

P.R. GUPTA & CO.

CHARTERED ACCOUNTANTS

January 07, 2021

'TAX ON PRESUMPTIVE PROFIT OF BUSINESS & PROFESSION'

By CA Pankaj Gupta, FCA, FCS

"An option has been given to certain category of assessee carrying on business or profession to pay income tax on presumptive income"

I. Preamble:

This is an old provision and by and large all tax-payers are aware of these beneficial provisions. However due to certain recent amendments, it is important to understand the latest provisions. Further certain intricacies and difficult aspects have also been discussed in this article.

II. Presumptive Income for "Business" under Section 44AD :

First of all this option is not applicable to a person carrying on profession as referred to in sub-section (1) of section 44AA. The applicable provisions are Section 44ADA.

Following eligible assesses are covered under the provisions of Section 44AD of the Income Tax Act, 1961. That is one who fulfills all these criteria.

- 1) Individual, HUF or partnership firm (Excluding LLP) who is Resident and

- 2) Who has not availed deduction under Section 10A,10AA,10B, 10B and deduction under Chapter VIA under the heading “C” i.e deduction under Section 80H to 80TT and
- 3) Carrying on any eligible business i.e any business except the plying ,hiring or leasing goods carriages referred to in section 44AE or Agency, commission or brokerage business and
- 4) The turnover or gross receipts of the eligible business in the previous year does not exceed an amount of Rs. Two crores.

Where the Tax -payer chooses to be taxed under this system, his profits are deemed as Greater of the two:

- 1) 6% of the Turnover/Gross receipts of such business during the previous year where amount received through banking channels till due date of return plus 8% of Turnover by other means and
- 2) a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee

III. Presumptive Profits for “Profession” under Section 44ADA :

This applies to any assessee who is Resident and carrying on profession as referred to in sub-section (1) of section 44AA and whose total gross receipts do not exceed fifty lakh rupees in a previous year.

Where the Tax -payer chooses to be taxed under this system, his profits are deemed as Greater of the two:



- 1) 50% of the Gross receipts of such business during the previous year and
- 2) a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee

IV. Benefits under Presumptive System :

The benefit in both cases i.e 44AD & 44ADA is that assessee is not required to maintain elaborate books and records as prescribed under section 44AA as long as he declares profits as per the presumptive scheme. In other words, the expenses being claimed by the assessee cannot be challenged by the Tax Department.

There will be no disallowances under Sec 40a for non-deduction of TDS on Payments. No disallowance for 40A(3) for cash payments and disallowance under 43B for some expenditure allowable on actual payment basis.

V. Limitations of Presumptive System :

However, there are some limitations under 44AD. Say an assessee has turnover of Rs 1 Cr. He actually earns 10 Lacs . Then he is supposed to declare profit of 10 Lacs even if the profits determined as per 6%/8% comes less than 10 Lacs. Say on this turnover assessee earns 5 Lacs, he has to declare profit of 6/8 Lacs. If assessee chooses not to get taxed at 6/8 Lacs, but a lower figure, then he has to gets his accounts audited under section 44AB i.e Tax



Audit. Similarly under 44ADA if presumptive profits have to be declared below 50% of Gross Receipts, then Tax Audit is compulsory.

This can burden assessee in many ways. Supposing, assessee having turnover less than prescribed limits was not maintaining books of accounts as he was to declare profits under presumptive tax. But at the fag-end of the year, he suffers huge losses as has happened during current financial year due to Pandemic. Now he will have to get the accounts audited but then he my not be having full records.

Secondly as per Income Tax Form, Position of Cash, Debtors, Sundry-creditors and Stock is mandatory to be reported. So most of records are to be maintained in any case. The applicability of GST will further necessitate some vigorous book-keeping. Even applicability of TDS provisions in many cases can be challenging. These are discussed subsequently.

Thirdly, Interest and remuneration to working partners otherwise allowable under normal system under section 40(b) is not allowed to be deducted from presumptive profits.

VI. Important Condition under Presumptive Tax System :

An assessee who has opted to declare profits as per Sec 44AD in a particular year and opts out of this presumptive system in any five subsequent years and if his income exceeds the maximum amount not chargeable in his case, then he can not avail this benefit for 5 subsequent years to the year in which he



opts out and will have to get tax audit done under clause (e) of Section 44AB for the year he has chosen not to declare such profits under 44AD(1) and 5 subsequent years.

