

# PROFITS AND GAINS OF BUSINESS OR PROFESSION



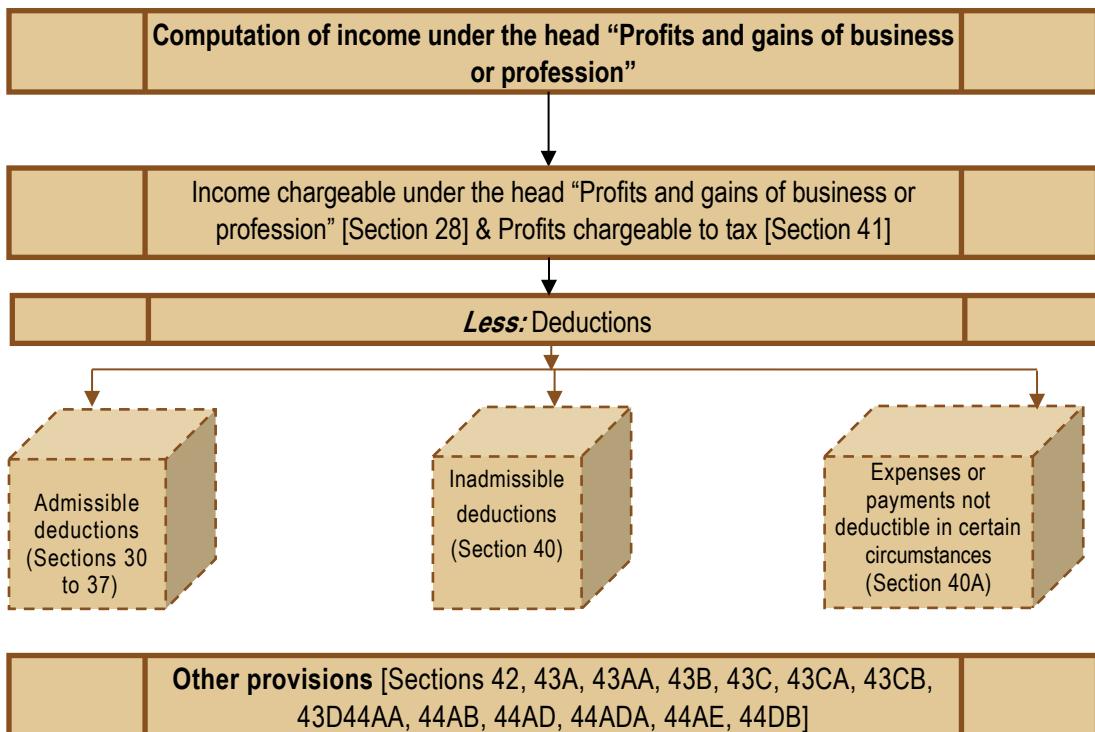
## LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **examine** whether a particular income would be chargeable to tax under the head “Profits and gains of business or profession” by analysing the provisions of section 28;
- **comprehend** the “Income Computation and Disclosure Standards” (ICDSs) and analyse and apply these standards to determine the income chargeable to tax under this head;
- **analyse and apply** the provisions of sections 30 to 37 to determine whether any particular expenditure /payment would be admissible as deduction while computing income under this head;
- **analyse and apply** the conditions contained under sections 40 & 40A to determine whether a particular expenditure/ payment would be admissible/ inadmissible as deduction while computing income under this head;
- **analyse and apply** the provisions of section 43B to allow/ disallow expenditures specified therein, in respect of which deduction is admissible only on actual payment;
- **examine** when certain receipts are deemed as income chargeable to tax under this head;

- **appreciate** the provisions of section 44AA relating to maintenance of books of account and identify the assessees, who are compulsorily required to maintain books of account;
- **appreciate** the provisions of section 44AB, listing the circumstances when an assessee is compulsorily required to get the books of account audited under Income-tax Act, 1961;
- **examine** the presumptive tax provisions contained in sections 44AD, 44ADA & 44AE to determine whether an assessee engaged in a business, profession or plying, hiring or leasing goods carriages can opt for such presumptive taxation schemes;
- **compute** income under this head applying the charging and deeming provisions, allowing the permissible deductions and disallowing the impermissible deductions.

## CHAPTER OVERVIEW



### 3.1 MEANING OF 'BUSINESS' AND 'PROFESSION'

The income chargeable to tax under this head is in respect of the profits and gains of **any business or profession**, carried on by an assessee at any time during the previous year.

Business	Profession
The term " <b>business</b> " has been defined in section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture".	The term " <b>profession</b> " has not been defined in the Act. It means an occupation requiring some degree of learning. The term 'profession' includes vocation as well [Section 2(36)]
<ul style="list-style-type: none"> <li>Thus, a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and even an astrologer are persons who can be said to be carrying on a profession but not business.</li> </ul>	

- It is, however, not material whether a person is carrying on a ‘business’ or ‘profession’ or ‘vocation’ since for purposes of assessment, profits from all these sources are treated and taxed alike (except in case of tax audit and presumptive income provisions, where the rates and threshold limits are different for business and profession).
- Business necessarily means a continuous exercise of an activity with a profit motive; nevertheless, profit from a single venture in the nature of trade may also be treated as business.

### Meaning of ‘Profits’

- (1) **Profits in cash or in kind:** Profits may be realised in money or in money’s worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind.
- (2) **Capital receipts:** Capital receipts are not generally to be taken into account while computing profits under this head.
- (3) **Voluntary Receipts:** Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer’s professional service to another would be assessable as the lawyer’s income.
- (4) **Application of the gains of trade is immaterial:** Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily by the assessee-owner personally, but it should be under his direction and control.
- (5) **Income from distinct businesses:** The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the business carried on by the assessee.
- (6) **Computation of profits:** Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act. The charge is not on the gross receipts but on the profits and gains.

- (7) **Legality of income:** The illegality of a business, profession or vocation does not exempt its profits from tax. The revenue is not concerned with the taint of illegality in the income or its source. Thus, income tax is not restricted in its application to lawful business only.

However, expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law would not be allowable as deduction while computing profits of such business.



## 3.2 INCOME CHARGEABLE UNDER THIS HEAD [SECTION 28]

The various items of income chargeable to tax as income under the head 'profits and gains of business or profession' are as under:

- (1) **Income from business, profession or vocation:** Income arising to any person by way of profits and gains from the business or profession carried on by him at any time during the previous year.

However, income from letting out of a residential house or a part of the house by the owner is chargeable to tax under the head "Income from house property" and not under the head "Profits and gains of business or profession".

- (2) **Any compensation or other payment due to or received by:**

- (i) Any person, by whatever name called, managing the whole or substantially the whole of -  
(a) the affairs of an Indian company or  
(b) the affairs in India of any other company

at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;

- (ii) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto;

- (iii) any person, for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business;

- (iv) any person, by whatever name called, at or in connection with the termination or modification of the terms and conditions, of any contract relating to his business.
- (3) Income from specific services performed for its members by a trade, professional or business:** Income derived by any trade, professional or similar associations from specific services rendered by them to their members. It may be noted that this forms an exception to the general principle of mutuality governing the assessment of income of mutual associations such as chambers of commerce, stock brokers' associations etc.
- As a result, a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the income received by the association should definitely or directly be related to these services.
- (4) Incentives received or receivable by assessee carrying on export business:**
- (i) **Profit on sale of import entitlements:** Profits on sale of a licence granted under the Imports (Control) Order, 1955<sup>1</sup> made under the Imports and Exports (Control) Act, 1947<sup>2</sup>.
  - (ii) **Cash assistance against exports under any scheme of GoI:** Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.
  - (iii) **Customs duty or excise duty re-paid or repayable as drawback:** Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971<sup>3</sup>.
  - (iv) **Profit on transfer of Duty Entitlement Pass Book Scheme or Duty Free Replenishment Certificate:** Any profit on the transfer of the Duty Entitlement Pass Book Scheme<sup>4</sup> or Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

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<sup>1</sup> Now Foreign Trade (Exemption from application of Rules in certain cases) Order, 1993

<sup>2</sup> Now Foreign Trade (Development and Regulation) Act, 1992

<sup>3</sup> Now Customs and Central Excise Duties Drawback Rules, 2017

<sup>4</sup> The pre-export DEPB scheme was abolished with effect from 1 April 2000. After several extensions through the years, the post-export scheme was phased out on 30 September 2011 and thereafter DEPB items were incorporated into the Duty Drawback Schedule with effect from 1 October 2011

- (5) **Value of any benefit or perquisite:** The value of any benefit or perquisite arising from business or the exercise of any profession, whether –

- convertible into money or not or
- in cash or in kind or partly in cash and partly in kind

**Example:**

*If a company provides rent free residential accommodation to a lawyer in consideration of professional services rendered by him to the company, the value of such accommodation would be assessable in the hands of the said lawyer as his income under the head “Profits and gains or business or profession”.*

- (6) **Sum due to, or received by, a partner of a firm:** Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business. However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b), in the computation of the income of the firm the income to be taxed shall be adjusted to the extent of the amount disallowed.

**Example:**

*Suppose a firm pays interest at 20% p.a. simple interest to a partner. The allowable rate of interest is 12% p.a. Hence, the excess 8% paid will be disallowed in the hands of the firm. Since the excess interest has suffered tax in the hands of the firm due to disallowance, the same will not be taxed in the hands of the partner. However, the interest allowed to the extent of 12% p.a. in the hands of firm will be taxed in the hands of partner.*

**Exemption of share income of a partner [Section 10(2A)]**

Section 10(2A) exempts from tax a partner's share in the total income of the firm. In other words, the partner's share in the total income of the firm determined in accordance with the profit-sharing ratio will be exempt from tax.

- (7) **Any sum whether received or receivable, in cash or kind, under an agreement**

- (i) **for not carrying out any activity** in relation to any business or profession; or

**However, the following sums received or receivable would not be chargeable to tax under the head “profits and gains from business or profession”:**

- (a) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or

right to carry on any business or profession, which is chargeable under the head "Capital gains".

- (b) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

- (ii) **for not sharing** any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

#### Meaning of certain terms

Term	Meaning
<b>Agreement</b>	Includes any arrangement or understanding or action in concert, - <ul style="list-style-type: none"> <li>(A) whether or not such arrangement, understanding or action is formal or in writing; or</li> <li>(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;</li> </ul>
<b>Service</b>	Service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

- (8) **Any sum received under a Keyman insurance policy:** Any sum received by the assessee, as an employer, under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business.
- (9) **Fair market value of inventory on its conversion as capital asset:** Fair market value of inventory on the date of its conversion or treatment as capital asset, determined in the prescribed manner, would be chargeable to tax as business income<sup>5</sup>.

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<sup>5</sup> Rule 11UAB inserted to prescribe the manner of determination of fair market value (FMV) of the inventory on the date of conversion. For detailed reading of 11UAB of the Income-tax Rules, 1962, refer to Annexure 2 at the end of this module.

- (10) Sum received on account of capital asset referred under section 35AD:** Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD) being demolished, destroyed, discarded or transferred.

**Note** - Where a specified person, being a partner of a firm or member of other AOP/Bol, receives during the P.Y. any stock in trade from a specified entity, being a firm or other AOP/Bol in connection with the dissolution or reconstitution of such specified entity, then, the specified entity would be deemed to have transferred such stock in trade to the specified person in the year in which it is received by the specified person. Profit and gains arising from such deemed transfer would be deemed to be the income of such specified entity in the same year of receipt by specified person and chargeable to income-tax under the "Profit and gains of business or profession" [Section 9B]. For detailed discussion on section 9B, refer Chapter 4 – "Capital Gains".



### 3.3 SPECULATION BUSINESS

Explanation 2 to section 28 specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business.

Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculative business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from profits and gains of business and profession from any other business.

#### (1) Meaning of Speculative Transaction

**"Speculative transaction"** means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips [Section 43(5)].

Where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply to the following companies –

- (i) A company whose gross total income consists of mainly income chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources”;
- (ii) A company, the principal business of which is –
  - (a) the business of trading in shares; or
  - (b) the business of banking; or
  - (c) the granting of loans and advances.

Accordingly, if these companies as mentioned above carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business [*Explanation to section 73*].

## **(2) Transaction not deemed to be speculative transaction**

The following forms of transactions shall not be deemed to be speculative transaction:

- (i) **Hedging contract in respect of raw materials or merchandise:** A contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him; or
- (ii) **Hedging contract in respect of stocks and shares:** A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation; or
- (iii) **Forward contract:** A contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or
- (iv) **Trading in derivatives:** An eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange.

**Meaning of certain terms**

Term	Meaning
<b>Eligible transaction</b>	<p>Any transaction,—</p> <p>(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and</p> <p>(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note, the unique client identity number allotted under any Act referred to in (A) above and permanent account number;</p>

- (v) **Trading in commodity derivatives:** An eligible transaction in respect of trading in commodity derivatives carried out in a recognised stock exchange, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013.

However, the requirement of chargeability of commodities transaction tax is not applicable in respect of trading in agricultural commodity derivatives.

**Meaning of certain terms**

Term	Meaning
<b>Eligible transaction</b>	<p>Any transaction,—</p> <p>(A) carried out electronically on screen-based systems through a member or an intermediary registered under the bye-laws, rules and regulations of the recognised stock exchange for trading in commodity derivative in accordance with the provisions of the Forward Contracts (Regulation) Act, 1952 and the rules, regulations or bye-laws made or directions issued under that Act on a recognised stock exchange; and</p> <p>(B) which is supported by a time stamped contract note issued by such member or an intermediary to every client indicating in the contract note, the unique client identity number allotted under the Act, rules, regulations or bye-laws referred to in (A) above, unique trade number and permanent account number</p>



## 3.4 METHOD OF ACCOUNTING

### (1) Method of Accounting (Section 145)

Section 145 of the Income-tax Act, 1961 provides for the method of accounting. Section 145(1) requires income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” to be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee, subject to the provisions of section 145(2).

However, as per section 145B, certain income would be taxable in the following manner:

- (i) interest received by an assessee on compensation or on enhanced compensation, shall be deemed to be the income of the year in which it is received. [Such income is taxable under the head “Income from other sources”]
- (ii) the claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.
- (iii) income referred to in section 2(24)(xviii) i.e., assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement, by whatever name called, by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Under section 145(2), the Central Government is empowered to notify in the Official Gazette from time to time, **income computation and disclosure standards (ICDSs)** to be followed by any class of assessees or in respect of any class of income.

Accordingly, the Central Government has, vide *Notification No. S.O.3079(E)* dated 29.9.2016, notified ten ICDSs to be applicable from A.Y.2017-18.

The notified ICDSs have to be followed by all assessees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head “Profits and gains of business or profession” or “Income from other sources”, from A.Y.2017-18.

The ten notified ICDSs are:

- ICDS I : Accounting Policies
- ICDS II : Valuation of Inventories
- ICDS III : Construction Contracts
- ICDS IV : Revenue Recognition
- ICDS V : Tangible Fixed Assets
- ICDS VI : The Effects of Changes in Foreign Exchange Rates
- ICDS VII : Government Grants
- ICDS VIII : Securities
- ICDS IX : Borrowing Costs
- ICDS X : Provisions, Contingent Liabilities and Contingent Assets

### Cardinal features of Notified ICDSs

- (1) **Applicability:** All the notified ICDSs are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of accounts. This is stated in the Preamble at the beginning of each ICDS.
- (2) **Position in case of conflict with the Income-tax Act, 1961:** In the case of conflict between the provisions of the Income-tax Act, 1961 and the notified ICDSs, the provisions of the Act shall prevail to that extent. This is also stated in the Preamble at the beginning of each ICDS.
- (3) **Scope Paragraph:** Each of the ten notified ICDSs has a scope paragraph explaining what exactly the ICDS deals with. In some standards, the scope paragraph also specifies what the ICDS does not deal with.
- (4) **Transitional Provisions:** All ICDSs (except ICDS VIII on Securities) contain transitional provisions to facilitate first time adoption and prevent any tax leakage or any double taxation.
- (5) **Disclosure Requirements:** All ICDSs (except ICDS VI on Effects of changes in foreign exchange rates and ICDS VIII on Securities) contain specific disclosure requirements. The last paragraph(s) of these ICDSs is on disclosure.

**Salient Features of the notified ICDSs****ICDS I: Accounting Policies**

- This ICDS deals with significant accounting policies.
- While it recognizes the fundamental accounting assumptions of going concern, consistency and accrual, it does not recognize the concepts of "materiality" and "prudence" in selection of accounting policies.
- Treatment and presentation of transactions have to be governed by their substance and not merely by the legal form.
- Marked to market loss or an expected loss is not to be recognized unless recognition of such loss is in accordance with the provisions of any other ICDS.

**ICDS II: Valuation of Inventories**

- "Inventories" has been defined to mean assets held for –
  - sale in the ordinary course of business;
  - in the process of production for such sale;
  - in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- This ICDS requires inventory to be valued at cost or net realizable value, whichever is lower.
- This ICDS requires disclosure of the accounting policies adopted in measuring inventories including the cost formulae used and the total carrying amount of inventories and its classification appropriate to a person.

**ICDS III: Construction Contracts**

- This ICDS is required to be applied in determination of income for a construction contract of a contractor.
- It recognizes percentage of completion method (POCM) for recognizing contract revenue and contract costs associated with a construction contract.
- However, contract revenue and contract costs associated with the construction contract, which commenced on or before 31.3.2016 but not completed by the said date, can be recognised based on the method regularly followed by the person prior to the previous year 2016-17.

- This ICDS also contains certain disclosure requirements, like the amount of contract revenue recognized as revenue in the period, the methods used to determine the stage of completion of contracts in progress etc.

#### **[ICDS IV: Revenue Recognition]**

- This ICDS deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from –
  - the sale of goods;
  - the rendering of services;
  - the use by others of the person's resources yielding interest, royalties or dividends.
- It does not, however, deal with the aspects of revenue recognition which are dealt with by other ICDSs.
- "Revenue" is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.
- This ICDS also contains a provision wherein the revenue from sale of goods could be recognized when there is reasonable certainty of its ultimate collection.
- Revenue from service transactions is required to be recognized on the basis of percentage completion method. However, revenue can be recognised on a straight line basis over a specific period of time, when services are provided by an indeterminate number of acts over such period.
- Revenue from service contracts with duration of not more than 90 days to be recognised when the rendering of services under that contract is completed or substantially completed.
- This ICDS contains certain disclosure requirements, like the amount of revenue from service transactions recognized as revenue during the previous year, the method used to determine the stage of completion of service transactions in progress, information relating to service transactions in progress at the end of the previous year etc.

#### **[ICDS V: Tangible Fixed Assets]**

- This ICDS deals with the treatment of tangible fixed assets.

- "Tangible fixed asset" is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.
- This ICDS provides the components of actual cost of such assets and valuation of such assets in special cases.
- The fair value of a tangible fixed asset acquired in exchange for shares or other securities or another asset shall be its actual cost.
- The ICDS also provides that depreciation on such assets and income arising on transfer of such assets shall be computed in accordance with the provisions of the Income-tax Act, 1961.
- The ICDS also contains disclosure requirements in respect of such assets, like the description of asset or block of assets, rate of depreciation, actual cost or written down value, as the case may be, additions or deductions during the year with dates, depreciation allowable and written down value at the end of the year.

**[ICDS VI: The Effects of changes in foreign exchange rates]**

- This ICDS deals with treatment of transactions in foreign currencies, translating the financial statements of foreign operations and treatment of foreign currency transactions in the nature of forward exchange contracts.
- This ICDS requires exchange differences arising on settlement of monetary items or conversion thereof at last day of the previous year to be recognized as income or as expense in that previous year.
- In respect of non-monetary items, exchange differences arising on conversion thereof as at the last day of the previous year shall not be recognized as income or as expense in that previous year.
- At the last day of each previous year, foreign currency monetary items shall be converted into reporting currency by applying the closing rate.
- Non-monetary items in a foreign currency shall be converted into reporting currency by using the exchange rate at the date of the transaction.
- Non-monetary item being inventory which is carried at net realisable value denominated in a foreign currency shall be reported using the exchange rate that existed when such value was determined.

- The ICDS contains provisions for initial recognition, conversion at the last date of the previous year and recognition of exchange differences. These provisions shall be subject to the provisions of section 43A of the Income-tax Act, 1961 and Rule 115 of the Income-tax Rules, 1962.

#### **ICDS VII: Government Grants**

- This ICDS deals with the treatment of government grants. It recognizes that government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks etc.
- This ICDS does not deal with Government assistance other than in the form of Government grants and Government participation in the ownership of the enterprise.
- It requires recognition of Government Grants when there is a reasonable assurance that the person shall comply with the conditions attached to them and the grants shall be received. However, it also states that recognition of Government grant shall not be postponed beyond the date of actual receipt.
- This ICDS requires Government grants relatable to depreciable fixed assets to be reduced from actual cost/WDV. It further provides that where the Government grant is not directly relatable to the asset acquired, then a pro-rata reduction of the amount of grant should be made in the same proportion as such asset bears to all assets with reference to which the Government grant is so received.
- The standard requires grants relating to non-depreciable fixed assets to be recognized as income over the same period over which the cost of meeting such obligations is charged to income.
- The standard also requires Government grants receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs to be recognized as income of the period in which it is receivable.
- All other Government Grants have to be recognized as income over the periods necessary to match them with the related costs which they are intended to compensate.
- The standard contains certain disclosure requirements, like nature and extent of Government grants recognized during the previous year as income, nature and extent of Government grants not recognized during the previous year as income and reasons thereof etc.

**ICDS VIII: Securities**

- This ICDS deals with securities.
- There are two parts. Part A deals with securities held as stock-in-trade. Part B deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 or the Companies Act, 2013.
- It requires securities (referred to in Part A) to be recognized at actual cost on acquisition, which shall comprise of its purchase price and include acquisition charges like brokerage, fees, tax, duty or cess.
- The actual cost of a security (referred to in Part A) acquired in exchange for other securities or another asset shall be the fair value of the security so acquired.
- Subsequently, at the end of any previous year, securities held as stock-in-trade have to be valued at actual cost initially recognized or net realizable value at the end of that previous year, whichever is lower.
- It goes on to provide that such comparison of actual cost initially recognized and net realizable value has to be done category-wise and not for each individual security.
- Where actual cost initially recognized cannot be ascertained by reference to specific identification, use of "First in First Out" method or "Weighted Average Cost" formula is permitted for subsequent measurement of securities held as stock-in-trade (other than unlisted or unquoted securities) referred to in Part A.
- Securities referred to in Part B to be classified, recognised and measured in accordance with the extant guidelines issued by the RBI in this regard. Any claim for deduction in excess of the said guidelines will not be taken into account. To this extent, the provisions of ICDS VI on the effect of changes in foreign exchange rates relating to forward exchange contracts would not apply.

**ICDS IX: Borrowing Costs**

- This ICDS deals with the treatment of borrowing costs. It does not deal with the actual or imputed cost of owners' equity and preference share capital.
- It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset. Other borrowing costs have to be recognized in accordance with the provisions of the Act.
- Qualifying asset has been defined to mean –
  - land, building, machinery, plant or furniture, being tangible assets;

- know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.
- This ICDS requires capitalization of specific borrowing costs and general borrowing costs.
- This ICDS provides the formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset.
- For the purpose of computing the amount of borrowing costs to be capitalized, in a case where the funds are not borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, a qualifying asset would be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production.
- It also provides as to when capitalization of borrowing costs would commence and cease.
- It requires disclosure of the accounting policy adopted for borrowing costs and the amount of borrowing costs capitalized during the year.

**ICDS X: Provisions, Contingent Liabilities and Contingent Assets**

- This ICDS deals with Provisions, Contingent Liabilities and Contingent Assets. However, it does not deal with provisions, contingent liabilities and contingent assets –
  - resulting from financial instruments,
  - resulting from executory contracts,
  - arising in insurance business from contracts with policyholders and
  - covered by another ICDS.
- It also does not deal with recognition of revenue dealt with by ICDS on Revenue Recognition.
- The ICDS specifies the conditions for recognition of a provision, namely, existence of a present obligation as a result of a past event, reasonable certainty that outflow of resources embodying economic benefits will be required to settle the obligation and making a reliable estimate of the amount of the obligation.

- It provides that a person shall not recognize a contingent liability or a contingent asset. However, it requires contingent assets to be assessed continually. When it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income have to be recognized in the previous year in which the change occurs.
- It contains provisions for measurement and review of a provision and asset and related income.
- It also provides that a provision shall be used only for expenditures for which the provision was originally recognized.
- The ICDS also contains specific disclosure requirements in respect of each class of provision, asset and related income recognized.

**Clarification on Income Computation and Disclosure Standards (ICDS) notified under section 145(2) of the Income-tax Act, 1961 – [Circular No. 10/2017, dated 23-03-2017]**

After notification of ICDS, it was brought to the notice of the CBDT by the stakeholders that certain provisions of ICDS may require amendment/ clarification for proper implementation. The matter was referred to an expert committee. The Committee after duly consulting the stakeholders in this regard has recommended a two-fold approach for the smooth implementation of ICDS i.e., amendment to the provisions of ICDS in respect of certain issues and issuance of clarifications by way of FAQs for the rest of issues.

The CBDT has, vide this circular, issued the following clarification on other issues:

**Question 1:** Preamble of ICDS I states that this ICDS is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purposes of maintenance of books of account. However, Para 1 of ICDS I states that it deals with significant accounting policies. Accounting policies are applied for maintenance of books of accounts and preparing financial statements. What is the interplay between ICDS I and maintenance of books of accounts?

**Answer:** As stated in the Preamble, ICDS is not meant for maintenance of books of accounts or preparing financial statements. Persons are required to maintain books of accounts and prepare financial statements as per accounting policies applicable to them. For example, companies are required to maintain books of account and prepare financial statements as per requirements of Companies Act, 2013. The accounting policies mentioned in ICDS-I being fundamental in nature shall be applicable for computing income under the heads "Profits and gains of business or profession" or "Income from other sources".

**Question 2:** Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?

**Answer:** The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years.

**Question 3:** Does ICDS apply to non-corporate taxpayers who are not required to maintain books of account and/or those who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc. of the Act?

**Answer:** ICDS is applicable to specified persons having income chargeable under the head 'Profits and gains of business or profession' or 'Income from other sources'. Therefore, the relevant provisions of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. For example, for computing presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.

**Question 4:** If there is conflict between ICDS and other specific provisions of the Income-tax Rules, 1962 governing taxation of income like rules 9A, 9B etc. of the Rules, which provisions shall prevail?

**Answer:** ICDS provides general principles for computation of income. In case of conflict, if any, between the provisions of Rules and ICDS, the provisions of Rules, which deal with specific circumstances, shall prevail.

**Question 5:** ICDS is framed on the basis of accounting standards notified by Ministry of Corporate Affairs (MCA) vide Notification No. GSR 739(E) dated 7<sup>th</sup> December, 2006 under section 211(3C) of erstwhile Companies Act 1956. However, MCA has notified in February, 2015 a new set of standards called 'Indian Accounting Standards' (Ind-AS). How will ICDS apply to companies which adopted Ind-AS?

**Answer:** ICDS shall apply for computation of taxable income under the head "Profit and gains of business or profession" or "Income from other sources" under the Income-tax Act. This is irrespective of the accounting standards adopted by companies i.e. either Accounting Standards or Ind-AS.

**Question 6:** Whether ICDS shall apply to computation of Minimum Alternate Tax (MAT) under section 115JB of the Act or Alternate Minimum Tax (AMT) under section 115JC of the Act?

**Answer:** MAT under section 115JB of the Act is computed on 'book profit' that is net profit as shown in the Profit and Loss Account prepared under the Companies Act subject to certain specified adjustments. Since, the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, the provisions of ICDS shall not apply for computation of MAT.

AMT under section 115JC of the Act is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act. Hence, the provisions of ICDS shall apply for computation of AMT.

**Question 7:** Whether the provisions of ICDS shall apply to Banks, Non-banking financial institutions, Insurance companies, Power sector etc.?

**Answer:** The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. For example, ICDS VIII contains specific provisions for banks and certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business.

**Question 8:** Para 4(ii) of ICDS-1 provides that Mark to Market (MTM) loss or an expected loss shall not be recognized unless the recognition is in accordance with the provisions of any other ICDS. Whether similar consideration applies to recognition of MTM gain or expected incomes?

**Answer:** Same principle as contained in ICDS-I relating to MTM losses or an expected loss shall apply *mutatis mutandis* to MTM gains or an expected profit.

**Question 9:** ICDS-1 provides that an accounting policy shall not be changed without 'reasonable cause'. The term 'reasonable cause' is not defined. What shall constitute 'reasonable cause'?

**Answer:** Under the Act, 'reasonable cause' is an existing concept and has evolved well over a period of time conferring desired flexibility to the tax payer in deserving cases.

**Question 10:** Which ICDS would govern derivative instruments?

**Answer:** ICDS -VI (subject to para 3 of ICDS-III) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts. For derivatives, not within the scope of ICDS-VI, provisions of ICDS-1 would apply.

**Question 12:** Since there is no specific scope exclusion for real estate developers and Build - Operate-Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether

*ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.*

**Answer:** At present, there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

**Question 13:** *The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even when the collection thereof is uncertain?*

**Answer:** As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non-recovery in either cases can be claimed as deduction in view of amendment to section 36(1)(vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS.

**Question 14:** *Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s 115A of the Act.*

**Answer:** Yes, the provisions of ICDS, also apply for computation of these incomes on gross basis for arriving at the amount chargeable to tax.

**Question 15:** *Para 8 of ICDS-V states expenditure incurred on commissioning of project, including expenditure incurred on test runs and experimental production shall be capitalized. It also states that expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption shall be treated as revenue expenditure. What shall be the treatment of expense incurred after the conduct of test runs and experimental production but before commencement of commercial production?*

**Answer:** As clarified in Para 8 of ICDS-V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure.

**Question 18:** *If the taxpayer sells a security on 30<sup>th</sup> April 2025. The interest payment dates are December and June. The actual date of receipt of interest is on 30<sup>th</sup> June 2025 but the interest on accrual basis has been accounted as income on 31st March 2025. Whether the taxpayer shall be permitted to claim deduction of such interest i.e. offered to tax but not received while computing the capital gain?*

**Answer:** Yes, the amount already taxed as interest income on accrual basis shall be taken into account for computation of income arising from such sale.

**Question 19:** Para 9 of ICDS-VIII on securities requires securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value (NRV) at the end of that previous year, whichever is lower. Para 10 of Part-A of ICDS-VIII requires the said exercise to be carried out category wise. How the same shall be computed?

**Answer:** For subsequent measurement of securities held as stock-in-trade, the securities are first aggregated category wise. The aggregate cost and NRV of each category of security are compared and the lower of the two is to be taken as carrying value as per ICDS-VIII. This is illustrated below –

Security	Category	Cost	NRV	Lower of cost or NRV	ICDS Value
A	Share	100	75	75	535
B	Share	120	150	120	
C	Share	140	120	120	
D	Share	200	190	190	
<b>Total</b>		<b>560</b>	<b>535</b>	<b>505</b>	
E	Debt Security	150	160	150	600
F	Debt Security	105	90	90	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
<b>Total</b>		<b>600</b>	<b>615</b>	<b>585</b>	<b>600</b>
<b>Securities Total</b>		<b>1160</b>	<b>1150</b>	<b>1090</b>	<b>1135</b>

**Question 20:** There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a)(i), 40(a)(ia), 40A(2)(b), etc. of the Act. Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under such specific provisions?

**Answer:** Since specific provisions of the Act override the provisions of ICDS, it is clarified that borrowing costs to be considered for capitalization under ICDS IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act.

**Question 21:** Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost?

**Answer:** The definition of borrowing cost is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing cost.

**Question 22:** How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS-IX to different qualifying assets?

**Answer:** The capitalization of general borrowing cost under ICDS-IX shall be done on asset by-asset basis.

**Question 24:** Expenditure on most post-retirement benefits like provident fund, gratuity, etc. are covered by specific provisions. There are other post-retirement benefits offered by companies like medical benefits. Such benefits are covered by AS-15 for which no parallel ICDS has been notified. Whether provision for these liabilities are excluded from scope of ICDS X?

**Answer:** It is clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS-X.

**Question 25:** ICDS-1 requires disclosure of significant accounting policies and other ICDS requires specific disclosures. Where is the taxpayer required to make such disclosures specified in ICDS?

**Answer:** Net effect on the income due to application of ICDS is to be disclosed in the Return of income. The disclosures required under ICDS shall be made in the tax audit report in Form 3CD. However, there shall not be any separate disclosure requirements for persons who are not liable to tax audit.

#### Notified ICDS and Corresponding AS and IND AS

ICDS	Corresponding AS	Corresponding IND AS
ICDS I - Accounting Policies	AS – 1 Disclosure of Accounting Policies	Ind AS 1 - Presentation of Financial Statements
ICDS II - Valuation of Inventories	AS - 2 Valuation of Inventories (Revised)	Ind AS – 2 Inventories
ICDS III - Construction Contracts	AS 7 – Construction Contracts	Ind AS 115 – Revenue from Contracts with Customers
ICDS IV - Revenue Recognition	AS 9 – Revenue Recognition	Ind AS 115 - Revenue from Contracts with Customers
ICDS V - Tangible Fixed Assets	AS 10 – Property, Plant and Equipment (Revised)	Ind AS 16 Property, Plant and Equipment
ICDS VI - The Effects of changes in foreign exchange rates	AS 11 – The Effects of Changes in Foreign Exchange Rates (Revised)	Ind AS 21 – The Effects of Changes in Foreign Exchange Rates

ICDS VII - Government Grants	AS 12 - Accounting for Government Grants	Ind AS 20 – Accounting for Government Grants and Disclosure of Government Assistance
ICDS VIII - Securities	AS 13 - Accounting for Investments (Revised)	Ind AS 40 – Investment Property, Ind AS109 – Financial Instruments, Ind AS 105 – Non-current Assets held for Sale and Discontinued Operations
ICDS IX - Borrowing Costs	AS 16 - Borrowing Costs	Ind AS 23 - Borrowing Costs
ICDS X - Provisions, Contingent Liabilities and Contingent Assets	AS 29 - Provisions, Contingent Liabilities and Contingent Assets (Revised)	Ind AS 37 - Provisions, Contingent Liabilities and Contingent Assets

***Student may note that the text of the notified ICDSs has been given as Annexure 1 at the end of this Module.***

#### **(2) Method of Accounting in certain cases [Section 145A]**

The Delhi High Court had, in the case of *Chamber of Tax Consultants & Anr vs. Union of India & Ors*, held that certain provisions of ICDSs are *ultra vires* the Act, since they seek to overcome binding judicial precedents and are, thus, contrary to the law settled by the Supreme Court and various High Courts.

