

5. PROFITS AND GAINS OF BUSINESS OR PROFESSION

PROBLEM NO. 1

Computation of depreciation allowance under section 32 for the A.Y. 2018-19

Particulars	Rs.	Plant and Machinery (15%) (Rs.)	Plant and Machinery (40%) Rs.
Opening WDV as on 01.04.2017		5,78,000	
Add: Plant and Machinery acquired during the year			
- Second hand machinery	2,00,000		
- Machinery Y	8,00,000		
- Air conditioner for office	3,00,000		
- Machinery Z	3,25,000	16,25,000	
		-	2,50,000
		22,03,000	2,50,000
Less: Asset sold during the year		3,10,000	Nil
Written down value before charging depreciation		18,93,000	2,50,000
Normal depreciation			
40% on air pollution control equipment			1,00,000
Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)			
- Second hand machinery (Rs. 2,00,000 × 7.5%)	15,000		
	24,375	39,375	
15% on the balance WDV being put to use for more than 180 days (Rs. 13,68,000 × 15%)		2,05,200	
Additional depreciation			
- Machinery Y (Rs. 8,00,000 × 20%)	1,60,000		
- Machinery Z (Rs. 3,25,000 × 10%)	32,500		Nil
- Air pollution control equipment (Rs. 2,50,000 × 20%)	50,000	2,42,500	50,000
Total depreciation		4,87,075	1,50,000

Notes:

- Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery.
- Additional depreciation is not allowed in respect of second hand machinery.
- No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.

PROBLEM NO. 2

Computation of deduction under section 35 for the A.Y.2018-19

Particulars	Rs.	Section	% of weighted deduction	Amount of deduction (Rs.)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	150%	1,50,000
IIT, Delhi	2,50,000	35(2AA)	150%	3,75,000
X Ltd.	4,00,000	35(1)(ia)	100%	4,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(1)(i)	100%	3,00,000
Capital expenditure (excluding cost of acquisition of land Rs. 5,00,000)	2,50,000	35(1)(iv)	100%	2,50,000
Deduction allowable under section 35				14,75,000

Note: Only company assesseees are entitled to weighted deduction @150% under section 35(2AB) in respect of in-house research and development expenditure incurred. However, in this case, the assessee is an individual. Therefore, he would be entitled to deduction@100% of the revenue expenditure incurred under section 35(1)(i) and 100% of the capital expenditure incurred under section 35(1)(iv) read with section 35(2), assuming that such expenditure is laid out or expended on scientific research related to his business.

PROBLEM NO. 3

1. The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula –

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganization had not taken place. In this case, the amount of deduction is Rs. 2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2017, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 30.11.2017, in this case); and

C = the total number of days in the financial year in which the business reorganization has taken place (i.e. 365 days).

2. The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Cooperative bank, in this case) under section 32 has to be determined in accordance with the formula – $A \times \frac{B}{C}$

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganization had not taken place. In this case, the amount of deduction is Rs. 2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganization (i.e. 1.12.2017, in this case) and ending on the last day of the financial year (i.e. 31.3.2018); and

C = the total number of days in the financial year in which the business reorganization has taken place (i.e. 365 days).

3. In this case, the deduction that would have been allowable under section 32 to Alpha cooperative bank had the business reorganization had not taken place is Rs. 2,40,000 and the business re-organization took place on 1.12.2017. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be Rs. 1,60,438 i.e., Rs. 2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be Rs. 79,562 i.e., Rs. 2,40,000 x 121/365.

PROBLEM NO. 4

Computation of written down value of Plant and Machinery of M/s. Dollar Ltd. As on 31-03-18

Particulars	Rs.
Opening written down value (as on 01.04.2017)	5,00,000
Add: Purchase of plant and machinery during the previous year	2,00,000
	7,00,000
Less: Sale proceeds of obsolete plant and machinery sold during the year	5,000
Closing Written Down Value (as on 31.03.2018)	6,95,000

Computation of Depreciation and Additional Depreciation for A.Y. 2018-19 as per section 32 of the Income-tax Act, 1961

Particulars	Rs.
Normal Depreciation (Rs. 6,95,000 x 15%)	1,04,250
Additional Depreciation (Refer Note 2) (Rs. 2,00,000 – Rs. 20,000 - Rs. 20,000) x 20%	32,000
Depreciation on Plant and Machinery	1,36,250

Notes:

1. Since the new plant and machinery was purchased and put to use before 1.10.2017, it was put to use for more than 180 days in the year. Hence, full depreciation is allowable for A.Y. 2018-19.
2. In view of the above provisions, additional depreciation cannot be claimed in respect of –
 - a) Plant and machinery of Rs.20,000 used previously for the purpose of business by the seller.
 - b) Plant and machinery of Rs.20,000, installed in office.

Therefore, in the given case additional depreciation has to be provided only on Rs.1,60,000 (i.e., Rs.2,00,000 - Rs.40,000).

