Department of Commerce (CA)

CORE PAPER-X-DIRECT TAX

SEMESTER:IV **SUB CODE:18MCC41C**

M.COM(CA)

UNIT III: Computation of Profits and Gains of Business or Profession- income from capital gain.

REFERENCE BOOK:

- INCOME TAX LAW AND PRACTICE- GAUR AND NARANG
- DIRECT TAXES-B.B.LAL
- INCOME TAX LAW AND PRACTICE-DINKAR PAGARE
- INCOME TAX LAW AND PRACTICE -MALHOTRA

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INCOME FROM BUSINESS OR PROFESSION

The meaning of the expression 'Business, has been defined in Section 2(13) of the Income-tax Act. According to this definition, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

According to the generally accepted principles, the meaning of the term 'profession' involves the conceptof an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator.

Income chargeable to the head 'business or profession'.

The scope of income chargeable under the head 'Profits and Gains from business or Profession' is coveredby Section 28 of the Act which lays down that the following items of income must be charged to tax under this head:

1) **Income from business or profession**: The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.

2) **Compensations**:

a) Received on termination of a managing agency of Indian company.

b) Received on termination of a managing agency of foreign company

c) Received on termination of any agency or on modification of terms of agency,

d) Received from government or a corporation on taking over of management of property or business.

3) **Income from Trade associations**: Any income derived by a trade or professional or other similar association from the specific servicesperformed by it for its members.

4) **Export Incentives:**

- Profits on sale of a license granted under the Imports

• Cash assistance (by whatever name called) received or receivable by any person against exportsunder any scheme of the Government of India;

• Any duty of customs or excise re-paid or re-payable as drawback to any person against exports.

5) **The value of any benefit or perquisite**, whether convertible into money or not, which arises from thecarrying on of a business or the exercise of a profession.

6) **Any interest, salary, bonus, commission or remuneration**, by whatever name called, due to or receivedby a partner of a firm from such firm.

7) Any sum, whether received or receivable in cash or kind, under an agreement for –

(a) Not carrying out any activity in relation to any business or

(b) not sharing any know-how, patent, copyright, trade mark, license, franchise or any other businessor commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services:

8) **keyman Insurance Policy:**Any sum received under a keyman Insurance Policy including the sum allocated by way of bonus onsuch policy.

9) any sum, whether received or receivable, in **cash or kind, on account of any capital asset** (other thanland or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if thewhole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

Computation of income from Business or Profession

Format for Computation of Business or Profession Income :
Computation of Income from Business

Net Profit as per Profit & Loss Account *Add* : Expenses disallowed/Inadmissible Expenses [i.e. items already debited in P & L A/c but not eligible for deduction] *Less* : Incomes Credited in P & L A/c to be treated separately under different heads of income *Less* : Expenses (not debited to P & L A/c) allowed as per Provisions	----------- ----------- (-----------) (----------)

Income from business	---------

Computation of Income from Profession

Receipts relating to Profession (on Cash Basis) *Less* : Payment relating to profession (both cash and accrual basis)	--------- (--------)
Income from Profession	---------

Deductions allowable u/s: 30 to 36

Rent, Rates, Taxes, Repairs and Insurance for Buildings (Section 30)

2) **Repairs and Insurance of Machinery, Plant and Furniture** (Section 31)

3) Depreciation (Section 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 the following conditions are to be fulfilled;

i. There must be an asset.

a) Tangible- building, machinery, plant.etc

b) Intangible- patent, copyright, trademark etc

ii. Such asset should be owned, wholly or partly, by the assessee

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

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

Depreciation will be charged on the 'Written Down Value'(WDV) of the 'Block of assets'.

