CHAPTER 8 Profits and Gains of Business or Profession

INTRODUCTION

Revenue receipts of businesses and professions are brought to tax under the head 'Profits and Gains of Business or Profession.' The expression profits and gains should be understood to include negative incomes as well. So that while profits and gains represent "plus income", losses represents "minus income". Both positive and negative profits are of revenue character and therefore both must be taken into account in computing taxable income under this head [*CIT* v. *Harprasad & Co. Pvt. Ltd.* (1975) 99 ITR 118 (SC)].

Since this head computes revenue receipts, as a matter of principle, capital outlays are not allowed while arriving at profit figures for this head. However, some exceptions have been made in this regard in the relevant provisions. Profits and gains of business or profession are required to be computed in accordance with the method of accounting regularly followed by the assessee [Sec. 145].

Sec. 28 is the charging provision that essentially entails incomes that are chargeable to tax as profits under this head. In addition to what is recognized as profit under sec. 28, there are certain incomes that are deemed to be profits for the purposes of this head. Sec. 41 and secs. 68 to 69D comprise of incomes that are deemed to be profits and taxable for the assessee. Sec. 29 permits deductions and allowances comprised in secs. 30 to 37 to be availed by the assessee while computing profits and gains under this head. Secs. 40, 40A and 43B list out expenses that are not allowed as deductible from profits.

COMPUTATION OF TAXABLE PROFITS

Taxable profits of business or profession are computed in accordance with the method of accounting regularly followed by an assessee (Sec. 145). There are two systems of book keeping - Cash system and Mercantile system.

Cash System of Book Keeping - According to the cash basis of accounting, a record is kept of actual receipts and actual payments, entries are made only when money is actually collected or disbursed. If the profits of a business or profession are accounted in this way, the tax is payable on the difference between the receipts and the disbursements for the period in question. Under this method, deduction for expenditure is allowed only in the year of disbursement, irrespective of the question when the liability to pay the same arose [*Re B.M. Kamdar* (1946)14 ITR 10 (Bom.) *CIT* v. *E.A.E.T. Sundararaj* (1975) 99 ITR 226 (Madras)]. Income is taxable on receipt basis irrespective of the timings of its accrual.

Mercantile System of Book Keeping - Under this system, the net profit or loss is calculated after taking into account all the income and the expenditure relating to the period whether such income has been actually received or not and whether such expenditure has been actually paid or not. Thus, the profit computed under the system is the profit actually earned, though not necessarily realised in cash, or the loss computed under this system is the loss actually sustained, though not necessarily paid in cash. If the accounts are kept on mercantile basis, the income is taxable when it accrues or is earned, irrespective of receipt, the charge being on the net "book profits".

A mere claim against the assessee is not sufficient to justify a deduction—a liability to pay must definitely arise [*CIT* v. *Swadeshi Cotton & Flour Mills (P.) Ltd.* (1964) 53 ITR 134 (SC)]. If an assessee has been taxed on "book-profits", which have accrued but not received, he cannot be taxed on the same sum of money when they are actually received in a later year of assessment [*Explanation 2* to Sec. 5].

COMPUTATION OF TAXABLE PROFITS IN CASE OF CASH SYSTEM OF BOOK-KEEPING

Those who follow cash system of accounting prepare "receipts and payments account", whereas the assessee following mercantile system of accounting, prepare the "profit and loss account". In order to compute taxable profits, the "receipts and payment accounts" or, as the case may be, the "profit and loss account" has to be adjusted in the light of the income-tax provisions, as demonstrated below.

TABLE 8.1: COMPUTATION OF PROFITS AND GAINS FROM BUSINESS OR PROFESSION

Particulars	Amt. (in ₹)	Amt. (in ₹)
Net Profits as per profit and loss account		xxxx
Add:		
(*a*) Amounts debited to P & L A/c but not allowable as deduction under the Income-tax Act	xxx	
(*b*) Income not credited to P & L A/c but are taxable under this head under the Income-tax Act	xxx	
		xxx
Less:		
(*a*) Amounts allowable under the Act but not debited to P & L A/c	xxx	
(*b*) Income credited to P & L A/c but are exempt under the Act or taxable under another head under the Act	xxx	
		xxx
Profits and Gains from Business or Profession		xxxx

MEANING OF BUSINESS [SEC. 2(*13*)]

According to the definition in sec. 2(*13*) business includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade or commerce or manufacture. Ordinarily, the term business is used in the sense of an occupation or profession, which occupies time, attention and labour of a person, normally with the object of making a profit [*State of Andhra Pradesh* v. *H. Abdul Bakshi and Bros.* (1964) 15 STC 644 (SC)]. "Business" being an inclusive definition and not an exhaustive one is therefore capable of having an expansive understanding [*Dr. Vadamalayan P* v. *CIT* (1969) 74 ITR 94 (Mad.)]. Nevertheless, in judicial interpretation of the term 'business' has often identified the following key essentials:

Systematic and Organised Activity: Business means some real, substantial and systematic or organised course of activity or conduct with a set purpose Business means an activity carried on continuously and systematically by a person by the application of his labour and skill with a view to earning an income [*Barendra Prosod Ray* v. *ITD* (1981) 6 Taxman 19/129 ITR 295 (SC)].

