

## **Group Meeting Lead by C.A. N.K.Jain**

### **Provisions As per Income Tax Act, 1961**

#### **Deduction in respect of expenditure on specified business.**

**35AD.** (1) An assessee shall be allowed a deduction in respect of the whole of any expenditure of capital nature incurred, wholly and exclusively, for the purposes of any specified business carried on by him during the previous year in which such expenditure is incurred by him :

**Provided** that the expenditure incurred, wholly and exclusively, for the purposes of any specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business, if—

(a) the expenditure is incurred prior to the commencement of its operations; and

(b) the amount is capitalised in the books of account of the assessee on the date of commencement of its operations.

(1A) Where the specified business is of the nature referred to in sub-clause (i) or sub-clause (ii) or sub-clause (v) or sub-clause (vii) or sub-clause (viii) of clause (c) of sub-section (8) and has commenced its operations on or after the 1st day of April, 2012, the deduction under sub-section (1) shall be allowed of an amount equal to one and one-half times of the expenditure referred to therein.]

(2) This section applies to the specified business which fulfils all the following conditions, namely :—

(i) it is not set up by splitting up, or the reconstruction, of a business already in existence;

(ii) it is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;

(iii) where the business is of the nature referred to in sub-clause (iii) of clause (c) of sub-section (8), such business,—

a) is owned by a company formed and registered in India under the Companies Act, 1956 (1 of 1956) or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;

(b) has been approved by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006) and notified by the Central Government in the Official Gazette in this behalf;

(c) has made not less than such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006)] available for use on common carrier basis by any person other than the assessee or an associated person; and

(d) fulfils any other condition as may be prescribed.

(3) Where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction shall be allowed under the provisions of [[section 10AA](#) and] Chapter VI-A under the heading “C.—Deductions in respect of certain incomes” in relation to such specified business for the same or any other assessment year.]

(4) No deduction in respect of the expenditure referred to in sub-section (1) shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year.

(5) The provisions of this section shall apply to the specified business referred to in sub-section (2) if it commences its operations,—

(a) on or after the 1st day of April, 2007, where the specified business is in the nature of laying and operating a cross-country natural gas pipeline network for distribution, including storage facilities being an integral part of such network;

(aa) on or after the 1st day of April, 2010, where the specified business is in the nature of building and operating a new hotel of two-star or above category as classified by the Central Government;

(ab) on or after the 1st day of April, 2010, where the specified business is in the nature of building and operating a new hospital with at least one hundred beds for patients;

(ac) on or after the 1st day of April, 2010, where the specified business is in the nature of developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and which is notified by the Board in this behalf in accordance with the guidelines as may be prescribed;

(ad) on or after the 1st day of April, 2011, where the specified business is in the nature of developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;

(ae) on or after the 1st day of April, 2011, in a new plant or in a newly installed capacity in an existing plant for production of fertilizer;

(af) on or after the 1st day of April, 2012, where the specified business is in the nature of setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);

(ag) on or after the 1st day of April, 2012, where the specified business is in the nature of bee-keeping and production of honey and beeswax;

(ah) on or after the 1st day of April, 2012, where the specified business is in the nature of setting up and operating a warehousing facility for storage of sugar; [and]]

**The following clauses (ai) and (aj) shall be inserted after clause (ah) of sub-section (5) of section 35AD by the Finance (No. 2) Act, 2014, w.e.f. 1-4-2015 :**

*(ai) on or after the 1st day of April, 2014, where the specified business is in the nature of laying and operating a slurry pipeline for the transportation of iron ore;*

*(aj) on or after the 1st day of April, 2014, where the specified business is in the nature of setting up and operating a semi-conductor wafer fabrication manufacturing unit, and which is notified by the Board in accordance with such guidelines as may be prescribed; and*

*(b) on or after the 1st day of April, 2009, in all other cases not falling under [any of the above clauses].*

(6) The assessee carrying on the business of the nature referred to in clause (a) of sub-section (5) shall be allowed, in addition to deduction under sub-section (1), a further deduction in the previous year relevant to the assessment year beginning on the 1st day of April, 2010, of an amount in respect of expenditure of capital nature incurred during any earlier previous year, if—

*(a) the business referred to in clause (a) of sub-section (5) has commenced its operation at any time during the period beginning on or after the 1st day of April, 2007 and ending on the 31st day of March, 2009; and*

*(b) no deduction for such amount has been allowed or is allowable to the assessee in any earlier previous year.*

(6A) Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation thereof to another person, the assessee shall be deemed to be carrying on the specified business referred to in sub-clause (iv) of clause (c) of sub-section (8).]

