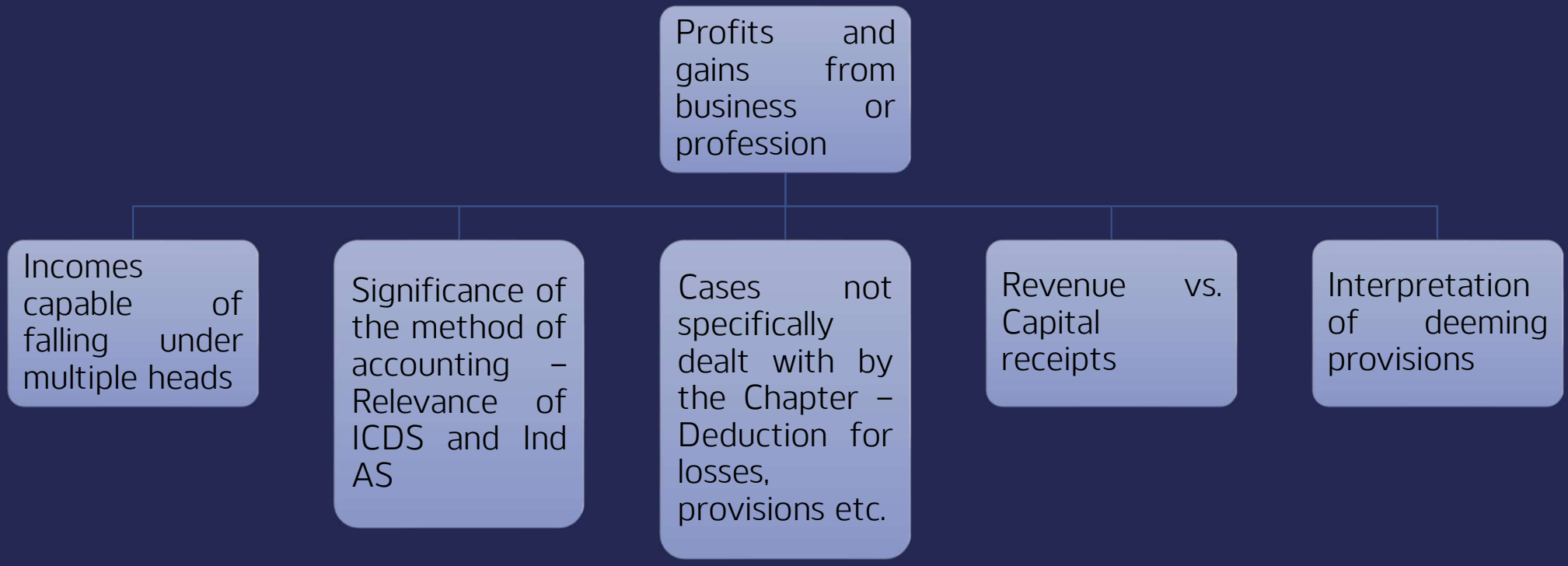
Profits and Gains from Business or Profession – Back to Basics

