

# **Section 44AD of The Income Tax Act, 1961**

**Special provision for computing profits and gains of business on presumptive basis**

**By:**

**CA. Sanjay Agarwal**

**CA. Sidharth Jain**

# **Applicability**

- The amended provisions of this section are applicable with effect from 1st April, 2011 and will accordingly apply in relation to assessment year 2011-12 and subsequent assessment years.

## **Reason for introducing new scheme for presumptive taxation**

- There has been a substantial increase in small businesses with the growth of transport and communication and general growth of the economy. A large number of businesses and service providers in rural and urban areas who earn substantial income are outside the tax-net.
- Introduction of presumptive tax provisions in respect of small businesses would help **a number of small businesses to comply with the taxation provisions** without consuming their time and resources.
- **To lowers the compliance cost** for small taxpayers & also **reduces the administrative burden** on the tax machinery.
- **To expand the scope of presumptive taxation to all businesses.**

**Difference Between**  
**Earlier provisions and Amended provisions-**  
**At Glance**

S.N.	Basis	<u>Upto the A.Y.2010-11</u>	<u>From the A.Y.2011-12</u>
1	Eligible assessee	Individual, HUF, AOP, BOI, firm, Co., Co-operative society or any other person.	Individuals, HUFs & partnerships firms (not being a LLP).
2	Eligible business	Civil construction or supply of labour for civil construction.	<b>Any business</b> except the business covered under Sec.44AE.
3	Gross Receipts	should not exceed 40 lakhs	should not exceed Rs 1 Crore.
4	provision of advance tax	Required to pay advance tax	No requirement of payment of advance tax
5	Applicability of Sec. 44AA & 44AB	To declare lower than deemed income.	To declare lower than deemed income and <u>his total income is chargeable to tax.</u>

# Provisions of the section 44AD.....

- Sub-Section (1) :  
Notwithstanding anything to the contrary contained in sections 28 to 43C,
- *In the case of an eligible assessee engaged in an eligible business,*
- *a sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year on account of such business,*
- *or a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee,*
- *shall be deemed to be the income under the head “Profits and gains of business or profession”.*

# **Eligible Assessee**

- *“eligible assessee” means,—*

*(i) an individual, Hindu undivided family or a partnership firm, who is a resident, but not a limited liability partnership firm.*

*(ii) who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA, or deduction under any provisions of Chapter VIA under heading C in the relevant assessment year.*

# **Eligible Business**

- *“eligible business” means,—*
  - (i) *any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE.*
  - (ii) *whose total turnover or gross receipts in the previous year does not exceed an amount of **1 Crore**.*

Note : - Eligible business may include speculative business.

# **Exclusions to Eligible Business**

- a. A person carrying on **Profession** as referred to in subsection (1) of Section 44AA;
- b. A person earning income in the nature of **Commission or Brokerage**; or
- c. A person carrying on any **Agency Business**.

# **Total sales/Turnover or Gross Receipts**

**“Gross Receipts” is not defined in the Act**

- It includes all the receipts in cash or kind.
- Arising from carrying on of the business.
- Which is assessable as business income under the act.
- U/s 145(1) “Sales”, “Turnover” or “Gross Receipts” computes either on cash or mercantile system.
- **As per the Guidance Note on Tax Audit: “Sales Turnover” means-** “The aggregate amount for which sales are effected. The ‘gross turnover’ & ‘net turnover’ ( or ‘gross sales’ and ‘net sales’) are sometimes used to distinguish the sales aggregate before and after deduction of returns and trade discounts.”

**Contd:**

- In case of Share brokers
  - Transaction entered on his personal a/c also included in the sale value for purpose of Sec 44AB.
  - Sub-broker is not different from a share broker.
  
- Turnover or Gross receipts:- In case of shares, securities & derivatives:
  - (a) Speculative Transaction:- Positive or negative difference amt arises on settlement of contracts is to be considered as Turnover.

(b) Difference of total favorable & unfavorable

- Premium received on sale of option
- Difference of any reverse trade entered

(c) Delivery based Transactions:- Total value of sales.

## *Issues:*

- The value of material supplied by the client is not included in Gross receipt.
- Value of work in progress would not constitute turnover.
- Turnover basis is mostly accepted by I. Tax Depts.
- Commission on sales is also included in Total Turnover.

- Section 44AD(1) does not deal with undisclosed receipts but deals with gross receipts [CIT v. Sobti Construction \(India\) \[2008\] 174 Taxman 39 \(Delhi\)](#)

***For E.g.:*** Mr. A is carrying on manufacturing business. The Turnover of which is Rs. 40 lakhs. The profit as per his books is Rs.5 Lakhs. But he opts to return the income u/s 44AD @ 8% i.e. Rs.3.2 Lakhs. Can the AO assess the difference amount as undisclosed income?  
Ans: **NO**

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

## Issues:

### A.O. does not have the power to assess if returned income is more than 8% of Gross receipts

Assessee filed return of income as per section 44AD declaring net profit at rate of 9.56% of total sale consideration.