PROBLEM NO. 5**Computation of depreciation under section 32 for A.Y.2018-19**

Particulars	Rs.	Rs.
Normal Depreciation		
Depreciation@15% on Rs. 51,00,000, being machinery (put to use for more than 180 days) [Opening WDV of Rs. 42,00,000 +Purchase cost of imported machinery of Rs. 9,00,000]	7,65,000	
Depreciation@7.5% on Rs. 10,00,000, being new machinery put to use for less than 180 days	75,000	
	8,40,000	
Depreciation@40% on computers purchased Rs. 2,00,000	80,000	9,20,000
Additional Depreciation (Refer Note below)		
Additional Depreciation@ 10% of Rs. 10,00,000 [being actual cost of new machinery purchased on 12-10-2016]	1,00,000	
Additional Depreciation@20% on new computer installed in generation wing of the unit [20% of Rs. 2,00,000]	40,000	1,40,000
Depreciation on Plant and Machinery		10,60,000

Note: The benefit of additional depreciation is available to new plant and machinery acquired and installed in power sector undertakings. Accordingly, additional depreciation is allowable in the case of any new machinery or plant acquired and installed by an assessee engaged, inter alia, in the business of generation or generation and distribution of power, at the rate of 20% of the actual cost of such machinery or plant.

Therefore, new computer installed in generation wing of the unit is eligible for additional depreciation@20%.

Since the new machinery was purchased only on 12.10.2017, it was put to use for less than 180 days during the previous year, and hence, only 10% (i.e., 50% of 20%) is allowable as additional depreciation in the A.Y. 2018-19. The balance additional depreciation would be allowed in the next year.

However, additional depreciation shall not be allowed in respect of, inter alia, any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person. Therefore, additional depreciation is not allowable in respect of imported machinery, since it was used in Colombo, before its installation by the assessee.

PROBLEM NO. 6

In the case of conversion of sole proprietary concern into a company as per section 47(xiv), the depreciation should be first calculated for the whole year assuming that no succession had taken place. Thereafter, the depreciation should be apportioned between the sole proprietary concern and the company in the ratio of the number of days for which the assets were used by them. It is assumed that in this case, the conditions specified in section 47(xiv) are satisfied.

Computation of depreciation allowable to Sidhant & Co. for A.Y.2018-19

Particulars	Rs.	Rs.
Building		
WDV as on 1.4.2017	3,50,000	

Depreciation @ 10%		35,000
Furniture		
WDV as on 1.4.2017	50,000	
Depreciation @ 10%		5,000
Plant and Machinery		
WDV as on 1.4.2017	2,00,000	
Add: Additions during the year (purchased on 15.10.2017)	1,00,000	
	3,00,000	
Less: Depreciation for the year (15% of Rs. 2,00,000 + 50% of 15% of Rs. 1,00,000) (Rs.30,000 + Rs.7,500) (Depreciation on new machinery is restricted to 50% of eligible depreciation, since the asset is put to use for less than 180 days in that year)		37,500
Total depreciation for the year		77,500
Proportionate depreciation allowable to Sidhant & Co. for 242 days		
On existing assets (i.e. 1.4.2017 to 28.11.2017) (i.e. 242/365 x Rs. 70,000)	46,411	
On new machine for 45 days i.e., 45/168 x Rs. 7,500	2,009	48,420

Computation of depreciation allowable to Sidhant Co. Ltd. for A.Y.2018-19

Particulars	Rs.
i) Depreciation on the assets on conversion Proportionately for 123 days i.e. after conversion period (123/365 x Rs. 70,000) + (123/168 x Rs. 7,500) = Rs. 23,589 + Rs. 5,491	29,080
ii) Depreciation @ 50% of normal rate of 15% on Rs. 50,000, being the value of plant purchased after conversion, which was put to use for less than 180 days	3,750
Depreciation allowable to Sidhant Co. Ltd.	32,830

Note: Since it has not been specifically mentioned that M/s Sidhant & Co. and Sidhant Co. Ltd. are manufacturing concerns or companies engaged in the business of generation or generation and distribution of power, additional depreciation is not provided for.

PROBLEM NO. 7

Computation of depreciation for Gopichand Industries for A.Y.2018-19

Particulars	Rs.	Rs.
Block 1 : Plant & machinery (Rate of depreciation – 15%)		
WDV as on 1st April (10 looms)	5,00,000	
Add: Additions during the year		
- 5 looms acquired on 5th July	4,00,000	
- 2 looms acquired on 10th January	<u>3,00,000</u>	
	<u>12,00,000</u>	
Less : Assets sold during the year		
- 15 looms sold on 7th December	10,00,000	
W.D.V. as on 31st March (2 looms)	2,00,000	
Depreciation on Rs. 2 lakhs @ 15% (limited to 50%)		15,000
Block II: Buildings (Rate of depreciation – 10%)		
WDV as on 1st April (3 buildings)	12,50,000	
Depreciation on Rs. 12,50,000 @ 10%		1,25,000
Total depreciation for the year		1,40,000

Notes:

- Closing balance of Block 1: Plant and machinery represents the looms acquired on 10th January. These looms have been put to use or less than 180 days during the previous year, and therefore, only 50% of normal depreciation is permissible.
- No additional depreciation @ 20% of the cost of new plant and machinery is provided for assuming that all conditions contained in the section 32(1)(ia) have not been fulfilled.

