

# **PRESUMPTIVE TAXATION AND PRATICAL ASPECTS**

## **A CRITICAL ANALYSIS OF SECTION 44AD OF INCOME TAX ACT,1961**

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# INTRODUCTION

- Till, 31<sup>st</sup> March, 2010, the Chapter Profit & Gains of Small business on Presumptive Basis was having majorly 3 sections for Indian entities.
- Section 44AD civil construction
- Section 44AE Transporters
- Section 44AF Retail Traders
- From 01.04.2010 the than honorable Finance Minister Mr. Pranab Mukharjee has kept the last two intact and has amended the first section i.e. 44AD along with 5 sub sections to facilitate the business operations of small taxpayers.
- Earlier this section was extended to civil constructions only but now this section has been extended to all small businesses.
- Apparently the section 44AD is very straightforward, but has lots of implications on the taxpayers.

# WHY PRESUMPTIVE SECTION INTRODUCED??

- Small businesses to comply with the taxation provisions without consuming much time and resources.
- To reduce the compliance cost and administrative burden.
- Expand the scope to all small businesses.
- To encourage the small businesses.

## THE SECTION 44AD IS AS FOLLOWS:

- *“Notwithstanding anything to the contrary contained in sections 28 to 43C, in the case of an eligible assessee engaged in an eligible business, a sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee, shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession””.*

FOR BETTER UNDERSTANDING, WE MUST KNOW THE MEANING OF THE FOLLOWING :-

- Eligible Assessee
- Eligible Business
- Total Turnover/Gross Receipts
- Significance of word Gross Receipts
- Claimed to have been earned

## *WHO IS AN ELIGIBLE ASSESSEE ???*

- A Resident individual
- A Resident HUF
- A Resident Partnership Firm ( NOT BEING A LLP) *LLP as defined under LLP Act, 2008.*

### *Additional Criteria*

- The assessee has not claimed any deduction under Sec. 10A, 10AA, 10B, 10BA, 80HH to 80RRB in the relevant assessment year.

# WHO ARE ALL NOT COVERED UNDER SEC. 44AD ?

- Individual who is not resident
- HUF who is not Resident
- Association of Person
- Firm having non-resident Status.
- A local Authority
- A co-operative Society
- Limited Liability Partnership both Indian as well as Foreign
- Companies both Domestic and Foreign company
- Every Artificial Juridical Person
- Individual/HUF/Firms claiming deduction under chapter III of the Act i.e Section 10A,10AA,10B,10BA relating to units located in FREE Trade Zone, Hardware & Software Technology Park etc.
- Individual/HUF/Firms claiming deduction under Chapter VIA Part-C (deductions in respect of certain Incomes) i.e. Section 80H to 80TT

# AFTER UNDERSTANDING THE MEANING OF ELIGIBLE ASSESSEE, NOW WE MOVE TO ELIGIBLE BUSINESS:

- The assessee should be engaged in *any business* (whether it is retail trading or wholesale trading or civil construction or any other business).

However, the following persons are not eligible to avail any benefit u/Sec. 44AD-

- A person carrying on profession as referred to in Sec. 44AA(1);
  - A person earning income in the nature of commission or brokerage;
  - A person carrying on any agency business; or
  - A person who is in the business of plying, hiring or leasing goods carriages.
- 
- Turnover Criteria:
  - Total Turnover/Gross Receipt in the P.Y of the eligible business should not exceed Rs. 1 Crores (Rs. 2 Crores from the A.Y 2017-18).



# THIS PROVISION IS STRAIGHTFORWARD AND INCLUDES ALL THE BUSINESS WHETHER IT IS :

- Manufacturing
- Trading
- Wholesale
- Retail
- Job Work
- Service Business
- Speculative/Non-Speculative

The Only criteria is turnover of the Eligible Business should not exceed Rs. 1 Crores (Rs. 2 Crores from the A.Y 2017-18) in the P.Y.

- Note: The Profession is not included because, there is specific reference to the word “ Business” in the Sec.44AD, and the Profession is different from Business.
- There is separate provision applicable to Profession i.e., Sec. 44ADA.

# WHAT DO YOU MEAN BY TOTAL TURNOVER OR GROSS RECEIPT?

- Total Turnover / Gross Receipts are amount received/receivable from clients in respect of sale of Previous Year.
- Section 145 relating to Method of Accounting applicable to Section 44AD As per this section the assessee's have an option to choose either Mercantile or cash method.
- Gross Receipts are the amounts received from clients for the services provided or to be provided and does not include the value of material supplied by the client.

