**BBA(Hons) SEMESTER - IV**

**INCOME TAX – LAW AND PRACTICE**

**UNIT 3 INCOME UNDER PROFITS AND GAINS OF BUSINESS AND PROFESSION & INCOME FROM CAPITAL GAIN**

**CHAPTER 6 PROFITS AND GAINS OF BUSINESS AND PROFESSION**

**Meaning of Business and Profession**

* As per Section 2(13), the term “business” is defined to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce of manufacture.
* The term “profession” has not been defined in the Act. It means an occupation requiring some degree of learning. The term profession includes vocation as well.
* For the purpose of this head, business or profession or vocation are treated and taxed in the same manner.

**Conditions for Chargeability/ Taxability under this Head**

1. There should be a business or profession
2. There should be real profits and gains from the business or profession
3. Profits or gains may be of any business or profession (i.e. legal or illegal)
4. The business or profession should be carried on by the assessee
5. The business or profession should be carried during the previous year
6. Income of previous year is taxable during the following assessment year
7. Tax incidence arises in respect of all business or profession (total)
8. Legal and beneficial ownership (i.e. the one actually receiving the income) both shall be chargeable
9. Profits arising only out of trading receipts are taxable as business income, capital receipts are not taxable.

**Income chargeable under this Head [Section 28]**

The following incomes are taxable under this head:

1. Profits and gains of any business or profession;
2. Profits and gains of managing an agency and compensation received for termination or modification of terms of any agency;
3. Income derived by a trade, professional or similar association from rendering specific services to its members;
4. Export incentives available to exporters;
5. The value of any benefit or perquisite arising from business or profession;
6. Any interest, salary, bonus, commission or remuneration received by a partner from the firm;
7. Any amount received for not carrying out certain activity or not to share any know-how, patent, copyright, trademark, etc.;
8. Any sum received under a key-man insurance policy;
9. Income from speculative transactions.

**Method of accounting [Section 145]**

* Income under this head shall be taxable as per the method of accounting regularly used by the assessee (i.e. cash system or mercantile system).
* While computing income under this head, every assessee is required to follow the ***“Income Computation and Disclosure Standards”*** notified by the Central Government.

**Expenses which are expressly allowed as deductions [Section 30 to 37]**

* Rent, rates, taxes, repairs and insurance of buildings used for business.
* Repairs and insurance of machinery, plant and furniture used for business.
* Depreciation [explained later]
* Expenditure on Scientific Research [Section 35]

Capital expenditure would be deductible in full in the previous year in which it is incurred. [No depreciation would be allowed as deduction].

Revenue expenditure and donation given to outsider approved university/ research centre is allowed @ 100% of amount incurred/donated.

* Amortisation of Preliminary Expenses [Section 35D]

Companies shall be allowed to amortise their preliminary expenses over a period of 5 consecutive years, starting from the year of incorporation.

The maximum eligible amount is either 5% of cost of project or 5% of capital employed [at the option of the assessee].

* Other Deductions [Section 36]
* Insurance premium on insurance policy taken against loss of stock
* Insurance premium paid for health insurance of employees
* Bonus and commission
* Interest on borrowed capital
* Contribution to employee’s Provident, Superannuation and Gratuity fund
* Contribution to employee’s Pension fund referred to in Section 80CCD
* Bad debts
* Securities Transaction Tax paid
* Commodities Transaction Tax paid [*for commodity derivatives*]