PROBLEM NO. 8

Computation of depreciation allowable to Honest Industry for the A.Y. 2018-19

Particulars	Plant & Machinery	Building	Intangible assets (patents)	Total (Rs.)
Rate of depreciation	15%	10%	25%	
Opening Balance as on 1.04.2017	14,50,000	25,00,000	15,00,000	
Add: Assets acquired during the year	16,00,000	15,00,000	5,00,000	
	30,50,000	40,00,000	20,00,000	
Less: Moneys payable in respect of asset sold or destroyed	50,000	-	3,00,000	
W.D.V as on 31.03.2018	30,00,000	40,00,000	17,00,000	
Asset held for less than 180 days	4,00,000	15,00,000	-	
Depreciation@50% of applicable rate	30,000	75,000	-	1,05,000
Asset held for more than 180 days	26,00,000	25,00,000	17,00,000	
Depreciation at the applicable rates	3,90,000	2,50,000	4,25,000	10,65,000
Total Depreciation allowable				11,70,000

Note: Land is not a depreciable asset. Therefore, Rs.3 lakh being the value of land, has been reduced from Rs.18 lacs, being the value of building acquired during the year, for the purpose of computing depreciation.

PROBLEM NO. 9

Under section 35AD, 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the specified business, which includes the business of building and operating a hotel of two-star or above category anywhere in India which commences its operations on or after 1.4.2010, would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

Accordingly, the deduction under section 35AD for the A.Y.2018-19 in the case of Win Ltd. would be calculated as follows, assuming that the expenditures were capitalized in the books of the company on 1.4.2017, being the date of commencement of operations-

Particulars	Rs. (in lakhs)
Cost of land (not eligible for deduction under section 35AD)	Nil
Cost of construction of hotel building (Rs. 30 lakhs + Rs. 150 lakhs)	180
Cost of plant and machinery	30
Deduction under section 35AD	210

Note:

- 1) For A.Y.2018-19, the loss from specified business of operating a three star hotel would be Rs.130 lakhs (i.e. Rs.210 lakhs – Rs.80 lakhs). As per section 73A, any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business. The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year.
- 2) Since the entire cost of plant and machinery and building qualifies for deduction under section 35AD, the same does not qualify for deduction under section 32.

PROBLEM NO. 10

Computation of taxable profits under the head PGBP & Loss from specified business to be carried forward as per section 73A

	Particulars	Rs. (in lakhs)
1.	Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)	25
	Less: Deduction under section 35AD	
2.	i) Capital expenditure incurred during the P.Y.2017-18 (excluding the expenditure incurred on acquisition of land) = Rs. 200 lakh – Rs. 150 lakh	50
	ii) Capital expenditure incurred prior to 1.4.2017 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2017	50
	Total deduction u/s 35AD for A.Y.2018-19	100
3.	Loss from the specified business of new hotel in Madurai	(75)
4.	Profit from the existing business of running a hotel in Coimbatore	120
5.	Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A	45

PROBLEM NO. 11

Computation of profits and gains of business of Mr. Anirudh for A.Y.2018-19

	Particulars	Rs. (in lakhs)
	Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	25
	Less: Depreciation under section 32 10% of Rs.60lakh, being (Rs.70lakh - Rs.20lakh + Rs.10lakh)	6
	Income chargeable under “profits and gains from business or profession”	19

Computation of loss from specified business to be carried forward as per section 73A

	Particulars	Rs. (in lakhs)
6.	Profits from the specified business of setting up warehousing facility for storage of pulses (before providing deduction under section 35AD)	14
	Less: Deduction under section 35AD	
7.	Capital expenditure incurred prior to 1.4.2017 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2017 (excluding the expenditure incurred on acquisition of land) = Rs.20 lacs (Rs.50 lacs - Rs.30 lacs)	20
8.	Capital expenditure incurred during the P.Y.2017-18	20
9.	Total capital expenditure (B + C)	40
10.	Deduction under section 35AD 150% of capital expenditure	60
	Total deduction u/s 35AD for A.Y.2018-19	60
11.	Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)	(46)

Notes:

- Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2018-19 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2017. Pulses constitute agricultural produce and therefore, the capital expenditure incurred for setting up a warehousing facility for storage of pulses is eligible for weighted deduction@150% under section 35AD.
- However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. Anirudh is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.

3. Mr. Anirudh can claim depreciation @ 10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2017-18.
4. Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of Rs. 46 lakh from the specified businesses of setting up and operating a warehousing facility for storage of pulses cannot be set-off against the profits of Rs. 19 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.

PROBLEM NO. 12

S.No.	Particulars	Rs.
1.	Skill development project (Rs.75,000 X 150%)	1,12,500
2.	Agricultural extension project (Rs.50,000 X 150%)	75,000
3.	Building under section 35(1)(iv) (note-1)	5,00,000
4.	Purchase of building for setting up and operating a warehousing facility	20,00,000
5.	Payment to its employees with a scheme of voluntary retirement(note-2)	4,00,000
Total amount allowed as a deduction:		30,87,500

Note 1: Z Ltd. would not be eligible for weighted deduction@200% under section 35(2AB), since the in-house research and development expenditure is incurred on land and building. However, it would be eligible for deduction of actual expenditure of Rs.5 lakh incurred on building under section 35(1)(iv) read with section 35(2).

