

PROFIT & GAINS OF BUSINESS OR PROFESSION

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IMPORTANT DEFINITION'S OF INCOME-SEC 2(24)

- (iiib) any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living
- (xi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

Explanation. – For the purposes of this clause*, the expression “Keyman insurance policy” shall have the meaning assigned to it in the Explanation to clause (10D) of section 10

- (xv) any sum of money or value of property referred to in clause (vii) or clause (viia) of sub-section (2) of section 56

I. **Section 56(2)(vii)**- where an individual or a HUF receives, in any previous year, from any person or persons on or after the 1st day of October, 2009,-

a.) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;

b.) any immovable property,- w.e.f.01-04-2014

i.) Without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property;

ii.) For a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the stamp duty value of such property as exceeds such consideration;

(c) any property other than immovable property,-

- i.) Without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;
- ii.) For a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property exceeds such consideration;

II. Section 56(2)(viiia): w.e.f.01/06/2010 receipt of shares of a company (in which public are not substantially interested)(only shares of such closely held companies and no other asset)without any consideration or for an inadequate consideration, received by:-

- a.) A Partnership Firm, or
- b.) A company in which public are not substantially interested will also be now taxable in the same manner as in case of “Movable Property” .

- (xvi) any consideration received for issue of shares as exceeds the fair market value of the shares to in clause(viib) of sub-section(2) of section 56

Section 56(2)(viib): (w.e.f. A.Y.2013-14): In case of a Company (other than a Company in which Public are substantially interested), receives consideration for issue of its shares and such consideration exceeds fair market value(FMV) of such shares, then such excess consideration so received by the Company will be taxable under this head.

However, this does not apply in the following two cases:

a.) A case where such excess consideration is received by a 'Venture Capital Undertaking' from

- i.) Venture Capital Company;
- ii.) Venture Capital Fund;

b.) A case where such excess consideration is received by a company from a class/classes of person notified by central government.

- (xvii) any sum of money referred to in clause (ix) of sub-section (2) of section 56;

Section 56(2)(ix): any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,-

- a.) Such sum is forfeited; and
- b.) The negotiations do not result in transfer of such capital asset.

The following proviso shall be inserted in section 51 by the Finance (No.2) Act,2014, w.e.f.01-04-2015:

Provided that where any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset, has been included in the total income of the assessee for any previous year in accordance with the provisions of clause (ix) of sub-section (2) of section 56, then such sum shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

ACCOUNTING PRACTICES AND ACCOUNTING STANDARD

- ✚ Tuticorin Alkali Chemical - (1997) 227 ITR 172 (SC)
- ✚ CIT vs. Karnal Co. operative Sugar Mills – (2000) 243 ITR 2 (SC)
- ✚ Commissioner of Income Tax vs. Bhor Industries Ltd.(2003)264 ITR 180 (Bom)

REAL INCOME THEORY

- ✦ Real income theory lays down that if income does not result at all, there cannot be a tax, even though in bookkeeping, an entry is made about a “hypothetical income”, which does not materialize. Thus there is a very thin line between the accrual of income and accrual of real income. One has to take a very cautious and proactive measure to convert an accrual of income into no income situation.
- ✦ UCO BANK vs. Commissioner of Income Tax(1999) 237 ITR 889(SC)
- ✦ Godhra Electricity Co. Ltd. vs. Commissioner of Income Tax (1997) 225 ITR 746(SC)

Regardless of whether the system of accounting followed by assessee is cash or mercantile, if the assessee has not earned any real income, the entries made in respect thereof do not reflect the real income of the assessee and hence could not be brought to tax.

WHAT IS THE MEANING OF “BUSINESS” & “PROFESSION” AS PER INCOME TAX ACT?

- ✚ **Business :**
“Business” simply means any economic activity carried on for earning profits. Sec. 2(13) has defined the term as “ business includes any trade, commerce, manufacturing activity or any adventure or concern in the nature of trade, commerce and manufacture”.

In this connection it is not necessary that there should be a series of transactions in a business and also it should be carried on permanently. Neither repetition nor continuity of similar transactions is necessary.

- ✚ **Profession :**
“Profession” may be defined as a vocation, or a job requiring some thought, skill and special knowledge like that of C.A., Lawyer, Doctor, Engineer, Architect etc. So profession refers to those activities where the livelihood is earned by the persons through their intellectual or manual skill.

PROFITS AND GAINS OF BUSINESS OR PROFESSION- SECTION 28

Following receipts shall also be chargeable to income-tax under the head “Profits and gains of business or profession”,—

- (iv) the value of any perquisite or benefit arising from business or profession, whether convertible into money or not;
- (v) any interest, commission, salary, remuneration, or bonus due to, or received by, a partner of a firm from such firm :

- (va) any sum, whether received or receivable, in cash or kind, under an agreement for-

a.) Not carrying out any activity in relation to any business;

The payment received as a non competition fee under a negative covenant was always treated as a capital receipt till AY 2003-04. There is a dichotomy between receipt of compensation received for loss of agency, which is treated as revenue receipt and receipt of compensation attributable to negative / restrictive covenant which is treated as capital receipt. It should be noted that it is only by section 28(va) inserted by Finance Act 2002 w.e.f. 1/4/2003, which is a mandatory and not clarificatory that the said capital receipt is now made taxable.