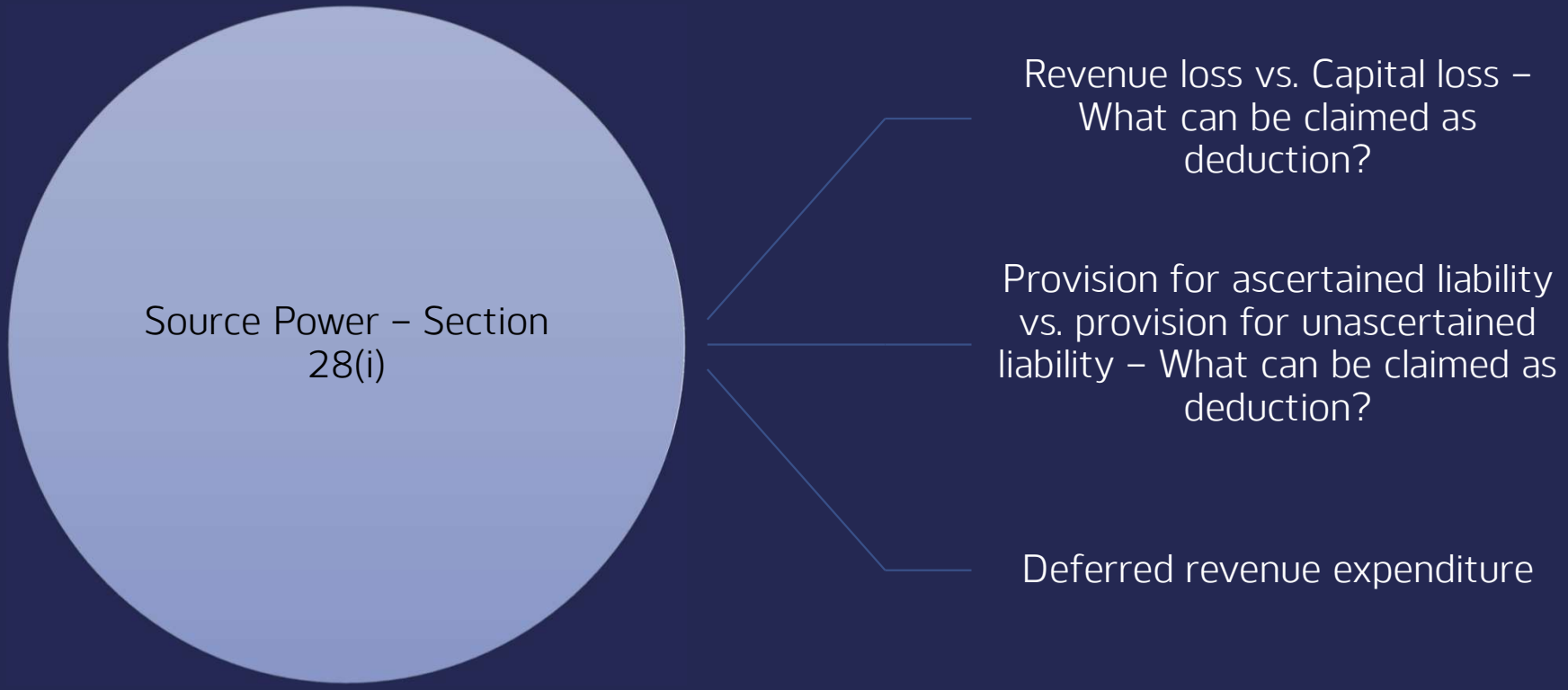
Overview of the Chapter

- Basis of Charge [Section 28]
- Computation of Income from Business or Profession [Section 29]
- Specific Deductions [Section 30-36]
- General Deductions [Section 37]
- Disallowances [Section 40, 40A and 43B]
- Maintenance of Books of Accounts [Section 44AA]
- Tax Audit [Section 44AB]
- Presumptive Taxation [Sections 44AD to 44C]
- Special provisions for NR [Sections 44D & 44DA]
- Special provision for Co-operative Banks [Section 44DB]

Basis of charge



Deduction of losses, provisions etc.



Deduction of losses, provisions etc. – Contd.

Badridas Daga [SC]

- Misappropriation of funds by an employee who has been given PoA to run the business.
- Loss incidental to business. Hence allowable.
- It is not enough that the loss is a business loss, it should also arise from running of business.

Continuum Wind Energe (India) (P.) Ltd [Mad HC]

- Forex loss on repayment of foreign currency loan taken to purchase capital assets.
- Held, loss being capital in nature and not allowable as deduction.
- Impact of Section 43A

Deduction of losses, provisions etc. – Contd.

Loan write off

- Vassanji Sons & Co. (P.) Ltd. [Bom HC], Spencers and Co. Ltd. [Mad HC], Gulf Oil Corpn. Ltd. [Hyd HC] – Allowable as business loss.
- Narang Industries Ltd. [Del HC] – Money advanced for commencement of new business became irrecoverable; Loss held to be capital in nature.
- Amarchand Sobhachand [SC] - Irrecoverability of moneys advanced by a partnership firm engaged in the business of money lending to another related partnership firm to save it from financial collapse; Loss held to be capital in nature.
- Motiram Nandram [SC] – Loss arising on account of irrecoverability of security deposit; Security deposit being temporary investment, the loss will capital in nature.

Deduction of losses, provisions etc. – Contd.

Deferred revenue expenditure

Torrent Pharmaceuticals [Guj HC] – Premium payable at the time of redemption of debentures can be claimed proportionately over the tenure of the debentures.

