DISALLOWANCE OF BUSINESS EXPENDITURE

There are two kinds of provisions under the Act, - one in respect of what is allowable and other in respect of what is not allowable, i.e., they override the provisions. As discussed also from time-to-time, overriding provisions should first be applied and then only one can decide the allowability of expenditure. If any expenditure is not allowable due to any provisions, then that expenditure is not allowable. These are specific and general provisions which do not allow the expenditures. Expenditure means a cost relating to the operations of an accounting period or to the revenue earned during the period or the benefits of which do not extend beyond the period.

While determining whether a particular expenditure is deductible or not, the first requirement must be to enquire whether the deduction is expressly prohibited under any other provision of the Income tax Act. If it is not so prohibited, then alone the allowability may be considered under ***Sec. 37(1)***. ***Sec. 40*** and ***40A*** provides for non-deductible expenses or payments. Under ***Sec. 43B*** certain deductions are to be allowed only on actual payment.

Overview of Section 40, 40A, 43B

Following amounts shall not be deducted while computing income under the head profits & gains of business or profession-

1) Interest, royalty, fees for technical services, etc, payable to a non-resident or outside India without deducting TDS and its payment;
2) Interest, commission or brokerage, fees for professional services or fees for technical services payable to any resident person without TDS and its payment;
3) Income Tax;
4) Wealth Tax;
5) Any payment which is chargeable under the head "Salaries", if it's payable outside India, or to a non-resident, and the tax has neither been paid in India nor deducted therefrom;
6) Any payment to provident fund or any other fund established for the benefit of employees of the assessee in respect of whom the assessee has not made effective arrangement to secure that tax shall be deducted at source from any payment made from the fund, which are taxable under the head 'salaries';
7) Any tax on non-monetary perquisite actually paid by employer on behalf of employee.
8) Sec. 40 A(2): Any payment made by an assessee to a related person shall be disallowed to the extent it is excess or unreasonable as per the Assessing Officer. Related person includes both "Relative" and "Person having substantial interest".
9) Sec. 40 A(3): Where any expenditure in respect of which payment is made in excess of Rs. 20,000 at a time otherwise than by Account-payee cheque or draft, 100% of such payment shall be disallowed.
10) No deduction shall be allowed in respect of any provision made by assessee for the payment of gratuity to his employees, provided such contribution is not

towards an approved gratuity fund or for the purpose of payment of gratuity, that has become payable during the previous year.

11) No deduction shall be allowed in respect of any sum paid by the assessee as an employer towards setting-up or formation of, or as contribution to any fund, trust, company, AOP,BOI, society or other institution for any purpose provided such sum is not by way of contribution towards approved superannuation fund, recognised provident fund, approved gratuity fund.
12) Deductions in respect of following expenses are allowed only if payment is made on or before the due date for furnishing return of income.
13) Sec. 43B-Following sums not paid before due date of filing return of income
    i. Any sum payable by way of tax, duty, cess, fee, etc.
    ii. Bonus or commission to employees.
    iii. Interest on loan or borrowing from any public financial institutions, etc.
    iv. Interest on any loans and advances from a scheduled bank.
    v. Leave encashment.
    vi Contribution to any P.F., superannuation fund, gratuity fund, etc.

Now we'll discuss the same in detail in following paras:-

Section 40

Amounts not deductible [Sec.40]

Notwithstanding anything contained in Sec. 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head profits and gains of business or profession.

In the case of any assessee [Sec. 40(a)]

These provisions are part of the set of provisions as contained in 'CHAPTER IV – COMPUTATION OF TOTAL INCOME' has been placed under 'Sub-chapter D – Profit & Gains of Business or Profession.' As is explicit from the heading of the section **"Amounts not deductible"**, the provisions deal with the expenses, which are not deductible while computing the income from profits and gains of business or profession under certain conditions. The provisions of clause (a) of section 40 deal with such amounts not deductible with respect to failure in compliance with the provisions of TDS as well as bar deductions on account of payment of certain taxes enumerated therein.

(a) Any interest, royalty, fees for technical services, or other sum chargeable under Income-tax Act which are payable a) Outside India; or b) In India to a non-resident, not being a company or to a foreign company on which tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under Sec. 200(1) before 30th April.

However, where in respect of any such sum:

a) Tax has been deducted in any subsequent year, or
b) Has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under Sec. 200(1),

Such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid. Chargeable under the Income-tax Act means that receipt of such income must be taxable in India.

Disallowance of business expenditure on account of non-deduction of tax on payment to resident-payee [Sec. 40(a)(ia)]

Any interest, commission or brokerage, rent, royalty, fees for professional services, fees for technical services, any amount payable to a resident contractor shall not be allowed as a deduction in the previous year in which the expenses are incurred, while computing the income chargeable under the head 'Profit and gains of business or profession', if in respect of such expenses:-

a. Tax has not been deducted, or
b. After deduction has not been paid on or before the due date mentioned under Sec.139 (1).

However, where in respect of any such sum,-

a. Tax has been deducted in any subsequent year, or
b. Has been deducted during the previous year but paid after the due date specified under Sec. 139(1),

such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

TDS on Income of non-resident (Sec. 195):-

Any person responsible for paying to non-resident, not being a company, or to a foreign company, any interest or any sum chargeable under this Act (Other than salary) shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force.

The meaning of the word 'interest' is very wide and would include interest on unpaid purchase price payable in any manner which would include any means of irrevocable letter of credit. Interest is not part of purchase price and is assessable as interest. Failure to deduct tax on such interest payable outside India shall not entitle the assessee to claim deduction of interest. Sec. 2(28A) defining "interest" does not include the discounting charges on discounting of Bills of Exchange.

Example:- X Company discounted its export sales bills with a company in Singapore and received a payment net of discounting charges. The Assessing Officer disallowed such expenses under Sec. 40(a)(i), for not deducting tax at source under Sec. 195. As the discounting charges cannot be analogous to interest expenses, the obligation to deduct tax under Sec. 195 would not arise and the X Company cannot be denied deduction of such expenses.

Sec. 40(a)(ia) of the Income Tax Act,1961 emphasis on that expenditure covered under mentioned TDS sections paid to resident and debited Profit & Loss Account will not be allowed as deduction while computing the income under the head "Profit and Gains of Business or Profession", if :-

a) Tax has not been deducted at source,
b) Tax deducted at source and the same is not remitted, or
c) If expenditure is debited and tax deducted at source during the previous year, tax is not remitted within the time-limits mentioned in section 200 such expenditure will be allowed as deduction in the year of remittance of the tax.

The following payments are covered under Section 40(a)(ia):

a) Interest U/s 194A
b) Commission or brokerage U/s 194H
c) Professional or Technical Fee U/s 194J and
d) Contractors & Sub Contractors U/s 194C

The provisions of the above mentioned TDS sections require that tax has to be deducted at source when amount is paid or credited to the account of the Payee, whichever is earlier. When the amount is credited to suspense account or any account, by whatever name called, then it is treated as amount credited to the account of the payee and tax has to be deducted at source. Hence, tax has to be deducted at source even on provisions made in the books of account to which TDS provisions are applicable.

Other important points:

a) Most of the assesses book the bills only at the time of payment of the bills.
b) They deduct tax at source only when the bill is booked, i.e., at the time of payment.
c) The assessee applies TDS rates applicable for the Financial Year in which the payments are made and not the rates applicable for the Financial Year in which the provision is made as the payments are made in the subsequent Financial Year.
d) Due to the procedure followed in case of points a, b and c, payments have to be made against which provisions are made on 31st March XXXX and are pending and TDS is not deducted at source.
e) Some payments relating to the expenses provided on 31st March XXXX are made in the month of May and June XXXX and the TDS is remitted in the month of June and July XXXX and attracts interest provisions.
f) So, care must be taken in matching the TDS remittances against the payments made and ensure that they are remitted within the prescribed time-limit or else the same must be disallowed and disclosed in the tax audit report as required.

In order to rationalise the provisions of disallowance on account of non-deduction of tax from the payments made to a resident payee, Sec. 40(a)(ia) has been amended to provide that where an assessee makes payment of the nature specified in the said section to a resident payee without deduction of tax and is not deemed to be an assessee-in-default under Sec. 201(1) on account of payment of taxes by the payee, then, for the purpose of allowing deduction of such sum, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee. These beneficial provisions are proposed to be applicable only in the case of resident payee.

In other words, if the deductor is able to establish that the payee has furnished the return of income by including such income in his return and has paid tax due on income declared by him in such return of income, it shall be deemed that the assessee has deducted and paid tax on such income on the date of furnishing return of income by the resident payee.

Taxes paid on income earned outside India [Explanation 1 to Sec. 40(a)(ii)]:

Any sum paid outside India and eligible for relief of tax under Sec. 90 or deduction from the income-tax payable under Sec. 91 is not allowable, and is deemed to have never been allowable, as a deduction under Sec. 40 of the Income-tax Act. However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with provision of Sec. 90 or Sec. 91, as the case may be.

Further, *Explanation* 2 has been inserted w.e.f. 1-6-2006 to provide that any sum paid outside India and eligible for relief of tax under newly inserted Sec. 90A will not be allowed as a deduction in the computation of profits and gains from business or profession.

