON INTERPRETATION OF PROVISIONS OF SECTION 10(2A) IN CASES WHERE INCOME OF FIRM IS EXEMPT

CIRCULAR NO. 8/2014, DATED 31-3-2014

1. A reference has been received in the Board in connection with the interpretation of provisions of section 10(2A) of the Income tax Act, 1961 ('Act') seeking clarification as to what will be the amount exempt in the hands of the partners of a partnership firm in cases where the firm has claimed exemption/deduction under Chapter III or VI A of the Act.

2. A firm is assessed as such and is liable to pay tax on its total income. A partner is not liable to tax once again on his share in the said total income.

3. It is clarified that 'total income' of the firm for section 10(2A) of the Act, as interpreted contextually, includes income which is exempt or deductible under various provisions of the Act. It is, therefore, further clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Accordingly, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes NIL in the hands of the firm on account of any exemption or deduction as per the provisions of the Act.

For example:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income for the firm before deduction under Chapter VI-A</td>
<td>100 lakh</td>
</tr>
<tr>
<td>Less: Deduction under section 80-IA</td>
<td>100 lakh</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Let's say profits as per books of account are also Rs. 100 lakh. There are two partners of the firm sharing profits equally. Now Rs. 50 lakhs is credited to capital account of each partner.

CBDT has clarified that although total income of the firm is Nil, yet each partner's capital account is exempt under section 10(2A).

LOSSES ETC. OF FIRMS

The losses and unabsorbed depreciation can be carried forward by a firm only.

SECTION 78(1): CARRY FORWARD AND SET OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM

Where a change has occurred in the constitution of a firm, then nothing shall entitle the firm to have carried forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

ANALYSIS OF SECTION 78(1)

Section 78(1) provides that where a change in constitution of firm takes place on account of retirement of partner or death of the partner then, the firm shall not carry forward and set off the following brought forward losses:

10.15
Share of the retired/ deceased partner in the brought forward losses of the firm | $X$
---|---
Less: Share of the retired/ deceased partner in the current year profit | $Y$
($x - y$) can not be carried forward by the firm or its partners. | $x - y$

**Illustration:**
A firm furnishes you the following data for the previous year ended 31.3.2021:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/G/B/P before setting off brought forward depreciation and brought forward losses</td>
<td>8,00,000</td>
</tr>
<tr>
<td>Brought forward losses of Assessment Year 2015-2016</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Brought forward Depreciation of Assessment Year 2015-2016</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

There were four partners A, B, C and D sharing profits and losses equally. On 30th June, 2020, the partner A had retired from the firm. Compute the total income of the firm.

**Answer:**
By virtue of Section 78(1), the firm shall not carry forward and set off the following loss:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of retired partner in brought forward losses</td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Share of the retired partner in the current profits ($2,00,000 \times 3/12$)</td>
<td>50,000</td>
</tr>
<tr>
<td>($x - y$) cannot be carried forward by the firm or its partners.</td>
<td>25,000</td>
</tr>
</tbody>
</table>

Therefore, Rs. 25,000 cannot be carried forward and set off by the firm. **It may be noted that section 78(1) is not applicable for brought forward depreciation.** Now, the income of the firm for Assessment Year 2021-2022 is as under:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Year P/G/B/P</td>
<td>8,00,000</td>
</tr>
<tr>
<td>Less: Brought Forward Losses</td>
<td>2,75,000</td>
</tr>
<tr>
<td>(3,00,000 - 25,000)</td>
<td>2,75,000</td>
</tr>
<tr>
<td>Less: Brought Forward Depreciation</td>
<td>1,00,000</td>
</tr>
<tr>
<td>4,25,000</td>
<td>4,25,000</td>
</tr>
</tbody>
</table>

**ILLUSTRATIONS**

**Illustration 1:**
A partnership firm submits the following information for Assessment Year 2021-2022:

### Part 1: Data

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Profit as per P &amp; L A/c.</td>
<td>3,60,000</td>
</tr>
<tr>
<td>(ii) Depreciation as per books of Account</td>
<td>20,000</td>
</tr>
<tr>
<td>(iii) Depreciation as per Income-Tax Act (Current Year)</td>
<td>40,000</td>
</tr>
<tr>
<td>(iv) Brought forward Depreciation</td>
<td>3,50,000</td>
</tr>
<tr>
<td>(v) Bought forward loss</td>
<td>13,000</td>
</tr>
<tr>
<td>(vi) Expenditure not allowable as per Income-tax Act debited in P &amp; L A/c</td>
<td>30,000</td>
</tr>
<tr>
<td>(vii) Interest paid to the partners debited in P &amp; L A/c</td>
<td></td>
</tr>
<tr>
<td>Partner A (24%)</td>
<td>10,000</td>
</tr>
<tr>
<td>Partner B (24%)</td>
<td>16,000</td>
</tr>
<tr>
<td>(viii) Remuneration paid to the partners debited in P &amp; L A/c.</td>
<td></td>
</tr>
</tbody>
</table>
The Partners A & B share profits and losses equally. Compute the taxable income of the firm and its partners.

**Answer:**

**Computation of Book Profit under section 40(b)**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per P &amp; L A/c</td>
<td>3,60,000</td>
</tr>
<tr>
<td>Add: Depreciation as per books</td>
<td>20,000</td>
</tr>
<tr>
<td>Add: Expenditure not allowable as per I. T. Act</td>
<td>30,000</td>
</tr>
<tr>
<td>Add: Interest to partners disallowed u/s 40(b)</td>
<td>13,000</td>
</tr>
<tr>
<td>Add: Remuneration to partners</td>
<td>2,50,000</td>
</tr>
<tr>
<td></td>
<td><strong>6,73,000</strong></td>
</tr>
<tr>
<td>Less: C/Y Depreciation as per I. T. Act</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td><strong>6,33,000</strong></td>
</tr>
<tr>
<td>Less: B/f Depreciation</td>
<td>3,50,000</td>
</tr>
<tr>
<td><strong>Book Profits</strong></td>
<td><strong>2,83,000</strong></td>
</tr>
</tbody>
</table>

Therefore, allowable remuneration as per section 40(b) is Rs. 2,54,700. Since remuneration paid is Rs. 2,50,000, Rs. 2,50,000 is allowed as deduction under section 40(b).

**Computation of the Total Income of the firm**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per P &amp; L A/c</td>
<td>3,60,000</td>
</tr>
<tr>
<td>Add: Depreciation as per books</td>
<td>20,000</td>
</tr>
<tr>
<td>Add: Expenditure not allowable as per I. T. Act</td>
<td>30,000</td>
</tr>
<tr>
<td>Add: Interest to partners disallowed u/s 40(b)</td>
<td>13,000</td>
</tr>
<tr>
<td></td>
<td><strong>4,23,000</strong></td>
</tr>
<tr>
<td>Less: C/Y Depreciation as per I. T. Act</td>
<td>40,000</td>
</tr>
<tr>
<td></td>
<td><strong>3,83,000</strong></td>
</tr>
<tr>
<td>Less: B/f Losses</td>
<td>13,000</td>
</tr>
<tr>
<td>Less: B/f Depreciation</td>
<td>3,50,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>20,000</strong></td>
</tr>
</tbody>
</table>

**Taxable income of partners:**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/G/B/P as per section 28(v):</td>
<td></td>
</tr>
<tr>
<td>(i) Salaries</td>
<td>1,40,000</td>
</tr>
<tr>
<td>(ii) Interest to the extent allowed</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>1,45,000</td>
</tr>
<tr>
<td>Other Incomes</td>
<td>2,20,000</td>
</tr>
<tr>
<td><strong>Taxable Income</strong></td>
<td><strong>3,65,000</strong></td>
</tr>
<tr>
<td>Tax thereon</td>
<td></td>
</tr>
<tr>
<td>Less: Rebate under section 87A</td>
<td></td>
</tr>
<tr>
<td><strong>{ Amendment by Finance Act (no.1) 2019}</strong></td>
<td></td>
</tr>
<tr>
<td>Add: Health &amp; Education Cess @ 4 %</td>
<td></td>
</tr>
</tbody>
</table>
Illustration 2:
Smart, Happy and Lucky are three partners of Small & Co., a partnership firm engaged in trading, sharing profits and losses in the ratio of 1:2:3. The Profit & Loss Account of the firm for the year ended 31.3.2021 is as under:

<table>
<thead>
<tr>
<th>SMALL &amp; CO.</th>
<th>Profit &amp; Loss Account for the year ended 31.3.2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr.</td>
<td>Cr.</td>
</tr>
<tr>
<td>PARTICULARS</td>
<td>AMOUNT Rs.</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>25,20,000</td>
</tr>
<tr>
<td>Staff Salaries</td>
<td>6,54,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>12,30,000</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Remuneration to Partners:</td>
<td></td>
</tr>
<tr>
<td>S</td>
<td>3,24,000</td>
</tr>
<tr>
<td>L</td>
<td>2,16,000</td>
</tr>
<tr>
<td>Interest on Capital to Partners:</td>
<td></td>
</tr>
<tr>
<td>S</td>
<td>1,80,000</td>
</tr>
<tr>
<td>L</td>
<td>1,80,000</td>
</tr>
<tr>
<td>Net Profit</td>
<td></td>
</tr>
<tr>
<td>S</td>
<td>99,000</td>
</tr>
<tr>
<td>L</td>
<td>2,97,000</td>
</tr>
<tr>
<td></td>
<td>68,10,000</td>
</tr>
</tbody>
</table>

Other information:
(1) The firm has been assessed as firm up to assessment year 2020-2021.
(2) The firm has completed all formalities and will be assessable as a firm for the assessment year 2021-2022.
(3) The partnership deed of the firm was amended on 30th June 2020 with retrospective effect from 1st April 2020 to provide remuneration and interest to partners as follows:

<table>
<thead>
<tr>
<th>Remuneration</th>
<th>Interest on Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smart (working partner)</td>
<td>27,000 p.m.</td>
</tr>
<tr>
<td>Happy (sleeping partner)</td>
<td>13,500 p.m.</td>
</tr>
<tr>
<td>Lucky (working partner)</td>
<td>18,000 p.m.</td>
</tr>
</tbody>
</table>

As per the earlier partnership deed the salary was as under:
Smart Rs. 15,000 p.m.
Happy Rs. 12,000 p.m.
Lucky  Rs. 9,000 p.m.