Taparia Tools [SC] – Interest on debentures paid upfront at a discounted rate instead of paying periodically, can be claimed as deduction in year of payment itself.

Madras Investment Corporation Ltd. [SC] – Discount on issue of debentures/bonds can be claimed proportionately over the tenure of the instrument.

Incomes capable of falling under multiple heads

Property letting

- Chennai Properties & Investments Ltd. [SC] - Where in terms of MOA, main object of the assessee was to acquire properties and earn income by letting out same, said income was to be brought to tax as business income and not as income from house property.
- Rayala Corporation Pvt. Ltd. [SC] - The business of the company is to lease its property and to earn rent and therefore, the income so earned should be treated as its business income.
- Keyaram Hotels P Ltd. [SC] (SLP Dismissal) – Income was generated out of exploitation of property by letting out the same. There is neither commercial activity nor business activity carried out by the assessee to earn such income. The object clause contained in the MOA would not alter the nature of activity of the assessee.
- East India Housing and Land Development Trust Ltd. [SC] – The assessee was formed with the object of developing and setting up markets. The income derived from letting out of shops will be income from property [Specific over general provision will prevail].

Incomes capable of falling under multiple heads – Contd.

Share trading

Circular 6/2016 – 1) If the assessee opts to treat the listed securities as SIT, then the income arising from sale of shares will be treated as business income. 2) If the listed securities held for a period of more than 12 months prior to the date of transfer and if the assessee desires to treat the income arising from sale as capital gains, then the same shall not be disputed by AO. The said stand should be consistently followed. 3) In all the other cases, the nature of income shall be decided based on previous Circulars.

Circular No. 4/2007 - 1) The existence of power to purchase and sell in MOA alone is not sufficient. 2) The substantial nature of transactions, the manner of maintaining books of accounts, the magnitude of purchases and sales and the ratio between purchase and sales would be a good guide. 3) Ordinary purchase and sale with an intention to earn profit would result in the transaction being treated as trade, where the intention is to hold the shares to earn income by way of dividend, then the shares will be treated as capital asset.

Incomes capable of falling under multiple heads – Contd.

Interest

- Interest from investments, deposits – in general, IOS
- Interest that can be considered inextricable to a project, held to be capital receipt
  - Bokaro Steel Limited [SC] - Held interest on advances to contractors engaged in construction & installation of plant capital in nature. Receipts were inextricably linked with the setting up of the capital structure of the company and thus the receipts, being capital in nature would go to reduce its cost of assets
  - Karanal Co-operative Sugar Mills Limited [SC] - Interest earned by the Assessee on opening letter of credit for purchase of machinery required for setting up plant is incidental to the acquisition of assets to set up the plant and machinery and not a case of investing surplus funds and hence is capital in nature

Incomes capable of falling under multiple heads – Contd.

Interest

- Interest that can be considered inextricable to a project, held to be capital receipt
  - Karnataka Power Corporation Limited [SC] - Interest and hire charges received from contractors are capital receipts and would go to reduce the cost of the asset.
  - Facor Power Ltd. [SC] - Interest received on margin money kept in the form of fixed deposits for procurement of various capital goods for setting up power plant is capital in nature.
- Surplus funds invested during construction period – Revenue in nature, taxable as IOS
  - Tuticorin Alkali Chemicals and Fertilisers Limited [SC]

Capital Receipts

Subsidy/Grant – Position prior to FA, 2015	Taxability dependent on nature of the subsidy – 'purpose test'
	Subsidy relatable to acquisition of asset to be reduced from cost of the said asset – Explanation 10 to Section 43(1)
	Sahney Steel and Press Works Limited [SC] – 1) Refund of sales tax subsidy on power consumed, exemption from payment of water tax. 2) Contention of assessee was that subsidy was calculable based on capital and that it was granted to enable assessee set up new business or expand existing business substantially. 3) Held, all incentives were payable only after assessee goes into production, manner on quantifying incentives not relevant in determining its nature, funds were given to enable assessee run the business more profitably, therefore would qualify as operational subsidies and therefore taxable.

Capital Receipts – Contd.