Block of Assets: It means a group of assets falling within a class of assets

Written down value of block of asset:

Calculation of WDV

Written Down Value of the block of assets at the beginning of the current Previous Year. Add: Actual cost of assets falling within that block, acquired during the Previous Year. Less: Moneys Payable and scrap value if any, in respect of asset sold/discarded/

demolished/destroyed during the Previous Year Written Down Value

Rate of depreciation for block of assets

Number	**Nature of Asset**	**Rate of depreciation .**
Block 1	Residential building other than hotels and boarding houses	**5%**
Block 2	Building- Office, factory, godowns or buildings which are not usedfor residential purpose	**10%**
Block 3	Buildings temporary erection such as wooden structures	**100%**
Block 4	Any furniture/ fitting including electrical fittings	**10%**
Block 5	Any plant & machinery and motor cars	**15%**
Block 6	Ships, vessels, speed boatsetc	**20%**
Block 7	Buses, lorries and taxies used in the business of running them on hire.	**30%**
Block 8	Aero planes	**40%**
Block 9	Containers made of glass or plastic used as refills and plant and machinery.	**50%**
Block 10	Computers including software	**60%**
Block 11	Energy saving device	**80%**
Block 12	Air pollution control equipment; water pollution control equipment; solid water control equipment; recycling and resource recovery systems etc	**100%**
Block 13	Intangible assets- Know-how, patents, copyrights, trademarks, Licences, Franchises etc	**25%**

Rates of Depreciation:
a) First year of Acquisition.
a) If put to use for more than 180 days- full rate of depreciation
b) If put to use for less than 180 days- half rate of depreciation.
b) Subsequent years- full rate of depreciation.
c) Additional depreciation of 20% of actual cost for new plant and machinery if installed after 31.03.2005, if put to use less than 180 days, then the additional depreciation will be 10%. **Expenditure on Scientific Research** (Section 35)
The term “scientific research” means any activity for the extension of knowledge in the fields of natural orapplied sciences including agriculture, animal husbandry or fisheries.

Particulars	**Deduction**	
Revenue Expenditure related to the business Incurred for own business	– Current year	100%

– Prior Period	100% upto 3 years prior to commencement	
Any sum paid to approved Scientific Research Association or University or College or Institution	For undertaking Scientific research	175% of amount paid
Any sum paid for scientific research, to a company, registered in India, having an object to carry out scientific research and development activities	For undertaking Scientific research	125% of amount paid
Any sum paid to an approved University, College or other Institution	For research in Social Science or Statistical research	125% of amount paid
Capital expenditure incurred for own Business (excluding cost of land)	related to Current year	100% reduction
Prior Period	100% upto 3 year prior to commencement	
Any sum paid to National Laboratory or University or IIT or a specified person	For undertaking a program approved by the prescribed Authority	200% of amount paid
In house research and development of Bio technology in the business of manufacture or production of any article or thing, not being an article or thing specified in list of Eleventh Schedule	Bio-technology or in houseresearch	200% of expense incurred allowed upto 31.3.2017

Other deductions

- Insurance Premium
- Bonus
- Interest on Borrowings

- Discount on zero coupon bond
- Contributions to Recognised Provident Fund, Approved Superannuation Fund
- Contribution towards pension scheme
- Approved Gratuity Fund
- Deposit of the Employee’s contribution by the Employer in relevant funds or or before date
- Bad Debts
- Expenditure on Family Planning
- Securities Transaction Tax
- Commodities Transaction Tax

Expenses Disallowed (Section 40)

The following amounts shall not be deducted in computing the income chargeable under the head "profits andgains of business or profession:

i. Interest, royalty, fees for technical services payable outside India

ii. TDS not deducted on certain payments:

iii. Rate or Tax Paid on Profits:

iv. Wealth Tax [Section 40a(iia)]:

v. Amount paid by way royalty, licence fee, service fee, privilege fee, service charge by State Government undertaking to State Government.

vi. Salaries [Section 40a(iii)]: Any payment which is chargeable under the head “salaries” if it is payable –

a) outside India; or

b) to a non-resident

vii. Payment to Provident Funds etc: Any payment to a Provident Fund or other fundestablished for the benefit of employees of the assessee would be disallowed in cases where the assessee (employer) has not made effective arrangements to secure deduction of tax at source from any payment made from the fund which are chargeable to tax under the head ‘salaries’ in the hands ofthe employees.

viii. Payment of tax on non-monetary perquisites [Section 40a(v)]:

ix. Payment to Partners by a firm (Discussed under the chapter Assessment of firms).

x. Payment by AOPs / BOIs (Discussed under the chapter assessment of AOP/BOI).