Interest was provided in the earlier partnership deed at the same rates.

(4) Depreciation as per Income-tax Act amounts to Rs. 9,60,000
(5) Expenses of Rs. 1,05,000 are not allowable under section 43B.
(6) The firm has a carried forward loss of Rs. 60,000.
(7) The other incomes of the partners are:
   Smart  Rs. 1,20,000
   Happy  Rs. 3,00,000
   Lucky  Rs. 2,70,000

You are required to compute the tax payable by the firm and its partners.

Answer:  Computation of Book Profit under section 40(b)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per P &amp; L A/c</td>
<td>5,94,000</td>
</tr>
<tr>
<td>Add: Depreciation as per books</td>
<td>12,30,000</td>
</tr>
<tr>
<td>Add: Expenditure disallowable u/s 43B</td>
<td>1,05,000</td>
</tr>
<tr>
<td>Add: Interest to partners (in excess of allowed limit)</td>
<td></td>
</tr>
<tr>
<td>Smart</td>
<td></td>
</tr>
<tr>
<td>1,80,000 × 8/20</td>
<td>72,000</td>
</tr>
<tr>
<td>Happy</td>
<td></td>
</tr>
<tr>
<td>6,00,000 × 12/24</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Lucky</td>
<td></td>
</tr>
<tr>
<td>1,80,000 × 8/20</td>
<td>72,000</td>
</tr>
<tr>
<td>Add: Remuneration to partners</td>
<td>7,02,000</td>
</tr>
<tr>
<td>Less: Long Term Capital Gains assessable under</td>
<td></td>
</tr>
<tr>
<td>Capital Gains</td>
<td>30,75,000</td>
</tr>
<tr>
<td>Less: Interest Income</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Less: Depreciation as per I. T. Act</td>
<td>9,60,000</td>
</tr>
<tr>
<td>Book Profits as per section 40(b)</td>
<td>8,25,000</td>
</tr>
</tbody>
</table>

Allowable Remuneration as per section 40(b):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>On First 3,00,000 of book profits @ 90%</td>
<td>2,70,000</td>
</tr>
<tr>
<td>On Balance 5,25,000 of book profits @ 60%</td>
<td>3,15,000</td>
</tr>
<tr>
<td></td>
<td>5,85,000</td>
</tr>
</tbody>
</table>

Remuneration allowable as per section 40(b):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smart: Rs. 15,000 × 3 Months+ Rs. 27,000 × 9 Months</td>
<td>2,88,000</td>
</tr>
<tr>
<td>Happy: Not a working partner</td>
<td>NIL</td>
</tr>
<tr>
<td>Lucky: Rs. 9,000 × 3 Months + Rs. 18,000 × 9 Months</td>
<td>1,89,000</td>
</tr>
<tr>
<td></td>
<td>4,77,000</td>
</tr>
</tbody>
</table>

Therefore, allowable remuneration is Rs. 4,77,000.

COMPUTATION OF THE TOTAL INCOME OF THE FIRM

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit as per P &amp; L A/c</td>
<td>5,94,000</td>
</tr>
<tr>
<td>Add: Depreciation as per books</td>
<td>12,30,000</td>
</tr>
<tr>
<td>Add: Expenditure disallowable u/s 43B</td>
<td>1,05,000</td>
</tr>
<tr>
<td>Add: Interest to partners (in excess of allowed limit)</td>
<td></td>
</tr>
<tr>
<td>Smart</td>
<td></td>
</tr>
<tr>
<td>1,80,000 × 8/20</td>
<td>72,000</td>
</tr>
<tr>
<td>Particulars</td>
<td>Amount</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>Happy 6,00,000 × 12/24</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Lucky 1,80,000 × 8/20</td>
<td>72,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Remuneration to partners</td>
<td>2,25,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Long Term Capital Gains assessable under Capital Gains</td>
<td>11,40,000</td>
</tr>
<tr>
<td>Less: Interest Income</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Less: Depreciation as per I. T. Act</td>
<td>9,60,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Brought forward losses P/G/B/P</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>P/G/B/P</strong></td>
<td><strong>2,88,000</strong></td>
</tr>
<tr>
<td><strong>Long Term Capital Gain</strong></td>
<td><strong>11,40,000</strong></td>
</tr>
<tr>
<td><strong>Income from other sources</strong></td>
<td></td>
</tr>
<tr>
<td>Interest Income</td>
<td>1,50,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>15,78,000</strong></td>
</tr>
</tbody>
</table>

**Tax thereon:**
- on Rs. 4,38,000 @ 30%          | 1,31,400   |
- on Rs. 11,40,000 @ 20%         | 2,88,000   |
**Tax Payable**                  | **4,19,400**|
Add: Health & Education cess @ 4% |            |
**Total Tax**                    |             |
Round off                        |             |

**TAXABLE INCOME OF PARTNERS:**

<table>
<thead>
<tr>
<th></th>
<th>Smart</th>
<th>Happy</th>
<th>Lucky</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Salaries allowed as deduction u/s 40(b)</td>
<td>2,88,000</td>
<td>NIL</td>
<td>1,89,000</td>
</tr>
<tr>
<td>(ii) Interest to the extent allowed u/s 40(b)</td>
<td>1,08,000</td>
<td>3,00,000</td>
<td>1,08,000</td>
</tr>
<tr>
<td><strong>P/G/B/P</strong></td>
<td>3,96,000</td>
<td>3,00,000</td>
<td>2,97,000</td>
</tr>
<tr>
<td>Other Incomes</td>
<td>1,20,000</td>
<td>3,00,000</td>
<td>2,70,000</td>
</tr>
<tr>
<td><strong>Taxable Income</strong></td>
<td><strong>5,16,000</strong></td>
<td><strong>6,00,000</strong></td>
<td><strong>5,67,000</strong></td>
</tr>
<tr>
<td><strong>Tax thereon</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
TAXATION OF CO-OPERATIVE SOCIETIES
FOR PROVISION ON COOPERATIVE SOCIETY REFER COMPENDIUM

QUESTIONS FROM PAST EXAMINATIONS

Question 1:
XYZ consumer Co-operative Society furnishes the following particular of its income in respect of financial year 2020-2021. You are required to work out the taxable income of the Co-operative Society:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from business</td>
<td>Rs.</td>
</tr>
<tr>
<td>Interest on deposits with bank</td>
<td>2,50,000</td>
</tr>
<tr>
<td><strong>Dividend on investments:</strong></td>
<td></td>
</tr>
<tr>
<td>Investments in share of other Co-operative societies</td>
<td>10,000</td>
</tr>
<tr>
<td>Other investments</td>
<td>4,000</td>
</tr>
<tr>
<td>Income from letting of godowns for storage of commodities</td>
<td>20,000</td>
</tr>
</tbody>
</table>

Give reason for your answer.

Answer:

Computation of taxable income for the assessment year 2021-2022

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from business</td>
<td>Rs.</td>
</tr>
<tr>
<td>Income from house property</td>
<td>2,50,000</td>
</tr>
<tr>
<td><strong>Income from other sources:</strong></td>
<td></td>
</tr>
<tr>
<td>Interest on deposit with bank</td>
<td>10,000</td>
</tr>
<tr>
<td>Dividend on investments in share of other co-operative society</td>
<td>4,000</td>
</tr>
<tr>
<td>Dividend on other investments</td>
<td>4,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>2,88,000</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 80P</strong></td>
<td></td>
</tr>
<tr>
<td>Deduction under section 80P in respect of dividend from other co-operative societies</td>
<td>4,000</td>
</tr>
<tr>
<td>Deduction under section 80P on account of Income from letting of godowns for storage of commodities</td>
<td>20,000</td>
</tr>
<tr>
<td>General Deduction under section 80P</td>
<td>1,00,000</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>1,64,000</td>
</tr>
</tbody>
</table>

Question 2:
Calcutta Suburban Co-operative Society is engaged in processing agricultural produce of its members without the aid of power, and its marketing, furnish the following particulars:

(i) Income from processing of agricultural produce **Rs. 17,000**
(ii) Income from marketing agricultural produce **Rs. 3,000**
(iii) Dividends from another co-operative society **Rs. 55,000**
(iv) Income from letting of godowns **Rs. 10,000**; and
(v) Income from agency business **Rs. 85,000**.

Determine its total income for the assessment year 2021-2022. (HOME WORK)
Answer:

Calcutta Suburban Co-operative Society
Assessment Year 2021-2022
Computation of taxable income

<table>
<thead>
<tr>
<th>Income from letting of godowns</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10,000</td>
</tr>
</tbody>
</table>

Business income-

<table>
<thead>
<tr>
<th>From processing of agricultural produce</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>From marketing of agricultural produce</td>
<td>3,000</td>
</tr>
<tr>
<td>From agency business</td>
<td>85,000</td>
</tr>
<tr>
<td>Dividend income</td>
<td>55,000</td>
</tr>
</tbody>
</table>

Gross Total Income | Rs. 1,70,000 |

Less: Deduction under section 80P

| (a) Processing of agricultural produce | 17,000 |
| (b) marketing of agricultural produce  | 3,000  |
| (c) Dividend from co-operative society | 55,000 |
| (d) letting of godown (Assuming that godowns are let out for storage etc. Of commodities) | 10,000 |
| (e) General Deduction                  | 50,000 |

Total Income | Rs. 35,000 |

TAXATION OF MUTUALITY / MUTUAL CONCERNS

Examples of Mutual Concerns: Resident Welfare Associations, Social Clubs, Sports Clubs, Bar Association, Shop Owners Association, FICCI, Bombay Chartered Accountants Society, PHD Chambers, etc.