Assessing Officer on basis of aforesaid statement of partner made addition of entire 'on money' to returned income of assessee.

Since there was no material with department to make addition of 'on money' and assessee had shown income of more than 8 per cent of total sale consideration, no addition of 'on money' to income of assessee could be made while working under section

44AD. [Abhi Developers v. ITO \[2007\] 12 SOT 444 \(Ahd.\)](#)

# Issues:

- Profit rate of 8 per cent as per the provisions of section 44AD is to be applied where the assessee does not maintain books of account and the turnover is less than Rs. 60 lakhs. (Now 1 Crore)
- In the instant case, the turnover was Rs. 6.21 crores and the assessee had maintained proper books of account which were duly audited and were free from any adverse comments from the auditors. Therefore, the provisions of section 44AD were not applicable to the instant case.
- Merely because after completion of scrutiny assessment, the assessee had destroyed the books of account, etc., and, consequently, could not produce same before the Commissioner, would not disprove the facts that those books of account maintained and audited, were produced before the Assessing Officer and were verified by the Assessing Officer.
- *Hence, the action of the Commissioner of applying net profit rate of 8 per cent was not justified.*
- Allied Engineers v. CIT [2009]180Taxman 70 (DELHI) (MAG)

## **Are Provisions of Section 40A(3), 41[1], 43B, 40a(ia) attracted**

Sub section (1) of sec. 44AD begins with a **non-obstante clause** and over-rides section 28 to 43C.

Accordingly provisions of Sec 40A(3),41(1),43B **shall not be applicable in case assessee opts for a presumptive taxation u/s 44AD.**

**Provisions of Section 40a(ia) are also not attracted**, in case the assessee was liable to deduct TDS [due to Tax Audit in preceding P/y]. However, the penal provisions u/s 201(1), 201(1A), 221, 271C may be invoked by the AO.

## **Multiple Eligible Businesses**

- If an assessee has multiple eligible businesses, then the turnover of all those businesses shall be **clubbed** to determine the limit of 1 Crore.

Eligible as well as ineligible business

**Each Business is a separate business:**

Business 1-Gross receipts < 1 crore

Eligible business

- He can opt for section 44AD.
- Tax audit is not required.
- No books of accounts are required to be maintained.

Business 2 -Gross Receipts > 1 crore

Ineligible business

- He cannot opt for section 44AD.
- Tax audit is required.
- Books of accounts are required to be maintained.

## **Extract from the Tax Audit Report**

- **Clause 12 provides for:**
- “Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section).”
- Thus, if an assessee has both eligible and ineligible business then he is required to report on the basis of this clause.

## **Example:**

- X, A Resident individual, is carrying on two business, the turnover of which is as under:
- Gross receipts from manufacturing business: 50 Lakhs
- Gross receipts from transportation business: 6 Lakhs
- Gross receipts from profession :28 Lakhs
  
- Sec 44AD shall apply to Manufacturing business.
- Sec 44AE shall apply to transportation business.
- Sec 44AB shall apply only to profession.

## Issue:

If common books are maintained, Proportionate expenditure is allowed:

If an assessee has not maintained separate books of accounts for business of civil work and consultancy work, then in the absence of correct and complete accounts,

- Proportionate expenditure pertaining to civil work shall be disallowed.
- [Samurai Techno trading Co.\(P\) Ltd. v CIT \(2010\)37 DTR \(Ker.\)386](#)

## **No deduction u/s 30 to 38 allowable**

- **Sub-Section(2)** provides that if income is computed under section 44AD then, no deductions shall be allowable u/s 30 to 38. i.e. any deduction allowable under these sections shall be deemed to have been already given full effect to and no further deductions shall be allowable.
- **However**, in the case of a firm the normal deduction in respect of salary and interest to partners u/s 40(b) shall be allowed.

## Note:

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

## Issues:

- Where income of a civil contractor has been assessed/computed by applying net profit rate to gross receipts, he would not be entitled to depreciation separately. [Surinder Pal Nayyar v. CIT \[2009\] 177Taxman207\(P.&H.\)](#)
- When an assessee is assessed u/s 44AD, Whether an addition can be made u/s 69? Yes, [ITO v. Devi Singh Solanki \[2006\] 154 Taxman155 \(JP.\)\(MAG.\)\(ITAT\)](#)

## **WDV of assets of the eligible business**

- **Sub-Section(3)** provides that, the WDV of any asset of an eligible business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.
- Deemed deduction of depreciation is assumed for the purpose of arriving at opening W.D.V. of the succeeding year, so as to enable the assessment in normal course for later years, if it becomes necessary. [**CIT v. Chopra Brothers India (P) Ltd (2001)252 Itr 412(P&H)**]

## *Exemption from payment of advance tax*

- *Sub-Section(4)*
- An assessee opting for the scheme shall be exempted from payment of advance tax related to such business.