(7) The provisions contained in sub-section (6) of [section 80A](#) and the provisions of sub-sections (7) and (10) of [section 80-IA](#) shall, so far as may be, apply to this section in respect of goods or services or assets held for the purposes of the specified business.

**The following sub-sections (7A), (7B) and (7C) shall be inserted after sub-section (7) of section 35AD by the Finance (No. 2) Act, 2014, w.e.f. 1-4-2015 :**

*(7A) Any asset in respect of which a deduction is claimed and allowed under this section shall be used only for the specified business, for a period of eight years beginning with the previous year in which such asset is acquired or constructed.*

*(7B) Where any asset, in respect of which a deduction is claimed and allowed under this section, is used for a purpose other than the specified business during the period specified in sub-section (7A), otherwise than by way of a mode referred to in clause (vii) of [section 28](#), the total amount of deduction so claimed and allowed in one or more previous years, as reduced by the amount of depreciation allowable in accordance with the provisions of [section 32](#), as if no deduction under this section was allowed, shall be deemed to be the income of the assessee chargeable under the head “Profits and gains of business or profession” of the previous year in which the asset is so used.*

*(7C) Nothing contained in sub-section (7B) shall apply to a company which has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986), during the period specified in sub-section (7A).*

(8) For the purposes of this section,—

(a) an “associated person”, in relation to the assessee, means a person,—

(i) who participates, directly or indirectly, or through one or more intermediaries in the management or control or capital of the assessee;

(ii) who holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the capital of the assessee;

(iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or

(iv) who guarantees not less than ten per cent of the total borrowings of the assessee;

(b) “cold chain facility” means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce;

(c) “specified business” means any one or more of the following business, namely :—

(i) setting up and operating a cold chain facility;

(ii) setting up and operating a warehousing facility for storage of agricultural produce;

(iii) laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network;

(iv) building and operating, anywhere in India, a [hotel] of two-star or above category as classified by the Central Government;

(v) building and operating, anywhere in India, a [hospital] with at least one hundred beds for patients;

(vi) developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;]

(vii) developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;

(viii) production of fertilizer in India;

(ix) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);

(x) bee-keeping and production of honey and beeswax;

(xi) setting up and operating a warehousing facility for storage of sugar;

**The following sub-clauses (xii) and (xiii) shall be inserted after sub-clause (xi) of clause (c) of sub-section (8) of section 35AD by the Finance (No. 2) Act, 2014, w.e.f. 1-4-2015 :**

*(xii) laying and operating a slurry pipeline for the transportation of iron ore;*

*(xiii) setting up and operating a semi-conductor wafer fabrication manufacturing unit notified by the Board in accordance with such guidelines as may be prescribed;*

(d) any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if—

(i) such machinery or plant was not, at any time prior to the date of the installation by the assessee, used in India;

(ii) such machinery or plant is imported into India from any country outside India; and

(iii) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the assessee;

(e) where in the case of a specified business, any machinery or plant or any part thereof previously used for any purpose is transferred to the specified business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent of the total value of the machinery or plant used in such business, then, for the purposes of clause (ii) of sub-section (2), the condition specified therein shall be deemed to have been complied with;

(f) any expenditure of capital nature shall not include any expenditure incurred on the acquisition of any land or goodwill or financial instrument.

## Deduction in respect of capital expenditure on specified business

### Deduction in respect of expenditure on specified business

Section 35AD has been inserted w.e.f. AY: 2010-11 to provide for investment-linked tax incentive by introducing the concept of allowing deduction for investment made in a **new business** 'based on investment'. The deduction u/s 35AD is available subject to fulfillment of certain conditions which are as follows

- Deduction under Section 35AD shall be available only if the investment is made in a "specified business" (list of 'specified business' appended below as Annexure-A)
- The specified business should be **new** i.e. the specified business **should not be set up by splitting up, or the reconstruction of a business already in existence**. Moreover, it should not be set up by the transfer of old plant and machinery. However, if the value of old plant and machinery transferred does not exceed 20% of the total value of plant & machinery used in the business the condition shall not be deemed to be violated.