Profits motive not essential: Though the element of profit is generally present in "business" but the motive of making profit or actual earning of profit is not an essential ingredient of business. For instance, mutual concerns and societies carry on business though not with a profit motive.

Business includes trade, commerce: Trade implies buying goods and selling them to make profit. If such transactions are done on a large scale, it is called commerce. Nobody can define the volume of business, which would convert a trade into commerce. But everybody understands the distinction between the two with sufficient vagueness [*Sri Gajalakshmi Ginning Factory Ltd.* v. *CIT* (1952) 22 ITR 502 (Mad.)].

"Business" is not merely confined to purchase and sale of articles or goods. It may consist of rendering services to others, *i.e.* communication service (*i.e.* telephone, telegraph, etc.) or transport (*i.e.* railways, bus, and aeroplane, etc.). There is no antithesis between service and business.

Business includes manufacture: The Finance Act, 2009 inserted the definition of the term manufacture. Accordingly under sec. 29BA manufacture with its grammatical variations, means a change in a non-living physical object or article or thing (*a*) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use or (*b*) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure. "Manufacture" implies a change but every change is not "manufacture".

It is only when the change, or a series of changes take the commodity to the point where commercially it can no longer be regarded as the original commodity but instead it is recognised as a new and distinct article, having its own name, identity character and end use [*CIT* v. *Oceanic Products Exporting Co.* (1996) 85 Taxman 554/219 ITR 293 (Ker.); *Assistant CIT* v. *Soni Photo Films P. Ltd.* (2000) 245 ITR (AT) 11 (Del.) (AT)].

Business includes any adventure or concern in the nature of trade or commerce - The word "business" in its commercial sense implies an element of continuity. But the income-tax law the wide definition of business does not require that there should be a series of transactions to constitute business. Even a single and isolated transaction may fall within the definition of business as being an adventure in the nature of trade, provided the transaction bears clear indication of trade. A transaction can be termed as an adventure in the nature of trade, commerce or manufacture if some elements of trade or business are present therein and not necessarily all elements be present. A single plunge may be enough, provided it is clearly demonstrated that the plunge is made in the water of trade.

It is a mixed question of facts and law whether a transaction constituted an adventure in the nature of trade, commerce, or manufacture. No hard and fast rule can be laid down in this respect. Each case has to be examined in the light of available facts. However, some guidance may be sought from the following broad principles, which are based on judicial pronouncements:

(*i*) *Intention to resell:* When the purchase is made solely with an intention to resell at a profit and purchaser has no intention of holding the property for himself, the transaction is an adventure in the nature of trade. Where the purchase of any article is made without an intention to sell at a profit, a resale under changed circumstances is only a realisation of capital investment and does not stamp the transaction with a business character.

(*ii*) *Transaction relating to business:* If a transaction is related to the business which is normally carried on by an assessee, though not directly part of it, it may be inferred that the transaction is an adventure in the nature of trade. For example, Mr. X is a cotton merchant. During a crisis in the cotton market, he is appointed under the power of attorney to wind up the affairs of a cotton firm and to dispose of the cotton bales and distribute the sale proceeds. The commission that he receives is taxable as business profits.

(*iii*) *The quantity of the commodity purchased:* Where the transaction is unrelated to business, which is normally carried on by an assessee, the quantity purchased and sold may throw some light on the nature of the transaction. If the quantity purchased is quite large which cannot be consumed by an assessee and his family in a reasonable time, and it does not give him any pride or possession, such transaction may be inferred as an adventure in the nature of trade.

(iv) Where the purchased property undergoes alteration and then sold: Where a commodity is purchased, altered, repaired or converted into a different property and then sold, it may be readily inferred that the transaction is an adventure in the nature of trade.

(*v*) *Concern in the nature of a trade:* A concern in the nature of trade, commerce, or manufacture also falls within the definition of "business". A

concern in the nature of trade implies that it has an adequate degree of business organisation for the purpose of carrying on an undertaking. The size of organisation must necessarily depend upon the character of the concern itself.

