Title

BCAS Tax Knowledge Sharing Series

Details:

Presumptive Taxation – Issues

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Sections 44AD and 44AE were introduced by the Finance Act, 1994 with effect from Assessment Year 1994-95. The Central Board of Direct Taxes (CBDT) explained the intention behind introducing the above provisions in Circular No. 684 dated 10 June 1994. As per the said Circular, the Estimated Income Method of assessment for certain categories of business was prevalent in several countries and the Tax Reforms Committee chaired by Dr. Raja J. Chelliah had also recommended gradual introduction of the Estimated Income Method in certain areas to facilitate better tax compliance. Accordingly, Section 44AD was inserted in the Income tax Act (Act) with a view to providing for a method of estimating income from the business of civil construction or supply of labour for civil construction work. This section was applicable to all the assessee whose gross receipts from the above mentioned business did not exceed INR 40 Lakhs. The income from such business was estimated @ 8% of the gross receipts paid or payable to the assessee. Further, Section 44AE provided for a method of estimating income from the business of plying, hiring or leasing trucks owned by a tax payer owning not more than 10 trucks. Section 44AE was not applicable to the persons who did not own any truck but operated trucks taken on hire. The income from each truck, being a heavy goods vehicle, was estimated at INR 2,000 for every month or part of a month during which the truck was owned by the assessee. The income from each truck, other than a heavy goods vehicle, was estimated at INR 1,800 for every month or part of a month during which the truck was owned by the assessee. It was clarified that all deductions under Sections 30 to 38 including depreciation, would be deemed to have been already allowed and no further deduction would be allowed under both these sections. The written down value would be calculated, where necessary, as if depreciation as applicable had been allowed. It was further clarified that in the case of firms, the deduction for salary and interest to partners to the extent permissible under clause (b) of section 40 would be allowed. However, originally in both the Sections such deduction to firms was not clearly provided for. Therefore, a proviso to sub-section (2) of Section 44AD and to sub-Section (3) of Section 44AE was inserted by the Finance Act, 1997 with effect from April 1, 1994 to provide that in case of firm, the deduction on account of salary and interest paid to partners would be allowed, subject to conditions and limits specified in clause (b) of Section 40. Schemes under both the Section 44AD and 44AE were optional.

Thereafter, the Section 44AD was amended by the Finance (No. 2) Act, 2009 from Assessment Year 2011-12, which provided applicability of this section to "eligible assessee" and for "eligible business". As per Explanation to said section "eligible assessee" means i) an individual, HUF or a partnership firm (other than LLP), who is resident, and ii) who has not claimed deduction under any of the Sections 10A, 10AA, 10B, 10BA or deduction under any provisions of chapter VIA under the heading "Deductions in respect of certain income" in the relevant assessment year.

"Eligible business" means i) any business except the business of plying, hiring or leasing goods, carriages referred to in Section 44AE and ii) whose total turnover or gross receipt in the previous year does not exceed an amount of INR 1 crore.

What was absent in the presumptive basis of taxation schemes was the scheme for professionals. The Finance Act, 2016 introduced a new Section 44ADA incorporating a similar scheme for presumptive taxation of professionals from Assessment Year 2017-18.

Section 44ADA is applicable to a person who is a resident of India and having income from profession referred in section 44AA(1) viz., legal, medical, engineering, architectural, accountancy, technical consultancy, interior decoration and any other profession as notified by the CBDT; and the gross receipts on account of such profession do not exceed INR 50 lakhs. Once the above said conditions are satisfied, the assessee has an option to declare either 50% or more of the gross receipts as income from such profession. While arriving at such presumed income it would be deemed that all deductions under the provisions of Sections 30 to 38 have been given efect to and the written down value of the assets used for the purposes of such profession would be deemed to be calculated as if the person would have claimed depreciation. However, if the person claims his income from profession to be

lower than 50% of the gross receipts from such profession and whose total income exceeds the maximum amount not chargeable to income-tax then the person has to maintain the required/specifed books of account, documents and get the accounts audited as per the provisions of the Section 44AB i.e. obtain a report in Form 3CA or 3CB along with the Form 3CD, as the case may be.

The objective behind introduction of presumptive basis of taxation scheme is to simplify the taxation scheme, to reduce the compliance burden and to facilitate the ease of doing business for the small taxpayers. However, some of the issues that have raised concerns on taxation of presumptive schemes due to amendments brought out in last year's budget are discussed below.

Deduction of partners' remuneration and interest

Sub-section 2 of Section 44AD and 44ADA provides that all deductions under section 30 to 38 would be deemed to have been allowed and no further deduction under the said sections would be allowable. With effect from Assessment Year 2017-18, second proviso to sub-section 2 of Section 44AD has been omitted which provided for deduction under Section 40(b) with regard to the salary and interest to partners. Therefore, the issue would arise is whether a deduction under section 40(b) with regard to the salary and interest of partners can be claimed.