Subsidy/Grant – Position prior to FA, 2015	Ponni Sugars and Chemicals Ltd. [SC] – 1) Benefit available to only new units or units that have substantially expanded, subsidy to be utilised for repayment of loans, quantification based on duty and price difference. 2) Held subsidy was capital in nature and not revenue.
Subsidy/Grant – Position post FA, 2015	Amendment to the definition of income. Any assistance in the form of subsidy, grant, incentive, duty drawback, waiver, concession or reimbursement by Government, authority, body or agency other than subsidy considered in determining cost of actual cost of asset will be treated as income. Relevance of the cases rendered under the unamended law?

Capital Receipts – Contd.

Subsidy/Grant Other aspects	–	Section 145B: deemed to be income in the year of receipt if not subjected to tax in earlier year.
		ICDS VII: 1) Relatable to depreciable assets - adjusted against actual cost/ WDV. 2) Relatable to non-depreciable assets – recognised as income over the same period for which cost of meeting obligations is charged to income and 3) Received as compensation for expenses or losses – recognised as income as and when receivable.
Carbon credits		Satia Industries Ltd. [ITAT Amritsar] Amounts received from sale of carbon credits – Capital receipt. Special rate of taxation [115BBG] will apply only when the carbon credits are validated by United Nations Framework Convention

Deeming provisions – Benefit/Perquisite

Position prior to FA 2023

- Section 28(iv) - value of benefit or perquisite, whether convertible to money or not, arising from business or exercise of profession.
- Mahindra & Mahindra [SC]: To apply provisions of Section 28(iv), the benefit has to be in some other form other than money.

Position after FA 2023

- Value of benefit or perquisite arising from business or exercise of profession
  a. whether convertible to money or not.
  b. in cash or in kind
- Liability to deduct/ensure payment of tax under Section 194R at 10%
- What would happen to:
  a. Concessional or interest free advance or loan?
  b. Benefits received by company and utilised by employees – world cup tickets given free of cost to Company A by its parent, which is then issued free of cost to its employees.

Other aspects

- Does the distinction between capital and revenue assume significance

General Deductions

Any expenditure (other than capex) incurred for the purpose of business/profession, can be claimed as deduction.

Expenditure incurred for a purpose which is an offence/prohibited by law (both domestic and foreign laws) is not allowable as deduction.

- Penalty vs. Interest
- Freebies to medical practitioners [New UCPMP Guidelines]
- Freebies to others in cases where the recipient is by law prohibited to accept the same
- Amount paid for compounding an offence.

General Deductions – Contd.

Aspects to be kept in mind while determining whether a payment is capital/revenue in nature – Bharathi Hexacom [SC].

- Expenses towards "acquisition of concern" is capital in nature; "carrying on a concern" is revenue in nature
- Mere payment of an amount in instalment does not convert or change capital payment into revenue payment
- Single transaction cannot be split in an artificial manner into capital and revenue.

General Deductions – Contd.

Assam Bengal Cement Co. Ltd [SC]

- The Assessee company acquired from State Government a lease for certain limestone quarries. In addition to rent and royalties assessee agreed to pay certain amount annually to lessor as 'production fees' and undertaking not to grant any lease, permit or prospecting licence regarding limestone to any other party.
- It is held that the payments made by assessee to lessor was for acquisition of an asset or advantage of enduring nature and, thus, was not allowable as business expenditure.
- The court observed that in the great diversity of human affairs and the complicated nature of business operations it is difficult to lay down a test which would apply to all situations. One has therefore got to apply these criteria one after the other from the business point of view and to conclude whether on a fair appreciation of the whole situation the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure

General Deductions – Contd.

Jalan Trading Co (P) Ltd [SC]