**Depreciation [Section 32]**

* Depreciation is an admissible expense, when the following conditions are satisfied:
* Asset should be owned by the assessee
* The asset must be used for the purpose of the business during the previous year.
* Depreciation is available as per **written down value method**. [For entities engaged in generation or distribution of power, straight line method is permitted].
* Depreciation is allowed on the block of assets. [i.e. all the assets of similar nature are shown together as one figure and depreciation is calculated on it].
* The percentage of depreciation on different assets is as under:

|  |  |  |
| --- | --- | --- |
| **Buildings** | | |
| Block 1 | Residential building | 5% |
| Block 2 | Other buildings | 10% |
| Block 3 | Purely temporary constructions | 40% |
| **Furniture and Fittings** | | |
| Block 1 | Furniture and fittings, including electrical fittings | 10% |
| **Plant & Machinery** | | |
| Block 1 | Motor buses, motor taxis | 30% |
| Block 2 | Aeroplanes | 40% |
| Block 3 | Specified air, water pollution control equipments | 40% |
| Block 4 | Computers including computer software | 40% |
| Block 5 | Annual publications owned by professionals/ Books owned by libraries | 40% |
| Block 6 | Plant and machinery | 15% |
| **Intangible Assets** | | |
| Block 1 | Patent, copyright, trademark, licences, franchises | 25% |

* If the asset is acquired in the previous year and is put to use for less than 180 days **[i.e. on or after 03/10/22]**, depreciation is allowed at **50% of the *specified rate***.

*Illustration 1:*

A business has following assets (book value as on 01/04/20):

Residential building Rs. 10,00,000

Commercial building Rs. 20,00,000

(includes land worth Rs. 2 lakhs)

Furniture Rs. 50,000

Electrical installations Rs. 5000

Motor Bus Rs. 80,000

Plant and Machine Rs. 1,00,000

Computer Rs. 40,000

Tally software Rs. 10,000

Franchise Rs. 50,000

Further, the following assets were purchased during the year (date is the date of purchase):

Office (super structure value) Rs. 25,00,000 01/07/20

Air pollution control equipment Rs. 50,00,000 14/09/20

Pollution control equipment is put to use on 03/12/20.

Calculate admissible depreciation as per the Income-tax Act.

[Solution: Rs. 30,87,000]

*Illustration 2:*

Z Ltd. owns two commercial buildings Atlanta and Atlantis. Total book value is Rs. 14,15,700. A new commercial building Atlas is purchased on 14/02/21 for Rs. 3,10,000 and Atlanta is sold on 14/01/21 for Rs. 8,70,000. Calculate admissible depreciation for A.Y. 2021-22.

STATEMENT SHOWING COMPUTATION OF DEPRECIATION (INCOME TAX)

BLOCK 1 : BUILDING (10%) [PY 20-21/AY 21-22]

|  |  |  |
| --- | --- | --- |
| Date | Particulars | Rs |
| 1/04/20 | Opening WDV | 14,15,700 |
| 20-21 | ADDITION |  |
|  | ‘- PURCHASE OF ATLAS (HALF RATE) | 3,10,000 |
|  | OPENING + ADDITION | 17,25,700 |
| 20-21 | SOLD |  |
|  | ‘- SALE OF ATLANTA | (8,70,000) |
| 31/03/21 | CLOSING WDV | 8,55,700 |
| 20-21 | DEPRECIATION  HALF RATE [3,10,000\*5%]  FULL RATE [(855700-310000)\*10%] | (70,070) |
| 1/04/21 | OPENING WDV | 7,85,630 |

[Solution: Rs. 70,070 (half on Atlas and full on remaining value)]

**Inadmissible Deductions [Section 40]**

* Tax paid on perquisites on behalf of employees [Section 40(a)(v)].
* Any **salary, bonus, commission, remuneration** paid by firm or LLP to a **non-working partner** [Section 40(b)].
* **Interest** paid by firm or LLP to its partner above **12% p.a.** (simple interest) [Section 40(b)].
* Remuneration paid by firm or LLP to its partner above the following limits [Section 40(b)(v)]:

|  |  |
| --- | --- |
| Book Profits | Quantum of Deduction |
| On the **first Rs. 3 lakhs** of book profit or in case of loss | Higher of-  Rs. 1,50,000 or 90% of book profit |
| On the **balance book profit** | 60% of book profit |

*Illustration 3:*

A firm has paid Rs. **7,50,000** as remuneration to it partners for P.Y. 2021-22. Its book profit is Rs. 10,00,000. What amount of remuneration is allowable as deduction and how much is disallowed?