However there is no such restriction under Section 44ADA for professionals.

VII. Applicability of TDS Provisions:

The following important points may be noted

- 1) Partnership firms though covered by section 44AD(1) under presumptive tax will have to deduct tax under all the provisions of TDS
- 2) Individual & HUF would be required to deduct tax under Sec 192 & 195 in all cases and there is no exemption
- 3) In respect of Section 194C, Individual and HUF will be liable to deduct tax if they are liable for Tax Audit under Section 44AB.
- 4) In respect of Section 194A,194H,194I & 194J , Individual and HUF will be liable to deduct tax if the turnover/gross receipts exceed Limits in the preceding financial year.

Monetary limit prescribed for “Business” under Section 44AB(a) is one crore only. However in certain cases where cash/Payment/Cash receipts are within 5% Limits , then Limit is 5 Cr. Monetary limit prescribed for profession is Rs 50 Lakhs.



5) There is anomaly in respect of Section 194C and other Sections 194A, 194H, 194I & 194J due to different wordings used in the respective sections. Liabilities for Tax Audit are different than prescribed limits for Tax Audit.

VIII. Some Important/ Debatable Issues:

1) “Business” Vs. “Profession”: This is a perennial issue. Business is defined under section 2(13) of the Income Tax Act, 1961 and “Profession” is not defined specifically under Income Tax Act,

But Section 44ADA mentions that it is applicable to “Profession” as per provisions of Sec 44AA(1) which are legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette

There are lots of subjectiveness and in ascertaining whether it is a business or Profession.

2) “Turnover” Vs. “Gross Receipts”: This is again a lot of confusion. Reference may be made to Tax Audit Guidance Note issued by Institute of Chartered Accountants of India.

Whether amount of GST etc. is to form part of turnover for the tax audit limit and for computing presumptive tax u/s 44AD? As per Tax Audit



Guidance Note, it is not to be included but as per ICDS, the same forms part of Turnover.

- 3) Perforced opting out of section 44AD due to more than Rs. 2 crores turnover in a year would compel assessee to get accounts audited in next year, whatever may be the profit .

- 4) Section 44ADA is applicable to a partner in professional firm & profit share in firm would be included in gross receipts to see applicability of 44ADA?

Say partner is earning 20 lacs as remuneration from professional firm of advocates and also earning 10 lacs as own practice . In my opinion he gets covered under 44ADA as remuneration is considered as business income and he is allowed to claim expenses incurred for earning such remuneration from the firm

- 5) A person can claim 44AD & 44ADA in respect of business income & professional income respectively?

- 6) All the credits in bank account whether business or personal can be asked to be explained in case of 44AD & 44ADA covered assessee.



- 7) An assessee to explain facts & figures in absence of books in case of 44AD would have to be reasonable in the absence of maintenance of regular books of account. Some difficulty can definitely arise.
- 8) . Whether income though earned more than 8% can still be shown at 8% under 44AD? The answer is No.
- 9) Whether by declaring 8% u/s 44AD or 50% u/s 44ADA, more capital/investment than the incomes returned under these sections can be created? Again the answer is No.

IX. Conclusion:

The Central Board of Direct Taxes (CBDT) needs to simplify the provisions and also see that where option is given to assess to pay taxes based on Turnover rather than ascertaining presumptive profits. This way More productive business/professionals will get incentivised to earn higher profits as compared to Non-productive businesses.

There is another anomaly. Though small businesses upto 2 Cr turnover will have to get audit done for not declaring profits as per 44AD, but there would be no Tax Audit requirement for Turnover between 2CR to 5CR. Although such businesses will have to keep books of accounts under Sec 44AA.



ABOUT AUTHOR:

Author is a Fellow Member of the Institute of Chartered Accountants of India (ICAI) and also Fellow Member of The Institute of Company Secretaries of India (ICSI). Author is doing CA practice and has more than 40 years of experience. He is a former Senior Vice-President of Noida Management Association, Former Chairman of Noida Chapter of the ICSI and Former Secretary of Noida Branch of ICAI.

DISCLAIMER:

(These are authors' personal views for educational purposes and reader is advised to consult his Consultant/Adviser in case of any clarification or further guidance. No portion of this Article can be quoted or reproduced or used in any manner for any purpose without permission of author. No responsibility can be attributed to the author in any manner.)

*****END*****