Note 2: Under section 35DDA, expenditure incurred on payment of any sum to the employees in accordance with a scheme of voluntary retirement is allowable as deduction in five equal installments over a period of five years, commencing from the previous year in which the payment was made.

Therefore, Rs.4 lakh, being one-fifth of Rs.20 lakh, would be allowable as deduction under section 35DDA, while computing the business income of Y Ltd. for A.Y.2018-19.

PROBLEM NO. 13

- i) **The statement is not correct:** As per the third proviso to section 32(1)(ii), 50% of the additional depreciation on new plant and machinery acquired and used for less than 180 days in the year of acquisition and installation which has not been allowed as deduction in that previous year, shall be allowed in the immediately succeeding previous year. Hence, the balance additional depreciation of 10% (i.e. 50% of 20%) can be claimed in the immediately succeeding previous year i.e., P.Y. 2017-18
- ii) **The statement is not correct:** The proviso to section 36(1)(iii) provides that interest paid on capital borrowed for acquisition of an asset (whether capitalized in the books of account or not) for the period upto the date on which such asset was first put to use shall not be allowed as deduction. This is irrespective of whether the acquisition of asset was for extension of existing business or not. Therefore, interest paid on capital borrowed for acquisition of an asset for the period upto the date on which such asset was first put to use shall be capitalized even if the acquisition is not for the extension of existing business or profession.

PROBLEM NO. 14

Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia).

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible under section 192 or any sum credited or paid by way of directors' remuneration on which tax is deductible under section 194J, would attract disallowance@30% under section 40(a)(ia). Whereas in case of salary, tax has to be deducted under section 192 at the time of payment, in case of directors' remuneration, tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in both the cases i.e., salary and directors' remuneration, tax is deductible in the P.Y. 2017-18, since salary was paid in that year and directors' remuneration was credited in that year. Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y. 2018-19 is as follows –

Computing business income for A.Y.2018-19 is as follows –

Particulars	Amount paid in Rs.	Disallowance u/s 40(a)(ia) @ 30% of sum paid
Salary [tax is deductible under section 192]	12,00,000	3,60,000
Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
Disallowance under section 40(a)(ia)		3,68,400

If the tax is deducted and paid in the next year i.e., P.Y.2018-19, the amount of Rs.3,68,400 would be allowed as deduction while computing the business income of A.Y.2019-20.

PROBLEM NO. 15

His profits and gains from the 3 trucks shall be deemed to be Rs.2,32,500 [(Rs.7,500 × 10) + (Rs.7,500 × 9) + (Rs.7,500 × 12)]

PROBLEM NO. 16

Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder –

Particulars	Rs.
Amount received in India on account of carriage of passengers from Mumbai	3,00,00,000
Amount received in India on account of carriage of goods from Mumbai	2,00,00,000
Amount received in India on account of carriage of passengers from Bangkok	1,00,00,000
Amount received in Bangkok on account of carriage of passengers from Mumbai	2,00,00,000
	8,00,00,000

Income from business under section 44BBA at 5% of Rs.8,00,00,000 is Rs.40,00,000, which is the income of Mr.Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y.2018-19.

PROBLEM NO. 17

As per *Explanation 3* to section 40(b), "book profit" shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

1. Computation of Book Profit of the firm under section 40(b)

Particulars	Rs.	Rs.
Net Profit (before deduction of depreciation, salary and interest)		7,00,000
Less: Depreciation under section 32	1,50,000	
Less: Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (5,00,000 × 12%)	60,000	2,10,000
Book Profit		4,90,000

2. Salary actually paid to working partners = Rs. 20,000 × 2 × 12 = Rs. 4,80,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits –

On the first Rs. 3,00,000 of book profit or in case of loss	Rs. 1,50,000 or 90% of book profit, whichever is More
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2018-19 in this case would be:

Particulars	Rs.
On the first Rs. 3,00,000 of book profit [(Rs. 1,50,000 or 90% of Rs. 3,00,000) whichever is more]	2,70,000
On the balance of book profit [60% of (Rs. 4,90,000 - Rs. 3,00,000)]	1,14,000
Maximum allowable partners' salary	3,84,000

Hence, allowable working partners' salary for the A.Y. 2018-19 as per the provisions of section 40(b)(v) is Rs. 3,84,000.

PROBLEM NO. 18

Computation of total income of Mr. Ramamurthy for A.Y.2018-19

Particulars	Rs.
Presumptive business income under section 44AE	
4 heavy goods vehicles for 2 months (4 x Rs. 7,500 x 2)	60,000
Balance 2 heavy goods vehicles for 10 months (2 x Rs. 7,500 x 10)	1,50,000
7 heavy goods vehicles for 10 months (7 x Rs. 7,500 x 10)	5,25,000
Business Income	7,35,000
Less: Brought forward business loss of discontinued business	50,000
Total Income	6,85,000

Note: The assessee is eligible for computing the income from goods carriages applying the presumptive provisions of section 44AE, since he does not own more than 10 goods carriages at any time during the previous year.

PROBLEM NO. 19

Under section 43B, interest on term loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee.

Explanation 3D to section 43B provides that if any interest payable by the assessee is converted into a loan, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. Therefore, the interest of Rs. 1.2 lakhs converted into loan cannot be claimed as business expenditure.