Double Taxation Relief (Sec. 90,90A & 91):-

In the case of a resident, if an income earned outside India is charged to tax in that country, then the application of Sec. 90, 90A & 91 in respect of double taxation relief has to be looked into. If a double taxation avoidance agreement has been entered into between Government of India and Government of that country (in which he/she has earned income) then the agreement will be looked into for deciding the taxability of such incomes arising or accruing outside India.

If an agreement with a foreign country does not exist, then in respect of income earned outside India, the tax paid on such income in the foreign country or the Indian rate of tax, whichever is lower, is deductible from the total tax payable by the assessee on his total income including such foreign income.

Disallowance of certain fee, charge, etc. in the case of State Government Undertakings [Section 40(a)(iib)]

State Government Undertakings are separate legal entities distinct from the State Government and are liable to income-tax. If they pay dividends to State Government which owns them, then the tax consequences are :

(i) dividend is not a deductible expense, and

(ii) dividend attracts dividend distribution tax under section 115-O.

So, State Governments instead of taking the profits from their undertakings in the form of dividends opt to take it in the form of royalty, privilege fee, etc. exclusively levied by them on State Government undertakings. Payments in the form of these levies which are exclusive levies on State Government Undertakings (i) do not attract DDT and (ii) are claimed as deduction by State Government Undertakings in computing their business profits. This leads to Revenue contesting them as non-genuine expenditure and colourable device to reduce taxable profits and income-tax on it and also to escape DDT. *Explanatory Memorandum* to the Finance Bill, 2013 states as under:

> "Disputes have arisen in respect of income-tax assessment of some State Government undertakings as to whether any sum paid by way of privilege fee, license fee, royalty, etc. levied or charged by the State Government exclusively on its undertakings are deductible or not for the purposes of computation of income of such undertakings...."

In order to protect the tax base of State Government undertakings vis-a-vis exclusive levy of fee, charge, etc., or appropriation of amount by the State Governments from its

undertakings, the Finance Act, 2013 has amended section 40 by inserting new sub-clause (iib) in section 40(a) with effect from 1-4-2014. The said new sub-clause (iib) provides that deduction shall not be allowed as deduction for the purposes of computation of income of such undertakings under the head 'Profits and gains of business or profession' in respect of :

(A) royalty, license fee, service fee, privilege fee, service charge or any other name whatever called if such royalty etc., is exclusively levied on a State Government undertaking by the State Government; or

(B) any amount which is appropriated directly or indirectly from a State Government undertaking by the State Government.

This amendment will take effect from 1-4-2014 and will, accordingly, apply in relation to the assessment year 2014-15 and subsequent assessment years.

'A State Government undertaking includes—

(i) a corporation established by or under any Act of the State Government;

(ii) a company in which more than 50% of the paid-up equity share capital is held by the State Government;

(iii) a company in which more than 50% of the paid-up equity share capital is held by the entity referred to in (i) or (ii) above (whether singly or taken together);

(iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

(v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government;'.

The disallowance is attracted only if the following conditions are satisfied:

(i) The amount is in the nature of fee or charge and not tax or duty

(ii) The fee or charge is levied exclusively on State Government Undertakings. If levy is non-exclusive, that is, applicable to others apart from State Government undertakings also, disallowance is not attracted

(iii) Levy is by State Government. If levy is by Central Government or any other authority, there will be no disallowance

If above conditions satisfied, it does not matter what nomenclature is given to this exclusive levy of fee or charge - Whether royalty, license fee, service fee, privilege fee or service charge or any other.

Such colourable distribution of profits by State Government undertakings to State Government will continue to be outside purview of DDT. However, deduction cannot be claimed from taxable profits. Again, these exclusive levies in the form of royalty etc. will continue to be expenditure for MAT purposes and no addition will be made to book profits as there is no corresponding amendment to section 115JB. So, these levies will

still be effective for reducing 'book profits' for MAT purposes but not for regular income-tax purposes.

(a) Tax levied on profits or gains [Sec. 40(a)(ii)]:

Any sum paid on account of any rate or 'tax' levied on profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains shall not be eligible for deduction;

Taxes which are not deductible

i. Indian income-tax
ii. Agricultural income-tax
iii. Interest payment in relation to income-tax
iv. Foreign income-tax.

Special Note:-

Taxes paid on income earned outside India [*Explanation* 1 to Sec. 40(a) (ii)] [W.r.e.f. assessment year 2006-07]: Any sum paid outside India and eligible for relief of tax under Sec. 90 or deduction from the income-tax payable under Sec. 91 is not allowable, and is deemed to have never been allowable, as a deduction under Sec. 40 of the Income tax Act. However, the taxpayers will continue to be eligible for tax credit in respect of income-tax paid in foreign country in accordance with the provisions of Sec. 90 or Sec. 91, as the case may be.

Further, the *Explanation* 2 has been inserted w.e.f. 1-6-2006 to provide that any sum paid outside India and eligible for relief of tax under newly inserted Sec. 90A will not be allowed as a deduction in the computation of profits and gains business or profession.

(b) Payment to provident fund or other funds [Sec. 40(a) (iv)]:

Any payment to provident fund or other fund established for the benefit of employees of the assessee shall not be eligible for deduction, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the funds which are chargeable to tax under the head Salaries.

As regards making of effective arrangement for deduction at tax of source, it has been held that a specific provision in the trust deed itself, for deduction of such tax would be a sufficient compliance. Further, the execution of a separate agreement with the trustees or issue of some deductions to the auditors , trustees or secretary to ensure such deduction, shall be treated as provision of effective arrangement.

(c) Tax paid by employer on non-monetary perquisites provided to employees [Sec. 40(a)(v)]:

Any tax actually paid by any employer on the perquisites not provided by way of monetary payment shall not be eligible for deduction while computing the business income of the employer.

Section 40A

Expenses or payments not deductible in certain circumstances: [Sec. 40A]

The provisions, which are being discussed under various sub-sections of Sec.40A have an overriding effect over the provisions of any other section, because sec. 40A (1) clearly states that the provision of Sec.40A shall have effect not withstanding anything to the

contrary contained in any other provisions of the Act. Therefore, any expenditure or allowance, though specifically allowable under any other provisions under the head business or profession, will not be deductible if any of the sub-section of Sec. 40A is applicable.

Expenses or payments not deductible where such payments are made to relatives [Sec.40 A(2)]

Where the assessee incurs any expenditure, in respect of which payment has been made or is to be made to certain specified persons (i.e., relatives or close associates of the assessee), and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived or accruing to him therefrom, so much of the expenditure, as is so considered by him to be excessive or unreasonable, shall not be allowed as a deduction.

Disallowance of 100% of expenditure if payment is made by any mode other than account-payee cheque or draft [Sec. 40 A(3)(a)]

Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account-payee cheque drawn on a bank or account-payee bank draft, exceeds Rs. 20,000 (Rs. 35,000 where payment is made for plying, leasing or hiring goods carriages), no deduction shall be allowed in respect of such expenditure.

Where payment is made for plying, hiring or leasing goods carriages, the payment shall have to be made by account-payee cheque or account-payee draft if the amount of payment exceeds Rs. 35,000 instead of Rs. 20,000 applicable in all other cases.

Situation where payment is made in subsequent year, although deduction for the expenses was already allowed in any earlier year: Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and, subsequently, during any previous year the assessee makes payment in respect thereof, otherwise than by an account-payee cheque drawn on a bank or account-payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and, Accordingly, chargeable to income-tax as income of the subsequent year if the amount of payment exceeds Rs. 20,000 (Rs. 35000).

Further, there are certain exceptions provided in rule 6DD, under which expenditure, even exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction, even though the payment or aggregate of payments made to a person in a day is not made by an account-payee cheque/draft.

These exceptions are as follows-

a) Where the payment is made to-
   i. The Reserve Bank of India or any banking company;
   ii. The State Bank of India or any subsidiary bank;
   iii. Any co-operative bank or land mortgage bank;
   iv. Any primary agricultural credit society or any primary credit society;
   v. The Life Insurance Corporation of India;

b) Where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in a legal tender;

c) Where the payment is made by:-

   i. any letter of credit arrangement through a bank;
   ii. a mail or telegraphic transfer through a bank;
   iii. a book adjustment from any account in a bank to any other account in that or any other bank;
   iv. a bill of exchange made payable only to a bank;
   v. the use of electronic clearing system through a bank account;
   vi. a credit card;
   vii. a debit card.

d) Where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

e) Where the payment is made for the purchase of-

   i. agricultural or forest produce; or
   ii. the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
   iii. fish or fish products; or
   iv. the product of horticulture or apiculture,

   to the cultivator, grower or producer of such articles, produce or products;

f) Where the payment is made for the purchase of products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

g) Where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

h) Where any payment is made to an employee of the assessee or the hire of any such employee, or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heirs does not exceed fifty thousand rupees;

i) Where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of Sec. 192 of the Act, and when such employee-

   i. is temporarily posted for a continuous period of fifteen days or more in place other than his normal place of duty or on a ship; and
   ii. does not maintain any account in bank at such place or ship;

j) Where the payment is required to be made on a day on which the banks are closed either on account of holiday or strike;

k) Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

l) Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

Exceptions:-

The provisions of the Section do not apply to repayment of loans or payment towards the purchase price of capital assets such as plant and machinery not for re-sale.