b.) Not sharing any know-how, patent, copyright, trade-mark, license, 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 of services:

BUSINESS INCOME NOT TAXABLE UNDER THE HEAD “PROFITS AND GAINS OF BUSINESS OR PROFESSION”

Nature of Income	Head under which it is chargeable to Tax
Rental income in the case of dealer in property	Rent of house property is taxable under Sec. 22 under the head “Income from House Property” even if property constitutes Stock-in-trade of recipient of rent or the recipient of rent is engaged in the business of letting properties on rent.
Dividend on shares in the case of a dealer-in-shares.	Dividend on shares are taxable under section 56(2)(i), under the head “Income from other sources” , even if they are derived from shares held as stock in trade or the recipient of dividends is a dealer-in-shares. However, dividend received from an Indian company is not chargeable to tax in the hands of shareholders.
Winning from Lotteries etc.	Winning from Lotteries, races, etc. are taxable under the head “Income from Other Sources” (even if derived as a regular business activity)

MATCHING CONCEPT - COST WITH REVENUE

- Matching Principle requires that expenses incurred by an Assessee must be charged to the income statement in the accounting period in which the revenue, to which those expenses relate, is earned. The *matching principle* is one of the cornerstones of the accrual basis of accounting. Thus, if there is a cause-and-effect relationship between revenue and the expenses, record them in the same accounting period.
- Taparia Tools Ltd. vs. JCIT- (2003) 260 ITR 102 (Bom)

PROVISION V/S. CONTINGENT LIABILITY

- Provision : Assessee following mercantile system, provisions are allowable
- Contingent Liability: Liabilities where liability itself arises on certain events/happening is contingent liability and is not allowable.

EXPENSES THAT CAN BE CLAIMED AS DEDUCTIBLE EXPENSES

	Name of Expenses...	Section
1.	Rent, Rates, Taxes, Repairs & Insurance of Premises/Buildings used for the purpose of the business	30
2.	Repairs and insurance of Plant & Machinery, Furniture used in business or professions.	31
3.	Depreciation on Building, , Plant & Machinery, Furniture owned by the assessee(Note 1)	32
4.	Investment Allowance (Note 2)	32AC
5.	Expenditure on scientific research : any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business.	35
	Revenue Expenditure incurred by the assessee himself : If the assessee himself carries on Scientific Research and incurred Revenue Expenditure which must relate to Business is allowed as Deductions.	35(1)(i)
	Contribution made to Outsiders : Where the assessee makes contribution to other Institutions for carry on scientific research for this purpose, a weighted deductions is allowed which is equal to 1 ¼ times of any sum paid to a scientific research association or to a university, college or other institutions.	35(1)(ii)(iii)

6.	<p>Amortisation of certain preliminary expenses : This Deduction is available to Indian Company or a resident non-corporate assessee. A foreign company even if it is resident cannot claim such Deduction u/s 35D.</p> <p>Expenses incurs, after the 31st day of March, 1970,</p> <p>(i) before the commencement of his business, or</p> <p>(ii) after the commencement of his business, in either for extension of his [industrial] undertaking or towards setting up a new [industrial] unit,</p> <p>the assessee shall be allowed a deduction of an amount equal to - one-tenth (1/10 th.) of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or the new [industrial] unit commences production or operation.</p>	35D
7.	<p>Amortisation of expenditure in case of amalgamation or demerger. : The Tax payer is an Indian company and incurs any expenditure, on or after the 01-04-1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to..</p> <p>- one-fifth (1/5) of such expenditure for each of the five(5) successive previous years beginning with the previous year in which the amalgamation or demerger takes place.</p>	35DD
8.	<p>Other Deductions:</p> <p>The deductions shall be allowed in respect of the matters dealt in section 36, in computing business income.</p>	36

<p>9.</p>	<p>General Deduction :</p> <p>There are numerous expenditures, for which deduction may be admissible, but not all of them can be covered in section 30 to 36(1). Therefore, section 37(1) has been inserted to specify that any other expenditure, other than those which are specifically covered by section 30 to 36(1), may also be allowed as a deduction provided the following conditions are satisfied:</p> <ul style="list-style-type: none"> ➤ It should not be a capital expenditure, ➤ It should not be a Personal Expenditure, ➤ It should be in respect of business carried on by the assessee ➤ It should have been incurred wholly and exclusively for the purpose of business/profession, ➤ It should have been incurred during the previous year, ➤ It should not have been incurred for any purpose which is an offence under any law or which is prohibited under any law. 	<p>37</p>
<p>10.</p>	<p>Expenditure on Corporate Social Responsibility(CSR)</p> <p>An explanation is inserted to section 37(1) to provide that “any expenditure incurred by an assessee on the activities relating to Corporate Social Responsibility referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession”.</p> <p>However, the Explanatory Memorandum clarifies that CSR expenditure can qualify for deduction under section 30 to 36, subject to the fulfilment of the conditions laid down in those sections.</p>	<p>37(1)</p>

NOTES:

1. Section 32: Depreciation : Depreciation on assets- available if all the following three conditions are satisfied:

- a.) Assessee should be the owner of the asset, either entirely on his own or jointly with others.
- b.) Asset must be used in the Business or Profession of the assessee.
- c.) Asset must have been used during the Previous Year.(whether 'active use' or 'passive use')
- d.) Depreciation is not charged on an individual asset, but is charged on a 'Block of Assets', as defined by section 2(11) and is computed on Written Down Value (WDV).

