

Proposed Amendment Relating to Deductions from Profits and Gains of Business or Profession

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The Finance Bill, 2005 contains certain proposals with regard to the deductions allowable against the income from profits and gains of business or profession. An attempt has been made in this article to review such provisions.

The relevant proposals relating to deductions from profits and gains of business or profession are detailed hereunder: -

(1) The Finance Bill, 2005 (The Bill) proposes to amend the fourth proviso of sub-section 4 of sub-section 4 of section 80IB of the Income Tax Act, 1961 (The Act). The said sub-section provides that industrial undertakings engaged in manufacture or production or operation of a cold storage plant set up during the period of 1st April 1993 to 31st March 2005 in the State of Jammu and Kashmir is eligible for deduction of whole of its profits for the period of 5 years followed by 25% (30% in the case of the companies) for the next 5 years. The proposal contained in the Bill is to extend the date up to which such deduction would be available from 31st March 2005 to 31st March 2007. The amendment takes effect from assessment year 2006-07. The amendment is being proposed with a view to promote the industrial development of the State of Jammu and Kashmir.

(2) The Bill proposes to introduce a sunset clause in Section 10A of the Act so as to provide that no deduction under sub section 1A of Section 10A of the Act shall be

allowed to any undertaking which begins to manufacture or produce such an articles or thing or computer software after 31st March 2009 in a Special Economic Zone. This amendment takes effect from assessment year 2006-07.

(3) Clause (i) of sub section 4 of the section 80IA of the Act provides that an enterprise carrying on the



business of developing, operating or maintaining any infrastructure facility which commences such operations and maintenance on or after 1st April 1995 is allowable for 100% deduction of profits for a period of 10 years. Sub-clause (a) of said clause further provides that

an enterprise should be owned by a company incorporated in India under the Companies Act, 1956 or by consortium of such companies. It is proposed in the Bill to amend the provisions of Section 80IA so as to enable an authority or a board or a corporation or any other body established or constituted under a Central or a State Act which is not incorporated under the Companies Act, 1956 to take advantage of the existing provisions of clause (i) of sub section 4 of section 80IA of the Act. This amendment is also effective from assessment year 2006-07.

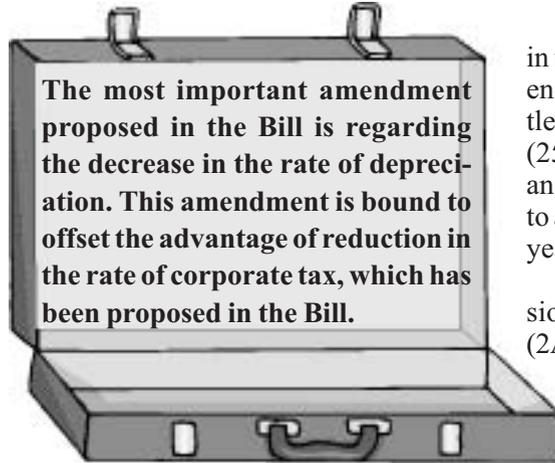
(4) The Bill also proposes to rationalize the existing rates of depreciation of general plant and machinery as also rate of initial depreciation on plant and machinery. It is proposed to amend the provisions of the Income tax Rules so as to reduce the rate of depreciation of the plant and machinery to 15% from the existing rate of 25%. The rates of depreciation of other capital assets are also proposed to be rationalised in line with the reduction of the rate of the general plant and machinery. It is also proposed to raise the initial depreciation rate in respect of new plant & machinery used for the business of manufacturer or production of an article or thing. The proposal is to increase such rate from 15% to 20%. It is also proposed in this regard that the requirement of creating a

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minimum increase of 10% in the installed capacity for availing initial depreciation should be deleted.

The initial depreciation would thus be available for new plant and machinery to the aforesaid concerns except such plant and machinery for which a specific prohibition exists in section 32(1) (iia) of the Act.

This provision will have a far-reaching effect on the profits and gains of the business or profession because the intention seems to be to reduce the depreciation rates for other assets also apart from the plant & machinery. Consequently, this would lead to a lower deduction of depreciation and eventually payment of higher tax by an assessee who is not engaged in the business of manufacture or production of an article or a thing. This is because



even after the increase in the allowance of initial depreciation, an assessee engaged in the business of a production of an article or thing would be allowed a reduced amount of depreciation i.e. less than that to which he would have been entitled to in the preceding years. For example, an assessee fulfilling the conditions specified

in the aforesaid section for the year ending 31.3.2005 would be entitled to a total depreciation of 40% (25%+15%). As against this, such an assessee would now be entitled to a total depreciation of 35% in the year ended 31st March 2006.