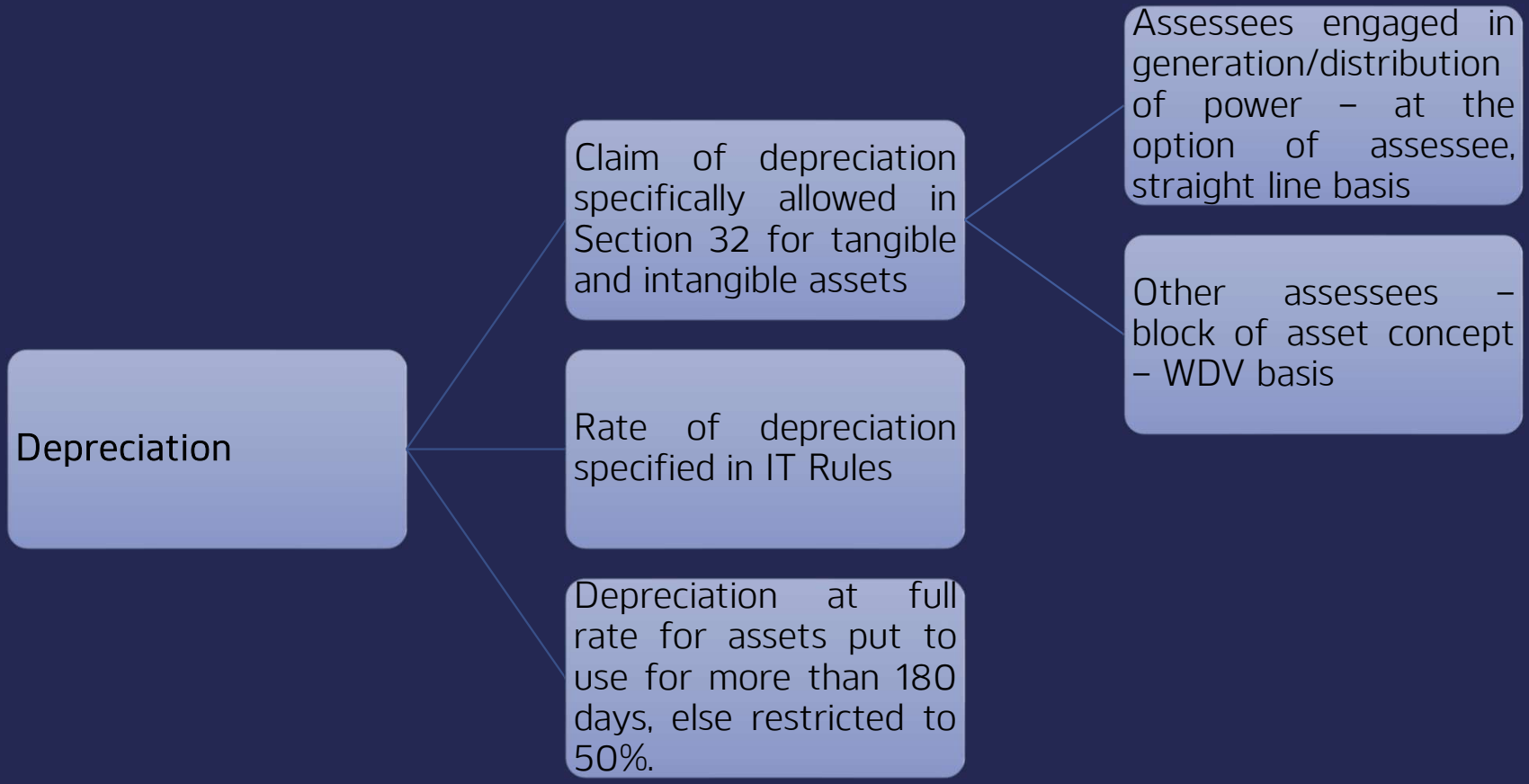
- Bharat Barrel sold its sole selling agency firm to Jalan Trading Co upon an agreement that Jalan Trading Co had to pay 75 % of the profits and commission and on the money received from manufactures. Jalan trading co claimed the royalty paid as business expenditure.
- Held, mere fact that the capital sum is payable by instalments spread over a certain length of time will not convert the nature of that payment from the capital expenditure into a revenue expenditure, but the payment of instalments in such a case would always have some relationship to the actual price fixed for the sale of the undertaking. The assessee acquired an asset of an enduring nature. Hence, mere payment of sum as percentage of revenue and the payment of sum in instalments will not alter the character of expenditure.

General Deductions – Contd.

