

NABAGRAM HIRALAL PAUL COLLEGE
Nabagram, Konnagar. Hooghly.

B.Com.
Semester IV

CC 4.1 Taxation I

Notes on

Business and profession

1.Regarding the classification of heads of income it is the third head of income.

2.**Business means** “any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture”. An isolated transaction may also fall within the definition of business as being an adventure in the nature of trade. It is not necessary that a business would be carried on with a profit motive. The burden of proof that the transaction is in the nature of trade rests with the income tax department.

3.**Profession means** “ a calling requiring specialized knowledge and often long and intensive preparation including instruction in skills and methods”. Profession includes vocation. What does not amount to ‘profession’ may amount to a ‘business’ , and what does not amount to ‘business’ may amount to a ‘vocation’.

4.The incomes which are **chargeable under this head** are:

- a. profits and gains from any business and profession.
- b. Any compensation due to be received by any person for specified managerial services.
- c. Income derived by a trade association from specific services performed for its members.
- d. Cash assistance received or receivable by any person against exports under any scheme of the Government of India.
- e. The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

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- f. Any sum received under a keyman insurance policy including the sum allocated by way of bonus on such policies.

5. Business income not chargeable under the head “Profit and gains of business or profession

The following incomes are not chargeable under the head “Profit and gains of business or profession”:

- a. Rental income from house property.
- b. Dividend income.
- c. Income from letting out of commercial assets.
- d. Income from lotteries, etc.

6. General principles for computation of business income:

- a. Business or profession carried on by the assessee:

Under this head, the owner of the business is chargeable. It is, however, not necessary that the business should be carried on by the assessee personally. The chargeability does not depend on the legal husk of ownership, but on the beneficial interest.

Exceptions

The guardian or manager of a minor, lunatic or idiot is chargeable to tax in respect of income of the business owned by the minor, lunatic or idiot.

- b. Business or profession carried on during the previous year:

The charge under this head arises in respect of any business carried on at any time during the previous year.

- c. **Discontinued business:** If the business is discontinued before the commencement of the previous year, the profit received during the previous year is not chargeable to tax.

Exceptions

- i) Recovery against any loss allowed as a deduction in any earlier previous year.
- ii) Sale proceeds of any asset used for the purpose of scientific research.
- iii) Recovery against any bad debts allowed as a deduction in any earlier previous year.
- iv) Balancing charge in respect of any asset of an undertaking engaged in the generation and distribution of power.

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7. Business loss are allowable on commercial principles provided the following conditions are satisfied:

- i) They are revenue in character.
- ii) They are incurred during the previous year.
- iii) They are not merely connected with the trade but are incidental to the trade himself.
- iv) They are actual and not notional or anticipated.

The following are some instances of various kinds of losses which are allowed as deduction.

Loss of stock in trade:

- a) Loss of stock due to theft or robbery.
- b) Loss of stock by fire.
- c) Loss of stock by ravages of white ants.
- d) Loss of stock by enemy action during the war.
- e) Loss of stock-in-transit.

Loss of cash:

- a) loss of cash due to dishonesty or negligence of the employees.
- b) loss of cash from office premises after office hours, due to burglary.
- c) Loss by a banking company due to dacoity of cash and securities after the banking hours.
- d) Shortage in cash in a money lending business found on making up the accounts of the day.

Loss of security / deposits:

- a) loss due non recovery of advances made in course of business.
- b) loss due non realisation of loan advanced to an importer.
- c) loss due to sale of securities held in the ordinary course of business.
- d) Loss due to forfeiture of security deposits given at the time of submitting tenders.

Loss on currency exchange:

- a) loss due to exchange rate fluctuations of foreign currency held on revenue account.
- b) Loss due to devaluation of rupee.

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Miscellaneous losses:

- a) loss due to breach of contract for delivery of goods.
- b) Loss due to guarantee entered into ordinary course of business.
- c) Loss due to sale of bonds which were purchased to secure an order.
- d) Loss due to non-realisation of advances given to Employee's Welfare Co-operative Society.
- e) Loss due to assessee's failure to lift stipulated quota of liquor as per contract.