Depreciation is not charged on an individual asset, but is charged on a 'Block of Assets', as defined by section 2(11) and is computed on Written Down Value (WDV).

- No depreciation is allowed when WDV of block of assets become zero or negative.(It is possible only when any of the assets within the same block is sold during the year and its/their selling price is equal to or more than the Opening WDV of the block(+)Cost of any new asset within the same block purchased during the year).

- Depreciation is allowable at the rates prescribed by the Income Tax Act and not at the rates prescribed by the Companies Act or as per wear and tear of the asset or as per normal practice followed by the assessee. Depreciation is always to be charged as per provisions of the Income Tax Act,1961 and the rates of Depreciation are provided by Appendix-1 and 1A of Income Tax Rule,1962.
- If an asset is newly purchased during the previous year and is used for less than 180 days, then only half year's depreciation is allowed. No depreciation is allowed in the year of sale of the asset.
- Charge of Depreciation is mandatory. In other words, Assessee has to charge the depreciation year after another, whether he wants to claim depreciation or not, as charging of depreciation is not optional to the assessee.
- **Depreciation in case of Lease:** When the asset is owned by 'Lessor', depreciation can be claimed only by 'Lessor' and not by 'Lessee'. This contradicts with Accounting standard AS-19 of ICAI, which says that in case of 'Finance Lease', Lessee will claim depreciation and in case 'Operating Lease', Lessor will claim depreciation. However, for tax purposes, CBDT circular is to be followed and not AS-19. However, on a Land/Building taken on lease, if assessee constructs any structure, then such structure will be deemed to be owned by him and depreciation will be allowed on it to the assessee.

- **Depreciation in case of 'Hire Purchase(H.P.) arrangement'**: Since, 'Purchaser' only is considered to be the owner from the beginning of such HP arrangement, he only will claim depreciation and not the 'Vendor'.
- **Depreciation on assets not entirely used for business/profession**: If the given asset is partly used for 'Personal Purpose' or for any other non-business or non-professional purposes, then only proportionate depreciation on such asset will be allowed. In other words, only that much proportion of total depreciation will be allowed to be claimed as deduction, as much as is the proportion of such asset used for business/profession.
- If the asset acquired is 'Building & Land appurtenant thereto' (whereby 'Bldg' is eligible for depreciation, but the 'Land' is not) and separate values of Bldg and Land are not available, then depreciation can be claimed on the entire value.
- Depreciation is available on 'Tangible' as well as 'Intangible' assets.

➤ Additional Depreciation:

- Apart from normal depreciation, assessee will be eligible for an additional depreciation @ 20% of the cost of acquisition of 'New Plant & Machinery', provided that the assessee is engaged in Manufacture/Production of any Article or a Thing or (w.e.f.A.Y.2013-14) in the business of Generation or Generation and Distribution of Power.
- If the new plant & machinery is put to use for less than 180days in the year of its acquisition, the Assnl.Depn. will be @ 10% of the cost of such plant & machinery(i.e.50% of 20%)
- The following Plant & Machinery are not eligible for Additional Depreciation:-
 - ✓ **Ships/Aircrafts/ any Road Transport Vehicle,**
 - ✓ **Any Plant & Machinery, which was previously used by any person (whether in India or outside India) before its installation by assessee(i.e. 'Second-hand Plant & Machinery)**
 - ✓ **Plant & Machinery installed in office premises/ residential accommodation/guest house,**
 - ✓ **Office Appliances,**
 - ✓ **Any Plant & Machinery, whose entire actual cost of acquisition was allowed as a deduction (by way of depreciation or otherwise) in any Previous Year under the head 'Profits and Gains of Business and Profession'.**

2. Section 32AC Investment Allowance:

- A company engaged in the business of manufacture or production of any article or thing (“manufacturing company”) acquiring and installing any new plant and machinery after 31st March, 2013 but before 01st April, 2015 where the aggregate amount of actual cost of such new assets exceeds Rs.100 crore, is allowed a deduction under section 32AC(1). The amount of deduction is –
 - ✓ For assessment year 2014-15 a sum equal to 15% of the actual cost of new assets acquired and installed during financial year 2013-14, if the aggregate amount of actual cost of such new assets exceeds Rs.100 crore; and
 - ✓ For the assessment year 2015-16, a sum equal to 15% of the aggregate amount of actual cost of such new assets acquired and installed during financial years 2013-14 and 2014-15 as reduced by the amount of deduction allowed, if any, under clause(a).

From A.Y. 2015-16

- With a view to extend the benefit of this section to companies which acquire and install new assets whose actual cost during any previous year exceeds Rs.25 crore, sub-section (1A) is inserted. Sub-section (1A) provides that where a manufacturing company acquires and installs new assets and the actual cost of the new assets acquired and installed during any previous year exceeds Rs.25 crore, it shall be allowed a deduction of 15% of the actual cost of such new assets. Such deduction is allowable up to A.y. 2017-18.

ILLEGAL EXPENSES - EXPLANATION TO SECTION 37

- Expenses incurred for any purpose, which is an offence or which is prohibited by law, shall not be allowed as business expense.