## Issue:

- How to calculate Advance Tax where the assessee is having both income from eligible business & other income:

- Presumptive income is Rs 4 lakhs & other income is Rs 8 lakhs
- In this case, whether the assessee is exempted from advance tax in all or he is liable to Pay advance Tax on other income of Rs.8.00 lakhs?

From the understanding of Law, it is clear that the assessee have to pay advance tax on other income of Rs 8 lakhs. But how this tax calculation is to be made matter is required to be resolved.

## **Exemption from maintenance of books of Accounts u/s 44AA**

- An assessee shall be exempted from maintenance of books of accounts related to such business under Section 44AA.
- Assessee shall have to maintain such books of account & document as will enable the assessing officer to compute his total income. **[Ref. Rule 6F]**
- Following records may be maintained:-
  - Records of daily sales
  - Sale Bills
  - Stock Records
  - Bank Statements
  - Account statement of parties
  - If sale bills are not maintained, the purchase bills and GP ratio of earlier years can be used to establish sales.

## Issues:

Assessee is not under any obligation to explain individual entry of cash deposit in bank unless such entry has no nexus with gross receipts. [\*CIT V. Surinder Pal Anand \[2010\] 192 Taxman 264 \(P. & H.\)\*](#)

- Under section 44AD when the books of account were not maintained, income has to be estimated only at 8 per cent. Hence, estimating the income at 8 per cent cannot be regarded as illegal. [\*Commissioner of Gift-tax v. A.Vajjiram & Bros.\[2010\] 326 ITR 551\(MAD.\)\*](#)

## Option to declare lower income than Deemed Income

- Sub-Section (5)
- If an assessee claims that his income is lower than income deemed under section 44AD(1) and his total income exceeds the maximum amount not chargeable to tax

Then,

*He shall have to maintain the books of accounts related to such business u/s 44AA.*

*He is also required to get them audited under section 44AB and furnish the prescribed report within prescribed time.*

## **Section 44AD(5) determination Issues**

<b>Income from Eligible Business</b>	<b>Total Income</b>	<b>Applicability of s. 44AD</b>	<b>Applicability of 44AA &amp; 44AB</b>
> 8% of Turnover	Exceeds Exemption Limit	Yes	No
= 8% of Turnover	Exceeds Exemption Limit	Yes	No
< 8% of Turnover	Exceeds Exemption Limit	No	Yes
< 8% of Turnover	<b>less than</b> Exemption Limit	No	No

## Issues:

- Assessee was called upon to furnish information for finalizing his assessment - As he failed to furnish same, Assessing Officer made assessment by treating 8 per cent of gross receipts as his income.
- On appeal, assessee produced fresh evidence in support of his claim and CIT(A) considering same allowed assessee's appeal. - Tribunal affirmed finding of CIT(A)
- Held That:
- Assessee having satisfied appellate authority by leading evidence that income declared by him was correct income, there was no ground to interfere with order of Tribunal.
- [\*CIT V. Brij Pal Sharma \[2009\] 185 Taxman252 \(P.& H.\)\*](#)

## Issues:

- If an assessee declares their profits less than 8% thereby maintaining books of account and getting their accounts duly audited, then the assessing officer cannot reopen the assessment under section 147 merely by providing the reason that profits declared is less than 8%, which is less than as provided in section 44AD of the Act.
- In ITO Bhopal vs. Project India (2007) 109 ITD 87 (Indore) : The reopening of assessment was held to be invalid.
- Similarly, in case of ITO vs. Mansi Enterprises (2007) 17 SOT 564 (Mum) it was held that since assessee had fulfilled all conditions of sec. 44AD, assessment could not be re-opened for the reason that a partner was not aware about business activities of firm and therefore the firm was non genuine.

## **Belated filing of Tax Audit Report u/s 44AB r/w sec.44AD[5]....Can lower profits so claimed be denied**

Nowhere in section 44AF (right from sub-section (1) to sub-section (5)) is it mentioned that the assessee will be denied the benefit of claiming lower profits and gains than the profits and gains as specified in sub-section (1) of section 44AF, if it furnishes the audit report beyond the due date as mentioned in section 44AB.

Thus, it is clear that it is not the intention of the Legislature to altogether deny the benefit of lower profits if the assessee maintains books of account and gets them audited and furnishes a report as required under section 44AB though belatedly.