# WHAT ARE THE RECEIPTS WHICH FORMS PART OF TURNOVER?

- Sales Tax, Excise Duty, Cess and other levy (NOW GST)
- Sales of unusable empties and packages
- Service charges charged for delivery

# WHAT ARE THE RECEIPTS WHICH DO NOT FORM PART OF THE TURNOVER?

- Sale of Property, Plant and Equipments
- Advance received from customers, deposits received or retention money.
- Any security, retention or other deposit obtained from employees.
- Interest income or other similar receipts.
- Value of inventory

# HOW TO CALCULATE THE LIMIT OF RS. 1 CRORES (RS. 2 CRORES FROM THE A.Y 2017-18)

- It includes all the *eligible businesses* carried on by an *eligible assessee* during the previous year and the Rs. 1 Crores (Rs. 2 Crores from the A.Y 2017-18) will be for all of them **cumulatively**.
- In other words, if an assessee has multiple eligible businesses, then the turnover of those businesses shall be **Clubbed** to determine the limit.

## *WHETHER SECTION 44AD APPLICABLE ON HIM?*

- Mr. Raju, A Resident individual, is carrying on three eligible business, the turnover of which is as under :
- Business A (Manufacturing) Rs.145 Lac
- Business B (Trading) Rs.35 Lac
- Business C (Service) Rs.25 Lac
  
- The Answer is **NO**.
- Because turnover of eligible business exceeds Rs.2 Crores.

## APPLICABILITY OF SEC. 44AD

- Mr. Raju, A Resident individual, is carrying on two businesses, the turnover of which is as under:
- Business A (Eligible Business) Rs.55 Lakhs
- Profession Rs. 20 Lakhs
- Business B (Transport u/s 44AE) Rs.6 Lakhs

Section 44AD and 44AE both are applicable, as profession is not included under section 44AD and section 44AD and 44AE are independent of each other.

## *WHO BEARS THE ONUS OF PROOF TO PROVE THE TURNOVER?*

- The onus of proof is on the assessee.
- It is his duty to prove the turnover.
- If the assessee is maintaining the books of accounts, then it will be easy for him to prove the same, but if he is not maintaining the books of accounts, then it will be very difficult for him to prove, because there is no specific provision for the same.



# WHAT DOCUMENTS YOU SHOULD PROVIDE TO THE AO TO PROVE THE TURNOVER?

- Copies of invoices issued during the PY
- Copies of cash memo
- Copies of Purchase bill
- Bank statement
- Inventory details, if any maintained
- Average G.P rate applicable to Particular business
- Returns filed under sales tax/vat/excise/service Tax laws. (*GST, if it is able to file*)

# WHAT IS THE MEANING OF

*“NOTWITHSTANDING ANYTHING CONTRARY CONTAINED IN SEC.28 TO SEC.43C” ??*

- Section 44AD(1) starts with wording “Notwithstanding Anything to contrary contained in section 28 to 43C” it means section 28 to 43C of Income Tax Act, 1961 is not applicable on eligible assessee carrying on small business.
- The some of the benefits & losses of this wording is enumerated as under by way of examples:

## FEW EXAMPLES:

- Ramdas has paid Rs.28000/- for purchase of goods in cash. No disallowance can be made under section 40A(3) for the same.
- Mahesh has paid Rs.42000/- to transporter for freight in cash. No disallowance can be made under Section 40A (3).
- Peter has contributed certain sum to national Laboratory which qualifies for deduction under section 35(2AA), if he chooses section 44AD , he will not eligible for benefit of this section.
- Salman has recovered certain bad debts written off in earlier years of Rs.35000/-. It may not be added in specified amount declared.

# *WHAT IS THE MEANING OF CLAIMED TO HAVE BEEN EARNED?*

- By the introduction of these words in section 44AD(1), the legislature shows his intention to accept specified income as returned income even if higher sum is earned by eligible assessee unless it is claimed by assessee in his Income Tax Return.

## **Example**

- Srinath is carrying on business. The Turnover is Rs.80 Lakhs. The profit as per his books or calculation is Rs.8 Lakhs. However, he opts to return the income under section 44AD @ 8% i.e. Rs.6.4 Lakhs.

