

CHAPTER – PROFITS AND GAINS OF BUSINESS OR PROFESSION - I

- ❖ **BUSINESS**:- Business simply means any economic activity carried on for earning profits. Section 2(13) has defined the term as “any trade, commerce, manufacture or any adventure or concern in the nature of trade, commerce and manufacture”. In the words of Justice S.R. Dass, “The word ‘business’ connotes some real, substantive and systematic or organised course, activity or conduct with a set purpose”.

- ❖ **PROFESSION {SECTION 2(36)}**:- A profession is an occupation requiring purely intellectual skill or manual skill controlled by the intellectual skill of the operator, e.g., lawyer, accountant, engineer, surgeon, author etc. So profession refers to those activities where the livelihood is earned by the persons through their intellectual or manual skill. Under section 2(36) profession includes vocation.

- ❖ **DEDUCTION ALLOWED – GENERAL PRINCIPLES**:- Sections 30 to 37 of income tax act provide for the deductions to be allowed while computing profit under the head ‘Business or Profession’. There are numerous types of expenses varying from business to business and according to the nature of the unit. These are:
 1. Any expenditure incurred in consideration of commercial expediency and on the basis of the principles of ordinary commercial trading is allowed as deduction.
 2. Commercial expediency simply means the expenditure made by prudent man for the purpose of his business, in the best interest of his business or any other expenditure incurred totally, and exclusively for the purpose of the business.
 3. Any other expenditure which was incurred in the carrying on of the business or profession and is incidental to such business or profession.
 4. Only those expenses are allowed which are not prohibited, expressed or implied.
 5. In the case of a new business, accounting year commences on the date when the business set up. Expenditure incurred prior to setting up cannot be allowed as it falls outside the accounting year. So deductions are made regarding those expenses only which are incurred in the relevant accounting year. Each accounting year is separate and distinct one.
 6. Deduction is to be made from the business for which the expenses were made. In case of more than one business, the expenses of one cannot be charged from the other in any case.
 7. The expenditure of a business which was discontinued before the commencement of the accounting year cannot be charged from the existing business. A general rule in such cases is that the expenses of a dead business become capital loss.
 8. In case of a single transaction all expenses are allowed whether incurred in that accounting year or earlier to that.
 9. A partner is allowed a deduction from his share of income from the firm’s profit such expenses which he might have incurred in earning this partnership profit.

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10. Only expenses are allowed to be deducted while the loss of any type is not allowed without considered its nature.
11. Capital expenditure is not allowed.
12. Expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time but putting aside a money which may become expenditure on the happening of an event is not expenditure.
13. Deduction will be allowed in case of only those expenses which have been incurred for the purposes of the assessee's own business.
14. Any amount previously allowed as deduction, if the same is recovered, will be taxable in the year in which it is so recovered.
15. The onus of proof that a particular as a deduction falls upon the assessee.

EXPRESSLY ADMISSIBLE DEDUCTIONS {SECTION 30-36}

Rent, Rates, Taxes, Repairs and Insurance in the case of Building Premises {Section 30}

A deduction is allowed regarding rent, rates, taxes, repairs and insurance premium paid for the building premises where the assessee is carrying on his own business or profession.

(a) Rent

- i. The full amount of rent will be an admissible deduction in case the building premises are taken on rent.

(b) Repairs

The word 'repairs' here mean such repairs which are required to keep the building in the workable condition i.e., minor changes (replacements) due to wear and tear. Repairs are simply to keep the asset working. It should not result into any increase in the value, efficiency etc. of the asset. The word 'current repairs' shall not include any expenditure, which is of the nature of capital expenditure.

(c) Local taxes, etc.

Any sums paid on account of land revenue, local rates or municipal taxes in respect of the premises used for the assessee's business, if the assessee is the owner of the building, are allowed under this category, in case the building is or rent then such part of these expenses which the assessee is supposed to pay under the contract of rent entered between the landlord and assessee are also allowed.