The Revenue may contend that both these sections begin with non obstante clause – "Notwithstanding anything contained in sections 28 to 43C" implying all the deductions and disallowances under said sections would be deemed to have been allowed and hence, deduction under Section 40(b) would not be allowable.

It would therefore be necessary to go through the legislative history regarding the allowability of deduction under Section 40(b) with regard to Sections 44AD and 44AE which pari-materia are similar to Section 44ADA. The CBDT vide its Circular no. 684 dated 10 June 1994 while explaining the scope of Sections 44AD and 44AE stated that the deduction under section 40(b) of partners' salary and interest would be allowed from the income computed on the presumptive basis. However, later the CBDT issued another Circular No. 737 dated 23 February 1996 holding that Circular No. 684 dated 10 June 1994 was erroneous to the extend it allowed deduction under section 40(b) and deleted the relevant portion of the earlier circular with retrospective efect from 1994. This gave rise to wide spread litigations but the controversy was laid to rest by the Finance Act, 1997 which inserted the proviso in Sections 44AD and 44AE specifically providing for deduction under section 40(b) with retrospective efect from Assessment Year 1994-95. The High Courts [Goswami & Bros v. UOI (250 ITR 359) (Raj) and Ranjan Constructions & Ors v. CBDT (232 ITR 76) (Ori)] struck down the CBDT Circular No. 737 dated 23 February 1996 in light of the said amendment.

Section 44ADA does not contain the provision similar to that of Sections 44AD and 44AE extending the deduction under Section 40(b) and more over the Finance Act, 2016 has omitted the said proviso from section 44AD though not from section 44AE. This would give rise to fresh round of litigation. It would be open for an assessee to argue that only deductions under Sections 30 to 38 have been specifcally deemed to have been allowed but not under other sections and hence, the deduction of partners' salary and interest under section 40(b) is to be allowed. However, if this argument holds good, then the efect of, disallowances as a consequence of non-observation of TDS and TCS provisions, disallowance of cash payments and allowability of government taxes/duties, employee welfare fund contributions etc. on cash/ payment basis, also need to be given efect to. In other words, the income from profession would be 50% of the gross receipts which would be further increased or decreased as per the provisions of Sections 40, 40A, 41, 43A, 43B, and 43C, the resultant amount would be the income from such profession. However, the Income Tax Appellate Tribunal of Jaipur had an occasion to deal with a similar issue in the case of ITO v. Devi Singh Solanki (99 TTJ 890) in the context of addition made under Section 69 when income was offered under presumptive scheme of Section 44AD, it held that Section 44AD has limited overriding efect only over Sections 28 to 43C; but not over the other sections of the Act. Reference can also be made to CIT v. G.S. Tiwari & Co (41 Taxmann.com 17) (All). Hence, the argument put forward in the above para may not sustain.

Applicability of Section 44ADA to a partner of firm receiving remuneration and/or interest from the firm

What will happen in case of partner of a professional firm who receives remuneration in the form of salary and interest from the firm. Such receipts would normally be taxed as professional income by virtue of Section 28(v) and therefore, the issue that would arise for consideration is whether such a partner can opt for the presumptive scheme under Section 44ADA. In this connection, attention is invited to the decisions of Kolkata bench of the Income Tax Appellate Tribunal in the case of Amal Ganguli v. DCIT (ITA No. 2135/Kol/2008) and Sagar Dutta v. DCIT (ITA No. 692/Kol/2012) wherein it was held that a partner would be liable to tax audit under Section 44AB if his salary from the partnership firm exceeds the threshold limit prescribed under Section 44AB. In the case of Amal Ganguli, the Tribunal observed that partner is carrying out his profession as a partner of the firm though not individually. Further, it held that if the salary, commission, bonus or interest received by a partner of the firm exceeds the limit prescribed for tax audit then the partner has to comply with the tax audit provisions in his individual capacity also. This implies that where a person is carrying out his professional as a partner of a firm, he satisfies the condition laid out in Section 44ADA of being 'engaged in a profession referred to in Section 44AA(i) and once the salary and interest are taxed as income from profession, all other sections of Chapter IV-D – "Profits and gains of business or profession" would apply to such income. Consequently, the provisions of Section 44ADA should also be applicable to the partner of a professional firm.

It can be contended that in case of a partnership, salary, bonus, interest etc. are nothing but profits of the firm provided to the partner on diferent accounts implying that taxation of salary, interest in the hands of the partner is nothing but extension of taxation of profits of the firm in diferent hands. In RM. Chidambaram Pillai (1977 AIR 489) (SC), it was held that a firm is not a 'legal person', though it has some attributes of a personality. In Income-tax law, a firm is a unit of assessment, by special provisions, but is not a full person. Thus, salary to a partner may be considered as only share of profit under a different name. Though the amendments brought out by the Finance Act, 1992 have changed the scheme of taxation of a partnership firm vis-à-vis the partner, the entire scheme is intertwined together in a manner that the profit of the firm is bifurcated into two or more parts which are taxable either in the hands of the firm or in the hands of the partners under the same head of income i.e. profits and gains of business or profession.