1. The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arise when a group of persons associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves. The objective should not be profit. The objective should be social security, entertainment, professional development, etc.

2. The principle of mutual association is that all the contributors to the common fund are entitled to participate in the surplus and all the participators to the surplus must be the contributors to the common fund.

3. It is not necessary for the mutual concern to distribute the surplus immediately. The participation in the surplus may be by way of reduction in future contributions or division of surplus on dissolution.

4. The fact that the mutual concern is incorporated as a company does not make any difference because incorporation does not destroy the identity of the contributors and participators.

5. The income of a mutual concern is exempt from tax as far as it is derived from activities of mutual nature, i.e., income received from members is exempt. The income from trading so far as it is confined to own members is also exempt. Where a mutual concern derives income from an activity with an outsider, then tax exemption will not apply to such income, i.e., income received from non-members is taxable.
6. Income of a mutual concern is taxable in the following circumstances:
   (a) Where the mutual concern is a trade, professional or similar association, then
   the income derived from specific services performed for its members is
   taxable as Profits & Gains of Business or Profession under section 28.
   However, if mutual concern is a resident welfare association, sports club,
   etc. then income derived from specific services performed for its members
   is not taxable.
   (b) Income received from non-members.

   **Trade & Professional Association**

1. Trade and professional association means an association of traders or professionals
for the protection or advancement of their common interest.

2. Any surplus arising to the trade or professional association from general
activities i.e., entrance fees, etc. will not be taxable. Therefore, the concerned
general expenditure shall also be not allowed as deduction from taxable income.
Only the income arising from performing specific services to members is taxable
and the expenditure to earn such income is deductible.

3. **Special Provision contained in Section 44A for Trade & Professional Association.**
   (a) Applicable only to that trade, professional or similar association, the income
   of which is not distributed to its members.
   (b) Amount Received by the association from its members by way of contribution
   or otherwise (other than amount received from performing specific services),
   i.e., General receipts from members

   **Less:** Expenditure incurred for the purposes of protection or advancement of
   interest of members (other than expenditure which is otherwise deductible
   under the Act and other than capital expenditure), i.e., General expenditure
   on member

   If negative - call it deficiency
   If positive - surplus exempt from tax
   (c) such deficiency will be allowed as a deduction in computing the income under
   the head P/G/B/P,
   (d) If deficiency is greater than income under the head P/G/B/P, then the balance
   deficiency will be allowed as deduction in computing income under other
   heads of income.
   (e) Before setting off the deficiency effect shall be first given to the deductions
   under this Act and brought forward losses and allowances.
   (f) The total deficiency which can be set off shall not exceed 50% of the Total
   income computed before giving deduction of deficiency.
KEYNOTE:
The tax rate applicable to a mutual concern shall be the same as applicable to an individual except where the mutual concern is incorporated as a company.

ILLUSTRATIONS
1. The assessee is a club and has income from letting out its rooms to its members. The ITO want to tax the same. Examine.
   **Answer:**
   The income of the club is exempt on grounds of mutuality (Cawnpore Club Ltd.).

2. A social club furnishes you the following data:
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>Receipts by way of entrance fees and annual membership fees from members</td>
</tr>
<tr>
<td>(b)</td>
<td>Expenditure on members</td>
</tr>
<tr>
<td>(c)</td>
<td>Bank Interest</td>
</tr>
<tr>
<td>(d)</td>
<td>Receipts from members for specific services.</td>
</tr>
<tr>
<td>(e)</td>
<td>Expenditure incurred on (d) above</td>
</tr>
</tbody>
</table>

   **Answer:** **SURPLUS/INCOME EXEMPT ON GROUND OF MUTUALITY**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Receipts from members by way of entrance fees and annual membership fees</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: Expenditure on members</td>
<td>50,000</td>
</tr>
<tr>
<td>Receipts from members for specific services (taxable only in case of trade, professional or similar associations)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: Expenditure on above</td>
<td>2,50,000</td>
</tr>
<tr>
<td><strong>Exempt Income</strong></td>
<td><strong>3,00,000</strong></td>
</tr>
</tbody>
</table>

   **TAXABLE INCOME**

   **INCOME FROM OTHER SOURCES**
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Interest</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

   **Total Income** | **1,00,000**

3. A trade Association furnishes you the following data:
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>General Receipts from members</td>
</tr>
<tr>
<td>(b)</td>
<td>General Expenditure on members</td>
</tr>
<tr>
<td>(c)</td>
<td>Receipts from specific services performed.</td>
</tr>
<tr>
<td>(d)</td>
<td>Expenditure on specific services.</td>
</tr>
<tr>
<td>(e)</td>
<td>Bank Interest</td>
</tr>
<tr>
<td>(f)</td>
<td>B/f Depreciation</td>
</tr>
</tbody>
</table>
Answer: **SURLUS / INCOME EXEMPT ON GROUND OF MUTUALITY**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>General receipts from members</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Less: General Expenditure on members</td>
<td>4,50,000</td>
</tr>
<tr>
<td>Deficiency to be dealt with as per section 44A</td>
<td>2,50,000</td>
</tr>
</tbody>
</table>

**TAXABLE INCOME ON TRADE ASSOCIATION**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts from performing specific services</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: Expenditure on specific services</td>
<td>1,60,000</td>
</tr>
<tr>
<td></td>
<td>1,40,000</td>
</tr>
<tr>
<td>Less: B/F Depreciation</td>
<td>60,000</td>
</tr>
<tr>
<td>P/G/B/P before setting off deficiency</td>
<td>80,000</td>
</tr>
<tr>
<td>Less: Deficiency as per section 44A</td>
<td>80,000*</td>
</tr>
<tr>
<td>Income from other sources</td>
<td></td>
</tr>
<tr>
<td>Bank Interest</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Less: Deficiency as per section 44A</td>
<td>1,10,000*</td>
</tr>
<tr>
<td></td>
<td>1,90,000</td>
</tr>
<tr>
<td></td>
<td>1,90,000</td>
</tr>
</tbody>
</table>

* The maximum deficiency, which can be set off as per section 44A is 50% of (80,000 + 3,00,000) = Rs. 1,90,000

**Note:** The balance deficiency of Rs. 60,000 (= Rs. 2,50,000 – Rs. 1,90,000) shall have no tax treatment and shall not be carried forward.

**FROM THE JUDICIARY**

1. **BANKIPUR CLUB LTD. (SUPREME COURT)**

The question arose before the Supreme Court as to whether the club is entitled to exemption for the receipts or surplus arising from the sales of drinks, refreshments, etc., or amounts received by way of rent for letting out the buildings or amounts received by way of admission fees, periodical subscriptions and receipts of a similar nature from its members. The Tribunal as also the High Court had found that the amounts received by the club were for supply of drinks, refreshments or other goods as also the letting out of building for rent or by way of admission fees, periodical subscription, etc., from the members of the clubs were only for/towards charges for the privileges, conveniences and amenities provided to the members, which they were entitled to, as per the rules and regulations of the club. It had also been found that club realised various sums on the above counts only to afford to their members, the usual privileges, advantages, conveniences and accommodation. In other words, the services offered on the above counts were not done with any profit motive, and were not tainted with commerciality. The facilities were offered only as a matter of convenience for the use of the members (and their friends, if any, availing of the facilities occasionally).

The Supreme Court held that in the light of the findings of fact the receipts for the various facilities extended by the clubs to its members, as part of the usual privileges, advantages and conveniences, attached to the membership of the club, could not be
said to be "a trading activity." The surplus-excess of receipts over the expenditure - as a result of mutual arrangement, could not be said to be "income" for the purpose of the Act.

Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and not with a view to earn profits and in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associating together in this way does not give rise to profit which are chargeable to tax.

If the object of the assesseee-company claiming to be a "mutual concern" or "club", is to carry on a particular business and money is realised both from the members and from non-members, for the same consideration by giving the same or similar facilities to all alike the dealings as a whole, disclose profit-earning motive and are alike tainted with commerciality. In other words, the activity carried on by the assesseee in such cases, claiming to be a "mutual concern" or "members' club" is a trade or an adventure in the nature of trade and the transactions entered into with the members or non-members alike is a trade/business/transaction and the resultant surplus is profit-income liable to tax.

2. **SIND CO-OPERATIVE HOUSING SOCIETY V. ITO (BOM.)**

Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?

High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assesseee. The amount paid was to be exclusively used for the benefit of the members as a class. The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

**TAXATION OF FILM PRODUCER & FILM DISTRIBUTOR**

<table>
<thead>
<tr>
<th>DEDUCTION IN RESPECT OF EXPENDITURE ON PRODUCTION OF FEATURE FILMS INCASE OF FILM PRODUCER</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.  &quot;Cost of production&quot;, in relation to a feature film, means the expenditure incurred on</td>
</tr>
<tr>
<td>the production of the film, not being—</td>
</tr>
<tr>
<td>(a)  the expenditure incurred for the preparation of the positive prints of the film; and</td>
</tr>
<tr>
<td>(b)  the expenditure incurred in connection with the advertisement of the film after it</td>
</tr>
<tr>
<td>is certified for release by the Board of Film Censors:</td>
</tr>
<tr>
<td><strong>Note:</strong> Expenditure referred in (a) and (b) above are allowable as revenue expenditure in the year of release of film.</td>
</tr>
</tbody>
</table>
2. The cost of production of a feature film, shall be reduced by the subsidy received by the film producer, under any scheme framed by the Government.

Deduction in respect of cost of production allowable under section 37 in the case of Abandoned Feature Films [Circular No. 16, dated 6.10.2015]
The deduction in respect of the cost of production of a feature film certified for release by the Board of Film Censors in a previous year is provided in Rule 9A.

In the case of abandoned films, however, since certificate of Board of Film Censors is not received, in some cases no deduction was allowed by applying Rule 9A of the Rules or by treating the expenditure as capital expenditure.

The CBDT has examined the matter in light of judicial decisions on this subject. The order of the Hon’ble Bombay High Court dated 28.1.2015 in ITA 310 of 2013 in the case of Venus Records and Tapes Pvt. Ltd. on this issue has been accepted and the aforesaid disputed issue has not been further contested.