(d) Insurance Premium

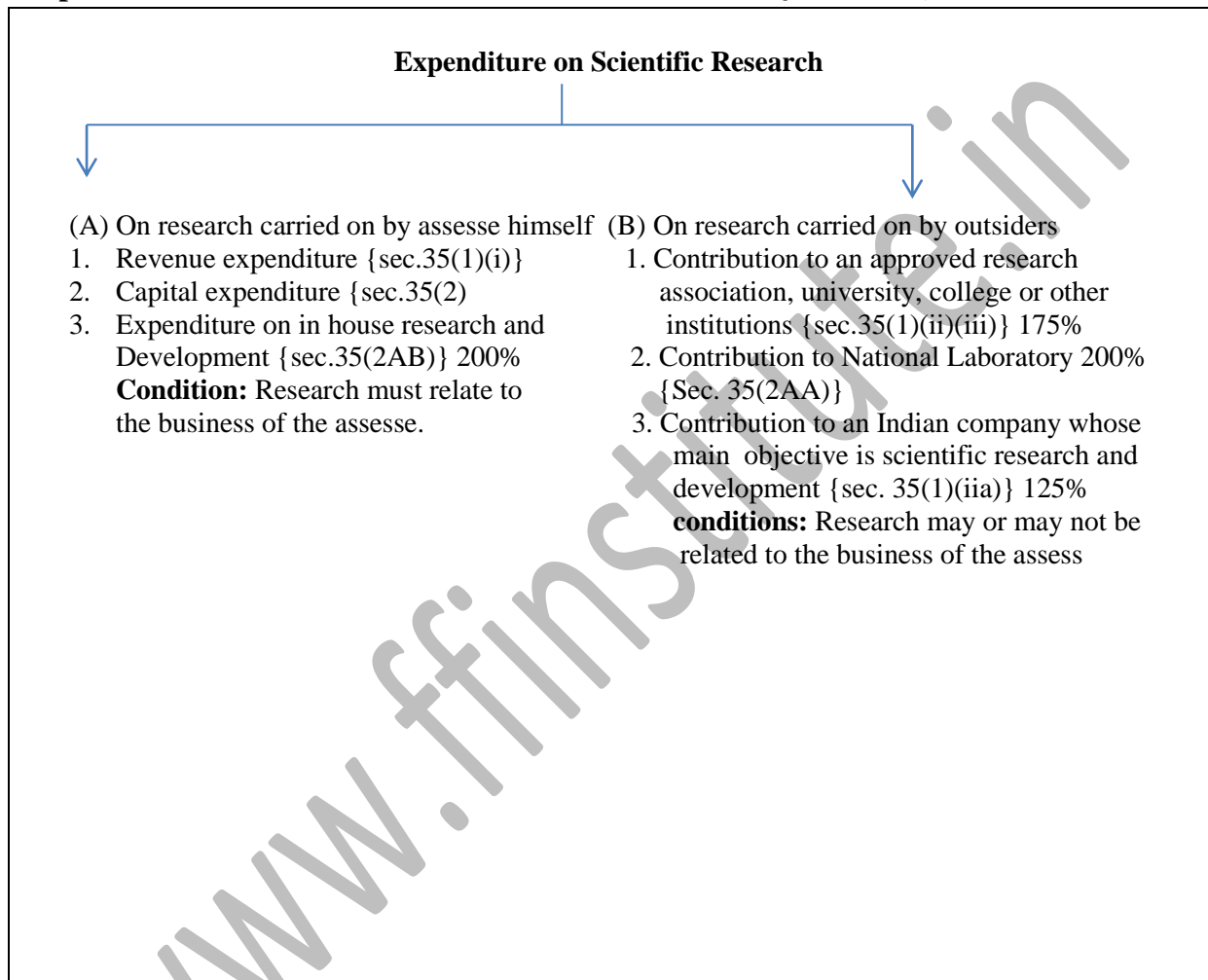
The amount of any premium paid is allowed as expenditure. Where the assessee has sub-let a part of the premises, the deduction under Section 30 will be limited to the difference between the rent paid and the rent received from sub-letting.

