

MCOM SEM 1

FINANCIAL & MANAGEMENT ACCOUNTING PAPER -3

PROFITS & GAINS OF BUSINESS OR PROFESSION

❖ The Five Heads of Income Under the Income Tax Act, 1961 are:

1. Income from salary
2. Income from House Property
3. Income from business OR profession
4. Income from Capital gains
5. Income from other sources.

❖ Definition of **BUSINESS**:

According to Section 2(13) of the Income Tax Act, 1961, 'business' includes any trade, commerce, or manufacturing activity or any adventure or concern like trade, commerce, or manufacture. Essentially, it covers any activity carried out with the intent of earning a profit.

❖ Definition of **Profession**:

According to Section 2(36) Profession: Profession means the activities for earning a livelihood which require intellectual skill or manual skill, e.g., the work of a lawyer, doctor, auditor, engineer, and so on, are in the nature of a profession. Profession includes vocation.

❖ **COMPUTATION OF BUSINESS PROFITS:**

For the computation of Business Profits, the Profit and Loss Account serves as the basis. The Profit and Loss Account shows certain expenses and losses that are either fully or partly disallowed under the provisions of the Income Tax Act. On the credited side, there are certain income s which are either Tax-Free or are not Taxable under this head. The following table can help a person to compute the business income of an assessee:

PROFORMA FOR COMPUTATION OF INCOME UNDER THE HEAD “PROFITS AND GAINS OF BUSINESS OR PROFESSION”

PARTICULAR	RS.	RS.
Net Profit /loss as per the statement of profit & loss		-----
I. Add Expenses claimed but not allowed under the Act		
1. All provisions and reserves (Reserve for bad debts/Depreciation/Income	-----	
2. All Taxes (i.e., Income Tax, Advance Income Tax, Wealth Tax, etc.) except Sales Tax, Excise Duty, and Local Taxes of premises used for business.	-----	
3. Rent paid to self	-----	
4. All Capital Expenses except scientific research	-----	
5. All Capital Losses	-----	
6. All Charities and Donations	-----	
7. All expenses relating to other heads of income (e.g., Taxes on House Property, etc.)	-----	
8. Any Interest on Capital unless the amount is borrowed.	-----	
9. All Personal Expenses (Drawing, etc.)	-----	
10. Gifts and presents (not advertisements)	-----	
11. Any type of Fine or Penalty	-----	
12. Any payment to a Partner (In case of firms, only by way of Salary, Interest, Bonus, Commission, or remuneration in excess of the prescribed limits)	-----	
13. Past Losses (i.e., Loss of the past year)	-----	
14. Salary paid to self or any other member of the family for casual help	-----	
15. Personal Life Insurance Premiums	-----	
16. Any amount invested in Savings such as NSS, NSC, PPF, etc.	-----	

17. Rent for residential portion	-----	
18. Speculation Loss	-----	
19. Bad Debt is still recoverable	-----	
20. Legal Expenses	-----	
21. Loss by theft from residence	-----	
22. Expenses on Illegal Business	-----	
23. Difference in Trial Balance	-----	-----
The total of these items is added to the Profit or is adjusted out of the Loss. (A)		=====
II. Deduct [out of the amount arrived at (A) above any Expenditure which is allowable under the Act but has not been debited to P & L A/c.		
1. Actual Bad Debt (not charged in P & L A/c.)	-----	
2. Depreciation (do)	-----	
3. Any other Expenditure incurred according to the provision of law	-----	(-----)
The total of these is deducted from (A) above, and we get (B)		=====
III. Deduct [out of the amount arrived at (B) above any Income which is either Exempt or not Taxable under this head		
<u>(a) Incomes Exempted from Tax:</u>		
1. Post Office Savings Bank Interest	-----	
2. Agricultural Receipts	-----	
3. Gifts from Relatives	-----	
4. Income Tax Refund	-----	
5. Bad Debt Recovered disallowed earlier	-----	
6. Life Insurance Maturity Amount	-----	
7. Any Capital Receipt	-----	
8. Withdrawal from PPF	-----	
<u>(b) Incomes Taxable under Other Heads:</u>		
1. Part-time Salary	-----	
2. Interest on Securities	-----	
3. Rent from House Property Let	-----	
4. Capital Gains	-----	
5. Dividend, Bank Interest, winnings from Lotteries, race course	-----	(-----)
The total of these deducted from (B) above, and we get the Taxable Profit from the Business. (C)		=====
Add: Income from any other business (legal or illegal) to get income taxable under the head Profit & Gains of Business or Profession.		-----
PROFITS AND GAINS OF BUSINESS		=====

Simple Format for calculation of PGBP

Particular	Rs.	Rs
Net profit as per P&L A/c		*****
Add: Inadmissible Expenses		*****

Less: Inadmissible Income		*****

Add: Admissible Income		*****

Less: Admissible expenses		*****
PROFITS AND GAINS OF BUSINESS		*****

❖ **Expenses that are not allowed:**

Those expenses that are not related to business but are debited to P&L A/c will be added as invalid expenses to P&L A/c.

For Example: Drawing, Personal payments, Reserves or provision, salary-bonus-commission-interest on capital of owner, Excessive Depreciation, Expenses of other income head.

❖ **Incomes that are not allowed:**

Those incomes that are not related to business but are credited to the P&L account will be less, as they are considered invalid incomes to the P&L Account.

For Example: income from salary, Income from House Property, Income from Capital gains, Income from other sources, Income tax refund, and Bad Debts Returns.