Problem: 1

From the following P&L. A/c of a merchant for the year ended 31st March, 2019 ascertain his taxable profit from business and house property:

Profit & Loss Account

Office salary 4,800 Gross Profit 1,35,532

General expenses 2,550 Commission 1,205

Bad Debts written – off 2,100 Discount 751

Reserve for Bad Debts 3,000 Sundry Receipts 202

Fire Insurance Premium 450 Rent of Building 52,640

Advertisement 2,500 Capital gain 3,000

Interest on Capital 1,000

Interest on Bank Loan 1,550

Donations 3,875

Depreciation 1,200

Net profit 1,70,305

1,93,330 1,93,330

The amount of depreciation available is 1,000

Solution: 1

Taxable Profit from Business (For the assessment year 2016 - 17)

Net Profit as per Profit & Loss Account 1,70,305

Less: Items not taxable under the head of Business

Rent of building 52,640

Capital gain 3,000 55,640

1,14,665

Add: Items not allowed:

Reserve for Bad Debts 3,000

Interest on Capital 1,000

Donations 3,875

Excess Depreciation not allowed 200 8,075

Taxable Profits from Business 1,22,740

Income from **House Property**:

Rent Received (A. V.) 52,640

Less: 30% of A. V. 15,792 **36,488**

Note: Donations are eligible for deduction under section 80G.

Problem: 2

Mr. Ram purchased an old car on 10th July for 60,000. The car is used for business as well as for personal purposes of the assesse. Compute the amount of depreciation for the previous year . The rate of depreciation from A. Y. 14 15%.

Solution:

Assessment year 1

Cost of car 60,000 Less: Depreciation @ 15% 9,000

Less: 1/3 for personal use 3,000 6,000

W. D. V. 54,000

Assessment year 2

W. D. V. 54,000

Less: Depreciation @ 15% 8,100

Less: 1/3 for personal use 2,700 5,400

W. D. V. 48,600

Assessment year 3

W. D. V. 48,600

Less: Depreciation @ 15% 7,290

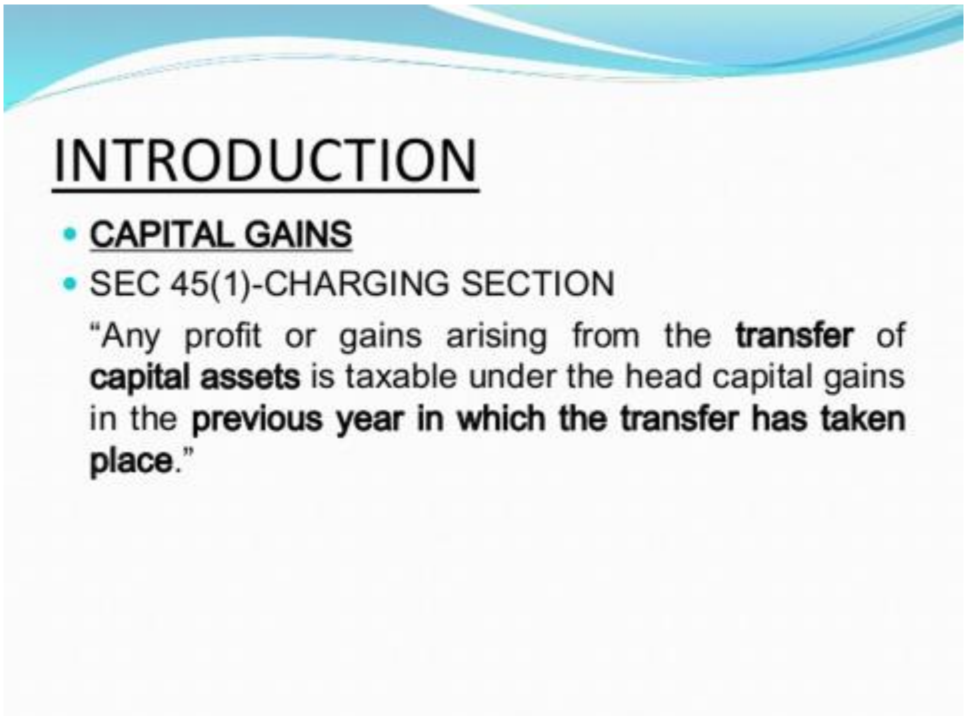
Less: 1/3 for personal use 2,430 4,860

43,740

Depreciation for the previous year would be 4,860

Note: when the ratio of the use of the car for business and private purposes is not known, usually 1/3 is taken as for personal use

INCOME FROM CAPITAL GAIN.



- Conditions for Gains to be charged under Capital Gains

There should be a capital asset.

- The capital asset should be transferred by the assessee.
- Such transfer should take place during the previous year.
- The profits or gains should arise as a result of this transfer.
- Such profit or gain should not be exempted from tax under sections 54, 54B, 54D, 54EC, 54F and 54G & 54GA.

SHORT TERM AND LONG TERM CAPITAL ASSETS

"Short term capital assets" means a capital asset held by the assessee for not more than 36 months, immediately prior to its date of transfer. However, the following assets are treated as short term assets if they are held for not more than 12 months, they are:

- Equity or preference shares in a company
- Securities like debentures, government securities listed in a recognized stock exchange in India.
- Units of UTI and
- Units of mutual funds.
- An asset other than a short-term capital asset is regarded as a "long term capital asset".

SHORT TERM CAPITAL GAIN

1)Find full value of consideration

2)Deduct the followings.

a) Expenditure incurred wholly and exclusively in connection with such transfer.

b) Cost of acquisition.

c) Cost of improvement

3) From resulting sum deduct exemption provided by u/s54 B, 54 D, 54 G, 54GA

4) The balancing amount is Short Term Capital Gain.

LONG TERM CAPITAL GAIN

1) Find full value of consideration

2) Deduct the followings

a) Expenditure incurred wholly and exclusively in connection with such transfer.

b) Indexed Cost of acquisition.

c) Indexed Cost of improvement.

3) From resulting sum deduct the exemption provided by section 54, 54 B, 54 D,

54 EC, 54 F, 54 G, 54 GA

The balancing amount is Long Term Capital Gain/Loss.

COMPUTATION OF CAPITAL GAINS IN THE CASE OF SELF GENERATED ASSETS.

Self Generated Assets	Sale Consideration	Cost of Acquisition (SEC-55)	Cost of Improvement (SEC 55)	Expenses on transfer
1. Goodwill of a Business	Actual	Nil	Nil	Actual
2. Tenancy Rights, Route Permits & loom Hours	Actual	Nil	Actual	Actual
3.Rights to manufacture, Produce or Process any article	Actual	Nil	Nil	Actual
4. Trade mark or brand name associated with a business	Actual	Nil	Actual	Actual

Any profit or gains arising from the transfer of a capital asset will be chargeable to income tax under the head capital gain. The terms '**Capital Asset**' and '**Transfer**' is discussed below;

'Capital assets' may be:-

1) Any stock in trade, raw material or consumable stores held for the purpose of business or profession.

2) Personal effects, ie. Movable properties held by the assesse, excluding the followinga) jewellery,

b) archaeological collections,

c) drawings,

d) paintings

e) sculptures, or

f) any art work

3) Rural agricultural land in India.

4) National defense gold bonds, 7% gold bonds issued by central government.

5) Special bearer bond 1991, issued by central government.

6) Gold deposit bonds issued under gold deposit scheme.