In order to bring certainty in the wake of such judicial pronouncements section 36(1)(xviii), section 40A(13), section 43AA, section 43CB, section 145A and section 145B have been inserted in the Income-tax Act, 1961 with effect from A.Y.2017-18.

Section 145A provides that for the purpose of determining the income chargeable under the head “Profits and gains of business or profession”:

- (a) the valuation of inventory shall be made at lower of actual cost or net realizable value computed in accordance with notified ICDS i.e., ICDS II “Valuation of inventories”.
- (b) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.
- (c) inventory being securities not listed or listed but not quoted on a recognised stock exchange with regularity from time to time shall be valued at actual cost initially recognised in accordance with the notified ICDS i.e., ICDS VIII: Securities.

- (d) inventory being listed and quoted securities, shall be valued at lower of actual cost or net realisable value in accordance with notified ICDS i.e., ICDS VIII: Securities. Such comparison of actual cost and net realisable value shall be done category-wise.

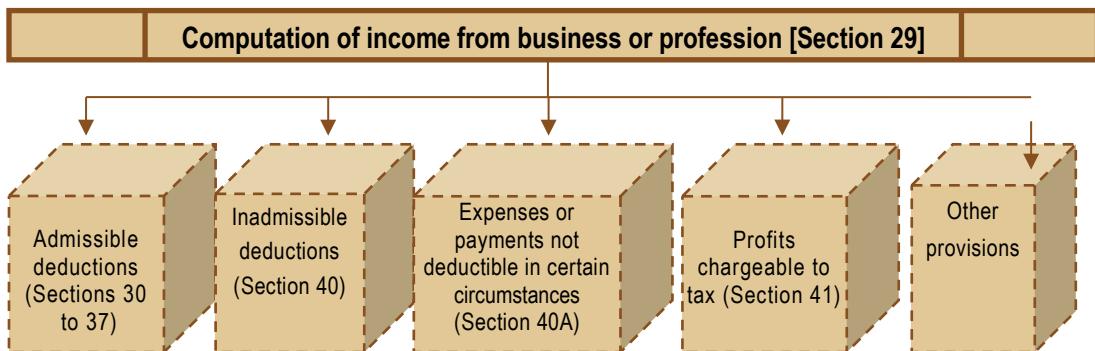
However, inventories being securities held by a scheduled bank or public financial institution shall be valued in accordance with notified ICDS after taking into account the extant guidelines issued by the RBI.

**Note:** Student may note that section 36(1)(xviii), section 40A(13), section 43AA, section 43CB, and section 145B are discussed at respective places in this chapter.



### 3.5 COMPUTATION OF PROFITS AND GAINS FROM BUSINESS OR PROFESSION [SECTION 29]

According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.



### 3.6 ADMISSIBLE DEDUCTIONS

#### (1) Rent, rates, taxes, repairs and insurance for buildings [Section 30]

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

- **Where the premises are occupied by the assessee as a tenant**, the rent paid for such premises and the amount paid on account of cost of repairs, if the assessee has undertaken to bear such repairs to the premises.
- **Occupation of premises by the assessee being the owner**: Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.
- **Repairs of the premises**: Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where
  - ◆ the assessee is the owner of the building or
  - ◆ the assessee is a tenant who has undertaken to bear the cost of repairs to the premises.
  - ◆ Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee, licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.
- **Cost of repairs and current repairs of capital nature not to be allowed as deduction**  
**[Explanation to section 30]**: Amount paid on account of the cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, shall not include any capital nature expenditure. In other words, cost of repairs and current repairs other than of capital nature is allowed as deduction while computing business income.
- **Other expenses**: In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed.
- **Premises used partly for business and partly for other purposes**: Where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction [Section 38(1)].

## (2) Repairs and insurance of machinery, plant and furniture [Section 31]

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

- **Usage of the asset:** In order to claim this deduction, the assets must have been used for purposes of the assessee's own business the profits of which are being taxed i.e., the assessee should be the beneficial owner of the asset.

The word 'used' has to be read in a wide sense so as to include active as well as passive use. However, insurance and repair charges of assets which are owned by the assessee but have not been used for the business during the previous year would not be allowed as a deduction.

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

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

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

- **Insurance premium:** The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions:

- ◆ The insurance must be against the risk of damage or destruction of the machinery, plant or furniture.
- ◆ The assets must be used by the assessee for the purposes of his business or profession during the accounting year.
- ◆ The premium should have been actually paid (or payable under the mercantile system of accounting).

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

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

- **Current repairs of capital nature not to be allowed [Explanation to section 31]:** Amount paid on account of current repairs of machinery, plant or furniture shall not include any capital nature expenditure. In other words, current repairs other than of capital nature expenditure is allowed as deduction in the computation of income under the head "profits and gains of business or profession".

- **Machinery, plant and furniture used partly for business and partly for other purposes:** Where the machinery, plant and furniture are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the machinery, plant and furniture used for purposes of business will be allowed as a deduction [Section 38(2)].

**(3) Depreciation [Section 32]**

- (1) **Charge of depreciation mandatory:** Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The *Explanation 5* to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

- (2) **Conditions to be satisfied for allowance of depreciation:** The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.

- (a) **The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:**

- (1) buildings, machinery, plant or furniture, being tangible assets;
- (2) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998, not being goodwill of a business or profession.
  - ❖ The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income.
  - ❖ No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected.
  - ❖ The term 'plant' as defined in section 43(3) includes ships, vehicle, books, scientific apparatus and surgical equipments used for the purpose of the business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

- ❖ However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus, plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability.
  - ❖ The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of machinery and building includes a part of the building.
  - ❖ Similarly, the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.
- (b) **The assets should be actually used by the assessee for purposes of his business or profession during the previous year** - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year. If the asset is acquired during the previous year and is not put to use in the same year, then the depreciation shall not be allowed for such asset but the cost of such asset would be added to the block of asset.

**Asset used for less than 180 days** - Where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed **at 50 per cent** of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

→ If the assets are not used exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

**Use includes passive use in certain circumstances:** One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. Depreciation is allowed when asset is actually put to use and not ready to use. However, in certain circumstances, Courts have held that, an asset can be said to be in use even when it is “kept ready for use”.

**For example,** stand by equipment and fire extinguishers can be capitalized if they are ‘ready for use’.

Likewise, machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, has to be capitalised. Hence, in such cases, the term “use” embraces both active use and passive use. However, such passive use should also be for business purposes.

- (c) **The assessee must own the assets, wholly or partly –** Depreciation is allowed only to the owner of the asset. If the assessee has taken an asset on lease, he, being the lessee, cannot avail depreciation in respect of such asset. On the other hands, the lessor will be entitled to depreciation on such asset as he is the owner.

→ However, in this connection, students may note that the *Explanation 1* to section 32 provides that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets “wholly” owned by the assessee but also in respect of assets “partly” owned by him and used for the purposes of his business or profession.

- (3) **Computation of Depreciation Allowance:** Depreciation allowance will be calculated on the following basis:

- (i) **Power generation undertakings:** In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

**Rule 5(1A)** - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power.

It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

- (ii) **Block of assets:** In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

**Block of Assets:** A “block of assets” is defined in section 2(11), as a group of assets falling within a class of assets comprising—

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession,

in respect of which the same percentage of depreciation is prescribed.

Block of asset simply means “same class of assets with same rate of depreciation”.

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

- (iii) **Additional depreciation on Plant & Machinery [Section 32(1)(ii)]:** Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or

transmission or distribution of power at the rate of 20% of the actual cost of such machinery or plant.

**Asset put to use for less than 180 days:** As per second proviso to section 32(1)(ii), 50% of additional depreciation to be allowed, where the plant and machinery is put to use for less than 180 days during the previous year in which such asset is acquired.

Further, third proviso to section 32(1)(ii) also provides that the balance 50% of the additional depreciation on new plant or machinery acquired and used for less than 180 days which has not been allowed in the year of acquisition and installation of such plant or machinery, shall be allowed in the immediately succeeding previous year.

**Note -** *In case of an individual, HUF, AoP (other than a co-operative society) or Bol or an artificial juridical person, additional depreciation is not allowable under the default tax regime under section 115BAC. Additional depreciation would be allowable only if such person has exercised the option of shifting out of the default tax regime provided under section 115BAC(1A) and pays tax as per the optional tax regime under the regular provisions of the Act.*

*In case of companies and co-operative societies, additional depreciation would not be allowable if they opted for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, additional depreciation would be allowable only if companies and co-operative societies pay tax under the normal provisions of the Act.*

### Plant and Machinery not qualifying for additional depreciation

Such additional depreciation will not be available in respect of:

- (i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person (second hand machinery); or
- (ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or
- (iii) office appliances or road transport vehicles; or
- (iv) any machinery or plant, the whole or part of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains of Business or Profession" of any one previous year.

**Note:** Additional depreciation is not allowed to power generation undertakings opting Appendix 1A of Rule 5 i.e., depreciation calculated as a percentage on the actual cost to the assessee.

**Eligibility for grant of additional depreciation under section 32(1)(ii) in the case of an assessee engaged in printing or printing and publishing [Circular No. 15/2016, dated 19-5-2016]**

An assessee, engaged in the business of manufacture or production of an article or thing, is eligible to claim additional depreciation under section 32(1)(ii) in addition to the normal depreciation under section 32(1).

The CBDT has, vide this Circular, clarified that the **business of printing or printing and publishing amounts to manufacture or production** of an article or thing and is, therefore, eligible for additional depreciation under section 32(1)(ii).

- (iv) **Terminal depreciation:** In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year (other than the previous year in which it is first brought into use) the depreciation amount will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

**Example:** Mahapower Ltd. purchased an asset on 20.7.2021. The actual cost of the asset was ₹ 100 lakhs. Mahapower Ltd. claimed depreciation @5% on the actual cost of the asset. WDV of the asset as on 1.4.2025 is ₹ 80 lakhs. On 15.5.2025, Mahapower Ltd. sold the asset for ₹ 55 lakhs. Deduction allowed as terminal depreciation u/s 32(1)(ii) for P.Y. 2025-26 is ₹ 25 lakhs (₹ 80 lakhs - ₹ 55 lakhs) provided the deficiency of ₹ 25 lakhs is actually written off in the books of Mahapower Ltd.

#### Meaning of certain terms

Term	Meaning
<b>Moneys payable</b>	In respect of any building, machinery, plant or furniture includes — (a) any insurance, salvage or compensation moneys payable in respect thereof; (b) where the building, machinery, plant or furniture is sold, the price for which it is sold.,

<b>Sold</b>	Includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force. However, it does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.
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**Clarification regarding treatment of expenditure incurred on purchase of participating interest by the Oil Exploration and Production (E&P) Companies [Circular No. 20/2019, dated 19.08.2019]**

Over the life cycle of an Oil & Gas block, Oil Exploration and Production (E&P) companies generally buy ('Farm in') and sell ('Farm out') their participating interests (PI) in the 'Production Sharing Agreement' (PSC). 'Farm-in' expenditure is incurred when an entity in this line of business acquires a PI from another entity(s) in oil/gas block(s) and becomes part of the PSC entered into with the Central Government.

The Government of India (GoI) offers exploration and development rights through global bidding for specified blocks in various rounds under the New Exploration and Licensing Policy (NELP), Hydrocarbon Exploration & Licensing Policy (HELP), Open Acreage Licensing Policy (OALP) etc. by signing the Production Sharing Contracts (PSC's) with the Oil & Gas companies. The successful Oil & Gas Companies are granted license to explore, develop and carry out production operations in Oil & Gas blocks and in India under a PSC with the GoI. Typically, owing to the large investments required and the risks involved, multiple E&P companies execute the PSC with the GoI in which each member has its agreed and defined PI.

It is common international practice for the upstream companies to buy (farm-in) and sale (farm-out) their PI in the PSC or similar contracts with the Government and thereby to share risk, bring new and niche expertise and technologies. In such transactions, PI are treated as interests in rights, licences and obligation under the PSC. Such farm-in purchase price is accounted as an asset as per guidance note issued by the Institute of Chartered Accountants of India. International accounting rules for Oil & Gas followed in Australia, Indonesia, UK etc. also require that such acquisition cost to be capitalized and depreciated. A perusal of the Model PSC's {as per the website of the Director General of Hydrocarbon (DGH)} indicates that participating interests are share in rights and obligation to explore, exploit and sell petroleum under the PSC along with related licences, permits etc. A few of the case-laws on this issue also support treatment of acquisition rights in a PSC as Intangible asset.

In this regard, it is relevant to mention that earlier vide Notification No. G.S.R. 117(E) dated 08.03.1996, in exercise of its powers under section 293A of the Act, Central Government had laid down that the persons with whom it enters into agreement for the association or

*participation in any business consisting of the prospecting for or extraction or production of mineral oils on or after the 1st day of April, 1992 -*

- a) *shall not be assessed on the income as association of persons or body of individuals consisting of such persons; but*
- b) *each of the persons referred to above be assessed in respect of his or its share of income, as the case may be, in the same status in which the person enters into the agreement with the Central Government.*

*Thus, as persons participating in an E&P contract are assessed individually in respect of their share of income, the sum expended on acquisition of whole or part of such 'Participating Interest' in an E&P contract where such acquisition is approved by the Government of India, represents the amount paid to acquire the underlying share (expressed as a percentage) being interests in rights, licences and obligations under the E&P contract.*

*In view of the above legal position, it is hereby clarified as under:-*

- i. *amount paid for acquiring the 'Participating Interest' shall not be treated either as cost for acquiring the share in partnership or investment for acquisition of a member's interest in an association of persons or body of individuals, rather it would be treated as an amount paid to acquire the underlying assets; and*
- ii. *the amount paid for acquiring the 'Participating Interest', after reducing component of cost attributable to tangible assets for purposes of section 32(1)(i), would be treated as an 'intangible asset' (being a business or commercial right akin to a licence), eligible for claim of depreciation for purposes of section 32(1)(ii).*

(4) **Rates of depreciation:** All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

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

<b>II</b>	<b>Furniture and Fittings</b>	
Block 1.	Furniture and fittings including electrical fittings ["Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.]	10%
<b>III</b>	<b>Plant &amp; Machinery</b>	
Block 1.	Motor cars other than those used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.3.2020 and put to use on or before 31.3.2020	30%
Block 2.	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990 [Other than motor cars mentioned in Block 1 above]	15%
Block 3.	Motor buses, motor lorries and motor taxis used in a business of running them on hire, acquired during the period from 23.8.2019 to 31.3.2020 and put to use on or before 31.3.2020	45%
Block 4.	Motors buses, motor lorries, motor taxis used in the business of running them on hire [Other than motor cars mentioned in Block 4 above]	30%
Block 5.	Moulds used in rubber and plastic goods factories	30%
Block 6.	Aeroplanes, Aeroengines	40%
Block 7.	Specified air pollution control equipments, water pollution control equipments, solid waste control equipment and solid waste recycling and resource recovery systems	40%
Block 8.	Plant & Machinery used in semi-conductor industry covering all Integrated Circuits (ICs) (other than mentioned in Block 7 Above)	30%
Block 9.	Life saving medical equipments	40%
Block 10.	Machinery and plant, acquired and installed on or after the 1st day of September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility	40%
Block 11.	Containers made of glass or plastic used as re-fills	40%
Block 12	Energy Saving Devices (as specified)	40%
Block 13.	Renewable Energy Saving Devices (as specified) including the devices specified in (i) to (iii) below	40%
	(i) Electrically operated vehicles including battery powered or fuel-cell powered vehicles	40%

	(ii) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014	40%
	(iii) Any special devices including electric generators and pumps running on wind energy installed on or after 1.4.2014	40%
Block 14.	Windmills and any specially designed devices running on windmills installed on or before 31.3.2014 and any special devices including electric generators and pumps running on wind energy installed on or before 31.3.2014	15%
Block 15.	Computers including computer software (See Note below)	40%
Block 16.	Books (annual publications or other than annual publications) owned by assessee carrying on a profession	40%
Block 17.	Books owned by assessee carrying on business in running lending libraries	40%
Block 18.	Plant & machinery (General rate)	15%
<b>IV</b>	<b>Ships</b>	
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by Block 3 below	20%
Block 3.	Speed boats operating on inland water	20%

**PART B INTANGIBLE ASSETS**

Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25%
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**Note** - Mobile phones and EPABX are **not** considered as computers and hence, not eligible for 40% rate of depreciation while computer accessories such as UPS, printers' scanners, etc. are eligible for 40% rate of depreciation.

**Note:** Students should refer to Income-tax Rules, 1962 for the detailed classification of assets under Rule 5(1) and the rate of depreciation applicable thereto.

**(5) Increased rate of depreciation for certain assets [Rule 5(2)]**

Any new machinery or plant installed to manufacture or produce any article or thing by using any technology or other know-how developed in or is an article or thing invented in a laboratory owned or financed by the Government or a laboratory owned by a public sector company or a University or an institution recognized by the Secretary, Department of

Scientific and Industrial Research, Government of India shall be treated as a part of the block of assets qualifying for depreciation @40% of written down value.

**Conditions to be fulfilled:**

1. The right to use such technology or other know-how or to manufacture or produce such article or thing has been acquired from the owner of such laboratory or any person deriving title from such owner.
2. The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and Industrial Research, Government of India to the effect that such article or thing is manufactured or produced by using such technology or other know-how developed in such laboratory or such article or thing has been invented in that laboratory.
3. The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh Schedule [The exclusion list comprises of beer, wine and other alcoholic spirits, tobacco and tobacco preparations, cosmetic and toilet preparations, tooth paste, dental cream, tooth powder and soap, confectionery and chocolates, office machines and apparatus, steel furniture etc.].

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

**ILLUSTRATION 1**

XYZ (P) Ltd., engaged in manufacturing business since 2016, furnishes the following particulars:

	<b>Particulars</b>	₹
(1)	Opening WDV of plant and machinery as on 1.4.2025 (i.e., WDV as on 31.3.2025 after reducing depreciation for P.Y. 2024-25)	30,00,000
(2)	New plant and machinery purchased and put to use on 08.06.2025	20,00,000
(3)	New plant and machinery acquired and put to use on 15.12.2025	8,00,000
(4)	Computer acquired and installed in the office premises on 2.1.2026	3,00,000

Compute the amount of depreciation and additional depreciation as per the Income-tax Act, 1961 for the A.Y. 2026-27. Assume that all the assets were purchased by way of account payee cheque and that the company does not opt for section 115BAA.

**SOLUTION****Computation of depreciation and additional depreciation for A.Y. 2026-27**

Particulars	Plant & Machinery (15%) (₹)	Computer (40%) (₹)
<b>Normal depreciation</b>		
<ul style="list-style-type: none"> <li>• @ 15% on ₹ 50,00,000 [See Working Notes 1 &amp; 2]</li> <li>• @ 7.5% (50% of 15%, since put to use for less than 180 days) on ₹ 8,00,000</li> <li>• @ 20% (50% of 40%, since put to use for less than 180 days) on ₹ 3,00,000</li> </ul>	7,50,000 60,000 -	- - 60,000
<b>Additional Depreciation</b>		
<ul style="list-style-type: none"> <li>• @ 20% on ₹ 20,00,000 (new plant and machinery put to use for more than 180 days)</li> <li>• @ 10% (50% of 20%, since put to use for less than 180 days) on ₹ 8,00,000</li> </ul>	4,00,000 80,000	- -
<b>Total depreciation</b>	<b>12,90,000</b>	<b>60,000</b>

**Working Note:****Computation of written down value of Plant & Machinery**

Particulars	Plant & Machinery (₹)	Computer (₹)
Written down value as on 1.4.2025	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2025 (put to use for more than 180 days)	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2025 (put to use for less than 180 days)	8,00,000	-
Computer acquired and installed in the office premises (put to use for less than 180 days)	-	3,00,000
<b>Written down value as on 31.03.2026</b>	<b>58,00,000</b>	<b>3,00,000</b>

### Composition of plant and machinery included in the WDV

Particulars	Plant & Machinery ₹	Computer ₹
Plant and machinery put to use for 180 days or more [₹ 30,00,000 (WDV) + ₹ 20,00,000 (purchased on 8.6.2025)]	50,00,000	
Plant and machinery put to use for less than 180 days	8,00,000	-
Computers put to use for less than 180 days	-	3,00,000
	<b>58,00,000</b>	<b>3,00,000</b>

**Notes:**

- As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2025 and computer acquired and installed on 02.01.2026, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to ₹ 80,000, being 10% (i.e., 50% of 20%) of ₹ 8 lakh.

- As per third proviso to section 32(1)(ii), the balance additional depreciation of ₹ 80,000 being 50% of ₹ 1,60,000 (20% of ₹ 8,00,000) would be allowed as deduction in the A.Y.2027-28 if XYZ (P) Ltd. does not opt for the provisions of section 115BAA.
- As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, *inter alia*, in the business of manufacture or production of any article or thing, @20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, *inter alia*, any machinery or plant installed in office premises, residential accommodation or in any guest house.

Accordingly, additional depreciation is not allowable on computer installed in the office premises.

**ILLUSTRATION 2**

A newly qualified Chartered Accountant, Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2025-26 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2026-27. Assume that all the assets were purchased by way of account payee cheque.

<b>Sl. No.</b>	<b>Description</b>	<b>Date of acquisition</b>	<b>Date when put to use</b>	<b>Amount ₹</b>
1.	Computer including computer software	27 Sept., 25	1 Oct., 25	35,000
2.	Computer UPS	2 Oct., 25	8 Oct., 25	8,500
3.	Computer printer	1 Oct., 25	1 Oct., 25	12,500
4.	Books (of which books being annual publications are of ₹ 12,000)	1 Apr., 25	1 Apr., 25	13,000
5.	Office furniture (Acquired from a practising C.A.)	1 Apr., 25	1 Apr., 25	3,00,000
6.	Laptop	26 Sep., 25	8 Oct., 25	43,000

**SOLUTION****Computation of depreciation allowable for A.Y.2026-27**

<b>Asset</b>	<b>Rate</b>	<b>Depreciation</b>
Block 1 Furniture [See working note below]	10%	30,000
Block 2 Plant (Computer including computer software, computer UPS, laptop, computer printer & books)	40%	34,500
<b>Total depreciation allowable</b>		<b>64,500</b>

**Working Notes:****Computation of depreciation**

<b>Block of Assets</b>	<b>₹</b>
<b>Block 1: Furniture – [Rate of depreciation - 10%]</b>	
Put to use for more than 180 days [₹ 3,00,000@10%]	<b>30,000</b>
<b>Block 2: Plant [Rate of depreciation - 40%]</b>	
(a) Computer including computer software (put to use for more than 180 days) [₹ 35,000@40%]	14,000

(b) Computer UPS (put to use for less than 180 days) [₹ 8,500@20%] [See Note below]	1,700
(c) Computer Printer (put to use for more than 180 days) [₹ 12,500@40%]	5,000
(d) Laptop (put to use for less than 180 days) [₹ 43,000@20%] [See Note below]	8,600
(e) Books (being annual publications or other than annual publications) (Put to use for more than 180 days) [₹ 13,000@40%]	5,200
	<b>34,500</b>

**Note** - Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2025-26 and acquired the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer UPS.

- (6) Depreciation in case of succession of firm/sole proprietary concern by a company or business reorganization, amalgamation or demerger of companies or succession of business otherwise than on death

As per the sixth proviso to section 32(1)(ii), depreciation allowable in the hands of

- predecessor and the successor in case of succession of firm/ sole proprietary concern by a company fulfilling the conditions mentioned in section 47(xiii)/(xiv) or
- predecessor company and successor LLP in case of conversion of a private company or an unlisted public company into an LLP fulfilling the conditions mentioned in section 47(xiib) or
- predecessor and the successor in case of succession of business otherwise than on death
- amalgamating/ amalgamated company or demerged or resulting company in case of amalgamation or demerger of companies

**shall not exceed the amount of depreciation** calculated at the prescribed rates as if the succession, business reorganization, amalgamation or demerger had not taken place.

It is also provided that such amount of depreciation shall be apportioned between the two entities **in the ratio of the number of days for which the assets were used by them**.

**ILLUSTRATION 3**

*Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose WDV as on 31.3.2025 after reducing depreciation for P.Y. 2024-25 was ₹ 40 lakhs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2025 for ₹ 14.40 lakhs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2026.*

*You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2026 assuming that the assets were transferred to Shirdi Ltd. at ₹ 60 lakhs. Also assume that the plant and machinery were purchased by way of account payee cheque.*

**SOLUTION**

**Statement showing computation of depreciation allowable  
to Sai Ltd. & Shirdi Ltd. for A.Y. 2026-27**

Particulars	₹
Opening WDV as on 1.4.2025 [i.e., WDV as on 31.3.2025 after reducing depreciation for P.Y. 2024-25]	40,00,000
Addition during the P.Y. 2025-26 (used for less than 180 days)	14,40,000
<b>Total</b>	<b>54,40,000</b>
Depreciation on ₹ 40,00,000 @15%	6,00,000
Depreciation on ₹ 14,40,000 @7.5%	1,08,000
<b>Total depreciation for the P.Y. 2025-26</b>	<b>7,08,000</b>
<b>Apportionment between two companies:</b>	
(a) Amalgamating company, Sai Ltd.	
₹ 6,00,000 × 275/365	4,52,055
₹ 1,08,000 × 61/151	43,629
	<b>4,95,684</b>
(b) Amalgamated company, Shirdi Ltd.	
₹ 6,00,000 × 90/365	1,47,945
₹ 1,08,000 × 90/151	64,371
	<b>2,12,316</b>

**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., ₹ 60 lakhs, has no implication in computing eligible depreciation.
- (7) **Hire purchase:** In the case of assets under the hire purchase system the allowance for depreciation would under *Circular No. 9 of 1943 R. Dis. No. 27(4) I.T. 43 dated 23-3-1943*, be granted as follows:
- In every case of payment purporting to be for hire purchase, production of the agreement under which the payment is made would be insisted upon by the department.
  - Where the effect of an agreement is that the ownership of the asset is at once transferred on the lessee, the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This principle will be applicable in a case where the lessor obtains a right to sue for arrears of installments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of hire purchase agreement.
  - Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by the hirer should for all tax purposes be regarded as made up of
    - (i) the consideration for hirer which will be allowed as a deduction in assessment, and
    - (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lessee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement.

The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If, however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination of agreement.

For the purpose of allowing depreciation, an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset.

In cases where no such certificate or other evidence is furnished the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum.

For the purpose of allowing depreciation the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in installments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(8) **Actual Cost [Section 43(1)]**

The expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

However, where an assessee incurs any expenditure for acquisition of any asset or part thereof in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode, exceeds ₹ 10,000, such expenditure shall not form part of actual cost of such asset [Second proviso to section 43(1)].

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

**Actual cost in certain special situations /Explanations to section 43(1)]**

Explanation	Situation	Actual cost of the asset to the assessee
1	Where an asset is used for the purposes of business after it ceases to be used for scientific research related to that business	<p>Actual cost to the assessee as reduced by any deduction allowed u/s 35(1)(iv).</p> <p><b>Note -</b> Actual cost of such asset would be Nil as already 100% deduction would have been claimed u/s 35(1)(iv)</p>
1A	Where inventory is converted or treated as a capital asset and is used for the purpose of business or profession	Fair market value of such inventory as on the date of its conversion into capital asset determined in the prescribed manner
2	Where an asset is acquired by way of gift or inheritance	<p>Actual cost to the previous owner <i>minus</i> depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets.</p> <p>Further, any expenditure incurred by the assessee such as expenditure on freight, installation etc. of such asset would also be includable in the actual cost.</p>
3	Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost)	An amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case

<b>4</b>	Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him	(a) the actual cost when he first acquired the asset <i>minus</i> depreciation allowable to the assessee as if asset was the only asset in the relevant block of assets; or (b) the actual price for which the asset is re-acquired by him whichever is less
<b>4A</b>	Where before the date of acquisition by the assessee, say, Mr. A, the assets were at any time used by any other person, say Mr. B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr. B and such person acquires on lease, hire or otherwise, assets from Mr. A	Actual cost of the transferred assets, in the case of Mr. A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr. B.
<b>5</b>	Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession	Actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee
<b>6</b>	When any capital asset is transferred by a holding company to its wholly owned Indian subsidiary company or by a subsidiary company to its 100% holding company, being an Indian company then, the transaction not being regarded as a transfer of a capital asset	The actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business

7	In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated Indian company	The actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business
7A	In the case of a demerger, where any capital asset is transferred by the demerged company to the resulting Indian company	<p>The actual cost of the transferred asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.</p> <p>However, the actual cost shall not exceed the WDV of the asset in the hands of the demerged company</p>

#### Explanation 4A overrides Explanation 3

*Explanation 3* to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having satisfied himself about such purpose of transfer with the prior approval of the joint commissioner, may determine the actual cost having regard to all the circumstances of the case.

In the *Explanation 4A*, a *non-obstante* clause has been included to the effect that *Explanation 4A* will have an overriding effect over *Explanation 3*. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. *Explanation 4A* is activated in every situation described above without inquiring about the main purpose.

#### **Example:**

A person (say "B") owns an asset and uses it for the purposes of his business or profession. B has claimed depreciation in respect of such asset. The said asset is transferred by B to another person (say "A"). B then acquires the same asset back from A on lease, hire or otherwise. A being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of A shall be the same as the written down value of the said assets at the time of transfer in the hands of B.

**Actual cost in other special situations**

- (i) **Capitalization of interest paid or payable in connection with acquisition of an asset:** Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use.

This capitalisation implies inclusion of such interest in the 'Actual Cost' of the asset for the purposes of claiming depreciation under the Income-tax Act, 1961. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counter-acting tax avoidance through this method and placing the matter beyond doubt, *Explanation 8* to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset.

- (ii) **Amount of duty of excise or additional duty leviable shall be reduced if credit is claimed:** Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944<sup>6</sup> [*Explanation 9*].

- (iii) **Subsidy or grant or reimbursement:** Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee [*Explanation 10*].

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<sup>6</sup> Now Central Excise Rules, 2002

**Note:** ICDS VII requires Government grants relatable to depreciable assets to be reduced from actual cost of the asset/WDV of the block of asset. It further provides that where the Government grant is not directly relatable to the asset acquired, then a pro-rata reduction of the amount of grant should be made in the same proportion as such asset bears to all assets with reference to which the Government grant is so received.

- (iv) **Asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India:** Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession, the actual cost of asset to the assessee shall be the actual cost of the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee [Explanation 11].
- (v) **Capital asset is acquired under a scheme for corporatization:** Where any capital asset is acquired under a scheme for corporatization of a recognised stock exchange in India approved by the SEBI, the actual cost shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization [Explanation 12].

**Note:** Under the scheme of corporatization, recognised stock exchange gets converted into 'Company' from the status of being 'Association of persons' or 'Body of Individuals'.

- (vi) **Capital asset on which deduction is allowable under section 35AD:** Explanation 13 to section 43(1) provides that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be nil.

**This would be applicable in the case of transfer of asset by the assessee where –**

- (1) the assessee himself has claimed deduction under section 35AD; or
- (2) the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of –
  - (a) gift, will or an irrevocable trust;
  - (b) any distribution on liquidation of the company;

- (c) any distribution of capital assets on total or partial partition of a HUF;
- (d) any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;
- (e) any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;
- (f) any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;
- (g) any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;
- (h) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);
- (i) any transfer of a capital asset or intangible asset by a sole proprietary concern to a company, where the sole proprietary concern is succeeded by a company (fulfilling the conditions specified).
- (j) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP as a result of conversion of the company into LLP (fulfilling the conditions prescribed).

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordance with the provisions of section 35AD(7B) (on account of being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee **as reduced** by the amount of depreciation allowable had the asset been used for the purpose of business, calculated at the rate in force, since the date of its acquisition [Proviso to Explanation 13 to section 43(1)]

(9) **Written down value [Section 43(6)]**

- (i) **Assets acquired by the assessee during the previous year:** In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.
- (ii) **Assets acquired before the previous year:** In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee less the aggregate of all deductions actually allowed in respect of depreciation. For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with *Explanation 3*].
- (iii) **In case of any block of assets:** The written down value of any block of assets shall be worked out as under in accordance with section 43(6)(c):

(1)	W.D.V. of the block of assets in immediately preceding previous year (P.Y. 2024-25)	xxx
(2)	Less: Depreciation actually allowed in respect of that block of assets in said preceding previous year (i.e., in P.Y. 2024-25)	xxx
<b>Opening balance as on 1<sup>st</sup> April of the current P.Y. (i.e., on 1.4.2025)</b>		xxx
<b>Increased by</b>		
(3)	Actual cost of assets acquired during the previous year 2025-26, not being on account of acquisition of goodwill of a business or profession	xxx
(4)	Total (1) - (2) + (3)	xxx
<b>Reduced by</b>		
(5)	Money receivable in respect of any asset falling within the block which is sold, discarded, demolished or destroyed during that previous year. However, such amount cannot exceed the amount in (4).	xxx
(6)	<b>In case of slump sale</b> , actual cost of the asset (-) amount of depreciation that would have been allowable to the assessee for any assessment year as if the asset was the only asset in the block. However, such amount of reduction cannot exceed the WDV.	xxx
(7)	W.D.V at the end of the year (as on 31.3.2026, on which depreciation is allowable) [(4) – (5) – (6)]	xxx
(8)	Depreciation at the prescribed rate (Rate of Depreciation × WDV arrived at in (7) above)	xxx

- (iv) **Succession to business or profession otherwise than on death:** When in the case of a succession to business or profession otherwise than on death, an assessment is made on the successor under section 170(2), the written down value of an asset or block of assets shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to [Explanation 1 to section 43(6)].

**Example:** Tapan succeeded his father's business due to retirement of his father. The WDV of the assets in the hands of Tapan would be the WDV of the assets in the hands of his father.