❖ **RULES:**

1. If any amount is added to the debit side of the Profit and Loss (P&L) Account, then the profit will decrease.
2. If any amount is decreased from the debit side of the P&L A/c, then the profit will increase.
3. If any amount is added to the credit side of the Profit and Loss (P&L) Account, then the profit will increase.
4. If any amount is decreased from the credit side of the P&L A/c, then the profit will decrease.
5. Unrecorded expenses will be deducted from the profit.
6. Unrecorded incomes will be added to the profit.

❖ Only the earlier allowed bad debt recovered amount will be considered as business income; the additional amount will be deducted from the Profit and Loss Account (P&L A/c).

❖ Assessment year –2026-27

❖ Previous year – 2025-26

UNIT9 INCOME FROM PROFITS AND GAINS OF BUSINESS OR PROFESSION-I

Structure

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9.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of business, profession, and vocation
- understand the general principles for calculating business and professional income
- compute depreciation allowance

9.1 INTRODUCTION

Profit and gains of Business or Profession (also known as PGBP) is third head in computation of income apart from four incomes, namely, income from salary, income from house property, income from capital gains and income from other sources. This head is divided into 3 parts since it is one of the major heads compassing many provisions for computing business or professional income. In this unit, we will discuss about meaning of business or profession, basis of charge for charging income tax on such income, general guidelines for computing business income or professional income and special deductions allowed under this head including depreciation allowance in detail.

9.2 MEANING OF BUSINESS OR PROFESSION OR VOCATION

Section 2 (13) of Income Tax Act, defines **business** to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

This definition of business is inclusive definition and not an exhaustive one. The activities of rendering services to others also come under this apart from activities by way of trade, commerce or manufacture or activities in the exercise of a profession or vocation. One can't enter into business transactions with oneself.

Profession involves the idea of an occupation requiring purely intellectual skill or manual skill on the basis of some special learning or qualification.

Vocation refers to any activity done to earn the livelihood e.g. Agency work, story or play writer, brokerage, magic activities, robbery, music, dance etc.

Income under the head profits and gains of business or profession include income from business, profession and vocation. Therefore, this distinction is not material.

9.3 BASIS OF CHARGE

Under Section 28, the following incomes shall be chargeable to income tax under this head and income will be computed in accordance with the provisions laid down in Sections 29 to 44DB:

- Profits or gains of any business or profession
- Any compensation or other payments due to or received by any person specified in Section 28 (ii)
- Income derived by a trade, professional or similar association from specific services performed for its members
- The value of any benefit or perquisite, whether convertible into money or not, arising from business or exercise of a profession

- Any profit on the transfer of the Duty Entitlement Pass Book Scheme.
- Any profit on the transfer of the Duty Free Replenishment Certificate.
- Export incentives for exporters
- Any interest, salary, bonus, commission or remuneration received by partner from a firm
- Any sum received under Keyman Insurance Policy including Bonus
- Any sum received for not carrying out any activity in relation to any business or profession or not to share any know-how, patent, copy right, trademark etc.
- Any sum received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of expenditure on such capital asset has been allowed as a deduction under section 35AD.
- Income from speculative transaction

9.4 GENERAL PRINCIPLES FOR CALCULATING BUSINESS AND PROFESSION INCOME

Necessary conditions for income to be chargeable under head ‘Profits and Gains of Business and Profession’:

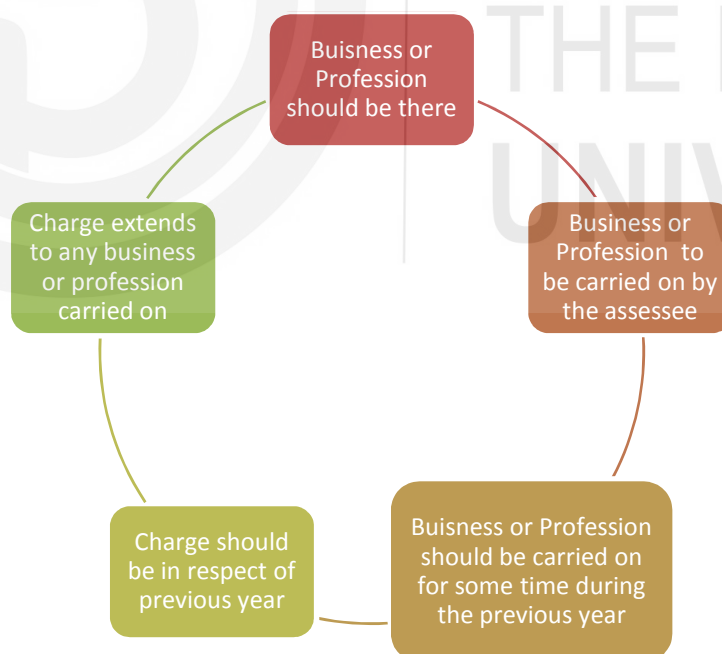


Fig. 9.1: Conditions for chargeable income under PGBP

- Business must be carried on during the previous year. Business may not necessary be carried out throughout the previous year or till the end of previous year. If assessee does not carry-on business at all, Section 28 shall not apply and the income so called cannot be assessed as Business income. However, there are exceptions to this rule and business though

not carried out by the assessee in the year of receipt, those receipts are still taxable as Income from business:

Table 9.1: Receipts taxable as income from business even when Business is not carried out by the assessee

Section	Income
41(1)	Recovery against any loss, expenditure or trading liability earlier allowed as deduction
41(2)	Balancing Charge in case of Electricity Companies
41(3)	Sale of Capital Asset used for scientific research
41(4)	Recovery against Bad Debts
41(4A)	Amount withdrawn from Special Reserve
176(3A),(4)	Receipt of Discontinued business under Cash system of Accounting