Case Law: ***Raja J. Rameshwar Rao* v. *CIT* (1961) 42 ITR 179 (SC)**

Facts: 'R' acquired some land with a view to develop it and further goes further and divides the land into plots and sells the land not as a single unit, but in parcels.

Held: Even a single venture may be regarded as in the nature of trade or business. When a person acquires land with a view to selling it later after developing it, he is carrying on an activity resulting in profit, and the activity can only be described as a business venture.

Case Law: ***G. Venkataswami Naidu & Co.* v. *CIT* (1959) 35 ITR 594 (SC)**

Facts: 'V' a firm into the business of managing agency, purchased four different plots of lands over a period of two years. Such lands were adjacent to the mills it was managing. 'V' never used the lands either for cultivation or building on it but with an intention to sell it for profit to the mills.

Held: Instances of realization of investments by purchase and profitable resale are clearly outside the domain of adventures in the nature of trade. But when purchase had been made solely and exclusively with the intention to reselling it at a profit and the purchaser has no intention of holding the property for himself or otherwise enjoying or using it; it would raise a strong presumption that the transaction is an adventure in the nature of trade. 'V' purchased four plots with the sole intention of selling them to the mills at a profit and this intention raised a strong presumption that it was an adventure in the nature of trade.

Case Law : ***CIT* v. *Moti Chand Khajanchi* [1987] 34 Taxman 498/[1988] 171 ITR 280 (Rajasthan)**

Facts: 'M' derived income from interest, dividends and shares from three partnership firms, besides income from property. 'M' had a hobby of collection of paintings and sold some of them to National Museum, New Delhi in national interest. 'M' claimed that receipt from the sale of paintings was not liable to tax as it was neither a business profit nor a capital gain.

Held: Since receipts from the sale of paintings were of a casual and non-recurring nature, it was not an adventure in the nature of trade or commerce.

MEANING OF PROFESSION [SEC. 2(*36*)]

A "profession" is an occupation requiring either purely an intellectual skill or manual skill, controlled by the intellectual skill of the operator. Examples of profession are medicine, law, engineering, auditing, painting, etc.

All professions are business, but all business are not professions. Only those businesses are professions the profits of which are dependent mainly upon the personal qualifications and in which no capital expenditure is required or only capital expenditure of a comparatively small amount is required. Politics is a profession or vocation [*CIT* v. *PVG Raju* (1975) 101 ITR 465 (SC)].

Profession includes Vocation [Sec. 2(*36*)] - A vocation, as normally understood, is a calling in which a person passes his life. It may even be stated to a way of living or a sphere of activity for which one has a special fitness, though it is not necessary that the activity should be indulged in for the purposes of livelihood [*K. Ramaswami Gounder* v. *CIT* (1984) 19 Taxman 5/(1987) 163 ITR 94 (Mad.)]. Social work and preaching religion may amount to vocation. Teaching is a vocation if not a profession, a teaching of vedant, even as a matter of religion, amounts to carrying on a vocation [*P. Krishna Menon* v. *CIT* (1959) 35 ITR 48 (SC)].

Distinction between Business, Profession is of no Importance - Distinction between business, profession and vocation is of no importance in the computation of taxable income. What does not amount to "profession" may amount to "business", and what does not amount to "business" may amount to vocation. The Act treats them on an equal footing and the charging provisions for computing taxable income are the same for all of them.

BASIS OF CHARGE [SEC. 28]

The following receipts/incomes are chargeable to income tax under the head "profits and gain of business or profession":

Profits and Gains of any business or profession carried on by the assessee at any time during the Previous Year [Sec. 28(*i*)]

The charge under the head is on profits and gains and not on the gross receipts or sale proceeds of the business or profession. The following points may be noted in this context:

Profits of each business be computed separately: If one and the same business is carried on at a number of places, there is only one business. Net profits of the business have to be ascertained by aggregating the profits earned in all the branches and reducing them from all the allowable expenses. If more than one business is carried on by the assessee, profits of each business must be computed separately.

Capital Receipts not Chargeable: Capital receipts are outside the purview of this clause unless specifically required to be included by the statutes. Take an example. The supplier of bottles received compensation from an American company for destroying empty bottles of Coca-cola and Fanta as the Government refused permission for bottling agreement. The A.O. did not tax the amount of compensation. The CIT revised the Order under Sec. 263 and taxed it. Held, the empty bottle being a capital asset, the compensation received for their distruction was a capital receipt [*CIT* v. *Soft Beverages P. Ltd.* (2001) 118 Taxman 846/249 ITR 552 (Mad.)].

Chargeability of Revenue Receipts: In order to be chargeable, the receipts must be of revenue nature either by way of sales or consultancy fees or in some other form. Receipts should be a part of consideration for goods or services. It should not be a capital receipt or a returnable deposit.