- (v) **Transfer of block of assets by a holding company to a subsidiary company or vice versa or by amalgamating company to amalgamated company:** Where in any previous year any block of assets is transferred by a holding company to its wholly owned Indian subsidiary company or by a subsidiary company to its 100% holding company, being an Indian company or by an amalgamating company to an amalgamated company, the latter being an Indian company, then the actual cost of the block of assets in the case of transferee-company or amalgamated company as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or amalgamating company, as the case may be, for the immediately preceding year as reduced by depreciation actually allowed in relation to the said previous year [Explanation 2 to section 43(6)].
- (vi) **Block of assets is transferred by demerged company to the resulting company:** Where in any previous year any asset forming part of a block of assets is transferred by demerged company to the resulting company, the written down value of the block of assets of the demerged company for the immediately preceding year shall be reduced by the written down value of the assets transferred to the resulting company [Explanation 2A to section 43(6)].
- (vii) **Block of assets is transferred by a demerged company to the resulting company:** Where any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets in the case of resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [Explanation 2B to section 43(6)].
- (viii) **Block of assets in the case of the successor LLP:** The actual cost of the block of assets in the case of the successor LLP on conversion of private or unlisted

company to a LLP and the conditions of clause 47(xiiib) are satisfied, shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

- (ix) **Block of assets transferred by a recognised stock exchange in India to a company under a scheme for corporatization:** Where any asset forming part of a block of assets is transferred in any previous year by a recognised stock exchange in India to a company under a scheme for corporatisation approved by SEBI, the written down value of the block shall be the written down value of the transferred assets immediately before the transfer [*Explanation 5* to section 43(6)].
- (x) **Depreciation provided in the books of account deemed to be depreciation actually allowed:** Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee *less* all depreciation actually allowed to him under the Income-tax Act, 1961.

Persons who were exempt from tax were not required to compute their income under the head "Profits and gains of business or profession". However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act, 1961 in respect of assets acquired during the years when the person was exempt from tax.

*Explanation 6* to section 43(6) provides that -

- (a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;
- (b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act, 1961 for the purposes of section 43(6);
- (c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

- (xi) **Composite Income:** *Explanation 7* provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable under the head "Profits and Gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

**Example:** If the turnover is, say, ₹ 20 lakh, the depreciation ₹ 1 lakh and other expenses ₹ 4 lakh, then, the income would be ₹ 15 lakh. Business income would be ₹ 6 lakh (being 40% of ₹ 15 lakh). In this case, ₹ 1 lakh, being the amount of depreciation would be deemed to have been actually allowed.

The WDV is required to be computed by deducting the full depreciation attributable to composite income i.e. ₹ 1 lakh. *Explanation 7* clarifies this legislative intent.

- (xii) **Cases where the Written Down Value reduced to Nil:** The written down value of any block of assets, may be reduced to nil for any of the following reasons:

- (a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or
- (b) All the assets in the relevant block may be transferred during the year.

#### **(10) Carry forward and set-off of depreciation [Section 32(2)]**

Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

**Example:** Profits and gains from business or profession of Mr. X for P.Y. 2024-25, before charging depreciation of ₹20 lakhs u/s 32, was ₹16 lakhs. In such a case, after setting off the depreciation, the unabsorbed depreciation of P.Y. 2024-25 would be ₹4 lakhs. If profits and gains from business or profession for P.Y. 2025-26 before depreciation is ₹11 lakhs and depreciation allowance u/s 32 for the said previous year is ₹5 lakhs, then, the unabsorbed depreciation of ₹4 lakhs for the P.Y. 2024-25 would be added to the depreciation allowance of ₹5 lakhs. Consequently, ₹9 lakhs would be allowed to be set-off against the profits of ₹11 lakhs and the taxable profits for P.Y. 2025-26 would be ₹2 lakhs.

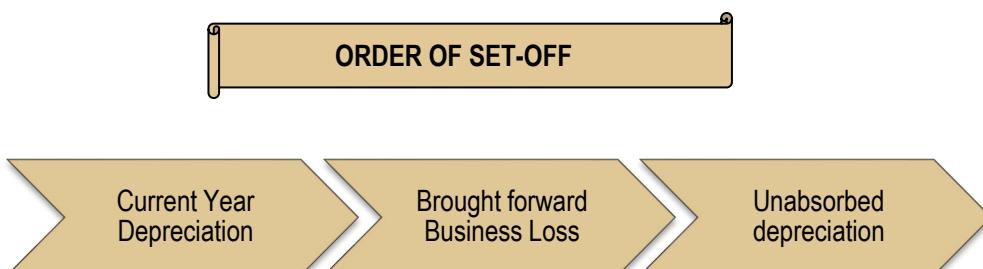
#### Order of set-off

However, in the order of set-off of losses under different heads of income, effect shall first be given to current year depreciation then brought forward business losses and only then to unabsorbed depreciation.

#### The provisions in effect are as follows:

- Since the unabsorbed depreciation forms part of the current year's depreciation, it can be set off against any other head of income except "Salaries".
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

**Current depreciation to be deducted first** - The Supreme Court, in *CIT v. Mother India Refrigeration (P.) Ltd. [1985] 23 Taxman 8*, has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.



**ILLUSTRATION 4**

*Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2025-26. Compute the depreciation allowable under section 32 for A.Y.2026-27 and the opening balance of written down value of the block of assets as on 01.04.2026, while computing his income under the head "Profits and gains of business or profession". The company has opted for the depreciation allowance on the basis of written down value. Assume that all the assets were purchased by way of account payee cheque and that the company has not opted for the special tax regimes under section 115BAA or under section 115BAB.*

	<b>Particulars</b>	(₹)
1.	<i>Opening Written down value of Plant and Machinery (15% block) as on 01.04.2025 (Purchase value ₹ 8,00,000) [WDV for P.Y. 2024-25 less depreciation for that year]</i>	5,78,000
2.	<i>Purchase of second hand machinery (15% block) on 29.12.2025 for business purpose</i>	2,00,000
3.	<i>Machinery Y (15% block) purchased and installed on 12.07.2025 for the purpose of power generation</i>	8,00,000
4.	<i>Acquired and installed for use a new air pollution control equipment on 31.7.2025</i>	2,50,000
5.	<i>New air conditioner purchased and installed in office premises on 8.9.2025</i>	3,00,000
6.	<i>New machinery Z (15% block) acquired and installed on 23.11.2025 for the purpose of generation of power</i>	3,25,000
7.	<i>Sale value of an old machinery X, sold during the year (Purchase value ₹ 4,80,000, WDV as on 01.04.2025 ₹ 3,46,800)</i>	3,10,000

**SOLUTION****Computation of depreciation allowance under section 32 for the A.Y. 2026-27**

<b>Particulars</b>	(₹)	Plant and Machinery (15%) (₹)	Plant and Machinery (40%) (₹)
Opening WDV as on 01.04.2025		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	-
- Air pollution control equipment		-	2,50,000
<b>Less: Asset sold during the year</b>		22,03,000	2,50,000
Written down value as on 31.3.2026 before charging depreciation		3,10,000	Nil
		18,93,000	2,50,000
<b>Normal depreciation</b>			
40% on air pollution control equipment ( $\text{₹ } 2,50,000 \times 40\%$ )		-	1,00,000
<b>Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)</b>			
- Second hand machinery ( $\text{₹ } 2,00,000 \times 7.5\%$ )	15,000		
- Machinery Z ( $\text{₹ } 3,25,000 \times 7.5\%$ )	24,375	39,375	
15% on the balance WDV being put to use for more than 180 days ( $\text{₹ } 13,68,000 \times 15\%$ )		2,05,200	
<b>Additional depreciation</b>			
- Machinery Y ( $\text{₹ } 8,00,000 \times 20\%$ )	1,60,000		
- Machinery Z ( $\text{₹ } 3,25,000 \times 10\%$ , being 50% of 20%)	32,500	1,92,500	-
- Air pollution control equipment ( $\text{₹ } 2,50,000 \times 20\%$ )		-	50,000
<b>Total depreciation</b>		4,37,075	1,50,000
<b>WDV as on 1.4.2026 [WDV of P.Y. 2025-26 less depreciation for that year]</b>		14,55,925	1,00,000

**Notes:**

- (i) Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery.
- (ii) Additional depreciation is not allowed in respect of second hand machinery and air conditioner installed in office premises.
- (iii) The balance 50% additional depreciation in respect of Machinery Z of ₹ 32,500 ( $10\% \times ₹ 3,25,000$ ) can be claimed as deduction in the subsequent financial year i.e., F.Y. 2026-27.

**(11) Building, machinery, plant and furniture not exclusively used for business purpose [Section 38(2)]**

Where any building, plant and machinery, furniture is not exclusively used for the purposes of business or profession, the deduction on account of expenses on account of current repairs to the premises, insurance premium of the premises, current repairs and insurance premium of machinery, plant and furniture and depreciation in respect of these assets shall be restricted to a fair proportionate part thereof, which the Assessing Officer may determine having regard to the user of such asset for the purposes of the business or profession.

**(12) Balancing Charge**

Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the moneys payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e., in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The *Explanation* below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

**Example:** Mahapower Ltd. purchased an asset on 20.7.2021. The actual cost of the asset was ₹ 100 lakhs. Mahapower Ltd. claimed depreciation @5% on the actual cost of the asset. WDV of the asset as on 1.4.2025 is ₹ 80 lakhs. On 15.5.2025, Mahapower Ltd. sold the asset for ₹ 90 lakhs. The balancing charge of ₹ 10 lakhs (₹ 90 lakhs - ₹ 80 lakhs) would be taxable as income u/s 41(2).

**(4) Tea Development Account/ Coffee Development Account/ Rubber Development Account [Section 33AB]**

- (i) Eligibility for deduction:** This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of growing and manufacturing tea or coffee or rubber in India.

- (ii) **Quantum of deduction:** It provides that where the assessee has before the expiry of six months from the end of the previous year or before the due date of furnishing the return of income, **whichever is earlier**,
- (a) deposited with a National Bank any amount in a special account maintained by the assessee with that Bank in accordance with a scheme approved by Tea Board or Coffee Board or Rubber Board, or
  - (b) deposited any amount in an account to be known as Deposit Account opened by the assessee in accordance with the scheme framed by the Tea Board or Coffee Board or Rubber Board, as the case may be, (hereinafter referred to as the deposit scheme) with the previous approval of the Central Government,

**the assessee shall be allowed a deduction of:**

- (a) A sum equal to the aggregate of the deposits made or
- (b) 40% of the profits of such business (as computed under the head 'Profits and gains of business or profession before making any deduction under this section),

whichever is less.

The above deduction will be allowed before the setting off of brought-forward loss under section 72.

- (iii) **No deduction to partner of assessee-firm or member of assessee-AOP/ BOI:** Where the assessee is a firm or any association of persons or any body of individuals, the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.
- (iv) **Non-eligibility of deduction in any other previous year:** Where any deduction in respect of any amount deposited in the special account or Deposit Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.
- (v) **Audit of books of accounts:** This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1), and the assessee furnishes by that date the report of such audit in the prescribed form duly signed and verified by such accountant.

Particulars	Due date of filing of return	Specified Date
Assesseees (other than a company) subject to tax audit	31 <sup>st</sup> October of the relevant A.Y.	30 <sup>th</sup> September of the relevant A.Y.
	For A.Y.2026-27, on or before 31 <sup>st</sup> October, 2026	For A.Y.2026-27, on or before 30 <sup>th</sup> September, 2026

However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

- (vi) **Condition to withdraw the amount from special account or deposit account:** Any amount standing to the credit of the assessee in the special account or deposit account cannot be withdrawn except for the purposes specified in the scheme, or, as the case may be, in the deposit scheme.

**The above amount can also be withdrawn in the following circumstances:**

- (a) Closure of business
- (b) Death of an assessee
- (c) Partition of HUF
- (d) Dissolution of a firm
- (e) Liquidation of a company.

- (vii) **Amount withdrawn and utilised for purchase of specified assets would be chargeable to tax as business income:** Where the sum standing to the credit of the assessee in the Special account or in the Deposit account is released by the National Bank or is withdrawn by the assessee from the Deposit account and is utilised for the purchase of:

- (a) Any machinery or plant installed in any office premises or residential accommodation including a guest house.
- (b) Any office appliances (other than computers)
- (c) Any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head 'Profits and gains of business or profession' of any one previous year;

- (d) Any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

the whole of such amount so utilised will be treated as taxable profits of that year and taxed accordingly.

- (viii) **Amount withdrawn on the closure of business or dissolution of a firm:** Where any amount is withdrawn by the assessee from the special account or deposit account during any previous year on the closure of his business or dissolution of a firm, the whole of such withdrawal shall be deemed to be the profits and gains of business of that previous year and shall be chargeable to tax as the income of that previous year, as if the business had not closed or the firm had not been dissolved.

- (ix) **Utilisation from scheme for business purpose not available as a deduction:** Where any amount standing to the credit of the assessee in the special account or in the deposit account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or deposit scheme, such expenditure shall not be allowed in computing the business income.

- (x) **Consequences of non-utilisation of withdrawn amount:** Where any amount in the special account which is released during any previous year by the National Bank or is withdrawn by the assessee from the Deposit Account, for being utilised by the assessee for the purposes of such business and is not utilized in accordance with the scheme or deposit scheme in that year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

However, where such amount is released during the previous year at the closing of the account on the death of the assessee, partition of a HUF or liquidation of a company, the above restriction will not apply.

- (xi) **Consequences of sale or transfer:** Where an asset acquired in accordance with the scheme or deposit scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which it was acquired, such portion of the cost relatable to the deduction allowed under section 33AB(1) shall be deemed to be profits and gains of business or profession of the previous year in which the asset is sold or transferred and shall be chargeable to income-tax as the income of that previous year.

**Exceptions:** Such restriction will not apply in the following cases:

- (a) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.
- (b) Where the sale or transfer is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers any asset to the company and the scheme or deposit scheme continues to apply to the company in the same manner as applicable to the firm.

Further, all the properties and liabilities of the firm relating to the business or profession immediately before the succession should become the properties and liabilities of the company and all the shareholders of the company should have been partners of the firm immediately before the succession.

- (xii) **Power to Central Government for specified period:** The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.
- (xiii) **Meaning of National Bank:** "National Bank" means the National Bank for Agricultural and Rural Development (NABARD).

#### **(5) Site Restoration Fund [Section 33ABA]**

- (i) **Eligibility for deduction:** This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of prospecting for, or extraction or production, of petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement with such assessee for such business.
- (ii) **Quantum of deduction:** It provides that where the assessee has before the end of the previous year -
  - (a) deposited any sum with the State Bank of India in a special account maintained by the assessee with that bank in accordance with the scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas, or
  - (b) deposited any amount in a Site Restoration Account opened by the assessee for the purposes specified in a scheme framed by the said Ministry (hereinafter referred to as the deposit scheme),

**the assessee shall be entitled to a deduction of —**

- a sum equal to the sum deposited; or
- a sum equal to **20%** of its profits (as computed under the head “Profits and gains of business or profession” before making any deduction under this section),

whichever is less.

For this purpose, it is provided that any amount credited in the special account or Site Restoration Account by way of interest shall also be deemed to be a deposit.

The above deduction will be allowed before the setting off of brought-forward loss under section 72.

- (iii) **No deduction to partner of assessee-firm or member of assessee-AOP/ BOI:** Where the assessee is a firm or any association of persons or anybody of individuals the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.
- (iv) **Non-eligibility of deduction in any other previous year:** Where any deduction in respect of any amount deposited in the special account or Site Restoration Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.
- (v) **Audit of books of accounts:** This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1) and the assessee furnishes by that date the report of such audit in the prescribed form duly signed and verified by such accountant.

However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

- (vi) **Condition to withdraw the amount** - Any amount standing to the credit in the special account or the Site Restoration Account will not be allowed to be withdrawn except for the purposes specified in the scheme or in the deposit scheme.

- (vii) **No deduction:** No deduction shall be allowed in respect of any amount utilised for the purchase of the following items:
- any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;
  - any office appliances (not being computers);
  - any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head 'Profits and gains of business or profession' of any one previous year;
  - any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.
- (viii) **Withdrawal on closure of account:** Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account **as reduced by** the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.
- Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee is no longer in existence, these provisions will apply as if the business is in existence in that previous year.
- (ix) **Utilisation from scheme for business purpose not available as a deduction:** Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or deposit scheme, such expenditure shall not be allowed in computing the business income.
- (x) **Consequences of non-utilisation of withdrawn amount:** Where any amount in the special account or Site Restoration Account is released in the previous year by the State Bank of India or is withdrawn from the Site Restoration Account for being utilised by the assessee for the purposes of such business and is not utilised in accordance with the scheme or the deposit scheme in that year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

(xi) **Consequences of sale or transfer** - Where any asset acquired in accordance with the scheme or the deposit scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which such assets were acquired, such part of the cost of such asset as is relatable to the deduction allowed under section 33ABA(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and shall accordingly be chargeable to income-tax as the income of that previous year.

**Exceptions:** This restriction will not apply in the following cases:

- (a) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.
- (b) Where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm.

Further, all the properties and liabilities of the firm relating to the business or profession immediately before the succession should become the properties and liabilities of the company and all the shareholders of the company should have been partners of the firm immediately before the succession.

(xii) **Power to Central Government for specified period:** The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

#### **(6) Expenditure on Scientific Research [Section 35]**

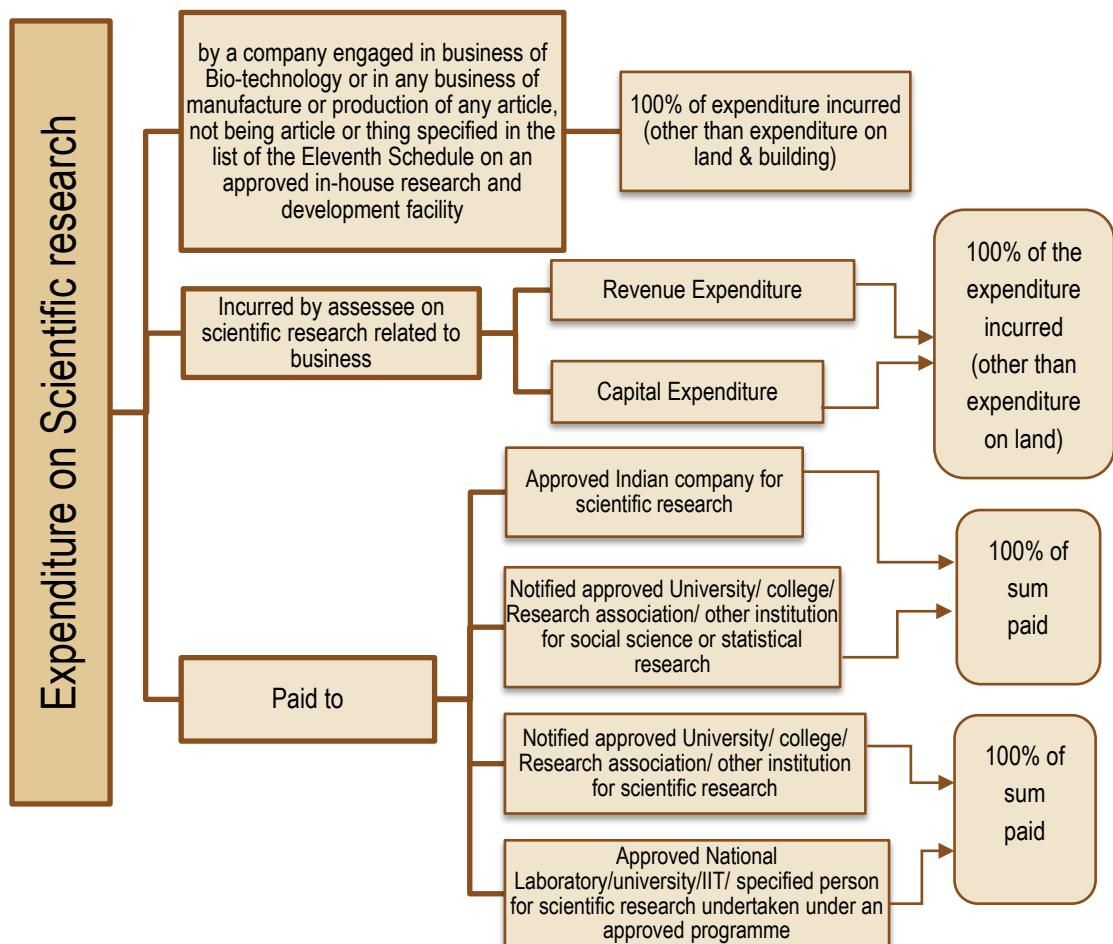
This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee.

**Meaning of certain terms:**

Term	Meaning
<b>Scientific research</b>	Activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries [Section 43(4)(i)].
<b>Scientific research expenditure</b>	Expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any

	expenditure incurred in the acquisition of rights in or arising out of scientific research.
<b>Scientific research related to a business or a class of business</b>	<p>Scientific research related to a business or a class of business would include</p> <ul style="list-style-type: none"> <li>(i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be;</li> <li>(ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.</li> </ul>

The deduction allowable under this section consists of –



**(I) Incurred by assessee:**

- (i) **Revenue Expenditure:** Any revenue expenditure incurred by the assessee on scientific research **related to his business** would be allowed as deduction in the year in which it was incurred. Expenditure incurred within 3 years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on purchase of material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority [Section 35(1)(i)]
- (ii) **Capital Expenditure:** Any expenditure of a capital nature on scientific research **related to the business** carried on by the assessee would be deductible in full in the previous year in which it is incurred [Section 35(1)(iv)].

**(a) Capital expenditure prior to commencement of business**

The *Explanation 1* to section 35(2)(ia) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business, the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced and will rank for deduction as expenditure for scientific research incurred during the previous year.

**Expenditure on land disallowed**

No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land whether the land is acquired as such or as part of any property.

**(b) Carry forward of deficiency**

Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year against any head of income other than salaries [Section 35(4)].

**(c) No depreciation**

Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

**(d) Sale of asset representing expenditure of capital nature on scientific research**

Section 41, *inter alia*, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research.

Where the asset representing expenditure of a capital nature on scientific research is sold without having been used for other purposes, the provisions of section 41(3) would be attracted. If the proceeds of sale together with the total amount of the deductions made under section 35(1)(iv) exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

In simple words, since amount of deduction under section 35(1)(iv) is equal to the amount of expenditure, lower of amount of sale proceeds or deduction allowed under section 35(1)(iv) will be the charged to tax as income of the business in the previous year in which the asset is sold.

**Example -** If capital expenditure incurred for scientific research in P.Y. 2024-25 is ₹ 3 lakhs, then deduction u/s 35(1)(iv) would have been ₹ 3 lakhs in that P.Y. If the asset is sold for ₹ 4 lakhs in P.Y. 2025-26, ₹ 3 lakhs, being lower of sale proceeds of ₹ 4 lakhs and deduction u/s 35(1)(iv) of ₹ 3 lakhs, would be charged to tax u/s 41(3) in the P.Y. 2025-26, being the year of sale.

**Note -** Deduction under section 35(1)(i) and 35(1)(iv) read with section 35(2) would be available to an assessee under the special concessional tax regimes under section 115BAA/115BAB/115BAC/115BAD/115BAE as well as the regular provisions of the Act.

**(II) Amount contributed or paid to:**

**(i) Notified approved research association, university, college or other institution:**

An amount equal to any sum paid to -

- a research association which has as its object, the undertaking of scientific research or
- to a university, college or other institution to be used for scientific research.

provided that such university, college, institution or association is approved for this purpose and notified by the Central Government. [Section 35(1)(ii)]

The payments so made to such institutions would be allowable irrespective of whether:

- (a) the field of scientific research is related to the assessee's business or not, and
- (b) the payment is of a revenue nature or of a capital nature.

**Note** - Deduction u/s 35(1)(ii) would be available to an individual, HUF, AoP (other than a co-operative society) or Bol or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.

In case of companies and co-operative societies, deduction u/s 35(1)(ii) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(1)(ii) would be allowable only if they pay tax under the normal provisions of the Act.

**(ii) Approved Indian company for scientific research:** A sum equal to any amount paid to a company to be used by it for scientific research [Section 35(1)(ia)]

However, such deduction would be available only if;

- the company is registered in India and
- has as its main object the scientific research and development.

Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

**Note -** Deduction u/s 35(1)(iiia) would be available to an individual, HUF, AoP (other than a co-operative society) or Bol or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.

In case of companies and co-operative societies, deduction u/s 35(1)(iiia) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(1)(iiia) would be allowable only if they pay tax under the normal provisions of the Act.

**(iii) Approved notified research association, university, college or other institution:**

A sum equal to any amount paid to

- a research association which has as its object the undertaking of research in social science or statistical research or
- a university, college or other institution to be used for research in any social science or statistical research

provided that they are approved for this purpose and notified by the Central Government. [Section 35(1)(iii)]

Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution for scientific research or research in a social science or statistical research or to a company for scientific research, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

**Note -** Deduction u/s 35(1)(iii) would be available to an individual, HUF, AoP (other than a co-operative society) or Bol or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.

In case of companies and co-operative societies, deduction u/s 35(1)(iii) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(1)(iii) would be allowable only if they pay tax under the normal provisions of the Act.

**Approval -**

The research association, university, college or other institution for scientific research or research in a social science or statistical research has to make an application in the prescribed form and manner to the Central Government for the purpose of grant of approval, or continuance thereof.

The Central Government before granting approval, call for such documents or information as it thinks necessary in order to satisfy itself about the genuineness of the activities of the research association, university, college or other institution and that Government may also make such inquiries as it may deem necessary.

Every notification in respect of research association, university, college or other institution or Indian company for scientific research issued on or before 1.4.2021 shall be deemed to have been withdrawn unless such association/institution/university/college/company makes an intimation to the prescribed income-tax authority in the prescribed form. Such intimation has to be made within 3 months from 1.4.2021. Such notification shall be valid for a period of 5 consecutive assessment years beginning with the A.Y. 2022-23 or thereafter subject to the intimation made by the association/institution/university/college/company.

However, where any notification is issued by the Central Government after 29.9.2020, it shall, at any time, have effect for such assessment year(s), but not exceeding 5 assessment years as may be specified in the notification.

**Requirements –**

Research association, university, college or other institution or Indian company for scientific research has to

- (i) prepare prescribed statement for prescribed period and deliver or cause to be delivered such statement to the prescribed income-tax authority or the person authorized by such authority in such form, verified in such manner, setting forth such particulars and within such prescribed time.

Such association/institution/university/college/company may also deliver to the prescribed authority a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement delivered in the prescribed form and verified in prescribed manner.

- (ii) furnish to the donor, a certificate specifying the amount of donation in the such manner, containing such particulars and within such time from the date of receipt of sum, as may be prescribed.

The deduction with respect to the donation given by the assessee to any research association, university, college or other institution referred to in section 35(1)(ii)/(iii) or the company referred to in section 35(1)(iia) would not be allowed unless such research association, university, college or other institution or company complies with the above requirements stipulated under section 35(1A).

- (iv) **Sum paid to National Laboratory, etc. [Section 35(2AA)]:** Section 35(2AA) provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out programmes of scientific research approved by the prescribed authority will be eligible for deduction of the amount so paid.

**No other deduction under the Act:** No contribution which qualifies for deduction under this clause will be entitled to deduction under any other provision of the Act.

Further, it has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to an approved National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme shall not be denied to the donor-assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid donee-entities or the programme has been withdrawn.

Term	Meaning
Specified person	A person who is approved by the prescribed authority

**Note -** Deduction u/s 35(2AA) would be available to an individual, HUF, AoP (other than a co-operative society) or Bol or an artificial juridical person only if they exercise the option of shifting out of the default tax regime provided under section 115BAC(1A) and pay tax as per the optional tax regime under the regular provisions of the Act.

In case of companies and co-operative societies, deduction u/s 35(2AA) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB and section 115BAD/115BAE, respectively. In other words, deduction u/s 35(2AA) would be allowable only if they pay tax under the normal provisions of the Act.

**(III) Company engaged in Business of bio-technology or manufacturing of article or thing etc. [Section 35(2AB)]**

Where a company engaged **in the business of bio-technology 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 [The exclusion list comprises of beer, wine and other alcoholic spirits, tobacco and tobacco preparations, cosmetic and toilet preparations, tooth paste, dental cream, tooth powder and soap, confectionery and chocolates, office machines and apparatus, steel furniture etc] incurs any expenditure on scientific research on in-house research and development facility as approved by the prescribed authority, a deduction of a **sum equal to the expenditure** will be allowed. Such expenditure **should not be in the nature of cost of any land or building**.

**“Expenditure on scientific research”** in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any state regulatory authority, and filing an application for a patent under the Patents Act, 1970.

**No other deduction under the Act:** No deduction will be allowed in respect of the above expenditure under any other provision of the Income-tax Act, 1961.

**Agreement with the prescribed authority:** No company will be entitled to this deduction unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and fulfills the prescribed conditions with regard to maintenance and audit of accounts and also furnishes prescribed reports in the prescribed manner.

**Approval of the Authority:** The prescribed authority shall submit its report in relation to the approval of the said facility to the Principal Chief Commissioner or the Chief Commissioner or Principal Director General Director General in such form and within such time as may be prescribed.

**Note -** In case of companies, deduction u/s 35(2AB) would not be allowable if they opt for the special provisions u/s 115BAA/115BAB. In other words, deduction u/s 35(2AB) would be allowable only if they pay tax under the normal provisions of the Act.

#### ILLUSTRATION 5

A Ltd., engaged in the business of manufacturing since 2015, furnishes the following particulars for the P.Y.2025-26. Compute the deduction allowable under section 35 for A.Y.2026-27, while computing its income under the head “Profits and gains of business or profession”, assuming that it does not opt for special tax regime under section 115BAA.

	<i>Particulars</i>	₹
1.	<i>Amount paid to notified approved Indian Institute of Science, Bangalore, for scientific research</i>	1,00,000
2.	<i>Amount paid to IIT, Delhi for an approved scientific research programme</i>	2,50,000
3.	<i>Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority</i>	4,00,000
4.	<i>Expenditure incurred on in-house research and development facility as approved by the prescribed authority</i>	
	(a) <i>Revenue expenditure on scientific research</i>	3,00,000
	(b) <i>Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research</i>	7,50,000

**SOLUTION****Computation of deduction under section 35 for the A.Y.2026-27**

<b>Particulars</b>	<b>₹</b>	<b>Section</b>	<b>% of deduction</b>	<b>Amount of deduction (₹)</b>
<b>Payment for scientific research</b>				
Indian Institute of Science	1,00,000	35(1)(ii)	100%	1,00,000
IIT, Delhi	2,50,000	35(2AA)	100%	2,50,000
X Ltd.	4,00,000	35(1)(iia)	100%	4,00,000
<b>Expenditure incurred on in-house research and development facility</b>				
Revenue expenditure	3,00,000	35(2AB))	100%	3,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(2AB)	100%	2,50,000
<b>Deduction allowable under section 35</b>				<b>13,00,000</b>

**(7) Expenditure for obtaining right to use spectrum for telecommunication services [Section 35ABA]**

- (i) Section 32 allows depreciation in respect of assets including certain intangible assets. Section 35ABB provides for amortisation of licence fee in case of telecommunication service.
- (ii) The Government has introduced spectrum fee for auction of airwaves.

(iii) In order to resolve the uncertainty in tax treatment of payments in respect of spectrum i.e., whether spectrum is an intangible asset and the spectrum fees paid is eligible for depreciation under section 32 or whether it is in the nature of a 'licence to operate telecommunication business' and eligible for deduction under section 35ABB, section 35ABA provides for tax treatment of spectrum fee.

**(iv) Tax treatment of spectrum fee:**

	Transaction	Manner of deduction							
<b>(1)</b>	<b>Acquisition of right to use spectrum</b>								
	Any capital expenditure incurred for acquisition of any right to use spectrum for telecommunication services either before the commencement of the business or thereafter at any time during any previous year and for which <b>payment has actually been made</b> to obtain a right to use spectrum.								
	<b>Meaning of relevant previous years:</b> <table border="1"> <thead> <tr> <th>Case</th><th>Meaning</th></tr> </thead> <tbody> <tr> <td>Where the spectrum fee is actually paid before the commencement of business to operate telecommunication services</td><td>The previous years beginning with the P.Y. in which such business commenced and the subsequent P.Y. or P.Y.s during which the spectrum, for which the fee is paid, shall be in force.</td></tr> <tr> <td>In any other case</td><td>The previous years beginning with the P.Y. in which the spectrum fee is actually paid and the subsequent P.Y. or years during which the spectrum, for which the fee is paid, shall be in force.</td></tr> </tbody> </table>			Case	Meaning	Where the spectrum fee is actually paid before the commencement of business to operate telecommunication services	The previous years beginning with the P.Y. in which such business commenced and the subsequent P.Y. or P.Y.s during which the spectrum, for which the fee is paid, shall be in force.	In any other case	The previous years beginning with the P.Y. in which the spectrum fee is actually paid and the subsequent P.Y. or years during which the spectrum, for which the fee is paid, shall be in force.
Case	Meaning								
Where the spectrum fee is actually paid before the commencement of business to operate telecommunication services	The previous years beginning with the P.Y. in which such business commenced and the subsequent P.Y. or P.Y.s during which the spectrum, for which the fee is paid, shall be in force.								
In any other case	The previous years beginning with the P.Y. in which the spectrum fee is actually paid and the subsequent P.Y. or years during which the spectrum, for which the fee is paid, shall be in force.								
	<b>Meaning of 'payment has actually been made'.</b>								
	Payment has actually been made means actual payment of expenditure irrespective of the previous year in which the liability for expenditure was incurred according to the method of accounting regularly employed by the assessee or payable in the prescribed manner.								
	<b>Rule 6A substantiates the meaning of the phrase 'payment has actually been made'</b>								
(a)	<b>In a case where full upfront payment of spectrum fee has been made:</b> Where an assessee has opted and been allowed by the Department of								

	Telecommunications, Government of India to make full upfront payment of spectrum fee, the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee;
(b)	<p><b>In a case where deferred payment is made:</b></p> <p>Where an assessee has opted and been allowed by the Department of Telecommunications, Government of India to make deferred payment, the amount which would have been payable by the assessee had he opted for full upfront payment of spectrum fee irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.</p>
	<p>However, in case of deferred payment referred to in clause (b) above, where there is failure by the assessee to comply with any of the conditions specified by the scheme of the Department of Telecommunications, Government of India and Department of Telecommunications terminates the allotment or assignment of spectrum, the Assessing Officer shall, in exercise of power vested in him under section 35ABA(3), re-compute the total income of the assessee for the previous year in which the deduction has been claimed and granted to him by deeming that,-</p> <ul style="list-style-type: none"> <li>(i) the total amount of spectrum fee paid up to the date of termination is the amount of "payment actually been made";</li> <li>(ii) the spectrum was in force up to the date of its termination for the purpose of computing "relevant previous year".</li> </ul>
(2)	<b>Transfer of the spectrum</b>
	<p><b>Case 1:</b> Where the proceeds of the transfer of spectrum are <b>less than</b> the expenditure incurred remaining unallowed</p> <p>The expenditure remaining unallowed <b>as reduced by</b> the proceeds of transfer shall be allowed in the previous year in which the spectrum has been transferred.</p> <p><b>Amount of deduction = Expenditure remain unallowed – Sale proceeds</b></p>
	<p><b>Case 2:</b> Where the proceeds of the transfer of whole or any part of the spectrum <b>exceed</b> the amount of expenditure remaining unallowed</p> <p>The excess amount or expenditure allowed till date (i.e., difference between expenditure incurred to obtain spectrum and the expenditure remain unallowed), <b>whichever is less</b>, shall be chargeable to tax as profits and gains of business in the previous year in which the spectrum has been transferred.</p> <p><b>Taxable as profits and gains from business and profession =</b></p> <p style="text-align: right;"><b>Sale proceeds – Expenditure remain unallowed      OR      Expenditure allowed till date</b></p> <p style="text-align: right;">} Whichever is less</p>

		If the spectrum is transferred in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as though the business is in existence in that previous year.
	<b>Case 3:</b> Where the proceeds of the transfer of whole or any part of the spectrum <b>are not less than</b> the amount of expenditure incurred remaining unallowed.	No deduction for such expenditure shall be allowed in the previous year in which spectrum is transferred or in respect of any subsequent previous year or years. <b>Amount of deduction = NIL</b>
	<b>Case 4:</b> Where a part of the spectrum is transferred and the case is not covered under Case 2 above i.e., the proceeds of transfer of a part of the spectrum does not exceed the amount of expenditure remaining unallowed	Unallowed expenditure would be amortised in the following manner – (i) subtracting the proceeds of transfer from the expenditure remaining unallowed; and (ii) dividing the remainder by the number of relevant previous years which have not expired at the beginning of the previous year during which the spectrum is transferred. $\text{Amount of deduction} = \frac{\text{Unallowed expenditure} - \text{Sale proceeds}}{\text{Unexpired number of relevant P.Y.s}}$
(3)	<b>Transfer of spectrum in a scheme of amalgamation</b>	
	If the amalgamating company sells or transfers the spectrum to the amalgamated company, being an Indian company under the scheme of amalgamation	The provisions of section 35ABA will apply to amalgamated company as they would have applied to amalgamating company as if the latter has not transferred the spectrum. The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the amalgamating company.
(4)	<b>Transfer of spectrum in a scheme of demerger</b>	
	If the demerged company sells or transfers the spectrum to the resulting company, being an Indian company under the scheme of demerger	The provisions of section 35ABA will apply to resulting company as they would have applied to demerged company as if the latter has not transferred the spectrum. The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the demerged company.