PROBLEM NO. 20

Computation of income under the head "Profits and gains of business or profession" of Mr. Q for the A.Y. 2018-19

Particulars	Rs.	Rs.
Net profit as per profit and loss account		93,950
Add: Expenses not allowable		
Expenses on building a new toilet – Capital expenditure, hence not allowable as per section 37(1).	1,00,000	
Interest payable on which tax has not been deducted at source [disallowed under section 40(a)] [See Note 1]	15,000	
Penalty for contravention of Central Sales Tax Act [Penalty paid for violation or infringement of any law is not allowable as deduction under section 37(1)]	24,000	
Payment to IIT, Mumbai for scientific research programme (to be treated separately)	1,00,000	2,39,000
		3,32,950
Less: Income not forming part of business income		
Interest from company deposits (chargeable under the head "Income from other sources") (See Note 2 below)	6,400	
Income-tax refund (not an income chargeable to tax)	8,100	14,500
		3,18,450

Less: Weighted deduction@150% under section 35(2AA) for payment to IIT for an approved scientific research program.		1,50,000
Profit and gains of business or profession		1,68,450

Note:

- Section 40(a)(ia) provides for disallowance of 30% of any sum paid, on which tax is deductible under Chapter XVII-B, but the same has not been deducted. Hence, Rs.15,000 being 30% of Rs.50,000 has to be added back while computing business income.
- Interest on company deposits may also be treated as business income presuming that the interest has been earned by Mr. Q out of available temporary surplus funds which are not immediately required for his business purposes but nevertheless meant only for Mr. Q's business activities. In such a case, income under the head "Profit and gains of business or profession" would be Rs. 1,74,850.

PROBLEM NO. 21**Profits and gains of business or profession of Mr. A for the year ended 31.3.2018**

Particulars	Rs.	Rs.
Net profit as per profit and loss account		94,500
Add: Expenses not allowable		
i) Expenses on raising compound wall – capital expenditure, hence disallowed	95,000	
ii) Interest payable outside India to a non-resident, as tax has not been deducted at source [Section 40(a)(i)]	12,000	
iii) Penalty for contravention of CST Act [Penalty paid for violation or infringement of any law is not allowable as deduction under section 37(1)]	24,000	
iv) Contribution for scientific research (to be treated separately)	1,00,000	2,31,000
		3,25,500
Less: Income not forming part of business income		
Interest from company deposits	6,400	
Dividend	3,600	
Income-tax refund	4,500	14,500
		3,11,000
Less: Deduction under section 35 for scientific research [See Note below]		1,50,000
Profit and gains of business or profession		1,61,000

Note: Contribution to approved scientific research association qualifies for deduction @ 150% under section 35(1)(ii).

PROBLEM NO. 22

- Yes.** Since his total turnover for the F.Y.2017-18 is below Rs.2 crore, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.
- His income from retail trade, applying the presumptive tax provisions under section 44AD, would be Rs. 6,59,680, being 8% of Rs. 82,46,000.

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 crore. The CBDT, has vide its Press Release dated 20th June, 2016, clarified that the higher threshold for non-audit of accounts has been given only to assessee's opting for presumptive taxation scheme under section 44AD.

Note: 6% rate has not been considered for calculations assuming that the assessee not satisfied the required conditions.

- In case he does not opt for the presumptive taxation scheme under section 44AD, and claims that his income is Rs. 5,85,600 (which is lower than the presumptive business income of Rs. 6,59,680), he has to maintain books of account as required under section 44AA(2) and also get them audited and furnish a report of such audit under section 44AB, since his total income exceeds the basic exemption limit of Rs. 2,50,000.

- d) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2018.

In case he does not opt for the presumptive taxation scheme and claims that his income is Rs.5,85,600 as per books of account, then he has to get his books of account audited under section 44AB, in which case the due date for filing of return would be 30th September, 2018.

PROBLEM NO. 23

Computation of total income of Mr. Raju for the A.Y. 2018-19

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Net profit as per profit and loss account		5,00,000
Add: Excess commission paid to brother disallowed under section 40A(2)	10,000	
Disallowance under section 40A(3) is not attracted since the limit for one time cash payment is Rs.35,000 in respect of payment to transport operators. Therefore, amount of Rs.33,000 paid in cash to a transport carrier is allowable as deduction.	Nil	
Salary paid to staff not recorded in the books (Assuming that the expenditure is in the nature of unexplained expenditure and hence, is deemed to be income as per section 69C and would be taxable @ 30% under section 115BBE – no deduction allowable in respect of such expenditure) [See Note 1 below]	48,000	
Bank term loan interest paid after the due date of filing of return under section 139(1) – disallowed as per section 43B	40,000	
State VAT penalty paid disallowed [See Note 2 below]	5,000	
Depreciation debited to profit and loss account	2,00,000	3,03,000
		8,03,000
Less: Dividend from domestic companies [Exempt under section 10(34)]	15,000	
Income from agriculture [Exempt under section 10(1)]	1,80,000	
Depreciation under the Income-tax Act, 1961 (As per working note)	2,25,000	4,20,000
		3,83,000
Income from house property		
Annual value of self-occupied property	Nil	
Less: Deduction under section 24(b) – interest on housing loan	23,000	(23,000)
Gross Total Income		3,60,000
Less: Deduction under section 80C in respect of Principal repayment of housing loan		50,000
Total Income		3,10,000