8. Instances of losses not allowed as deduction:

- a) Loss due to advances made, which is not in the ordinary course of business of the assessee.
- b) Loss for providing guarantee in favour of another person, which is not in course of business.
- c) Loss due to non recovery of tax paid by a commission agent on behalf of a non resident assessee.
- d) Loss due to purchase of shares in a company with a view to providing the company with finances.
- e) Loss from sale of land which was received in satisfaction of a loan kept for several years as capital stock.

9. In computing the income from business and profession, depreciation is an allowable expenditure. The charge of depreciation is mandatory and has to be allowed whether or not the assessee has claimed the deduction or not.

Conditions for claiming the deduction :

i) Assets must be owned by the assessee: Depreciation is allowed to the owner of the asset. In the following cases, the assessee shall be deemed to be the owner of the asset and accordingly, shall be eligible for depreciation allowance:

- A lessee of a land upon which a building has been built by him in respect of the building even if the lease deed provides that the building will belong to the lessor upon the expiry of the lease.
- In a hire purchase contract, the hire purchaser is regarded as the owner of the asset.

Even partial owner of the assets are also allowed depreciation.

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- ii) Assets must be used for the purpose of business and profession of the assessee: The term 'used' for this purpose should be construed liberally so as to include not only active use but also passive use.
- iii) Assets must be used during the previous year: The assets in respect of which depreciation is claimed must be used at least for sometime during the previous year.
- iv) Aggregate of depreciation must not exceed total cost.

10. Important consideration:

- a. Depreciation is not allowable on the cost of the land upon which the building is constructed.
- b. Building includes roads which links or approach buildings, driveways and compound walls, fences, culverts and drainage.
- c. Plant includes ships, vehicles, books, scientific apparatus and surgical equipments used for the purpose of business and profession but does not includes tea bushes or livestock.

11. Methods of computation:

- a. Depreciation is to be computed not with reference to each and every item of assets, but with reference to Block of assets.
- b. With reference to each block of assets, depreciation is to be computed on the written down value at the relevant applicable rates.
- c. In respect of a block of assets, depreciation shall be allowed only if the block has a written down value as on the last day of the previous year.

If during the previous year any asset (or all assets) belonging to the block of assets is sold, discarded and such sales value exceeds the written down value then there will be short term capital gains.

If during the previous year all assets belonging to the block of assets is sold, discarded and such sales value does not exceed the written down value then there will be short term capital loss.

12. Block of assets: It means 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 in respect of which the same percentage of depreciation is prescribed.

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13. Written down value: For the purpose of charging depreciation of the current year, 'written down value' means:

- a) in the case of assets acquired in the previous year, the actual cost to the assessee ;
- b) in the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation allowed to him.

However, in respect of any existing block of assets if there are purchases and / or sales, the written down value shall be computed under the following steps:

- I) Find out the written down value of the block of assets as at the beginning of the relevant previous year.
- II) **Add**, actual cost of assets falling within the block acquired during the year.
- III) **Deduct**, moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of scrap value ,if any.

14. Written down value when there is a slump sale:

- I) Find out the written down value of the block of assets as at the beginning of the relevant previous year.
- II) **Add**, actual cost of assets falling within the block acquired during the year.
- III) **Deduct**, moneys payable in respect of any asset (other than those sold in the slump sale) which is sold or discarded or demolished or destroyed during that previous year together with the amount of scrap value (not exceeding total of step I and II)
- IV) **Less**, actual cost of assets falling in the block sold in slump sale as reduced by (a) depreciation charged upto assessment years 1987-88 (b) depreciation allowable for any assessment year commencing on or after 1st April, 1988.

Deduction in step IV shall not exceed the summation of step I+ II+ III.

The balance amount, if any, is the written down value of the block of the assets, on which the depreciation shall be allowed at the prescribed rate.