Consequently, it is clarified that Rule 9A does not apply to abandoned feature films and that the expenditure incurred on such abandoned feature films is not to be treated as a capital expenditure. The cost of production of an abandoned feature film is to be treated as revenue expenditure and allowed as per the provisions of section 37 of the Income-tax Act, 1961.

REFER COMPENDIUM FOR RULE 9A & RULE 9B
Trading losses which are incidental to the operations of the business must be allowed even if it is not specially coded anywhere in the Act.

### Sec 37(1): General Deduction of Expenses

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>It is not specified u/s 30 to 36.</td>
</tr>
<tr>
<td>(b)</td>
<td>It is not personal in nature.</td>
</tr>
<tr>
<td>(c)</td>
<td>It is not capital in nature.</td>
</tr>
<tr>
<td>(d)</td>
<td>It is incurred wholly and exclusively for the purpose of B &amp; P.</td>
</tr>
</tbody>
</table>

**Explanation 1 to Sec 37(1)**

Any expenditure incurred for any purpose which is an **offence or prohibited** by law shall **not be allowed** as deduction.

**Explanation 2 to Sec 37(1)**

Any expenditure incurred on the activities relating to **CSR** referred in **Sec 135** of Companies Act, 2013 shall **not be allowed** as deduction u/s 37(1).

**Notes:**

- Donation to **Swach Bharat, clean Ganga, PM CARES FUND** forms part of CSR and it is **allowed** u/s 80G.
- Expenditure on certain activities which is **otherwise allowable** under any other Sec will **not be disallowed** u/s 37(1).
- Donation to certain trusts mentioned u/s 35(1)(ii)/35(1)(iii) etc. will be allowed as deduction.

### Penalties

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensatory</td>
<td>Penal</td>
</tr>
<tr>
<td>Allowed</td>
<td>Disallowed</td>
</tr>
</tbody>
</table>
Note: -
1. Interest and penalties under Income tax is not allowed.
2. Interest on GST is allowed.
3. Penalties under Direct & Indirect Tax both will not be allowed.
4. Secret Commission shall not be allowed as deduction.

Circular No. 5/2012
Any freebies provided by pharmaceutical sector to medical practioner and their professional association shall not be allowed as deduction in the light of Explan 1 to Sec 37(1). Further such amount would be taxable in the hands of recipient.

Premium of Keyman Insurance Policy
CBDT has clarified that premium paid by firm for a KIP of a partner, to safeguard the firm against disruption of business is allowable u/s 37(1).

Dr. T.A. Qureshi v/s CIT(SC)
Losses of illegal business will be allowed as deduction to compute the real profits and gains as explanation 1 to Sec 37(1) has nothing to do with case of losses, it only covers expenses.

Sec 37(2B)
Notwithstanding anything contained in Sub sec (1), any expenditure incurred by an assessee on advertisement in any brochure or pamphlet of a political party shall be disallowed.

Note on BOT:
It was held that **Sale proceeds of the scrap** after demolishing the building was treated as **business income** and if that was so, the payment of **interest** which is a contractual obligation should also be **allowed** as business expenditure.

**Confederation of Indian Pharmaceutical Industry (H.P.)**

It was held that **Circular 5/2012** dated 01.08.2012 is in line with **Explanation 1 to sec 37(1)**. However, **if the assessee satisfies the assessing authority** that the expenditure incurred is **not in violation** of the regulations framed by the Medical Council then it may legitimately **claim a deduction**, but it is **for the assessee to satisfy** the Assessing Officer that the expense is not in violation of the Medical Council Regulations.

**CIT v. Kap Scan and Diagnostic Centre P. Ltd. (P&H)**

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

**Dinesh Mills Ltd. (Gujarat HC)**

**Facts:**

Company's clerk mis-apportioned cash on various occasions :-

- P.Y. 2011-12 → Rs 4,40,000
- P.Y. 2012-13 → Rs 5,20,000
- P.Y. 2013-14 → Rs 3,80,000

The said embezzlement was discovered in the year 2015-16 & assessee claimed Loss in P.Y. 2015-16.

**Judgement:-**

1. It was held that loss should be incidental to the business.
2. It should be **allowed in the year in which it is discovered** irrespective of the year to which it pertains.
GENERAL DEDUCTIONS

CIT v/s Khemchand Motilal Jain Tobacco Products (P. Ltd)
(Contradictory to Expl. 1 to Sec 37(1).)
It was held that the ransom money paid to release the director from dacoits where police was unsuccessful to do so shall be allowed as deduction.

Shanti Bhushan v. CIT (Delhi)
It was held the amount paid for heart surgery can neither be allowed u/s 31 nor u/s 37(1).

Millennia Developers (P) Ltd. (Karnataka)
It was held that the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under Sec 37. Merely describing the payment as a compounding fee would not alter the character of the payment.

CIT v/s Neelavathi & Others (Karn)
It was held that, if the assessee had incurred expenditure for the purpose of security, the same would have been allowed as deduction. However, in the instant case, since the payment has been made to the police and gundas to keep them away from the business premises, such a payment is illegal and hence, not allowable as deduction.

Hindustan Zinc Ltd. (Raj. H.C.)
The assessee owned a plant which required huge quantity of water for its day to day operations. It was held that this expenditure was incurred with an objective of facilitating its trade operations. Further, it was held that it was incurred to conduct business more efficiently & profitably and therefore, it should be allowed as revenue expenditure.

Triveni Engineering & Industries Ltd. (Delhi H.C.)
The advance given to employees which became irrecoverable is a “trading Loss” and therefore it would be allowed as deduction to arrive at profits. Non-Recovery of security Deposits to Landlord for obtaining Tenancy Rights is a Capital Loss. It won’t be allowed as deduction.
1. This exp. doesn’t bring into existence a capital asset.
2. It is not an asset of permanent nature. It was further observed that it has short shelf life.
3. It was observed that it decays with weather and requires frequent replacements. The replacement is necessary almost every year.
4. Therefore, it was held that the expenditure was incurred with the object of facilitating business operations and not acquiring capital assets & therefore it should be allowed as deduction.

**CIT v. Sree Rama Multitech ltd. [2018] (SC)**

The interest accrued on deposit of share application money with bank is eligible for set off against the public issue expenses; such interest is not taxable as “Income from Other Sources”.

**Allowability or not of Certain Expenses**

1. Dividend paid is not allowed as deduction.
2. Income tax, wealth tax, surcharge & education cess is not allowable as deduction.
3. Provision for loss of subsidiary company is not allowable as deduction.
4. Provision for deferred tax as per IND AS 12 is not allowable as deduction.
5. Provision for diminution in the value of investment / assets as per IND AS is not allowable as deduction.
6. Provision for unascertained liability is not allowable as deduction.
7. Prior period expenses are not allowable as deduction, but they are allowable if liability to pay crystallized during the Previous Year. (E.g. increased salary is paid in current year under pay commission).
8. Salary & Perquisites paid to directors are fully allowed as deduction subject to sec 40A(2). If, however, salary paid to director exceeds limit prescribed under the Companies Act, then such excess salary shall be disallowed.

ALL THE BEST
# CHAPTER 6
## DISALLOWANCES

<table>
<thead>
<tr>
<th>Disallowances</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sec 40A</strong></td>
</tr>
<tr>
<td>2. 40A(3)/(3A): Cash &gt; Rs 10,000.</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

### Sec 40A(2): Excess Payment to Relatives:

<table>
<thead>
<tr>
<th>Assessee Incurs Expenditure (+) made payment to Specified person If AO considers to be unreasonable and Excessive (+) A.O. may disallow</th>
</tr>
</thead>
<tbody>
<tr>
<td>Having regard to Fair Market Value &amp; Legitimate needs of business.</td>
</tr>
</tbody>
</table>

- If the Co. sells goods of Rs 1,00,000 to director whereby the FMV of goods sold is Rs 1,50,000 then, A.O. can’t invoke Sec 40A(2) as it is applicable only to expenditure and not income.
DISALLOWANCES

**Sec 40A(3)**

<table>
<thead>
<tr>
<th>Assessee incurs a expenditure (Revenue)</th>
<th>(+) Payment OR Aggregate of Payments</th>
<th>(+) To a person in a single day of a sum exceeding Rs 10,000**</th>
</tr>
</thead>
</table>

By other than “Account payee crossed cheque OR Bank Draft OR ECS or such other electronic mode as may be prescribed.

Such other Electronic Mode would include CC/DC/Net Banking/IMPS/UPI/RTGS/NEFT/BHIM. {Rule 6ABBA}

** For payment made to transporters the Limit is Rs 35,000.

**Sec 40A(3A)**

<table>
<thead>
<tr>
<th>P.Y. 2020-21</th>
<th>P.Y. 2021-22</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary a/c</td>
<td>80K</td>
</tr>
<tr>
<td>To Salary (o/s) (This is not paid but still allowed on Accrual Basis in PY 2020-21)</td>
<td>80K</td>
</tr>
<tr>
<td>Rs 80,000 is paid to a person in single day by cash in PY 2021-22.</td>
<td># RESULT:- It can’t be disallowed u/s 40A(3) as it is not allowed in P.Y. 2021-22 but as per Sec 40A(3A) it will be deemed to be PGBP Income of P.Y. 2021-22</td>
</tr>
</tbody>
</table>

I. Depreciation disallowance u/s 32 and capital Expenditure u/s 35AD on cash payment:

1. In order to discourage cash transactions even for CAPEX, a proviso has been attached to Sec 43(1), which states that where an assessee incurs any exp for
acquisition of any asset, in respect of which payments or aggregate of payments made to a person on a day otherwise than by A/c payee cheque drawn or A/c payee bank draft or use of ECS or such other electronic mode as may be prescribed exceeds Rs. 10,000, then such expenditure shall be ignored for the purpose of determination of actual cost of such asset. (FA 2019)

Further, 35AD(8)(f) states that any expenditure in respect of which payment or aggregate of payment made to a person in a day otherwise than by A/c payee cheque or bank draft or ECS or such other electronic mode as may be prescribed exceeds Rs. 10,000, no deduction shall be allowed in respect of such expenditure.