**(v) No depreciation**

Where a deduction is claimed and allowed for any previous year under this section, then no depreciation on capital expenditure so incurred shall be allowed by way of depreciation under section 32(1) for the same previous year or in any other previous year.

**(vi) Consequences of failure to comply with the conditions after grant of deduction:**

Where, in a previous year, any deduction has been claimed and granted to an assessee and subsequently, there is failure to comply with any of the provisions of this section, then –

- (1) the deduction shall be deemed to have been wrongly allowed;
- (2) the Assessing Officer may recompute the total income of the assessee for the said previous year and make the necessary rectification. This is notwithstanding anything contained in the Income-tax Act, 1961;
- (3) the provisions under section 154 for rectification of mistake apparent from the record would apply. The period of four years would be reckoned from the end of the previous year in which the failure to comply with the provisions of section 35ABA takes place.

**(8) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]**

**(i) Tax treatment of licence fee:**

	Transaction	Manner of deduction	
<b>(1)</b>	<b>Acquisition of right to operate telecommunication services</b>		
	Any capital expenditure incurred for acquisition of any right to operate telecommunication services either before the commencement of the business or thereafter at any time during any previous year and for which <b>payment has actually been made</b> (actual payment of expenditure) to obtain a licence.	Appropriate fraction of the amount of such expenditure [1/ total number of relevant previous years]  <b>Meaning of relevant previous years:</b>	
		<b>Case</b>	<b>Meaning</b>
		Where the licence fee is actually paid before the commencement of business to operate telecommunication services	The previous years beginning with the P.Y. in which such business commenced and the subsequent P.Y. or P.Y.s during which the licence, for which the fee is paid, shall be in force.
		In any other case	The previous years beginning with the P.Y. in which the licence fee is actually paid and the subsequent

		P.Y. or years during which the licence, for which the fee is paid, shall be in force.
	<b>Payment has actually been made means</b> the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.	
(2)	<b>Transfer of the licence</b>	
	<b>Case 1:</b> Where the proceeds of the transfer of licence are <b>less than</b> the expenditure incurred remaining unallowed	The expenditure remaining unallowed <b>as reduced by</b> the proceeds of transfer shall be allowed in the previous year in which the licence has been transferred.  <b>Amount of deduction =</b> Expenditure remain unallowed – Sale proceeds
	<b>Case 2:</b> Where the proceeds of the transfer of whole or any part of the licence <b>exceed</b> the amount of expenditure remaining unallowed	The excess amount shall be chargeable to tax as profits and gains of business in the previous year in which the licence has been transferred. However, the excess should not exceed the difference between the expenditure incurred to obtain the licence and the amount of expenditure remaining unallowed.  <b>Taxable as profits and gains from business and profession =</b> Sale proceeds – Expenditure remain unallowed OR Expenditure allowed till date } Whichever is less
	<b>Case 3:</b> Where the proceeds of the transfer of whole or any part of the licence <b>are not less than</b> the amount of expenditure incurred remaining unallowed.	If the licence is transferred in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as if the business is in existence in that previous year.  <b>Amount of deduction = NIL</b>
	<b>Case 4:</b> Where a part of the licence is transferred and the case is not covered under Case 2 above	Unallowed expenditure would be amortised in the following manner – (i) subtracting the proceeds of transfer from the expenditure remaining unallowed; and (ii) dividing the remainder by the number of relevant

	i.e., the proceeds of transfer of a part of the licence does not exceed the amount of expenditure remaining unallowed	previous years which have not expired at the beginning of the previous year during which the licence is transferred.
		Amount of deduction = $\frac{\text{Unallowed expenditure} - \text{Sale proceeds}}{\text{Unexpired number of relevant P.Y.s}}$
(3)	<b>Transfer of licence in a scheme of amalgamation</b>	
	If the amalgamating company sells or transfers the licence to the amalgamated company, being an Indian company, under the scheme of amalgamation	The provisions of section 35ABB will apply to amalgamated company as they would have applied to amalgamating company as if the latter has not transferred the licence.  The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the amalgamating company.
(4)	<b>Transfer of licence in a scheme of demerger</b>	
	If the demerged company sells or transfers the licence to the resulting company, being an Indian company, under the scheme of demerger	The provisions of section 35ABB will apply to resulting company as they would have applied to demerged company as if the latter has not transferred the licence.  The tax treatment in cases 1, 2 & 3 given in (2) above will not apply to the demerged company.

**(ii) No depreciation**

Where a deduction is claimed and allowed for any previous year under this section, then no depreciation on capital expenditure so incurred shall be allowed by way of depreciation under section 32(1) for the same previous year or in any other previous year.

**ILLUSTRATION 6**

*X Ltd., providing telecommunication services, acquired a telecom licence at cost of ₹ 50 lakhs on 01.04.2023 for a period of 10 years. Assuming the telecom licence is transferred by X Ltd. in P.Y. 2025-26, say for: (a) ₹ 32 lakhs; (b) ₹ 43 lakhs or (c) ₹ 52 lakhs, and if:*

- (i) Whole of the license is transferred
- (ii) Part of the license is transferred.

*Explain, how the transfer shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2026-27.*

**SOLUTION****(i) Whole of the license is transferred:**

Particulars	₹ (in lakhs)
Cost of the licence	50
Less: Deduction u/s 35ABB for P.Y. 2023-24	5
	<b>45</b>
Less: Deduction u/s 35ABB for P.Y. 2024-25	5
<b>Expenditure remaining unallowed</b>	<b>40</b>
<b>(a) If transferred for ₹ 32 lakhs</b>	
Proceeds from transfer	32
Deduction allowed u/s 35ABB in P.Y. 2025-26 (Expenditure remaining unallowed <b>as reduced by</b> the proceeds of transfer)	8
<b>(b) If transferred for ₹ 43 lakhs</b>	<b>43</b>
Proceeds from transfer	
Taxable as profits and gains from business and profession (Lesser of: ₹ 3 lakhs i.e., Proceed from transfer - Expense remain unallowed i.e. ₹ 43 lakhs - ₹ 40 lakhs <b>or</b> ₹ 10 lakhs i.e., expense allowed till date)	3
<b>(c) If transferred for ₹ 52 lakhs</b>	
Proceeds from transfer	52
Taxable as profits and gains from business and profession (Lesser of: ₹ 12 lakhs i.e., Proceed from transfer - Expense remain unallowed i.e. ₹ 52 lakhs - ₹ 40 lakhs <b>or</b> ₹ 10 lakhs i.e., expense allowed till date)	10
Short Term Capital Gains (₹ 52 lakhs - ₹ 40 lakhs - ₹ 10 lakhs)	2

**(ii) Part of the license is transferred:**

Particulars	₹ (in lakhs)
Cost of the licence	50
Less: Deduction u/s 35ABB for P.Y. 2023-24	5
	<b>45</b>
Less: Deduction u/s 35ABB for P.Y. 2024-25	5
<b>Expenditure remaining unallowed</b>	<b>40</b>

<b>(a) If transferred for ₹ 32 lakhs</b>		
Proceeds from transfer	32	
Deduction allowed u/s 35ABB in P.Y. 2025-26 [₹ 40 lakhs - ₹ 32 lakhs)/ 8 years]	1	
<b>(b) If transferred for ₹ 43 lakhs</b>		
Proceeds from transfer	43	
Taxable as profits and gains from business and profession (Lesser of: ₹ 3 lakhs i.e., Proceeds from transfer - Expense remaining unallowed i.e. ₹ 43 lakhs - ₹ 40 lakhs <b>or</b> ₹ 10 lakhs i.e., expense allowed till date)	3	
<b>(c) If transferred for ₹ 52 lakhs</b>		
Proceeds from transfer	52	
Amount taxable as profits and gains from business and profession (Lesser of: ₹ 12 lakhs i.e., Proceeds from transfer - Expense remaining unallowed i.e. ₹ 52 lakhs - ₹ 40 lakhs <b>or</b> ₹ 10 lakhs i.e., expense allowed till date)	10	
Short Term Capital Gains (₹ 52 lakhs - ₹ 40 lakhs - ₹ 10 lakhs)	2	

**(9) "Investment-linked tax incentives" for specified businesses [Section 35AD]**

- (i) **List of specified businesses:** With the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely –
- setting-up and operating 'cold chain' facilities for specified products;
  - setting-up and operating warehousing facilities for storing agricultural produce;
  - laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network;
  - building and operating a hotel of two-star or above category, anywhere in India;
  - building and operating a hospital, anywhere in India, with at least 100 beds for patients;
  - developing and building a housing project under a notified scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government.

- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government;
- production of fertilizer in India;
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
- bee-keeping and production of honey and beeswax;
- setting up and operating a warehousing facility for storage of sugar;
- laying and operating a slurry pipeline for the transportation of iron ore;
- setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines;
- developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility.

(ii) **Deduction for Capital Expenditure:** 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income to the assessee opting for deduction under section 35AD.

→ However, expenditure incurred on acquisition of any **land, goodwill or financial instrument** would not be eligible for deduction.

→ Further, any expenditure in respect of which payment or aggregate of payment made to a person of an amount exceeding **₹ 10,000 in a day** otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic mode would not be eligible for deduction. The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [Notification No. 8/2020 dated 29.01.2020].

**Note -** In case of an individual/HUF/AoP/Bol carrying on specified business, deduction u/s 35AD would be available only if such person exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). If such person is paying concessional rates of tax under the default tax regime u/s 115BAC, deduction u/s 35AD would not be available.

A company/ cooperative society would not be eligible for deduction under section 35AD, if it opted for the special provisions of section 115BAA/115BAB or section 115BAD/115BAE, respectively.

- (iii) **Expenditure prior to commencement of operation:** 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.

The amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

- (iv) **Conditions to be fulfilled:** For claiming deduction under section 35AD, the specified business should fulfill the following conditions –

<b>General Conditions:</b>	
<b>To be fulfilled by every specified business</b>	
(i)	it should not be set up by splitting up, or the reconstruction, of a business already in existence;
(ii)	<p>it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose;</p> <p>In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in such specified business.</p> <p>For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied:</p> <ul style="list-style-type: none"> <li>(a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;</li> <li>(b) the plant or machinery was imported into India from a foreign country;</li> <li>(c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.</li> </ul>

**Conditions required to be fulfilled by certain specified businesses:**

**I. Business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network**

- (i) Such business should be owned by a company formed and registered in India under the Companies Act, 1956<sup>7</sup> or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;
- (ii) It should have been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette
- (iii) It should have made not less than such proportion of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person.
- (iv) It should fulfill any other prescribed condition.

**II. Business of developing or operating and maintaining or developing, operating and maintaining a new infrastructure facility**

- (i) The business should be owned by a company registered in India or by a consortium of such companies or by an authority or a board or corporation or any other body established or constituted under any Central or State Act.
- (ii) The entity should have entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing or operating and maintaining or developing, operating and maintaining, a new infrastructure facility.

- (v) **No deduction under section 10AA or Chapter VI-A under the heading “C.-Deductions in respect of certain incomes”:** Where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction under the provisions of Chapter VI-A under the heading “C - Deductions in respect of certain incomes” or section 10AA is permissible in relation to such specified business for the same or any other assessment year.

Correspondingly, section 80A has been amended to provide that where a deduction under any provision of this Chapter under the heading “C – Deductions in respect of certain incomes” is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.



In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading “C.-Deductions in respect of certain incomes” or section 10AA, **for the same or any other year and vice versa.**

<sup>7</sup> Now Companies Act, 2013

(vi) **No deduction allowable under the Act in respect of expenditure for which deduction allowed under this section:** The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act, 1961 in the current year or under this section for any other year, if the deduction has been claimed or opted by him and allowed to him under section 35AD.

(vii) **Date of Commencement of specified businesses:**

S. No.	Specified business	Date of commencement of operations
1.	Laying and operating a cross country natural gas pipeline network for distribution, including storage facilities being an integral part of such network	on or after 1st April, 2007
2.	(a) building and operating anywhere in India, a hotel of two-star or above category as specified by the Central Government (b) building and operating a hospital with at least 100 beds for patients (c) notified scheme for slum redevelopment or rehabilitation housing projects	on or after 1st April, 2010
3.	(a) notified scheme for affordable housing projects and (b) production of fertilizer in a new plant or in a newly installed capacity in an existing plant	on or after 1 <sup>st</sup> April, 2011
4.	(a) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, (b) bee-keeping and production of honey and beeswax and (c) setting up and operating a warehousing facility for storage of sugar	on or after 1 <sup>st</sup> April, 2012
5.	(a) laying and operating a slurry pipeline for the transportation of iron ore or (b) setting up and operating a semi-conductor wafer fabrication manufacturing unit	on or after 1 <sup>st</sup> April, 2014
6.	developing or operating and maintaining or developing, operating and maintaining, any infrastructure facility	on or after 1 <sup>st</sup> April, 2017
7.	In any other case, namely, setting and operating - (a) "cold-chain" facilities for specified products or (b) warehousing facilities for storing agricultural produce	on or after 1st April, 2009

**(viii) Meaning of certain terms**

Term	Meaning
<b>Cold chain facility</b>	A chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.
<b>Associated person</b>	In relation to the assessee means a person— (i) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee; (ii) who holds, directly or indirectly, shares carrying not less than 26% of the voting power in the capital of the assessee; (iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or (iv) who guarantees not less than 10% of the total borrowings of the assessee.
<b>Infrastructure facility</b>	(i) A road including toll road, a bridge or a rail system. (ii) A highway project including housing or other activities being an integral part of the highway project. (iii) A water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system. (iv) A port, airport, inland waterway, inland port or navigational channel in the sea.

**(ix) Set-off or carry forward and set-off of loss from specified business:**

The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD.

Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business but the assessee has to file return of income on or before the due date of filling return of income under section 139 for carry forward of losses from specified business.

**Example:**

A assessee can therefore, set-off the losses of a hospital or hotel which begins to operate after 1<sup>st</sup> April, 2010 and which is eligible for deduction section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category) started before 1<sup>st</sup> April, 2010, even if the latter is not eligible for deduction under section 35AD.

**ILLUSTRATION 7**

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2025. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2025 to March, 2025 exclusively for the above businesses, and capitalized the same in its books of account as on 1<sup>st</sup> April, 2025. The cost of land included in the above figures is ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. During the P.Y. 2025-26, he incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/ reconstruction of the building purchased and used exclusively for the above businesses.

The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2026-27 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively. Assume in respect of expenditure incurred, the payments are made by account payee cheque or use of ECS through bank account.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2026-27 and the loss to be carried forward, assuming that Mr. A is exercising the option of shifting out of the default tax regime provided under section 115BAC(1A) and has fulfilled all the conditions specified for claim of deduction under section 35AD and wants to claim deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes".

**SOLUTION****Computation of profits and gains of business or profession for A.Y. 2026-27**

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32 10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	3
<b>Income chargeable under "Profits and gains from business or profession"</b>	<b>28</b>

**Computation of income/loss from specified business under section 35AD**

	Particulars	Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)  <b>Less: Deduction under section 35AD</b>	16	14	30
(B)	Capital expenditure incurred prior to 1.4.2025 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2025 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y.2025-26	20	15	35
(D)	<b>Total capital expenditure (B + C)</b>	50	35	85
(E)	<b>Deduction under section 35AD</b> 100% of capital expenditure (food grains/sugar)	50	35	85
	<b>Total deduction u/s 35AD for A.Y.2026-27</b>	50	35	85
(F)	<b>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)</b>	(34)	(21)	(55)

**Notes:**

- (i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2026-27 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 01.04.2012 or on or after 01.04.2009, respectively.
- (ii) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.
- (iii) Mr. A can, however, 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. 2025-26.

- (iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 55 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 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 provided Mr. A files his return of income on or before the due date as specified u/s 139.

### ILLUSTRATION 8

*XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2025. The company incurred capital expenditure of ₹ 50 lakh during the period January, 2025 to March, 2025 exclusively for the above business, and capitalized the same in his books of account as on 1<sup>st</sup> April, 2025. Further, during the P.Y. 2025-26, it incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business.*

*Compute the income under the head “Profits and gains of business or profession” for the A.Y.2026-27, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and opted for claiming deduction under section 35AD; and has not claimed any deduction under Chapter VI-A under the heading “C. – Deductions in respect of certain incomes”. The company is not opting for the concessional tax regime under section 115BAA.*

*The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2026-27 is ₹ 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations fifteen years back, the profits from which are ₹ 120 lakhs for the A.Y.2026-27. Also, assume that expenditure incurred during the previous year 2025-26 were paid by account payee cheque or use of ECS through bank account.*

### SOLUTION

#### Computation of profits and gains of business or profession for A.Y. 2026-27

Particulars	₹ (in lakhs)
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)	25
<b>Less: Deduction under section 35AD</b>	
Capital expenditure incurred during the P.Y.2025-26 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakhs – ₹ 150 lakhs	50 lakh

Capital expenditure incurred prior to 1.4.2025 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2025	50 lakh
Total deduction under section 35AD for A.Y.2026-27	100
<b>Loss from the specified business of new hotel in Madurai</b>	(75)
Profit from the existing business of running a hotel in Coimbatore	120
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A	45

- (x) **Transfer of hotel built by the assessee:** Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, he would be eligible to claim investment-linked tax deduction under section 35AD.

Therefore, in effect, the assessee shall be deemed to be carrying on the specified business of building and operating hotel if –

- (i) The assessee builds a hotel of two-star or above category;
- (ii) Thereafter, he transfers the operation of the hotel to another person;
- (iii) He, however, should continue to own the hotel.

- (xi) **Other conditions contained under section 35AD**

S. No.	Particulars	Condition
1.	<b>Transfer of goods and services</b>	Where any goods or services held for the purposes of the specified business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the specified business shall be computed as if the transfer was made at market value. <b>Market value</b> means the price such goods or services would ordinarily fetch in the open market, subject to statutory or regulatory restrictions, if any.
2.	<b>Close connection between assessee</b>	Where due to the close connection between the assessee and the other person or for any other reason, it appears to

	<b>and any other person</b>	the Assessing Officer that the profits of specified business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.
2.	<b>Audit of accounts</b>	The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income.
3.	<b>Asset to be used for specified business for eight years</b>	Section 35AD(7A) provides that any asset in respect of which a deduction is claimed and allowed under section 35AD shall be used only for the specified business for a period of eight years beginning with the previous year in which such asset is acquired or constructed.
4.	<b>Asset demolished, destroyed, discarded or transferred for which a deduction has been allowed</b>	If any asset on which a deduction under section 35AD has been claimed and allowed, is demolished, destroyed, discarded or transferred, the sum received or receivable for the same is chargeable to tax under clause (vii) of section 28. This does not take into account a case where asset on which deduction under section 35AD has been claimed is used for any purpose other than the specified business by way of a mode other than that specified above.
5.	<b>Asset used for any other business other than specified business during 8 years [Section 35AD(7B)]</b>	If asset is <b>used for any purpose other than the specified business</b> during 8 years beginning with the previous year in which such asset is acquired, the total amount of deduction so claimed and allowed in any previous year(s) in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed under section 35AD, <u>shall be deemed to be income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used.</u> In such a case, as per the proviso to <i>Explanation 13</i> to Section 43(1), the actual cost of such asset for the assessee shall be the actual cost as reduced by amount of depreciation would have been allowable had the asset been used for the purpose of business since the date of its acquisition. However, the deeming provision under sub-section (7B) shall not be applicable to a company which has become a sick industrial company under section 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, during the intervening period of eight years specified in sub-section (7A).

**ILLUSTRATION 9**

*ABC Ltd. is a company having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non-specified business of operating a warehousing facility for storage of edible oil.*

*Unit A commenced operations on 1.4.2024 and it claimed deduction of ₹ 100 lakhs incurred on purchase of two buildings for ₹ 50 lakhs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y. 2025-26. However, in February, 2026, Unit A transferred one of its buildings to Unit B.*

*Examine the tax implications of such transfer in the hands of ABC Ltd.*

**SOLUTION**

Since the capital asset, in respect of which deduction of ₹ 50 lakhs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2025-26, the deeming provision under section 35AD(7B) is attracted during the A.Y. 2026-27.

Particulars	₹
Deduction allowed under section 35AD for A.Y.2025-26	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2025-26 [10% of ₹ 50 lakhs]	5,00,000
<b>Deemed income under section 35AD(7B)</b>	<b>45,00,000</b>

ABC Ltd., however, by virtue of proviso to *Explanation 13* to section 43(1), can claim depreciation under section 32 on the building in Unit B for A.Y. 2026-27. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

Particulars	₹
Actual cost to the assessee	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2025-26 [10% of ₹ 50 lakhs]	5,00,000
<b>Actual cost in the hands of ABC Ltd. in respect of building in Unit B</b>	<b>45,00,000</b>

**(10) Contributions for Rural Development [Section 35CCA]**

This section allows a deduction of the following payment or contribution made by the assessee during the previous year to:

- (1) **Notified rural development fund** - Payment to a rural development fund set up and notified by the Central Government.
- (2) **Notified National Urban Poverty Eradication Fund** - Payments made to "National Urban Poverty Eradication Fund" (NUPEF) set up and notified by the Central Government.

**No other deduction** - It has been specifically provided that in every case where any deduction under this section is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to such notified fund, no deduction in respect of the same expenditure can again be claimed by the assessee under any other relevant provision for the same or any other assessment year.

**(11) Deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]**

- (i) **Eligible project and Quantum of Deduction:** In order to incentivize the business entities to provide better and effective agriculture extensive services, section 35CCC provides a deduction of a sum equal to expenditure incurred by an assessee on agricultural extension project in accordance with the prescribed guidelines.
- (ii) **No other deduction:** In case deduction in respect of such expenditure is allowed under this section then, no deduction in respect of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.
- (iii) **Project must be notified:** The agricultural extension project eligible for this deduction shall be notified by the CBDT.

The agricultural extension project shall be considered for notification if it fulfils **all** of the following conditions, namely:—

- (a) the project shall be undertaken by an assessee for training, education and guidance of farmers;
- (b) the project shall have prior approval of the Ministry of Agriculture, Government of India; and
- (c) an expenditure (not being expenditure in the nature of cost of any land or building) exceeding the amount of ₹ 25 lakhs is expected to be incurred for the project.

**Components of expenditure:** All expenses (not being expenditure in the nature of cost of any land or building), as reduced by the amount received from beneficiary, if any, incurred wholly and exclusively for undertaking an eligible agricultural extension project **shall be eligible for deduction** under section 35CCC.

However, expenditure incurred on the agricultural extension project which is reimbursed or reimbursable to the assessee by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCC.

- (iv) **Conditions for claiming deduction:** Deduction in respect of expenditure incurred for notified agricultural extension project would be available, if
- ◆ assessee maintain separate books of account of such agricultural extension project and get such books of account audited by an Accountant and
  - ◆ furnish the following on or before the due date of furnishing the return of income to the Commissioner of Income-tax or Director of Income-tax, as the case may be :-
    - ❖ the audited statement of accounts of the agricultural extension project along with the audited report and amount of deduction claimed under this section,
    - ❖ a note on agricultural project undertaken and programme of agricultural extension project to be undertaken during the current year and financial allocation for such programme and
    - ❖ a certificate from Ministry of Agriculture, Government of India, regarding the genuineness of such project.

**Note -** In case of an individual, HUF, AoP (other than a co-operative society) or Bol or an artificial juridical person, deduction u/s 35CCC would be available only if such person exercises the option of shifting out of the default tax regime provided under section 115BAC(1A). If such person is paying concessional rates of tax under the default tax regime u/s 115BAC, deduction u/s 35CCC would not be available.

A company/ cooperative society would not be eligible for deduction under section 35CCC, if it opted for the special provisions of section 115BAA/115BAB or section 115BAD/115BAE, respectively.

**(12) Deduction in respect of expenditure incurred by companies on notified skill development project [Section 35CCD]**

- (i) **Quantum of Deduction:** In order to encourage **companies** to invest on skill development projects in the manufacturing sector, section 35CCD provides for a deduction of a sum equal to the expenditure (not being expenditure in the nature of cost of any land or building) on skill development project incurred by the company in accordance with the prescribed guidelines. However, expenditure incurred on the notified skill development project which is reimbursed or reimbursable to the company by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCD.

- (ii) **No other deduction allowed:** In case deduction in respect of such expenditure is allowed under this section then, no deduction of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.
- (iii) **Only notified projects are eligible:** The skill development project eligible for this deduction shall be notified by the CBDT.

A skill development project would be considered for notification if it is undertaken by an eligible company (a company engaged in the business of manufacture or production of any article or thing, not being beer, wine and other alcoholic spirits and tobacco and tobacco preparations or engaged in providing specified services) and the project is undertaken in separate facilities in a training institute.

Skill development project in respect of existing employees of the company, however, would not be eligible for notification, where the training of such employees commences after six months of their recruitment.

Further, the deduction would be available, if the company undertaking such project

- maintain separate books of account of the skill development project and get such books of account audited by an accountant.
- furnish the audited statement of accounts of the skill development project along with the audited report and amount of deduction claimed under this section, to the Commissioner of Income-tax or Director of Income-tax, as the case may be.

**Note -** A company would not be eligible for deduction under section 35CCD, if it opted for the special provisions of section 115BAA/115BAB.

### (13) Amortisation of Preliminary Expenses [Section 35D]

- (i) **Nature of expenditure:** Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.
- (ii) **Applicable:** This section applies
- (a) only to Indian companies and resident non-corporate assessee;
  - (b) in the case of new companies to expenses incurred before the commencement of the business;

- (c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - expenses incurred till the new unit commences production or operation.
- (iii) **Amount eligible for deduction:** Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.
- (iv) **Eligible expenses** - The following expenditure are eligible for amortisation:
  - (I) Expenditure in connection with –
    - (a) the preparation of feasibility report
    - (b) the preparation of project report;
    - (c) conducting market survey or any other survey necessary for the business of the assessee;
    - (d) engineering services relating to the assessee's business;

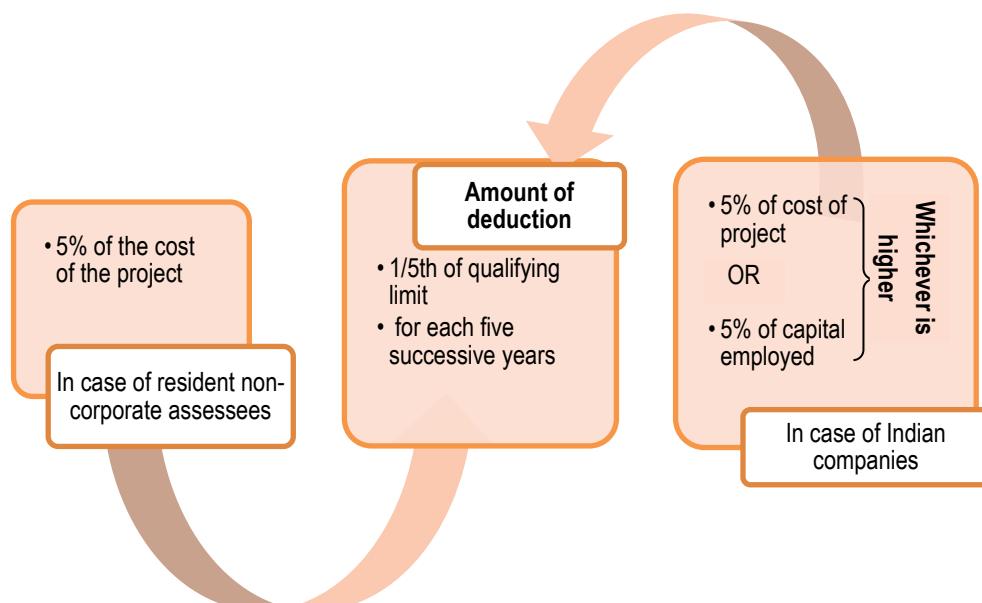
The assessee has to furnish a statement containing the particulars of above expenditure within one month prior to the due date for furnishing the return of income as specified under section 139(1) to the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, or any person authorised by the Principal Director General of Income-tax (Systems) or Director General of Income-tax (Systems) in the Form No. 3AF in prescribed manner for each previous year [Rule 6ABBB].
  - (II) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.
  - (III) **Where the assessee is a company**, in addition to the above, expenditure incurred –
    - (f) by way of legal charges for drafting the Memorandum and Articles of Association of the company;
    - (g) on printing the Memorandum and Articles of Association;

- (h) by way of fees for registering the company under the Companies Act; 1956<sup>8</sup>;
- (i) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and
- (IV) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.
- (v) **Overall Limits** - The maximum aggregate amount of the qualifying expenses that can be amortised is

**In case of resident non-corporate assessee** - 5% of the cost of the project

**In the case of an Indian company** – 5% of the cost of the project or, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher.

The excess, if any, of the qualifying expenses shall be ignored.



<sup>8</sup> Now Companies Act, 2013

## (vi) Meaning of certain terms:

Terms	Meaning
<b>Cost of the project</b>	<p>(i) <b>Expenses incurred before the commencement of business:</b> The actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;</p> <p>(ii) <b>Expenses incurred for extension of the business or setting up of a new unit:</b> The cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, in so far as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.</p>
<b>Capital employed in the business of the company</b>	<p>(i) <b>In the case of new company:</b> The aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;</p> <p>(ii) <b>In the case of extension of the business or the setting up of a new unit:</b> The aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.</p>
<b>Long-term borrowing</b>	<p>(i) Any moneys borrowed in India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution eligible for deduction under section 36(1)(viii) or any banking institution, or</p> <p>(ii) any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of plant and machinery where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than 7 years.</p>

- (vii) **Audit of accounts:** In cases where the assessee is a person other than a company or a co-operative society, the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered Accountant before the date specified in section 44AB i.e., one month prior to the due date for furnishing return of income u/s 139(1); and the assessee has, by that date, furnished for the first year in which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed.

Particulars	Due date of filing of return	Specified Date
Assessees (other than a company) subject to tax audit	31 <sup>st</sup> October of the relevant A.Y.	30 <sup>th</sup> September of the relevant A.Y.
	For A.Y.2026-27, on or before 31 <sup>st</sup> October, 2026	For A.Y.2026-27, on or before 30 <sup>th</sup> September, 2026

- (viii) **Special provisions for amalgamation and demerger-** Where the undertaking of an Indian company is transferred, before the expiry of the period of five years, to another Indian company under a scheme of amalgamation, the aforesaid provisions will apply to the amalgamated company as if the amalgamation had not taken place. But no deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

Likewise, in the scheme of demerger where the resulting company will be able to claim amortisation of preliminary expenses as if demerger had not taken place, and no deduction shall be allowed to the demerged company in the year of demerger.

- (ix) **No other deduction under any provision of the Act:** It has been clarified that in case where a deduction under this section is claimed and allowed for any assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of the Act for the same or any other assessment year.

#### (14) Amortisation of expense for Amalgamation/demerger [Section 35DD]

- (i) **Nature of expenditure:** This section applies where an assessee, being an Indian company, incurs expenditure, wholly and exclusively for the purpose of amalgamation or demerger.

- (ii) **Amount of deduction:** The assessee shall be allowed a deduction **equal to one-fifth of such expenditure** for five successive previous years beginning with the previous year in which amalgamation or demerger takes place.
- (iii) **No other deduction under any provision of the Act:** No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

**(15) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA]**

- (i) **Nature of expenditure:** This section applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.
- (ii) **Amount of deduction:** The amount of **deduction allowable is one-fifth of the amount paid** for that previous year, and the balance in four equal installments in the four immediately succeeding previous years.
- (iii) **Transfer of business:** In case of amalgamation, demerger, reorganisation or succession of business during the intervening period of the said 5 years, the benefit of deduction will be available to the “new company” for the balance period including the year in which such amalgamation/ demerger/ reorganisation or succession takes place.