15. If the asset is used for **less than 180 days** then the relevant rate of depreciation will be **half of the original rate applicable.**

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16. Actual cost: It means of the asset to the assessee, reduced by the portion of the cost thereof, if any, as has been directly met by the other person. It includes all expenditure necessary to bring the assets into existence and put them into working conditions. The following have been held to be the part of the actual cost of the asset:

- a) Expenditure incurred on trial run of plant.
- b) Expenditure incurred on laying the foundation stone of a factory building,
- c) Fees paid to the government, insurance premia and traveling expenses of trips within and outside India in connection with acquisition of the capital assets.
- d) Interest on loan for acquisition of capital assets or on the unpaid price of the plant up to the date of commencement of production.

17. Sec. 37(1) entails general deduction in respect of any expenditure which are not covered **under sec. 30 to 36**. This is a residuary section and covers only expenditure, not business losses. Deduction under this section is allowed if the following conditions are fulfilled:

- a) The expenditure is not covered u/s 30 to 36.
- b) It is incurred wholly and exclusively for the purpose of business and profession carried on by the assessee during the previous year.
- c) It is not in the capital nature.
- d) It is not in the nature of personal expenses of the assessee.
- e) It is not incurred by the assessee for any purpose which is an offence or which is prohibited by law.

18. A few instances of expenditure **allowed** under **section 37 (1)**

A. Legal expenses / accountancy expenses etc :

- Legal expenses incurred in the normal course of business.
- Legal expenses incurred for alleged breach of trading contract.
- Legal expenses incurred to defend assessee's title to his assets.
- Legal expenses incurred for recovery of debt.
- Legal expenses incurred to resist winding up petition by the shareholders.
- Legal expenses for obtaining loan from bank.
- Legal expenses on defending an employee against criminal prosecution in the interest of business.

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- Legal expenses incurred in successfully defending the assessee against alleged infringement of patent rights.
- Fees paid to professional advisers in connection with income-tax proceedings.
- Legal expenses to protect the assessee from being declared insolvent.
- Fees paid to auditors for preparing or certifying the accounts.
- Expenditure on income tax proceedings.

B. Interest:

- Interest on borrowed funds to pay of trading loss.
- Interest on purchase consideration due or on unpaid purchase price of plant and machinery.
- Interest on funds borrowed to pay advance tax.
- Interest on arrear tax payable under the Sales Tax Act.
- Interest on loan taken to pay purchase tax.
- Interest for delayed payment under the employees ' Provident Funds Act'.
- Interest on arrear of tax under U.P Sugarcane Purchase Tax Act.

C. Brokerage and Commission:

- Commission paid to selling agents.
- Commission paid for procuring business contracts.
- Brokerage paid for sale of old plant.
- Brokerage paid in connection with the lease of business premises.
- Commission paid to bank in respect of guarantee for payment of purchase consideration of assets.

D. Fines, penalties , damages, compensation, etc :

Fines and penalties for illegal activities or for infraction of law cannot be claimed as deduction. However, penalties, damages, etc, which are compensatory in nature and paid for breach of contract are allowable, provided that these are paid by the assessee in his character as a trader. Some instances of expenses covered under these category are as follows:

- Penalty for delay in payment of Sales Tax.
- Demurrage paid to port or railway authorities for delay in clearing goods.
- Compensation for breach of contract.

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- Penalties/Compensation paid for delay in executing contracts.
- Penalty for not producing or exporting a stipulated quantity of goods.
- Penalty/ Compensation paid by building contractor for deviation from the original building plan.

E. Compensation/Payment to employees and outsiders:

- Payment made to get rid of an employee.
- Gratuity paid to widow of a director in accordance with the companies articles of association.
- Compensation paid to workers at a time of closure of some units. (not the whole business)
- Retrenchment compensation paid to employees on the ground of commercial expediency.
- Ex-gratia/pension paid to dependents of former employees.

F. Taxes :

- Tax on business or profession levied by local authority.
- Purchase tax on goods.
- Profession tax levied by the state.

G. Ceremonial expenses, gift donation and contribution:

- Expenditure on celebration of annual day.
- Expenditure incurred on the inauguration ceremony of the factory.
- Gifts made on the occasion of marriage of relatives of the employees.
- Contribution made to the trade association with a view to prevent uneconomic competition.