- Business Expenditure v. Business Loss
 - ✓ DR. T.A. QUERESHI vs. COMMISSIONER OF INCOME TAX(2006) 287 ITR 547 (SC)

- Contractual violations, Compensatory nature Vs. prohibited by law

DEFERRED REVENUE EXPENDITURE/ENDURING BENEFIT

➤ **Discount on debenture**

- ✓ Madras Industrial Investment Corpn. Ltd. Vs. Commissioner of Income Tax (1997) 225 ITR 802 (SC)

➤ **Expenditure on introduction of new product**

- ✓ Joint Commissioner of Income Tax vs. Modi Olivetti (2004) 84 TTJ 1038 (Del)
- ✓ Commissioner of Income Tax vs. Laxmi Talkies (2005) 275 ITR 125 (Guj)

DONATION/CHARITABLE EXPENSE

- Temple Expenses
- Donation of Bus to School, where children of employee's assessee are studying.
- Contribution to Police department.
- Peripheral development expenses like road, drinking water etc.

DEEMED PROFITS AND HOW THEY ARE CHARGED TO TAX U/S 41

➤ **Recovery against any deduction of any earlier previous year [Sec. 41(1)]**

If assessee was allowed a deduction in any earlier previous year by way of loss, expenditure or trading liability and now during the current previous year, assessee has obtained a refund of such liability (by way of cash or in any other manner) or there is a remission/cessation of such trading liability (by way of writing it off in the books of accounts or by unilateral act of the assessee) then the amount obtained by assessee as refund or the value of any benefit received by assessee due to remission/cessation of such liability will be taxable in the current previous year.

Even if such recovery is in the hands of the successor to business under amalgamation/demerger / conversion / succession by death of assessee, then such amount will be taxable in the hands of the successor, provided such recovery was allowed as a deduction to the predecessor.

Section 41(1) applies, even if the business, in respect of which deduction was allowed, is not in existence in the year of recovery.

Examples:

(a.) If stock in trade is destroyed by fire and allowed as trading loss and later insurance compensation is received for the same, such insurance compensation will be taxable.

(b.) If raw material is purchased on credit and is claimed as deduction, later the amount payable to seller is bargained and settled for a lesser amount, then such benefit arising on remission of liability will be taxable u/s.41(1).

➤ **Recovery of Bad Debt [Sec.41(4)] :**

If a deduction was allowed to the assessee on account of Bad Debt and subsequently such Bad Debt is recovered, then it is taxable in the year in which it is recovered.

MINIMUM ALTERNATE TAX (MAT) [SECTION 115JB]

- This provision specifically states that Tax payable for an assessment year by any corporate assessee cannot be less than 18.5% of the Book Profit. In other words if the Income Tax payable by a company on its total income as computed under the Income Tax Act is less than 18.5% of the book profits, then such book profit shall be deemed total income of the assessee with tax payable on same @ 18.5% plus Sur charge plus Education Cess.

- Wherein Book Profit is arrived at after making following adjustments in the Profits after Tax of the company:

Particulars	Amount (Rs.)
Net Profit as per Profit & Loss Account	XX
<u>ADD:</u>	
The amount of income-tax (including DDT and Deferred Tax) paid or payable, and the provision there of;	XX
The amounts carried to any reserves, by whatever name called	XX
The amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities;	XX
Expenditure incurred for earning an income which is exempt u/s.10,11 or 12[Other than those expenditure incurred for earning an income which is exempt u/s.10(38)]	XX
Depreciation debited to Profit & Loss account	XX

The amount by way of provision for losses of subsidiary companies;	XX
The amount or amounts of dividends paid or proposed.	XX
Provision for Diminution in the value of any asset	XX
Amount standing in Revaluation Reserve(relating to Revalued Asset) on the retirement or disposal of such asset, if not credited to P&L A/c	XX
<u>Less:</u>	
The amount transferred from or withdrawn from any reserves or provision, other than Revaluation Reserve A/c and credited to the Profit and Loss Account;	XX
The amount of any income to which any of the provisions of Sec 10,11 or 12 [excluding income referred to u/s 10(38)] applies if any such amount is credited to the Profit and Loss Account;	XX
The amount of depreciation debited to the Profit and Loss Account (excluding depreciation on revaluation of assets);	XX
The amount withdrawn from Revaluation reserve and credited to Profit and Loss Account to the extent it does not exceed the amount of depreciation on account of revaluation of assets;	XX
The amount of brought forward losses or unabsorbed depreciation whichever is less as per books of accounts;	XX

XX

The amount of profit of a Sick Industrial Company for the assessment year commencing from the assessment year in which the said company has become a sick industrial company u/s 17(1) of the Sick Industrial Companies (Special Provisions) Act' 1985 and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses

Relevant Shipping income of a Tonnage Tax company as per section 115VO credited to P& L A/c

XX

Income Tax Refund(if credited to P&L A/c) and Deferred Tax

XX

BOOK PROFIT AS PER SECTION 115 JB

XXX

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- Every company is required to electronically file report of a Chartered Accountant in a prescribed form i.e. Form no.29B alongwith its e-return of income w.e.f A.Y.2013-14, certifying the correct computation of Book Profit.
 - In case of Apollo Tyres Ltd. v/v CIT(2002) 255 ITR 273(SC), it was held that once the books of accounts are prepared in accordance with PART II and PART III of SCHEDULE-VI to the Companies Act,1956 audited by Statutory Auditors, laid before an AGM, approved by members in AGM, submitted to ROC, approved by ROC, then thereafter A.O. cannot embark/order any fresh inquiry with regards to any infirmity found in the books of accounts of the company, unless circumstances so warrant and A.O. has reason to suspect. If Books of Accounts were not prepared in accordance with PART II and PART III of SCHEDULE-VI to the Companies Act, then A.O. will have the power to do the needful in the matter.
 - In JCIT v/s Rolta (India) Ltd.(2011) (SC), Supreme court held that advance tax shall be higher of the Normal Tax or MAT, which shall be payable by way of advance tax. Therefore, interest u/s.234B and 234C shall be attracted on default.