[Sec. 40A(4)] Immunity to payer in suits where payment made/tendered by A/c payee cheque or draft as required by section 40A(3)

As per ***Sec. 40A(4),*** notwithstanding anything contained in any other law for the time being in force or in any contract, where any payment is required by section 40A(3) to be made by an account-payee cheque drawn on a bank or by an account-payee draft, then the payment may be made by such cheque or draft; and where the payment is so made or tendered, no persons hall be allowed to raise, in any suit or other proceeding, a plea based on the ground that the payment was not made or tendered in cash or in any other manner.

Disallowance in respect of provision for gratuity [Sec. 40A(7)]

Gratuity is a liability which normally arises according to the length of the service of the employees of the assessee. The liability would generally accrue year after year. However, due to practical difficulties in computing the deduction allowable on accrual basis, it has been provided under Sec. 40A(7) that deduction on account of provision for gratuity shall be allowed only when:-

a) The amount of gratuity has actually become payable during the previous year to the employees' (provided deduction has not been claimed under clause (b) below); or
b) When a provision has been made for payment of a sum by way of any contribution towards an approved gratuity fund.

Disallowance in respect of contributions to non-statutory funds [Sec. 40A(9)]

As per provisions of various sections, only the sum contributed by the assessee as an employer towards an approved gratuity fund, recognised provident fund or an approved superannuation fund (for the purposes and to the extent required by law), shall be allowed as a deduction. No deduction shall be allowed in respect of any sum paid towards setting-up or formation of any fund, trust, society, etc., for any other purpose which is not approved or recognised.

Section 43B

Deduction allowed on actual payment [Sec. 43B]

Notwithstanding anything contained in any other provisions of the income-tax Act, in respect of certain expenditure/payments, the deduction is allowed (irrespective of the previous year to which the liability to pay such sum was incurred by the assessee according to method of accounting regularly employed by him) only if the amount has been actually paid during the previous year. However, in case an assessee follows mercantile system of accounting, the payments mentioned below can be claimed on 'due' basis, provided the payment for the same is made within stipulated period mentioned against each expenditure:

Nature of Expense

1) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.
2) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.
3) Any sum payable to an employee as bonus or commission for service rendered.
4) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or State Financial Corporation or State Industrial Investment Corporation like IDBI, IFCI, UPSIDC, Delhi Financial Corporation, etc., in accordance with the terms and conditions of the agreement governing such loan or borrowing.
5) Any sum payable by the assessee as interest or any loan or advance from scheduled bank in accordance with the terms and conditions of the agreement governing such loan.
6) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

Example:-

1.) of Modvat/CENVAT against excise duty payable is considered as "actually paid" for the purpose of allowance under Sec.43B.

2.) Interest on overdraft facility/cash credit limits paid to banks is covered under Sec. 43B and, thus, allowed on accrual basis only when the payment of the same is made on or before the due date of furnishing the return of income specified under Sec. 139(1).

Stipulated Time Period for making payment:-

Due amount should be paid on or before the due date of furnishing the return of income u/s 139 (1) in respect of the previous year in which the liability to pay such sum was incurred.

However, in cases (1) to (6), if the payment of outstanding liability is made after the due date, deduction can be claimed in the year of payment.

Special Note:-

Presently, payment of interest on any loan/borrowing from a public financial institution, State Financial Corporation or State Industrial Development Corporation and interest on any loan/advance from a scheduled bank is allowed as a deduction from business income, when such interest is actually paid.

Provisions of ***Sec.43B*** are applicable only in respect of employers contribution to provident fund, ESI, etc. Employees contribution to provident fund, ESI, etc., shall be allowed as deduction only when the payment of the same is made on or before the due date mentioned under the respective welfare Acts. If the employer's contribution to such fund is paid after the due date under the respective Acts, the deduction for such payment made by the employer shall not be allowed under ***Sec. 36(1)(va)***.

FAQs

1. What are the expenses which are not allowed as deductions under Sec. 40(a)?

Notwithstanding anything contained in sections 30 to 38, the following amount shall not be deducted in computing the income chargeable under the head profit and gains of business or profession.

1). In the case of an assessee [Sec. 40(a)]

a) Interest, royalty, fee for technical services or other sum payable outside India or in India to a non-resident [Sec. 40 (a)(i)]: Any interest, royalty, fee for technical services, or other sum chargeable under Income-tax Act which is payable-

i. outside India; or

ii. in India to a non-resident, not being a company or to a foreign company on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in subsequent year before the expiry of time prescribed under Sec. 200 (1), shall not be allowed as deduction.

However, where in respect of any such sum, tax has been deducted in any subsequent year or, has been deducted in previous year but is paid in any subsequent year after the expiry of the time prescribed under Sec, 200(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Chargeable under the Income-tax Act means that receipt of such income must be taxable in India.

b) Interest, commission, brokerage, etc., paid or payable to a resident [Sec.40(a)(ia)]

W.e.f. assessment year 2005-06, under certain circumstances of non-compliance with TDS provisions, the following amount shall not be allowed as a deduction in computing the income chargeable under the head 'Profit and gains of business or profession'-

i. Any interest, commission or brokerage, rent, royalty, fees for professional services, fee for technical services payable to a resident;

ii. Any amount payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work).

The disallowance can be resorted to in case of above expenses if the tax deductible at source under Chapter XVIIB from such expenses has not been deducted or after deduction has not been paid on or before the due date specified in Sec.139(1).

However, where in respect of any such sum-

a) Tax has been deducted in the subsequent year, or

b) Has been deducted during the previous year but has been paid after the due date specified under Sec. 139(1),

Such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Hence, the assessee who has failed to deduct the tax at source should ensure that the resident payee has satisfied all the conditions and filed the return of income much before the due date mentioned in Sec.139(1) of that relevant assessment year in order that the assessee obtains a certificate from the chartered account and claims the deduction of such

expenses in the same previous year. If the return in filed by the resident payee after the due date mentioned in Sec.139(1) deduction of expenses will be allowed to the deductor in the previous year in which return is filed by the resident payee.

Amendment made by the Finance Act, 2012, w.e.f. A.Y. 2012-13

In order to rationalise the provisions of disallowance on account of non-deduction of tax from the payment made to a resident payee, Sec. 40(a)(ia) has been amended to provide as under:

Where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee-in-default under the first proviso to sub-section (1) of Sec.201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has:

a) deducted, and
b) paid the tax on such sum

on the date of furnishing of return of income by the resident payee referred to in the said proviso.

The amended first proviso to Sec. 201(1) provides as under:

Any person, including the Principal Officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee-in-default in respect of such tax if such resident:-

i. has furnished his return of income under Sec. 139;
ii. has taken into account such sum for computing income in such return of income, and
iii. has paid the tax due on the income declared by him in such return of income.

and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed.

Therefore, if the resident payee satisfies all the above 3 conditions and the deductor furnishes a certificate to this effect from a Chartered Accountant in such form as may be prescribed, then the deductor will be allowed the deduction of the expenses mentioned in Sec. 40(a) (ia) by assuming that the deductor has deducted and paid the tax on such sum on the date of furnishing return of income by the resident payee.

(e) Tax levied on profits or gains [Sec. 40(a)(ii)]:

Any sum paid on account of any rate or 'tax' levied on profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains shall not be eligible for deduction;

Taxes which are not deductible

i. Indian income-tax
ii. Agricultural income-tax
iii. Interest payment in relation to income-tax
iv. Foreign income-tax.

Special Note:-

Taxes paid on income earned outside India [*Explanation* 1 to Sec. 40(a) (ii)] [W.r.e.f. assessment year 2006-07]: Any sum paid outside India and eligible for relief of tax under

Sec. 90 or deduction from the income-tax payable under Sec. 91 is not allowable, and is deemed to have never been allowable, as a deduction under Sec. 40 of the Income tax Act. However, the taxpayers will continue to be eligible for tax credit in respect of income-tax paid in foreign country in accordance with the provisions of Sec. 90 or Sec. 91, as the case may be.

Further, the *Explanation* 2 has been inserted w.e.f. 1-6-2006 to provide that any sum paid outside India and eligible for relief of tax under newly inserted Sec. 90A will not be allowed as a deduction in the computation of profits and gains of business or profession.

(i) Payment to provident fund or other funds [Sec. 40(a) (iv)]:

Any payment to provident fund or other fund established for the benefit of employees of the assessee shall not be eligible for deduction, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the funds which are chargeable to tax under the head Salaries.

As regards making of effective arrangement for deduction at tax of source, it has been held that a specific provision in the trust deed itself, for deduction of such tax would be a sufficient compliance. Further, the execution of a separate agreement with the trustees or issue of some deductions to the auditors , trustees or secretary to ensure such deduction, shall be treated as provision of effective arrangement.

(j) Tax paid by employer on non-monetary perquisites provided to employees [Sec. 40(a)(v)]:

Any tax actually paid by any employer on the perquisites not provided by way of monetary payment shall not be eligible for deduction while computing the business income of the employer.