WORKING NOTE:

Computation of depreciation under the Income-tax Act, 1961

Particulars	Rs.
Depreciation @ 15% on Rs.14 lakh (Opening WDV of Rs.12 lakh plus assets purchased during the year and used for more than 180 days Rs. 2 lakh)	2,10,000
Depreciation @ 7.5% on Rs. 2 lakh (Cost of assets used for less than 180 days)	15,000
	2,25,000

Notes (Alternate views):

- It is also possible to take a view that the salary not recorded in the books of account was an erroneous omission and that the assessee has offered satisfactory explanation for the same. In such a case, the same should not be added back as unexplained expenditure, but would be allowable as deduction while computing profits and gains of business and profession.
- Where the imposition of penalty is not for delay in payment of sales tax or VAT but for contravention of provisions of the Sales Tax Act (or VAT Act), the levy is not compensatory and therefore, not deductible. However, if the levy is compensatory in nature, it would be fully allowable. Where it is a composite levy, the portion which is compensatory is allowable and that portion which is penal is to be disallowed.

Since the question only mentions "State VAT penalty paid" and the reason for levy of penalty is not given, it has been assumed that the levy is not compensatory and therefore, not deductible. It is, however, possible to assume that such levy is compensatory in nature and hence, allowable as deduction. In such a case, the total income would be Rs. 3,05,000.

PROBLEM NO. 24

Particulars	Amount (Rs.)
1. Scientific research expenditure related to its business (note-1) (2,40,000 X 100%)	2,40,000
2. Building acquired for scientific research excluding cost of land is allowed as capital expenditure (12,00,000-5,00,000)	7,00,000
3. Amount paid to Indian Institute of Science (50,000 X 150%)	75,000
4. Demerger expenses allowed for five successive previous years (5,00,000 X 1/5)	1,00,000
5. Contribution to the account of employees as per pension scheme (note-2)	23,00,000
6. Amount recovered from employees towards provident fund contribution	7,00,000
7. Non-monetary perquisites provided to the employees	It should be Disallowed
8. Gain due to change in the rate of exchange of foreign currency	Reduced from the actual cost

Note –1: If Raghav Industries Ltd. is a company engaged in the business of biotechnology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule, it would be entitled to a weighted deduction of Rs. 3,60,000 (150% of Rs. 2,40,000, being the revenue expenditure on scientific research related to its business) under section 35(2AB), if the in-house research and development facility is approved by the prescribed authority and the company has entered into an agreement with the prescribed authority for cooperation in such research and development facility and for audit of accounts maintained for that facility.

Note –2: The employer's contribution to the account of an employee under a pension scheme referred to in section 80CCD, upto 10% of salary of the employee in the previous year, is allowable as deduction under section 36(1)(iva) while computing business income.

Disallowance under section 40A(9) would be attracted only in respect of the amount in excess of 10% of salary. Accordingly, Rs. 23 lakhs would be allowed as deduction and Rs. 7 lakhs would be disallowed.

PROBLEM NO. 25

- As per section 43B, municipal tax is not deductible for A.Y. 2018-19 since it is not paid on or before 30.09.2018, being the due date of filing the return for A.Y. 2018-19.

Note – It is assumed that the company has not undertaken any international transaction during the year, and therefore, does not have to file a transfer pricing report under section 92E. Therefore, the due date of filing of return of the company would be 30th September, 2018.

- Patent is an intangible asset eligible for depreciation@25%, as per section 32(1)(ii). Since it has been acquired and put to use for more than 180 days during the previous year 2017-18, full depreciation of Rs. 6,25,000 (i.e. 25% of Rs. 25,00,000) is allowable as deduction.
- Weighted deduction@150% is available under section 35(2AB) in respect of expenditure incurred by a company on scientific research on in-house research and development facility as approved by the prescribed authority. However, cost of land is not eligible for deduction.

Deduction under section 35(2AB) = 150% of Rs. 10 lakhs = Rs. 15,00,000.

Note: It is presumed that the in-house research and development facility is approved by the prescribed authority and is hence, eligible for weighted deducted @ 150% under section 35(2AB).

- Bad debts i.e. Rs. 4,00,000 written off in the books of account as irrecoverable is deductible under section 36(1)(vii), provided the debt has been taken into account in computing the income of the company in the current previous year or any of the earlier previous years.
- As per section 40(a)(v), income-tax of Rs. 1,10,000 paid by the company in respect of non-monetary perquisites provided to its employees, exempt in the employee's hands under section 10(10CC), is not deductible while computing business income of the employer-company.

6. Expenditure towards advertisement in souvenir of a political party is disallowed under section 37(2B) while computing business incomes.

However, the same is deductible under section 80GGB from gross total income provided the payment is made by any mode other than cash.

7. Refund of a trading liability is taxable under section 41(1), if a deduction was allowed in respect of the same to the taxpayer in an earlier year.

Since sales tax was claimed as expenditure in an earlier year, refund of the same during the year would attract the provisions of section 41(1).