**Conditions to be satisfied -** This will be applicable in the following situations:

- (i) where an Indian company is transferred to another Indian company in a scheme of amalgamation;
- (ii) where the undertaking of an Indian company is transferred to another company in a scheme of demerger;
- (iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling the conditions in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions in section 47(xiv);
- (iv) where a private company or unlisted company is succeeded by LLP fulfilling the conditions laid down in section 47(xiiib).

In the above cases, the **deduction shall be available to the successor** company as such deduction would have applied to the original entity if such transfer had not taken place at all.

It is further provided that **no deduction shall be available to the original entity** being the amalgamating company, demerged company, or the firm or proprietary concern or private company (as the case may be) **for the previous year in which the amalgamation, demerger or succession takes place.**

- (iv) **No other deduction under any provision of the Act:** No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

**(16) Amortisation of expenses for prospecting and development of certain minerals [Section 35E]**

- (i) **Eligible assessee:** This provision applies only to expenditure incurred by an Indian company or other resident non-corporate taxpayer. In order to qualify for amortisation, the assessee should be engaged in any operations relating to prospecting for or the extraction or production of any mineral.
  - (ii) **Eligible expenses** - The nature and kind of expenditure qualifying for amortisation are –
    - (i) It must have been incurred during the year of commercial production and any one or more of the four years immediately preceding that year,
    - (ii) It must be incurred wholly and exclusively on any operations relating to the prospecting for any mineral or group of certain minerals listed in the Seventh Schedule of the Income-tax Act, 1961 or on the development of a mine or other natural deposit of any mineral or group of associated minerals.
  - (iii) **Expenditure not allowed for deduction** - Any portion of the expenditure which is met directly or indirectly by any other persons or authority and the sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure should be excluded from the amount of expenditure qualifying for amortisation.
- Further, specific provision has been made to the effect that the following items of expenses do not qualify for amortisation at all viz.:
- (a) Expenditure incurred on the acquisition of the site of the source of any minerals or group of associated minerals stated above or of any right in or over such site;
  - (b) Expenditure on the acquisition of the deposits of minerals or group of associated minerals referred to above or to any rights in or over such deposits; or
  - (c) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under section 32.
- (iv) **Amount of deduction** - The assessee will be allowed for each of ten relevant previous years, a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure.

Thus, the deduction to be allowed for any relevant previous year is

- (i) one-tenth of the expenditure or
- (ii) such amount as will reduce to nil the income of the previous year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred,

whichever figure is less.

The amount of the deduction admissible in respect of any relevant previous year to the extent to which it remains unallowed, shall be carried forward and added to the installment relating to the previous year next following and shall be deemed to be a part of the installment and so on, for ten previous years beginning from the year of commercial production.

**(v) Meaning of certain terms:**

Term	Meaning
<b>Operation relating to prospecting</b>	Any operation undertaken for the purpose of exploiting, locating or proving deposits of any minerals and includes any such operation which proves to be infructuous or abortive.
<b>Year of commercial production</b>	The previous year in which as a result of any operation relating to prospecting or commercial production of any material or one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule to Act actually commences.
<b>Relevant previous year</b>	Ten previous years beginning with the year of commercial production

- (vi) Audit of accounts:** The provisions with regard to audit of accounts relating to the qualifying expenditure are similar to those applicable for amortisation of preliminary expenses discussed earlier.
- (vii) Special provisions for amalgamation or demerger:** In the case of amalgamation, such deduction would continue to be admissible to the amalgamated company as if the amalgamation had not taken place.

Likewise, in case of demerger where such deduction can be availed of by the resulting company as if the demerger had not taken place.

Further, no deduction will be admissible to the amalgamating/ demerged company in the year of amalgamation/ demergers.

- (viii) **No other deduction allowed in respect of the expenditure for which deduction is claimed under this section:** Where a deduction is claimed and allowed on account of amortisation of the expenses under section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profits and gains under any other provisions of the Act for the same or any other assessment year.

#### **(17) Other Deductions [Section 36]**

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

- (1) **Insurance premia paid [Section 36(1)(i)]** - If insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession, the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.
- (2) **Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)]** - Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.
- (3) **Premia paid by employer for health insurance of employees [Section 36(1)(ib)]** - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by
  - (i) the General Insurance Corporation of India and approved by the Central Government; or
  - (ii) any other insurer and approved by the IRDA.
- (4) **Bonus and Commission [Section 36(1)(ii)]** - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission.

It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

- (5) **Interest on borrowed capital [Section 36(1)(iii)]** - Deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business.

As per proviso to section 36(1)(iii), deduction in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed.

*Explanation 8 to section 43(1)* clarifies that interest relatable to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should, therefore, be capitalised.

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

- (6) **Discount on Zero Coupon Bonds (ZCBs) [Section 36(1)(iiia)]** - Section 36(1)(iiia) provides deduction for the discount on ZCB on pro rata basis having regard to the period of life of the bond to be calculated in the manner prescribed.

Term	Meaning
<b>Discount</b>	Difference of the amount received or receivable by an infrastructure capital company/ infrastructure capital fund/ public sector company/ scheduled bank on issue of the bond and the amount payable by such company or fund or bank on maturity or redemption of the bond.
<b>Period of life of the bond</b>	The period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

**Meaning of Infrastructure Capital Company [Section 2(26A)]**

"Infrastructure capital company" means such company which makes investments by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged –
  - (a) in the business referred to in section 80-IA(4) i.e. business of
    - (i) developing/ operating and maintaining/ developing, operating and maintaining any infrastructure facility fulfilling the specified conditions
    - (ii) providing telecom services, whether basic or cellular
    - (iii) developing, developing and operating or maintaining and operating an industrial park or special economic zone notified by the Central Government
    - (iv) generating, transmitting or distributing power or undertaking substantial renovation and modernization of the existing network of transmission or distribution lines.
  - (b) in the business referred to in section 80-IAB(1) i.e. any business of developing a SEZ.
- (2) an undertaking developing and building a housing project referred to in section 80-IB(10) i.e. approved before 31.3.2008 by a local authority and commences or commenced development and construction on or after 1.10.98 and completes or completed development and construction within the time specified.
- (3) a project for constructing a hotel of not less than three-star category as classified by the Central Government or
- (4) a project for constructing a hospital with at least 100 beds for patients.

**Meaning of Infrastructure Capital Fund [Section 2(26B)]**

Infrastructure capital fund means such fund operating under a trust deed registered under the provisions of the Registration Act, 1908 established to raise monies by the trustees for investment by way of acquiring shares or providing long-term finance to -

- (1) any enterprise or undertaking wholly engaged in the business referred to in section 80-IA(4) or section 80-IAB(1); or

- (2) an undertaking developing and building a housing project referred to in section 80-IB(10); or
  - (3) a project for constructing a hotel of not less than three star category as classified by the Central Government; or
  - (4) a project for constructing a hospital with at least 100 beds for patients.
- (7) **Contributions to provident and other funds [Section 36(1)(iv) and (v)]** - Contribution to the employees' recognised provident fund/approved superannuation fund is allowable subject to the limits laid down for the purpose of recognizing the provident fund or approving superannuation fund.
- Contribution to an approved gratuity fund is allowable subject to the condition that the gratuity fund should be for exclusive benefit of the employees under an irrevocable trust
- The nature of the benefit available to the employees from the fund is not material; it may be pension, gratuity or provident fund.
- (8) **Employer's contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]**

- (i) Section 36(1)(iva) to provide that the employer's contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.
- (ii) However, deduction would be restricted to 14% of salary of the employee in the previous year.
- (iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.
- (iv) Correspondingly, section 40A(9), which provides for disallowance of any sum paid by an employer towards contribution to any fund or trust has been amended to exclude from the scope of its disallowance, contribution by an employer to the pension scheme referred to in section 80CCD, to the extent to which deduction is allowable under section 36(1)(iva).

#### **ILLUSTRATION 10**

*X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees.*

Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

### SOLUTION

#### Computation of deduction u/s 36(1)(iva) and disallowance u/s 40A(9)

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	4,00,000
<b>Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)</b>	<b>14,00,000</b>
Actual contribution (20% of basic salary i.e., 20% of ₹10 lakh)	2,00,000
<b>Less: Permissible deduction under section 36(1)(iva) [14% of (basic salary plus dearness pay) = 14% of ₹ 14,00,000 = ₹ 1,96,000]</b>	<b>1,96,000</b>
Excess contribution disallowed under section 40A(9)	4,000

- (9) **Amount received by assessee-employer as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date**  
 – Section 36(1)(va) and section 57(ia) provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date.

<b>Due date</b>	The date by which the assessee is required as an employer to credit such contribution to the employee's account in the relevant fund under the provisions of any law on term of contract of service or otherwise.
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As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month.

**Note** - It is clarified that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis on or before due date of filing of return of income for relevant assessment year, does not apply and would deemed never to be applied on employee's contribution received by employer towards any welfare fund of such employee. In effect, the extended time upto due date of filing of return for is not available for credit of employees contribution towards any welfare fund received by the employer.

- (10) Allowance for animals [Section 36(1)(vi)]** – This clause grants an allowance in respect of animals which have died or become permanently useless.

The amount of the allowance is the difference between the actual cost of the animals and the price realized on the sale of the animals themselves or their carcasses.

The allowance under the clause would thus recoup to the assessee the entire capital expenditure in respect of animal.

- (11) Bad debts [Section 36(1)(vii) and section 36(2)]** – These can be deducted subject to the following conditions:

- (a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.
- (b) The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

**I. Deduction under section 36(1)(vii) for bad debts limited to the amount by which bad debts exceed credit balance in the provision for doubtful debts account under section 36(1)(viiA)**

Under section 36(1)(vii), bad debt actually written off as irrecoverable in the books of account of the assessee is deductible. However, in the case of entities for which provision for bad and doubtful debts is allowable under section 36(1)(viiA), deduction for bad debts written off under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viiA). This is provided in the proviso to section 36(1)(vii).

The CBDT has, clarified vide Circular no. 12/2016, dated 30-05-2016, that claim for any debt or part thereof in any previous year, shall be admissible under section 36(1)(vii), if it is written off as irrecoverable in the books of accounts of the assessee for that previous year and it fulfills the conditions stipulated in section 36(2).

However, no such requirement is there in law that the assessee has to establish that the debt has, in fact, become irrecoverable.

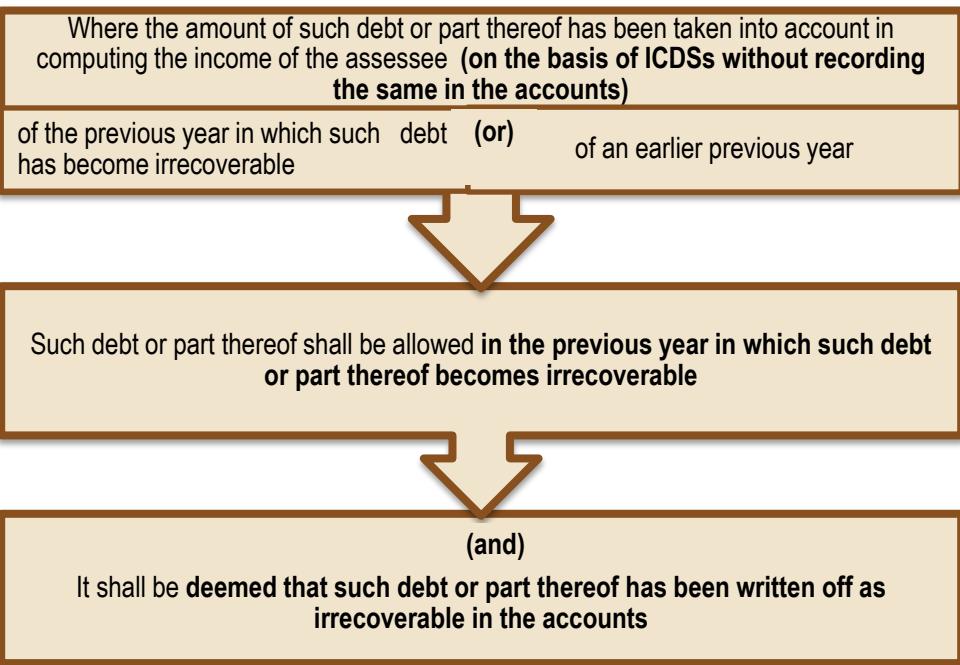
Further, the provisions of section 36(1)(vii) are subject to the provisions of section 36(2). Section 36(2)(v) provides that where the debt or part thereof relates to advances made by an assessee, to which section 36(1)(viia) applies, no deduction shall be allowed unless the assessee has debited the amount of such debt or part of such debt in that previous year to the provision for bad and doubtful debts account made under section 36(1)(viia).

*Explanation 2* to section 36(1)(vii) states that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein shall be made in respect of provision for bad and doubtful debts under section 36(1)(viia) and such account shall relate to all types of advances, including advances made by rural branches.

Therefore, in the case of an assessee to which section 36(1)(viia) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viia) without any distinction between rural advances and other advances.

- II. Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable [Second proviso to section 36(1)(vii)]**
- (i) Under section 36(1)(vii), deduction is allowed in respect of the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year.
  - (ii) Therefore, write off in the books of account is an essential condition for claim of bad debts under section 36(1)(vii).
  - (iii) Amount of debt taken into account in computing the income of the assessee on the basis of notified ICDSs to be allowed as deduction in the previous year in which such debt or part thereof becomes irrecoverable.

If a debt, which has not been recognized in the books of account as per the requirement of the accounting standards but has been taken into account in the computation of income as per the notified ICDSs, has become irrecoverable, it can still be claimed as bad debts under section 36(1)(vii) since **it shall be deemed that the debt has been written off as irrecoverable in the books of account by virtue of the second proviso to section 36(1)(vii)**. This is because some ICDSs require recognition of income at an earlier point of time (prior to the point of time such income is recognised in the books of account). Consequently, if the whole or part of such income recognised at an earlier point of time for tax purposes becomes irrecoverable, it can be claimed as bad debts on account of the second proviso to section 36(1)(vii).



### III. Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery

If on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently

to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

**Recovery of a bad debt subsequently [Section 41(4)]** - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

**Example:** For P.Y. 2024-25, bad debts of ₹ 40,000 was allowed by the Assessing Officer out of total bad debts of ₹ 75,000. Subsequently, ₹ 44,000 is recovered during P.Y. 2025-26.

Actual bad debts of the assessee after recovery = ₹ 75,000 – ₹ 44,000 i.e. ₹ 31,000 but the bad debts allowed in P.Y. 2024-25 were ₹ 40,000, so the excess ₹ 9,000 that was allowed in P.Y. 2024-25 would be deemed to be the profits and gains of business or profession of P.Y. 2025-26 and will be chargeable as income of the P.Y. 2025-26 in which it is recovered.

#### (12) Provision for bad and doubtful debts in cases of specified banks [Section 36(1)(viia)]

- (i) A scheduled bank which is not a bank incorporated by or under the laws of a country outside India or a non-scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, the following deductions will be allowed:
  - (a) an amount not exceeding 8.5% of the total income (computed before making any deduction under this clause and Chapter VI-A), and
  - (b) an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank computed in the manner prescribed by the CBDT.

Accordingly, Rule 6ABA prescribed the manner for computation of aggregate average advance. The aggregate average advances made by the rural branches of a scheduled bank shall be computed in the following manner–

- (i) the amounts of advances made by each rural branch as outstanding at the end of the last day of each month comprised in the previous year shall be aggregated separately;

- (ii) the sum so arrived at in the case of each such branch shall be divided by the number of months for which the outstanding advances have been taken into account for the purposes of clause (i)
- (iii) the aggregate of the sums so arrived at in respect of each of the rural branches shall be the aggregate average advances made by the rural branches of the scheduled bank.

Such scheduled bank or a non-scheduled bank shall, at its option, be allowed in any of the relevant assessment years, deduction in respect of any provision made by it for any assets classified by the RBI as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding 5% of the amount of such assets shown in the books of account of the bank on the last day of the previous year.

Such scheduled bank or a non-scheduled bank shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government.

It is also provided that this deduction shall not be allowed unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

#### **Meaning of certain terms:**

Term	Meaning
<b>Scheduled Bank</b>	It refers to the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the Reserve Bank of India Act, 1934.
<b>Non-Scheduled Bank</b>	This refers to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 which is not a scheduled bank.
<b>Rural branch</b>	A branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

<b>Co-operative bank, primary agriculture credit society, primary co-operative agricultural and rural development bank</b>	Shall have the same meaning assigned in <i>Explanation</i> to section 80P(4).
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- (ii) **Foreign Banks:** In the case of foreign banks the deduction will be an amount not exceeding 5% of the total income (computed before making any deduction under this clause and Chapter VI-A).
- (iii) **Public financial institutions:** A public financial institution, a State Financial Corporation and a State Industrial Investment Corporation will be entitled to a deduction in respect of provision for bad and doubtful debts made out of profits. The maximum amount to be allowed as a deduction will be limited to 5% of its total income before making any deduction in respect of the provision for bad and doubtful debt or in respect of any deduction in Chapter VI-A.
- (iv) **Non-Banking Financial Companies (NBFCs):** Since Non-Banking Financial Companies (NBFCs) are also engaged in financial lending to different sectors of society, deduction on account of provision for bad and doubtful debts of an amount not exceeding 5% of total income (before making any deduction under section 36(1)(viiA) and Chapter VI-A) would be allowed in the case of NBFCs also.

**Meaning of certain terms:**

Terms	Meaning
<b>Public Financial Institution</b>	Shall have the meaning assigned to it in section 4A of the Companies Act, 1956 <sup>9</sup>
<b>State Financial Corporation</b>	A financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951.
<b>State Industrial Investment Corporation</b>	A Government company within the meaning of Section 617 of the Companies Act, 1956 <sup>10</sup> engaged in the business of providing long-term finance for industrial projects and eligible for deduction under clause (viii) of this sub-section.

<sup>9</sup> Now section 2(72) of the Companies Act, 2013

<sup>10</sup> Now section 2(45) of the Companies Act, 2013

<b>Non-Banking Financial Company</b>	<p>Shall have the same meaning assigned to it in Section 45-I(f) of the Reserve Bank of India Act, 1934. Accordingly, it means</p> <ul style="list-style-type: none"> <li>(i) a financial institution which is a company</li> <li>(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner</li> <li>(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.</li> </ul>
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#### Provision for bad and doubtful debts in cases of specified banks/FIs/NBFCs

**Indian scheduled banks  
Non-scheduled banks  
Co-operative banks\***

**Foreign Banks  
Public Financial Institutions  
State Financial Corporations  
State Industrial Investment Corporations  
Non-Banking Financial Companies**

Maximum 8.5% of Total Income [before deduction u/s 36(1)(viiia) and Chapter VI-A]  
+

Maximum 10% of aggregate average advances made by Rural branches

Maximum 5% of Total Income [before deduction u/s 36(1)(viiia) and Chapter VI-A]

\* other than a primary agricultural credit society or primary co-operative agricultural and rural development bank

#### (13) Special deduction to specified entities engaged in eligible business [Section 36(1)(viii)]

- (i) This section provides deduction in respect of any special reserve created and maintained by a specified entity.
- (ii) **Amount of deduction:** The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head "Profits and gains of business or profession" (before making any deduction under this clause) carried to such reserve account.

However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

In simple terms, **quantum of deduction shall be the least of the following**

- (i) Amount transferred to special reserve
  - (ii) 20% of profit derived from eligible business (before this deduction)
  - (iii) 200% of paid up capital and general reserve *less* aggregate amount carried to Special Reserve account.
- (iii) **Eligible business for specified entities:** The eligible business for different entities specified are given in the table below –

	<b>Specified entity</b>	<b>Eligible business</b>
1.	(a) Financial Corporation specified in section 4A of the Companies Act, 1956 <sup>11</sup> (b) Financial corporation which is a public sector company (c) Banking company (d) Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank)	<b>Business of providing long-term finance for -</b> (i) industrial or agricultural development or (ii) development of infrastructure facility in India; or (iii) development of housing in India.
2.	A housing finance company	Business of providing long-term finance for the construction or purchase of residential house in India.
3.	Any other financial corporation including a public company	Business of providing long-term finance for development of infrastructure facility in India.

<sup>11</sup> Section 2(72) of the Companies Act, 2013

(iv) **Infrastructure facility has been defined to mean -**

- (a) (1) an infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA i.e.
  - (i) a road including toll road, a bridge or a rail system;
  - (ii) a highway project including housing or other activities being an integral part of the highway project;
  - (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and
  - (iv) a port, airport, inland waterway or inland port or a navigational channel in the sea
- (2) any other public facility of a similar nature as may be notified by the CBDT in this behalf in the Official Gazette and which fulfils the prescribed conditions;

**Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii) [Notification No. 188/2006, dated 20.7.2006]**

The following public facilities have been notified by the CBDT as infrastructure facility for purposes of section 36(1)(viii)-

- (i) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962
- (ii) Mass Rapid Transit system
- (iii) Light Rail Transit system
- (iv) Expressways
- (v) Intra-urban or semi-urban roads like ring roads or urban bypasses or flyovers
- (vi) Bus and truck terminals
- (vii) Subways
- (viii) Road dividers

- (ix) Bulk Handling Terminals which are developed or maintained or operated for development of rail system
- (x) Multilevel Computerized Car Parking.

**Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility [Notification No.187/2006 dated 20.7.2006]:**

Rule 6ABAA has been inserted in the Income-tax Rules, 1962 which specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of sub-section (1) of section 36. The conditions specified therein are -

- (i) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;
  - (ii) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (a) developing or (b) operating and maintaining or (c) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the *Explanation* to section 80-IA(4)(i);
  - (iii) it has started or starts operating and maintaining such infrastructure facility on or after 1<sup>st</sup> April, 1995.
- (b) an undertaking referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (4) of section 80-IA (i.e. an undertaking providing telecommunication services, an undertaking developing, developing and operating, maintaining and operating an industrial park or SEZ notified by the Central Government, an undertaking generating, distributing or transmitting power, substantial renovation and modernization of existing network of transmission or distribution lines); and
- (c) an undertaking referred to in sub-section (10) of section 80-IB i.e. an undertaking developing and building housing projects approved by a local authority.

- (v) **Long term finance** - Long-term finance means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than 5 years.

**Amount withdrawal from special reserve [Section 41(4A)]** - Where a deduction has been allowed in respect of any special reserve created and maintained under section 36(1)(viii), and subsequently the amount is withdrawn from such special reserve then such amount shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which such amount is withdrawn.

If the amount is withdrawn in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as though the business is in existence in that previous year.

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

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

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

- (15) **Deduction for expenditure incurred by entities established under any Central, State or Provincial Act [Section 36(1)(xii)]** - Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if –

- (i) it is constituted or established by a Central, State or Provincial Act;
- (ii) such corporation or body corporate is notified by the Central Government in the Official Gazette for this purpose having regard to the objects and purposes of the Act;

- (iii) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted and established.

Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii).

**(16) Deduction of contribution by a public financial institution to Credit guarantee fund trust for small industries [Section 36(1)(xiv)]**

- (i) Section 36(1)(xiv) provides for deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries notified by the Central Government in the Official Gazette.
- (ii) Public financial institution has the meaning assigned to it in section 4A<sup>12</sup> of the Companies Act, 1956.

**(17) Deduction of securities transaction tax paid [Section 36(1)(xv)]** - The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head 'Profits and gains of business or profession'.

Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

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

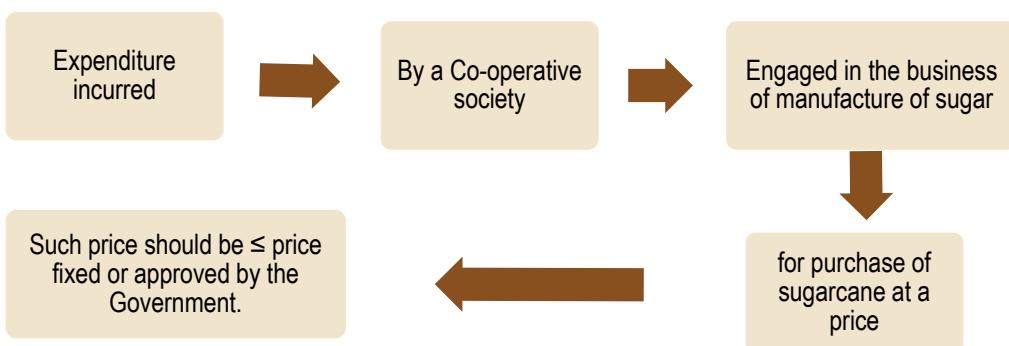
- (i) Section 36(1)(xvi) provides that an amount equal to the CTT paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".
- (ii) A 'taxable commodities transaction' means a transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities, traded in recognised stock exchange.

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<sup>12</sup> Section 2(72) of the Companies Act, 2013

- (iii) A “commodity derivative” means –
- A contract for delivery of goods which is not a ready delivery contract
  - A contract for differences which derives its value from prices or indices of prices -
    - of such underlying goods; or
    - of related services and rights, such as warehousing and freight; or
    - with reference to weather and similar events and activities having a bearing on the commodity sector.

**(19) Amount of expenditure incurred by a co-operative society for purchase of sugarcane at price fixed by the Government allowable as deduction [Section 36(1)(xvii)]** - Section 36(xvii) provides for deduction of expenditure incurred by a co-operative society engaged in the business of manufacture of sugar for purchase of sugarcane at a price equal to or less than the price fixed or approved by the Government.



The CBDT has, vide Circular no. 18/2021 dated 25.10.2021, clarified that the phrase 'price fixed or approved by the Government' includes price fixation by State Governments through State-level Acts/Orders or other legal instruments that regulate the purchase price for sugarcane, including State Advised Price, which may be higher than the Statutory Minimum Price/ Fair and Remunerative Price fixed by the Central Government.

**(20) Marked to market loss [Section 36(1)(xviii)]** - Marked to market loss or other expected loss as computed in accordance with the ICDS notified under section 145(2), shall be allowed as deduction. ICDS I provides that marked to market losses would not be allowed unless the same is in accordance with any other ICDS. Therefore, only marked to market losses specifically permitted under any other ICDS would be allowable as deduction under section 36.

**(18) Residuary Expenses [Section 37]**

- (1) **Revenue expenditure incurred for purposes of carrying on the business, profession or vocation** - This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.
- (2) **Conditions for allowance:** The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section:
- The expenditure should not be of the nature described in **sections 30 to 36**.
  - It should have been **incurred by the assessee** in the accounting year.
  - It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.
  - It must have been incurred after the business was set up.
  - It should not be in the nature of **any personal expenses** of the assessee.
  - It should have been laid out or expended **wholly and exclusively for the purposes of such business**.
  - It should not be in the nature of **capital expenditure**.
  - The expenditure should not have been incurred by the assessee for any purpose which is an **offence or is prohibited by law**.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. Therefore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

- (3) **Expenditure incurred 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.

- (4) **Explanation 1 to section 37(1)** - This Explanation provides that any expenditure incurred by the assessee for any purpose which is an offence or is prohibited by law shall not be allowed as a deduction or allowance.
- (5) **Explanation 3 to section 37(1)** – It is clarified that the expression “expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law” in (4) above would include and would be deemed to have always included the expenditure incurred by an assessee, -
  - (i) for any purpose which is an offence under any law for the time being in force, in India or outside India or which is prohibited by any law for the time being in force, in India or outside India; or
  - (ii) to provide any benefit or perquisite, in whatever form, to a person, whether or not carrying on a business or exercising a profession, and acceptance of such benefit or perquisite by such person is in violation of any law or rule or regulation or guidelines, as the case may be, for the time being in force, governing the conduct of such person; or
  - (iii) to compound an offence under any law for the time being in force, in India or outside India [*Explanation 3 to section 37(1)*].

- (v) to settle proceedings initiated in relation to contravention under such law as may be notified by the Central Government in this behalf.

*W.e.f. 23.4.2025, the Central Government has, vide notification no. 38/2025 dated 23.4.2025, notified that any expenditure incurred to settle proceedings initiated in relation to contravention or defaults under the following laws 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 –*

- (a) *the Securities and Exchange Board of India Act, 1992;*
- (b) *the Securities Contracts (Regulation) Act, 1956;*
- (c) *the Depositories Act, 1996;*
- (d) *the Competition Act, 2002.*

**For eg:** expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry are in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations. Hence, such expenditure is considered to be expenses prohibited by the law and not allowed in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies.

The Supreme Court, in *Apex Laboratories Pvt. Ltd. v. DCIT* (2022) 442 ITR 1, held that the incentives (or "freebies") given by the pharmaceutical company, to the doctors, had a direct result of exposing the recipients to the odium of sanctions, leading to a ban on their practice of medicine. Those sanctions are mandated by law, as they are embodied in the code of conduct and ethics, which are normative, and have legally binding effect. The conceded participation of the assessee – Pharmaceutical company, i.e., the provider or donor, was plainly prohibited, as far as their receipt by the medical practitioners was concerned. That medical practitioners were forbidden from accepting such gifts, or "freebies" was no less a prohibition on the part of their giver, or donor, i.e., pharmaceutical company.

Thus, pharmaceutical companies' gifting freebies to doctors is clearly "prohibited by law" and not allowed to be claimed as a deduction under section 37(1). Doing so would wholly undermine public policy.

*Explanation 3 inserted in section 37(1) is in consonance with the above Supreme Court judgement.*

**(6) 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 in respect of companies having net worth/turnover/net profit exceeding specified threshold limits. Such companies have to spend a specified percentage of their average net profits on CSR activities.
  - (ii) 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.
  - (iii) It has now been clarified that for the purposes of section 37(1), any expenditure incurred by an assessee 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.
  - (iv) 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.
  - (v) 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.
- (7) **Advertisements in souvenirs of political parties:** Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply notwithstanding anything to the contrary contained in section 37(1).
- In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business.

Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

**(8) 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.

#### ILLUSTRATION 11

*Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2026 is ₹ 35,25,890 after debiting the following items:*

S. No.	Particulars	₹
1.	Purchase price of raw material used for the purpose of in-house research and development	11,80,000
2.	Purchase price of asset used for in-house research and development	
	(a) Land	5,00,000
	(b) Building	3,00,000
3.	Expenditure incurred on notified agricultural extension project	25,50,000
4.	Expenditure on notified skill development project:	

	(a) Purchase of land	40,00,000
	(b) Expenditure on training for skill development	32,50,000
5.	Expenditure incurred on advertisement in the souvenir published by a political party	75,000
6.	Expenditure incurred on issue of right shares	80,000
7.	Expenditure incurred on issue of debentures	50,000
8.	Penalty paid under GST Act	35,000
9.	Interest paid on loan taken from bank for payment of advance income-tax	60,000
10.	Provision for loss of subsidiary	85,000

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2026-27 of Isac Ltd assuming that the company does not opt for the provisions of section 115BAA.

### SOLUTION

#### Computation of income under the head "Profits and gains of business or profession" for the A.Y.2026-27

Particulars	₹	₹
Net profit as per profit and loss account		35,25,890
<b>Add: Items debited to profit and loss account, but to be disallowed</b>		
Purchase price of raw material used for the purpose of in-house research and development – qualifies for 100% deduction u/s 35(2AB)	-	
Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35	5,00,000	
Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)	-	
Expenditure incurred on notified agricultural extension project – 100% deduction is allowed under section 35CCC	-	
Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	40,00,000	

Expenditure incurred on notified skill development project - Expenditure on training for skill development – 100% deduction is allowed under section 35CCD	-	
Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	75,000	
Expenditure incurred on issue of right shares not allowed as deduction since expenses is of capital nature	80,000	
Expenditure incurred on issue of debentures [allowable]	-	
Penalty paid under GST Act - Not allowed as deduction	35,000	
Interest paid on loan taken from bank for payment of advance income-tax not allowed as deduction since the same is not for the purpose of business or profession	60,000	
Provision for loss of subsidiary not allowed as deduction	85,000	<b>48,35,000</b>
<b>Profit and gains from business</b>		<b>83,60,890</b>

**Note:** The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head "Profit and Gains of Business or Profession" but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

- (9) In case of an assessee carrying on business, it is relevant to see whether an outlay constitutes an expenditure "for the purpose of business" as used in section 37(1), for the purpose of claiming deduction thereunder. The source of funds from which the expenditure is made is not relevant. Every application of income towards the business objective of the assessee is a business expenditure. There can be an amount treated as a capital receipt while the same amount expended may be a revenue expenditure. **[National Co-operative Development Corporation v. CIT [2020] 427 ITR 288 (SC)]**
- (19) Clarification regarding treatment of expenditure incurred for development of roads/highways in Build-Operate-Transfer (BOT) agreements under the Income-tax Act, 1961 [Circular No. 09/2014, dated 23.04.2014]

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 [1997] 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.
- (ii) 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.



## 3.7 INADMISSIBLE DEDUCTIONS [SECTION 40]

By dividing the assessees into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows:

**In the case of any assessee, the following expenses are not deductible:**

**(1) Section 40(a)(i)**

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.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

- (i) has furnished his return of income under section 139;
- (ii) has taken into account such sum for computing income in such return of income; and
- (iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum on the date on which return of income has been furnished by the payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(i) in the year in which the said expenditure is incurred. However, such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

**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).

## (2) Section 40(a)(ia)

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.

In case, assessee fails to deduct the whole or any part of tax on any such sum but is not deemed as assessee in default under the first proviso to section 201(1) by reason that such payee –

- (i) has furnished his return of income under section 139;
- (ii) has taken into account such sum for computing income in such return of income; and
- (iii) has paid the tax due on the income declared by him in such return of income, and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed,

it would be deemed that the assessee has deducted and paid the tax on such sum.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the payee.

Since the date of furnishing the return of income by the payee is taken to be the date on which the payer has deducted tax at source and paid the same, 30% of such expenditure/payment in respect of which the payer has failed to deduct tax at source shall be disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. However, 30% of such expenditure will be allowed as deduction in the subsequent year in which the return of income is furnished by the payee, since tax is deemed to have been deducted and paid by the payer in that year.