- **Business Loss:** A trading loss is deductible in computing the profit earned by the business if following conditions are satisfied:



Fig. 9.2: Conditions for deduction of Trading Loss

Table 9.2: Losses incidental to trade

Business Loss Deductible from income	Business Loss Not Deductible from income
<ul style="list-style-type: none"> ▪ Loss of Stock –in Trade due to enemy action, or arising under similar circumstances ▪ Loss of Stock-in trade because of destruction by God ▪ Loss on account of failure on the part of the assessee to accept delivery of goods ▪ Depreciation in funds kept in foreign currency for purchase of stock-in-trade ▪ Loss due to exchange rate fluctuations of foreign currency ▪ Loss arising from sale of securities held in the regular course of business. ▪ Loss of cash and securities in a banking company on account of dacoit. ▪ Loss incurred on realisation of amount advanced in connection with business. ▪ Loss of security deposit for the purpose of acquisition of stock-in-trade. ▪ Loss due to forfeiture of a deposit made by the assessee for properly carrying out the contract for supply of commodities. ▪ Loss on account of embezzlement by an employee. ▪ Loss incurred due to theft or burglary in factory premises. ▪ Loss of precious stones or watches of a dealer while bringing them from business premises to his house. ▪ Loss arising from negligence or dishonesty of employees. ▪ Loss incurred on account of insolvency of banker with which current account is maintained. ▪ Loss incurred due to freezing of the stock-in-trade by enemy action. 	<ul style="list-style-type: none"> ▪ Loss which is not incidental to trade or profession, carried on by the assessee. ▪ Loss incurred due to damage, destruction, etc. of capital asset. ▪ Loss incurred due to sale of shares held as investment. ▪ Loss of advances made for setting up of a new business which ultimately could not be started. ▪ Depreciation of funds kept in foreign currency for capital purposes. ▪ Loss arising from non-recovery of tax paid by an agent on behalf of the non-resident. ▪ Anticipated future losses. ▪ Provision made by the assessee in respect of non-performing assets. ▪ Loss relating to any business or profession discontinued before the commencement of previous year.

- Income of previous year is taxable during the following assessment year. There are, however, certain exceptions to this rule.
- There is no distinction between legal or illegal business. Therefore, profits from illegal business are taxable in a similar manner as legal business.
- Not only the legal ownership but beneficial ownership is also to be considered for Section 28.
- Anticipated profits or potential or notional profits are not considered for calculating taxable income under this head.
- The mode or system of bookkeeping cannot override the substantial character of a transaction.

Special cases where income from business is not taxable under ‘Profit and Gains of Business’:

Table 9.3: Cases where income from business is not taxable under ‘Profit and Gains of Business’

Income	Chargeability under Head
Rent from house Property	<ul style="list-style-type: none"> ▪ Income from Business of owning and letting out of residential houses is taxable under the head ‘Income from house property’. ▪ Residential houses let out to the employees for efficient conduct of assessee own business is taxable as business income.
Dividend Income	<ul style="list-style-type: none"> ▪ Assessee carrying on business in dealing in shares and securities and earn income by way of dividend, is taxable under ‘Income from other sources’
Winnings from Lotteries, races etc.	<ul style="list-style-type: none"> ▪ Winning from lotteries, races etc. is taxable under head ‘Income from other sources’, if it is derived as a regular business activity
Interest received on compensation or enhanced compensation	<ul style="list-style-type: none"> ▪ Interest is taxable under the head ‘Income from other sources’

9.5 COMPUTATION OF INCOME FROM BUSINESS OR PROFESSION

Section 29 states that profits and gains of business and profession which are chargeable to tax under Section 28 shall be computed in accordance with the provisions contained in Section 30 to 43 D including sections 44 to 44 D consisting of special provisions regarding computation of profits and deduction of expenditure in certain cases.

- General principles for allowing deduction:
 - a) Expenditure should have been incurred during the previous year.
 - b) Expenditure should be incurred for the purpose of business.
 - c) Expenditure done before in respect of setting up of business is not allowed.
 - d) No expenses in respect of discontinued business is allowed to be deducted.
 - e) Reserves/ provisions for contingencies/ anticipated losses cannot be claimed as a deduction.
 - f) No deduction is admissible in respect of diminution or exhaustion of the capital asset from which income is derived.
 - g) No deduction is allowed in respect of non-taxable business; like agricultural income in India is exempt.
 - h) No deduction is allowed in respect of depreciation of investment.
- Method of Accounting :
 - a) Income to be deducted either on the basis of cash or accrual system of accounting as followed or employed regularly by the assessee.[Section 145 (1)]
 - b) Central Government is empowered to notify income computation and disclosure standards. [Section 145 (2)]
 - c) Assessing Officer is empowered to make assessment in the manner provided in section 144 in certain special cases.[Section 145 (3)]
- Allowances under section 30 to 37 are cumulative and not alternative.
- Scheme of allowing business expenses:
 - Section 30 to 37 – Expenses expressly allowed
 - Section 40 – Expenses specifically disallowed
 - Section 40 A – Expenses or payments not deductible in certain cases

9.6 SPECIFIC DEDUCTIONS-I

Depending on the type of accounting system followed by assessee, expenses will be allowed or treated. If assessee follows cash basis, expenses will be treated to be paid only when they have been actually paid and on accrual basis, it will be treated as paid irrespective of whether they have been paid or not.