Further, where any machinery or plant is imported by the assessee from any country outside India it shall be treated as good as new machinery (provided the machinery was never used by the assessee at any time prior to its installation nor was depreciation claimed by him)

- Books of accounts of the assessee should be audited

#### Manner of Claiming Deduction

- Deduction u/s 35AD is allowed on the Capital Expenditure incurred wholly and exclusively for the purpose of specified business if
  - The expense is incurred prior to commencement of business and
  - Capitalized in the books of assessee on the date of commencement of operation.
- Expenditure in capital nature shall not include any expenditure in nature of land/goodwill/financial instrument. i.e. deduction U/s 35AD cannot be claimed for the amount spend on land, goodwill & financial instrument
- The deduction available is 100% or 150% of the Capital Expenditure incurred depending upon the date of commencement of business (details provided in Annexure-A)

#### Consequences of claiming Deduction under Section 35AD

- If deduction is claimed under Section 35AD the assessee shall not be entitled to claim deduction under the provisions of Chapter VIA under Section 80HH to 80RRB for the same or other assessment years.
- All such expenditure in respect of which deduction has been claimed under the Income Tax Act shall be added back to the Net Profit
- Any sum received by the assessee on account of any Capital asset in respect of which deduction u/s 35AD has been claimed shall be treated as the Income of the assessee and chargeable to tax under the head Business and Profession
- Any loss arising in the 'specified business' shall be available for set off only against the profits and gains of any other 'specified business'. Unabsorbed loss if any will be carried forward in the following assessment year and so on
- If the assessee owns two units one of which qualifies for deduction u/s 35AD and the other one is not eligible for the same and there is inter-unit transfer of goods or services between the two units

then for the purpose of Section 35AD calculation will be made as if such transactions are made at market value.

**Business for which deduction u/s 35AD is available are:**

SI	Particulars	Deduction Allowed				
		Date of <b>Commencement</b> of business on or after				
		1/4/2009	1/4/2010	1/4/2011	1/4/2012	1/4/2014
i)	Setting up and operating cold chain facility	100%	100%	100%	150%	150%
ii)	Setting up and operating a warehousing facility for storage of agricultural produce	100%	100%	100%	150%	150%
iii)	Petroleum oil pipeline	100%	100%	100%	100%	100%
iv)	Building and operating hotel of two stars or above category	-	100%	100%	100%	100%
v)	Building and operating hospital with one hundred bed or above	-	100%	100%	150%	150%
vi)	Houses under slum redevelopment	-	100%	100%	100%	100%
vii)	Developing housing project under scheme for affordable housing	-	-	100%	150%	150%
viii)	Production of fertilizer in India	-	-	100%	150%	150%
ix)	Setting up and operating inland container depot	-	-	-	100%	100%
x)	Bee keeping	-	-	-	100%	100%
xi)	Setting up and operating a warehousing facility for storage of sugar	-	-	-	100%	100%
xii)	laying and operating a slurry pipeline for the transportation of iron ore	-	-	-	-	100%
xiii)	setting up and operating a semi-conductor wafer fabrication manufacturing unit notified by the Board in accordance with such guidelines as may be prescribed	-	-	-	-	100%

**Meaning of Date of Commencement of Business:** The Section does not define ‘Date of Commencement of Business’ but the date of commencement of business as is normally construed refers to the date of commencement of operations. In other words only when the business has established its profit-making structure and started its first commercial activity that it can be regarded as having commenced operation.

**Illustration:****Expenses incurred prior to April 1, 2015**

	Rs.
Purchase of land of warehouse	50,00,000
Construction cost of warehouse	68,00,000
Purchase of know-how for warehouse	10,00,000
Salary to staff	1,00,000
Purchase of old plant and machinery (from India)	2,00,000
Purchase of old plant and machinery (from Germany)	4,00,000
Purchase of new plant and machinery	9,00,000
Purchase of goodwill	<u>3,50,000</u>
These expenses are capitalized on March 31, 2015	<u>1,47,50,000</u>

**Profit & Loss A/c 2014-15**

Particulars	Amount	Particulars	Amount
Depreciation of machinery	3,50,000	Revenue	78,00,000
Depreciation of building @ 5%	3,40,000		
Cost of know-how (written off)	10,00,000		
Other operating expenses	7,50,000		
Donation to a political party	10,000		
<b>Net profit as per companies act</b>	<b>53,50,000</b>		
	<b>78,00,000</b>		<b>78,00,000</b>