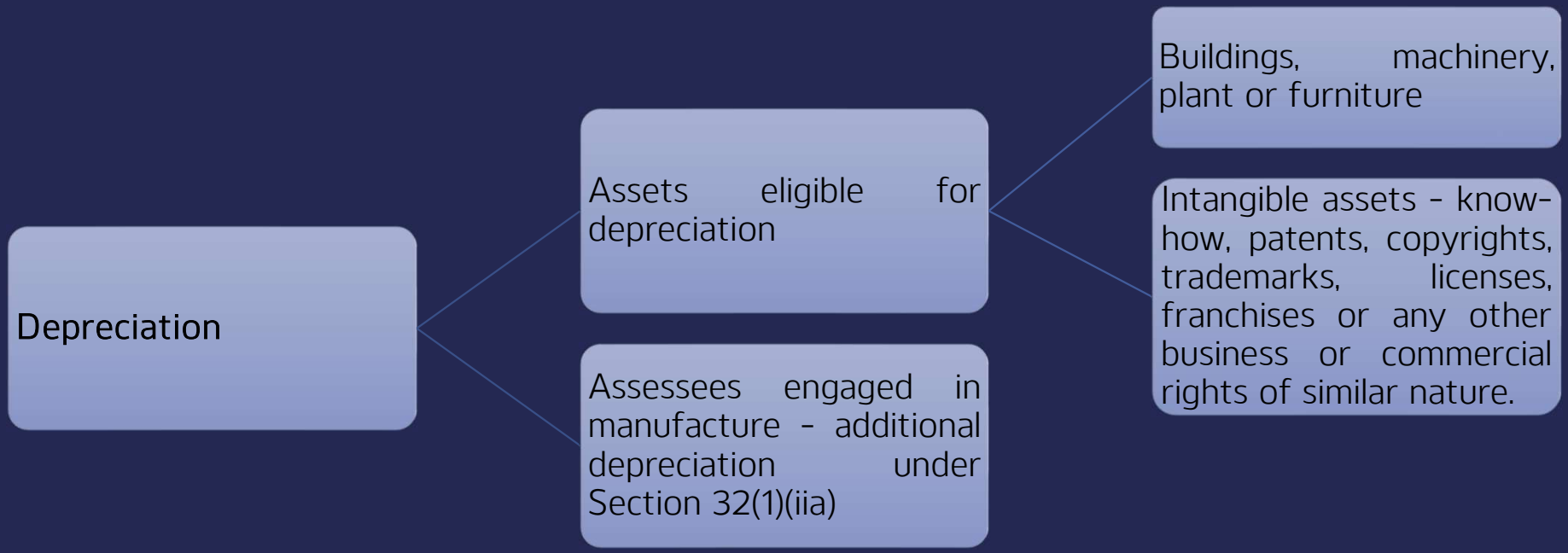
Pingle Industries Ltd [SC]

- The assessee was carrying on the business sale of Shahabad stones which had to be extracted from quarries, dressed, and then sold. For its business, the assessee took on contract the right to excavate stones from certain quarries in six villages for a period of 12 years and a lease from Government which was required to pay the amount in monthly instalments. The assessee claimed such expenditure as deductions while computing the income from business or profession.
- Held, the assessee acquired by long term lease a right to win stones and leases conveyed to him a part of land. The payment though was periodic in nature, was neither rent nor royalty but a lump sum payment for acquiring a capital asset which provides an enduring benefit to the assessee in his business. Thus, the payments is capital expenditure.

Depreciation



Depreciation – Contd.



Depreciation – Contd.

Issues

- How to interpret “any other business/commercial rights of similar nature”. Depreciation benefit for leasehold rights, mining rights, tenancy rights etc.,
- Depreciation eligibility in case of assets taken on financial lease.
- Impact of 43A; Recasting of opening WDV

TDS Disallowance

Section 40(a)(i) – amounts paid to non-resident on which tax is deductible but not deducted and paid before 139(1) date.

- Expenditure not allowable as deduction in the year of non-compliance.
- Expenditure allowable if compliance is made in any subsequent year.

Section 40(a)(ia) – amounts paid to resident on which tax is deductible but not deducted and paid before 139(1) date.

- 30% of expenditure not allowable in the year of non-compliance.
- Allowable if compliance made in any subsequent year.

TDS Disallowance – Contd.

No disallowance if payee has paid tax and not considered as assessee in default under S. 201.

Instances of short deduction – disallowance not applicable:

- DCIT v. S. K. Tekriwal
- PCIT v. Future First Info Services

Non-compliance with Section 194R: Whether disallowance would apply?

Non-compliance with Section 194R: Benefit/perquisite provided in kind

TDS Disallowance – Contd.

No proceedings initiated under 201(1) for non-deduction of tax

- Can disallowance be made?
- Time limit for passing orders under 201(1) – 7 years from end of financial year in which payment is made or credit is given or 2 years from the end of financial year in which correction statement is filed whichever is earlier.
- If proceedings are initiated under S.201(1) but no assessment is proposed on payee?