2. Which expenses are allowed subject to deduction and deposit of TDS?

As per Sec. 40(a)(ia), the following payments made to a resident shall be allowed as deductions only if tax is deducted at source as per the provisions of Chapter XVII-b and deposited as per the provisions of Sec. 200(1):

a) Interest- Sec. 193 or section 194A
b) Payment to contractors/sub-contractors- Sec. 194C
c) Commission or brokerage- Sec. 194H
d) Fee for technical services, fees for professional services u/s. 194J
e) Rent u/s 194-I
f) Royalty u/s 194J

However, where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted in the previous year but has been paid in any subsequent year after the expiry of time prescribed u/s 200(1) such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid- proviso to Sec.40(a)(ia).

As per amendment to Sec. 40(a) made by the Finance Act, 2008 w.r.e.f. asst. year 2005-06 if the tax is deducted in the last month of the financial year, i.e., in the month of March and is deposited on or before the due date of filling of return of income, the deduction for the said expenses will be admissible in the previous year in which the

deduction is made. In case the tax is deposited after the due date of filing of return of income, the expenditure shall be admissible in the year in which the tax is deposited.

3. What are the conditions to be fulfilled for disallowance of an expenditure under Sec. 40A (2)?

For an amount to be disallowed under this section, following three conditions have to be fulfilled:

i. The payment is in respect of an expenditure;
ii. The payment has been made or is to be made to a specified person (i.e., relative or close associates of the assessee) in respect of such expenditure;
iii. The Assessing Officer is of the opinion that such an expenditure is excessive or unreasonable having regard to:
    a. The fair market value of the goods, services or facilities for which payment is made; or
    b. The legitimate business needs of the assessee's business or profession, or
    c. The benefit derived by or accruing to the assessee from the payment.

then, so much of the expenditure as is considered by him to be excessive or unreasonable, shall not be allowed as a deduction:

provided that no disallowance, on account of any expenditure being excessive or unreasonable, having regard to the fair market value, shall be made in respect of a specified domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in clause (ii) of Sec. 92F.

Sec. 40A(2) is applicable where any of the requirement mentioned in (a), (b) and (c) above is satisfied. It is not necessary that all the three requirements should be cumulatively satisfied.

4. Which expenses are not allowed u/s 40A(2)under certain circumstances (like payment to relatives) ?

Notwithstanding anything to the contrary, sec. 40A(2) provides as under:

a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing Officer is of opinion that such an expenditure is excessive or is unreasonable, having regard to the fair market value of the goods, services or facilities for which the payment is made or legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, much of the expenditure as is considered by him to be excessive or unreasonable shall not be allowed as a deduction.

b) The person referred to in clause a) would be the following, namely:

i. Where the assessee is an individual- any relative of the assessee;
ii. Where the assessee is a company, firm, association of persons or Hindu Undivided Family- any director of the company, partner of the firm, or member of the association or family, or any relative of such director, partner or member;
iii. Any individual who has a substantial interest in the business or profession of the assessee, or any relative of such an individual;

iv. A company, firm, association of persons or Hindu Undivided Family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member;

v. A company, firm, association of persons or Hindu Undivided Family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;

vi. Any person who carries on a business or profession,-

A) Where the assessee, being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person; or

B) Where the assessee, being a company, firm, association of persons or Hindu Undivided Family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person.

Explanation:- For the purposes of this sub-section, a person shall be deemed to have a substantial interest in a business or profession, if-

a) In a case where the business or profession is carried on by the company, such person is, at any time during the previous year, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend, whether with or without a right to participate in profits) carrying not less than 20 per cent of voting power; and

b) In any other case, such person is, at any time during the previous year, beneficially entitled to not less than 20 per cent of the profits of such business or profession.

5. What are the provisions relating to disallowance of expenditure exceeding Rs. 20,000 made in cash?

As per sec. 40A(3), with effect from asst. year 2009-10, where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by account-payee cheque drawn on bank or account-payee bank draft, exceeds Rs. 20,000, no deduction shall be allowed in respect of such an expenditure.

W.e.f. 1st October, 2009, in case of payment made for plying, hiring or leasing goods carriage, disallowance will be made, if the payment is made in excess of Rs. 35,000 otherwise by way of account-payee cheque or account-payee bank draft in a day to any person. However, the limit of Rs. 20,000 for payment to all other persons shall continue.

Further, as per Sec.40A(3A) w.e.f. asst. year 2009-10, in case any allowance is made in the assessment for any year on the basis of incurred liability, but in the subsequent year or years, assessee makes a payment exceeding Rs. 20,000 in a day, otherwise than by an account-payee cheque drawn on a bank or account-payee bank draft, in respect of such liability, then the payment so made shall be deemed to be the profit of the year in which such payment is made. The limit of Rs.35,000 will apply u/s. 40A(3A) as well w.e.f. 1st October, 2009, in case of payment made for plying, hiring or leasing of goods carriages.

However, no such disallowance shall be made u/s 40A(3) and u/s 40A(3A), if such payment falls in the prescribed exceptions, having regard to the nature and extent of

banking facilities available, considerations of business expediency and other relevant factors.

6. What are the prescribed exceptions for payments exceeding Rs. 20,000 made otherwise than by account-payee cheque drawn on a bank or account-payee bank draft ?

After the amendment to Sec.40A(3) by the Finance Act, 2008, following exceptional circumstances have been prescribed under Rule 6DD *vide* Notification No. S.O. 2431(E), dated 10th Oct., 2008- applicable with effect from A.Y. 2009-10.

No disallowance under sub-sec (3) of sec. 40A shall be made and no payment shall be deemed to be the profit and gains of business or profession under sub-sec. (3A) of sec. 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account-payee cheque drawn on a bank or account-payee bank draft exceeds Rs. 20,000 in the cases and circumstances specified hereunder, namely :

a) Where the payment is made to-
   i. the RBI or any banking company as defined in clause (c) of sec. 5 of the Banking Regulation Act, 1949;
   ii. the State Bank of India or any subsidiary bank as defined in sec. 2 of the State Bank of India (Subsidiary Banks) Act, 1959;
   iii. any co-operative bank or land mortgage bank;
   iv. any primary agricultural credit society or any primary credit society as defined u/s 56 of the Banking Regulation Act, 1949;
   v. the Life Insurance Corporation of India established u/s 3 of the Life Insurance Corporation Act, 1956;

b) Where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in a legal tender;

c) Where the payment is made by:
   i. any letter of credit arrangements through a bank;
   ii. a mail or telegraphic transfer through a bank;
   iii. a book adjustment from any account in a bank to any other account in that or any other bank;
   iv. a bill of exchange made payable only to a bank;
   v. the use of electronic clearing system through a bank account;
   vi. a credit card;
   vii. a debit card.

d) Where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

e) Where the payment is made for the purchase of-
   i. agricultural or forest produce; or
   ii. the produce of animal husbandry (including live stock, meat, hides and skins) or dairy or poultry farming; or
   iii. fish or fish products; or
   iv. the products of horticulture or apiculture,

- to the cultivator, grower or producer of such articles, produce or products;

f) Where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;

g) Where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;

h) Where any payment is made to an employee of the assessee or to the heirs of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and aggregate of such sums payable to the employee or his heirs does not exceed Rs. 50,000.

i) Where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of Sec. 192 of the Act, and when such employee-

- is temporarily posted for a continuous period of 15 days or more in a place other than his normal place of duty or on a ship, and
- does not maintain any accounts in any bank at such place or ship;

j) Where the payment is required to be made on a day on which the banks are closed either on account of holiday or strike;

k) Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

l) Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

7. What are the provisions regarding disallowance in respect gratuity?

Gratuity is a liability which normally arises according to the length of the service of the employees' of the assessee. The liability would generally accrue year after year. However, due to practical difficulties in computing the deduction allowable on accrual basis, it has been provided under Sec. 40A (7) that deduction on account of provision for gratuity shall be allowed only when:

a) the amount of gratuity has been paid or actually becomes payable during the previous year to the employees (provided deduction has not been claimed under clause (b); or

b) when a provision has been made for payment of a sum by way of any contribution towards an approved gratuity fund.

Therefore, no deduction shall be allowed in respect of any provision made for the payment of gratuity to the employees, even though the assessee may be following the mercantile system of accounting, unless it is a provision for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund.

Excess contribution to gratuity fund: There is a ceiling on the contribution which an employer can make to an approved gratuity fund. It is only the provision for such

expenditure that will be allowable under Sec. 36(1)(v), read with Sec.40A(7). But where actual payment has been made, such amount, to the extent that it may exceed the limit , whether it is allowable or not under Sec. 36(1)(v), would be allowable under Sec.37 of the Act.

8. Are there any exceptions under which there will be no disallowance even if payment exceeding Rs. 20,000/ Rs. 35,000 is made otherwise than by account-payee cheque or draft ?

There are certain exceptions provided in rule 6DD, under which expenditure, even exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction, even though the payment or aggregate of payments made to a person in a day is not made by an account-payee cheque/draft.

Rule 6DD has been notified as per Notification No. 97/2008, dated 10-10-2008 w.e.f. assessment year 2009-10.