Receipt may be in cash or kind: Receipts may be in money or money's worth, in cash or in kind. When a company sells its trading asset for fully paid shares in another company, the profit of the transaction is assessable although no cash passes [*British South Africa Co.* v. *CIT* (1946) 14 ITR 17 (PC)] (SUPP).

Voluntary Payments - All revenue receipts arising from business or the exercise of profession or vocation are chargeable under this section. Voluntary payments by persons who are under no obligations to pay anything at all would be income receipts in the hands of the receiver if those are received in the course of business or in the exercise of profession. Thus, an amount paid to the lawyer by a person who was not a client who had benefited by his professional services to another [*Susil C. Sen*, In re (1941) 9 ITR 261 (Calcutta)] or a voluntary payment made to an actress by a producer of film who had engaged her services [*C. Lakshmi Rajyam* v. *CIT* (1960) 40 ITR 340 (Madras)] are taxable under this clause.

Illegal Business: The income-tax law is not concerned with the legality or illegality of the business. The illegality of a business, profession or vocation does not exempt its profits from being taxed. Profits from carrying on the business of smuggling are thus taxable. Likewise, profits from illicit trafficking in drugs or illicit trafficking in liquor, contrary to prohibition laws, are chargeable to tax. Similarly, a man who lives by regularly receiving and reselling stolen goods is liable to be taxed on such profits.

The loss in illegal business can also be set off against the profits of such business. Thus, where an assessee carries on the business of dealing in smuggled gold and the gold is confiscated by the custom authorities, the loss due to confiscation of gold can be set off against the income in respect of such gold business [*CIT* v. *Piara Singh* [1980] 3 Taxman 67/124 ITR 40 (SC). Also see C. *Krishanalal Jain* v. *CIT* (1986) 26 Taxman 452/(1987) 163 ITR 747 (Kar.)].

Ownership of Business not essential for Chargeability: A person carrying on the business profession is assessable on business profits. Normally, this right is vested with the owner of business and so he would be assessable on business profits.

However, in a few cases, the right to carry on the business may not vest with its owner even though the profits may accrue to him. In such cases, the Revenue would charge the person who is vested with the right to carry on the business. Thus, promoters are assessable on pre-incorporation profits and not the company even though it might have ratified all pre-incorporation deals and accepted pre-incorporation profits [*CIT* v. *City Mills Distributors (P.) Ltd.* (1996) 85 Taxman 352/219 ITR 1 (SC)].

Where a guardian of a minor has the right to carry on business, he is to be assessed on such profits. Similarly, where the court takes away the right of the owner to carry on his business and appoints somebody else to carry on the business, the person appointed by the court is assessable on business profits. The owner is not assessable as he is not carrying on the business [*Saifudin Alimohamed* v. *CIT* (1954) 25 ITR 237 (Bom.)].

Business to have been carried on during the previous year: For chargeability of business profits, it is necessary that the business should have been carried on

by the assessee at any time during the previous year. It is not necessary that business should have been carried on throughout the previous year [*CIT* v. *Express Newspapers* (1964) 53 ITR 250 (SC)].

Receipt after Discontinuance of Business, following Cash System of Accounting [Sec. 176(3A)/(4)]: In a business–profession, following cash system of accounting, profits and gains received after its discontinuance could not have been taxed as income from business or profession because no business–profession exists during the year of receipts.

Section 176(3A) and (4) plug this loop-hole. It provides that receipts from a discontinued business profession, following cash system of accounting, would still be taxable as the income from business–profession even though no source of income exists during the year of receipts.

The exception has no relevance to a business or profession, following mercantile system of accounting where profits might have accrued and charged to tax during the continuance of business or profession.

Receipts prior to setting up business: A business must be carried on before there can be any profits and gains. Any receipt, received before the business is carried on, is not a business receipt and if any expenditure is incurred before the business has started, it is also not a business expense. Where the assessee received grants-in-aid before it started business, it could not be treated a business receipt [*CIT* v. *State Trading Corporation of India Ltd.* (1973) 92 ITR 294 (Delhi)].

Case Law: ***CIT* v. *T.V. Sundaram Iyengar & Sons Ltd.* [1996] 88 Taxman 429/222 ITR 344 (SC)**

Facts: 'S' received certain deposits from customers in course of its business which were originally treated as capital receipt but subsequently written back in profit and loss because since these remained unclaimed had become time barred. Assessing Officer treated such amount as its trading receipt.

Held: Although the amounts received originally was not of revenue in nature and therefore were not taxable in the year of receipt, the amount changed its character when the amount became the assessee's own money because of limitation or by any other statutory or contractual right and treated as trade surplus.