- Whether the comparison between past years brought forward business loss and unabsorbed depreciation should be done on year to year basis or between aggregate figures?

e.g.: If the figures of brought forward unabsorbed depreciation and brought forward losses of the last few years as per Books of Accounts are as follows:

<u>Assessment Year</u>	<u>b/f Business Loss</u>	<u>b/f Unabsorbed Depreciation</u>	<u>Lower of the two(year wise)</u>
2010-11	100 Lacs	40 Lacs	40 Lacs
2011-12	NIL	80 Lacs	NIL
2012-13	30 Lacs	13 Lacs	13 Lacs
Total	130 Lacs	133 Lacs	53 Lacs

In the above example if the comparison between the two figures is made on year to year basis, then the lower of the two is 40 Lacs, NIL and 13 Lacs respectively for the three assessment years, totaling to **Rs.53 Lacs**. But if comparison is made on aggregate figures of all the three years then out of Rs.130 Lacs and Rs. 133 Lacs, the lower of the two will be **Rs. 130 Lacs**. As per CBDT circular, comparison is to be made between the aggregate figures and not on a year to year basis.

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- The provisions of section 115JB were not to apply to an Entrepreneur or a Developer(including a Co-Developer) in a Special Economic Zone(SEZ) u/s.10AA.(w.e.f. 01/04/2005). However, now w.e.f. A.Y.2012-13, this relief is withdrawn and provisions of section 115JB is now applicable to an Entrepreneur or a Developer (including a Co-Developer) in a Special Economic Zone(SEZ) u/s.10AA.
 - **MAT Credit (Section 115JAA):** Excess of MAT (including Surcharge and Education cess) paid over Normal Tax (including Surcharge and Education cess) payable will be allowed as a credit to be carried forward to **next 10 consecutive Assessment Years**, to be set off against excess of Normal Tax over MAT in those subsequent Assessment Years.

Thank You

DEPRECIATION

CONCEPT OF DEPRECIATION

- ✘ Depreciation is a *non-cash expenditure* allowed under Income Tax Act, 1961 following the block concept
- ✘ Under the Block concept defined u/s 43(6) of the income Tax Act, 1961; the assets falling within the same class and subject to same rate of depreciation are clubbed together and considered as single asset.
- ✘ Any alterations to the value of block have to be strictly in accordance with the provisions of Chapter IV D of the Income Tax Act, 1961.



DEPRECIATION - S. 32 OF THE I.T. ACT



- × An assessee is entitled to claim depreciation on fixed assets only if the following conditions are satisfied:
 - + Assessee must be **owner** of the asset – registered owner need not be necessary.
 - × ***Mysore Minerals Ltd. vs. CIT [1999] 239 ITR 775***
 - + The asset must be **used** for the purposes of business or profession.
 - + The asset must be used during the **previous year**.

DEPRECIATION ON LEASED ASSETS

× Two Types of Leasing

Particulars	Operating Lease	Finance Lease
Purpose	To Operate	To Finance
Owner	Lessor	Lessee
Property in Assets	With Lessor	With Lessee
Risk	With Lessor	With Lessee
Income offered to tax	Entire Lease Rent	Only Interest
Who can Claim Depreciation?	Lessor	Lessee

DEPRECIATION ON LEASED ASSETS

I.C.D.S. Ltd. v. CIT [2013] 350 ITR 527(SC)

Facts:

- ✘ Engaged in business of hire purchase, leasing and real estate, etc., vehicles purchased from manufacturers were leased out to customers.
- ✘ Depreciation was claimed on said vehicles.
- ✘ Rejected claim of depreciation on ground that it merely financed purchase and was neither owner nor user.

Decision:

- It was apparent from the records that assessee was exclusive owner of vehicles at all points of time and, in case of default committed by lessee, assessee was empowered to re-possess the vehicle and at conclusion of lease period, lessee was obliged to return the vehicle.

I.C.D.S. LTD. V. CIT [2013]

350 ITR 527(SC)

(CONT...2/2)

- It was also undisputed that income derived from leasing of vehicles was assessed as business income.
- Both the requirements of section 32 were satisfied. i.e. ownership & usage of vehicles for purpose of business.
- The claim of depreciation in respect of vehicles leased out to be allowed.