These exceptions are as follows:-

a) Where the payment is made to-
   i. The Reserve Bank of India or any banking company;
   ii. The State Bank of India or any subsidiary bank;
   iii. Any co-operative bank or land mortgage bank;
   iv. Any primary agricultural credit society or any primary credit society;
   v. The Life Insurance Corporation of India;

b) Where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in a legal tender;

c) Where the payment is made by:-
   i. any letter of credit arrangement through a bank;
   ii. a mail or telegraphic transfer through a bank;
   iii. a book adjustment from any account in a bank to any other account in that or any other bank;
   iv. a bill of exchange made payable only to a bank;
   v. the use of electronic clearing system through a bank account;
   vi. a credit card;
   vii. a debit card.

d) Where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;

e) Where the payment is made for the purchase of-
   i. agricultural or forest produce; or
   ii. the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
   iii. fish or fish products; or
   iv. the product of horticulture or apiculture,

   to the cultivator, grower or producer of such articles, produce or products;

f) Where the payment is made for the purchase of products manufactured or processed without the aid of power in a cottage industry to the producer of such products;

g) Where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides or is carrying on any business, profession or vocation in any such village or town;

h) Where any payment is made to an employee of the assessee or the hire of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heirs does not exceed fifty thousand rupees;

i) Where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of Sec. 192 of the Act, and when such employee-

   i. is temporarily posted for a continuous period of fifteen days or more in place other than his normal place of duty or on a ship; and
   ii. does not maintain any account in bank at such place or ship;

j) Where the payment is required to be made on a day on which the banks are closed either on account of holiday or strike;

k) Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;

l) Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travelers cheques in the normal course of his business.

9. Will the provisions of Sec. 40A(3) be attracted when the expenditure exceeds Rs. 20,000 or the payment exceeds Rs. 20,000?

The provisions of Sec.40A(3) are attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. However, where several cash payments made to same party during a day, the limit of Rs. 20,000 is to be applied to the aggregate of cash payments made during the day.

It is possible that a person may make different payments at different times during the day to the same person and the aggregate of the payments during the day to the same party may exceed Rs. 20,000. In such a case also, section 40A(3) is attracted.

10. Whether expenditure covered under Sec.43B be claimed as a deduction in the year of payment, although it is an expenditure of a subsequent year?

Sec. 43B requires that specific items listed therein otherwise eligible for deduction may be allowed only on payment in the year of payment. But where such payment is made in advance, it can be allowed in the year of payment, though the amount is deductible in normal circumstances under the law in the year in which it is booked as an expenditure. As long as the payment is for an admissible item of expenditure it is deductible, irrespective of the year to which it relates to as long as it is paid during the year.

MCQ

1. Whether interest can be disallowed u/s 40(a)(i) where assessee has paid interest outside India for delayed payment for the purchase of machinery without deduction of TDS?

a) True b) False

Correct Answer: b)

Justification of correct answer:

The interest paid by assessee is not interest on loan, therefore, the provisions of Sec. 40(a)(i) are not attracted. Therefore, no disallowance can be made u/s 40(a)(i). Thus, option b) is correct.

Comment on incorrect answer:

Sec. 40(a)(i) applies in case of there is delayed payment of interest on loan. Thus, option a) is incorrect.

2. Whether disallowance u/s 40A(3) can be made for cash payments made on bank holidays?

a) True b) False

Correct Answer: b)

Justification of correct answer:

As per Rule 6DD(j) payment made on a day on which the banks are closed either on account of holiday or strike, shall not come within the ambit of disallowance u/s 40A(3). Thus, option b) is correct.

Comment on incorrect answer:

Payment made on bank holiday's would not fall under the ambit of Sec.40A(3). Thus, option a) is incorrect.

3. Assessee-company sells goods manufactured by it to its directors for Rs.1,00,000. The market price of such goods is Rs. 1,75,000. Assessing Officer wants to invoke Sec. 40A(2). Is it a true statement ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

No expenditure has been incurred by the company for which payment needs to be made. Sec. 40A(2) cannot be invoked. Thus, option b) is correct.

Comment on incorrect answer:

Sec. 40A(2) can be invoked where the expenditure has been incurred by the assessee for which payment has been or is required to be made to certain specified persons. Thus, option a) is incorrect.

4. A company pays salary of Rs.30,000 p.m. to its director. The company decides to pay further 1% of its net profits to the director in addition to the salary payment. Whether the same is an allowable expenditure?

a) True b) False

Correct Answer: b)

Justification of correct answer:

If the Assessing Officer proves that salary and commission paid is unreasonable having regard to the services rendered by the director, then the Assessing Officer can disallow that unreasonable portion under Sec. 40A(2). Thus, option b) is correct.

Comment on incorrect answer:

Salary or commission disallowed under Sec. 40A(2) shall be taxable in the hands of director. Thus, option a) is incorrect.

5. Mr. X purchased goods on credit on 01.08.20XX for Rs. 50,000. He makes payment of bills as follows:- On 02.08.20XX Rs. 20,000 On 03.08.20XX Rs.18,000 On 04.08.20XX Rs. 12,000. Whether such an expenditure shall be disallowed u/s 40A(3)?

a) Yes b) No

Correct Answer: b)

Justification of correct answer:

Nothing shall be disallowed as none of the payment exceeds Rs. 20,000 during one day. Thus, option b) is correct.

Comment on incorrect answer:

Sec.40A(3) is attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. Thus, option a) is incorrect.

6. Mr. X purchased goods on following dates:-

01.08.20XX for Rs. 15,000

02.08.20XX for Rs. 20,000

03.08.20XX for Rs. 18,000

He makes a cash payment of the bills on 04.08.20XX of Rs. 53,000. Whether such expenditure shall be disallowed u/s 40A(3)?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:

Nothing shall be allowed as cash payments exceed Rs. 20,000 during one day. Thus, option a) is correct.

Comment on incorrect answer:

Sec.40A(3) is attracted only when a payment exceeding Rs. 20,000, is made to a person on a day in a mode other than account-payee cheque/draft. Thus, option b) is incorrect.

7. Whether only one provision is available under the Act with respect to allowability of an expenditure ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

There are two provisions available under the Act-one in respect of what is allowable and other in respect of what is not allowable. Thus, option b) is correct.

Comment on incorrect answer:

While determining whether a particular expenditure is deductible or not, the first requirement must be to enquire into whether the deduction is expressly prohibited under any other provision of the Income-tax Act? If it is not so prohibited, then alone the allowability may be considered under ***Sec. 37(1)***. Thus, option a) is incorrect.

8. Mr. X purchases goods in cash from his brother for Rs. 40,000, whose market value is Rs. 35,000. Whether any part will be disallowed ?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:

Rs. 5,000 will be disallowed under Sec. 40A(2) and 100% of balance, i.e., Rs. 35,000 will be disallowed under Sec. 40A(3). Thus, option a) is correct.

Comment on incorrect answer:

Sec.40A(3) is attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. Thus, option b) is incorrect.

9. Whether purchase will be covered under expenditure for applying the provisions of Sec. 40A(3) ?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:

Purchases are also covered under expenditures. Thus, option a) is correct.

Comment on incorrect answer:

Since the word expenditure has not been defined, it is a word of wide import. Purchases are also covered under expenditures. Thus, option b) is incorrect.

10. Whether the provisions of Sec. 40A(3) would be applicable where the payment was made in advance for purchase of goods ?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:-

Where the goods are purchased against cash whether the payment is made prior to the delivery of the goods or after delivery of goods, it is payment in cash and it is payment of

consideration for the goods purchased and the same is covered by Sec. 40A(3). Thus, option a) is correct.

Comment on incorrect answer:

Whether payment is made in advance or later on, same will be considered under Sec. 40A(3). Thus, option b) is incorrect.

11. Whether expense incurred on account of interest, royalty, fee for technical services payable to non-resident or outside India without deducting TDS will be allowed as business expenditure?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Under Sec. 40 (a)(i) interest, royalty, fee for technical services payable to non-resident on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in subsequent year before the expiry of the time prescribed under Sec. 200(1), shall not be allowed as deduction. Thus, option b) is correct.

Comment on incorrect answer:

Under Sec. 40(a)(i) it is mandatory to deduct TDS where any interest, royalty, fee for technical services is payable to a non-resident. Thus, option a) is incorrect.

12. Whether expense incurred on account of Interest, commission or brokerage, fees for professional services or fees for technical services is payable to any resident person without deducting TDS and whether its payment will be allowed as business expenditure ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Under Sec. 40 (a)(ia) interest, commission or brokerage, fee for professional services payable to resident on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sec. 139(1).Thus, option b) is correct.

Comment on incorrect answer:

Under Sec. 40(a)(ia) it is mandatory to deduct TDS where any interest, commission or brokerage, fee for professional services is payable to a resident. Thus, option a) is incorrect.

13. Whether tax levied on profits or gains of any business is eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Under Sec. 40(a)(ii) any sum paid on account of any 'tax' levied on the profit or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains shall not be eligible for deduction. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40(a)(ii) any sum paid on account of any 'tax' levied on the profit or gains of any business or profession shall not be eligible for deduction. Thus, option a) is incorrect.

14. Whether taxes paid on income earned outside India are eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Any sum paid outside India and eligible for relief of tax under Sec. 90 or deduction from the income-tax payable under Sec. 91 is not allowable, and is deemed to have never been allowable, as a deduction under Sec. 40 of the Income-tax Act. However, the taxpayers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with provision of Sec. 90 or Sec. 91, as the case may be. Thus, option b) is correct.

