

EXPENSES NOT DEDUCTIBLE IN CERTAIN CIRCUMSTANCES : AT A GLANCE

1. Payment to relative or associate concern in excess of market rate.
2. Payment in cash exceeding ₹ 10,000/₹ 35,000—100% of payment shall be disallowed. There are certain exceptions.
3. Provision for gratuity provided the gratuity fund is not an approved fund.
4. Contribution to any unapproved fund by the employer.
5. Expenses incurred on corporate social responsibility by companies.

Illustration 2

State with reasons whether the following items are admissible under the Indian Income Tax Act, 1961 :

- (a) Commission of ₹ 500 paid in order to secure orders for the business.
- (b) The assessee was carrying on money-lending business and in the course of this business he acquired certain property in lieu of debts owing from a debtor which he kept as stock-in-trade. The property so acquired was destroyed in war, the assessee claimed this loss as a deduction in computing his taxable income under the head 'Business'.

- (c) Loss of ₹ 1,000 which were snatched away from the *khazanchee's* possession while going to bank to deposit the amount.
- (d) Loss due to embezzlement by an employee.
- (e) Brokerage paid for raising loan for the business.
- (f) ₹ 1,000 spent in connection with installation of a new telephone connection.
- (g) Fees paid to lawyer on 1.6.2017 for drafting the Deed of Agreement with an outsider relating to the setting-up the business.
- (h) Pension paid to the widow and children of a deceased engineer of the factory voluntarily.
- (i) Interest paid for funds borrowed specifically for the acquisition of a capital asset.

Solution

- (a) The commission of ₹ 500 paid in order to secure orders for the business is an expenditure in the ordinary course of business and hence it is admissible.
- (b) In the course of his money-lending business the assessee acquired certain property in lieu of debts and kept it as stock-in-trade. This loss is allowable as it is the loss of stock-in-trade.
- (c) This loss is admissible as it was part of his duty to carry cash for depositing it in bank and hence it is incidental to the business.
- (d) It is admissible as it has been sustained during the ordinary course of business.
- (e) Brokerage paid for raising a loan for the business is an admissible expenditure.
[India Cement Ltd. vs. CIT (1966) 60 ITR 52 (SC)]
- (f) It is an admissible deduction under executive instruction.
- (g) It is not admissible as it is in the nature of capital expenditure, but 1/5th of it will be allowed under section 35D for five successive previous years.
- (h) Pension paid to the widow and children of a deceased engineer is not allowed as deduction as it is not an obligatory expenditure in connection with the business.
- (i) Interest paid for funds borrowed specifically for the acquisition of a capital asset will be capitalised from the date of borrowing till the date asset is put to use [u/s 36(1)(iii)].

Illustration 3

Advise an assessee about the admissibility or otherwise of the claims, with regard to the following items, giving reasons :

- (a) Compensation paid to an employee for premature termination of his services.
- (b) Amount spent in a successful suit filed against another for infringing the assessee's trademark.
- (c) Penalty paid to customs authorities for importing prohibited goods which yielded a large margin of profits.
- (d) Travelling expenses of a director who went to Europe for negotiating the purchase of a new heavy machinery which was eventually installed next year.
- (e) Cost of erecting a medical annexe to the factory for the emergency treatment of the employees.
- (f) Lump-sum consideration paid on 1.7.2017 for acquiring know-how ₹ 6,00,000.

Solution

- (a) Assuming that the termination of the services of an employee was in the interest of the business, this item will be treated as an admissible expenditure.
- (b) It is admissible as the expenditure has been incurred to maintain an asset (*viz.*, the trademark).
- (c) Penalty paid for illegal activities of the assessee are not to be allowed as expenditure under the Income Tax Act.
- (d) It is inadmissible as it is incurred for the acquisition of a new asset.
- (e) It is not an admissible expenditure, being of a capital nature. However, depreciation can be claimed u/s 32(1).
- (f) On the cost of know-how depreciation shall be allowed @ 25% on W.D.V. basis u/s 32(1).

Illustration 4

Discuss with reasons the admissibility or otherwise of the following expenditure by an assessee under the provisions of Income Tax Act, 1961 :

- (a) A sum of ₹ 30,000 was provided towards value added tax liability in the accounts for the year ending 31.3.2018.
- (b) An expenditure of ₹ 15,000 incurred towards the cost of Neon Sign Board fixed on office premises for advertising his products.
- (c) Stock-in-trade was lost in fire amounting to ₹ 10,000 and was debited to Profit and Loss Account.
- (d) Interest paid on borrowed capital to acquire an asset till the date on which such asset is put to use.

Solution

(a) Provision for value added tax liability is deductible only if it is paid on or before the due date for furnishing the return of income. If it is paid after the due date of furnishing the return of income, then deduction will be available in the assessment year relevant to the previous year in which the payment is made. However, if a State Government has amended its Value Added Tax Act to the effect that deferment of VAT by the State Government will be deemed to be VAT paid, it will also be deemed to have been paid under the Income Tax Act and will, therefore, be allowable as deduction.

(b) Expenditure incurred towards the cost of Neon Sign Board fixed on office premises for advertising products, is capital expense. Hence, cannot be allowed. However, depreciation can be claimed u/s 32(1).

(c) Loss of stock-in-trade due to fire amounting to ₹ 10,000 is a trading loss and hence it is deductible.

(d) Interest for this period shall be capitalised and added to the cost of the asset.

Illustration 5

State, giving brief reasons, whether the following items are allowable while computing profits and gains of business or profession :

- (i) Donation to a political party.
- (ii) Fees paid to the lawyer for drafting a new Partnership Deed.
- (iii) Sums paid to a Labour leader to call off the strike.
- (iv) Salary paid to son, who is working in the office. The salary is reasonable.
- (v) Rent paid to daughter for office block which was gifted to her at the time of her marriage.
- (vi) Bonus to partner for extra services.
- (vii) Interest paid to wife on money borrowed from her.
- (viii) Subscription for magazines paid by a Doctor for the benefit of his patients.
- (ix) Major repairs to the air-conditioner in the office.
- (x) In the course of money-lending business, the assessee acquired certain properties in lieu of debts and held them as stock-in-trade. The properties so acquired were destroyed by enemy action and the assessee claims the loss as deduction.
- (xi) Expenses incurred in respect of a branch the business of which was discontinued during the year.

Solution

- (i) Not allowed as it has nothing to do with the purpose of the business. However, he is entitled to deduction from gross total income u/s 80GGC.
- (ii) Allowed u/s 37(1).
- (iii) Not allowed. The payment is just a protection money which is against public policy. [Explanation Sec. 37(1)]
- (iv) It is allowed since it is reasonable. Salary paid to relatives is allowable.
- (v) It is allowed provided it is reasonable.

- (vi) Allowed provided it is as per Partnership Deed and fulfils all conditions of Sec. 40(b).
- (vii) It is allowed provided it is reasonable.
- (viii) It is allowed as it is in the interest of profession.
- (ix) It is allowed provided it is in the nature of current repairs.
- (x) It is allowed as it is the loss of stock-in-trade. The properties were kept as stock-in-trade.
- (xi) Discontinuing a branch is not discontinuance of business. Hence, expenses are allowable.

[See *CIT vs. Prithvi Insurance Co. Ltd.* (1967) 63 ITR 632 (S.C.)]

Section 6

for the year ended