**[Leyland Automobiles v. ITO 303 ITR \[AT\] 086 \(Coc.\)](#)**

## *Simplified Return Form*

- An individual / HUF opting for this scheme can submit his / its return of income in ITR-4S (which is a simplified return form). This Return form is also called as Sugam.

## **permissibility of adopting the principle underlying the said section**

- *Where in a particular case, where amount of gross receipts is in excess of Rs. 40 lakhs (now 60 lakhs) and section 44AD is not applicable, then, the principle underlying said section can not be adopted, when it was not applicable as such as no legal authority had been shown to support the proposition.*
- In the present case, the assessee's gross receipts exceeded Rs. 40 lakhs yet the Assessing Officer adopted the net profit rate criteria. Tribunal also proceeded on the basis of adopting the principle underlying section 44AD and also declined disallowance of depreciation contrary to law, thus, the order of the Tribunal was to be set aside. [\*\*Shri Ram Jhanwar Lal v. ITO \[2009\] 321 ITR 040 \(RAJ.\)\*\*](#)

## Issues:

The provisions of sec 44AD were inserted in the Act with effect from 1-4-1994 and it can be a guideline for the purpose of applying a particular net profit rate in the case of civil contractor even in earlier years.

Thus if it is a case of A.Y. 1992-93, Then in such case provisions of sec44AD can be applied.

*Arihant Builders, Developers & Investors (P.) Ltd. v. ACIT [2007] 106 ITD 10 (Indore) (SB)*

## Issues:

Incase Tax audit of an Individual or HUF has been conducted on account of declaring lower profits in accordance with section 44AD(5), whether such an assessee would be required to deduct TDS in subsequent years u/s 194A, 194C, 194I, 194J.

The obligation to deduct TDS under above section arises incase tax audit for preceding previous year has been conducted u/s 44AB(a)/(b).

Thus, there would be no obligation to deduct TDS under above sections incase accounts have been tax audited in view of conditions provided u/s 44AD(5).

## Issues:

Hamid Khan V/s ITO [ 2014 ] 49 taxmann.com 219  
(Jodhpur - Trib.)

During assessment proceedings, Assessing Officer noticed difference in total contract receipts shown by assessee in his books of account and that shown by contractee in Form No. 26AS - In absence of any satisfactory explanation, Assessing Officer made addition of such differential receipts - Whether since differential receipts were not shown by assessee in regular books of account, expenses related thereto might have also not been shown in books of account and in such circumstances, income was to be determined by applying net profit rate of 8 per cent on said receipts.

## Issues:

Delhi ITAT in Yash Deep Kumar V/s ITO Dated 03.03.2015, ITA No.470/Del/2012 Assessment Year : 2006-07

When the Act has given an option to the assessee not to maintain accounts in the circumstances as have been enumerated u/s 44AD and the assessee has availed such option, now it can't be expected of the assessee to maintain books of account by showing all the bank deposits and withdrawals from its business transactions in the books of account.

## Issues:

### ITO V/s Mark Construction, ITAT Kolkatta in ITA No.602/Kol/2011 dated 11.05.2012

Under the special provision of section 44AD of the IT Act exemption from maintenance of books of accounts have been provided and the presumptive tax at 8% of the gross receipts itself is the basis for determining the taxable income, the assessee was not under obligation to explain individual entry of cash deposits in the bank unless such entries had no nexus with the gross receipts. In the present case though from the details filed by assessee the Id. AO observed that no TDS has been recovered, in our opinion, since assessee has disclosed the profits more than 8% of the gross receipts and there is no dispute in receipt of the gross receipts the addition made by Id. CIT(A) u/s 40(a)(ia) of the IT Act is not sustainable.

# **Imposition of penalty u/s 271B**

- *As per the books of accounts of the assessee, turnover was less than 40 lakhs. But during search operations, additional sales was found and assessee included the same in block assessment. Can the A.O impose penalty u/s 271B for not getting the accounts audited?*
- The additional sales found as a result of search, was not recorded in the books of accounts regularly kept in the course of business by the appellant. Merely because the appellant accepted the additional sales for the purpose of assessment of the relevant year on the basis of entries in the seized documents, the same would not constitute accounts of the appellant maintained in the regular course of business and on that basis alone liability cannot be fastened on the assessee by holding him to have committed the default.
- However, if the suppression of sales is proved, penalty proceedings u/s 271B and also other sections can be initiated.
- ***Brij Lal Goyal v. ACIT [2004] 88 ITD 413 (Del.)***

## **Section Applicable only to the Income Under the Head “PGBP”**

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

***THANK YOU!!!***

***CA. Sanjay Agarwal***

***agarwal.s.ca@gmail.com***

***Mobile No. : 9811080342***