Comment on incorrect answer:

As per proviso to Sec. 90 or Sec. 91 taxpayers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country. Thus, option a) is incorrect.

15. Whether sum payable on account of wealth tax will be eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

As per Sec. 40(a)(iia) any sum paid on account of wealth tax under the Wealth Tax Act and any tax of a similar character chargeable under any law in force in any country outside India shall not be eligible for deduction. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40(a)(iia) any sum paid on account of wealth tax under the Wealth Tax Act chargeable under any law in force in any country outside India shall not be eligible for deduction. Thus, option a) is incorrect.

16. Whether salary payable outside India or to a non-resident without deducting TDS will be eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

As per Sec.40(a)(iii) any payment which is chargeable under the head 'Salaries' , if it is payable: i) outside India, or ii) to a non-resident shall not be eligible for deduction if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B. Thus, option b) is correct.

Comment on incorrect answer:

Any salary remitted outside India would not be eligible for deduction. Thus, option a) is incorrect.

17. Whether payment to provident fund or other fund will be eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of the correct answer:

Any payment to provident fund or other fund established for the benefit of employees of the assessee shall not be eligible for deduction, unless the assessee has made effective arrangement to secure that tax shall be deducted at source from any payments made from the funds which are chargeable to tax under the head salaries. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40(a)(iv) any payment to provident fund or other fund established for the benefit of employees of the assessee shall not be eligible for deduction. Thus, option a) is incorrect.

18. Whether tax paid by employer on non-monetary perquisites provided to employees will be eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Any tax actually paid by any employer on the perquisites not provided by way of monetary payment shall not be eligible for deduction while computing the business income of the employer. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40(a) (v) any tax actually paid by any employer on the perquisites not provided by way of monetary payment shall not be eligible for deduction. Thus, option a) is incorrect.

19. Whether failure to deduct tax at source on usance interest paid outside India is covered under Sec. 40(a)(i)?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Usance interest is not part of purchase price and is assessable as interest. Failure to deduct tax on such interest payable outside India shall not entitle the assessee to claim deduction of interest as per Sec. 40(a)(i). Thus, option a) is correct.

Comment on incorrect answer:

The meaning of the word ‘interest’ is very wide and would include interest on unpaid purchase price payable in any manner which would include by means of irrevocable letter of credit. Thus, option b) is incorrect.

20. Whether Sec. 43B is applicable to interest on sales tax ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Interest on delayed payment of sales tax also partakes the character of tax, so that such amount is also admissible as a deduction only on actual payment. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by way of tax, duty, cess, fee, etc. Thus, option b) is incorrect.

21. Whether Sec. 43B is applicable to water charges ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Water charges are in the nature of statutory liability, same come under Sec.43B. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by way of tax, duty, cess, fee, etc. Thus, option b) is incorrect.

22. Whether to claim deduction under Sec. 40(a)(ia) some conditions are required to be fulfilled ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Sec. 40(a)(ia) of the Income Tax Act,1961 emphasis on that expenditure paid to resident will not be allowed as deduction while computing the income under the head "Profit and Gains of Business or Profession", if :-

a) Tax has not been deducted at source,
b) Tax is deducted at source and the same is not remitted, or
c) If expenditure is debited and Tax is deducted at source during the previous year, tax is not remitted within the time-limits mentioned in section 200 such expenditure will be allowed as deduction in the year of remittance of the tax.

Thus, option a) is correct.

Comment on incorrect answer:

Above conditions require to be fulfilled to claim expenditure. Thus, option b) is incorrect.

23. Whether taxes paid on income earned outside India will be eligible for deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Any sum paid outside India and eligible for relief of tax under Sec. 90 or deduction from the income-tax payable under Sec. 91 is not allowable, and is deemed to have never been allowable, as a deduction under Sec. 40 of the Income-tax Act. However, the taxpayers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with provision of Sec. 90 or Sec. 91, as the case may be. Thus, option b) is correct.

Comment on incorrect answer:

As per proviso to Sec. 90 or Sec. 91 taxpayers will be eligible for tax credit in respect of income-tax paid in a foreign country. Thus, option a) is incorrect.

24. Whether payment made to relative will be eligible for deduction ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Where the assessee incurs any expenditure, in respect of which payment has been made or is to be made to certain specified persons (i.e., relatives or close associates of the assessee), and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived or accruing to him therefrom, so much of the expenditure, as is so considered by him to be excessive or unreasonable, shall not be allowed as a deduction. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40A(2) where the assessee incurs any expenditure in respect of which payment has been made to certain specified persons in unreasonable manner, same will be disallowed as a deduction. Thus, option a) is incorrect.

25. Whether when payment mode is other than account-payee cheque, same will attract 100% non-deduction of expenditure ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments is made to a person in a day, otherwise than by an account-payee cheque drawn on a bank or account-payee bank draft exceeds Rs. 20,000, no deduction shall be allowed in respect of such expenditure. Thus, option a) is correct.

Comment on incorrect answer:

Sec.40A(3) is attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. Thus, option b) is incorrect.

26. Where payment exceeds Rs.20,000 and same is made to the Reserve bank of India or any banking company will section 40A(3) be attracted ?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where such payment is made to the Reserve bank of India or any banking company. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeding Rs. 20,000 is made to RBI same will be allowed as an expenditure. Thus, option b) is incorrect.

27. Where payment exceeds Rs.20,000 and same is made to any primary agricultural society or any primary credit society will section 40A(3) be attracted?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where such payment is made to primary agricultural society or any primary credit society. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made to primary agricultural society/primary credit society same will be allowed as an expenditure. Thus, option b) is incorrect.

28. Where payment exceeds Rs.20,000 and same is made to life insurance corporation of India will section 40A(3) be attracted?

a) Yes b) No

Correct Answer: a)

Justification of correct answer:

Under Rule 6DD expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where such payment is made to life insurance corporation of India. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made to life insurance corporation same will be allowed as expenditure. Thus, option b) is incorrect.

29. Where payment exceeds Rs.20,000 and same is made to Government will section 40A(3) be attracted ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where such payment is made to the Government and, under the rules framed by it, such payment is required to be made in a legal tender. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made to Government same will be allowed as expenditure. Thus, option b) is incorrect.

30. Where payment exceeds Rs.20,000 and same is made in any letter of credit arrangement through a bank will section 40A(3) be attracted?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where such payment is made in any letter of credit arrangement through a bank. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made in letter of credit arrangement through a bank it will be allowed as expenditure. Thus, option b) is incorrect.

31. Where payment exceeds Rs.20,000 and same is made with respect to a mail or telegraphic transfer through a bank will section 40A(3) be attracted?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where such payment is made through a mail or telegraphic transfer through a bank. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made through mail or telegraphic transfer through a bank it will be allowed as an expenditure. Thus, option b) is incorrect.

32. Where payment exceeds Rs.20,000 and same is made through a book adjustment from any account in a bank to any other account in that or any other bank will section 40A(3) be attracted?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where there is a book adjustment from any account in a bank to any other account in that or any other bank. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is through a book adjustment from any account in a bank to any other account in that or any other bank will be allowed as an expenditure. Thus, option b) is incorrect.

33. Where payment exceeds Rs.20,000 and same is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee will section 40A(3) be attracted?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where the same is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee will cover under expenditure. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee will be allowed as expenditure. Thus, option b) is incorrect.

34. Where payment exceeds Rs.20,000 and same is made for the purchase of products manufactured or processed without the aid of power in a cottage industry, to the producer of such products will section 40A(3) be attracted?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Expenditure exceeding Rs. 20,000/Rs. 35,000 shall be allowed as deduction where the same is made for the purchase of products manufactured or processed without the aid of power in a cottage industry, to the producer of such products. Thus, option a) is correct.

Comment on incorrect answer:

Under Rule 6DD when a payment exceeds Rs. 20,000 and same is made for the purchase of products manufactured or processed without the aid of power in a cottage industry, to the producer of such products it will be allowed as expenditure. Thus, option b) is incorrect.

35. Whether provision for gratuity will be allowed as deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Gratuity is a liability which normally arises according to the length of the service of the employees of the assessee. The liability would generally accrue year after year. However, due to practical difficulties in computing the deduction allowable on accrual basis, it has been provided under Sec. 40A(7) that deduction on account of provision for gratuity shall not be allowed. Thus, option b) is correct.

Comment on incorrect answer:

Under Sec. 40A(7) deduction on account of provision for gratuity shall not be allowed. Thus, option a) is incorrect.

36. Whether contributions to non-statutory funds will be covered under expenditure?

a) True b) False

Correct Answer: a)

Justification of correct answer:

As per provisions of various sections, only the sum contributed by the assessee as an employer towards an approved gratuity fund, recognised provident fund or an approved superannuation fund (for the purposes and to the extent required by law), shall be allowed as a deduction. No deduction shall be allowed in respect of any sum paid toward setting-up or formation of any fund, trust, society, etc., for any other purpose which is not approved or recognised. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by way of tax, duty, cess, fee, etc. Thus, option b) is incorrect.