# CAN THE AO ASSESS THE DIFFERENCE AMOUNT AS UNDISCLOSED INCOME?

- **No,**
- The Answer is No due to following reasons:
  - The section has been amended for the benefit of the assessee.
  - The word “Claim” signifies the right of assessee, and it is not an obligation of the assessee.
  - The distinction between Right and obligation is very necessary here.
  - The language of section of section 44AD(1) requires claims to have been made by an assessee for returning higher income.
  - If there is no claim made by assessee in return for higher income, there is no higher income.

The following judicial decisions support this view:

- Samta construction Co V. Pawan Kumar Sharma(2000) 244 ITR 845 (MP)
- CIT V. ARVIND MILLS LTD(1992) 193 ITR 255(SC)
- AC,BANGLORE VELLIAPA TEXTILES LIMITED AND ANOTHER (2003) ITR 560(SC)

## OTHER POINTS:

- The assessee can voluntarily declare a higher income.
- All deductions u/Sec. 30 to 38, including depreciation and unabsorbed depreciation, are deemed to have been already allowed and no further deduction is allowed.
- Up to A.Y 2016-17, in case of Firm, the normal deduction in respect of salary and interest to partners u/Sec. 40(b) shall be allowed. (From A.Y 2017-18 this deduction is Not Available)
- The WDV is calculated, as if depreciation as applicable has been allowed.

# CONTINUED...

- Further, it will be assumed that disallowance, if any, u/Sec. 40, 40A and 43B has been considered while calculation the estimated income @ 8 percent.
- **An assessee (up to A.Y 2016-17), is exempted from payment of advance tax related to SUCH business.**
- **From A.Y 2017-18, an assessee who opts from this scheme is required to pay advance tax related to such business. However, advance tax can be paid during the F.Y on or before March 15.**
- **In other words, no need to advance tax related to SUCH business on or before June 15, September 15 or December 15).**
- Presumptive Income to be 6% in respect of the amount of such total turnover or gross receipts received by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account during the previous year or before the **due date** specified in sub-section (1) of Section 139 in respect of that previous year

## CONTINUED...

Particulars	Income
Amount received Digitally	6% of Amount – (A)
Amount received in Cash	8% of Amount – (B)
Amount not received before due date u/sec.139(1)	8% of Amount – (C)
Total Income	A+B+C



# IS IT POSSIBLE TO DECLARE LOWER INCOME (UP TO A.Y 2016-17):-

- Yes, he can declare his income to be lower than the deemed profits and gains. But following consequences are applicable –
- Maintain the books of accounts as per Sec. 44AA (irrespective of Income or Turnover), if his TOTAL INCOME exceeds the Exemption Limit.
- Get his books of accounts audited u/Sec. 44AB (irrespective of turnover), if his TOTAL TURNOVER exceeds the exemption limit.

# IS IT POSSIBLE TO DECLARE LOWER INCOME (UP TO A.Y 2017-18):-

- Where an Eligible Assessee declares profit for any P.Y at the rate of 8 percent of Turnover u/Sec. 44AD and he declares profit for any of the 5 consecutive subsequent assessment years at lower than 8 percent, he shall not be eligible to claim the benefit of Sec. 44AD for *5 subsequent A.Y.* [i.e., subsequent to the A.Y relevant to P.Y in which the profit has not been declared at the rate of 8 percent]

# SEC. 44AD APPLICATION ISSUES

Income from Eligible Business	Total Income	Applicability of Sec. 44AD	Applicability of Sec. 44AA & Sec. 44AB
> 8% of Turnover	Exceeds Basic Exemption Limit	YES	NO
= 8% of the Turnover	Exceeds Basic Exemption Limit	Yes	NO
< 8% of the Turnover	Exceeds Basic Exemption Limit	NO	YES
< 8% of the Turnover	Less than Basic Exemption Limit	NO	NO

GENERALLY, AS PER THE INCOME-TAX LAW, THE TAXABLE BUSINESS INCOME OF EVERY PERSON IS COMPUTED AS FOLLOWS :

Particulars	Amount
Turnover or gross receipts from the business	XXXXXX
<i>Less</i> : Expenses incurred in relation to earning of the income	(XXXXXX)
Taxable Business Income	XXXXXX

For the purpose of computing taxable business income in the above manner, the taxpayers have to maintain books of account of the business and income will be computed on the basis of the information revealed in the books of accounts.