**Example:** Tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2025-26, the same has to be paid by 31<sup>st</sup> July/ 31<sup>st</sup> October 2026, as the case may be. Otherwise, 30% of royalty paid would be disallowed in computing the income for A.Y. 2026-27. If in respect of such royalty, tax deducted during the P.Y.2025-26 has been paid after 31<sup>st</sup> July/ 31<sup>st</sup> October, 2026, 30% of such royalty disallowed in A.Y. 2026-27, would be allowed as deduction in the year of payment, i.e. A.Y. 2027-28

**ILLUSTRATION 12**

*Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2026 without deduction of tax at source. What would be the consequence of non-deduction of tax at source by Delta Ltd. on these amounts during the financial year 2025-26, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd.?*

	<b>Particulars</b>	<b>Amount (₹)</b>
(1)	Salary to its employees (credited and paid in March, 2026)	13,00,000
(2)	Directors' remuneration (credited in March, 2026 and paid in April, 2026)	28,000

*Would your answer change if Delta Ltd. has deducted tax on directors' remuneration in April, 2026 at the time of payment and remitted the same in July, 2026?*

**SOLUTION**

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.2025-26, 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.2026-27 is as follows –

	<b>Particulars</b>	<b>Amount paid in ₹</b>	<b>Disallowance u/s 40(a)(ia)@ 30% (₹)</b>
(1)	Salary [tax is deductible under section 192]	13,00,000	3,90,000
(2)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
<b>Disallowance under section 40(a)(ia)</b>			<b>3,98,400</b>

If the tax is deducted on directors' remuneration in the next year i.e., P.Y.2026-27 at the time of payment and remitted to the Government, the amount of ₹ 8,400 would be allowed as deduction while computing the business income of A.Y.2027-28.

**Disallowance of any sum paid to a resident at any time during the previous year without deduction of tax under section 40(a)(ia) [Circular No.10/2013, dated 16.12.2013]**

There have been conflicting interpretations by judicial authorities regarding the applicability of provisions of section 40(a)(ia), with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'. Some court rulings have held that the provisions of disallowance under section 40(a)(ia) apply only to the amount which remained payable at the end of the relevant financial year and would not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source.

**Departmental View:** The CBDT's view is that the provisions of section 40(a)(ia) would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia), the term "payable" would include "amounts which are paid during the previous year".

### ILLUSTRATION 13

*During the financial year 2025-26, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2025 was ₹ 99 lakhs):*

- (i) Interest of ₹ 45,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;
- (ii) ₹ 15,00,000 was paid as salary to a resident individual without deduction of tax at source;
- (iii) Commission of ₹ 26,000 was paid to Mr. Vidyasagar on 2.7.2025 without deduction of tax at source.

*Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) of the Income-tax Act, 1961 assuming that the payees in all the cases mentioned above, have not paid the tax, if any, which was required to be deducted by Mr. Raja?*

### SOLUTION

Disallowance under section 40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

- (i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2024-25 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 100 lakhs, he is not liable to deduct tax at source. Hence, disallowance under section 40(a)(ia) is not attracted in this case.
- (ii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII-B. Section 192, which requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee-employer even if the turnover amount does not exceed ₹ 1 crore in the immediately preceding previous year.

Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed i.e. ₹ 4,50,000 (₹ 15 lakhs × 30%).

- (iii) The obligation to deduct tax at source under section 194-H from commission paid in excess of ₹ 20,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2024-25 exceeds ₹ 1 crore. Thus, in present case, since the turnover of the assessee is less than ₹ 1 crore, he is not liable to deduct tax at source under section 194H. Mr. Raja is not required to deduct tax at source u/s 194M also since the aggregate of such commission to Mr. Vidyasagar does not exceed ₹ 50 lakh during the P.Y. 2025-26. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

### **(3) Section 40(a)(ib)**

Section 40(a)(ib) provides that where any consideration is paid or payable to a non-resident for a specified service on which equalisation levy is deductible, and such levy has not been deducted or after deduction, has not been paid on or before the due date under section 139(1), then, such expenses incurred by the assessee towards consideration for specified service shall not be allowed as deduction.

However, where in respect of such consideration, if the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified under section 139(1), such sum shall be allowed as deduction in computing the income of the previous year in which such levy has been paid.

**(4) Section 40(a)(ii)**

Any sum paid on account of rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or on the basis of any such profits and gains is not allowed as deduction from business income.

- (a) Any sum paid outside India (on account of any rate or tax levied) which is eligible for tax relief under section 90 or deduction from the income-tax payable under section 91 is not allowable and is deemed to have never been allowable as a deduction under section 40(a).
- (b) However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with the provisions of section 90 or section 91, as the case may be.
- (c) Any sum paid outside India (on account of any rate or tax levied) and eligible for relief under section 90A will not be allowed as a deduction.
- (d) The term "tax" would include and would be deemed to have always included any surcharge or cess, by whatever name called, on such tax. Hence, tax including surcharge and cess would be disallowed while computing business income.

**(5) Section 40(a)(iib)**

- (i) any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, etc., which is levied exclusively on, or
- (ii) any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government (SG)

A State Government undertaking includes –

- (a) A corporation established by or under any Act of the State Government;
- (b) A company in which more than 50% of the paid up equity share capital is held by the State Government;
- (c) A company in which more than 50% of the paid up equity share capital is held singly or jointly by (a) or (b);
- (d) A company or corporation in which the State Government has the right to appoint the majority of directors or to control the management or policy decisions

- (e) An authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.

**(6) Section 40(a)(iii)**

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.

**(7) Section 40(a)(iv)**

Any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'Salaries'.

**(8) Section 40(a)(v)**

**Tax paid on perquisites on behalf of employees is not deductible** - 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.

**In the case of any firm assessable as such or a limited liability partnership (LLP) the following amounts shall not be deducted in computing the business income**

**Section 40(b)**

- (1) Remuneration to non-working partner** - Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term 'remuneration' is applied to denote payments in the nature of salary, bonus, commission);
- (2) Remuneration to a working partner not authorized by deed** - Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed

- (3) **Remuneration to a working partner or interest to a partner authorized by deed but relates to an earlier period** - It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in section 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto.

**Example:** If a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, 2025 but effective from April 1, 2025 the firm would get deduction for the remuneration paid to its working partners from July 1, 2025 onwards, but not for the period from April 1 to June 30. It will not be possible to give retrospective effect to oral agreements entered into *vis-a-vis* such remuneration prior to putting the same in a written partnership deed.

- (4) **Interest to any partner in excess of 12% p.a.-** Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.
- (5) **Remuneration to a working partner in excess of prescribed limits** - Any remuneration paid to a working partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

Book Profits	Quantum of deduction
On the first ₹ 6 lakh of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is higher
on the balance of book profit	60% of book profit

- (6) **Meaning of certain terms:**

Term	Meaning
<b>Book Profit</b>	The net profit as shown in the profit and loss account for the relevant previous year computed in accordance with the provisions for computing income from profits and gains [Explanation 3 to section 40(b)].

	The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.
<b>Working partner</b>	An individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner [Explanation 4 to section 40(b)]

### ILLUSTRATION 14

A firm assessed as such has paid ₹ 8,50,000 as remuneration to its partners for the P.Y.2025-26, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakh as computed under section 40(b). What is the remuneration allowable as deduction?

### SOLUTION

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

Particulars	₹
On first ₹ 6 lakh of book profit [₹ 6,00,000 × 90%]	5,40,000
On balance ₹ 4 lakh of book profit [₹ 4,00,000 × 60%]	2,40,000
	<b>7,80,000</b>

The excess amount of ₹ 70,000 (i.e., ₹ 8,50,000 – ₹ 7,80,000) would be disallowed as per section 40(b)(v).

### (7) Explanations to section 40(b)

- (i) Where an individual is a partner in a firm in a representative capacity:
  - (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 this clause.
  - (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 this clause [Explanation 1 to section 40(b)]
- (ii) Where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person [Explanation 2 to section 40(b)].

**Example:** Mr. A is a partner in ABC & Co. on behalf of Shah HUF. Interest to its partners @15% is authorised by ABC & Co. ABC & Co. pays ₹ 7 lakhs as interest to Mr. A out of which ₹ 4 lakhs on the funds advanced by Mr. A in his individual capacity and ₹ 3 lakhs on the funds advanced by him in his representative capacity on behalf of Shah HUF. The interest of ₹ 4 lakhs paid to Mr. A in his individual capacity is allowed as deduction subject to section 40A(2) and shall not be taken into account for purpose of section 40(b). Whereas the interest paid to Mr. A in his representative capacity would be allowed to the extent of ₹ 2.40 lakhs i.e., ₹ 3 lakhs/15% x 12%.

### ILLUSTRATION 15

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of ₹ 17,00,000 before deduction of the following items:

- (1) Salary of ₹ 40,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).
- (2) Depreciation on plant and machinery under section 32 (computed) ₹ 1,50,000.
- (3) Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest ₹ 5,00,000.

Compute:

- (i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.
- (ii) Allowable working partner salary for the assessment year 2026-27 as per section 40(b).

### SOLUTION

- (i) 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:

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

Particulars	₹	₹
Net Profit (before deduction of depreciation, salary and interest)		17,00,000
Less: Depreciation under section 32	1,50,000	
Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (₹ 5,00,000 × 12%)	60,000	2,10,000
<b>Book Profit</b>		<b>14,90,000</b>

- (ii) Salary actually paid to working partners = ₹ 40,000 × 2 × 12 = ₹ 9,60,000.

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 ₹ 6,00,000 of book profit or in case of loss	₹ 3,00,000 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. 2026-27 in this case would be:

Particulars	₹
On the first ₹ 6,00,000 of book profit [(₹ 3,00,000 or 90% of ₹ 6,00,000) whichever is more]	5,40,000
On the balance of book profit [60% of (₹ 14,90,000 - ₹ 6,00,000)]	5,34,000
<b>Maximum allowable partners' salary</b>	<b>10,74,000</b>

Hence, allowable working partners' salary for the A.Y. 2026-27 as per the provisions of section 40(b)(v) is ₹ 9,60,000.

**In the case of Association of persons or body of individuals, following amounts shall not be deducted in computing the business income**

**Section 40(ba)**

Any payment of interest, salary, commission, bonus or remuneration made by an association of persons or body of individuals to its members will also not be allowed as a deduction in computing the income of the association or body.

There are three Explanations to section 40(ba):

***Explanation 1*** - Where interest is paid by an AOP or BOI to a member who has paid interest to the AOP/BOI, the amount of interest to be disallowed under clause (ba) shall be limited to the net amount of interest paid by AOP/BOI to the partner.

***Explanation 2*** - Where an individual is a member in an AOP/BOI in a representative capacity, interest paid by AOP/BOI to such individual or by such individual to AOP/ BOI otherwise than as member in a representative capacity shall not be taken into account for the purposes of clause (ba). But interest paid to or received from each person in his representative capacity shall be taken into account.

***Explanation 3*** - Where an individual is a member in his individual capacity, interest paid to him in his representative capacity shall not be taken into account.



### 3.8 EXPENSES OR PAYMENTS NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES [SECTION 40A]

#### (1) Payments to relatives and associates

Section 40A(2) 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 or 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.

Assessee	Specified Person
(1)	(2)
<b>Individual</b>	<ol style="list-style-type: none"> <li>1. Any relative of the individual assessee</li> <li>2. Any person who carries on a business or profession, if           <ul style="list-style-type: none"> <li>• the individual has a substantial interest in the business of that person <b>or</b></li> <li>• any relative of the individual has a substantial interest in the business of that person</li> </ul> </li> </ol>
<b>Company, Firm, HUF or AOP</b>	<ol style="list-style-type: none"> <li>1. Any director, partner of the firm or member of the family or association or any relative of such director, partner or member or</li> <li>2. In case of a company assessee, any individual who has substantial interest in the business or profession of the company or any relative of such individual or</li> <li>3. 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 in the business of that person</li> </ol>

<b>All assessees</b>	The following are specified persons:	
	<b>Person who has substantial interest in the assessee's business</b>	<b>Other related persons of such person, who has a substantial interest in the assessee's business</b>
	Company/ AOP/ Firm/ HUF	<ul style="list-style-type: none"> <li>• Any director of such company, partner of such firm or the member of such family or association <b>or</b></li> <li>• Any relative of such director, partner <b>or</b> member <b>or</b></li> <li>• Any other company carrying on business or profession in which the first mentioned company has a substantial interest</li> </ul>
<p><b>Relative in relation to an Individual means the spouse, brother or sister or any lineal ascendant or descendant of that individual [Section 2(41)].</b></p> <p><b>Substantial interest in a business or profession</b></p> <p>A person shall be deemed to have a substantial interest in a business or profession if -</p> <ul style="list-style-type: none"> <li>- 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</li> <li>- 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.</li> </ul>		

## (2) Payments in excess of ₹ 10,000 made otherwise than through prescribed modes

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 through such other prescribed electronic modes exceeds ₹ 10,000, such expenditure shall not be allowed as a deduction.

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT

(National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

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 ₹ 32,000 incurred by X Ltd., 4 cash payments of ₹ 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 ₹ 32,000 would be disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr. Y exceeds ₹ 10,000.*

**Payments in excess of ₹ 10,000 made otherwise than through prescribed modes deemed to be the income of the subsequent year, if 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 through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay, 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 ₹ 10,000 [Section 40A(3A)].

**Increase in limit of cash payment, where payment made to transport operator:** This limit of ₹ 10,000 has been raised to ₹ 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 ₹ 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 through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay. In all other cases, the limit would continue to be ₹ 10,000.

**Cases where disallowances would not be attracted:**

- (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 ₹ 10,000 at a time are required to be made by account payee cheques or drafts or electronic clearing system or through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay 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 through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay 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/ account payee bank draft/ use of ECS through a bank account or through such other prescribed electronic modes [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 through such other prescribed electronic modes such as credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay, exceeds ₹10,000 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;
- (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;
- (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;

**Notes -**

- (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 ₹ 50,000;
- (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;
- (j) 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;
- (k) 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.

**Note:** Where any payment in respect of any expenditure is required to be made by an account payee cheque/ account payee bank draft or use of electronic clearing system through a bank account or through such other prescribed electronic modes in order that such expenditure may not be disallowed as a deduction under section 40A(3), then the payment may be made by such cheque or draft or electronic clearing system or through such other prescribed electronic modes.

No person is allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

This is notwithstanding anything contained in any other law for the time being in force or in any contract.

### (3) Disallowance of provision for gratuity

Section 40A(7) provides that no deduction would be allowable to any taxpayer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason.

The reason for this disallowance is that, under section 36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business.

A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer.

This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made as per section 40A(7) in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee's retirement, death, termination of service etc.

Further, where any provision for gratuity for any reason has been allowed as a deduction to the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way to gratuity to employee shall not be allowed as deduction to the assessee in the year in which it is paid.

**(4) Contributions by employers to funds, trust etc. [Sections 40A(9)]**

This sub-section has been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees.

Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose.

However, where such sum is paid in respect of funds covered by sections 36(1)(iv), 36(1)(iva) and 36(1)(v) or any other law, then the deduction will not be denied.

**(5) Marked to market loss or other expected loss [Sections 40A(13)]**

Section 40A(13) provides that no deduction or allowance in respect of any marked to market loss or other expected loss shall be allowed except as allowable under section 36(1)(xviii). 36(1)(xviii) provides that marked to market loss or other expected loss as computed in accordance with the ICDS notified under section 145(2), would be allowed as deduction. ICDS I provide that marked to market losses would not be allowed unless the same is in accordance with any other ICDS. Therefore, only marked to market losses specifically permitted under any other ICDS would be allowable as deduction under section 36. Other marked to market losses would not be allowed as deduction as per section 40A(13). This amendment was effective from A.Y. 2017-18.



## 3.9 PROFITS CHARGEABLE TO TAX [SECTION 41]

This section enumerates certain receipts which are deemed to be income under the head "business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises. The particulars of such receipts are given below:

**(1) Remission or cessation of trading liability [Section 41(1)]**

Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

#### **Successor in business:**

- (i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.
- (ii) Where a firm carrying on a business or profession is succeeded by another firm the successor will be the other firm.
- (iii) In any other case, where one person is succeeded by any other person in that business or profession the other person will be the successor.
- (iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

#### **(2) Balancing charge, sale of capital asset used for scientific research, recovery of a bad debt subsequently and withdrawal from reserves created [Section 41(2), (3), (4) & (4A)]**

The provisions of section 41(2) relating to balancing charge, section 41(3) relating to sale of capital assets acquired for scientific research, section 41(4) dealing with recovery of bad debts and of section 41(4A) relating to withdrawal from special reserve created have been dealt with earlier under the respective items.

#### **(3) Brought forward losses of defunct business [Section 41(5)]**

In cases where a receipt is deemed to be profit of a business under section 41 relating to a business that had ceased to exist and there is an unabsorbed loss, not being a speculation loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this section even after the expiry of 8 years.



## **3.10 OTHER PROVISIONS**

#### **(1) Special provisions for deduction in case of business for prospecting etc. for mineral oil [Section 42]**

This section enables an assessee to claim an allowance which may on general principles be inadmissible, e.g., allowance in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial

expenditure incurred on the setting up of a profit-earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract or arrangements entered into by the Central Government for prospecting for, or the extraction or production of mineral oils.

#### (i) Allowable expenses

The allowance permissible under this section shall be in relation to

- (a) the expenditure by way of infructuous or abortive exploration expenses in respect of an area surrendered prior to the beginning of commercial production by the assessee;
- (b) after the beginning of commercial production, the expenditure incurred by the assessee, whether before or after such commercial production in respect of drilling or exploration activities or services or in respect of physical assets used in that connection; and
- (c) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding years as may be specified in the agreement.

#### (ii) Amount of deduction

The sum of those allowances should be computed and deduction should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation of the Central Government or any authorized person by it in such business for the prospecting or exploration of mineral oil.

It has been specifically provided that the other provisions of the Act are being deemed, for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of the agreement. It may be noted that allowances in this regard are made in lieu of or in addition to the other allowances permissible under the Act, depending upon the terms of the agreement.

#### (iii) Taxability in case of transfer

	Transaction	Manner of deduction
(1)	Subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, in accordance with the aforesaid agreement,	
	<b>Case 1:</b> Where the proceeds of the transfer are less than the expenditure incurred remaining unallowed	<p>The expenditure remaining unallowed <b>as reduced by</b> the proceeds of transfer shall be allowed in the previous year in which the business or interest has been transferred.</p> <p><b>Amount of deduction = Expenditure remain unallowed – Sale proceeds</b></p>

<b>Case 2:</b> Where the proceeds of the transfer of whole or any part of the business or interest therein exceed the amount of expenditure remaining unallowed	The excess amount or expenditure allowed till date (i.e., difference between expenditure incurred in connection with the business or to obtain interest therein and the expenditure remaining unallowed), <b>whichever is less</b> , shall be chargeable to tax as profits and gains of business in the previous year in which the business or interest therein has been transferred.
	Taxable as profits and gains from business and profession $=$ $\text{Sale proceeds} - \text{Expenditure remain unallowed}$ OR $\left. \begin{array}{l} \text{Expenditure allowed till date} \\ \hline \end{array} \right\} \text{Whichever is less}$
	If the business or interest therein is transferred in a previous year in which the business is no longer in existence, the taxability would arise in the above manner as though the business is in existence in that previous year.
<b>Case 3:</b> Where the proceeds of the transfer are not less than the amount of expenditure incurred remaining unallowed.	No deduction for such expenditure shall be allowed in the previous year in which business or interest therein is transferred or in respect of any subsequent previous year or years. $\boxed{\text{Amount of deduction} = \text{NIL}}$
<b>Case 4:</b> Where transfer of the business or interest is not covered under Case 2 above	Deduction of unallowed expenditure <b>as reduced by</b> the proceeds of transfer from the expenditure remaining unallowed $\text{Allowable deduction} = \text{Unallowed expenditure} - \text{Sale proceeds}$
<b>(2)</b> <b>Transfer of business in a scheme of amalgamation</b>	If the amalgamating company sells or transfers the business to the amalgamated company, being an Indian company under the scheme of amalgamation The provisions of section 42 will apply to amalgamated company as they would have applied to amalgamating company as if the latter has not transferred the business or interest therein. The tax treatment in cases 1, 2, 3 & 4 given in (1) above will not apply to the amalgamating company.

(3)	<b>Transfer of business in a scheme of demerger</b>
If the demerged company sells or transfers the business to the resulting company, being an Indian company under the scheme of demerger	<p>The provisions of section 42 will apply to resulting company as they would have applied to demerged company as if the latter has not transferred the business or interest therein.</p> <p>The tax treatment in cases 1, 2, 3 &amp; 4 given in (1) above will not apply to the demerged company.</p>

**Note:** Mineral oil includes petroleum and natural gas.

## (2) Changes in the rate of exchange of currency [Section 43A]

- (i) The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee **at the time of making the payment**, the following values may be changed accordingly with respect to the increase or decrease in such liability:
  - (a) the actual cost of the asset under section 43(1)
  - (b) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)
  - (c) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)
  - (d) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.
- (ii) Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.
- (iii) Where the assessee has entered into a contract with authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

**(3) Taxation of foreign exchange fluctuation [Section 43AA]**

- (i) Section 43AA provides that, subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, which shall be computed in accordance with the notified ICDS i.e., ICDS VI: The effects of changes in foreign exchange rates.
- (ii) Gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to –
  - (a) monetary items and non-monetary items;
  - (b) translation of financial statements of foreign operations
  - (c) forward exchange contracts;
  - (d) foreign currency translation reserves.

**(4) Certain Deductions to be made only on actual payment [Section 43B]**

The following sums are allowed as deduction only in that previous year in which such sum is actually paid i.e., on actual payment basis.

- (a) Any sum payable 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 employees, or
- (c) **Bonus or Commission** for services rendered payable to 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**, or
- (da) Any sum payable by the assessee as **interest on any loan or borrowing from notified class of non-banking financial companies**, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or
- (e) **Interest on any loan or advance from a scheduled bank or co-operative bank** other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

- (f) Any sum paid by the assessee as an **employer in lieu of earned leave of his employee**, or
- (g) Any sum payable by the assessee **to the Indian Railways for use of Railway assets**.

For the purpose of claiming deduction of the **sums referred to above in clauses (a) to (g)** in the relevant previous year in which the expenditure is incurred, the above sums have to be **paid by the assessee on or before the due date for furnishing the return of income under section 139(1)** in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

#### **Conversion of interest into a loan or borrowing or debenture or any other instrument**

*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 or debenture or any other instrument by which the liability to pay is deferred to a future date, 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 or debenture or any other instrument by which the liability to pay is deferred to a future date 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.

#### **Meaning of Non-banking financial company:**

- (i) a financial institution which is a company;
- (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) such other non-banking institution or class of such institutions, as the bank may, specify with the previous approval of the Central Government and by notification in the Official Gazette.

**ILLUSTRATION 16**

*Hari, an individual, carried on the business of purchase and sale of agricultural commodities like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation (APSFC) and Indian Bank and has not paid interest as detailed hereunder:*

		₹
(i)	<i>Andhra Pradesh State Financial Corporation (P.Y. 2024-25 &amp; 2025-26)</i>	<i>15,00,000</i>
(ii)	<i>Indian Bank (P.Y. 2025-26)</i>	<i>30,00,000</i>
		<b><i>45,00,000</i></b>

*Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2025-26, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2026, Hari paid 5 installments to APSFC and 3 installments to Indian Bank.*

*Hari claimed the entire interest of ₹ 45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.*

**SOLUTION**

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to, *inter alia*, scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to APSFC and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.2026-27 shall be calculated as follows:

	Interest outstanding (₹)	Number of Instalments	Amount per instalment (₹)	Instalments paid	Interest allowable (₹)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
<b>Total amount eligible for deduction</b>					<b>2,75,000</b>

***Clarification on non-applicability of section 43B in respect of employee's Contribution to welfare funds [Explanation 5 to section 43B]***

As per section 2(24)(x), any sum received by an assessee, being an employer from his employee as contribution to any provident fund or superannuation fund or any fund set up under Employee's State Insurance Act, 1948 or any other fund for the welfare of employees would be considered as the income of an employer.

The deduction in respect of above sum will be allowed to the assessee under section 36(1)(va) only if such sum is credited by the assessee to the employee's account in the relevant fund on or before the due date, being the date specified under the relevant Act, Rule, order or notification issued thereunder.

As per section 43B, 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 employees, would be allowable during any P.Y. if the same has been paid on or before the 'due date' applicable in his case for furnishing the return of income under section 139(1) in respect of that P.Y.

*Explanation 5* clarifies that the provisions of section 43B regarding allowability of certain expenditure in a previous year only on actual payment basis (i.e., payment on or before the due date of filing of return of income for relevant assessment year), does not apply and would deemed never to be applied to employee's contribution received by employer towards any welfare fund. In effect, clause (b) of section 43B covers only employer's contribution to provident fund, superannuation fund, gratuity fund or any other fund for welfare of employees, for remittance of which extended time limit upto due date of filing return u/s 139(1) is available; however, it does not include within its scope, employees' contribution to such funds received by the employer, which has to be credited to the employee's account in the relevant fund on or before the due date specified under the relevant Act, Rule etc. Amount credited after the said due date but on or before the due date under section 139(1) would not be eligible for deduction.

**Section 43B [Clause (h)]**

Any sum payable by the assessee to a micro or small enterprise beyond the time-limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 would be allowed as deduction only in that previous year in which such sum is actually paid.

Section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 mandates payment of goods or services to supplier, being a micro or small enterprises by the buyer on or before the date agreed upon between them in writing i.e., as per the written agreement, which cannot be more than 45 days from the day of acceptance or the day of deemed acceptance of any goods or services by a buyer from a supplier. If there is no such written agreement, the payment shall be made before the appointed day i.e., within 15 days.

If the sum payable by the assessee to a micro or small enterprise is paid as per written agreement (maximum within 45 days) or within 15 days in case of no agreement, the deduction can be claimed on accrual basis if mercantile method of accounting is followed by the assessee.

However, if the sum payable by the assessee to a micro or small enterprise is not paid as per written agreement or within 15 days in case of no agreement, the deduction would be allowed in the previous year in which it is actually paid.

**Example:** Mr. A has purchased goods of ₹ 10,000 from A & Co., a micro enterprise on 1.3.2026. As per the written agreement between them, the payment has to be made by 5.4.2026. Mr. A follows mercantile method of accounting.

**(i) If Mr. A paid the sum on 2.4.2026**

Since Mr. A paid the sum on or before 5.4.2026, the deduction would be allowed in P.Y. 2025-26.

**(ii) If Mr. A paid the sum on 20.4.2026**

Since Mr. A paid the sum beyond the time limit, the deduction would be allowed in the year of actual payment i.e., P.Y. 2026-27.

**Example:** Suppose Mr. Raju has purchased goods of ₹ 10,000 from A & Co., a medium enterprise on 1.3.2026. As per the written agreement between them, the payment has to be made by 5.4.2026, however Mr. Raju paid the sum on 10.4.2026. Mr. Raju follows mercantile method of accounting.

In such case, since disallowance under section 43B(h) is not applicable on sum payable to medium enterprise, the deduction would be allowed in P.Y. 2025-26 on due basis.

***Meaning of Micro and Small enterprise***

S. No.	Meaning		
(1)	<b>Micro Enterprise</b>		
	Investment in Plant and Machinery or Equipment $\leq$ ₹2.5 crore	AND	Turnover $\leq$ ₹10 crore
(2)	<b>Small Enterprise</b>		
	Investment in Plant and Machinery or Equipment $\leq$ ₹25 crore	AND	Turnover $\leq$ ₹100 crore

Any sum payable means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law.

**(5) Special provision for computation of cost of acquisition of certain assets [Section 43C]**

- (i) Where an asset acquired under a scheme of amalgamation is sold by an amalgamated company as its stock-in-trade then in computing the profits and gains derived from sale of such stock-in-trade, the cost of acquisition of stock-in-trade to the amalgamated company shall be the cost of acquisition of the asset to the amalgamating company as increased by the cost, if any, of any improvement thereto and the expenditure incurred wholly and exclusively in connection with such a transfer.
- (ii) The provisions of section 43C will thus apply to the following cases of revaluation:
  - (a) When the stock-in-trade of the amalgamating company is taken over at revalued price by the amalgamated company under the scheme of amalgamation.
  - (b) Where a capital asset of the amalgamating company is taken over as stock-in-trade by the amalgamated company after revaluation under the scheme of amalgamation.
- (iii) The situation referred to at (b) above will in turn cover three situations:
  - (a) When the capital asset is converted to stock-in-trade by the amalgamating company with revaluation and the revalued asset is taken over by the amalgamated company under the scheme of amalgamation.
  - (b) Where the capital asset is taken over as stock-in-trade by the amalgamated company at revalued price at the time of amalgamation.
  - (c) Where the capital asset of the amalgamating company is taken over by the amalgamated company as a capital asset and has been converted into stock-in-trade and revalued.

- (iv) In a case referred to (c) above, where the revaluation and conversion of capital asset into stock-in-trade takes place in the hands of the amalgamated company, the provisions of section 45(2) will apply. In such a case, the provisions of section 43C will not apply. This has been done with a view to ensure that a tax payer does not face double taxation in respect of the same transaction. However, when the stock-in-trade referred to in item (ii)(a) as well as at (a) and (b) of (iii) above are sold, the provisions of section 43C will apply.
- (v) A similar provision in section 43C has also been made to cover cases where the asset sold as stock-in-trade has been acquired by the assessee either by way of full or partial partition of HUF or under a gift or will or an irrevocable trust and such asset is sold as stock-in-trade.

**(6) Stamp Duty Value of land and building to be taken as the full value of consideration in respect of transfer, even if the same are held by the transferor as stock-in-trade [Section 43CA]**

- (i) Section 43CA has been inserted as an anti-avoidance measure to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business or profession". However, if the stamp duty value does not exceed 110% of the consideration received or accruing then, such consideration shall be deemed to be the full value of consideration for the purpose of computing profits and gains from transfer of such asset.
- (ii) Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by way of an account payee cheque/account payee bank draft or use of ECS through a bank account or through such other prescribed electronic modes on or before the date of the agreement.

The prescribed electronic modes include credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

- (iii) The Assessing Officer may refer the valuation of the asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957 in the following cases -

- (1) Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and
  - (2) the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court.
- (iv) Where the value ascertained by the Valuation Officer exceeds the value adopted or assessed or assessable by the Stamp Valuation Authority, the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer.

The term "assessable" covers transfers executed through power of attorney.

The term '**assessable**' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

Date of transfer of land / building held as stock-in-trade	Actual consideration	Stamp duty value on the date of agreement	Stamp duty value on the date of registration	Full value of consideration	Remark
					₹ in lakhs
<b>Example:</b>					
1/9/2025	100 (₹ 10 lakhs received by A/c payee cheque on 1/7/2025)	120 (1/7/2025)	210 (1/9/2025)	120	As part of the consideration is received by A/c payee cheque on the date of agreement, Stamp duty value (SDV) on the date of agreement to be adopted as full value of consideration, since the SDV exceeds 110% of consideration i.e., ₹ 110 lakhs.

**Example:**

1/9/2025	100 (₹ 10 lakhs received by cash on 1/7/2025)	109 (1/7/2025)	130 (1/9/2025)	130	SDV on the date of registration to be adopted as full value of consideration and such SDV exceeds 110% of consideration i.e., ₹ 110 lakhs. Since part of consideration is received by cash on the date of agreement, the SDV on the date of agreement cannot be considered vis-à-vis actual consideration.
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**Example:**

31/1/2026	100 (₹ 10 lakhs received by A/c payee cheque on 1/7/2025)	109 (1/7/2025)	130 (31/1/2026)	100	Actual sales consideration would be the full value of consideration, since SDV on the date of agreement does not exceed 110% of actual consideration. SDV on the date of agreement can be considered vis-à-vis actual consideration, since part of the consideration has been received by account payee cheque on the date of agreement.
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**Example:**

31/3/2026	100 (Full amount received in cash on the date of registration)	120 (1/5/2025)	130 (31/3/2026)	130	Stamp duty value of the date of registration would be the full value of consideration since the stamp duty value exceeds 110% of consideration i.e., ₹ 110 lakhs.
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**(7) 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 -

Method	Condition
Project completion method	If the duration of the contract is not more than 90 days
Straight line method	If the contract involves indeterminate number of acts over a specific period of time

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.

**(8) Special Provision in case of income of Public Financial Institutions [Section 43D]**

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
- notified class of non-banking financial companies,

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 for that year or in the previous in which it is actually received by it, whichever is earlier.



### 3.11 COMPULSORY MAINTENANCE OF ACCOUNTS [SECTION 44AA]

- (1) **Maintain the books of account and other documents by notified profession [Section 44AA(1)]:** This section 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 CBDT 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.

**Prescribed books of accounts & other documents:** The CBDT has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to prescribe by rules the books of account and other documents including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and the place at which they must be kept and maintained.

**Rules pertaining to maintenance of books of accounts & other documents:**

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44AA(1).

**Prescribed class of persons:** As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in Rule 6F(2) in the following cases :

- if his **gross receipts exceed ₹ 1,50,000 in all the 3 years immediately preceding the previous year;** or
- if, where the profession has been newly set up in the previous year, his **gross receipts are likely to exceed ₹ 1,50,000 in that year.**

**Note:** Students may note that professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been specified in the Rule.

In other words, they are required to maintain (as per point (1) above) such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

**Prescribed books of accounts and other documents [Sub-rule (2) of Rule 6F]:** The following books of account and other documents are required to be maintained.

- (i) a cash book;
- (ii) a journal, if accounts are maintained on mercantile basis;
- (iii) a ledger;
- (iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding ₹ 25;
- (v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

**In case of a person carrying on medical profession,** he will be required to maintain the following in addition to the list given above:

- (i) a daily case register in Form 3C.
- (ii) an inventory under broad heads of the stock of drugs, medicines and other consumable accessories as on the first and last day of the previous year used for his profession.

**Place at which books to be kept and maintained:** The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.

**Period for which the books of account and other documents are required to be kept and maintained:** The Central Board of Direct Taxes has also been empowered to

prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

**Prescribed period:** The above books of account and documents shall be kept and maintained for a minimum of 6 years from the end of the relevant assessment year.

### ILLUSTRATION 17

*Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:*

	₹
Financial year 2022-23	1,15,000
Financial year 2023-24	1,80,000
Financial year 2024-25	2,10,000

*What is his obligation regarding maintenance of books of accounts for Assessment Year 2026-27 under section 44AA of Income-tax Act, 1961?*

### SOLUTION

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account 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.

