

## **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 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.

#### **Revised Return (Sec 139(5))**

- ☆ For the AY 10-11 i.e. for the FY 09-10 the revised return should have been filed before 31/03/2012.
  
- ☆ Similarly for the AY 11-12 the revised return should be filed before 31/03/2013. If, however, the assessment is completed before 31<sup>st</sup> March, 2013 (say April 15, 2012) then the revised return should be filed before 15/03/2012

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

Sl	Particulars	Deduction Allowed	
		Date of <b>Commencement</b> of business on or after	
		1/4/2009	1/4/2012
i)	Setting up and operating cold chain facility. (150% deduction)	100%	150%
ii)	Setting up and operating a warehousing facility for storage of agricultural produce. (150% deduction)	100%	150%
iii)	Petroleum oil pipeline	100%	100%
iv)	Building and operating hotel of two stars or above category.	100%	100%
v)	Building and operating hospital with one hundred bed or above (150% deduction)	100%	150%
vi)	Houses under slum redevelopment	100%	100%
vii)	Developing housing project under scheme for affordable housing. (150% deduction)	100%	150%
viii)	Production of fertilizer in India (150% deduction)	100%	150%
ix)	Setting up and operating inland container depot.	-	100%
x)	Bee keeping	-	100%
xi)	Setting up and operating a warehousing facility for storage of sugar.	-	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.

**Meaning of Cold chain facility:** for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and diary products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for preservation of such produce.

**Illustration:****Expenses incurred prior to April 1, 2009**

	Rs.
Purchase of land of warehouse	50,00,000
Construction cost of warehouse	8,00,000
Purchase of know-how for warehouse	10,00,000
Salary to staff	78,000
Construction of warehouse	60,00,000
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	3,50,000

These expenses are capitalized on March 31, 2009

**Profit & Loss A/c. 2009-10**

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	7,51,000		
Donation to a political party	10,000		
<b>Net profit as per companies act</b>	<b>53,49,000</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	8,00,000
Purchase of know-how for warehouse	10,00,000
Salary to staff	78,000
Construction of warehouse	60,00,000
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
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Total amount admissible for deduction under section 35 AD	Total <b><u>93,78,000</u></b>

**Step-2****Computation of Income as per I Tax Act for the PY 2009 - 10**

Net profit as per P/L A/c. (As per companies act)	53,49,000
<b>Add</b>	
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>93,78,000</u>
<b>Loss from warehouse in accordance with <u>Income tax act</u></b>	<b><u>(23,39,000)</u></b>

### Step-3

**BOOK PROFIT** = 53,49,000/-

Tax on Book Profit (@18%+EC+SHE) = 9,91,705/-

#### **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. 9,91,705/-.

#### **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.