9.6.1 Rent, Rates, Taxes, Repair, and Insurance of Buildings [Section 30]

Expense	Treatment
Rent & Repairs	<ul style="list-style-type: none"> ▪ Rent & repairs of building is deductible ▪ Allowed only if assessee has occupied the property as a tenant ▪ Expenditure is not of capital nature

Municipal taxes/land revenue/ Other taxes	<ul style="list-style-type: none"> Taxes are deductible subjected to the provisions of section 43 B i.e. payment should be made actually during the previous year or till the due date of submission of return of income
Insurance	<ul style="list-style-type: none"> Insurance against risk of damage or destruction of the building is deductible.

9.6.2 Repair and Insurance of Machinery, Plant & Furniture [Section 31]

Expense	Treatment
Rent & Repairs	<ul style="list-style-type: none"> Rent & repairs of machinery, plant and furniture for business purpose is deductible Expenditure is not of capital nature

9.6.3 Depreciation [Section 32]

Depreciation is the diminution in the value of an asset due to normal wear and tear and due to obsolescence over the useful life of the asset.

Methods for calculating depreciation in financial accounting commonly used are:

- Straight line method (SLM)
- Written Down Value Method (WDV)

The method of claiming depreciation as expense is different in Income tax in comparison to financial accounting.

Different types of depreciation allowance which are allowed in Income tax are as follows:

- Normal depreciation (Block of Assets) – Section 32 (1) (ii)
- Additional depreciation in case of any eligible new machinery or plant (other than ship and Aircraft) – Section 32 (1) (ia)

Normal depreciation for an undertaking engaged in the business of generation or generation and distribution of power –Section 32 (1) (i)

Normal depreciation on written down value method is allowed in case of Block of assets whereas straight line method is used for calculating depreciation on every asset separately in case of undertaking engaged in the business of generation and distribution of power.

In first year of acquiring and installation of asset, additional/extra depreciation is allowed @ 20% or 35% of the cost of the eligible plant and machinery. This is allowed to be deducted in calculating written down value of the asset for next year.

9.6.3.1 General Principles for Depreciation Allowance

- Depreciation is allowed on:

Tangible Assets	Building, Machinery, Plant and furniture
Intangible Assets	Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature

- Plant may include any other asset as well.
- Depreciation is allowed to owner/co-owner of the asset only. Owner of the asset means who can exercise the right of the owner in his own right but not on the behalf of the owner. In case of lease, lessor is entitled to depreciation allowance whereas lessee is not allowed to claim the same. However, where an assessee carries on a business or profession in capacity of lessee and incurs capital expenditure on construction of any structure or any work in relation to the building by way of improvement, renovation or extension, he will be entitled to depreciation allowance.
- Asset may be owned partially or fully by the assessee.
- Depreciation is allowed if asset is used for the purpose of business or profession. Building given to the employee for residential purpose is considered to have been used wholly for the purpose of the employer's business. Similarly, fans, refrigerators, air-conditioners and furniture etc. provided by the employer at the residence of employees shall be considered to have been used wholly for the employer's business.
- Allowed on the basis of the actual cost to the owner.
- Allowed on block of assets
- Allowed on written down value method (in case of power generation undertaking, straight line method is used)
- Computed on written down value method of the asset as on the last day of the previous year
- The asset must have been used for the purpose of business during the relevant previous year. If asset is used for few days or few hours during the year, depreciation will be allowed for the whole year. In first year, however, in which asset is acquired, the asset should be used for at least 180 days to claim depreciation for whole year. If asset is put to use for less than 180 days, half year's depreciation is provided in the first year in which asset is acquired.

9.6.3.2 Block of Assets [Section 2 (11)]

Block of assets 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, licences, franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed.

Classes of Asset: There are four types of classes' i.e. Building, furniture, plant & machinery and intangible assets.

From assessment year 2018-19, maximum rate of depreciation has been fixed @ 40 %, thereby reducing the number of blocks from 12 to 10.

Table 9.4: Classes of Assets

Block Number	Nature of Asset	S. No of Block	Assets to be included in Block of Assets	Rate of Depreciation
1.	Building	Group 1	Building - for residential purposes except hotels and boarding houses.	5%
		Group 2	Buildings - other than covered in block 1 and 3 and not used mainly for residential purposes.	10%
		Group 3	Buildings - temporary erections such as wooden structures & building acquired on or after September 1, 2002 for installing Machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under section 80-IA (4) (i)	40%
2.	Furniture and Fittings	Group 4	Furniture – any furniture/fittings including electrical fittings	10%
3.	Machinery and Plant	Group 5	Plant & Machinery - any plant and machinery [not covered by block 6,7,8], motor cars (other than those used in a business of running them on hire) acquired or put to use on or after April 1 , 1990, oil wells	15%
		Group 6	Plant & Machinery – Ocean –going ships, vessels ordinarily operating on inland waters including speed boats	20%
		Group 7	Plant & Machinery – Buses, lorries and taxis used in the business of running them on hire, machinery used in semi-conductor industry, moulds used in rubber and plastic goods factories and lifesaving medical equipment	30%

		Group 8	<ul style="list-style-type: none"> • Aeroplanes – Aero engines • Commercial vehicles which is acquired by the assessee on or after 1.10.1998 but before 1.4.1999 and is put to use for any period before 1.4.1999 for the purpose of business or profession • Specified lifesaving medical equipment • Container made of glass or plastic used as re-fills • New Commercial vehicle which is acquired on or after 1.1.2009 but before 1.10.2009 and is put to use before 1.10.2009 for the purpose of business or profession • Computers including computer software • Books, (other than books (a) being annual publications, (b) books owned by assessee carrying on business in running lending libraries) • Gas cylinders including valves and regulators, direct fire glass melting furnaces, plant used in field operations by mineral oil concerns • Energy saving devices, renewal energy devices, rollers in flour mills, sugar works and steel industry • Air pollution control equipments, water pollution control equipments, solid waste control equipments, recycling and resource recovery systems 	40%
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**Income from House
Property & Profits
and Gains of Business
or Profession**