Mitsubishi Corporation India Private Limited [Del HC] – No discrimination should be there between tax deductible payments made to Non-resident and resident when it comes to disallowance on account of non-deduction of TDS

43B Disallowance

Deductions to be allowed on actual payment

Tax, duty, cess, fee.	Contributions to provident fund etc. Covers only employer contributions. Employee contributions were specifically excluded w.e.f. 01.04.2021.	Interest on borrowings from PFI, SFC, SIIC, NBFC, Banks.	Leave salary.	Amounts payable to MSME

43B Disallowance – Contd.

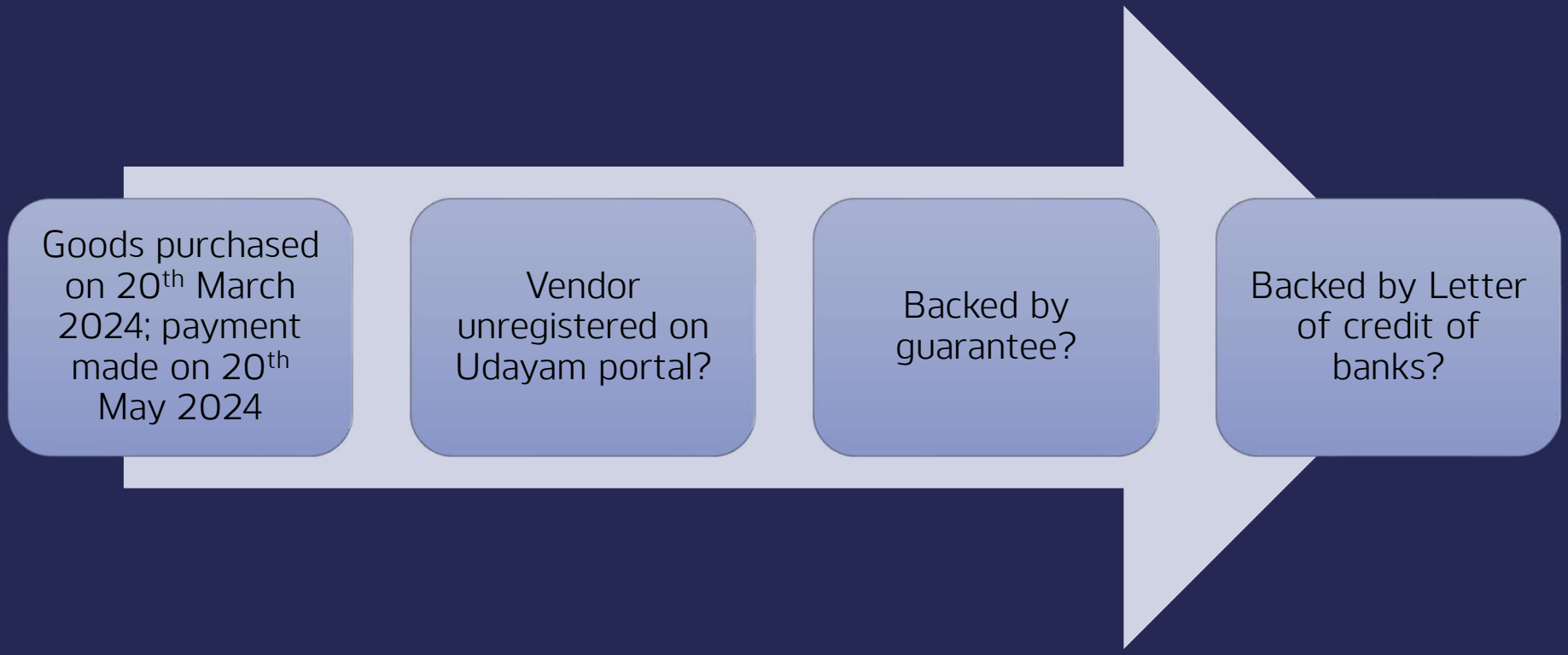
Except for MSME payments all amounts available as deduction provided payment made on or before 139(1) date.

