INCOME FROM BUSINESS/PROFESSION

Business is an activity of purchase and sell of goods with the intention of making profit. Profession is an occupation requiring intellectual skill. E.g. Doctor, Lawyer etc. Vocation is an activity, which requires a special skill, which is used to earn income. e.g. Painter, Singer etc. For income tax purpose there is no difference between business income, profession income and vocation income.

Section 2 (13) :

BUSINESS

" Business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

Profession :

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

ESSENTIAL FEATURES OF PROFITS FROM BUSINESS AND PROFESSION

1. Business or Profession carried on by assessee:
   It is must that business or profession must be carried out by assessee himself during the previous year.
2. Business or profession should have been carried on the previous year.
3. Aggregate income of different businesses is assessed to tax
4. Profits from speculation business are also taxed under the head income from business.
5. Income from previous year should be taxed for the current assessment year
6. The real profit i.e. the profit received or receivable during the previous year are taxed

<u>BUSINESS EXPENSES NOT TAXABLE UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS</u> :

1. Advertisement expenses incurred by an assessee on advertisement in any souvenir, magazine, pamphlet published by political party.
2. Interest, royalty, fees paid outside india without TDS shall be disallowed
3. Any amount of income tax, Arrears of income Tax or Advance income tax paid is disallowed
4. Wealth tax paid on the wealth of an assessee
5. Payment of provident fund paid outside India without TDS
6. Payment to a relative by way of salary, provident fund, or Interest
7. Any Expenditure paid in cash or through bearer cheque exceeding Rs. 20,000 will be disallowed
8. Capital expenditures
9. All types of provisions, reserves and fund
10. Drawing of proprietor
11. Personal expenses of proprietor

12. Fines and penalties
13. Past losses and provisions for lossess
14. Charity and Donation
15. Registration expenses of business assets
16. Legal expenses related to capital assets
17. Life insurance premium on the life of proprietor
18. Expenditures on raising capital
19. Expendture on shifting registered office
20. Gifts made on personal consideration

BUSINESS INCOME NOT TAXABLE UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS OR PROFESSION" :

In the following cases, income from trading or business is not taxable under Sec. 28, under the head "Profits and Gains of Business or Professions" :

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

BASIS OF CHARGE: SECTION 28

Under Section 28 following are the income chargeable to tax under the head Profits or Gains from Business or profession: -

1) Profits and Gains of any business or profession that is carried on by the assessee at any time during the previous year.

2) Any compensation or other payment due to or received by an assessee for loss of agency due to termination or modification of terms.

3) Income derived by a trade, professional or a similar association for specific services performed for its members.

4) Any profit on sale of a license granted under Imports (controls) Order 1955 made under Imports & Exports (control) Act of 1947.

5) Any cash assistance (by whatever name called) received or receivable against exports under any scheme of Government of India.

6) Any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duty's Drawback Rules 1971.

7) Any profit on the transfer of the Duty entitlement pass book scheme under export import policy. 8) Any profit on the transfer of the Duty free replenishment certificate under export import policy.

9) The value of any benefit or perquisite whether convertible into money or not arising from business or exercise of a profession e.g. A gift received by the lawyer from his client.

10) Any interest, salary, bonus, commission or remuneration due to or received by partner of a firm from such firm.

11) Sum received or receivable in cash or in kind under an agreement for not carrying out any activity in relation to any business or not sharing any know how, patent, copyright, trade mark, license franchise or any other business or commercial right of similar nature or information or technique likely to assist the manufacture or processing of goods or provision of services.

12) Any sum received including bonus under Keyman Insurance Policy.

13) 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 the expenditure on such capital asset has been allowed as a deduction under section 35AD. 14) Income from a speculative business.

DEDUCTIONS FOR EXPENSES SPECIFICALLY ALLOWED SECTION 30 TO SECTION 43D

1. Rent, rates, taxes, repairs and insurance of building (Section 30):

- If assessee has occupied the premises as a tenant, rent of the premises and if he has agreed to bear cost of repairs, such cost is allowed as deduction, provided it is not of capital nature.
- If assessee has occupied premises as the owner; repairs, land revenue, local taxes, insurance premium etc. are allowed as deduction. However, no expenditure in form of capital expenditure is allowed.

2. Repairs & Insurance of machinery, Plant & Furniture (Sec.31):

Amount paid on account of repairs and insurance premium against risk of damage in respect of machinery, plant & furniture are allowed as deduction provided they are not of capital nature.

3. Depreciation u/s 32:

Under Section 32 depreciation on assets is allowed as deduction while computing income from business or profession. To claim this deduction following conditions should be satisfied:

1) Assessee should be owner of the asset.

2) Asset must be used for the business.

3) Such use must be in the previous year.