<table>
<thead>
<tr>
<th>Rule 6DD: Exception</th>
</tr>
</thead>
<tbody>
<tr>
<td>Circular No. 10/2008, Dated 5-12-2008: Clarification Regarding Rule 6DD</td>
</tr>
<tr>
<td>“Fish or Fish Products”</td>
</tr>
<tr>
<td>Would include other marine products, such as shrimp, prawns, cuttlefish, squid, crabs, lobsters, etc.</td>
</tr>
</tbody>
</table>

40A(2) vs 40A(3) the Interlinking:

<table>
<thead>
<tr>
<th>Sec 40A(7) :- Provision for Payment of Gratuity is Disallowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial Valuation</td>
</tr>
<tr>
<td>(--) Amount available in Gratuity fund</td>
</tr>
<tr>
<td>Provisions for payment of Gratuity Disallowed u/s 40A(7)</td>
</tr>
<tr>
<td>18,00,000</td>
</tr>
<tr>
<td>15,00,000</td>
</tr>
<tr>
<td>3,00,000</td>
</tr>
</tbody>
</table>
Gratuity liability is determined by Actuary in the year of retirement or termination of employment. Suppose, determined liability comes to Rs 18,00,000. Now, the employer is liable to pay this Rs 18,00,000 to employee on retirement.

However, amount available in Grant. Fund is Rs 15,00,000. Employer passed the following entry in BOA:-

<table>
<thead>
<tr>
<th>Gratuity A/c</th>
<th>Dr 3,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Prov. for Gratuity A/c</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

This amount is disallowed u/s 40A(7). However, when this Rs 300,000 is actually paid to employee, it will be allowed as deduction.

**Sec 40A(9) :- Contribution to Unrecognized Provident Fund etc. is Disallowed.**

→ **CASE I:-** If an employer contributes Rs 60,000 p.a. to Recognised P.F. etc then this contribution itself is allowed as deduction in respective years u/s 36(1).

→ **CASE II:-** If an employer contributes Rs 60,000 to an unrecognized P.F. then this contribution every year will be disallowed by virtue of sec 40A(9). However when this amount is actually discharged to employees it will be allowed in the hands of employer.

**Sec 40(a)(i): Payments to N.R. or Foreign Company of any Interest, Royalty, Fees for Technical Services or other sum chargeable Payable**

<table>
<thead>
<tr>
<th>In India</th>
<th>OR</th>
<th>Outside India</th>
</tr>
</thead>
<tbody>
<tr>
<td>To a NR OR foreign Company</td>
<td>Deduct Tax</td>
<td>AND</td>
</tr>
</tbody>
</table>

*100% expenditure will be disallowed* if the tax is not deducted OR after deducting is not paid till the due date specified u/s 139(1).
DISALLOWANCES

Where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date of filing of return, then it will be allowed in the P.Y. in which payment is made.

Where assessee has failed to deduct TDS & he is not treated as Assessee in default u/s 201(1), then for the purpose of sec 40(a)(i) it shall be deemed that assessee has deducted and paid the tax on such amount on the date of furnishing of return by Non Resident payee & deduction of such expenditure will be allowed.

All the aforesaid sums must be taxable in the hands of the recipient under IT Act, 1961. (Refer Past Questions for Illustration)

Circular No. 3/2015 dated 12/02/2015

Doubts have been raised about interpretation of the term “other sum chargeable” i.e. whether this term refers to the whole sum being remitted abroad or only the portion representing the sum chargeable to IT under relevant provision of the Act.

CBDT clarifies that for the purpose of making disallowance u/s 40(a)(i) the appropriate portion of the sum which is chargeable to tax under the Act shall form the basis of such disallowances & it has to be determined by A.O. considering facts & circumstances.

Sec 40(a)(ia): Payment to Residents Payee

| Deduct Tax | AND | Deposit till time limit specified u/s 139(1) i.e. Due Date of filing of Return |

Note:- If tax is not deducted or after deducting it is not paid then 30% of expenditure will be disallowed. (FA 2014).

Where in respect of any such sum, where tax has been deducted in any subsequent year, or has been deducted in the previous year but paid after the due date of filing of return, then 30% expenditure will be allowed in the P.Y. in which payment is made.
**Sec 201(1): Assessee in Default**

If an assessee

- Fails to deduct TDS
- OR
- After deduction fails to pay TDS

Then he shall be deemed to be “Assessee in Default”

**Consequently, he is liable to pay:**

1. **Penalty u/s 221** which can be up to TDS not deducted or not paid.
2. **Interest u/s 220 @ 1% p.m.**

*It is well established law laid down by various courts that deductor shall be treated as “Assessee in default” only if :-*

1. Deductor has failed to deduct TDS AND
2. Deductee has also failed to pay tax directly.

**2nd Proviso to Sec 40(a)(ia)**

Where assessee has failed to deduct TDS & he is not treated as Assessee in default u/s 201(1), then for the purpose of sec 40(a)(ia) it shall be deemed that assessee has deducted and paid the tax on such amount on the date of furnishing of return by resident payee & deduction of such expenditure will be allowed.

**Very much needed Clarificatory Judgement:**

It was held by SC in the case of *Palam Gas Services* that disallowance u/s 40(a)(ia) shall apply not only in respect of those amount which are payable during the PY but is also applicable in respect of those amount which are paid during the PY.

Further, disallowance u/s 40(a)(ia) is applicable not only to assesses following mercantile system but also cash system. The above judgement is also applicable to sec 40(a)(i).

As per Sec 40(a)(iii) any payment which is chargeable under the head *Salaries*, if it is payable outside India or to a *Non Resident* and if the tax has not been paid
thereon nor deducted therefrom under CH XVII-B then the salary expenditure is disallowed.

<table>
<thead>
<tr>
<th>Sec 40(a)(ii)</th>
<th>Sec 40(a)(iia)</th>
<th>Sec 40(a)(iib)</th>
<th>Sec 40(a)(v)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax is disallowed.</td>
<td>Wealth tax is disallowed.</td>
<td>Royalty, fees, service charges etc. paid by State Govt. undertaking to State Govt.</td>
<td>Employer paying tax on Non monetary perquisites of Employees. Such perquisite is Exempt. {10(10CC)}</td>
</tr>
</tbody>
</table>

Sec 43B:- Certain Deductions Allowed only on Actual Payment

Notwithstanding anything contained in any of the provision of IT Act, following deductions will be allowed on actual payment:

(a) Tax, duty, cess or fees under any other law OR

(b) Employer's contribution to any provident fund or superannuation fund or gratuity fund or any fund for the welfare of EE’S OR

(c) Bonus or commission payable to Employees OR

(d) Interest on any loan or borrowing from public Financial Institutions or state Finance Corp. or State Industrial Investm Corporation OR

(e) Interest on any loan or advance from scheduled Bank (including Cooperative Banks) or NBFC OR

(f) Any Leave Salary OR

(g) Any expenditure which is payable to Indian Railways for use of Railway Assets shall be allowed as deduction only in the year in which it is ACTAULLY PAID.

Note:

1) The above deductions will be allowed in the year in which it incurred even if it is paid till due date of return specified u/s 139(1).
2) However, if the payment is not made till due date of filling of return, then it will be allowed in the year of actual payment.

3) A bank guarantee given by a company towards disputed tax liabilities does not amount to actual payment and hence it is not allowed as deduction.

4) Whether GST is Inclusive of Turnover or Exclusive provisions of Sec 43B will be applicable.

Employee Related Issues:
 Treatment of Employees Contribution in the hands of Employer :-

The intention of the legislature is far clear that EE’s contribution is not subject to the due date mentioned u/s 43B, but it is the funds due date only. However, Delhi H.C. in the case of Aimil Ltd & Uttrakhand H.C. in Kiccha Sugar Co. Ltd has given a contradictory view by holding that the due date should be read as mentioned in Sec 43B.

However, Gujarat High Court has disallowed the Employees Contribution if payment is made after 15 days.

Explantion 3C, 3CA & 3D to Sec 43B

For removal of doubts, it is hereby declared that a deduction of interest under clause (d)(da) & (e) is available only if it is actually paid & not if it is just converted into new Loan.

Circular 7/2006 Dated 17/7/2006:-

Any O/S interest which is converted into a loan will be allowed as deduction in the year in which such converted loan is actually paid irrespective of nomenclature being loan.

ALL THE BEST
Sec 41(1):- Recovery of Expenditure & Remission & Cessation of Trading Liability (Deemed Income)

<table>
<thead>
<tr>
<th>Sec 41(1)</th>
<th>Sec 41(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where any loss or expenditure has been allowed as deduction AND subsequently such amount is received/written off in respect of such loss or expenditure then it is deemed to be Business Income.</td>
<td>Remission or cessation of Trading liability is also deemed to be Business Income.</td>
</tr>
<tr>
<td>If working cap loan is waived off (trading liab.) then Sec 41(1) is applicable.</td>
<td>If loan of FA is waived off. (Non-trading liab) Sec 41(1) is Not Applicable. *</td>
</tr>
</tbody>
</table>

1. This section is applicable even in the year in which business has ceased.
2. This section is applicable in the hands of successor if it is recovered by it, where deduction was claimed by predecessor.
3. * If loan of Fixed Asset is waived by CG/SG/Authority/Body/Agency then it is Income as per Sec 2(24)(xviii). If Loan is waived by a Company/Firm/LLP etc then it is not taxable. (This is discussed earlier in the Chapter of Depreciation)

Sec 41(1) applicable in case of Unilateral Cessation of Trading Liability

<table>
<thead>
<tr>
<th>Mr. A:- Seller</th>
<th>Mr. B:- Buyer</th>
</tr>
</thead>
<tbody>
<tr>
<td>B/S</td>
<td>B/S</td>
</tr>
<tr>
<td>Debtors 1,00,000</td>
<td>Crs. 100000</td>
</tr>
</tbody>
</table>

Where Mr. B i.e. buyer ceases a liability of Rs 1,00,000, then also Sec 41(1) is applicable even though such amount is not written off as bad debt by Mr. A as it amount to unilateral cessation of Trading Liability.
**Polyflex India (P) Ltd v/s CIT (SC)**

The assessee Co. paid excise duty under protest & took the deduction of the same. The assessee challenged the levy of such duty in H.C. & subsequently H.C. decided the case in the favour of the assessee. Department gave the refund of such E.D. to the assessee on the direction of H.C. Further, department challenged H.C. decision in S.C.