ADDITIONAL DEPRECIATION – S. 32(1)(IIA) OF THE ACT

- ✘ 20% available on acquisition of a new Plant & Machinery
- ✘ who is **already** engaged in business of manufacture or Production of Article or thing
- ✘ From A.Y. 2013-14 “in generation or generation and distribution of power” inserted

Proviso 1- No Additional depreciation benefit if Plant & Machinery:

- used within or outside India before installation;
- Installed in office premises or residential accommodation including guest-house;
- Constitutes any office appliances or Road Transport vehicles;
- Entire cost allowed as deduction while arriving as Taxable business income

ADDITIONAL DEPRECIATION – S. 32(1)(IIA) OF THE ACT

Controversy 1: Can additional depreciation be claimed on Windmills ? (on or before A.Y. 2012 - 13)

- × Whether generation of power can be tantamount to be article or thing ?
- × If no, still can be claimed by manufacturing unit.

“Goods “ may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capability of being bought and sold; and (c) capability of being transmitted, transferred, delivered, stored and possessed.”

1. **CST Madhya Pradesh, Indore vs. Madhya Pradesh Electricity Board, Jabalpur (1969) 1 SCC 200 (SC)**
2. **State of A.P. vs. National Thermal Power Corporation Ltd. and others (2002) 5 SCC 203 (SC).**

ADDITIONAL DEPRECIATION – S. 32(1)(IIA) OF THE ACT

Commissioner of Income Tax vs. VTM Ltd.[2009] 319 ITR 336 (Madras HC)

Facts:

- ✘ Engaged in business of manufacture of textile goods- Windmill was set up for generation of power - additional depreciation u/s 32(1)(iia) claimed.
- ✘ Claim was disallowed - windmill has no connection with manufacture of textile goods.
- ✘ The CIT(A) and ITAT allowed additional depreciation. On appeal to High court;

Decision:

- ✘ New Plant & machinery should have been acquired and installed after 31-03-2002 by an assessee who is already in business of manufacture or production of any article or thing
- ✘ The proviso nowhere mentions that said Plant & machinery acquired should have operational connectivity to the article or thing already being manufactured.
- ✘ Decision of ITAT was upheld.

ADDITIONAL DEPRECIATION – S. 32(1)(IIA) OF THE ACT

Controversy 2: When asset is put to use for less than 180 days ; Can balance 10% be claimed in immediately succeeding year?

- ✘ The second proviso to section 32(1)(ii) restricts the allowances only to 50 per cent - assets have been acquired and put to use for a period less than 180 days
- ✘ There is no restriction in the form of additional sum of depreciation shall not be available in the subsequent year.
- ✘ Section 32(2) provides for a carry forward/set up of unabsorbed depreciation.
- ✘ Law does not prohibit that balance 50 per cent will not be allowed in succeeding year.

ADDITIONAL DEPRECIATION

CONTROVERSY 2

(CONT... 2/2)

- It is onetime benefit to encourage the industrialization. It has to be interpreted reasonably, liberally and purposively to make the provision meaningful while granting the benefit. **Supreme Court - Bajaj Tempo Ltd. v. CIT [1992] 196 ITR 188/ 62 Taxman 480.**

DCIT vs. Cosmo Films Ltd. [2012] 24 taxmann.com 189 (Delhi-ITAT)

- Followed by Cochin Tribunal in case of Apollo Tyres Ltd. (ITA No. 616/Coch/2011) [date of pronouncement: 20-12-2013]

- May invite litigation

CAN DEPRECIATION BE ALLOWED ON THE PORTION OF SUBSIDY ...? – EXPLANATION 10 TO SEC 43(1)

Types of Subsidy/ incentive	Nature	To be Capitalized ?	Needs to be Reduced from cost of Assets ?
For Establishing Industries in Backward Areas	Promoter's contribution	Yes	No
For Acquiring Assets	Capital	Yes	Yes: Explanation 10 to Sec.43(1) would apply
For meeting cost of production	Revenue	To be offered as income	Not applicable

CIT vs. Sun Fibre Optics (P) Ltd.[2012] 20 taxmann.com 143 (Ker.)

- Explanation 10 to sec 43(1)- Inserted w.e.f 01-04-1999 i.e. A.Y. 1999-2000 – is prospective in nature – would not apply to subsidy received before 1-4-98

DEPRECIATION ON GOODWILL – S. 32(1)(II)

- ✘ Section 32 (1)(ii) describes the intangible assets :
 - + Know- how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature
- ✘ Goodwill is a bundle of rights which include, inter alia, patents, trade marks, licenses, franchises, etc.
- ✘ for claiming depreciation - needs to be demonstrated particular benefit or advantages or reputation built by a person / company / business house over a period of time and customers associate themselves with such assets



CIT VS. SMIFS SECURITIES LTD.

[2012] 24 TAXMANN.COM 222(SC)

Facts:

- ✘ In scheme of amalgamation with 'Y' Ltd, assets and liabilities of 'Y' Ltd. were transferred. Excess consideration paid over value of 'net assets' acquired of 'Y' Ltd. considered as goodwill on which depreciation was claimed.
- ✘ AO rejected claim for depreciation as 'goodwill' was not an asset falling under Explanation 3 to section 32(1)(ii). On appeal to High Court.

Decision:

- ✘ The CIT(A) as well as tribunal recorded a finding that on amalgamation with 'Y' Ltd., the difference between cost of an asset and amount paid constituted goodwill.
- ✘ The question raised was whether goodwill was an asset u/s 32.
- ✘ Goodwill falls under the expression 'any other business or commercial rights of similar nature' in clause(b) of Explanation 3 to s.32(1). Applying principle of ejusdem generis 'Goodwill' is an asset. Hence, depreciation on 'goodwill' is allowable.