Depreciation is allowed not on individual asset items, but on block of assets under following categories: -

1) Buildings

2) Plant & Machinery

3) Furniture

4) Intangible Assets acquired after March 31, 1998 such as know- how, Patents, Trademarks, licenses, franchises or any other business or commercial rights of similar nature.

The term plant includes ships, vehicles, books, scientific apparatus and surgical equipments used for the business but excludes tea bushes or live stock.

If any asset falling in block of assets is acquired during the year and put to use during the previous year for less than 180 days depreciation on such asset shall be restricted to 50% of the normal depreciation.

No depreciation is allowed on motor car which is manufactured outside India and acquired on or after 1st March 1975 but before 1st April 2001. However, this restriction does not apply if:

1) Assessee carries on a business of running the car on the hire for tourist, or

2) If assessee is using the car outside India for his business in another country. If business is carried on in a building not owned by the assessee but acquired on lease or any other occupancy right and any capital expenditure is incurred by him in respect of this building, such expenditure will be considered as cost of asset as if he is the owner of such property

Capital gain

Profit or gains on account of transfer of capital assets is known as capital gain. For income tax purpose the capital gains are classified into 2 types

- Long term capital gain
- Short term capital gain

Depreciation [Sec. 32]

Depreciation is the diminution in the value of an asset due to normal wear and tear or due to obsolescence. In order to allow depreciation as notional expenses in computing profits and gains of Business or Profession,

The following conditions are to be fulfilled;

(i) It is allowed only on Capital assets : It may be classified into two types.

(a) Tangible assets : Buildings, machinery, plant or furniture

(b) Intangible assets : Know-how, patents, copy rights, trademarks, licences, franchise or any other business or commercial right of similar nature acquired on or after 1st April, 1998.

(ii) Such asset should be owned, wholly or partly, by the assessee : Ownership does not necessarily mean legal ownership. Assessee will be treated as owner if he is capable of enjoying the right of the owner in respect of asset in his own right and not on behalf of the owner in whom title vests even though a formal deed of title has not been executed and registered (Mysore Minerals Ltd. vs. CIT[(1999) 239 ITR 775(SC)].

In case of a building in which Business or Profession is carried on is not owned by the assessee but he holds a lease or other right of occupancy though he is not entitled to depreciation on the building, depreciation is allowed on the capital expenditure incurred for the purposes of Business or Profession on construction of any structure or renovation etc.

(iii) Such asset should be used for purposes of Business or Profession.

(iv) It should be used during the relevant Previous Years.

Depreciation Mandatory Explanation 5 to Sec. 32 inserted by the Finance Act, 2001 w.e.f. 1.4.2002,

it is clarified that the depreciation provisions shall apply, whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income.

Block of Assets [Sec. 2(11) and Explanation 3 to Section 32]:

It means a group of assets falling within a class of assets comprising,

(i) Tangible assets : Buildings, machinery, plant or furniture;

(ii) Intangible assets : Know-how, patents, copyright, trademarks, licences, franchises or any other business or commercial rights of similar nature in respect of which same percentage of depreciation has been prescribed.

Aligning the definition of 'Block of Asset" [Explanation 3 to Section 32(1)] [W.e.f. A.Y. 2010-11]

The term "Block of Assets" has been defined in section 2(11) and in Explanation3 to section 32(1) of the Income-Tax Act. However, these definitions are not identical and therefore they are subject to misuse. Accordingly, Explanation of section 32(1) has been amended so as to delete the definition of "Block of Assets" provided therein. Consequently, "Block of Assets" will derive its meaning only from section 2(11) and Explanation 3 shall contain the meaning of assets which shall be applicable for electricity undertaking only.

Written Down Value [Sec. 43(6)]

(i) In case of assets acquired in the Previous Year, Written Down Value is the actual cost to the assessee.

(ii) In case of assets acquired before the Previous Year :- Written Down Value is the actual cost of the asset to the assessee as reduced by depreciation actually allowed to him in respect of such asset under this Act.

(iii) In case of any block of assets :

Written Down Value of the block of asset is computed as per the following mechanism.

Written Down Value at the beginning of the year	Xxx
Add: Actual cost of the assets purchased	Xxx
Less: Assets Sold/ Scraped/ Demolished/Destroyed during the previous year	Xxx
Written down Value at the End	xxx

Note : Written down value cannot be negative i.e. it shall be reduced to 'nil'

Meaning of Actual Cost

Actual cost to the Assessee XXX

- **Less: Subsidy/ Grant Received**
- **Add: Cost paid for acquiring the assets**
    - **Cost of installation**
    - Insurance
    - Freight
    - Loading and unloading
    - Repairs
    - Commission
    - Brokerage etc..