Compensation for loss of office [Sec. 28(*ii*)]

Any compensation or other payment due to (under the mercantile system of accounting) or received (under cash system of accounting) by any person for the loss of office in the specified cases is chargeable to tax as business income. Such specified cases are given below:

(*a*) Compensation due to or received by any person who is managing the affairs of an Indian company wholly or substantially for the termination of his management or for the modification of the terms and conditions relating thereto.

(*b*) Compensation due to on received by any person who is managing the affairs of any other company in India at the termination of his office or modification of the terms and conditions relating thereto.

(*c*) Compensation due to or received by any person who is holding an agency in India for any part of the activities relating to the business of any other person for the termination of the agency or the modification of the terms and conditions relating thereto.

(*d*) Compensation due to or received by any person for vesting of the management of any property or business in the government or in any corporation owned or controlled by the government.

(*e*) Compensation due to or received by any person at or in connection with the termination or the modification of the terms and conditions, of any contract relating to his business (inserted w.e.f. 1.4.2019).

Income of trade or Professional Association from specific service [Sec. 28(*iii*)]

This clause makes an exception to the general rule that income of mutual associations is exempt from tax. Income derived by trade, professional or similar association from specific services performed for its members is chargeable to tax as "profits and gains of business or profession".

Specific services mean "conferring particular benefits" which may be available only on payment of the specific fee charged for such benefits. Income derived from general services, performed for its members continues to be exempt from tax. For example, where Miners' Association allows higher quota of coal to a member on payment of royalty, such royalty is taxable under this clause. Similarly, where chamber of commerce intervenes to settle the dispute between members on payment of arbitration fees, such fees is taxable under this clause.

Income derived from specific services performed for non-members is chargeable to tax either under the "other sources" or under clause (*i*) of sec. 28 but not under this clause. The applicability of this clause is restricted only to the members.

Social clubs fall outside the preview of this provision. Therefore, surplus accruing to a social club even from specific services to its members would be governed by the general principle of mutuality and hence not assessable [*CIT* v. *Delhi Race Club (1940) Ltd.* [1970] 75 ITR 111 (Delhi)].

Profit on sale of licence [Sec. 28(*iiia*)]

Profit on sale of a licence granted under the Imports (Control) Order, 1955, is chargeable as business profit. Thus, sale proceeds of import entitlements is to be statutorily taxed as business income.

Cash assistance against exports [Sec. 28(*iiib*)]

Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of Government of India is taxable as business

income. Thus, where an exporter gets cash compensatory support (CSS) from the government or receives any other subsidy, it is taxable as business income.

Repayment of any duty of custom or excise [Sec. 28(*iiic*)]

Repayment of any duty of custom or excise as drawback to any person against the exports under the Customs and Central Excise Duties Drawback Rules, 1971 is chargeable to tax as business income.

Profit on the transfer of Duty Entitlement Pass Book Scheme (DEPS) [Sec. 28(*iiid*)]

Any profit on the transfer of the DEPS, being Duty Remission Scheme, under the export and import policy formulated and announced under sec. 5 of the Foreign Trade (Development and Regulation) Act, 1992 is chargeable to tax as business income.

Profit on the transfer of Duty Free Replenishment Certificate (DFRC) [Sec. 28(*iiie*)]

Any profit on the transfer of the DFRC, being Duty Remission Scheme, under the export and import policy formulated and announced under sec. 5 of the Foreign Trade (Development and Regulation) Act, 1992 is chargeable to tax as business income.

Value of Benefits or Perquisite [Sec. 28(*iv*)]

The value of any benefit or perquisite, whether convertible into money or not, or cash or in kind or partly in cash and partly in kind, arising from the exercise of business or a profession, is chargeable to tax as "profits and gains of business or profession". For instance, in addition to payment of medical fees, a patient also gives gift to a doctor who has cured him from chronic disease. The market value of such gift is also assessable as income from profession. A gift is taxable as business income if it has been received in the course of the business. Similarly, where a partner uses the residential premises, car, telephone belonging to the firm, the value of perquisites is taxable in his hands as business income [*V. P. Warrier* v. *CIT* (1990) 49 Taxman 314/181 ITR 303 (MP)] Award received by a professional sportsman is in the nature of a benefit in the exercise of his profession, and therefore, it is taxable.

Thus, the benefit or perquisite under the provision is other than in shape of money. If it is money, it does not fall in this provision. All revenue receipts arising from business profession or vocation are chargeable even if they are of non-recurring nature. Benefits assessable under this clause would not qualify for exemption under sec. 10(*2A*).