Note: Requisite points for amalgamation needs to be met

NON-COMPETE FEES

WHETHER CAPITAL OR REVENUE?

- Not compete fees are paid to ensure that payee does not enter into the same business for certain periods. Advantage is only by way of facilitation of the assessee's business and ensuring greater efficiency as well as profitability, on the other side, arrangement was to endure for a substantial period, i.e. more than one year. In such circumstances, deduction cannot be claimed as a revenue expenditure, it clearly falls within the capital field.
 - **Sharp Business System [2012] (27 taxmann.com 50) Delhi HC**

NON-COMPETE FEES

WHETHER ELIGIBLE FOR DEPRECIATION?

- ✘ Non compete is not tangible asset.
- ✘ To be an “Intangible asset” u/s 32(1)(ii), the rights must be in “**in rem**” & “**Transferrable**”.
- ✘ Non-compete fees creates “Right in personam”
- ✘ words 'similar business or commercial rights' have to necessarily result in an intangible asset against the entire world which can qualify for depreciation u/s 32(1)(ii).

Sharp Business System[2012] 27 taxmann.com 50- Del HC

Arkema Peoxides India (P) Ltd. [2013] 31 taxmann.com 4 –Chennai ITAT

- Depreciation on non-compete fees can't be allowed relying upon Smifs Securities Ltd. as there Supreme Court C dealt only with Good will and Non-compete fees is not Goodwill.

✓ Gujarat Glass Private Limited vs. ACIT –ITAT Mumbai

SECTION 32(1)(II) : NON-COMPETE FEES

- ✘ A vested right is created (Kind of monopoly to run his business) which can be enforced upon, accordingly, depreciation is allowable.

Real image Tech (P) Ltd. [2009] (177 taxman 80) –
Chennai ITAT

Medicorp Technologies India (P) Ltd.
[122 TTJ 394]- Chennai ITAT

Ind Global Corporate Finance (P) ltd.[2013]
33 taxmann.com 338- Mumbai ITAT

- Tribunal referred one decision **against** the assessee **Srivatsan Surveyors (P.) Ltd. v. ITO [2009] 32 SOT 268 (Chennai)** and one in **favour** of the assessee **ITO v. Medicorp Technologies India (P.) Ltd. [2009] 30 SOT 506 (Chennai)** and held that
- When there are two views possible, the view favorable to the assessee should be followed.
 - ✓ **ACIT vs. GE Plastics India Ltd. [2012] 23 taxmann.com 243 (Ahd-ITAT)**

All the above decisions are prior to Delhi high Court decision of Sharp Business Systems [2012] (27 taxmann.com 50) Delhi HC]

CHARITABLE TRUST – APPLICATION OF INCOME

CAPITAL EXPENDITURE AND DEPRECIATION THEREON

S.11 & S.10(23C) provides exemption to income when applied to acquired capital asset

Notional depreciation on such capital asset also applied for charitable purpose.

Hence, double benefit is claimed by trusts and Institutions

- CIT vs. Institute of Banking Personnel Selection (IBPS) [2003]131 Taxmann 386 (Bom)
- CIT vs. Desh Bhagat memorial trust [2011]12 Taxmann.com 113 (P& H)
- CIT vs. Devi Shakuntal Tharal charitable Foundation [2014] 46 taxmann.com241 (MP)

CHARITABLE TRUST – APPLICATION OF INCOME

CAPITAL EXPENDITURE AND DEPRECIATION THEREON

× Amendment in Finance Bill, 2014

- + S.11 and S. 10(23C) is amended to curb the double benefit.
- + Income for the purposes of application shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under these sections in the same or any other previous years
- + **Applicable w.e.f. 01-04-2015 i.e. Assessment Year 2015-16**

Hence, if cost of asset has been claimed as applied for charitable purpose in any previous year; depreciation won't be allowed from A.Y. 2014-15.

DEVELOPMENT OF INFRASTRUCTURE FACILITIES ON BUILD-OPERATE-TRANSFER(BOT)

ELIGIBLE FOR DEPRECIATION?

What are BOT Agreements?

- ✘ A developer in terms of concessionaire agreement with Govt. is required to construct, develop and maintain infrastructure facility of roads/highways, etc at its own cost and its utilization thereof for a specified period.
- ✘ Possession of land is handed over without actual transfer of ownership and assessee has only right to develop and maintain such asset.
- ✘ In lieu of consideration of expenditure incurred, developer can collect toll from users.
- ✘ Whether developer can claim depreciation on cost of development and maintenance of infrastructure facility?

DEVELOPMENT OF INFRASTRUCTURE FACILITIES ON BUILD-OPERATE-TRANSFER(BOT)

WHETHER ELIGIBLE FOR DEPRECIATION?