			<ul style="list-style-type: none"> • Wooden parts used in artificial silk manufacturing machinery • Cinematograph films – bulb of studio lights • Match Factories – Wooden match frames • Tubs, winding ropes, haulage ropes and sand stowing pipes, and safety lamps used in mines and quarries • Salt works – Salt pans, reservoirs and condensers etc. made of earthy, sandy or clayey material or any other similar material • Books owned by assessee carrying on a profession, being annual publications • Books owned by assessee carrying on business in running lending libraries • Air pollution control equipment, water pollution control equipment, solid waste control equipments, solid waste recycling and resource recovery system 	
		Group 9	Plant & Machinery-Motor lorries and motor taxi (used in a business of running them on hire) acquired on or after August 23, 2019 but before the April 1, 2020 and is put to use before April 1, 2020.	45%
4.	Intangible Assets	Group 10	Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25%

9.6.3.3 Block Formation & Calculation of Written Down Value of Asset for Charging Depreciation

Step 1

Formation of Block – One type of class of asset having same rate of depreciation will be grouped as one block. Once block is formed, determine the written down value of the entire block at the beginning of the previous year which will be written down value of that block of assets in the immediately preceding previous year less depreciation allowed in respect of that block of assets in relation to the said preceding previous year.

Step 2

Add: Actual cost of any asset falling within the block, acquired during the previous year.

Step 3

Less: Deduct money received/receivable (together with scrap value) in respect of the asset of the same block, which is sold or discarded or demolished or destroyed during the previous year.

Step 3 cannot be more than the sum of step 1 and step 2

Step 4

Final Figure: The figure arrived at will be written down value of the block at the end of the year for the purpose of charging current year's depreciation.

Illustration 1

Classify the assets into different blocks of assets:

Asset	WDV (Rs)	Rate of Depreciation
Building A	2,40,000	10%
Building B	5,60,000	5%
Building C	4,00,000	10%
Building D	1,25,000	5%
Building E	6,75,000	40%
Building F & G	10,00,000	10%
Plant A and B	1,45,000	15%
Machinery C,D and F	8,45,250	30%
Car –B	8,30,000	15%
Furniture and Fixtures	1,50,000	10%

Solution:

Block – Building

Block 1 (5%)	Rs.
Building B	5,60,000
Building D	<u>1,25,000</u>
Total	<u>6,85,000</u>

Block 2 (10%)

Building A	2,40,000
Building C	4,00,000
Building F & G	<u>10,00,000</u>
Total	<u>16,40,000</u>

Block 3 (40%)

Building E	<u>6,75,000</u>
Total	<u>6,75,000</u>

Block – Furniture & Fixtures

Block 1 (10%)

Furniture & Fixtures	<u>1,50,000</u>
Total	<u>1,50,000</u>

Block – Plant and machinery

Block 1 (15%)

Plant A and B	1,45,000
Car –B	<u>8,30,000</u>
Total	<u>9,75,000</u>

Block 2 (30%)

Machinery C, D &F	<u>8,45,250</u>
Total	<u>8,45,250</u>

Illustration 2

Depreciated value of the block of assets of Dhruv Private Ltd (consisting of machinery A, B and C) on 01/04/2022 is Rs.25,00,000. Addition of machinery D was done on 01/09/2022 for Rs.3,00,000 and this machinery was put to use on 08/09/2022. Cost of machinery E purchased on 24/12/2022 was Rs.5,00,000. Machinery A which was originally purchased on 01/04/2005 for Rs.1,80,000, was sold on 03/03/2023 for Rs.25,00,000. Assuming that the rate of depreciation on machinery was 15%, find out the admissible depreciation for the assessment year 2023-24.

Solution:

Block: Machinery (15%)	Rs.
Written down value of block as on 01/04/2022	25,00,000
Add: Additions during the previous year:	
Machinery D	3,00,000
Machinery E(for less than 180 days)	<u>5,00,000</u>
	<u>8,00,000</u>
	33,00,000

Less: Asset sold during the previous year:

Machinery A 25,00,000

Written down value as on 31/03/2023 8,00,000

Depreciation:

On Rs 5,00,000 × 7.5% (Half of 50% of normal rates) 37,500

On (Rs 8,00,000-Rs 5,00,000) = 3,00,000 × 15% 45,000

Total admissible depreciation **82,500**

9.6.3.4 Computation of Depreciation Allowance

Depreciation allowance is of two kinds – Normal and Additional Depreciation.

Calculation of Normal Depreciation

Step 1

Calculate written down value of each block on the last day of previous year

Step 2

On the calculated value, compute depreciation at the rate prescribed for each block

OR

Depreciation Allowance = Written down value on last day × Rate of depreciation

However, there are certain exceptions to this rule:

- a) If WDV of the block of asset is reduced to 0, though block is still exist
- b) If block of asset is empty or ceases to exist on last day of the previous year (WDV is not zero)
- c) Imported Cars
- d) If in first year of acquisition, asset is put to use for less than 180 days
- e) In case of amalgamation, succession, business re-organization or de-merger

Illustration 3

Mr Kumar owns following machines on 01/04/2022

Machine	WDV as on 01/04/2022 (Rs.)	Rate of Depreciation
Machine X	2,10,000	15%
Machine Y	3,28,000	15%
Machine Z	2,52,000	15%

He purchased a new machinery (A) for Rs 1,80,000 on 25/12/2022 and sold machine (Y) and machine (Z) on 25/03/2023 for consideration of Rs. 3,60,000 and Rs. 2,00,000 respectively.