If payment made subsequently, deduction available in such subsequent period

MSME payments to be made before end of financial year:

- Deduction not available only for those amounts that are due beyond the time limit specified in MSMED [15 days/45 days]

43B Disallowance [Contd.] – Issues in MSME payments



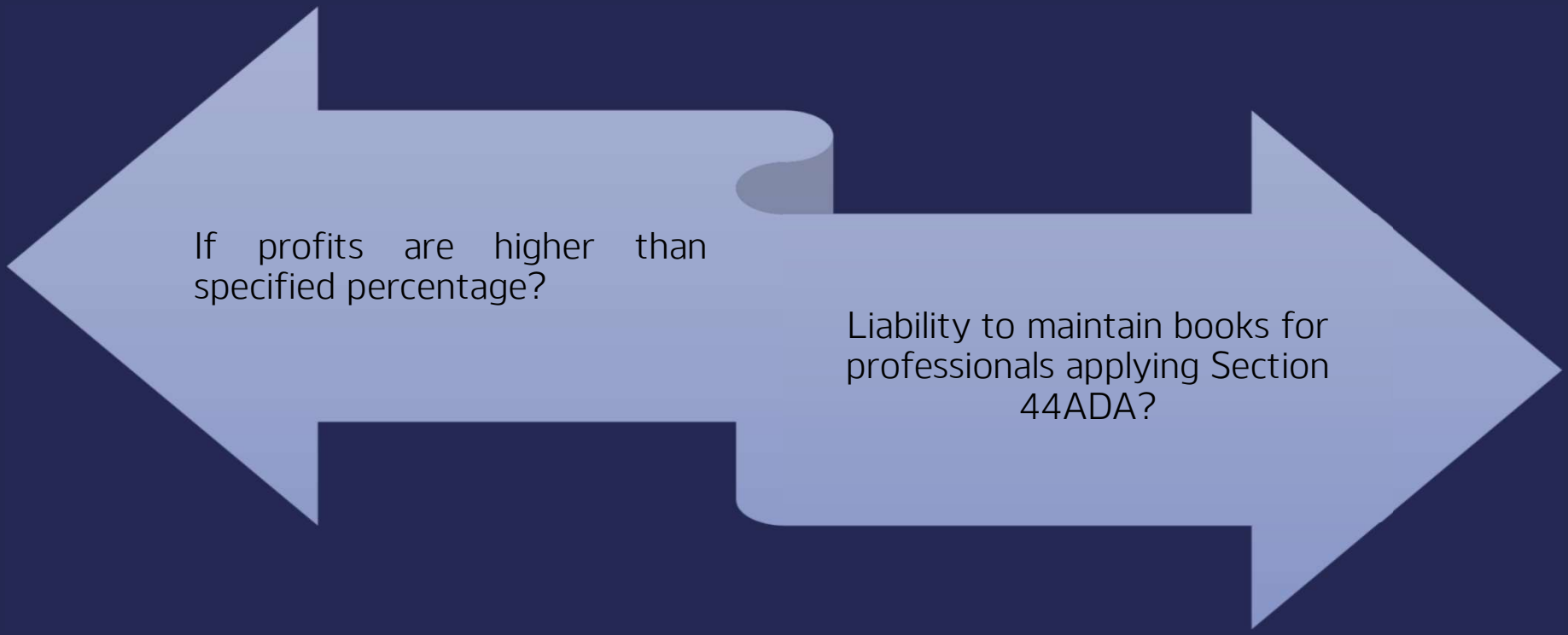
Presumptive taxation

For Business [Section 44AB]						
Applicable only for resident individuals, HUFs, firms who do not claim any income-based deductions.	Not applicable for professions, commission, brokerage and agency business	Applicable only upto a turnover threshold of 2 crores or 3 crores as the case maybe	8% or 6% of the total turnover or gross receipts or higher sum claimed to have been earned by Assessee, deemed to be profits.	All deductions deemed to be allowed.	Income declared under 44AD in year 1, next 5 years income should be declared only under 44AD.	Above condition is not complied, 44AD cannot be applied for 5 years.

Presumptive taxation – Contd.

For Profession [Section 44DA]			
Applicable to resident individuals, partnership firms	Applicable upto gross receipt threshold of 75 lakhs (previously 50 lacs)	For above threshold, cash receipts to not exceed 5% of total receipts.	50% of gross receipts or higher sum claimed to have been earned by Assessee, deemed to be profits.

Presumptive taxation – Contd.



THANK YOU!

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