ON FIRST 3L = 270000

BALANCE 7L= 420000

**690000**

[Solution: Rs. 6,90,000 and **Rs. 60,000disallowed**]

* Payment made to relatives or associate concerns in excess of reasonable market price [Section 40A(2)].
* Payment othertwise than by way of an account payee cheque or account payee draft (i.e. by cash or by bearer cheque) in excess of Rs. 20,000 to one person in one day. [Section 40A(3)].

However, payments made to government or banks are allowed without any limit [Rule 6DD].

**Deemed Profits and Incomes [Section 41]**

* Bad debt recovered

**Deductions allowed only on Payment basis [Section 43B]**

* Any tax, duty, cess, fee payable under any law
* Any sum payable to employee’s provident, superannuation or gratuity fund(EMPLOYERS CONTRIBUTION TO PF)
* Bonus or commission payable to employees
* Interest on loan taken from banks or state financial corporations
* Any sum of leave encashment payable to employee
* Any sum payable to Indian Railway for use of assets of Railway.

**Maintenance of books of accounts [SEC 44AA]**

* Every assessee having **business income** of Rs 1,20,000/- or more or Turnover of Rs 10,00,000 or more should maintain his books of accounts.
* Such books of account should be preserved for minimum 6 years from the end of relevant assessment year. *[i.e. total 7 years from end of financial year]*.
* Such books of account should be kept at the principal place of business.

HOW TO COMPUTE PROFITS AND GAINS FROM BUSINESS AND PROFESSION

|  |  |  |
| --- | --- | --- |
| PARTICULARS | RS | RS |
| Net Profit as per Profit and Loss Account |  | Xx |
| Add: |  |  |
| 1. Expenses which are not allowed in Income Tax | XX |  |
| 1. Income which is not recorded in P&L A/c | XX | XX |
|  |  | XX |
| Less: |  |  |
| 1. Expenses allowed in Income tax but not debited in P&L A/c | (XX) |  |
| 1. Income credited to P&L A/c but not taxable under the head PGBP | (XX) | (XX) |
| PGBP (Taxable Business Income) |  | XX |

1. Only business-related expenses can be debited to P&L A/c. Personal expenses cannot be debited to P&L A/c;
2. Capital expenses cannot be debited. Only revenue expenses can be debited.
3. Depreciation on assets is allowed as per sec. 32 of the Income Tax Act,1961.
4. **Any expenditure** exceeding Rs 10000 (Rs 35000 for freight) in **a day** to **a person** is allowed only of the same is paid by-

a) A/c payee cheque

b) A/c payee draft

c) ECS through bank

d) debit-credit card

e)BHIM pay

f) UPI pay

g) Internet banking

h) Any banking channel

In other words, payment in respect of an expenditure in cash/ bearer cheque/ crossed draft is not allowed if the amount is exceeding Rs 10000 in a day

1. Excessive or unreasonable payment to relative is disallowed.
2. Following payments are allowed only if they are paid before the due date of filing return of income u/s 139(1) i.e. 31st July/ 31st October of the Assessment Year:
3. Bonus or commission to employees
4. Taxes, duties or cess payable to Govt.
5. Interest on loan payable to Financial Institution
6. Employer’s contribution to Provident Fund
7. Leave salary/ other retirement benefits to employees
8. Amount payable to Indian Railways for using railway assets.
9. Scientific research expenses or donation for scientific research is allowed @ 100%.
10. Provision for baddebt, provision for taxation or any other provision is not allowed as deduction. Actual baddebt or expense is allowed as deduction if they are written off in the books of accounts.
11. Taxes are allowed as follows-
12. Income Tax – Not allowed
13. Interest on Income tax – Not allowed
14. Penalty under Income tax – Not allowed
15. GST/Customs duty – Allowed
16. Interest on GST/Customs duty – Allowed
17. Penalty in GST/Customs duty/ any other law – Not allowed
18. Interest on loan to partner by partnership firm is allowed maximum upto 12% p.a. (simple interest)