Rate of Depreciation for different 'Block of Asset':

Section 2(11) provides that it is not necessary that assets should be used for purpose of business during the year under consideration. The use of the asset is important for the purpose of actual alllowability of depreciation, but not for determining whether the asset falls within the block of assets or not.

A taxpayer may have different block of assets as given below

Block	Block of Assets	Rate of Depreciation
Block 1	Building- Residential building other than hotels and boarding houses	5%
Block 2	Building- Office, factory, godowns or buildings which are not mainly used for residential purpose (it cover hotels and boarding houses except cover under Block 3)	10%
Block 3	Buildings- The followings buildings: i. 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 80IA(4)(i). ii. temporary erection such as wooden structures	100
Block 4	Any furniture/ fitting including electrical fittings	10
Block 5	Any plant & machinery (except covered by Block 6, 7,8, 9, 10, 11 or 12) and 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	15%
Block 6	Ocean-going ships, vessels ordinarily operating on inland waters including speed boats	20%

Block 7	**Buses, lorries and taxies used in the business of running them on hire, machinery used in Semi-conductor industry, moulds used in rubber and plastic goods factories.**	**30%**
Block 8	**Aero planes- besides, it includes commercial vehicle which is acquired after September 30, 1998 but before April 1, 1999 and it is put to use for any period prior to April 1, 1999; life saving medical equipment**	**40%**
Block 9	**Containers made of glass or plastic used as refills and plant and machinery which satisfy conditions of rule 5(2) and the followingi. new commercial vehicle acquired during 2001-02 and put to use before March 31, 2002 for the purpose of business or profession; ii. machinery/plant used in weaving, processing and garment sector of textile industry which is purchase under Technology Upgradation Fund Scheme during April 1, 2001 and March 31, 2004 and put to use up to March 31, 2004; and iii. new commercial vehicle which is acquired during January 1, 2009 and September 30, 2009 and put to use before October 1, 2009 for the purpose of business or profession.**	**50%**
Block 10	**Computers including computer software. Besides, it includes new commercial vehicles acquired in replacement of condemned vehicle of 15 years of age and put to use before April 1, 1999 or put to use before April 1, 2000. It also includes books owned by a professional. It also includes gas cylinders; plant used in field operation by mineral oil concerns; direct fire glass melting furnaces**	**60%**
Block 11	**Energy saving device; renewal energy devices; rollers in flour mills, sugar works & steel industry.**	**80%**
Block 12	**Air pollution control equipments; water pollution control equipments; solid water control equipments; recycling and resource recovery systems;**	**100%**

	machinery acquired and installed on or after September 1, 2002 in a water supply project or water treatment system or for the purpose of providing infrastructure facilities; wooden parts used in artificial silk manufacturing machinery; cinematograph films, bulbs of studio lights; wooden match frames; some plants used in mines, quarries and salt works: and books carrying on business in running lending libraries	
Block 13	**Intangible assets- Know-how, patents, copyrights, trademarks, Licences, Franchises and any other business or commercial rights of similar nature**	**25%**

Rate of Depreciation

1. 1^{st} year of Acquisition
   Assets used 180 days or more---Full Rate of depreciation
   Assets used less than 180 days-----Half of the normal rate of depreciation
2. Subsequent Year------ Full Rate of Depreciation

Additional Depreciation :

Applicable
For assesses engaged in the business of manufacture or production of any article or thing or engaged in the business of generation or generation and distribution of power

Assets eligible for additional depreciation
Any new plant or machinery acquired and installed after 31.3.2005

Rate of Additional Depreciation
20% of the Actual Cost of Plant or Machinery

Note: If the newly acquired asset is “put to use” for a period of less than 180 days during the Previous Year, in which it is acquired, the rate of additional depreciation shall be provided at 50% of the normal rate = 50% × 20% = 10%

UNABSORBED DEPRECIATION [SEC. 32(2)]

When on account of insufficient profits of business or profession the full or a part of depreciation allowance can not be deducted, the balance of such allowance not so deducted is known as unabsorbed Depreciation

Unabsorbed depreciation shall be treated as part of the current year depreciation such unabsorbed depreciation can be set off not only against income under "Profits and Gains of Business or Profession" but also against income under any other head. Unabsorbed depreciation can be carried forward indefinitely and the business need not be continued in order to get the benefit of carry forward of unabsorbed depreciation.

Unabsorbed depreciation is adjusted as under

1. Un- absorbed depreciation can be set-off from the profits of other business or profession during the same year.
2. The profits of any other business or profession are unable to absorb the amount of depreciation, the same may be adjusted against the income under any other head of that year.
3. The balance if any can be forward to be set- off against the assessable incomes of subsequent years.

The following is the treatment of unabsorbed depreciation

Business Profits of the current year	XXX
Less: Current year Depreciation xx	
Less : B/F Business Loss	
Less : B/F Unabsorbed Depreciation	XXX
	XXX