As per Rule 6F, a person carrying on a notified profession shall be required to maintain **specified books of accounts, only if:**

- (i) his gross receipts in all the three years immediately preceding the relevant previous year has exceeded ₹ 1,50,000; or
- (ii) it is a new profession which is setup in the relevant previous year, it is likely to exceed ₹ 1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded ₹ 1,50,000 in financial year 2022-23, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him for A.Y. 2026-27.

Mr. Vinod, however, required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

- (2) Maintenance of books of account and other documents by persons carrying on business or profession [other than notified professions referred to in section 44AA(1)] [Section 44AA(2)]:
- I. **In case of Individual or HUF:** An Individual or HUF carrying on any business or profession (other than notified professions specified in section 44AA(1)) must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:
- (i) **Existing business or profession:** In cases where the **income** from the existing business or profession **exceeds ₹ 2,50,000 or the total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 25,00,000 in any one of three years immediately preceding** the accounting year; or
  - (ii) **Newly set up business or profession:** In cases where the business or profession is newly set up in any previous year, if his **income** from business or profession **is likely to exceed ₹ 2,50,000 or his total sales, turnover or gross receipts**, as the case may be, in the business or profession **are likely to exceed ₹ 25,00,000** during the previous year.
- II. **Person (other than individual or HUF):** Every person (other than individual or HUF) carrying on any business or profession (other than the notified professions referred to in section 44AA(1)) must maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance the provisions of the Income-tax Act, 1961 in the following circumstances:
- (i) **Existing business or profession:** In cases where the **income** from the business or profession **exceeds ₹ 1,20,000 or the total sales, turnover or gross receipts**, as the case may be, in the business or profession **exceed ₹ 10,00,000 in any one of three years** immediately preceding the accounting year; or
  - (ii) **Newly set up business or profession:** In cases where the business or profession is newly set up in any previous year, if his **income** from business or profession **is likely to exceed ₹ 1,20,000 or his total sales, turnover or gross receipts**, as the case may be, in the business or profession **are likely to exceed ₹ 10,00,000** during the previous year;

- III. Showing lower income as compared to income computed on presumptive basis under section 44AE or (section 44BB or section 44BBB)<sup>13</sup>:** Where profits and gains from the business are calculated on a presumptive basis under section 44AE or section 44BB or section 44BBB and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.
- IV. Where the provisions of section 44AD(4) are applicable in his case and his income exceeds the basic exemption limit in any previous year:** In cases, where an assessee not eligible to claim the benefit of the provisions of section 44AD(1) 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 44AD(1) and his income exceeds the basic exemption limit during the previous year.

- (3) **Penalty for failure to maintain books of account [Section 271A]:** If a 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 or to retain such books of account and other documents for the specified period, the Assessing Officer or the Joint Commissioner (Appeals) or the Commissioner (Appeals) may direct a penalty of ₹ 25,000 would be leviable under section 271A.



## 3.12 AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION [SECTION 44AB]

- (1) **Requirement of Tax Audit:** It is obligatory for the persons mentioned in column (2) of the table below, carrying on business or profession, to get his accounts audited before the "specified date" by a Chartered Accountant, if the conditions mentioned in the corresponding row of column (3) are satisfied

	Persons	When tax audit is required?
(1)	(2)	(3)
I	In case of a person carrying on business	
(a)	In case of a person carrying on business	If his total sales, turnover or gross receipts in business > ₹ 1 crore in the relevant PY

<sup>13</sup>Section 44BB and 44BBB will be discussed in Chapter 21: Non-resident taxation in Module 4 of the Study Material.

		<b>Note – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44AD(1).</b>
	If in case of such person carrying on business -  (i) Aggregate cash receipts in the relevant PY $\leq$ 5% of total receipts (including receipts for sales, turnover, gross receipts); and  (ii) Aggregate cash payments in the relevant PY $\leq$ 5% of total payments (including amount incurred for expenditure)	If his total sales, turnover or gross receipts in business $>$ ₹ 10 crore in the relevant PY
<b>Note –</b> For this purpose, the payment or receipt, as the case may be, by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the payment or receipt, as the case may be, in cash.		
(b)	In case of an assessee covered u/s 44AE i.e., an assessee engaged in the business of plying, hiring or leasing goods carriages who owns not more than 10 goods carriages at any time during the P.Y.	If such assessee claims that the profits and gains from business in the relevant P.Y. are lower than the profits and gains computed on a presumptive basis u/s 44AE [i.e., ₹ 1000 per ton of gross vehicle weight or unladen weight in case of each heavy goods vehicle and ₹ 7,500 for each vehicle, other than heavy goods vehicle, for every month or part of the month for which the vehicle is owned by the assessee].
(c)	In case of an eligible assessee carrying on business, whose total turnover, sales, gross receipts $\leq$ ₹ 200 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)  In case of an eligible assessee carrying on business, whose aggregate cash receipts in the relevant PY $\leq$ 5% of total turnover or gross receipts and whose total turnover, sales, gross receipts $\leq$ ₹ 300 lakhs, and who has opted for section 44AD in any earlier PY (say, P.Y. 2024-25)	If he declares profit for any of the five successive PYs (say, P.Y. 2025-26) not in accordance with section 44AD (i.e., he declares profits lower than 8% or 6% of total turnover, sales or gross receipts, as the case may be, in that year), then, he cannot opt for section 44AD for five successive PYs after the year of such default (i.e., from P.Y. 2026-27 to P.Y. 2030-31). For the year of default (i.e., P.Y. 2025-26) and five successive previous years (i.e., P.Y. 2026-27 to P.Y. 2030-31), he has to maintain books of account u/s 44AA and get them audited u/s 44AB, if his income exceeds the basic exemption limit.

II	In case of persons carrying on profession	
(a)	In case of a person carrying on profession	If his gross receipts in profession > ₹ 50 lakh in the relevant PY. <b>Note</b> – The requirement of audit u/s 44AB does not apply to a person who declares profits and gains for the previous year on presumptive basis u/s 44ADA(1).
(b)	In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal, medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose gross receipts ≤ ₹ 50 lakhs  In case of an assessee carrying on a notified profession under section 44AA(1) i.e., legal, medical, engineering, accountancy, architecture, interior decoration, technical consultancy, whose aggregate cash receipts in the relevant PY ≤ 5% of total gross receipts and whose gross receipts ≤ ₹ 75 lakhs	If such resident assessee claims that the profits and gains from such profession in the relevant PY are lower than the profits and gains computed on a presumptive basis u/s 44ADA (50% of gross receipts) and his income exceeds the basic exemption limit in that PY.

- (2) **Audit Report:** The persons 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. The audit report furnished may be revised by the person by getting revised report of audit from a chartered accountant, duly signed and verified by such chartered accountant, if there is payment by such person after furnishing of report which necessitates recalculation of disallowance under section 40 or section 43B. The said revised audit report has to be furnished before the end of the relevant assessment year for which the report pertains.
- (3) **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.

- (4) **Specified date:** The expression “**specified date**” in relation to the accounts of the previous year or years relevant to any assessment year means the date one month prior to the due date for furnishing the return of income under section 139(1).

The due date for filing return of income in case of assessees (other than companies) who are required to get their accounts audited is 31<sup>st</sup> October of the relevant assessment year. Hence, the specified date for tax audit would be 30<sup>th</sup> September of the relevant assessment year.<sup>14</sup>

- (5) **Non-applicability:** 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)<sup>15</sup>.
- (6) **Penal provision:** If any person fails to get his accounts audited in respect of any previous year or furnish the audit report by the specified date, penalty of lower of (a) and (b) mentioned below would be leviable on such person –
- (a) ½% of total sales, turnover or gross receipts, as the case may be, in business or of the gross receipts in profession, in such previous year; or
  - (b) ₹ 1,50,000 [Section 271B].



### 3.13 SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS [SECTION 44AD/ 44ADA/ 44AE]

	Particulars	Section 44AD	Section 44ADA	Section 44AE
(1)	<b>Eligible Assessee</b>	Resident individual, HUF or Partnership firm (but not LLP) engaged in eligible business and who has not claimed deduction	Resident individual or resident partnership firm (but not LLP) engaged in any profession specified u/s 4AA(1),	An assessee owning not more than 10 goods carriages at any time during the P.Y.

<sup>14</sup> In case of a person whose due date for filing return of income is 30<sup>th</sup> November of the relevant assessment year, the specified date for tax audit would be 31<sup>st</sup> October of the relevant assessment year.

<sup>15</sup> Section 44B and 44BBA will be discussed in Chapter 21: Non-resident taxation in Module 4 of the Study Material.

		<p>under section 10AA or Chapter VIA under "C – Deductions in respect of certain incomes"</p> <p><b>Non-applicability of section 44AD in respect of the following persons:</b></p> <ul style="list-style-type: none"> <li>- A person carrying on profession specified u/s 44AA(1);</li> <li>- A person earning income in the nature of commission or brokerage;</li> <li>- A person carrying on any agency business.</li> </ul>	<p>namely, 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)</p>	
(2)	<b>Eligible business/ profession</b>	<p>Any business, other than business referred to in section 44AE, whose total turnover/ gross receipts in the P.Y. <math>\leq</math> ₹ 200 lakhs</p>	<p>Any profession specified under section 44AA(1), whose gross receipts <math>\leq</math> ₹ 50 lakhs in the relevant P.Y.</p>	<p>Business of plying, hiring or leasing goods carriages</p>
		<p>Any business, other than business referred to in section 44AE, whose total turnover/gross receipts in the P.Y. <math>\leq</math> ₹ 300 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY <math>\leq</math> 5% of total turnover or gross receipts.</p>	<p>Any profession specified u/s 44AA(1), whose gross receipts <math>\leq</math> ₹ 50 lakhs in the relevant P.Y., if aggregate cash receipts in the relevant PY <math>\leq</math> 5% of total gross receipts.</p>	

		<p>In effect, if the turnover of business is &gt; ₹ 200 lakhs ≤ ₹ 300 lakhs, the benefit of section 44AD can be availed only if aggregate cash receipts in relevant P.Y. ≤ 5% of total turnover or gross receipts.</p> <p><b>Note:</b> For this purpose, the receipt of amount or aggregate of amounts by a cheque drawn on a bank or by a bank draft, which is not account payee, would be deemed to be the receipt in cash.</p>	<p>In effect, if the gross receipts from profession is &gt; ₹ 50 lakhs ≤ ₹ 75 lakhs, the benefit of section 44ADA can be availed only if aggregate cash receipts in relevant P.Y. ≤ 5% of total gross receipts.</p>	
(3)	Presumptive income	<p><b>8% of total turnover/sales/gross receipts</b> or a sum higher than the aforesaid sum claimed to have been earned by the assessee.</p> <p><b>6% of total turnover/gross receipts</b> in respect of the amount of total turnover/sales/ gross receipts received by A/c payee cheque/ bank draft/ ECS through a bank account or through such other prescribed electronic modes (credit card, debit card, net banking, IMPS, UPI, RTGS, NEFT, and BHIM Aadhar Pay) <b>during the P.Y. or before due date of filing of return u/s 139(1)</b> in respect of that P.Y. (or) such higher sum</p>	<p><b>50% of gross receipts of such profession</b> or a sum higher than the aforesaid sum claimed to have been earned by the assessee.</p>	<p><b>For each heavy goods vehicle ₹ 1,000 per ton of gross vehicle weight</b> or unladen weight, as the case may be, for every month or part of a month;</p> <p><b>For each vehicle, other than heavy goods vehicle: ₹ 7,500 per month or part of a month</b> during which such vehicle is owned by the assessee or an amount claimed to have been actually earned from such vehicle, whichever is higher.</p>

		claimed to have been earned by the assessee.		
(4)	Non-allowability of deductions while computing presumptive income	Deductions allowable under <b>sections 30 to 38</b> shall be <b>deemed to have been given full effect to</b> and no further deduction shall be allowed.  Even in case of a firm, salary and interest paid to partners is <b>not</b> deductible.	Even in case of a firm, salary and interest paid to partners is <b>not</b> deductible.	In case of a firm, <b>salary and interest paid to partners is deductible</b> subject to the conditions and limits specified in <b>section 40(b)</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	If eligible assessee declares profits and gains in accordance with the provisions of section 44AD, he is <b>not</b> required to maintain books of account u/s 44AA or get them audited u/s 44AB.  However, if after declaring profits on presumptive basis u/s 44AD, say, for A.Y.2026-27, non-declaration of profits on presumptive basis for any of the 5 successive A.Y.s thereafter (i.e., from A.Y.2027-28 to A.Y.2031-32), say, for A.Y. 2028-29, would disentitle the	If eligible assessee declares profits and gains in accordance with the provisions of section 44ADA, he is <b>not</b> required to maintain books of account u/s 44AA or get them audited u/s 44AB.  However, if the assessee <b>claims his profits to be lower</b> than the profits computed by applying the presumptive rate, he has to maintain books of account and other documents <b>u/s 44AA(1)</b> and get his accounts <b>audited u/s 44AB</b> , if <b>his total income &gt;</b>	If eligible assessee declares profits and gains in accordance with the provisions of section 44AE, he is <b>not</b> required to maintain books of account u/s 44AA or get them audited u/s 44AB.  However, if the assessee <b>claims his profits to be lower</b> than the profits computed by applying the presumptive rate, he has to maintain books of account u/s 44AA(2) and get

		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.2029-30 to A.Y. 2033-34). In such a case, the assessee would have to <b>maintain books of account and other documents u/s 44AA(2)</b> and get his accounts audited u/s <b>44AB</b> , if his total income exceeds the basic exemption limit in those years.	basic exemption limit for that year.	his accounts audited u/s <b>44AB</b> .
(7)	<b>Advance obligation tax</b>	The eligible assessee opting for section 44AD is required to pay advance tax by <b>15th March of the financial year (F.Y.)</b> .	The eligible assessee opting for section 44ADA is required to pay advance tax by <b>15th March of the F.Y.</b>	The eligible assessee has to pay advance tax in four installments [ <b>See Chapter 13 in Module 3 for details</b> ].

**Meaning of certain terms for the purpose of section 44AE:**

S.No	Term	Meaning
(1)	<b>Heavy goods vehicle</b>	any goods carriage, the gross vehicle weight of which exceeds 12,000 kilograms.
(2)	<b>Gross vehicle weight</b>	total weight of the vehicle and load certified and registered by the registering authority as permissible for that vehicle.
(3)	<b>Unladen weight</b>	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

The CBDT clarified that in respect of a “heavy goods vehicle” i.e. any goods carriage vehicle whose gross vehicle weight exceeds 12,000 kilograms, the profits and gains from each goods carriage would be at the rate of ₹ 1,000 per ton of gross vehicle weight for every month or part of the month.

However, in respect of a tractor or a road-roller, where the gross vehicle weight is not applicable, and unladen weight exceeds 12,000 Kilograms, the profits and gains from each goods carriage shall be at the rate of ₹ 1,000 per ton of unladen weight for every month or part of the month [Clarification dated 14.8.2019].

**Example:**

Let us consider the following particulars relating to a resident individual, Mr. A, being an eligible assessee carrying on retail trade business whose total turnover do not exceed ₹ 2 crore in any of the previous years relevant to A.Y.2026-27 to A.Y.2028-29

Particulars	A.Y.2026-27	A.Y.2027-28	A.Y.2028-29
Total turnover (₹)	1,80,00,000	1,90,00,000	2,00,00,000
Amount received through prescribed electronic modes on or before 31 <sup>st</sup> October of the A.Y.	1,60,00,000	1,45,00,000	1,80,00,000
Income offered for taxation (₹)	11,20,000	12,30,000	10,00,000
% of gross receipts	6% on ₹ 1.60 crore and 8% on ₹ 20 lakhs	6% on ₹ 1.45 crore and 8% on ₹ 45 lakhs	5% on ₹ 2 crore
Offered income as per presumptive taxation scheme u/s 44AD	Yes	Yes	No

In the above case, Mr. A, an eligible assessee, opts for presumptive taxation under section 44AD for A.Y.2026-27 and A.Y.2027-28 and offers income of ₹ 11.20 lakhs and ₹ 12.30 lakhs on gross receipts of ₹ 1.80 crore and ₹ 1.90 crore, respectively.

However, for A.Y.2028-29, he offers income of only ₹ 10 lakhs on turnover of ₹ 2 crores, which amounts to 5% of his gross receipts. He needs to maintain 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. 2026-27, he will not be eligible to claim the benefit of section 44AD for next five assessment years succeeding A.Y.2028-29 i.e., from A.Y.2029-30 to 2033-34.

**ILLUSTRATION 18**

*Mr. Praveen engaged in retail trade, reports a turnover of ₹ 2,98,50,000 for the financial year 2025-26. Amount received in cash during the P.Y. 2025-26 is ₹ 14,00,000 and balance through prescribed electronic modes on or before 31<sup>st</sup> July 2026. His income from the said business as per books of account is ₹ 15,00,000 computed as per the provisions of Chapter IV-D “Profits and gains from business or Profession” of the Income-tax Act, 1961. Retail trade is the only source of income for Mr. Praveen. A.Y. 2025-26 was the first year for which he declared his business income in accordance with the provisions of presumptive taxation u/s 44AD.*

- (i) *Is Mr. Praveen also eligible for presumptive determination of his income chargeable to tax for the assessment year 2026-27?*
- (ii) *If so, determine his income from retail trade as per the applicable presumptive provision.*
- (iii) *In case Mr. Praveen wants to declare profits as per books of account from retail trade, what are his obligations under the Income-tax Act, 1961?*
- (iii) *What is the due date for filing his return of income under both the options?*

**SOLUTION**

- (i) Yes. Since his cash receipts during the P.Y. does not 5% of the total turnover ( $14,00,000/2,98,50,000 \times 100$ ) and his total turnover for the F.Y. 2025-26 is below ₹ 300 lakhs, he is eligible 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 ₹ 18,19,000 (₹ 1,12,000, being 8% of ₹ 14,00,000 + ₹ 17,07,000, being 6% of ₹ 2,84,50,000).
- (iii) Mr. Praveen had declared profit for the previous year 2024-25 in accordance with the presumptive provisions and if he wants to declare profits as per books of account which is lower than the presumptive income for any of the five consecutive assessment years i.e., A.Y. 2026-27 to A.Y. 2030-31, he would not be eligible to claim the benefit of presumptive taxation for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance the presumptive provisions i.e. if he declares profits lower than the presumptive income in say P.Y. 2025-26 relevant to A.Y. 2026-27, then, he would not be eligible to claim the benefit of presumptive taxation for A.Y. 2027-28 to A.Y. 2031-32.

Consequently, Mr. Praveen is required to maintain the books of accounts and get them audited under section 44AB, since his income exceeds the basic exemption limit.

- (iv) In case he declares presumptive income under section 44AD, the due date would be 31<sup>st</sup> July, 2026.

In case he declares profits as per books of account which is lower than the presumptive income, he is required to get his books of account audited, in which case the due date for filing of return of income would be 31<sup>st</sup> October, 2026.

#### ILLUSTRATION 19

*Mr. X commenced the business of operating goods vehicles on 1.4.2025. He purchased the following vehicles during the P.Y.2025-26. Compute his income under section 44AE for A.Y.2026-27.*

	<b>Gross Vehicle Weight (in kilograms)</b>	<b>Number</b>	<b>Date of purchase</b>
(1)	7,000	2	10.04.2025
(2)	6,500	1	15.03.2026
(3)	10,000	3	16.07.2025
(4)	11,000	1	02.01.2026
(5)	15,000	2	29.08.2025
(6)	15,000	1	23.02.2026

*Would your answer change if the two goods vehicles purchased in April, 2025 were put to use only in July, 2025?*

#### SOLUTION

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2025-26, he is eligible to opt for presumptive taxation scheme under section 44AE. ₹ 1,000 per ton of gross vehicle weight or unladen weight per month or part of the month for each heavy goods vehicle and ₹ 7,500 per month or part of month for each goods carriage other than heavy goods vehicle, owned by him would be deemed as his profits and gains from such goods carriage.

Heavy goods vehicle means any goods carriage, the gross vehicle weight of which exceeds 12,000 kg.

(1)	(2)	(3)	(4)
Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	No. of months × No. of vehicles [(1) × (3)]
<b>Heavy goods vehicle</b>			
2	29.08.2025	8	16
1	23.02.2026	2	2
			<b>18</b>
<b>Goods vehicle other than heavy goods vehicle</b>			
2	10.4.2025	12	24
1	15.3.2026	1	1
3	16.7.2025	9	27
1	02.1.2026	3	3
			<b>55</b>

The presumptive income of Mr. X under section 44AE for A.Y.2026-27 would be -

₹ 6,82,500, i.e.,  $55 \times ₹ 7,500$ , being for other than heavy goods vehicle +  $18 \times ₹ 1,000 \times 15$  ton being for heavy goods vehicle.

The answer would remain the same even if the two vehicles purchased in April, 2025 were put to use only in July, 2025, since the presumptive income has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.



### 3.14 METHOD OF COMPUTING DEDUCTION IN THE CASE OF BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 44DB]

- (1) This section provides the manner in which the deduction under the following sections are to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year –
  - (i) Section 32 (Depreciation);
  - (ii) Section 35D (Amortisation of certain preliminary expenses);
  - (iii) Section 35DD (Amortisation of expenses in case of amalgamation or demerger);

- (iv) Section 35DDA (Amortisation of expenditure incurred under voluntary retirement scheme).
- (2) **Quantum of Deduction to predecessor co-operative bank:** The amount of deduction allowable to the predecessor co-operative bank under the above-mentioned sections 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 if the business reorganisation had not taken place;
- B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and
- C= the total number of days in the financial year in which the business reorganisation has taken place.

- (3) **Quantum of Deduction to successor co-operative bank or to the converted banking company:** The amount of deduction allowable to the successor co-operative bank or to the converted banking company under the above-mentioned sections 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 if the business reorganisation had not taken place;
- B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and
- C = the total number of days in the financial year in which the business reorganisation has taken place.

**Example:**

Let us take a case where the deduction allowable under section 32 to the predecessor co-operative bank is, say, ₹ 1,20,000 and the business re-organisation took place on 1.11.2025. Then, the deduction allowable to the predecessor co-operative bank under section 32 would be ₹ 70,356 i.e., ₹ 1,20,000 x 214/365. The deduction allowable to the successor co-operative bank or to the converted banking company would be ₹ 49,644 i.e., ₹ 1,20,000 x 151/365.

(4) **Manner for computing deduction:** In a case where an undertaking of the predecessor co-operative bank entitled to the deduction under sections 35D, 35DD or 35DDA is transferred before the expiry of the period specified therein to a successor co-operative bank or to a converted banking company on account of business reorganisation, the provisions of section 35D, section 35DD or section 35DDA shall apply to the successor co-operative bank or to converted banking company in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.

(5) **Meaning of certain terms:**

Term	Meaning
<b>Business reorganisation</b>	The reorganisation of business involving the amalgamation or demerger of a co-operative bank or conversion of a primary co-operative bank.
<b>Conversion</b>	Transition of a primary co-operative bank to a banking company under the scheme of the RBI as notified vide its circular no. DCBR. CO. LS. PCB. Cir. No. 5/07.01.000/2018-19, dated 27.09.2018.
<b>Converted banking company</b>	A banking company formed as a result of conversion from primary co-operative bank.
<b>Co-operative bank</b>	The meaning assigned to it in clause (cci) of section 5 of the Banking Regulation Act, 1949 i.e., a primary co-operative bank or Central Co-operative bank or a State co-operative bank.
<b>Banking company</b>	The meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949 i.e., any company which transacts the business of banking in India.
<b>Predecessor co-operative bank</b>	The amalgamating co-operative bank or the demerged co-operative bank or primary co-operative bank which has been succeeded as a result of conversion, as the case may be.
<b>Primary co-operative bank</b>	The meaning assigned to it in clause (ccv) of section 5 of the Banking Regulation Act, 1949 i.e., a co-operative society, other than a primary agricultural credit society – <ul style="list-style-type: none"> <li>(i) the primary object or principal business of which is the transaction of banking business;</li> <li>(ii) the paid-up share capital and reserves of which are not less than ₹ 1 lakh; and</li> <li>(iii) The bye-laws of which do not permit admission of any other co-operative society as a member. However, it shall not</li> </ul>

	apply to the admission of a co-operative bank as a member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for this purpose.
<b>Successor co-operative bank</b>	the amalgamated co-operative bank or the resulting bank, as the case may be.
<b>Amalgamated co-operative bank</b>	(1) a co-operative bank with which one or more amalgamating co-operative banks merge; or (2) a co-operative bank formed as a result of merger of two or more amalgamating co-operative banks.
<b>Amalgamating co-operative bank</b>	(1) a co-operative bank which merges with another co-operative bank; or (2) every co-operative bank merging to form a new co-operative bank.
<b>Amalgamation</b>	the merger of an amalgamating co-operative bank or banks with an amalgamated co-operative bank, in such a manner that – (1) all the assets and liabilities of the amalgamating co-operative bank or banks immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to the amalgamated co-operative bank) become the assets and liabilities of the amalgamated co-operative bank; (2) the members holding 75% or more voting rights in the amalgamating co-operative bank become members of the amalgamated co-operative bank; and (3) the shareholders holding 75% or more in value of the shares in the amalgamating co-operative bank (other than the shares held by the amalgamated co-operative bank or its nominee or its subsidiary, immediately before the merger) become shareholders of the amalgamated co-operative bank.
<b>Demerger</b>	The transfer by a demerged co-operative bank of one or more of its undertakings to any resulting co-operative bank, in such manner that– (1) all the assets and liabilities of the undertaking or undertakings immediately before the transfer become the assets and liabilities of the resulting co-operative bank; (2) the assets and the liabilities are transferred to the resulting co-operative bank at values (other than change in the value of assets consequent to their revaluation) appearing in its books of account immediately before the transfer;

	(3) the resulting co-operative bank issues, in consideration of the transfer, its membership to the members of the demerged co-operative bank on a proportionate basis;
	(4) the shareholders holding 75% or more in value of the shares in the demerged co-operative bank (other than shares already held by the resulting bank or its nominee or its subsidiary immediately before the transfer), become shareholders of the resulting co-operative bank, otherwise than as a result of the acquisition of the assets of the demerged co-operative bank or any undertaking thereof by the resulting co-operative bank;
	(5) the transfer of the undertaking is on a going concern basis; and
	(6) the transfer is in accordance with the conditions specified by the Central Government, by notification in the Official Gazette, having regard to the necessity to ensure that the transfer is for genuine business purposes.
<b>Demerged co-operative bank</b>	the co-operative bank whose undertaking is transferred, pursuant to a demerger, to a resulting bank.
<b>Resulting co-operative bank</b>	(1) one or more co-operative banks to which the undertaking of the demerged co-operative bank is transferred in a demerger; or (2) any co-operative bank formed as a result of demerger.

#### ILLUSTRATION 20

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2025. The depreciation for the year ended 31.3.2026 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to ₹ 2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2026-27.

#### SOLUTION

- (i) 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 reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.
- B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e., 1.4.2025, in this case) and ending on the day immediately preceding the date of business reorganization (i.e., 30.11.2025, in this case); and
- C = the total number of days in the financial year in which the business reorganisation has taken place (i.e., 365 days).

- (ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative 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 reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.
- B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2025, in this case) and ending on the last day of the financial year (i.e. 31.3.2026); and
- C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

- (iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is ₹ 2,40,000 and the business re-organisation took place on 1.12.2025. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be ₹1,60,438 i.e., ₹ 2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be ₹ 79,562 i.e., ₹ 2,40,000 x 121/365.



### 3.15 COMPUTATION OF BUSINESS INCOME IN CASES WHERE INCOME IS PARTLY AGRICULTURAL AND PARTLY BUSINESS IN NATURE

**(1) Income from the manufacture of rubber [Rule 7A]**

- (i) Income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.
- (ii) In computing such income, an allowance shall be made in respect of the cost of planting rubber plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includable in the total income.

**(2) Income from the manufacture of coffee [Rule 7B]**

- (i) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax.
- (ii) Income derived from the sale of coffee grown cured, roasted and ground by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.
- (iii) In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in such replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of section 10(31), is not includable in the total income.

## (3) Income from the manufacture of tea [Rule 8]

- (i) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.
- (ii) In computing such income, an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provision of section 10(30), is not includable in the total income.

**Taxability in case of composite income: A Summary**

Rule	Nature of composite income	Business income (Taxable)	Agricultural Income (Exempt)
7A	Income from sale of rubber products derived from rubber plants grown by the seller in India	35%	65%
7B	Income from sale of coffee		
	- grown and cured by the seller in India	25%	75%
	- grown, cured, roasted and grounded by the seller in India	40%	60%
8	Income from sale of tea grown and manufactured by the seller in India	40%	60%

**ILLUSTRATION 21**

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31-3-2026:

S. No.	Particulars	₹
(i)	Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.	3,00,000
(ii)	Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.	1,00,000
(iii)	Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.	2,50,000

(iv)	<i>Income from sale of tea grown and manufactured in Shimla.</i>	4,00,000
(v)	<i>Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.</i>	80,000

You are required to compute the business income and agricultural income of Miss Vivitha for the assessment year 2026-27.

### SOLUTION

#### Computation of business income and agricultural income of Ms. Vivitha for the A.Y.2026-27

Sr. No.	Source of income	Gross (₹)	Business income		Agricultural income
			%	₹	₹
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	1,95,000
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	75,000
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. ( <b>See Note 1 below</b> )	2,50,000	100%	2,50,000	-
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	2,40,000
(v)	Saplings and seedlings grown in nursery in India ( <b>See Note 2 below</b> )	80,000		Nil	80,000
<b>Total</b>				<b>5,40,000</b>	<b>5,90,000</b>

#### Notes:

- Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri Lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agricultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.
- Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income whether or not the basic operations were carried out on land.*

## SIGNIFICANT SELECT CASES

S. No.	Case Law	
1.	<i>Frontier Information Tech Ltd. v DCIT (ITA 239/2008, Judgment, Telangana High Court)</i>	
	Issue	Facts, Analysis and Decision
	Whether conversion of interest due on loan into equity of the company amounts to actual payment of the interest and is to be allowed as deduction as per section 43B of the Act?	<p><b>Facts of the Case:</b> The assessee-company, a developer of software, had converted the interest due of ₹ 75.75 lakhs to Andhra Pradesh Industrial Development Corporation Limited, being a State industrial investment corporation and interest of ₹ 39.94 lakhs to Andhra Pradesh State Financial Corporation into equity shares. The Assessing Officer held that actual payment of the amount was sine qua non for allowing deduction under section 43B. It was further held that conversion of outstanding interest liability into loan i.e., funding interest or into equity did not amount to actual payment. Accordingly, the amount was disallowed under section 43B on the ground that the same was not actually paid.</p> <p><b>Analysis and Decision:</b> The High Court held that as the liability of the assessee to pay interest ceased to exist on issue of shares, the same would tantamount to actual payment within the meaning of section 43B. The assessee, therefore, is entitled to claim the benefit of deduction under section 43B.</p>
2.	<i>Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673 (SC); Rayala Corporation (P) Ltd. v. Asstt. CIT (2016) 386 ITR 500 (SC); and Raj Dadarkar and Associates v. ACIT (2017) 394 ITR 592 (SC)</i>	
	Issue	Analysis & Decision
	Would rental income from the business of leasing out properties be taxable under the head "Income from house property" or "Profits and gains from business or profession"?	In <i>Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673</i> , the Supreme Court observed that holding of the properties and earning income by letting out of these properties is the main objective of the company. Further, in the return of income filed by the company and accepted by the Assessing Officer, the entire income of the company comprised of income from letting out of

		<p>such properties. The Supreme Court, accordingly, held that such income was taxable as business income. Likewise, in <i>Rayala Corporation (P) Ltd. v. Asst. CIT (2016) 386 ITR 500</i>, the Supreme Court noted that the assessee was engaged only in the business of renting its properties and earning rental income therefrom and accordingly, held that such income was taxable as business income. However, in <i>Raj Dadarkar and Associates v. ACIT (2017) 394 ITR 592</i>, on account of lack of sufficient material to prove that substantial income of the assessee was from letting out of property, the Supreme Court held that the rental income has to be assessed as "Income from house property".</p> <p><b>Note:</b> The Finance (No. 2) Act, 2024 inserted an Explanation 3 to section 28 and clarified that the income from <b>letting out of a residential house or a part of the house</b> by the owner would be chargeable to tax under the head "Income from house property" and will no longer be considered under the head "<b>Profits and gains of business or profession</b>" even though the main business of the assessee is to let out the residential house properties. Accordingly, the rationale of the above rulings hold good only in respect of letting out of commercial properties.</p>				
3. <b>CIT v. K and Co. (2014) 364 ITR 93 (Del)</b>						
	<table border="1"> <thead> <tr> <th>Issue</th><th>Analysis &amp; Decision</th></tr> </thead> <tbody> <tr> <td>Whether interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable the head 'Profits and Gains from Business or Profession' or under the head 'Income from other sources'?</td><td> <p>The interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee. If the assessee had not furnished bank guarantee, it would not have got the contract.</p> <p>Therefore, the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".</p> </td></tr> </tbody> </table>	Issue	Analysis & Decision	Whether interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable the head 'Profits and Gains from Business or Profession' or under the head 'Income from other sources'?	<p>The interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee. If the assessee had not furnished bank guarantee, it would not have got the contract.</p> <p>Therefore, the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".</p>	
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Whether interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable the head 'Profits and Gains from Business or Profession' or under the head 'Income from other sources'?	<p>The interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee. If the assessee had not furnished bank guarantee, it would not have got the contract.</p> <p>Therefore, the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".</p>					

4.	<i>I.C.D.S. Ltd. v. CIT (2013) 350 ITR 527 (SC)</i>	
	Issue	Analysis & Decision
	<p>Can depreciation on leased vehicles be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles?</p>	<p>Section 32 imposes a twin requirement of “ownership” and “usage for business” as conditions for claim of depreciation thereunder. As far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. <b>In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.</b></p> <p>As long as the assessee-lessor has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –</p> <ul style="list-style-type: none"> <li>• The assessee is the exclusive owner of the vehicle at all points of time;</li> <li>• The assessee is empowered to repossess the vehicle, in case the lessee committed a default;</li> <li>• At the end of the lease period, the lessee was obliged to return the vehicle to the assessee;</li> <li>• The assessee had a right of inspection of the vehicle at all times.</li> </ul> <p>The proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee. <b>The assessee-lessor was, therefore, entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32, namely, ownership of the vehicles and its usage in the course of business.</b></p>

5.	<p><b>CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)</b>  <b>CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 0049 (Delhi)</b>  <b>Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)</b></p>	
	Issue	Analysis & Decision
6.	What is the eligible rate of depreciation in respect of computer accessories, peripherals and UPS under the Income-tax Act, 1961?	<p><b>Computer accessories and peripherals such as printers, scanners and server etc. form an integral part of the computer system and they cannot be used without the computer.</b> Since they are part of the computer system, <b>they would be eligible for depreciation at the higher rate of 40% applicable to computers including computer software.</b></p> <p><b>Depreciation on UPS is allowable@40%,</b> being the eligible rate of depreciation on computers including computer software, and not at the general rate of 15% applicable to plant and machinery.</p>
	Can EPABX and mobile phones be treated as computers to be entitled to higher depreciation?	<b>EPABX and mobile phones are <u>not</u> computers and therefore, are not entitled to higher depreciation@40%.</b>
6.	<p><b>CIT v. Ceebro's Hotels Private Limited [2018] 409 ITR 423 (Mad)</b></p>	
	Issue	Analysis & Decision
6.	Can an assessee setting up a hotel claim deduction under section 35AD for the relevant previous year, on the basis that it had commenced its operations and made an application for three-star category classification in beginning of the said previous year, even though the same was granted by the authority only in the next year due to the requirement of completion of inspection?	<p>As the application for three star category classification was granted with no discrepancy during inspection, the assessee could not be penalised for the delay on the part of the concerned authority (the Hotel and Restaurant Approval and Classification Committee, in the instant case) to complete inspection before the end of the financial year. Under section 35AD, deduction is available from the previous year in which the assessee commences operation of the specified business i.e., hotel business, in this case. Section 35AD does not mandate that the date of the certificate has to be with effect from a particular date.</p> <p>Thus, the assessee is entitled to claim the deduction under section 35AD for the relevant previous year, since the provision which was</p>

		introduced to encourage the establishment of hotels of a particular category is a beneficial provision, and hence, should be read and interpreted liberally.
7.	<b>Berger Paints India Ltd v. CIT (2017) 393 ITR 113 (SC)</b>	
	Issue	Analysis & Decision
	Whether "premium" on subscribed share capital is "capital employed in the business of the company" u/s 35D to be eligible for a deduction?	Share premium collected by the assessee on its subscribed issued share capital could not be part of "capital employed in the business of the company" for the purpose of section 35D(3)(b). If it were the intention of the legislature to treat share premium as being "capital employed in the business of the company", it would have been explicitly mentioned. Moreover, Sl. No. IV(i) in Form MGT- 7 read with section 92 of the Companies Act, 2013 dealing with capital structure of the company provides the break-up of "issued share capital" and "subscribed share capital" which does not include share premium at the time of subscription. Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed. Also, section 52 of the Companies Act, 2013 requires a company to transfer the premium amount to be kept in a separate account called "securities premium account". The assessee is, therefore, not entitled to claim deduction u/s 35D in relation to the premium amount received from shareholders at the time of share subscription.
8.	<b>Shasun Chemicals &amp; Drugs Ltd v. CIT (2016) 388 ITR 1 (SC)</b>	
	Issue	Analysis & Decision
	In a case where payment of bonus due to employees is paid to a trust and such amount is subsequently paid to the employees before the stipulated due date, would the same be allowable u/s 36(1)(ii) while computing business income?	The embargo contained in section 43B(b) or section 40A(9) does not come in the way of the assessee's claim, since the bonus was ultimately paid to the employees before the due date as per the statutory requirement. Therefore, the payment in respect of bonus is allowable as deduction.