Case Law: ***Commissioner* v. *Mahindra and Mahindra Ltd.* [2018] 93 taxmann.com 32/255 Taxman 305 (SC)**

Facts: 'M' entered into an agreement with 'K' for the purchase of tools and other equipments for which 'K' agreed to provide a loan. Subsequently, 'K' was taken over by another company 'A' which waived the loan of 'M'. Issue was whether waiver of loan by 'A' was a perquisite for 'M'.

Held: The very first condition for application of this provision is that any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money. Since waiver amount represented cash/money, provisions of section 28(*iv*) were inapplicable.

Case Law: ***Ms. Priyanka Chopra* v. *Dy. CIT* [2018] 89 taxmann.com 286/169 ITD 1 (Mum. - Trib.)**

Facts: 'P', a film actress had done promotional activity on being brand ambassador of a campaign and received a car as a gift which was added as perquisites. 'P' contended that the gift of car was not a part of her fee/remuneration for the campaign.

Held: The car received by 'P' is a part and parcel of the agreement for the professional services rendered by her and is rightly added as perquisite.

Case Law : ***ACIT* v. *Shahrukh Khan* [2017] 84 taxmann.com 209/189 TTJ 547 (Mumbai)**

Facts: 'S', being a film actor by profession, received a gift of Villa from 'N' a Dubai based company. The Revenue authorities contended that the villa was a professional receipt in lieu of 'S' having attended the annual day celebration of the said company. 'S' claimed that the villa was a unilateral act of gift by his friend who happened to be the Executive Director of 'N' company on account of natural love and affection.

Held: No addition could be made merely on the basis of mere suspicion, conjectures or surmises. The gift was offered to 'S' in the year 2004, whereas, the Annual Day took place in the year 2007 and, therefore, 'S' was under no obligation to attend the same and undertake any sort of brand endorsements for donor company. It is not a professional receipt under sec. 28(*iv*).

Remuneration due to or received by a partner from the firm [Sec. 28(*v*)]

Any interest, salary, bonus, commission or remuneration due to or received by a partner from the firm is taxable as his business income, provided such payments were deducted while computing taxable profits of the firm. For example, R is a partner in a firm. He receives a sum of ₹ 50,000 as salary, interest, bonus and commission. While computing taxable profits of the firm, a sum of ₹ 20,000 was disallowed on account of these payments. R is assessable on a sum of ₹ 30,000 as his business income.

Non-compete fees and fees for exclusivity rights [Sec. 28(*va*)]

Any sum received or receivable under agreement for not carrying out any activity in relation to any business (but not profession) is chargeable to tax as business income.

Similarly, any sum received or receivable under an agreement for not sharing any know-how, patent, copyright, trademark, licence, franchise or any other business or commercial rights of similar nature or information or technique likely to assist in the manufacture processing of goods or provision for services is taxable as business income.

Payment for non-compete fees and fees for exclusivity rights may be paid in cash or kind.

However, any sum received or receivable for not carrying out any activity is not treated as business income in the following two cases:

(*i*) any sum, received or receivable in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business which is chargeable under the head "capital gains".

(*ii*) any sum received as compensation from the multilateral fund of the Montreal Protocol on Substances that deplete the Ozone layer under the United Nations Environment Programme in accordance with the terms of agreement entered into with the Government of India.

"Agreement" includes any arrangement, understanding or action in concert. It may be formal or in writing. It may not be intended to be enforceable by legal proceedings.

"Service" means service of any description, which is made available to potential users. It includes the provision of services in connection with business of any industrial or commercial nature, such as accounting, banking, communication, conveying of news of information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy boarding and lodging.

It must be noted that payment received as non-competition fee under a negative covenant was not taxable before 1-4-2003 as it was a capital receipt. It is only after 1-4-2003 by virtue of Finance Act, 2002 that non-competition fees under a negative covenant is taxable under sec. 28(*va*).

Case Law : ***Shiv Raj Gupta* v. *CIT* [2020] 117 taxmann.com 871/272 Taxman 391 (SC)**

Facts: 'S' and his family, being controlling shareholders of company C, sold their shares to company SWC. 'S' received a consideration towards non-competition fee from SWC. The revenue authorities contended that true nature of the transaction was that of payment received as compensation for terminating management of 'S' in company C. Non-compete fee was a colourable device to avoid payment of tax.

Held: There was no colourable device involved in having two separate agreements for two entirely separate and distinct purposes. Since non-competition fee under a negative covenant was always treated as a capital receipt till assessment year 2003-04 and 'S' had entered the agreement within during this time, amounts received by him were such capital receipts that not were not chargeable to tax.

Receipt under a keyman insurance policy [Sec. 28(*vi*)]

Any sum received under a keyman insurance policy including the sum allocated by way of bonus is also treated as business income.