'Transfer' means;

The term transfer includes the following types of transactions:-

i) The sale, exchange of asset,

ii) The extinguishment of any right therein,

iii) The compulsory acquisition under any law ,

iv) Conversion of capital asset to stock in trade,

v) The maturity or redemption of zero coupon bond,

vi) Part performance of the contract,

vii) Transactions having the effect of transferring of an immovable property, eg. power of attorney transactions

Transactions which do not constitute transfer [Sections 46 and 47]

1. any distribution of capital assets on the total or partial partition of a Hindu Undivided Family;
2. any transfer of a capital asset under a gift or will or an irrevocable trust
3. any transfer of a capital asset by a company to its subsidiary company, if–

a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and

b) the subsidiary company is an Indian company.

4. any transfer of a capital asset by a subsidiary company to the holding company, if –

a) the whole of the share capital of the subsidiary company is held by the holding company, and

b) the holding company is an Indian company;

Short Term Capital Gain (STCG) and Long Term Capital Gain (LTCG)

Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. According to Section 2(42A) of the Income-tax Act:**"Short term" capital asset** means a capital asset held by an assessee for not more than thirty-six monthsimmediately preceding the date of its transfer. In the case of capital assets (being equity or preference share ina company) held by an assessee for not more than 12 months immediately prior to its transfer.However, an unlisted security and a unit of a mutual fund (other than an equity oriented mutual fund) shall be a short-term capital asset if it is held for not more than thirty six months.

It is calculated as follows Full value of consideration ---------------

Less: expenses on transfer ---------------

Net consideration ---------------

Less: i) cost of acquisition -----------

ii) Cost of improvements ----------- ---------------

Short term capital gain

Long Term Capital Gain is the gain arising from long term capital assets. And assets other than short-term capital assets are known as **'long-term capital assets'.** In the case of other long- term capital assets, the period of holding is determinable subject to any

rules made by CBDT.

It is calculated as follows Full value of consideration -------------

Less: expenses on transfer -------------

Net consideration -------------

Less: i) Indexed cost of acquisition --------
ii) Indexed Cost of improvements ---------
Long term capital gain ------------

Process of Indexing:
C.I.I of the year of Sale
Indexed cost of acquisition = Actual cost X
C.I.I of the year of purchase
C.I.I of the year of Sale
Indexed cost of improvement = Actual cost X
C.I.I of the year of improvement

Problem: 1
Sri.Bhagwan Das had an income of 2, 25,000 from the head 'Income from Business or Profession' for the previous year ending on 31st March, 2016. During the previous year he sold the following assets:
(i) Residential house which was sold on August 15, 2015 for 12,00,000 was purchased by him on Jan. 1, 1984 for 58,000.
(ii) Silver purchased in June, 1987 for 60,000 was sold on 1st June, 2015 for 3,50,000.
(iii) Shares in a private company purchased in June, 2014 for 50,000 were sold on 25 April, 2015 for 75,000.
(iv) Land purchased in Jan. 2013 for 1,00,000 was sold on 15th April, 2015 for 2,50,000. He purchased a residential house in May, 2014 for 6,50,000.
Compute the taxable income of Sri. BhagwanDas for the assessment year 2016 – 17. Cost inflation indexes for 1983 – 84 is 116; for 1987 – 88 is 150 and for 2015 – 16 is 1,081.
Solution: 1
Computation of Total Income
(for the assessment year)
Business income (a) 2, 25,000
Capital Gains:
Selling price of residential house 12,00,000
Less: Indexed cost (58,000 × 1,081 ÷ 116) 5,40,500
LTCG 6,59,500
Less: Cost of new house purchased within one year before transfer 6,50,000
LTCG (b) 9,500
Selling price of silver 3,50,000
Less: Indexed cost (60,000 × 1,081 ÷ 150) 4,32,400

LTCL (c) (-)82,400
LTCL c/f (c-b) = **72,900**
Selling price of shares 75,000
Less: Cost 50,000
STCG (d) 25,000
Selling price of land 2,50,000
Less: Cost 1,00,000
STCG (e) 1,50,000
STCG (d + e) (f) 1,75,000
Total Income (a + f) 4,00,000
Note: LTCL can be set-off only against LTCG.