(5) Under the existing provisions contained in sub-section (2AB) of Section 35 of the Act, a company engaged in the business of bio-technology or in the business of manufacture or production of any drugs, pharmaceuticals, electronic equipments, computers, chemicals, etc. incurs any expenditure on scientific research (excluding cost of land or building) on in-house research and development facility, as approved by the prescribed authority is allowed a weighted deduction of a hundred and fifty per cent of the expenditure so incurred. However, deduction with regard to such

The Bill proposes that no deduction under sub section 1A of Section 10A of the Act shall be allowed to any undertaking which begins to manufacture or produce such an article or thing or computer software after 31st March 2009 in a Special Economic Zone. This amendment takes effect from assessment year 2006-07.

expenditure incurred is to be allowed upto 31st March 2005. It is proposed to extend the time limit for availing the weighted deduction under the said sub-section for two more years i.e. up to 31.3.2007 so as to encourage indigenous development of in-house scientific research.

(6) Under the existing provisions of sub-section (8A) of section 80IB of the Act, a company carrying on scientific research and development is allowed a hundred per cent deduction of the profits of such business for a period of ten assessment years, if such company is approved by the Secretary, Department of Scientific and Industrial Research, Ministry of Science & Technology, before 1st April, 2005.

It is proposed to extend the period of the allowance of such deduction upto 31st March 2007.

The proposed amendment will take effect from 1st April, 2006 and will, accordingly, apply in relation to assessment year 2006-07 and subsequent years.

(7) Under the existing provisions of section 33AC a shipping company is allowed a specified deduction in respect of amounts credited to a reserve account to be utilised for acquiring a new ship. The acquisition of a new ship is gen-

erally financed partially by debt and partially by internal accruals. The internal accruals could be from general reserves or special reserves created for this purpose. It is also provided in the said section that in case company sells or transfers the ship after the three years' lock-in period and the sale proceeds are not utilised for the purpose of acquiring a new ship within a period of one year from the end of the previous year in which such sale or transfer took place, the sale proceeds shall be deemed to be the profits of the assessment year immediately following the previous year in which the ship was sold or transferred.

The existing provisions thus do not make a distinction of the borrowed capital and internal accruals used for acquiring ship when the sale of ship takes place as the entire sales proceeds are subjected to tax. This implies that both borrowed capital and amount withdrawn from reserves would bear the burden of tax. The real intent to restrict the incidence of the tax on the amount utilised from the reserve account for acquiring the ship is not being fulfilled. The proposed amendment seeks to clarify this real intent whereby only so much of the sale proceeds which represent the amount credited to the reserve account and utilised for acquisition of the ship would be deemed to be the profits exigible to tax.

This amendment will take retrospective effect from 1st April 2004, and will, accordingly, apply in relation to the assessment year 2004-05 and subsequent years.

(8) As per existing provisions of section 35 DDA of the Act, one-fifth of the amount paid to an employee at the time of voluntary retirement is allowed as deduction and the balance is allowed to be deducted in four equal installments in the four succeeding years. Where part payments are made at the time

of voluntary retirement, only the payment made in the first year is allowed to be amortised over five years. The balance paid in installments in subsequent year is not allowed as deduction. The proposed amendment seeks to provide for amortisation of the amount of the payment made in any year, each such payment independently admissible for amortisation over a period of five years.

This amendment will take retrospective effect from 1st April 2004, and will, accordingly, apply in relation to the assessment year 2004-05 and subsequent years.

There are few other provisions, which are not really connected with the deduction allowable under profits and gains of business or profession but have a bearing on the assessment of profits and gains of business. The most important amendment in this regard is the allowing of the tax credit for Minimum Alternate Tax paid under section 115JB of the Act. The Bill proposes to revive the provisions of section 115JAA of the Act and make the same applicable to the provisions of section 115JB of the Act so as to allow the credit of tax paid under section 115JB of the Act. It is proposed in the Bill that credit for such tax shall be available in respect of minimum alternate tax paid for the assessment year 2006-07 and onwards. Another provision, which is connected with the business profits, is the inclusion of dredgers as qualifying ship for the purpose of tonnage tax scheme. This proposed amendment will also have effect from assessment year 2006-07.

It would thus be observed from the above that the most important amendment proposed in the Bill is regarding the decrease in the rate of depreciation. This amendment is bound to offset the advantage of reduction in the rate of corporate tax, which has been proposed in the Bill. ■