37. Whether sum payable by way of tax, duty, cess or fee on due basis will be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

An assessee who follows mercantile system of accounting, the payments made by way of tax, duty, cess or fee can be claimed on 'due' basis, provided the payment for the same is made within stipulated period. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by way of tax, duty, cess, fee, etc. Thus, option b) is incorrect.

38. Whether sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees will be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

An assessee who follows mercantile system of accounting, the payments made by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees can be claimed on 'due' basis, provided the payment for the same is made within stipulated period. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by way of contribution to any P.F., superannuation fund, gratuity fund, etc. Thus, option b) is incorrect.

39. Whether sum payable to an employee as bonus or commission for service rendered will be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

An assessee who follows mercantile system of accounting, the payments made to an employee as bonus or commission for service rendered can be claimed on 'due' basis, provided the payment for the same is made within stipulated period. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by way of bonus or commission for service rendered. Thus, option b) is incorrect.

40. Whether sum payable by the assessee as interest or any loan or advance from scheduled bank in accordance with the terms and conditions of the agreement governing such loan will be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

An assessee who follows mercantile system of accounting, the payments made by the assessee as interest or any loan or advance from scheduled bank in accordance with the terms and conditions of the agreement governing such loan can be claimed on 'due' basis, provided the payment for the same is made within stipulated period. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable as interest or any loan or advance from scheduled bank in accordance with the terms and conditions of the agreement governing such loan. Thus, option b) is incorrect.

41. Whether sum payable by the assessee as an employer in lieu of any leave at the credit of his employee will be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

An assessee who follows mercantile system of accounting, the payments made by the assessee as an employer in lieu of any leave at the credit of his employee can be claimed on 'due' basis, provided the payment for the same is made within stipulated period. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee. Thus, option b) is incorrect.

42. Whether CENVAT against excise duty payable is considered as "actually paid" for the purpose deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Adjustment of Modvat/CENVAT against excise duty payable is considered as "actually paid" for the purpose of allowance under Sec.43B. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income or CENVAT against excise duty payable is considered as "actually paid" for the purpose deduction. Thus, option b) is incorrect.

43. Whether payment of interest on any loan from a public financial institution is allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

As per Sec. 43B payment of interest on any loan/borrowing from a public financial institution, State Financial Corporation or State Industrial Development Corporation and interest on any loan/advance from a scheduled bank is allowed as a deduction from business income, when such interest is actually paid. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income on any sum payable by the assessee of interest on any loan from a public financial institution. Thus, option b) is incorrect.

44. Whether royalty payable to Government is covered under Sec. 43B and allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Royalty payable to the Government is a tax for purposes of Sec.43B which allows tax, duty, cess or fee only on actual payment. Thus, option a) is correct.

Comment on incorrect answer:

Sec. 43B will be applicable on sum not paid before due date of filing return of income or royalty payable to Government. Thus, option b) is incorrect.

45. Whether TDS on royalty payable outside India paid by the assessee is allowed as deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

In case if the assessee pays full royalty but pays TDS himself, he will be allowed deduction of the amount of royalty paid in the year in which TDS is paid but TDS so paid by him shall not be eligible for deduction. Thus, option b) is correct.

Comment on incorrect answer:

TDS paid as a consequence of default under the Income tax Act is in the nature of penalty. Thus, option a) is incorrect.

46. Whether Sec. 40A(2) will be applicable where the assessee is not carrying on business or profession ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Where the assessee is not carrying on any business or profession Sec. 40A(2) will not be applicable. Thus, option b) is correct.

Comment on incorrect answer:

To claim an expenditure it is a must that assessee should be carrying on any business or profession. Thus, option a) is incorrect.

47. Whether only director of the company will be covered under specified person ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

As per Sec. 40A(2) any director of the company or relative of such director will be covered under specified person list. However, director's not the only 'Specified person'. Thus, option b) is correct.

Comment on incorrect answer:

Definition of specified person covers relatives or close associates of the assessee. Thus, option b) is incorrect.

48. Whether a person can be deemed to have a substantial interest in a business or profession?

a) True b) False

Correct Answer: a)

Justification of correct answer:

A person shall be deemed to have a substantial interest in a business or profession if-

a) In a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of shares carrying not less than twenty percent of the voting power; and

b) in any other case, such person is, at any time during the previous year, beneficially entitled to not less then twenty percent of the profits of such business or profession.

Thus, option a) is correct.

Comment on incorrect answer:

Substantial interest is a must as mentioned in above rules. Thus, option b) is incorrect.

49. Whether interest payment made to relatives will be considered under business expenditure?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Interest payment made to relatives, such as son and wife of the assessee would not fall under business expenditure. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40A(2) interest payment made to relatives will not be covered under specified persons list. Thus, option a) is incorrect.

50. Mr. A sells some material to his brother for Rs. 10,000 while the market value of the material is Rs. 20,000. Whether the provision of Sec. 40A(2) be attracted ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Where an assessee *bona fide* sells his goods to a specified person at a rate which is lower than the market rate, there is no expenditure incurred by him and Sec. 40A(2) cannot be invoked. Thus, option b) is correct.

Comment on incorrect answer:

Under Sec. 40A(2) expenditure booked at less than market value would not have any impact. Thus, option a) is incorrect.

51. Whether provision of sec. 40A(3) be attracted when the expenditure exceeds Rs. 20,000?

a) True b) False

Correct Answer: a)

Justification of correct answer:

The provisions of Sec. 40A(3) are attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. Thus, option a) is correct.

Comment on incorrect answer:

Sec.40A(3) is attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. Thus, option b) is incorrect.

52. Whether provision of sec. 40A(3) can be applicable for repayment of loan ?

a) Yes b) No

Correct Answer: b)

Justification of correct answer:

The provision of Sec. 40A(3) does not apply to re-payment of loans or payment towards the purchase price of capital assets, such as plant and machinery not for re-sale. Thus, option b) is correct.

Comment on incorrect answer:

Sec.40A(3) is attracted only when a payment exceeding Rs. 20,000, at a time is made in respect of expenditure which is allowable as deduction a mode other than account-payee cheque/draft. Thus, option a) is incorrect.

53. Whether overseas maintenance cost reimbursed to employees will be allowed as deduction ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

An Amount paid by the assessee to its employees toward overseas maintenance allowance constitutes only reimbursement of the expenses incurred by the employees and would not form part of the salary in the hands of receipts. Sub-clause (iii) of clause (a) of section 40 would not be applicable. Thus, option a) is correct.

Comment on incorrect answer:

Mere reimbursement of expenses will be allowed as deduction. Thus, option b) is incorrect.

54. Whether expenditure incurred by resident company on behalf of non-resident parent company and later on reimbursed will be allowed as deduction ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

As no income accrues or arises to the payee from the payment made by the assessee to its non-resident parent company in respect of the expenditure incurred by the latter in connection with the business activity carried on by assessee it is not required to deduct tax at source and, therefore, the payments can't be disallowed by invoking the provision's of Sec. 40(a)(i). Thus, option a) is correct.

Comment on incorrect answer:

Mere reimbursement of expenses will be allowed as deduction. Thus, option b) is incorrect.

55. Whether a transporter who is not liable to get his accounts audited under Sec. 44AB, payment made by him without deducting TDS will be allowed as deduction ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

A transporter who is not liable to get his accounts audited under Sec. 44AB.,in the immediately preceding assessment year, is not required to deduct tax at source under section 194C from the payments and they can't be disallowed under Sec. 40(a) (ia) on account of non-deduction of TDS. Thus, option a) is correct.

Comment on incorrect answer:

Where transporter is not liable to get his accounts audited under Sec. 44AB, expenditure incurred on deducting TDS is an allowable expenditure. Thus, option b) is incorrect.

56. Whether a transporter who hires services of other transporters, payment made by him to other transporters without deducting TDS will be allowed as deduction ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

A transport contractor himself executes whole of the contract for transportation of goods by hiring trucks from various truck owners, and the payments made for hiring of vehicles fall in the category of payment to sub–contractor and, therefore, the assessee is not liable to deduct tax at source as per the provision of Sec. 194C for the payments made to the truck owners and the same can't be disallowed under section 40(a)(ia). Thus, option b) is correct.

Comment on incorrect answer:

Main contractor's payments attract TDS liability, he is not supposed to deduct TDS from sub-contractor's payments. Thus, option a) is incorrect.

57. Mr. X purchases a software from Mr. M and sells the same in the Indian market. Whether this transaction will fall under royalty regime?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Mr. X purchases a software from Mr. M and sells the same in the Indian market. Mr. X acts as a dealer. This can't be termed as royalty, therefore, Sec. 40 (a)(i) will have any application. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40 (a)(i) Interest, royalty, fees for technical services, etc, payable to a non-resident or outside India without deducting TDS out of its payment is not allowable expenditure. Thus, option a) is incorrect.

58. Mr. X incurred expenditure small fraction of while belongs to labour charges, he does not deduct TDS out of same. Whether this payment will be allowed as an expenditure?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Disallowance cannot be made under section 40(a)(ia) on account of non-deduction of tax at source in respect of estimated labour charges, which is a small fraction of the total expenditure in respect of goods purchased. Thus, option a) is correct.

Comment on incorrect answer:

Non-deduction of expenditure on small fraction of labour charges would not attract dis-allowability. Thus, option b) is incorrect.