Keyman insurance policy is taken by a business concern on the life of an employee (keyman) whose services contribute substantially to the success of the business. The object of the keyman insurance is to indemnify a business concern from the loss of earnings resulting from the death of a valuable employee. The amount of keyman insurance can be estimated as the monetary value of the likely setback to profits of the concern due to the death of the keyman. Any sum received by a business house on such policies including bonus is taxed as business income. The exemption under sec. 10(*10D*) is not available in respect of such policy.

FMV of inventory converted into capital asset [Sec. 28(*via*)]

The Finance Act, 2019 inserted a new category to be charged as profits under this head. The fair market value of inventory on the date on which it is converted into, or treated as, a capital asset will be brought to tax as profits.

Any sum received on demolition of capital asset [Sec. 28(*vii*)]

Any sum, received or receivable, in cash or kind, on account of demolition, destruction, dismissal or transfer of any capital asset, (other than land or goodwill or financial instrument) is taxable as business income provided the whole of the expenditure on such capital asset has been allowed as deduction (under sec. 35AD).

Speculative profits [*Explanation 2* to Sec. 28]

Where speculative transactions, carried on by an assessee, constitute business, the speculation business is deemed to be distinct and separate from any other business (under *Explanation 2* of Sec. 28).

Speculative Transaction Defined [Sec. 43(5)]

"Speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity including stock and shares is periodically or ultimately settled otherwise than the actual delivery or transfer of the commodity or scrips [sec. 43(5)]. For example, N agrees to supply 10 cotton bales to M @ ₹ 5,000 per cotton bale after one month. On the date of delivery market price has fallen from ₹ 5,000 to ₹ 4,200 per bale. Both the parties agree to settle the contract by realising difference of prices. Thus, N gains ₹ 8,000 and M loses ₹ 8,000. It is speculation profit/speculation loss.

The term "commodity" signifies a thing, produce, merchandise or goods. Therefore, contracts in real property, and, houses do not fall within the scope of "speculative transaction". A renunciation letter in relation to right of allotment of shares is neither a share nor a commodity [*CIT* v. *Nirmal Trading Company* (1971) 82 ITR 782 (Cal.)]. Units of the Unit Trust of India are held not to be shares for the purposes of this sole-section [*CIT* v. *Appollo Tyres Ltd.* [1998] 101 Taxman 167/[1999] 237 ITR 706 (Ker.) *affirmed by SC in Appollo Tyres Ltd.* v. *CIT*

[2002] 122 Taxman 562/255 ITR 273 (SC)]. Thus, a contract for sale or purchase of units of UTI, settled without delivery, is not a speculative transaction.

The term "actual delivery" should not be understood as physical delivery, but it should be understood as per of the custom of the trade. Thus, where obtaining delivery order, without taking physical delivery of goods, is treated as actual delivery as per custom of the trade, any profit or loss on the sale of goods on the basis of delivery order cannot be treated as speculative profit or loss [*Raghunath Prasad Poddar* v. *CIT* [1973] 90 ITR 140 (SC)].

Under Sales of Goods Act, the concept of delivery entails that it can be made either by physical delivery of the commodity directly to the purchaser or to the carrier for him or by transferring the documents of title to the commodity. An ordinary contract for sale of goods should not be held to be speculative merely because the actual delivery could not be effected because of the supervening circumstances [*CIT* v. *Panachand Khemchand* [1994] 210 ITR 1053 (Guj.)].

At the outset of the contract the parties might have decided to settle the contract by taking actual delivery but if ultimately the contract is settled by accepting the difference in prices it becomes a speculative transaction.

Isolated speculative transaction not to constitute speculation business: *Explanation 2* refers to "speculative transactions". A single speculation transaction would not amount to a speculation business. Accordingly, an isolated speculative transaction would not constitute a speculation business.

Breach of contract settled without delivery not to be treated speculative transaction: A transaction is considered to be speculative if it is settled otherwise than by the actual delivery or transfer of the commodity or scrips but it does not follow that all contracts which are settled or adjusted without delivery are speculative. There may be a number of cases where there may not be any delivery for various reasons, that is, the party has become insolvent or the business of the party has been banned or one party is unable to give the delivery or the other party is unable to take the delivery. Where the obligation to supply or take the delivery comes to an end through impossibility or by operation of law, any compensation paid for breach of contract cannot be treated a speculative loss. It must be noted that sec. 43(5) speaks of a settlement of contract and, consequently, where there is a breach of the contract resulting in a dispute between the parties and culminating in award of damages as compensation by an arbitration award, the transaction cannot be treated as a 'speculative transaction' within the meaning of section 43(5) [*CIT* v. *Shanti Lal (P) Ltd.* (1983) 14 Taxman 1/144 ITR 57 (SC)].