PROBLEM NO. 26

- a) **True:** Section 36(1)(xv) allows a deduction of the amount of securities transaction tax paid by the assessee in respect of taxable securities transactions entered into in the course of business during the previous year as deduction from the business income of a dealer in shares and securities.
- b) **True:** As per section 40A(3), in the 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 exceeding Rs. 10,000 has been made in the subsequent year otherwise than by an account payee cheque or an account payee bank draft or use of electronic payment system, then the payment so made shall be deemed to be the income of the subsequent year in which such payment has been made.
- c) **True:** According to the Explanation 5 to section 32(1), allowance of depreciation is mandatory. Therefore, depreciation has to be provided mandatorily while calculating income from business / profession whether or not the assessee has claimed the same while computing his total income.
- d) **True:** Section 36(1)(ib) provides deduction in respect of premium paid by an employer to keep in force an insurance on the health of his employees under a scheme framed in this behalf by GIC or any other insurer. The medical insurance premium can be paid by any mode other than cash, to be eligible for deduction under section 36(1)(ib).
- e) **False:** Expenditure incurred in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, will be entitled to deduction in 5 equal annual installments beginning from the year in which each payment is made to the employee.
- f) **False:** Additional depreciation can be claimed only in respect of eligible plant and machinery acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power. In this case, the assessee is engaged in trading activities and the new plant has been acquired and installed in a trading concern. Hence, the assessee will not be entitled to claim additional depreciation under section 32(1)(iia).

PROBLEM NO. 27

- a) **Not allowable as deduction:** As per section 40A(7), no deduction is allowed in computing business income in respect of any provision made by the assessee in his books of account for the payment of gratuity to his employees except in the following two cases:

- where any provision is made for the purpose of payment of sum by way of contribution towards an approved gratuity fund or;
- where any provision is made for the purpose of making any payment on account of gratuity that has become payable during the previous year.

Therefore, in the present case, the provision made on the basis of actuarial valuation or payment of gratuity has to be disallowed under section 40A(7), since, no payment has been actually made on account of gratuity.

Note: It is assumed that such provision is not for the purpose of contribution towards an approved gratuity fund.

- b) **Allowable as deduction:** As per Rule 6DD, in case the payment is made for purchase of agricultural produce directly to the cultivator, grower or producer of such agricultural produce, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds Rs. 10,000.

Therefore, in the given case, disallowance under section 40A(3) is not attracted since, cash payment for purchase of oil seeds is made directly to the farmer.

- c) **Not allowable as deduction:** Income-tax of Rs.20,000 paid by the employer in respect of non-monetary perquisites provided to its employees is exempt in the hands of the employee under section 10(10CC). As per section 40(a)(v), such income-tax paid by the employer is not deductible while computing business income.
- d) **Allowable as deduction:** Payment for fire insurance is allowable as deduction under section 36(1). Since payment by credit card is covered under Rule 6DD, which contains the exceptions to section 40A(3), disallowance under section 40A(3) is not attracted in this case.
- e) **Not allowable as deduction:** Disallowance under section 40(a)(iii) is attracted in respect of salary payment of Rs. 2,00,000 outside India by a company without deduction of tax at source.
- f) **Allowable as deduction:** As per Rule 6DD, if the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender, no disallowance under section 40A(3) is attracted even though the cash payment for the expense exceeds Rs. 10,000.
Therefore, in the given case, no disallowance under section 40A(3) is attracted since payment of sales tax is covered by the above mentioned exception contained in Rule 6DD.
- g) **Allowable as deduction:** The limit for attracting disallowance under section 40A(3) for payment otherwise than by way of account payee cheque or account payee bank draft is Rs. 35,000 in case of payment made for plying, hiring or leasing goods carriage. Therefore, in the present case, disallowance under section 40A (3) is not attracted for payment of Rs. 30,000 made in cash to a transporter for carriage of goods.

PROBLEM NO. 28

- a) Recovery of a bad debt claim disallowed in the earlier year cannot be brought to tax under section 41(4). Section 41(4) can be invoked only in a case where bad debts or part thereof has been allowed as deduction earlier under section 36(1)(vii).
- b) The scope of section 40(a)(ia) has been expanded to cover all sums in respect of which tax is deductible under Chapter VII-B. Section 192, which requires deduction of tax at source from salary income, forms part of Chapter VII-B. Therefore, salary payment without deduction of tax at source would attract disallowance under section 40(a)(ia). However, only 30% of salary paid without deduction tax at source would be disallowed under section 40(a)(ia).
- c) It is deductible in 5 equal annual instalments commencing from the previous year of payment. Rs. 24 lakhs, being 1/5th of Rs. 120 lakhs, is deductible under section 35DDA for the A.Y.2018-19.
- d) As per section 41(4), any amount recovered by the assessee against bad debt earlier allowed as deduction shall be taxed as income in the year in which it is received.
Therefore, in this case, Rs. 50,000 would be taxable in the F.Y.2017-18 (A.Y.2018-19).