Compute the depreciation for the assessment year 2023-24

Solution:

Block of Machine (15%)

WDV of the block as on 01/04/2022	Rs.	Rs.
(Rs 2,10,000 + Rs 3,28,000+ Rs 2.52,000)		7,90,000
Add: Machine (A) purchased during the year	<u>1,80,000</u>	9,70,000
Less: Sale proceeds of Machine (Y) and Machine (Z) (Rs 3,60,000 + Rs 2,00,000)		<u>5,60,000</u>
WDV of this block as on 31/03/2023		4,10,000

Less: Depreciation:

@7.5% on Rs 1,80,000	13,500	
@ 15% on (Rs 4,10,000 –Rs 1,80,000) = Rs 2,30,000	<u>34,500</u>	<u>48,000</u>

WDV of block as on 01/04/2023

3,62,000

Important Point:

If written down value of the block of asset at the end of the year falls less than the value of asset which is acquired during the year and put to use for less than 180 days due to other assets being sold in that block, in that case, depreciation will be charged @ 50% of normal rate of depreciation on the entire written down value of that block at the end of the year, provided that said asset exists in that block.

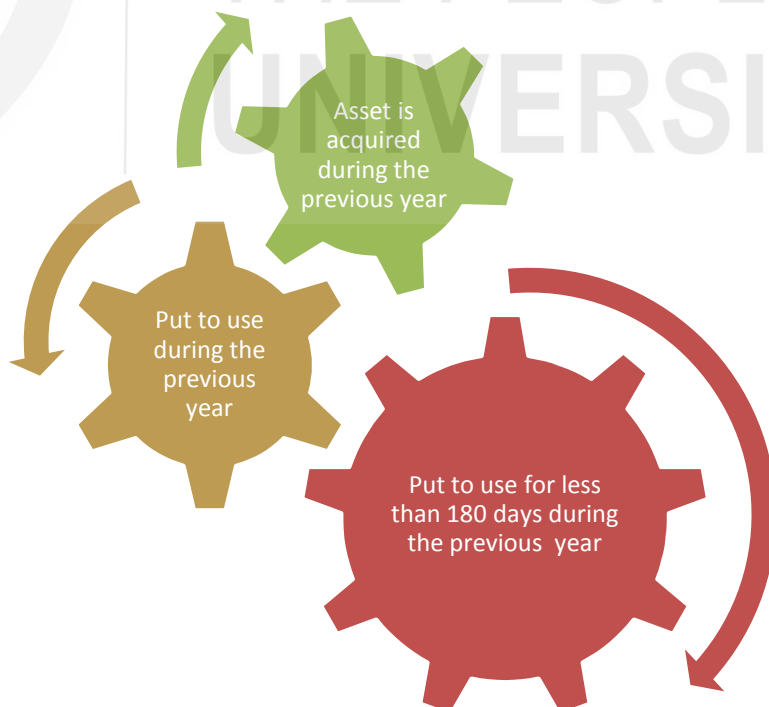


Fig. 9.3: Depreciation on written down value of the block

Illustration 4

Compute depreciation as directed in different cases:

Particulars	Case 1	Case 2	Case 3
WDV as on 1.4.2022	Rs.3,00,000	Rs. 3,00,000	Rs. 3,00,000
Asset	Machinery A & B	Plant X and Y	Plant B and Z
Rate of Depreciation	15%	15%	15%
Addition during year	Machinery C	Plant Z	Plant D
Date	2.11.2022	2.11.2022	2.11.2022
Cost of asset	Rs. 1,50,000	Rs.1,50,000	Rs.1,50,000
Sold During year	Machine C	Plant X	Plant B and Z
Money Received	Rs. 2,00,000	Rs. 2,00,000	Rs. 2,00,000

Solution:

(Rs.)

	Case 1	Case 2	Case 3
WDV as on 1.04.2022	3,00,000	3,00,000	3,00,000
(+) Addition during the year	1,50,000	1,50,000	1,50,000
(-) Sold during the year	2,00,000	2,00,000	2,00,000
WDV as on 31.03.2023	2,50,000	2,50,000	2,50,000
Depreciation calculation	2,50,000 @ 15% = 37,500	1,50,000 @ 7.5% + 1,00,000 @ 15% = 11,250 + 15,000 = 26,250	1,50,000 @ 7.5% + 1,00,000 @ 15% = 11,250 + 15,000 = 26,250 (Although Plant D only exists in the block which costs Rs.1,50,000 but depreciation on rest written down value of block i.e. Rs.1,00,000 will be allowed @ 15% as block still exists)

Note:

In the previous year, if the asset is used for less than 180 days, 50% depreciation of normal rates is allowed.

9.6.3.5 Cases Where WDV of a Block at the End of the Year Shall Be Reduced To Nil

Case A

All assets in the block are transferred i.e., block ceases to exist

Table 9.5: Cases where block ceases to exist

Situation 1	Situation 2
Sale price of all assets > WDV + Asset purchased during the previous year = Short term capital gain	Sale price of all assets < WDV + Asset purchased during the previous year = Short term capital loss
No Depreciation will be allowed since block ceases to exist	No Depreciation will be allowed since block ceases to exist

Illustration 5

Compute short term gain/loss in different situations:

Rs.

	Situation 1	Situation 2	Situation 3	Situation 4
WDV as on 1.4.2022	4,00,000	4,00,000	2,50,000	2,50,000
Addition during year	3,50,000	3,50,000	1,00,000	1,00,000
Sale value of block (all assets)	9,50,000	4,00,000	3,00,000	5,00,000

Solution:

No Depreciation will be allowed since all assets of the block have been transferred

Rs.