59. Mr. X obtained Form no. 15-I from sub-contractor. Whether payment made to him will be allowed as an expenditure?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Once Mr. X has obtained Form No 15 –I from the sub-contractors; he is not liable to deduct tax from the payments made to sub-contractors and no disallowance can be made under section 40 (a) (ia). Thus, option a) is correct.

Comment on incorrect answer:

When non-deduction of tax certificate is available by deductees, same transaction would not attract TDS. Thus, option b) is incorrect.

60. Mr. X took a franchisee from company Y and they entered into an agreement to divide the profit between them; payment was made from Mr. X to company Y without deducting TDS. Will it be allowed as an expenditure?

a) True b) False

Correct Answer: a)

Justification of correct answer:

Franchisee agreement did not stipulate payment to be made to the licencee for any work done on behalf of the company Y and it was merely a case of running a centre and to apportion profits thereof between the company Y and the licencee and, therefore, provisions of section 194C are not applicable and no disallowance under ***Sec. 40 (a) (ia)*** can be made. Thus, option a) is correct.

Comment on incorrect answer:

TDS implication will come into picture when service is being provided. Thus, option b) is incorrect.

61. Where wrong amount of TDS deducted will be expenditure be allowed as deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Mr. X paid to Mr. Y machine hire charges on which Mr. X deducted TDS u/s 194C at 1%. The authority held that the payment was "rent" and TDS ought to have been deducted at 10% u/s 194-I. Authority disallowed the expenditure u/s 40(a)(ia). Thus, option b) is correct.

Comment on incorrect answer:

Wrong TDS deduction not only disallows the expenditure but at the same time will attract penalty clause. Thus, option a) is incorrect.

62. Whether the interest paid along with purchase will be considered to be part of the purchase price and will be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

When the amount of interest paid has been considered to be part of the purchase price and not interest under section 194A, such payment cannot be disallowed under section 40a(ia). Thus, option a) is correct.

Comment on incorrect answer:

Interest paid on purchase will become part of purchase price and same will become part of expenditure. Thus, option b) is incorrect.

63. If TDS deducted on interest & commission or brokerage and not deposited on time will expenditure be allowed as deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

TDS deducted on interest & commission or brokerage after deduction if same is not paid on time or before the due date mentioned under Sec.139 (1), it won't be allowed as an expenditure. Thus, option b) is correct.

Comment on incorrect answer:

As per Sec. 40(a) if TDS is deducted and after deduction has not been paid on or before due date mentioned under Sec.139 (1) it would not be allowed as a deduction. Thus, option a) is incorrect.

64. If payment of TDS deducted on amount is made beyond period prescribed under sub-sec. (1) of Sec. 200 will expenditure be allowed as deduction?

a) True b) False

Correct Answer: a)

Justification of correct answer:

There may be some delays in payment of tax deducted at source beyond the period prescribed in sub-section (1) of Sec. 200, read with Rule-30 of the Income-tax Rules. The expression in sub-clause (ia) to the effect that "after deduction, has not been paid during the previous year," implies that even if after deduction there is delay in payment, the expense will be deducted in computing the total income, if the tax deducted is paid within the previous year. Thus, option a) is correct.

Comment on incorrect answer:

Delay would not cause any impact on allowability of an expenditure, since same has been paid during the previous year. Thus, option b) is incorrect.

65. Whether transaction charges paid by broker company to stock exchange will attract provision of Sec. 40 (a)(ia)?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Transaction charges paid by the brokers to the stock exchanges are not for any services provided by the stock exchange, hence, the provisions of Sec. 40(a)(ia) would not be attracted, though no tax is deducted. Thus, option b) is correct.

Comment on incorrect answer:

Transaction charge payment is not with respect to any services provided to broker. Thus, option a) is incorrect.

66. Whether transportation of goods through train will attract provision of Sec. 40 (a)(ia)?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Transportation of goods by railways does not fall with in the ambit of "work" within the meaning of section 194C and, therefore, there is no obligation on the assessee to deduct tax at source under section 194C from the payments made and, accordingly, no disallowance can be made under section 40(a)(ia). Thus, option b) is correct.

Comment on incorrect answer:

As transportation of goods does not fall under works, same will not fall under the ambit of Sec. 40(a)(ia). Thus, option a) is incorrect.

67. Whether deductions are allowed only on actual payment basis?

a) True b) False c) Both

Correct Answer: c)

Justification of correct answer:

As per Sec. 43B certain deductions are to be allowed only on actual payment basis. However, in case an assessee follows mercantile system of accounting, the payments can be claimed on 'due' basis, provided the payment for the same is made within stipulated period mentioned against such expenditure. Thus, option c) is correct.

Comment on incorrect answer:

If assessee is following mercantile accounting system then payment can be claimed on due basis. If the assessee is following cash basis accounting system then same can be claimed on actual payment basis. Thus, options a) & b) are incorrect.

68. Whether any expenditure disallowed under Sec. 37(1), will be allowable under Sec. 43B?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Sec. 43B is applicable only where deduction is allowable under the Act. When the expenditure is not allowable under Sec. 37(1) or any other section, then that expenditure cannot be allowed under this section. Thus, option b) is correct.

Comment on incorrect answer:

Sec. 43B regulates the time of deduction and not the admissibility or otherwise of the the deduction itself. Thus, option a) is incorrect.

69. Whether post-dated bearer cheques would fall under Sec. 40A(3) ?

a) True b) False c) Both

Correct Answer: c)

Justification of correct answer:

Where payment is partly made in cash and partly by means of post-dated cheques and the cash payments do not exceed the prescribed limit, provision of sub-sec. (3) of Sec.40A would not be applicable. Thus, option c) is correct.

Comment on incorrect answer:

Sec. 40A(3) is attracted only when a payment exceeding Rs. 20,000, at a time is made in a mode other than account-payee cheque/draft. Thus, option a) & b) is incorrect.

70. Whether expenditure incurred in a year can go beyond a period?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Expenditure means a cost relating to the operations of an accounting period or to the revenue earned during the period the benefits of which do not extend beyond the period. Thus, option b) is correct.

Comment on incorrect answer:

Principally expenditure incurred in a financial year can be claimed in the same year. Thus, option a) is incorrect.

71. Whether allowability of an expenditure depends upon prohibition?

a) True b) False

Correct Answer: a)

Justification of correct answer:

While determining whether a particular expenditure is deductible or not, the first requirement to enquire whether the deduction is expressly prohibited under any other provision of the Income tax Act? If it is not so prohibited, then alone the allowability may be considered under ***Sec. 37(1)***. Thus, option a) is correct.

Comment on incorrect answer:

If an expenditure is prohibited, allowability can't be considered. Thus, option b) is incorrect.

72. Company X makes a royalty payment to foreign collaborator, i.e., company Y. While making payment TDS liability was borne by Company X. Whether this deduction will be allowed ?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Company X fails to deduct TDS and pays the royalty without deducting TDS. It will not be allowed the deduction on account of such royalty paid. If Company X pays royalty to foreign collaborator, i.e., Company Y where tax is deducted by X before making royalty payment, then the deduction of the gross amount of royalty will be allowed. Thus, option b) is correct.

Comment on incorrect answer:

It is mandatory to deduct tax where the same is applicable. In case company fails to deduct the same, deduction would not be allowed as an expenditure. Thus, option a) is incorrect.

73. Mr. X incurred an expenditure and same was excessive having regard to fair market value. Whether same will be allowed as a deduction?

a) True b) False

Correct Answer: b)

Justification of correct answer:

Where expenditure is excessive or unreasonable, having regard to the fair market value of the goods, services or facilities for which the payment is made for the legitimate needs of the business or profession of the assessee or the benefit derived or accruing to him therefrom, so much of the expenditure, as is so considered to be excessive or unreasonable, shall not be allowed as a deduction. Thus, option b) is correct.

Comment on incorrect answer:

Unreasonable expenditure is not allowed as deduction. Thus, option a) is incorrect.

74. If transaction has been done or performed on arm's length basis whether the same will be allowed as a deduction ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

As per sec. 40A(2) no disallowance of any expenditure being excessive or unreasonable shall be made if such transaction is at arm's length price. Thus, option a) is correct.

Comment on incorrect answer:

Transaction done on arm's length basis shall be allowed as deduction. Thus, option b) is incorrect.

75. Company X makes payment to transport operator of Rs. 32,000. Whether same will be allowed as deduction ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

As per Sec. 40A(3) payment to transport operator is allowed up to Rs. 35,000. In this case deduction will be allowed. Thus, option a) is correct.

Comment on incorrect answer:

Payment made to transport operator in excess of Rs. 35,000 & Rs. 20,000 in other cases, will not be allowed as deduction. Thus, option b) is incorrect.

76. Company X deposited the amount in an approved/recognised gratuity fund. Whether same will be allowed as deduction ?

a) True b) False

Correct Answer: a)

Justification of correct answer:

As per Sec. 40A(7) employer shall be allowed deduction if he has deposited the amount in approved/ recognised gratuity fund. Thus, option a) is correct.

Comment on incorrect answer:

No deduction shall be allowed if the amount has been deposited in an unapproved or unrecognised fund. Thus, option b) is incorrect.