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Repairs and Insurance of Machinery, Plant and Furniture {Section 31}

1. The amount on account of current repairs thereto;
2. The amount of any premium paid in respect of insurance against the risk of damage or destruction thereto.

Expenditure Incurred in the Field of Scientific Research {Section 35}



OTHER DEDUCTIONS {SECTION 36}

1. **Insurance Premium {Sec. 36(1)(i)}**. The amount of any insurance premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purpose of the business or profession (only cheque is allowed).
2. **Insurance Premium for cattle {Sec. 36(1)(ia)}**. The finance Act 1979 has introduced new sub-section (ia) under which any premium paid by a Federal Milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society is allowed.

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3. **Insurance Premium for employees {sec. 36(1)(ib)}**. The amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by the general insurance corporation of India and approved by the central government and any other insurer and approved by the insurance regulatory and development authority.
4. **Bonus or commission {sec. 36(1)(ii)}**.
The amount of bonus or commission paid should be reasonable with reference to:
 - a. The pay of the employee and conditions of his service;
 - b. The profit of the business or profession for the previous year in question; and
 - c. The general practice or local practice in similar business or profession.
5. **Interest on borrowed capital {sec. 36(1)(iii)}**. Any interest paid on borrowed capital is an allowable deduction. The borrowed capital must be used in business/profession of the assessee. The borrowing must, however, be genuine and not bogus.
6. **Deduction of discount on zero coupon bond {section 36(iia)}**
Meaning of zero coupon bond. (Section 2(48)). Zero coupon bond means a bond issued by any infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank on or after 1-6-2005.
Total discount for issuer = (Amount Payable on maturity/redemption) – (Amount received on issue)
Treatment of discount for the issuer. Such discount shall be allowed as deduction to the issuer on pro rata basis having regard to the period of life of such bond, calculated in the manner as may be prescribed.
7. **Contribution to Provident and superannuation fund {sec. 36(1)(iv)}**.
Important points
 - a. The above contribution shall be allowed as deduction to the employer subject to the provisions of section 42B i.e. the amount for any previous year must have been actually paid either during the same previous year or on before the due date of furnishing of return of income of that previous year.
 - b. Employer's contribution towards unrecognized provident fund shall not be allowed as deduction under this section. However, such contribution shall be allowed as deduction to employer u/s 37.
8. **Employer's contribution towards employee's pension scheme {section 36(A)(iva)}**. Employer's contribution upto 10% of employee's salary towards

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employee's pension scheme (as referred to in section 80CCD) shall be allowed as deduction. So in case employer contributes more than 10% of employee's salary, excess over 10% shall be disallowed.

Salary for this purpose shall include dearness allowance, if terms of employment so provide and commission on turnover.

Thus, salary = Basic salary + D.A. (Enters) + commission on turnover.

- 9. Loss of animals {sec. 36(1)(9vi)}.** If the animals are used in the business or profession of the assessee otherwise than as stock in trade and have died or become permanently useless for such purposes and any loss, suffered due to the death or becoming permanently useless for the unit, will be allowed as deduction.
- 10. Bad debts {sec. 36(1)(vii)}.** A deduction is allowed in respect of the debt of the business or profession which have actually become irrecoverable in the previous year.
Bad debts recovered {sec. 41 (4)}. If in any previous year, the debt becoming bad is written off and a deduction was claimed but if later on the same debt is recovered in full or in part thereof, the amount so recovered will be treated as the income of the year in which it is received or recovered.
- 11. Bad debts of banks, financial institution and industrial investment corporation etc. {sec. 36(1)(viii)}.**
- a. A scheduled bank or a non scheduled bank (excluding foreign banks) or a co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank) can create a reserve 7.5% of total income (i.e., before allowing deduction under this section and u/s 80) and 10% of aggregate average advances made by the rural branches of such bank.
 - b. A foreign bank can create reserve upto a maximum of 5% of total income computed.
 - c. A public financial institution, or a state financial corporation or state industrial investment corporation may create reserve upto a maximum of 5% of total income.
 - d. Non banking financial companies are also allowed a deduction for provision for bad and doubtful debts to the extent of 5% of their income while calculating their total income.
- 12. Expenditure on family planning {section 36(1)(ix)}.** The company assessee are allowed a deduction in respect of the bona fide revenue expenditure incurred by them for the purpose of promoting family planning amongst its employees.
The employees will be spread over a period of five years and every year one instalment will be allowed as deduction beginning from the previous year in which expenditure was incurred.