The issue under consideration is whether **Sec 41(1)** will be applicable when the assessee has received the money & matter is pending in S.C.

**Judgement**

Sec 41(1) is a **deeming fiction** which comes into play as soon as **assessee receives** any amount in respect of such expenditure or losses. It is **irrelevant** that such receipt has been **disputed** by the department in further appeal. A.O. is justified in invoking **sec 41(1)** in the year in which assessee received the money.

⇒ **Note:**

Assessee has received the refund, therefore it is taxable in the year of receipt. In case, the **refund is not received** but only the **order of HC** is **passed**, then such amount **won't be taxable** till the time amount is received.

**Recovery of Bad Debts**

As per **Sec 41(4)** **Recovery of Bad Debts** which was allowed a deduction will be deemed to be **business income** irrespective of whether the business exists or not.

Further it was held by Supreme Court in the case of **P.K. Kaimal** that bad debts claimed by Predecessor and **recovered by successor** is not chargeable to tax.
CHAPTER 8
MISCELLANEOUS ISSUES

Sec 14A: - Expenditure Incurred Disallowed in Respect of Exempt Income under this Act

→ No deduction shall be allowed in the respect of expenditure incurred for earning exempt income under this ACT.

→ The A.O. shall determine the amount of expenditure disallowed in prescribed manner (Rule 8D)

Rule 8D: Method for determining amount of expenditure disallowed in respect to Exempt Income.

(i) Amount of Expenditure Directly relating to exempt income.

AND

(ii) an amount equal to one percent of the annual average of the monthly averages of the opening and closing balances of the value of investment, income from which does not or shall not form part of total income.

Circular 5/2014

Doubts have been raised by industry whether disallowances can be made even in those cases where no income has been earned by an assessee which has been claimed as exempt during the Financial year.

CBDT has put an emphasis on term income should be exempt under this Act & not under the year in which the expenditure is disallowed.

CIT vs Kribhco (2012) (Delhi)

The High Court observed that Sec 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Sec 14A is applicable only if an income is not included in the total income as per Sec 10 of the Income-tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/exemptions provided under Sec 10.

Sec 14A of the Income-tax Act, 1961 ['Act'] provides for disallowance of expenditure in relation to income not "includible" in total income.
**Sec 43D: - Interest Income on Bad & Doubtful Debts**

In case of public Financial Institutions OR State Financial Corporation OR State Industrial Investment Corp. OR Scheduled Bank OR COOPERATIVE BANKS or NBFC OR Public Company [whose object is providing L.T. Finance for Construction & Purchases of Houses in India], the Interest on Bad & Doubtful Debts shall be taxable in the year in which the Interest is recovered or credited to BOA whichever is earlier.

**Sec 44AA: Maintenance of Books of Accounts**

<table>
<thead>
<tr>
<th>Specified Profession</th>
<th>Existing</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Keep &amp; maintain BOA if GR &gt; 1.5L in All 3 preceding PY’s</td>
<td></td>
<td>Keep &amp; maintain BOA, if GR is likely to be greater than 1.5 lakhs</td>
</tr>
</tbody>
</table>

⇒ Note:- All the above BOA should be maintained for 6 PY’s from the end of Relevant AY’s.

**Business and other Non-Specified Professions**

<table>
<thead>
<tr>
<th>In case of existing business or profession</th>
<th>Other than Individual &amp; HUF</th>
<th>Individual &amp; HUF</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. If PGBP exceeds in any of the 3 preceding PYs (OR)</td>
<td>1,20,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>2. If Turnover exceeds in any of the 3 preceding PYs</td>
<td>10,00,000</td>
<td>25,00,000</td>
</tr>
</tbody>
</table>

**If business or profession is newly set up**

<table>
<thead>
<tr>
<th></th>
<th>Other than Individual &amp; HUF</th>
<th>Individual &amp; HUF</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. If PGBP is likely to exceed (OR)</td>
<td>1,20,000</td>
<td>2,50,000</td>
</tr>
<tr>
<td>2. If Turnover is likely to exceed</td>
<td>10,00,000</td>
<td>25,00,000</td>
</tr>
</tbody>
</table>

**Sec 271A :- Penalty** for failure to keep & maintain BOA, other documents, etc.
A.O. or CIT (Appeals) may direct that such person shall pay by way of penalty a sum of Rs. 25,000.

**Sec 44AB:** - Tax Audit

1. **In Case of Business** the T/O > Rs. 1 Cr
2. **In Case of Profession** the T/O/GR > Rs. 50 Lacs
3. **If an eligible assessee opts for Sec 44AD,** then he should not get his BOA audited unless the T/O exceeds Rs. 2 cr. This increase in limit from 1 cr to 2 cr of tax audit is only applicable to assessee opting for **Sec 44AD.** In other words, if the assessee claims that his actual profits are lower than deemed profits, then he has to conduct tax audit.

**Amendment made by Finance Act 2020**

In order to reduce compliance burden on small and medium enterprises, it is proposed to increase the threshold limit for a person carrying on business from one crore rupees to five crore rupees in cases where,-

(i) aggregate of all receipts in cash during the previous year does not exceed five per cent of such receipt; and

(ii) aggregate of all payments in cash during the previous year does not exceed five per cent of such payment.

**Due Date:** One month prior to Due Date u/s 139(1).

**Sec 271B:**- Penalty for failure to get Accounts Audited

It is 0.5% of Turnover or Rs. 1,50,000 whichever is lower.

**Expenditure on Issue of Shares & Debentures or other Long Term Borrowings:**

(1) It was held in case of **Punjab State Industrial Development Corp. Ltd. (SC)** that fees paid to ROC for expansion of authorized capital of the Company is directly related to capital Expenditure, hence not allowable.
MISCELLANEOUS ISSUES

(2) It was held that in the case of Brooke Bond India Ltd. expenditure incurred by Co. in connection with a view to increase its share capital is directly related to expansion of capital base of the company and such exp. will be considered as capital expenditure as the benefit from them will be enduring in nature.

(3) It was held in the case of General Insurance Corporation that issuance of bonus shares does not result in any inflow of fresh funds or increase in the capital employed; the capital employed remains same. It is merely capitalization of reserves of company’s fund. Thus, it is revenue in nature.

(4) It was held by Supreme Court in the case of India Cements Ltd that any expenditure incurred for raising loans or debentures is fully allowed as deduction. Therefore, expenses on issue of non convertible as well as convertible bonds/ debentures is allowed as deduction.

(5) It was held in the case of Madras Industrial Investment Corp. that discount on issue of debentures will be allowed as deduction over the life of debentures.

(6) It was held in the case of Kodak India Ltd expenditure incurred on issue of shares will always be capital in nature. It was further held that, whichever way one looked at it, the object of the assessee was to increase its share capital, whether it did so to continue the business after the RBI directive.

(7) It was held in the case of S.M. Holding & Finance (P) Ltd. (Bom. H.C.) (2009) that premium on redemption of debentures is allowable as deduction and there should not be any argument regarding its certainty.

(8) It was held in the case of ITC Hotels Ltd that expenditure in respect of issue of convertible debentures shall be treated as revenue expenditure, even though it will be converted at a Later Stage.

Alternative View:
However, some courts have held that such expenditure is done for enduring benefits and therefore, nature of such expenditure will be capital and hence, not allowable.

(9) It was held in the case of Mascon Technical Services Ltd that the expenditure on issue of shares will be capital in nature notwithstanding the fact that public issue was not materialize due to non clearance by SEBI.

• All the above 9 judgements are relevant if the case does not fall under Sec 35D.
CHAPTER 9
PRESUMPTIVE INCOMES

Sec 44AD: - Notwithstanding anything to contrary Contained in Sec 28 to Sec 43C.

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Individuals, HUF,</td>
<td>Any Business except Sec 44AE &amp;</td>
</tr>
<tr>
<td>Partnership Firm but not an LLP.</td>
<td>T/O, GR, Sales ≤ 2 Cr.</td>
</tr>
<tr>
<td>All Resident.</td>
<td></td>
</tr>
</tbody>
</table>

Then Deemed profits = 8% of T/O.

Note:
FA 2017 has inserted a new proviso u/s 44AD(1) to provide that deemed profits would be 6% of Total T/O received during the FY or before D/D of filing of Return u/s 139(1) provided it is received by any of the following modes:

1. A/c Payee Cheque
2. A/c Payee Bank Draft
3. Use of ECS
4. such other electronic mode as may be prescribed (Finance Act 2019)

However, the existing rate of 8% would continue to apply in respect of Total T/O received by any other mode.

→ Conditions to get covered u/s 44AD:-

1. Assessee should not claim deduction under the head “Deduction in respect of certain Incomes “i.e. deduction under CH VI A from 80-IA to 80RRB {Profit Linked Deductions}
2. Sec 44AD is not Applicable for certain assessees:-
   → Any profession {Refer 44ADA}
   → Any person earning any income in the nature of commission or brokerage.
   → Any person carrying on any agency business.

→ Notes :-
• Disallowances u/s 40A(3) can’t be made because Sec 44AD over rides Sec 28 to Sec 43C.
Any deduction u/s 30 to 38 shall be deemed to have been already allowed.

The WDV of any asset shall be deemed to have been calculated as if depreciation is actually allowed.

Deduction u/s 80C to Sec 80G GC can be claimed.