9.	<b><i>CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 (Delhi)</i></b>	
	<b>Issue</b>	<b>Analysis &amp; Decision</b>
	What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?	<p>The expenditure on glow sign boards displayed at dealer outlets is revenue in nature due to the following reasons-</p> <ul style="list-style-type: none"> <li>(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.</li> <li>(ii) The glow sign board is not an asset of permanent nature. It has a short life.</li> <li>(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.</li> <li>(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.</li> </ul>
10.	<b><i>CIT v. ITC Hotels Ltd. (2011) 334 ITR 109 (Kar.)</i></b>	
	<b>Issue</b>	<b>Decision</b>
	Would the expenditure incurred on issue and collection of convertible debentures be treated as revenue expenditure or capital expenditure?	The expenditure incurred on the issue and collection of debentures would 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.
11.	<b><i>CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)</i></b>	
	<b>Issue</b>	<b>Analysis &amp; Decision</b>
	Would expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business be classified as a revenue	Since the feasibility studies were conducted by the assessee for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of revenue nature.

	expenditure, where the project was abandoned without creating a new asset?	
12.	<b><i>National Co-operative Development Corporation v. CIT (2020) 427 ITR 288 (SC)</i></b>	
	Issue	Analysis & Decision
	Is source of funds from which expenditure is incurred for the purpose of business relevant for the purpose of allowability of deduction u/s 37(1)?	In case of an assessee carrying on business, it is relevant to see whether an outlay constitutes an expenditure "for the purpose of business" as used in section 37(1), for the purpose of claiming deduction thereunder. <b>The source of funds from which the expenditure is made is <u>not</u> relevant.</b> Every application of income towards the business objective of the assessee is a business expenditure. There can be an amount treated as a capital receipt while the same amount expended may be a revenue expenditure.
13.	<b><i>CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476 (P&amp;H)</i></b>	
	Issue	Analysis & Decision
	Can the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure u/s 37 or would it be treated as illegal and against public policy to attract disallowance?	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.  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, <b>the commission paid to doctors for referring patients for diagnosis is not allowable as business expenditure.</b>
14.	<b><i>Shanti Bhushan v. CIT (2011) 336 ITR 26 (Delhi)</i></b>	
	Issue	Analysis & Decision
	Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, be allowed as business expenditure u/s 31, by treating it as current repairs considering heart as	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, <b>the heart cannot be said to be plant for the business or profession of the assessee.</b>

	plant and machinery, or u/s 37, by treating it as expenditure incurred wholly and exclusively for the purpose of business or profession?	<p>Therefore, the expenditure on heart surgery is not allowable as repairs to plant u/s 31.</p> <p>Also, there is 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 u/s 37 is also not tenable. Hence, the heart surgery expenses shall <u>not</u> be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.</p>
15.	<b>CIT v. Neelavathi &amp; Others (2010) 322 ITR 643 (Karn)</b>	
	<b>Issue</b>	<b>Analysis &amp; Decision</b>
	Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?	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.
16.	<b>Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401 (Karn.)</b>	
	<b>Issue</b>	<b>Analysis &amp; Decision</b>
	Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?	<p>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.</p> <p>As per the provisions of the Karnataka Municipal Corporations Act, 1976, <b>the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction u/s 37</b>. Merely describing the payment as a compounding fee would not alter the character of the payment.</p>

17.	<i>CIT v. Maruti Suzuki India Limited (2018) 407 ITR 165 (Del)</i>	
	Issue	Analysis & Decision
	Can payments made by an assessee to a non-resident agent who does not have any income assessable in India be disallowed u/s 40(a)(i) for non-deduction of tax at source on the ground that no application was made by the assessee u/s 195(2) for making deduction of tax at source at Nil rate?	<p>The non-resident agent who operated outside India did not have any income arising in India. Accordingly, <b>the commission earned by a non-resident agent who was in the business of selling Indian goods abroad, did not accrue or arise in India, and hence, no tax was deductible on such commission payment to a non-resident agent.</b></p> <p>Since the assessee has made payment to a non-resident agent and such income is not chargeable to tax in India, section 40(a)(i) could not be invoked to disallow deduction of such payment for non-deduction of tax at source while computing the business income of the assessee.</p>
18.	<i>CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All)</i>	
	Issue	Analysis & Decision
	Can remuneration paid to working partners as per the partnership deed be considered as unreasonable and excessive for attracting disallowance u/s 40A(2)(a), even though the same is within the statutory limit prescribed u/s 40(b)(v)?	<p><b>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 u/s 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.</b></p> <p>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 u/s 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 by invoking the provisions of section 40A(2)(a).</p>

## TEST YOUR KNOWLEDGE

### Questions

1. Examine critically the following cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2026-27. Support the answers with relevant case laws and workings.
  - (a) Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 20 different machinery items as at 31-03-2026. One of the machineries used for packing had become obsolete and was discarded by Mr. Janak in July 25.  
  
 Assessee filed its return for A.Y. 2026-27 claiming total depreciation of ₹ 40 lakhs which includes ₹ 4 lakhs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of ₹ 4 lakhs during the course of scrutiny assessment.  
  
 Comment on the validity of action taken by A.O.
  - (b) X. Ltd. issued debentures in the previous year 2025-26, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of ₹ 60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the return of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2025-26. Examine the correctness of the action of Assessing Officer.
2. Compute the quantum of depreciation available under section 32 of the Income-tax Act, 1961 in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., by paying through account payee cheque, which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2026. Assume company does not opt for the provisions of section 115BAA:

	(₹ in crores)
New machinery installed on 1-5-2025	84
New Windmill purchased and installed on 18-6-2025	22
Lorries for transporting goods to sales depots (purchased and put to use in July, 2025)	3
<b><u>Items purchased after 30th November 2025:</u></b>	
Fork-lift-trucks, used inside factory	4
Computers installed in office premises	1
Computers installed in factory	2
New imported machinery	12

The new imported machinery arrived at Chennai port on 30-03-2026 and was installed on 3-4-2026. All other items were installed during the year ended 31-3-2026.

The company was newly started during the year.

Also, compute the WDV of the various blocks of assets as on 1.4.2026 after charging depreciation for P.Y. 2025-26.

3. (A) Examine the taxability and/ or allowability of the following receipts or expenditures under the provisions of the Income-tax Act, 1961, for the assessment year 2026-27:
- (i) Secret commission was paid during the previous year 2025-26.
  - (ii) P Ltd. paid dollars equivalent to ₹ 50 lakhs as sales commission for the year ended 31.03.2026, without deducting tax at source, to Mr. Rodrigues, a citizen of UK and non-resident who acted as agent for booking orders, from various customers who are outside India.
- (B) Can the following transactions be covered under section 43B for disallowance?
- (i) A bank guarantee given by a company towards disputed tax liabilities.
  - (ii) Interest payable to Goods and Services Tax Department but not paid before the due date specified in section 139(1).
4. ILT Limited is engaged in manufacturing of pipes and tubes. The profit and loss account of the company for the year ended 31<sup>st</sup> March, 2026 shows a net profit of ₹ 405 lakhs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2026-27 indicating reasons for treatment of each item, assuming that the company has not opted for special provisions under section 115BAA or 115BAB.

- (i) A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2025-26. The same is encashed by the company for ₹10 lakhs in April 2025 and credited to General Reserve Account.
  - (ii) A regular supplier of raw materials agreed for settlement of ₹8 lakhs instead of ₹10 lakhs for poor quality of material supplied during the previous year which was not given effect in the running account of the supplier.
  - (iii) Andhra Bank sanctioned and disbursed a term loan in the financial year 2022-23 for a sum of ₹50 lakhs. Interest of ₹8 lakhs was in arrears. The bank has converted the arrear interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.
  - (iv) The company remitted ₹5 lakhs as interest to a company incorporated in USA on a loan taken 2 years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15<sup>th</sup> July, 2026. The said interest was debited to profit and loss account.
  - (v) Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31<sup>st</sup> May, 2025 to 18<sup>th</sup> June, 2025 and 28<sup>th</sup> September, 2025 to 15<sup>th</sup> October, 2025 for the business development. The company has paid Sandeep's salary in cash, from its local office at Bangalore for the month of May, 2025 (payable on 1<sup>st</sup> June) and September 2025 (payable on 1<sup>st</sup> October), amounting to ₹45,000 and ₹47,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of "salary" debited to Profit and Loss Account.
  - (vi) The company has contributed ₹50,000 by account payee cheque to an electoral trust and the same stands included under the head "General Expenses".
5. G Ltd., a company in which public are substantially interest, is engaged in the business of growing and manufacturing tea in India. For the previous year ended 31.03.2025, its composite business profits before allowing deduction u/s 33AB is ₹ 60,00,000. On 01.09.2025, it deposited a sum of ₹ 11,00,000 in the Tea Development Account. During the previous year 2023-24, G Ltd. had incurred a business loss of ₹ 14,00,000 which has been carried forward. On 25.01.2026, it withdrew ₹ 10 lakhs, from deposit account which is utilized as under:

₹6,00,000 for purchase on non-depreciable asset as per the scheme specified.

₹3,00,000 for purchase of machinery to be installed in the office premises.

₹1,00,000 was spent for the purpose of scheme on 5.4.2026.

(i) You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the A.Y. 2026-27.

(ii) What will be the consequence if the asset which was purchased for ₹ 6,00,000 is sold for ₹8,00,000 in April, 2026.

6. The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2026 is as under:

**Trading Account**

Particulars	₹	Particulars	₹
Opening Stock	3,75,000	Sales	1,55,50,000
Purchases	1,25,75,000	Closing Stock	4,50,000
Freight & Cartage	1,26,000		
Gross profit	29,24,000		
	<b>1,60,00,000</b>		<b>1,60,00,000</b>

**Profit and Loss Account**

Particulars	₹	Particulars	₹
Bonus to staff	47,500	Gross profit	29,24,000
Rent of premises	53,500	Income-tax refund	20,000
Advertisement	5,000	Warehousing charges	15,00,000
Bad Debts	75,000		
Interest on loans	1,67,500		
Depreciation	71,500		
Goods and Services tax demand paid	1,08,350		
Miscellaneous expenses	5,25,650		
Net profit of the year	33,90,000		
	<b>44,44,000</b>		<b>44,44,000</b>

*On scrutiny of records, the following further information and details were extracted/gathered:*

- (i) *There was a survey under section 133A on the business premises on 31.3.2026 in which it was revealed that the value of closing stocks of 31.3.2025 was ₹ 8,75,000 and a sale of ₹ 75,000 made on 13.3.2026 was not recorded in the books. The value of closing stocks after considering these facts and on the basis of inventory prepared by the department as on 31.3.2026 worked out at ₹ 12,50,000, which was accepted to be correct and not disputed.*
- (ii) *Income-tax refund includes amount of ₹ 4,570 of interest allowed thereon.*
- (iii) *Bonus to staff includes an amount of ₹ 7,500 paid in the month of December 2025, which was provided in the books on 31.03.2025.*
- (iv) *Rent of premises includes an amount of ₹ 5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.*
- (v) *Advertisement expenses include an amount of ₹ 2,500 paid for advertisement published in the souvenir issued by a political party. The payment is made by way of an account payee cheque.*
- (vi) *Miscellaneous expenses include:*
  - (a) *amount of ₹ 15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,*
  - (b) *amount of ₹ 1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The junior advocate of High Courts normally charge only ₹ 25,000 for the same opinion,*
  - (c) *amount of ₹ 1,00,000 paid to an Electoral Trust by cheque.*
- (vii) *Goods and Services Tax demand paid includes an amount of ₹ 5,300 charged as penalty for delayed filing of returns and ₹ 12,750 towards interest for delay in deposit of tax.*
- (viii) *The company had made an investment of ₹ 25 lakhs on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2025 and the income from this activity is credited in the Profit and Loss account under the head "Warehousing charges".*
- (ix) *Depreciation under the Income-tax Act, 1961 works out at ₹ 65,000.*

- (x) Interest on loans includes an amount of ₹ 80,000 paid to Mr. X, a resident, on which tax was not deducted.

Compute the income chargeable to tax for assessment year 2026-27 of Pingu Trading Pvt. Ltd, ignoring MAT and provisions of section 115BAA. Support your answer with working notes.

7. (a) A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of ₹ 1.2 lakhs on 7.4.2025 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2025-26. The Assessing Officer, however, held that the pre-payment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre-payment premium in the P.Y.2025-26. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.
- (b) Explain the tax treatment of emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.
8. "Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 1.4.2023 for a period of 10 years ending on 31.3.2033 against a fee of ₹ 27 lakhs to be paid in 3 installments of ₹ 9 lakhs each by April, 2023, April, 2024 and April, 2025, respectively. The company has commenced business on 1.4.2024.

Explain, how the payment made for licence fee shall be dealt with under the Income-tax Act, 1961 and the amount, if any, deductible for A.Y. 2026-27.

9. Alpha Ltd., a manufacturing company, has disclosed a net profit of ₹ 12.50 lakhs for the year ended 31<sup>st</sup> March, 2026. You are required to compute the taxable income (ignore the provisions of section 115BAA) of the company for the Assessment year 2026-27, after considering the following information, duly explaining the reasons for each item of adjustment:
- (i) Advertisement expenditure debited to profit and loss account includes the sum of ₹ 60,000 paid in cash to the sister concern of a director, the market value of which is ₹ 52,000.
- (ii) Repairs of plant and machinery debited to profit and loss account includes ₹ 1.80 lakhs towards replacement of worn out parts of machineries. Such expenditure does not increase the future benefit from the asset beyond its previously assessed standard of performance.

- (iii) A sum of ₹ 6,000 on account of liability foregone by a creditor has been taken to general reserve. The original purchases was debited to the Profit & Loss Account in the A.Y.2021-22.
- (iv) Sale proceeds of import entitlements amounting to ₹ 1 lakh has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.
- (v) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:
  - (a) Research equipments purchased ₹ 1,50,000.
  - (b) Remuneration paid to scientists ₹ 50,000.

*The total amount of ₹ 2,00,000 is debited to the profit and loss account.*

10. (i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of ₹ 75 lakhs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the depreciation be denied in the Corporation's hands on the ground that there was no registration of the buses in favour of the Corporation?
- (ii) Ravi succeeded to his father's business in the year 2023. In the previous year ended 31.3.2026, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.

## Answers

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1. (a) The issue under consideration is whether disallowance of depreciation made by the Assessing Officer with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.  
One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.  
The other aspect to be considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" appearing in section 43(6), so as to deduct its value from the written down value of the block.

The facts in the present case are similar to facts in the case of *CIT v. Yamaha Motor India Pvt. Ltd.* (2010) 328 ITR 297, wherein the Delhi High Court observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

For the purpose of section 43(6), "moneys payable" means the sale price, in case of sale, or the insurance, salvage or compensation moneys payable in respect of the asset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no "moneys payable" in this case, which alone is deductible while computing the WDV of the block to which it belongs.

Applying the rationale of the above case, the action of the Assessing Officer in disallowing ₹ 4 lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

- (b) The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, can the entire upfront interest paid, be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred revenue expenditure in the books of account have any impact on the tax treatment.

The facts of the case are similar to the facts in *Taparia Tools Ltd. v. JCIT* (2015) 372 ITR 605, wherein the above issue came up before the Supreme Court. In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

The moment the option for upfront payment was exercised by the subscriber, the liability of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

As per the rationale of the Supreme Court ruling in *Taparia Tools Ltd.*'s case, when the deduction of entire upfront payment of interest is allowable as per the Income-tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2025-26 to one-fifth of the upfront interest paid is not correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2025-26.

## 2. Computation of depreciation allowance under section 32 for the A.Y. 2026-27

Particulars	Normal Depreciation [u/s 32(1)(ii)]	Additional Depreciation [u/s 32(1)(iia)]
	(₹ in crores)	
(A) Plant and Machinery (15% block) (Put to use for 180 days or more)		
- New machinery installed on 01.05.2025	84.00	84.00
- Lorries for transporting goods to depots	3.00	-
	87.00	84.00
Normal Depreciation @15% & additional depreciation @20%	13.05	16.80
(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Fork-lift trucks, used inside a factory	4.00	4.00
Normal Depreciation @ 7.5% & additional depreciation @10%	0.30	0.40

(C) Plant and Machinery (40% block) (Put to use for less than 180 days, hence depreciation restricted to 20%, i.e., 50% of 40%)		
	1.00	-
	2.00	2.00
	<b>3.00</b>	<b>2.00</b>
Normal depreciation @20% & additional depreciation@10%	0.60	0.20
(D) Plant and Machinery (40% block) (Put to use for 180 days or more) (See Note 1)		
- New windmill purchased and installed on 18.06.2025	22.00	22.00
Normal Depreciation @ 40% & additional depreciation @ 20%	<b>8.80</b>	<b>4.40</b>
<b>Total depreciation and additional depreciation</b>		
- Plant and Machinery (15% block) (A +B)	13.35	17.20
- Plant and Machinery (40% block) (C + D)	9.40	4.60
<b>Depreciation available under section 32 = ₹ 44.55 crores</b>		

**Computation of Written Down Value (WDV)  
after charging depreciation for P.Y. 2025-26**

Particulars	Plant & Machinery	
	15%	40%
	(₹ in crores)	
WDV as on 01.04.2025 (The company was started during the year – as given in question)	Nil	Nil
Add: Plant and Machinery acquired during the year		
- New Machinery installed on 01.05.2025	84.00	
- Lorries for transporting goods to sales depots	3.00	
- Fork-lift trucks, used inside factory	4.00	

- New imported machinery	12.00	103.00	-
- New Windmill purchased and installed on 18.6.2025	-	22.00	22.00
- Computers installed in office premises	-	1.00	1.00
- Computers installed in factory	-	2.00	2.00
	<b>103.00</b>	<b>25.00</b>	
<i>Less: Asset sold during the year</i>		Nil	Nil
<b>WDV as on 31.3.2026 (before charging depreciation)</b>		<b>103.00</b>	<b>25.00</b>
<i>Less: Depreciation for the P.Y.2025-26</i>			
- Normal depreciation	13.35	9.40	9.40
- Additional depreciation	17.20	4.60	4.60
<b>WDV as on 1.4.2026 (after charging depreciation for P.Y. 2025-26)</b>		<b>72.45</b>	<b>11.00</b>

**Notes:**

- (1) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation @ 40%.
- (2) New imported machinery was not installed during the previous year 2025-26. Hence, it would not be eligible for additional depreciation for A.Y. 2026-27. It would also not be eligible for normal depreciation for A.Y 2026-27, since it was not put to use in the P.Y.2025-26 being the year of acquisition.
- (3) It may be noted that investment in the following plant and machinery would not be eligible for additional depreciation under section 32(1)(iia):
  - (a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and
  - (b) Computers installed in office premises.
- (4) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a “vehicle” excludes, *inter alia*, a vehicle of special type adopted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of “vehicle”. Hence, it is eligible for additional depreciation under section 32(1)(iia).

3. (A) (i) Secret commission is one of the forms of commission payment generally made by business organizations. Secret commission is a payment for obtaining business orders or contracts from parties and /or customers and paid to employees and / or officials of those parties and / or customers or companies from whom business orders are obtained by the assessee.

*Explanation 1* below section 37(1) of Income-tax Act, 1961 provides 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 and no deduction or allowance shall be made in respect of such expenditure. In view of the *Explanation*, any expenditure incurred for a purpose which is an offence and prohibited by law cannot be allowed as expenditure. Therefore, since secret commission payment is a payment for an offence prohibited by law, the same cannot be allowed as deduction.

- (ii) A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source. Thus, the amount of ₹ 50 lakhs remitted to Mr. Rodrigues outside India in foreign currency towards commission would not attract disallowance under section 40(a)(i) for non-deduction of tax at source.

- (B) (i) For claiming deduction of any expense enumerated under section 43B, the requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee [*CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)*]
- (ii) Interest payable to Goods and Services Tax department is part of Goods and Services Tax.

Therefore, interest payable to Goods and Services Tax department, which is not paid before the “due date” of filing of return of income, would attract disallowance under section 43B [*Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)*]

#### 4. Computation of total income of ILT Ltd. for the A.Y.2026-27

Particulars	₹ (in lakhs)
<b>Profits and gains from business or profession</b>	
Net profit as per profit and loss account	405.00
<b>Add: Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed</b>	
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2
Interest payable outside India to a foreign company is allowable [See Note 1 below]	-
Salary paid to employee Sandeep is eligible for deduction. Disallowance under section 40A(3) will not apply [See Note 2 below]	-
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	0.50
	12.50
<b>Less: Amount of deduction allowable</b>	
Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee.	417.50

Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e., converted loan) actually paid is allowable as deduction. Hence, ₹ 1,60,000, being two instalments of ₹ 80,000 each, actually paid is deductible.		1.60
<b>Business Income</b>		<b>415.90</b>
<b>Gross total income</b>		<b>415.90</b>
<b>Less: Deduction under Chapter VI-A</b>		
Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.		0.50
<b>Total Income</b>		<b>415.40</b>

**Notes:**

- Since tax has been deducted on interest payable outside India to a foreign company during the previous year 2025-26 and the same has been deposited before the due date of filing return of income under section 139(1), disallowance under section 40(a)(i) is not attracted. Since the interest has already been debited to profit and loss account, no further adjustment is required.
  - In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as the payments fall within the scope of Rule 6DD(i). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore which is not the place of his normal duty. Further tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. No disallowance under section 40A(3) is attracted in respect of such salary.
5. (i) **Computation of Business Income of G Ltd.  
and tax consequences for the A.Y. 2026-27**

Particulars	₹
₹ 10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	
- ₹ 6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme.	Not taxable

<p>[As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of ₹ 11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2025-26 (<b>See Working Note below</b>)].</p>		
-	₹ 3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2025-26 as per section 33AB(4).	3,00,000
-	₹ 1,00,000 was spent for the purpose of scheme on 05.04.2026. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2025-26) in which the amount is withdrawn from the deposit account.	1,00,000
<p>When any part of withdrawal amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated. Accordingly, ₹ 1,60,000, being 40% of ₹ 4,00,000 (₹ 3,00,000 + ₹ 1,00,000) would be chargeable to tax as business income and the balance ₹ 2,40,000, being 60% of ₹ 4,00,000 would be agricultural income exempt from tax.</p>		

#### Working Note:

##### Computation of Business Income of G Ltd. for the A.Y. 2025-26

Particulars	₹
Composite business profits before allowing deduction under section 33AB	60,00,000
Less: Deduction under section 33AB(1) would be the lower of:	
<ul style="list-style-type: none"> <li>- Amount deposited in Tea Development Account on or before 30.9.2025 [i.e., ₹ 11,00,000]</li> <li>- 40% of profits of such business [i.e., ₹ 24,00,000, being 40% of ₹ 60,00,000]</li> </ul>	11,00,000
	49,00,000
Less: 60% of ₹ 49,00,000, being agricultural income [ <b>as per Rule 8</b> ]	29,40,000
Business income	19,60,000
Less: Brought forward business loss of A.Y.2024-25 set-off as per section 72	14,00,000
Business income chargeable to tax	5,60,000

**(ii) Consequences, if asset purchased out of deposit account is sold during the previous year 2026-27**

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, ₹ 6,00,000 would be deemed to be the business income (composite) for the A.Y.2027-28. However, since the full cost of the asset was deducted in the assessment year 2025-26 (being part of ₹ 11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non-agricultural portions of income should be segregated in the year in which such amount becomes taxable on account of sale of asset before the expiry of eight years. Therefore, ₹ 3,60,000, being 60% of ₹ 6,00,000 would represent agricultural income. The balance ₹ 2,40,000 being 40% of ₹ 6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of the asset would be chargeable to tax as "Short term capital gains", which is computed as follows:

Sales consideration	8,00,000
Less: Cost of acquisition	<u>6,00,000</u>
<b>Short term capital gain</b>	<b><u>2,00,000</u></b>

**6. Computation of Income of Pingu Trading Pvt. Ltd.  
chargeable to tax for the A.Y.2026-27**

Particulars	₹
Net profit as per profit and loss account	33,90,000
<b>Less:</b> Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head "Income from other sources"	20,000
	<b>33,70,000</b>
<b>Add:</b> Expenses either not allowable or to be considered separately but charged in the profit & loss account - Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not	-

allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37.	
- Advertisement in the souvenir of political party not allowable as per section 37(2B) ( <b>See Note 2</b> )	2,500
- Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed ( <b>See Note 4</b> )	75,000
- Payment made to electoral trust by cheque ( <b>See Note 5</b> )	1,00,000
- Penalty levied by the Goods and Services tax department for delayed filing of returns not allowable as being paid for infraction of law ( <b>See Note 6</b> )	5,300
- Depreciation as per books	71,500
- 30% of interest paid on loan paid to Mr. X, a resident, without deduction of tax at source not allowable as per section 40(a)(ia)	24,000
	<b>36,48,300</b>
<b>Less:</b> Depreciation allowable as per Income-tax Act, 1961	65,000
	<b>35,83,300</b>
<b>Less:</b> Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately ( <b>See Note 7</b> )	15,00,000
<b>Income from business (other than specified business)</b>	<b>20,83,300</b>
<b>Add:</b> Difference in the value of stocks detected on survey under section 133A on 31.03.2026 chargeable as income ( <b>See Note 8</b> )	3,75,000
	<b>24,58,300</b>
<b>Computation of income/ loss from specified business (<b>See Note 7</b>)</b>	
Income from specified business	₹ 15,00,000
<b>Less:</b> Deduction under section 35AD @ 100% of ₹ 25 lakhs	₹ 25,00,000
<b>Loss from specified business to be carried forward as per section 73A</b>	<b>(₹ 10,00,000)</b>
<b>Income from Other Sources</b>	
Interest on income-tax refund	4,570
<b>Gross Total Income</b>	<b>24,62,870</b>

<b>Less: Deduction under section 80GGB</b>		
Contribution to political party ( <b>See Note 2</b> )	₹ 2,500	
Contribution to an Electoral trust ( <b>See Note 5</b> )	₹ 1,00,000	1,02,500
<b>Total Income</b>		<b>23,60,370</b>

**Notes:**

- (1) Bonus for the previous year 2024-25 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2024-25. However, when the same has been paid in December 2025, it should be allowed as deduction in the P.Y.2025-26 (A.Y.2026-27). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.
- (2) The amount of ₹ 2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expenditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.
- (3) The penalty of ₹ 15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.
- (4) It has been assumed that ₹ 25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only ₹ 25,000 for the same opinion and therefore, the balance ₹ 75,000 has been disallowed.
- (5) Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.
- (6) The interest of ₹ 12,750 paid on the delayed deposit of goods and services tax is for breach of contract and hence, is allowable as deduction. However, penalty of ₹ 5,300 for delay in filing of returns is not allowable since it is for breach of law.

- (7) Deduction @ 100% of the capital expenditure is available under section 35AD in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that ₹ 25 lakhs does not include expenditure on acquisition of any land.

The loss from specified business under section 35AD (warehousing) should be segregated from the income from other businesses, since, as per section 73A(1), any loss computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

In view of the provisions of section 73A(1), the loss of ₹ 10 lakhs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

- (8) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be filed for the previous year ended on 31.3.2026.

#### Revised Trading Account

Particular	₹	Particular	₹
Opening Stock	8,75,000	Sales (₹ 1,55,50,000 + ₹ 75,000)	1,56,25,000
Purchases	1,25,75,000	Closing Stock	12,50,000
Freight and Cartage	1,26,000		
Gross Profit	32,99,000		
	1,68,75,000		1,68,75,000

The difference of gross profit of ₹ 32,99,000 - ₹ 29,24,000 = ₹ 3,75,000 is to be added as income of the business for the year as undisclosed income<sup>16</sup>.

7. (a) This issue came up before the Delhi High Court in *CIT v. Gujarat Guardian Ltd* (2009) 177 Taxman 434. The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of

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<sup>16</sup> No loss (whether brought forward or otherwise) or unabsorbed depreciation under section 32(2) can be set-off against undisclosed income.

section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee. The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

Therefore, applying the ratio of the above case, the contention of A Ltd. is correct and not that of the Assessing Officer.

**Note** – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, *inter alia*, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

- (i) pre-payment premium represents interest as per section 2(28A);
  - (ii) such interest is deductible as business expenditure as per section 36(1)(iii);
  - (iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).
- (b) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises – whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the Delhi High Court in *CIT v. Insilco Ltd (2010) 320 ITR 322*. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and

form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

**Note** – One of the conditions for claim of depreciation is that the asset must be “used for the purpose of business or profession”. In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is “kept ready for use”. For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term “use” embraces both active use and passive use for business purposes.

8. The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be allowed as deduction in equal instalments during the number of years for which the license is in force.

**If the payment is made before the commencement of business:** The deduction shall be allowed beginning with the year of commencement of business.

**In any other case:** It will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2026-27 is worked out below:-

(1)	(2)	(3)	(4) = (3)/(2)
Previous year of payment	Unexpired period of license	Instalment paid (₹)	Deduction in respect of each instalment (₹)
2023-24	9 years	9,00,000	1,00,000
2024-25	9 years	9,00,000	1,00,000
2025-26	8 years	9,00,000	1,12,500
		<b>27,00,000</b>	<b>3,12,500</b>

The deduction under section 35ABB from assessment year 2026-27 shall be ₹ 3,12,500.

9.

## Computation of taxable income of Alpha Ltd. for the A.Y.2026-27

Particulars	₹
Net profit as per profit and loss account	12,50,000
<b>Add: Items debited to profit and loss A/c but not deductible or income to be taxed</b>	
1. Payment of advertisement expenditure of ₹60,000	
(i) ₹ 8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of ₹ 52,000 exceeds ₹ 10,000, 100% shall be disallowed under section 40A(3)	52,000
2. Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction.  The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)].  Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required.  Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.	
3. Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)]	6,000
4. Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iii). As the amount has already been credited to profit and loss account, no further adjustment is necessary.	-
5. Expenditure on in-house research and development is entitled to a weighted deduction of 100% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1). As the amount has already been debited to profit and loss account, no further adjustment is necessary	-
<b>Taxable Income</b>	<b>13,16,000</b>

10. (i) The decision of the Supreme Court in *Mysore Minerals Ltd v. CIT* (1999) 239 ITR 775 is relevant in the context of the facts stated. The term "asset used" in section 32 must be assigned a wider meaning and anyone in possession of property in his own title, exercising dominion over the property, to the exclusion of others and having the right to use and enjoy it, must be taken to be the owner.

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot, therefore, be denied depreciation on the buses. A similar decision was also taken in *CIT v. J & K Tourism Development Corporation* (2001) 248 ITR 94 (J&K).

- (ii) The deduction of bad debt is allowed if it is written off in the books of account of the assessee. In this case, Ravi has succeeded to the business carried on by his father. Under clause (vii) of section 36(1) the amount has been written off in the books of account as irrecoverable is eligible for deduction provided the debt has been taken into account in computing the income of the business in an earlier previous year [vide section 36(2)].

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount due for the supplies made by previous owner viz. deceased father of Ravi.[*CIT v. T. Veerabhadra Rao, K. Koteswara Rao and Co* (1985) 155 ITR 152 (SC)].