**Solution****Step-1****(Calculation of amount of deduction u/s 35AD)**

Purchase of land of warehouse	Nil
Construction of cost of warehouse	68,00,000
Purchase of know-how for warehouse	10,00,000
Salary to staff	1,00,000
Purchase of old plant and machinery (from India)	2,00,000
Purchase of old plant and machinery (from Germany)	4,00,000
Purchase of new plant and machinery	9,00,000
Purchase of goodwill	Nil

Total amount admissible for deduction under section 35 AD    Total    **94,00,000**

**Step-2****Computation of Income as per I Tax Act for the AY 2015-16**

Net profit as per P/L A/c. (As per companies act)    53,50,000

**Add**

Depreciation of building disallowed since deduction claimed u/s 35AD	3,40,000
Depreciation of plant and machinery disallowed since deduction claimed u/s 35AD	3,50,000
Cost of know-how (claimed u/s 35AD so disallowed)	10,00,000



Less : Deduction u/s 35AD	<u>94,00,000</u>
<b>Loss from warehouse in accordance with Income tax Act</b>	<b><u>(23,60,000)</u></b>

### Step-3

<b>BOOK PROFIT</b>	=	53,50,000/-
Tax on Book Profit (@18.5%+EC+SHE)	=	10,19,440/-

### Tax liability

The tax payable as per the IT Act is the higher of tax computed under the normal provisions and the tax computed under MAT. In the given example the tax computed under MAT provisions is higher than the tax computed under normal provisions and hence the assessee will be liable to pay tax of Rs. 10,19,440/-.

### Carry forward of tax paid under MAT

It must be noted that the extra tax which the company has to pay because of MAT provisions will be available for 'tax credit' under Section 115JAA. This credit can be set off against the future tax liability of the company in the year in which the tax computed under the normal provisions is more than the tax computed under MAT.

### Carry forward of Loss

It should be noted that the loss so incurred from the business of operating the warehouse (computed above) can be carried forward and set off against the income from the businesses specified u/s 35AD only. In this case, there is no other specified business and hence loss will be carried forward (**without any time limit**) for being set off against income from operating warehouse or any other specified business under Section 35AD.

### Time Period for Use of Capital Assets

The existing provisions of section 35AD do not provide for a specific time period for which capital assets on which the deduction has been claimed and allowed, are to be used for the specified business. With a view to ensure that the capital asset on which investment linked deduction has been claimed is used for the purposes of the specified business, it is proposed to insert sub-section (7A) in section 35AD to provide that any asset in respect of which a deduction is claimed and allowed under section 35AD, shall be used only for the specified business for a period of eight years beginning with the previous year in which such asset is acquired or constructed.

If any asset on which a deduction under section 35AD has been allowed, is demolished, destroyed, discarded or transferred, the sum received or receivable for the same is chargeable to tax under clause (vii) of section 28. This does not take into account a case where asset on which deduction under section 35AD has been claimed is used for any purpose other than the specified business by way of a mode other than that specified above. Accordingly, it is proposed to insert sub-section (7B) to provide that if such asset is used for any purpose other than the specified business, the total amount of deduction so claimed and allowed in any previous year in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed under section 35AD, shall be deemed to be income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used.

Example:			
Deduction claimed under section 35AD on a capital asset	:		100
Depreciation eligible on such asset under section	:		35

32			
Profit chargeable to tax in accordance with the proposed sub-section (7B) of section 35AD	:		65

The provisions contained in the proposed sub-section (7B) of the said section would, however, not apply to a company which has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 within the time period specified in sub-section (7A).

### **No Deduction u/s 10AA**

The existing provisions of sub-section (3) of the aforesaid section provide that where any assessee has claimed a deduction under this section, no deduction shall be allowed under the provisions of Chapter VIA for the same or any other assessment year.

As section 10AA also provides for profit linked deduction in respect of units set-up in Special Economic Zones, it is proposed to amend section 35AD so as to provide that where any deduction has been availed of by the assessee on account of capital expenditure incurred for the purposes of specified business in any assessment year, no deduction under section 10AA shall be available to the assessee in the same or any other assessment year in respect of such specified business.

As a consequence of this amendment, section 10AA is also proposed to be amended so as to provide that no deduction under section 35AD shall be available in any assessment year to a specified business which has claimed and availed of deduction under section 10AA in the same or any other assessment year.

These amendments will take effect from 1<sup>st</sup> April, 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent assessment years.

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