H. Expenses allowed under specific instruction of C.B.D.T:

- Diwali and Mahurat expenses.
- Expenditure on replacement of fluorescent tubes.
- Deposit under Tatkal Telephone Deposit Scheme.
- Legal charges for renewal of lease where the duration of the lease is for less than 50 years.
- Advertisement expenses, other than those prohibited under Section 37(2B).

I. Miscellaneous expenses :

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- Expenditure on registration of trademark.
- Lump sum paid to an employee in commutation of annual pension.
- Legal charges for obtaining loans from financial institutions.
- Expenditure on foreign trip by a medical practitioner on attending conference.
- Expenditure on foreign trip by directors of a company for promotion of the business.
- Fees paid for revaluation of fixed assets.
- Commission paid to general manager as a percentage of net profit.
- Expenditure incurred on stamp duty, registration fees, legal costs, lawyer's fees in connection with lease of property and issue of debentures.
- Expenditure on propaganda to oppose nationalisation of business.
- Donation to government sponsored relief funds with a view to obtain export permits.
- Legal charges for amending memorandum and articles of association to facilitate company's trading operation.

19. A few instances of expenses **not allowed** under section 37(1)

A. Legal expenses / accountancy expenses:

- Legal expenses incurred by a company in increasing or decreasing its share capital.
- Legal expenses incurred in defending proceedings taken by some shareholders to restrain a company from declaring dividend.
- Legal expenses incurred in defending the assessee from criminal prosecution.
- Legal expenses incurred in resisting appointment of a government inspector to report the affairs of the assessee.
- Legal charges, brokerage, commission, in connection with the issue of the preference shares.
- Legal expenses incurred in connection with acquisition of capital assets.
- Charges paid to an accountant in connection with floatation of a company.

B. Interests:

- Interest paid for delay in payment of income tax.
- Interest on funds borrowed for payment of income tax.
- Interest on fund borrowed for donation.
- Interest on overdraft for payment of income tax.

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- Interest on borrowed fund which is utilised for the for personal purpose of the assessee.

C. Brokerage and commission:

- Secret commission paid to promote business.
- Brokerage and commission in connection with the issue of preference shares.
- Brokerage paid on sale of shares held by a company as investment and not as stock-in-trade.

D. Fines, penalties, damages, compensation, etc:

- Fine paid for infringement under the Factories act.
- Penalty for non-payment of sales tax within prescribed time.
- Penalty paid for delay in filing sales tax returns.
- Penalty paid for infraction of law, e.g., breach of customs.
- Fine paid for delay in payment of contribution to Employee's Provident Fund.
- Compensation paid for cancellation of a contract to buy capital assets.
- Penalty for default in payment of municipal taxes.

E. Taxes:

- Income tax and wealth tax.
- Tax paid on behalf of a non-resident assessee, which ultimately could not be removed.
- Surcharge paid on tax.

F. Compensation/payment to employees:

- Voluntary pension and lump sum payments made by a company to its employees on its winding up.
- Retrenchment compensation to the employees on transfer or closure of the entire business.

G. Ceremonial expenses, gifts, donation:

- Donation for flood relief in areas where the assessee has its office.
- Expenditure incurred for puja and dinner to workers on the last day of the working

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sessions.

- Donation for the purpose of charity.
- Donation to political party if there are no links between such donation and business of the assessee.
- Donation to refugee relief project if there are no links between such donation and business of the assessee.

H. Miscellaneous expenses:

- Non-recovery of house-building loans to the employees.
- Expenditure incurred to launch a new project.
- Expenditure on shifting factory/registered office to new location due to locational advantage.
- Expenditure for raising new shares/redeemable preference shares.
- Liability arising out of failure to deduct tax at source from the salary of the employees.
- Expenses paid for acquiring a concern or goodwill.
- Payment to a tenant to induce him to vacate.
- Premium paid by a leasee for the grant of a renewal of lease.
- Expenditure incurred in completing imperfect title to a capital assets.
- Expenditure incurred to buy off or elimination of competition.
- Discount on issue of shares.
- Provision in respect of a contingent liability.
- Amount paid for the acquisition of a monopoly right to manufacture a product.