Facts : Where assessee in terms of agreement with Government of Madhya Pradesh was required to develop, construct and maintain a road on BOT basis at its own cost for a specified period and it had capitalized costs incurred on development and construction of infrastructural facility under head 'License to collect Toll'

Held : Assessee claimed depreciation on amount capitalized under head 'License to collect Toll' contending that right to collect toll obtained by it was akin to a license, being an intangible asset within meaning of section 32(1)(ii) - Whether assessee was eligible for depreciation inasmuch as right to collect toll was an intangible asset falling within purview of section 32(1)(ii)

- Assistant Commissioner of Income-tax, Central Circle - 1, Nashik v. Ashoka Infraways (P.) Ltd.* 33 taxmann.com 499 (Pune - Trib.)
- Deputy Commissioner of Income-tax, Circle -3(3), Hyderabad v. Swarna Tollway (P.) Ltd. 43 taxmann.com 252 (Hyderabad - Trib.)

DEVELOPMENT OF INFRASTRUCTURE FACILITIES ON BUILD-OPERATE-TRANSFER(BOT)

CBDT Circular 09/2014 dated 23rd April, 2014 clarification on treatment of expenditure:

Applicable to:

- ✘ Infrastructure Projects for Development of Roads/Highways on BOT agreements
- ✘ Where ownership is not vested with the assessee under the concessionaire agreement

Post Clarification:

- ✘ Expenditure incurred by assessee on BOT agreements brings it an enduring benefit in the form of right to collect the toll during the period of agreement.
- ✘ Expenditure incurred should be allowed to spread during the tenure of concessionaire/agreement.

Period of amortization clarified:

- ✘ The amortization may be computed at the rate which ensures that the whole of the cost incurred in creation of infrastructure facility is amortized evenly over the period of agreement after excluding the time taken for creation of such facility.

RENOVATION /EXTENSION / IMPROVEMENT IN LEASED BUILDING V TEMPORARY STRUCTURE

Explanation 1 to Section 32(1):

- Business or profession is carried on in a building not owned by assessee
- Expenditure incurred on the construction of any structure or doing of any work in or in relation to or by way of renovation or extension of or improvement to the building
- it would be treated as building owned by the assessee.

V/s.

Under building blocks :

Item (4):

- Purely temporary erection such as wooden structure - 100%

RENOVATION /EXTENSION / IMPROVEMENT IN LEASED BUILDING V/S TEMPORARY STRUCTURE ETC.

Which rate would be applicable to expenditure incurred on renovation of building, Temporary partition of wooden structure, false ceiling etc. ... ??

ABT Ltd. vs. Assistant Commissioner of Income Tax [2013] 30 taxmann.com 11 (Chennai-Trib.)

- ✘ To make the lease building suitable, expenditure was incurred on renovations, repairs and interiors and claimed as revenue expenditure
- ✘ It is held that the expenditures fall within the ambit of Explanation 1 to section 32(1) and hence the expenditure should be treated as capital expenditure. and allowed depreciation @ 10%.

EDS electronic Data Systems (India) (P) Ltd. (2008) 26 SOT 483 (Del) (Trib.):

- ✘ In case of expenditure on leased premises in order to make it fit for assessee's business, if any extra facility was created by way of brick works and connected expenditure, the same would be a capital expenditure eligible for depreciation under explanation 1 to s. 32(1)

CIT VS. GUJARAT COOP. MILK MARKETING FEDERATION LTD.

[2014] 43 TAXMANN.COM 398(GUJ)

Facts:

- ✘ Land was leased by Ahmedabad Urban Development Authority, Wooden structure constructed for running AMUL Milk parlour - depreciation @ 100% was claimed.
- ✘ AO reduced the depreciation to 10% on the ground that it was pukka constructed.
- ✘ ITAT held that land use right given by AUDA was temporary and parlour could be demolished any time by AUDA. Hence, allowed full depreciation @100%. On appeal to High Court:

Decision:

- ✘ Clause (4) of item I of Part A of Appendix I to the Income Tax Rules, 1962 provides 100% deduction on 'purely temporary erections' such as wooden structures.
- ✘ Agreement was made and right to use the land was given by AUDA on certain terms and conditions. Conditions did not have any right to develop any part of land or put up

CIT VS. GUJARAT COOP. MILK MARKETING FEDERATION LTD.

[2014] 43 TAXMANN.COM 398(GUJ)

(CONT...2/2)

construction without permission of AUDA.

- ✘ Combined readings of the said conditions would establish that right was given to put the parlour for a period of 5 years. Hence, the conditions were limited from right to use the land for limited purpose and for limited period.
- ✘ In view of decision of Supreme Court in case of Madras Auto Service (P) Ltd. and in particular looking at the nature of agreement where construction was 'purely temporary erection', and it qualified for 100% depreciation as the parlour could be demolished at any time after 5 years.



CIT VS. PRINT SYSTEMS & PRODUCTS

[2006] 285 ITR 337 (MADRAS HC)

Facts:

- ✘ Temporary partitions, false ceilings, etc. made on the property acquired was treated as capital expenditure and claimed 100% depreciation.
- ✘ AO treated the temporary erections as revenue expenditure as the property was not a leased property and disallowed the claim of depreciation.

Decision:

- ✘ ITAT held that ownership or taking the property on lease was of no consequence so far as the construction of a temporary partition was concerned.
- ✘ Moreover, revenue did not point out any rule or section to substantiate that depreciation @ 100% was not allowed on temporary erection.
- ✘ ITAT, hence allowed 100% depreciation in respect of the addition on temporary erection.
- ✘ High Court upheld the order of ITAT as no substantial questions of law arise.

Questions...?



Thank You