PROBLEM NO. 29

- a) **True:** In order to escape the disallowance specified in section 40A(3), payment in respect of the business expenditure ought to have been made through an account payee cheque or draft or use of electronic payment system. Payment through a cheque crossed as "& Co." will attract disallowance under section 40A(3).
- b)
- i) **True:** It is mandatory to write off the amount due from a debtor as not receivable, in order to claim the same as bad debt under section 36(1)(vii).
- ii) **True:** Section 40(a)(ia) provides that failure to deduct tax at source from rent or royalty payable to a resident, in accordance with the provisions of Chapter XVII-B, will result in disallowance of 30% of such expenditure, where the resident payee has not paid the tax due on such income.
- c) **False:** Sub-clause (a) of section 36(1)(vii) allows the co-operative banks to claim deduction for provision for bad and doubtful debts in respect of advances made by rural branches of such banks. However, the deduction should not exceed 10% of the aggregate average advances made by the rural branches of such banks computed in the prescribed manner.

PROBLEM NO. 30

- i) **Yes.** Since his total turnover for the F.Y.2017-18 is below Rs. 200 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.
- ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be Rs. 15,88,000, being 8% of Rs. 1,98,50,000.

Note: 6% rate has not been considered for calculations assuming that the assessee not satisfied the required conditions.

- iii) In case he does not opt for the presumptive taxation scheme under section 44AD, and claims that his income is Rs.13,20,000 (which is lower than the presumptive business income of Rs.15,88,000), he has to maintain books of account as required under section 44AA(2) and also get them audited and furnish a report of such audit under section 44AB, since his total income exceeds the basic exemption limit of Rs. 2,50,000.

Note: 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 crore. The CBDT, has vide its Press Release dated 20th June, 2016, clarified that the higher threshold for non-audit of accounts has been given only to assessees opting for presumptive taxation scheme under section 44AD.

- iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2018. In case he does not opt for the presumptive taxation scheme and claims that his income is Rs.13,20,000 as per books of account, then he has to get his books of account audited under section 44AB, in which case the due date for filing of return would be 30th September, 2018.

PROBLEM NO. 31**Allowability of expenses of M/s. Arora Ltd. for the A.Y. 2017-18**

- i) Payment of professional fees is subject to TDS under section 194J. Since no tax is deducted at source, Rs. 15,000, being 30% of the expenditure of Rs. 50,000 is disallowed under section 40(a)(ia).
- ii) Since the tax was deducted in March, 2018 and paid on or before the due date of filing the return (i.e., on or before September 30th, 2018), the expenditure on interior works will be allowed as deduction. Hence, disallowance under section 40(a)(ia) is not attracted.
- iii) The maximum time allowable for deposit of tax deducted at source is upto the due date of filing of return i.e., 30th September, 2018. In this case, since tax deducted under section 194-I was paid after the due date of filing the return, Rs. 4,50,000 being 30% of Rs.15,00,000 is disallowed under section 40(a)(ia) for the previous year 2017-18.
- iv) The tax deducted at source can be deposited on or before the due date of filing of return to avoid disallowance under section 40(a)(ia). In this case, disallowance would not be attracted since tax deducted during December 2017 was deposited before 30th September 2018 i.e. on 28.09.2018.

PROBLEM NO. 32

- i) The entire revenue expenditure of Rs. 5,65,000 on scientific research related to the business of the company qualifies for deduction under section 35(1)(i).
- ii) As per section 35(1)(iv) read with section 35(2), if any capital expenditure (other than expenditure on acquisition of land) is incurred on scientific research related to the business carried on by the assessee, the whole of such capital expenditure is allowable as deduction in the previous year in which it is incurred. Therefore, Rs.12,50,000 (i.e. Rs. 22,00,000 – Rs. 9,50,000, being the cost of land) is allowable as deduction for the A.Y.2018-19. It is assumed that the scientific research is related to the business of Purnit Agro Industries.
- iii) The employer's contribution to the account of an employee under a pension scheme referred to in section 80CCD, upto 10% of salary of the employee in the previous year, is allowable as deduction under section 36(1)(iva) while computing business income. Disallowance under section 40A(9) would be attracted only in respect of the amount in excess of 10% of salary. Accordingly, Rs.38,20,000 would be allowed as deduction under section 36(1)(iva) and Rs. 6,80,000 would be disallowed as per section 40A(9).
- iv) The tax of Rs.5,50,000 borne by the employer on non-monetary perquisites provided to the employees is disallowed under section 40(a)(v).

PROBLEM NO. 33

Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for A.Y. 2018-19

Particulars	Rs.
Written down value (WDV) as on 1.4.2017	40,00,000
Add: Addition during the year (used for less than 180 days)	14,40,000
	54,40,000
Depreciation on Rs. 40,00,000 @ 15%	6,00,000
Depreciation on Rs. 14,40,000 @ 7.5%	1,08,000
Total depreciation for the year	7,08,000
Apportionment between two companies:	
a) Amalgamating company, Sai Ltd.	
Rs. 6,00,000 × 275/365	4,52,055
Rs. 1,08,000 × 61/151	43,629
	4,95,684
b) Amalgamated company, Shirdi Ltd.	
Rs. 6,00,000 × 90/365	1,47,945
Rs. 1,08,000 × 90/151	64,371
	2,12,316

Notes:

- i) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.
- ii) The price at which the assets were transferred, i.e., Rs.60 lacs, has no implication in computing eligible depreciation.

THE END