In view of the above, partner receiving the remuneration in the form of salary or interest can be covered by the provisions of Section 44ADA, subject to fulfilment of other conditions.

Share of profits of a partner - Gross receipts for the purpose of Section 44ADA

One of the condition for applicability of Section 44ADA is that the 'total gross receipts' of the assessee engaged in the profession should not exceed INR 50 lakhs. Whereas Section 44AD provides 'total turnover or gross receipts'. The words gross receipts or total turnover are not defened in the Act and therefore, one needs to understand their meaning under commercial parlance. The Black's law dictionary describes gross receipts as – "The total amount of money or other consideration received by a business taxpayer for goods sold or services performed in a year, before deductions."

The Guidance Note issued by the Institute of Chartered Accountants of India on "Tax Audit" clarifies that in case of gross receipts of the business it will include all receipts whether in cash or in kind arising from carrying on of the business and it specially provides that for the purposes of Section 44AB it would exclude partners share of profit which is exempt under section 10(2A). Though the said exclusion is provided for arriving at the gross receipts of the business; the same logic can be extended while arriving at the gross receipts of the profession.

The Mumbai Bench of the Income Tax Appellate Tribunal in the case of ACIT v. India Magnum Fund (81 ITD 295) also held that in order to trigger the provisions of Section 44AB, there should be first computation of profits and gains of business or profession i.e. computation of total income as per Section 4. As the income exempt under Section 10 does not form part of the total income, such exempt income cannot be subjected to the provisions of Section 44AB. Consequently, one may argue that share of partners profit which is exempt under section 10(2A) would not be considered for the purposes of the gross receipts.

Maintenance of books of account

Section 44AA deals with maintenance of books of account. The books of account are not required to be maintained by assessees who opt to offer income under presumptive taxation. In other words, if the assessees intend to offer income lower than the specified percentage, then they are required to maintain the books of account. This is specifically provided in Section 44AA only with reference to those assessees who are covered by Sections 44AD and 44AE. However, Section 44AA is silent in relation to the assessees who are covered by Section 44ADA. This implies that the Section 44ADA overrides only Sections 28 to 43C and not Section 44AA and therefore, Revenue may take a stand that it is mandatory for the professional who is covered under Section 44ADA to maintain books of accounts though he has opted for the presumptive taxation scheme. Although, the Memorandum to the Finance Bill, 2016 provides that an assessee opting for Section 44ADA would not be required to maintain books of account under Section 44AA(1), the same has not been brought out clearly in the Section 44AA. One may rely upon the legislative intent put forth by the Memorandum to the Finance Bill and also the fact that without the exception to maintain books of account the very purpose of the presumptive taxation scheme would be defeated.

As per the tutorial on “Tax on Presumptive Basis in case of Certain Eligible Businesses or Professions” published by the Tax Department on Government’s official website, it is clarified that to give relief to small taxpayers from the tedious job of maintenance of books of account and from getting the accounts audited, the Income-tax Act has framed the presumptive taxation scheme under Sections 44AD, 44ADA and 44AE. In case of a person engaged in a specified profession referred in Section 44AA(1) and who opts for the presumptive taxation scheme under section 44ADA, the provision of Section 44AA relating to maintenance of books of account will not apply.

In view of the above, a position can be taken that if an assessee exercises the option to be governed by the provisions of Section 44ADA and declares his income from the profession @50% or more of the gross receipts, he is not required to maintain the books of account in respect of the specified profession.

The Finance Act, 2016 further amended sub-section 4 of Section 44AD with effect from Assessment Year 2017-18 whereby if a person opts for the presumptive taxation scheme, he is also required to follow the same scheme for next 5 years. If he fails to do so, then presumptive taxation scheme will not be available to him for the next 5 years. For example, an assessee claims to be taxed on presumptive basis under Section 44AD for Assessment Years 2017-18, 2018-19 and 2019-20 and he offers income on the basis of the presumptive taxation scheme. However, for the Assessment Year 2020-21, he opts not to be governed by the presumptive taxation Scheme. In this case, he will not be eligible to claim benefit of the presumptive taxation scheme for the next five Assessment Years, i.e. for Assessment Years 2021-22 to 2025-26. Further, he is required to keep and maintain books of account and he is also liable for tax audit as per Section 44AB from the Assessment Year in which he opts out from the presumptive taxation scheme. This would be irrespective of threshold limit of gross receipts prescribed under Section 44AB. Similar consequences of not following the presumptive taxation scheme continuously for 5 years are absent in the case of assessees who are covered by Section 44ADA.

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