Unabsorbed depreciation u/s 32(2) can’t be set off. However, brought forward losses u/s 72 can be set off.

If an assessee claims that his actual profits are lower than deemed profits u/s 44 AD, then

Keep and maintain BOA as per Sec 44AA     Conduct Tax Audit u/s 44 AB.

Note: However above option will have serious consequences from Finance Act 2016 onwards.

Amendments made by Finance Act 2016 in Sec 44 AD

1) It is also amended that expenditure in the nature of salary, remuneration, interest etc paid to the partner as per Sec 40(b) shall not be deductible while computing the income u/s 44 AD. (Not allowed for 44 ADA also but allowed for 44 AE)

2) It is also amended that where an eligible assessee declares profit for any previous year in accordance with the provisions of this sec and he declares profit for any of the five consecutive AY’s relevant to the PY succeeding such PY not in accordance with the provision of 44 AD, then he shall not be eligible to claim the benefit of this Sec for 5 AY’s subsequent to the AY relevant to the PY in which the profits have not been declared in accordance with the provisions of Sec 44 AD. (Same provision also there in Sec 115 BBF)

3) The eligible assessee shall be required to pay Advance tax once by 15th March of the Financial year. (Same in sec 44 ADA but u/s 44 AE pay 4 times)
Sec 44ADA: Presumptive Income To SPECIFIED Professionals

A new sec 44ADA is inserted in the Act, to provide for presumptive Income of an assesse who is engaged in any profession which is specified under Sec 44AA(1) such as, 
- Legal, Medical, engineering, Architecture, Accountancy, Technical consultancy or interior Decoration or any other profession as notified by BOARD and
Whose gross Receipts does not exceed Rs. 50L in a previous year. Then Deemed profits are 50% of Gross Receipt.
- This benefit is available to all Resident assesse.
- The restriction of 5 yrs as applicable in 44AD is not applicable here.
- The eligible assesse shall be required to pay Advance tax once by 15th March of the Financial year.

[Rest all same as Sec 44AD]

Sec 44AE:- Deemed income in case of business of plying, hiring or leasing goods carriage

This Sec is applicable if the assesse does not own more than 10 Goods Carriage at any time during the PY.
Light Motor Vehicle: Deemed Income = Rs. 7,500 per month or part of the month per vehicle for no. of months vehicles are owned by the assessee (All whether R or not)
Heavy Motor Vehicle: Deemed Income = Rs. 1,000 per ton, per month or part of the month, per vehicle for no. of months vehicles are owned by the assesse. (All whether Resident or Non-Resident)

⇒ Heavy Motor Vehicle = Gross Vehicle weight > 12000 kgs.
⇒ Deduction of remuneration & interest to a Firm is allowed as per sec 40(b). (Not allowed in sec 44AD/ADA)
⇒ Pay Advance Tax 4 Times (In Sec 44AD/ADA it was only once)
⇒ If an assesse claims that his actual profits are lower than deemed profits u/s 44AE, then

Keep and maintain BOA u/s 44AA Conduct Tax Audit u/s 44AB

ALL THE BEST
### Sections where **Manufacturing or Production** is mentioned:

1. **Sec 32(1)(iiia)** - Additional Depreciation.
2. **Sec 35(2AB)** - In house Scientific Research.
3. **Sec 35AD** - Investment Linked Deductions (3 Business).
4. **Sec 32AD** - Investment Allowance for 4 States.

### Sections where **Company** is mentioned:

1. **Sec 36(1)(ix)** - Expenditure on Promotion of Family Planning.
2. **Sec 35(2AB)** - In house Scientific Research.
3. **Sec 35AD** - Investment Linked Deductions (2 Business).
4. **Sec 35CCD** - Expenditure on Notified Skill Development.

### Sections where **Indian Company** is mentioned:

1. **Sec 35D** - Amortisation of Preliminary Expenses.
2. **Sec 35E** - Amortisation of Exploration Expenses.
3. **Sec 35DD** - Amortisation of Amalgamation or Demerger Expenses.
4. **Sec 35AD** - Investment Linked Deductions (2 Business).

### Sections where **Amortisation** is mentioned:

1. **Sec 36(1)(ix)** - 1/5th.
2. **Sec 35D** - 1/5th.
3. **Sec 35E** - 1/10th.
4. **Sec 35DD** - 1/5th.
5. **Sec 35DDA** - 1/5th.
6. **Sec 35ABB/ABA** - Over the life of License.

### Sections where deduction is based on percentage:

1. **Sec 33AB** - 40% PGBP (before 33AB & b/f losses).
2. **Sec 33ABA** - 20% PGBP (before 33ABA & b/f losses).
3. **Sec 36(1)(viia)** - 8.5%/5 % of GTI & 10% Aggregate Rural Advances.
### 4. Sec 36(1)(viii) - 20% of PGBP from 36(1)(viii) Activities OR

200% of (Paid up Capital + GR) on last day - SR A/c on 1st day.

### 5. Sec 35D - Higher of (5% of COP or 5% of CE). Compare with Actual Exp and then whichever is lower.

### 6. Sec 32AD - 15% of Actual Cost of New P&M.

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#### Sections where Lock in is mentioned:

1. **Sec 32AD** - 5 years from the date of Installation.
2. **Sec 33AB/ABA** - 8 years from the end of the PY in which asset was Purchased.
3. **Sec 35AD** - Do not use for Non-Specified Purpose for a period of 8 Years from the beginning of the PY in which asset was installed.

#### Sections where New Plant & Machinery is mentioned:

1. **Sec 32(1)(iia)** - Additional Depreciation.
2. **Sec 32AD** - Investment Allowance for 4 States.
3. **Sec 35AD** - Investment Linked Deductions (2 Exceptions).

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**ALL THE BEST**
CHAPTER 11
TAXATION OF VARIOUS ENTITIES

Taxation of Cooperative Societies

<table>
<thead>
<tr>
<th>Tax Rates:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to Rs. 10,000</td>
<td>10% of Total income.</td>
</tr>
<tr>
<td>Between Rs. 10,000 to Rs. 20,000</td>
<td>1000 + 20% of Excess.</td>
</tr>
<tr>
<td>Above Rs. 20,000</td>
<td>3,000 + 30% of Excess.</td>
</tr>
</tbody>
</table>

⇒ Note: If TI > Rs. 1 cr, then Surcharge @ 12%. Health & Education cess @ 4%.
⇒ Note: No AMT if Cooperative Societies Income is Deductible u/s 80P.

Sec 80P:- Deduction in respect of Income of cooperative Societies :

A) Specified Deductions (100% deductible)

I) Profits of following specified Activities:-

(i) Carrying on business of banking or providing credit facilities to its members.

Note:- *

* However, exemption not available to Co-operative Banks.

* But exemption is available in respect of primary agricultural society or a primary co-operative agricultural and rural development bank.

(ii) A cottage industry

(iii) Marketing of Agriculture produce grown by its members.

(iv) Purchase of agriculture implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying its members.

(v) Processing without aid of power of agriculture produce of its members.

(vi) Collective disposal of Labour of its members.

(vii) Fishing or allied activities.

I) Profits of Certain Primary Cooperative Society:-

A co-operative society engaged in supplying milk, oil seeds, fruits or vegetables grown or raised by its members.

To

(2) Govt. or Local Authority.
(3) Govt. Co. or statutory Corp.
All of the above should be engaged
(III) Income from *investment* with Co-operative Societies → 100% *Interest / Dividend* is deductible.

(IV) Income from *letting of godowns* or warehouse for Agriculture Purpose → 100% of *Rental Income* is deductible.

(B) **General Deduction**

<table>
<thead>
<tr>
<th>(i) If it is a Consumer co-operative society- Rs. 1,00,000 Flat.</th>
<th>(ii) In case of any other Society - Rs. 50,000 Flat.</th>
</tr>
</thead>
</table>

**Taxation of Film Producer / Film Distributor**

<table>
<thead>
<tr>
<th>Quantum of deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Taxation of Film producer/Distributor Rule 9A/Rule 9B</td>
</tr>
<tr>
<td>(a) Film producer/Distributor sells all rights of exhibition of the film in P.Y.</td>
</tr>
<tr>
<td>(b) Film producer/Distributor himself exhibits the film in all or some areas.</td>
</tr>
<tr>
<td>(c) Film producer/Distributor sells the rights of exhibition in respect of some areas.</td>
</tr>
<tr>
<td>(d) Film producer/Distributor himself exhibits the film in certain areas and sells the rights of exhibition in respect of all or some of remaining areas.</td>
</tr>
</tbody>
</table>
**Note:**

a) If any portion is met by govt, then it shall be reduced from the cost of production.

b) Cost of Production shall not include the following:
   1. Expenditure incurred for preparation of positive prints.
   2. Expenditure incurred in connection with the advertisement of the film.

   These 2 expenses will be allowed as revenue expense in the year of release.

c) It is clarified that Rule 9A does not apply to abandoned feature films. The cost of production of an abandoned feature film is to be treated as revenue expenditure and allowed as per the provisions of Sec 37.

### Taxation of Mutual concerns

The basic principle of mutuality is that no person can trade with himself or make income out of it. These associations arise when group of persons associate together with a common object and contribute fund for achieving that object.

### How Mutual concerns are taxed?

<table>
<thead>
<tr>
<th>Others (Social Clubs etc)</th>
<th>Trade / professional Association (Sec 44A)</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Receipts from member</td>
<td>Specific Sr. to member Specific services to outsiders</td>
</tr>
<tr>
<td>Exempt</td>
<td>Taxable General Receipts(x) from members Receipts from members/outsiders for specific (-) General Expense(x) Service xxx</td>
</tr>
</tbody>
</table>
*** This deficit can be set off against the business income or any other income subject to 50% of total income. (First give the effect of B/F Loss & UAD and then set off the deficiency u/s 44A) (Refer Illustration on Page___________)

**Banikpur Club Ltd. (SC)**

It was held by SC that in this case sale of drinks, refreshments, etc to members does not involve any commerciality as these are privileges, conveniences, etc which members are entitled from clubs. The objective of club was not profit motive, but it was to give services to its members. This transaction is not subject to tax.

