



CHAPTER 6

PROFITS AND GAINS FROM BUSINESS OR PROFESSION

INTRODUCTION

❖ The charging section for this head is **Section 28.**



❖ The charge under this head depends on the following **3** conditions –

1. There should be a business or profession
2. It should be carried on by the assessee
3. It should be carried on during the previous year.

BUSINESS

- ❖ **Sec 2(13)** defines **“business”** as “business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.”
- ❖ **Trade** – Exchange of goods for money or any other goods.
- ❖ **Commerce** – A regular activity of trading in a large scale including related activities.
- ❖ **Manufacture** – Making articles (Finished goods) by converting raw materials.

PROFESSION OR VOCATION

- ❖ Both these activities involve provision of services and not goods.
- ❖ **Profession** – An occupation involving intellectual work requiring special knowledge or personal qualifications. **For e.g.** – CA, Lawyer, Doctor, Architect, etc.
- ❖ **Vocation** – Vocation involves manual or technical work which does not require any specific qualification. **For e.g.** – Hair cutting, Typing, Repair work, Spiritual talks, etc.

PROFITS

- ❖ Profits under PGBP should arise from a **business**. However there are 2 exceptions for this rule. The following 2 will not be charged to PGBP even though they are businesses.
 1. Rent from House property is always charged under “Income from House Property”
 2. Winning from Lottery, races etc. is always taxed under “Income from Other Sources”
- ❖ **“Net Profits”** are charged under income tax and not Gross profits.

PROFITS

- ❖ These profits should be earned in the previous year to be taxed in the Assessment year.
- ❖ The relevant P.Y. is 2019-20 and the relevant A.Y. is 2020-21.
- ❖ Profits should be computed according to the standard accounting principles and practices.
- ❖ Revenue losses regarding to the business, incurred in the PY are allowed to be deducted.

METHOD OF ACCOUNTING

- ❖ The profits of the business can be computed through any method of accounting.

- ❖ There are basically 2 methods of accounting and the profits are to be computed according to the method employed by the businessman to maintain his books of Accounts.

- ❖ The 2 methods are –
 1. Mercantile system (Accrual basis)
 2. Cash system (Cash basis)

COMPUTATION OF BUSINESS INCOME

- ❖ The Net profit in the P&L Account of the assessee is not always the Taxable income.
- ❖ The income according to Income Tax Act could be different as certain expenses are allowed or disallowed by the Income Tax Act.
- ❖ So to get the taxable income, we need to focus on 3 things –
 1. Ignore Exempt amounts
 2. Deduct amounts which are expressly allowed
 3. Add back amounts which are expressly disallowed.

DEDUCTIONS EXPRESSLY ALLOWED

- ❖ The following specific deductions are allowed while computing taxable profits –
 - a) Rent, rates, taxes and insurance of building (sec. 30)
 - b) Repairs and insurance of machinery and furniture (sec. 31)
 - c) Depreciation (sec. 32)
 - d) Specific expenses and allowances (sec. 36)
 - e) Other expenses, not specifically covered in above sections (sec. 37)

- ❖ These deductions are allowed subject to the following rules –
 - 1) The expenditure must be “paid” according to the method of accounting.
 - 2) The expenditure must be related to the business carried on by the assessee.

DEPRECIATION (Sec. 32)

- ❖ According to sec. 32, depreciation is allowed towards in respect of –
 1. Specified tangible assets like – Buildings, machinery, plant or furniture.
 2. Specified intangible assets like – Know-how, patents, copyrights, trademarks etc.
- ❖ This asset should be owned, wholly or partly by the assessee.
- ❖ Such asset should be used for the purpose of his business or profession.
- ❖ This depreciation needs to be allowed at a prescribed rate.
- ❖ It is to be applied on the written down value for a particular block of assets.

SPECIAL CASES IN DEPRECIATION

- ❖ While normally, depreciation is computed at the prescribed rates on the WDV.
- ❖ There are certain special cases where the depreciation is computed differently -
 1. **50%** of Depreciation for Assets used for **Less than 180 days.**
 2. **No depreciation** when W.D.V of a block of asset becomes **negative.**

SCIENTIFIC RESEARCH (Sec. 35)

SIMPLE DEDUCTION (100%)

- ❖ Deduction for expense incurred for scientific research related to business.
- ❖ Sum paid to a company to conduct a research.
- ❖ Any sum paid to a research association for a research in social science or statistics.
- ❖ Any Capital expenditure incurred towards scientific research

SCIENTIFIC RESEARCH (Sec. 35)

WEIGHTED DEDUCTION (150%)

- ❖ Sum paid to a research organization to conduct scientific research
- ❖ Any sum paid to a National Laboratory, University or IIT for conducting scientific research.
- ❖ Expenditure on scientific research on in-house R&D facility incurred by a company engaged in the business of bio-technology.

AMORTISATION OF PRELIMINARY EXPENSES (Sec. 35D)

- ❖ This section applies to Indian Companies or Resident non – corporate assesseees.
- ❖ It is related to expenses incurred before the commencement of the business.
- ❖ It can also be related to any new operation to be commenced by an existing business.
- ❖ Such Preliminary expenses can be **“amortised”** (claimed) in **5 consecutive years**
- ❖ **20%** of such expenditure is allowable for deduction in each year

SPECIFIC DEDUCTIONS (Sec. 36)

- ❖ Insurance premium on stocks
- ❖ Insurance on Health of Employees (If paid by any Non – Cash Method)
- ❖ Bonus or Commission paid to employees
- ❖ Interest on Capital Borrowed
- ❖ Discount on Zero Coupon Bonds
- ❖ Employer's Contribution to RPF / Superannuation fund / Pension
- ❖ Employee's Contribution to P.F. paid in time
- ❖ Bad Debts written off

GENERAL EXPENDITURE (Sec. 37)

- ❖ This is a residual section for expenses which are not covered in the previous sections
- ❖ Expenses should NOT be Capital Expenditure
- ❖ Expenses should NOT be Personal Expenses of the Assessee
- ❖ These expenses must be used exclusively and wholly used for business purpose.
- ❖ Such expense should NOT be for a purpose which is an offence or is illegal

EXPENSES EXPRESSLY DISALLOWED

- ❖ Advertisements in Political Souvenir
- ❖ Sums payable outside India without TDS
- ❖ Securities Transaction Tax / Fringe Benefit Tax / Income Tax
- ❖ Remuneration (Salary) paid by Partnership firm to partners above the limits
- ❖ Interest on Capital paid to a partner above 12% p.a.
- ❖ Any Revenue Expenditure exceeding Rs. 10,000/- paid in Cash

COMPUTING TAXABLE INCOME FROM PGBP

RECEIPTS AND PAYMENTS ACCOUNT

- ❖ Consider - the receipts related to business or profession
- ❖ Deduct - business expenses and other expenses expressly deductible
- ❖ Ignore - Capital Receipts, Exempt Income or Income from other heads
- ❖ Ignore - Capital expenses, personal expenses, expenses related to other heads
- ❖ Ignore - Appropriations like Income tax, Drawings and expenses expressly disallowed

COMPUTING TAXABLE INCOME FROM PGBP

PROFIT AND LOSS ACCOUNT

❖ Start of with the Net profit which is given in the P&L Account.

❖ Additions to be made to the Net Profit

1. Unrelated items debited to the P&L Account
2. Expenses expressly disallowed
3. Items expressly chargeable as business income

❖ Deductions to be made from the Net Profit

1. Unrelated items credited to the P&L Account
2. Depreciation allowable under the Income tax Act
3. Deductions expressly allowable