Non-recovery of loss suffered by a broker in speculative transactions: Where a broker/commission agent carries out speculative transactions on behalf of his clients and the loss suffered in such speculative transactions cannot be recovered from the clients, such loss is not a speculative loss. It is a normal business loss from the commission business. Such loss can be set off against business profits.

If the speculation business is done by the commission agent on his behalf, such loss is a speculative loss, It cannot be set off against the profits of commission

business [*CIT* v. *Pangal Vittal Nayak and Company (P.) Ltd.* (1969) 74 ITR 754 (SC)].

Case Law : *CIT* v. *Pangal Vittal Nayak and Co. (P.) Ltd.* (1969) 74 ITR 754 (SC)

Facts: 'P' a company was a member of an association for speculation in coconut oil. 'P' speculated for its own business and also entered into forward contracts on behalf of its clients and received commission in respect of such transactions, irrespective of whether the clients made profits or suffered losses. 'P' claimed to set off losses from its speculation business against this commission income since it claimed that commission was also a part of its speculation business.

Held: The receipts of commission business was entirely of a different character from the profits and losses of the speculative transactions. There was thus no element of speculation in the commission income received by 'P' and the commission was earned and received by him independently of the profit or loss sustained by the his clients in the transaction. Accordingly, 'P' was not entitled to get the commission receipts assessed under the head "speculation business" and therefore cannot set off speculation loss against said income.

Hedging transactions not to be treated speculative transactions: Hedging transactions are not deemed to be speculative transactions. Such transactions are entered into by manufacturers and merchants in the course of business to guard against loss through future price fluctuations. A hedging loss is treated as business loss and is allowed to be set off against business profits. Likewise, hedging profit is treated as business profits.

Scope of Hedging Transactions: Hedging transactions include the following:

(*a*) a contract in respect of raw material or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandize sold by him; or

(*b*) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or

(*c*) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against the loss which may arise in the ordinary course of his business as such member.

(*d*) An eligible transaction carried out in respect of trading in derivatives (referred to in Sec. 2(*ac*) of the Securities Contracts (Regulation) Act, 1956), in a recognised stock exchange is not deemed to be a speculative transactions.

"*Eligible transaction*" means any transaction—

(*i*) carried out electronically on screen board-based system through a stock broker or sub-broker or such other intermediary registered under sec. 12 of the Securities and Exchange Board of India

Act in accordance with the provision of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1952 or the Depositories Act, 1996; and

(*ii*) which is supported by a time-stamped contract note issued by such broker or sub-broker or such other intermediary to every client indicating in the contract note the unique client identity number allotted under any Act referred to sub-clause (*A*) and permanent account number under this Act.

RECEIPT FROM HOUSE PROPERTY USED FOR BUSINESS OR PROFESSION [SEC. 22]

Where a house property owned by the assessee and used for his business or profession, the profits of which are chargeable to tax, the annual value of such property is not assessable under the head "house property". Income from such property is taxed as business income.

COMPUTATION OF PROFITS AND GAINS [SEC. 29]

For the purposes of this head, the computation of profits should be in accordance with the provisions contained in secs. 30 to 43D (Sec. 29). The list of allowances enumerated in secs. 30 to 43D is not exhaustive. An item of expenditure or loss which is incidental to business or profession may be allowed under this section on the basis of ordinary commercial principles even though there may be no express provision under these sections [*G.G. Dandekar Machine Works Ltd.* v. *CIT* (1993) 202 ITR 161 (Bom.)].

Enquiry to be held about justification for deduction - In order to determine whether a particular item (not covered by Secs. 30 to 37) may or may not be deducted from profits under this section, one should first ascertain whether its deduction is expressly prohibited under any of the sections, and if not, whether it is of such nature that its deduction may be allowed on ordinary commercial principle in computing taxable profits. If the answer is in the affirmative, the deduction may be allowed.

Allowance for Business Losses - Business losses, though fall outside the purview of secs. 30 to 43D, may be allowed under this section on the basis of ordinary commercial principles provided following conditions are satisfied:

(*i*) Losses are not of capital nature [*Mandani Development Corpn. (P.) Ltd.* v. *CIT* (1986)161 ITR 165 (SC)].

(*ii*) They are not merely connected with the trade but are incidental to the trade itself [*CIT* v. *Textool Co. Ltd.* (1982) 10 Taxman 293/135 ITR 200 (Mad.)]

(*iii*) There is no provision, direct or indirect, against such deduction. These principles were affirmed by Supreme court in [*Badridas Daga* v. *CIT* (1958) 34 ITR 10 (SC) and *CIT* v. *Nainital Bank Ltd.* (1965) 55 ITR 707 (SC)].