	Situation 1	Situation 2	Situation 3	Situation 4
Sale value of block(all assets)	9,50,000	4,00,000	3,00,000	5,00,000
WDV as on 1.4.2022	(4,00,000)	(4,00,000)	(2,50,000)	(2,50,000)
Addition during year	(3,50,000)	(3,50,000)	(1,00,000)	(1,00,000)
Loss/Gain	2,00,000 (Short term Capital Gain)	(3,50,000) (Short term capital Loss)	(50,000) (Short term capital Loss)	1,50,000 (Short term Capital Gain)

Case B

Only a part of block is sold, and the sale price exceeds the value of the block

Sale price (including scrap value) of a part of block of asset $\geq$ WDV + Asset purchased during the previous year = Short term capital gain, if any and

WDV of the block will be nil as certain assets still exist and no depreciation will be charged.

Illustration 6

Calculate WDV of the block and Depreciation allowance:

		Rs.
WDV as on 1.4.2022(4 assets)	4,00,000	4,00,000
Addition during year	3,50,000	3,50,000
Sale value of block (2 assets are sold)	8,00,000	7,50,000

Solution:

		Rs.
WDV as on 1.4.2022 (4 assets)	4,00,000	4,00,000
Addition during year	3,50,000	3,50,000
Sale value of block (2 assets are sold)	8,00,000	7,50,000
WDV as on 01.04.2023	50,000 (Short term Capital gain)	NIL

9.6.3.6 Depreciation Allowance for Special Cases

Case 1: Depreciation in case of Power Units [Section 32 (1) (i)] – An undertaking engaged in the business of generation or generation and distribution of power can use any one of the methods:

- a) **Straight line method** – In case of tangible assets at the percentage specified in Appendix IA to the Income tax rules on the actual cost of individual asset.
- b) **Written down value method** – Like any other assessee, option should be exercised before the due date of furnishing return of income. Once opted, it will apply to all subsequent years.

Case 2: Additional Depreciation on New Machinery or Plant [Section 32 (1) (i)] Condition for claiming additional depreciation (in addition to normal depreciation):

- Engaged in the manufacture or production of any article or thing or generation, transmission or distribution of power.
- New plant and machinery installed and acquired after 31st March, 2005– Few exceptions are there where assets are not eligible for additional depreciation:
 - a) Ships and aircraft
 - b) Any machinery or plant which, before its installation by the assessee, was used either within or outside India or any other person

- c) Any machinery or plant which is installed in any office premises, any residential accommodation, or in a guest house
 - d) Any office appliances or road transport vehicles
 - e) Any machinery or plant, which is eligible for 100% deduction in the first year
- Additional Depreciation @ 20% of the actual cost of asset acquired and installed after March 31, 2005. If asset is put to use for less than 180 days, then 10% depreciation shall be allowable and rest 10% shall be allowed in the immediately next year.
 - In case for acquisition of any depreciable asset in respect of which a payment (or aggregate of payments made to a person in a day), otherwise than by an account payee cheque/ draft or use of electronic clearing system through a bank account, exceeds Rs.10,000, such payment shall not be eligible for additional depreciation.
 - If new plant and machinery is acquired for setting an undertaking in notified backward area in Andhra Pradesh, Bihar, Telangana and West Bengal during April 1, 2015 to March 31, 2020, additional depreciation will be provided @ 35% instead of 20%. The rate will be half if machinery is used for less than 180 days i.e. 17.5% and rest 17.5% shall be allowed in the immediately next year.
 - Additional Depreciation shall be allowed to be deductible while computing WDV for the next year.

9.6.3.7 Unabsorbed Depreciation

- If during any previous year, the depreciation cannot be absorbed owing to no profits or gains from business or due to insufficient profits or gains during the relevant previous year, then it will be set off in the following sequence:
 - a) Current year's profits or gains as far as possible
 - b) Income from other heads (Except Income from salary)
 - c) If still left, then it will be allowed to carry forward to next year
 - d) In next year, the following sequence will be followed to set off unabsorbed

Depreciation of last previous years:

- i) Current Year's Depreciation
 - ii) Brought forward business loss
 - iii) Unabsorbed Depreciation of previous years
- Depreciation provision shall apply whether or not the assessee has claimed this deduction in computing total income.
 - Unabsorbed Depreciation can be carried forward for infinite time period.
 - Depreciation can be carried forward by the same assessee.

- Continuity of business is not relevant for set off and carry forward provisions.

Check Your Progress A

- 1) State whether the following statements are True or False
 - a) Decrease in the book value of the asset is called Devaluation
 - b) Depreciation is a capital loss
 - c) If an asset is used for less than 180 days, depreciation is charged at half rates of normal rates.
 - d) Land is depreciated.
- 2) Fill in the blanks:
 - a) The rate of charging depreciation on fully temporary wooden structure is
 - b) The rate of depreciation in case of intangible assets is
 - c) Depreciation is allowed on..... assets.
 - d) The assets used for less than 180 days shall be depreciated at half rates of.....rates.

9.6.3.8 Incentive for Acquisition and Installation of New Plant or Machinery in Notified Backward Areas in Certain States [Section 32 AD]

- Incentive – 15% of actual cost of new asset being eligible plant and machinery
- Conditions to be fulfilled –
 - a) Any company or non-company assessee engaged in the business of manufacture of an article or thing on or after 01.04.2015 in any backward notified area by Central Government in state of Andhra Pradesh, Bihar, Telangana and West Bengal.
 - b) Acquired and installed new assets on or after 01.04.2015 and installed on or before 31.03.2020
 - c) Company can claim both deduction under section 32 AC & 32 AD, if conditions are satisfied for both
- Deduction shall be allowed in the year of installation of new asset.