**Sind Co-operative housing society (Bombay H.C)**

H.C. held any amount received as transfer fees from incoming members or outgoing members are not subject to tax as these amounts are used for maintenance of property of society only.

**Taxation of Firm (including LLP)**

Sec 184: - Assessment as Firm

2 Conditions

- Evidenced by an Instrument/Deed
- AND
- Individual share is specified in deed

Other conditions

* A certified Copy of deed shall accompany the Return of Income for first time.
* Deed Should be certified by all the partners, not being minor.
* If there is change then furnish in constitution Revised instrument of partnership along with ROI
Deduction of Remuneration, Salary, Bonus, Commission:-
Interest/ Remuneration shall be not be allowed in following cases

<table>
<thead>
<tr>
<th>Sec 184(5)</th>
<th>Sec 185</th>
</tr>
</thead>
<tbody>
<tr>
<td>If firms fails to comply with Sec 144 (Best Judgement Assessment)</td>
<td>If the firm does not comply with technical requirements of Sec 184.</td>
</tr>
</tbody>
</table>

* Note:- However above expenditures will not be taxable in the hands of the partner.

Sec 187:- Change in constitution of Firm

| At the time of making assessment u/s 143, 144, 147 or 153A | It is found that a change has occurred. | Then assessment shall be made on Reconstituted Firm. |

* However, as per Sec 188A all the partners will be jointly and severally liable.

Sec 188:- Succession of one firm by another firm

* If the case is not covered by Sec 187, then separate assessment for predecessor separate for successor.

* Succession occurs when all the partners change.

Sec 188A:- Joint & several liability of partners for Tax payable by Firm:-

→ Every person who was, during the P.Y. a partner, a legal representative of such person who is deceased, shall be jointly and severally liable along with the firm for any tax, penalty or other sum payable.

Sec 189:- Firm dissolved or business discontinued

* Every person who was at the time of dissolution, a partner and a legal representative of such person, shall be jointly or severally liable.

* Tax Rate of Firm =Flat 30% (+) (12% Surcharge if TI > Rs. 1 Cr) (+) 4 % Health & Education cess. LTCG taxed u/s 112, STCG taxed u/s 111A, LTCG referred u/s 112A are taxed at their respective rates.
### Sec 40(b) :- Remuneration and Interest to Partners.

<table>
<thead>
<tr>
<th>Remuneration</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) To working partners.</td>
<td>(1) To Any partner</td>
</tr>
<tr>
<td>(2) To Individual only.</td>
<td>(2) To Any partner</td>
</tr>
<tr>
<td>(3) Should be authorized by Deed.</td>
<td>(3) Should be authorized by Deed</td>
</tr>
<tr>
<td>(4) In the partnership Deed:-</td>
<td>(4) Rate of Interest should be specified in the deed.</td>
</tr>
<tr>
<td>specify amount OR</td>
<td></td>
</tr>
<tr>
<td>lays down the manner</td>
<td></td>
</tr>
<tr>
<td>(5) Should not be retrospective.</td>
<td>(5) Should not be retrospective.</td>
</tr>
</tbody>
</table>

#### Circular No. 739 (By CBDT) (1996):-

The CBDT has clarified that remuneration shall be admissible only if the deed either specifies the amount or lays down the manner of quantifying the same. If the assessee does not fulfils the above conditions, then A.O. is justified in disallowing the remuneration.

#### Novel Distributing Enterprise (2001) (Kerela HC)

It was held that assessee has to mention the rate of interest of both current and capital A/c. Such impugned (disputed) interest on current A/c will be disallowed as it is not specified in the deed, notwithstanding the fact, the partners have included in their individual returns.

### Sec 40(b) :- Interest can’t exceed 12% p.a. (Simple Interest)

### Sec 40(b) :- Maximum Permissible Remuneration:-

<table>
<thead>
<tr>
<th>(a) In case Book profit is negative</th>
<th>Rs. 1,50,000 flat</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b) In case Book profit is upto Rs. 3,00,000</td>
<td>Rs. 150,000 OR 90% of Book profit (whichever is more)</td>
</tr>
<tr>
<td>(c) On Balance book profits</td>
<td>60% of Book profit</td>
</tr>
</tbody>
</table>
### Explanation to Sec 40(b): Meaning of Book Profits:

1. **Net profit** as per profit and loss A/c.
2. Give effect from Sec 28 to 44D.
3. **Add remuneration** if debited to P & L A/c.

### Steps to be followed during questions:

**Step 1**: Find out Book Profit. *(Ignore B/F Losses & CH VIA here)*

**Step 2**: Find out Maximum Remuneration Allowable.

**Step 3**: Find out Total Income & Tax Liability. *(Reduce B/F Losses & CH VIA here)*

### Explanation to Sec 40(b)

<table>
<thead>
<tr>
<th>Explanation 1</th>
<th>Explanation 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where an individual is a partner in representative capacity, then interest paid on individual capacity will <strong>not be covered by Sec 40(b)</strong></td>
<td>Where an individual is a partner in a firm in personal capacity, then Sec 40(b) will <strong>not be applicable for any amount paid to HUF</strong></td>
</tr>
</tbody>
</table>

### Great City Manufacturing Co. (Allahabad H.C.)

It was held that disallowances covered **u/s 40A(2)** can’t be made to cases covered under Sec 40(b). Sec 40(b) allows remuneration, the moment the amount or the manner in which the remuneration is to be quantified is mentioned. Remuneration paid to working partner within the limits specified **u/s 40(b)** can’t be disallowed by invoking Sec 40A(2).

### Sec 10(2A) - Circular No. 8/2014 → 31.03.2014.

It is clarified that income of the firm whether taxed in the hands of the firm or exempt, under no circumstances it will be taxed in the hands of the partner.

**→ Whether remuneration and interest are allowed for Assesssee’s who are covered under presumptive income (Sec 44AD/44ADA/44AE)?**

**Ans:** No for Sec 44AD/ADA. But for Sec 44AE it is allowed.
Sec 78(1): C/F and Set off of Losses in case of Change in Constitution

Where a change in constitution of firm taxes place on account of retirement or death of a partner, the firm shall not c/f and set off the following b/f losses:

| Shares of Retired / Deceased partner in b/f losses | xx |
| (-) Share in C.Y. profits | (xx) |
| Can't be c/f by the firm | xx |

Note: Sec 78(1) is not applicable if the partner does not die/retire but there is only a change in PSR.

Remuneration paid by HUF to Karta or any member of HUF:-

Jugal kishore Baldeo Sahai v/s CIT

(a) Paid under valid & bonafide Agreement. (b) In the interest of & expedient for the business of family. (c) Reasonable & not excessive.

Taxation of Political Parties

Exemption u/s Sec 13A:

Following incomes shall not be included in total income:

Income from HP/CG/IFOS/ Voluntary contributions (See below for conditions)

Conditions for Voluntary Contributions

(a) Keeps & maintains BOA & other documents as would enable A.O. to compute income. (b) If V/C per person exceed Rs.20,000 then keep record of name & address of donor. (c) Audit by Accountant.

Conditions:

1. To claim exemption u/s 13A, a political party is supposed to furnish return u/s 139(4B) on or before the due date of furnishing return u/s 139(1). (Refer Page_____ for Sec 139(4B))
2. No donation of Rs. 2,000 or more is received otherwise than by A/c payee crossed cheque/ A/c payee bank draft/ ECS/ Electoral Bonds (Refer Below)/ such other electronic mode as may be prescribed.

Further, in order to address the concern of anonymity of the donors, Sec 13A provide that the political parties shall not be required to furnish the name and address of the donors who contribute by way of electoral bond.

**Sec 13B: Taxation of Electoral Trust**

(1) Any voluntary donation received by such trust would be exempt u/s 13B, if 95% of aggregate donation received during the PY along with surplus if any brought forward from earlier years is distributed to a registered political party.

(2) If an ET earns an income in form of interest or any other income by investing in fixed deposit or other securities then such interest / other income will not be exempt u/s 13B.

(3) Donations given to such trust are eligible for deduction in the hands of the donor u/s 80G/GC.

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**Taxation of AOP / BOI**

**Sec 167B**

Where shares of the members are known & determinate

Where shares of the members are unknown and indeterminate.

---

**Where shares of the members are known and determinate:**

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>None of the members have *TI &gt; BEL AND None of the members are</td>
<td>One or more members have *TI &gt; BEL. AND None of members are assessable at a rate higher than M.M.R</td>
<td>One or more members are assessable at rate higher than M.M.R Tax on AOP / BOI shall be aggregate of: (i) Tax at such higher rate on</td>
</tr>
</tbody>
</table>

---

*TI > BEL
<table>
<thead>
<tr>
<th>Where share is indeterminate &amp; unknown</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Where none of members are assessable at a rate higher than MMR</td>
<td>Where any of the members are assessable at a rate higher than MMR</td>
</tr>
<tr>
<td>Tax Entire AOP at MMR</td>
<td>Tax entire AOP at such higher rate</td>
</tr>
<tr>
<td>Share of Income from AOP is Exempt as per sec 86.</td>
<td>Share of Income from AOP is Exempt as per sec 86.</td>
</tr>
</tbody>
</table>

**Note:**

1. As per **Sec 2(29C)**, MMR i.e. maximum marginal rate means the highest of the slab rates applicable to an individual including surcharge & cess. \[ \text{MMR} = 42.744\% \]. (For **Sec 115TD** MMR is 34.944\% i.e. 30\% + 12\% + 4\%)
2. As per **Sec 40(ba)**, No deduction of remuneration and interest shall be allowed to AOP/BOI.
3. *Total Income includes all income other than share of income* from AOP or BOI.
4. **No MAT** shall be applicable on that share of Income from AOP/BOI, on which AOP/BOI has paid tax at MMR. *(Refer Chapter of MAT)*

**ALL THE BEST**