## EXAMPLE:

- An eligible assessee claims to be taxed on presumptive basis of 8 percent of turnover u/Sec. 44AD for A.Y 2017-18.
- He offers income of Rs. 8 Lakhs on the turnover of Rs. 1 Crores. For the A.Y 2018-19 and A.Y 2019-20 also he offers income in accordance with the provisions of Sec. 44AD.
- However, for A.Y 2020-21, if he offers the income of Rs. 6 Lakhs on turnover of Rs. 1 Crores (not through bank mode), in this case since he has not offered income in accordance with the provisions of Sec. 44AD for 5 Consecutive A.Y after A.Y 2017-18, he will not be eligible to claim the benefit of Sec. 44AD for next 5 A.Y's. (i.e., for A.Y's 2021-22 to 2025-26).

## CONTINUED....

- Consequently, for the A.Y's 2020-21 to 2025-26-
- Maintain books of accounts as per Sec. 44AA (irrespective of income or turnover), if his TOTAL INCOME *exceeds* the basic exemption limit; and
- Get his books of accounts audited u/Sec. 44AB (irrespective of income or turnover), if his TOTAL INCOME *exceeds* the exemption limit.

## ISSUES (CASE LAWS)

- If net profit rate of 8.15% applied by assessee, it took care of every addition.
- Separate addition made by authorities over and above said rate is required to be deleted *Kangiri Contractor v. ITO [2011] 45 SOT 1 (Jodh.)(URO)*

# ISSUES (CASE LAWS)

- Profit rate of 8 per cent as per the provisions of section 44AD is to be applied where the assessee does not maintain books of account and the turnover is less than Rs. 1 Crores (Now 2 Crores)
- In the instant case, the turnover was Rs. 6.21 Crores and the assessee had maintained proper books of account which were duly audited and were free from any adverse comments from the auditors. Therefore, the provisions of section 44AD were not applicable to the instant case.
- *Merely because after completion of scrutiny assessment, the assessee had destroyed the books of account, etc., and, consequently, could not produce same before the Commissioner, would not disprove the facts that those books of account maintained and audited, were produced before the Assessing Officer and were verified by the Assessing Officer.*
- *Hence, the action of the Commissioner of applying net profit rate of 8per cent was not justified.*

*Allied Engineers v. CIT [2009]180Taxman 70 (DELHI) (MAG)*



# ISSUE – REQUIREMENT TO DEDUCT TDS IN YEAR SUBSEQUENT TO YEAR IN WHICH ACCOUNTS AUDITED U/S 44AB R/W SECTION 44AD

- A general issue being raised across is as to whether in year subsequent to year of tax audit u/s 44AB r/s 44AD (due to lower profits being claimed), whether an assessee would be liable for deduction of TDS u/s 194A, 194C, 194I, 194J.
- In this regard, one may note that **THERE IS NO REQUIREMENT IN SUCH CASES TO DEDUCT TDS**, since all above sections says the ‘turnover of the business should be in excess of the monetary limit specified u/s 44AB(a) or 44AB(b) and there is no reference to section 44AB(d).

## ISSUES (CASE LAWS)

- Sec 44AD overrides sec 28 to 43C but does not override chapter VI. *Therefore, current year losses & brought forward losses can be setoff against deemed income.*
- However, *current year & brought forward depreciation can not be set off* against the deemed income since that is governed by sec 32.
- *DCIT v. Sunil M. Kankariya [2008] 298 ITR (AT) 205(ITAT-Pune).*

## ISSUES (CASE LAWS)

- Assessee, entitled to computation on presumptive basis, cannot avoid tax on income from fixed deposits assessable under the head-other sources by claiming it to be a part of business income U/S 44AD.
- *Dy. CIT V Allied Construction (2007) 291 ITR (AT) 16 (Del)*

# SUMMARY OF AMENDMENTS IN SEC. 44AD



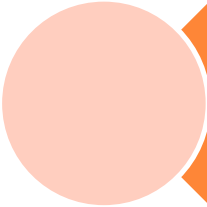
Increase in threshold limit of Eligible Business  
from Rs.1 Crores to Rs. 2 Crores



Salary, Interest, Remuneration paid to  
partners as per Sec. 40(b) **NOT deductible**



Advance tax to be paid on or before 15<sup>th</sup> of  
March of the F.Y



In case of non offering of Income as per Sec.  
44AD for 5 consecutive years, Eligible Assessee  
cannot opt for Sec. 44AD for the next 5 AY's  
after the A.Y of first non-option

# THANK YOU

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