Check Your Progress B

- 1) Match the following:

Expenses as Deductions	Section
1) Depreciation Allowance	a) Sec 32 AD
2) Repair and insurance of Machinery	b) Sec 30
3) Rent, repairs and insurance for Building	c) Sec 32
4) Incentive for acquisition/installation of new plant by manufacturing company	d) Sec 31
5) Incentive for acquisition/installation of new plant in notified backward area by Central Government	e) Sec 32 AC

2) Fill in the blanks:

- a) Depreciation is allowable in case of _____ & _____ assets both.
- b) Where the entire block of asset is sold for a price less than opening WDV plus cost of asset acquired during the year, if any, the balance amount to be treated as _____.
- c) Where a part of the block of asset is sold for a price less than the opening WDV plus cost of asset acquired during the year, if any, the balance amount to be treated as _____.
- d) Unabsorbed depreciation which could not be set off in the same assessment year can be carried forward for _____.

9.7 LET US SUM UP

Income from profits and gains from business or profession being major third head is important component of income computation for tax purpose. Income under the head profit and gains of business or profession includes income from business, profession and vocation. Though there is distinction between three, this is not material as all are covered under single head 'Profits and gains from business and profession'. Section 28 of Income tax Act enumerates the income that shall be chargeable under this head and income will be computed in accordance with the provisions laid down in Section 29 to 44DB. Various expenditures have been allowed under the Act while computing income as deductions. Sections 30 to 37 discuss about expressly allowed expenses as deduction whereas Section 40 lists expenses which are specifically disallowed. There is another section which talks about expenses or payments which are not deductible in certain cases. Section 32 specifically explains the procedure of computing depreciation in income tax as calculating depreciation is way different in financial accounting. Section 32 AC provides special incentive for acquisition and installation of new plant or machinery by manufacturing company whereas Section 32 AD provides incentive to assessee engaged in the business of manufacture in notified backward areas by Central Government in states of Andhra Pradesh, Bihar, Telangana and West Bengal.

9.8 KEY WORDS

Business: Section 2 (13) defines business to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Profession: It involves the idea of an occupation requiring purely intellectual skill or manual skill based on some special learning or qualification.

Vocation: It refers to any activity done to earn the livelihood.

Depreciation: It is the diminution in the value of an asset due to normal wear and tear and due to obsolescence over the useful life of the asset.

Block of assets: It means a group of assets falling within a class of assets comprising tangible assets, being buildings, machinery, plant or furniture and

intangible assets, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

Classes of Asset: It includes four types of classes – Building, furniture, plant & machinery and intangible assets.

New Asset: It means any new plant or machinery but does not include ships and aircraft, any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person or any machinery or plant which is installed in any office premises, any residential accommodation, or in a guest house or any office appliances or road transport vehicles or any machinery or plant, which is eligible for 100% deduction in the first year.

9.9 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress A

- 1) a. False, b. false, c. True, d. False
- 2) a. 40%, b. 25%, c. Fixed, Normal

Check Your Progress B

- i) 1. c 2. d 3. b 4. e 5. a
- ii) (a) tangible & intangible (b) short term capital loss (c) WDV (d) infinite time.

9.10 TERMINAL QUESTIONS/EXERCISES

- 1) List any five incomes that shall be chargeable under head 'Profits and Gains of Business or profession'.
- 2) Explain necessary conditions for income to be chargeable under the head 'Profit and gains of Business or profession'.
- 3) State any five business losses which are not deductible from business income.
- 4) Explain special cases where income from business is not taxable under 'Profit and gains of Business or profession'.
- 5) Name specific deduction allowed under the Income Tax Act while calculating income from business or profession.
- 6) Explain general principles to be followed while calculating depreciation allowance.
- 7) What do you mean by Block of Assets? Explain various blocks in brief.
- 8) Write steps for calculating WDV of asset for charging depreciation.
- 9) Explain the provisions related to providing additional depreciation on new plant and machinery.
- 10) Calculate the depreciation for the AY 2023-24, on the basis of the information furnished by Mr Akash.

- a) The written down value of cars as on 01/04/2022 Rs 3,00,000
(The cars were purchased prior to 01/04/1990)
- b) Car purchased in December 2022 being manufactured in India
Rs 2,00,000 and used in business for taxi purpose
- c) Purchased car during the previous year manufactured abroad
Rs 1,50,000
- d) Purchased car manufactured in South Korea in July, 2019 and gave
Rs. 4,50,000 hire for tourists.
- e) The written down value of a motor taxi on 01/04/2022 Rs 60,000

[Answer: Rs 2, 50,500]

11) FROM the following information given by Goel Ltd., compute depreciation allowable as per Income Tax Act, 1961 for assessment year 2023-24.

- a) Written down value of plant and machinery on 01/04/2022 Rs 3,24,000
- b) Additions to plant made on 01/12/2022 to produce an article Rs 1,00,000
- c) Machinery purchased on 31/12/2022 for Rs 1,20,000 which could not be installed during the PY.
- d) Sale proceeds of the machinery which was originally purchased for Rs. 1,30,000 on 01/04/2020 for Rs 1,00,000
- e) Machinery destroyed in a fire happening on 30/03/2023.
Its original cost was Rs 50,000 purchased on 01/04/2021
The amount received from Insurance company Rs. 30,000
Rate of depreciation 15%

[Answer: 2,21,900]

Note: These questions and illustrations are helpful to understand this unit. Do efforts for writing the answers to these questions but do not send your answer to the University. It is only for your practice.