Important points

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1. No depreciation u/s 32 shall be allowed on capital expenditure incurred/capital asset acquired to promote family planning amongst employees.
2. Expenditure on family planning incurred by a non corporate assessee (i.e. individual, HUF, firm etc.) is not allowed as deduction u/s 36(1)(ix).

IN THE CASE OF ANY ASSESSEE U/S 40(a)

1. Any interest, commission or brokerage, fees for professional services or fees for technical services payable:
 - a. Outside India;
 - b. In India to a non-resident not being a company; or
 - c. To a foreign company.

On which tax is deductible at source but has not been deducted before the end of the previous year or, after deduction, has not been paid to the government before the due date specified u/s 139(1) it shall be allowed to be debited.

2. Any sum payable to a resident on which tax is deductible at source under chapter XVII B (i.e. under section 192 to 194 LA but has not been deducted during the previous year or after deduction has not been paid on or before the due date specified u/s 139(1), 30% of such sum shall not be allowed to be debited in the previous year in which the expense is incurred.
3. Any consideration paid or payable to a non resident for a specified service on which equalization levy is deductible under the previous of Chapter VIII of the finance act 2016, and such levy has not been deducted or after deduction, has not been paid on or after the due date specified in section 139(1), such sum shall be allowed to be debited in the previous year in which the expense is incurred.

PAYMENTS TO RELATIVES:- Under section 40A (2), payments made or to be made to the persons or associate concerns of the assessee may be disallowed, if in the opinion of the assessing officer, such payments are considered to be excessive or unreasonable. If any portion of such payment is excessive or unreasonable, then that portion is to be disallowed.

PROVISION FOR THE PAYMENT OF GRATUITY – u/s40A(7):- With effect from 1-4-2000, no assessee shall be allowed a deduction in respect of any provisions made for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.

DEDUCTION OF CERTAIN PAYMENTS ONLY IF ACTUALLY PAID (SECTION 43B)

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Any payment of sales tax, employer's contribution to any provident fund, superannuation fund or gratuity fund, or any other fund for the welfare of employees will be allowed only in computing the income of that previous year in which such sum is actually paid by him. In case a deduction has already been claimed on accrual basis in any earlier previous year. It will not be allowed again in the year in which it is actually paid.

These payments are:

- a. Any sum payable by the assessee by way of tax, duty, cess or fee by whatever name called, under any law for the time being in force.
- b. Any sum payable by the assessee as an employer by way of contribution of any provident fund, or superannuation fund or gratuity fund or any other for the welfare of employees.
- c. Any sum referred to in clause (ii) of sub section (1) of section 36, i.e., bonus or commission payable to employees.
- d. Any sum payable by assessee as interest or any loan or borrowing from public financial institutions or state financial corporation or a state industrial investment corporation in accordance with the terms and conditions governing such loans or borrowing.
Deduction regarding these payments shall be allowed if such payments are actually made before filing of return u/s 139(1).
- e. Any sum payable by the assessee as interest or any term loan from a scheduled bank in accordance with the terms and conditions of the agreements governing such loan.
- f. Any amount payable by the assessee as an employer in lieu of any leave at the credit of employee shall be allowed to be debited only if it is made in accordance with the provisions of section 43B.
- g. Any sum payable by the assessee to the Indian Railways for the use of railway assets.
In case deduction for the above mentioned amount has already been claimed upto previous year ending on 31st March 2001, the same will not be considered for the deduction in the year in which it is actually paid. {section 43B Explanation 3B}