



# RAMA UNIVERSITY

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**FACULTY OF COMMERCE AND MANAGEMENT**

**COURSE: B.COM VI SEM.**

**SUBJECT: Corporate Tax Planning**

**SUBJECT CODE: BCH 403**

**LECTURE: 30**

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## LECTURE-30



## **MAKE OR BUY**

The following considerations guide the decision-making relating to “make or buy”:

Utilisation of capacity

Inadequacy of funds

Latest technology

Variable cost of manufacturing vis-à-vis purchase price

Dependence on supplier

Labour problem in the factory, etc.

In addition, the following tax considerations one has to consider-

Establishing a new unit - If the decision to manufacture a part or component involves setting up a separate industrial unit, then tax incentives available under sections 10A, 10B, 32, 801A, 801B and 801C are available.

Exports - If make or buy decision is taken for export of goods, then tax incentives available under section 80HHC depend on whether goods manufactured by the tax payers themselves are exported or goods manufactured by others are exported by the tax payers.

Sale of Plant and Machinery consequent on buying - If buying is cheaper than manufacturing and assessee decides to ‘buy’ parts/ components for a longer period, he may like to sell the existing plant and machinery.

Tax implications under Section 50 need to be taken into consideration.

Section 50: Computation of capital gains in case of depreciable assets: Where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of section 48 and 49 shall be subject to the following modifications:

Where the full value of consideration received or accruing for the transfer of the asset plus the full value of such consideration for the transfer of any other capital asset falling with the block of assets during the previous year exceeds the aggregate of the following amounts namely:

Expenditure incurred wholly and exclusively in connection with such transfer;

WDV of the block of assets at the beginning of the previous year;

The actual cost of any asset falling within the block of assets acquired during the previous year, such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, if the aggregate of the above 3 items exceed the full value of consideration received / accruing for the transfer of asset(s), the loss shall be deemed to be short-term capital loss.

### **Repairs, Replacement, Renewal or**

The deductions are covered in Sections 30 to 37 (i) of the Income Tax Act Section 30:

Rent, Routine taxes, repairs and insurance for building: If the assessee is the owner of the premises and uses the premises for his business purposes, no notional rent would be allowed under this section. He can claim only the following expenses under this section.

Local rates, municipal taxes, Land revenue, etc.

Insurance premium covering the risk of the damage or destruction of premises

Current repairs to the building [Not including expenditure in the nature of capital expenditure].

If assessee is a tenant, he can claim rent paid under this section. Besides this he can claim all expenses which he has undertaken to bear e.g., – cost of repairs [Not including expenditure in the nature of capital expenditure], local rates, municipal taxes, land revenue, insurance, etc.

Section 31: Repairs and Insurance of Machinery, Plant and Furniture: An assessee can claim the following deductions under this section:

Insurance Premium paid (or payable by the assessee under mercantile system) Deduction for insurance of machinery, plant or furniture is allowable u/s 31 subject to the following conditions:

The assets must be used by the assessee for the purpose of his business or profession during the accounting year.

Insurance must be against the risk of damage or destruction of the machinery, plant or furniture.

Repairs to Plant and Machinery are allowable subject to the following conditions:

Plant, Machinery, Furniture must have been used by the assessee for the purpose of his own business or profession. This deduction is available even if assessee is not the owner. What is essential is that assets must have been used by the assessee in his own business during the previous year though not continuously i.e., even if an asset is used for a part of the accounting

year, the assessee is entitled to the deduction of the full amount of expenses on repairs and insurance charges and not merely an amount proportionate to the period of this use.

Under this section only current repairs are deductible. Current repairs refer to the expenditure incurred with a view to preserve and maintain an existing asset and not with a view to bringing a new asset into existence or obtaining any new or fresh advantage. The term 'repairs' under this section does not mean petty repairs. It includes renewal or renovation of an asset but not replacement or reconstruction. The following points are noteworthy in this connection:

This section is applicable to current repairs but not arrears of repairs for earlier years [though arrears of repairs are deductible u/s 37 (1)].

This section is not applicable to cost of replacing or reconstruction.

### **Deductions under Section 37**

General deductions are expenses which are not covered by any other section and are allowed as a deduction under section 37 provided the following conditions are satisfied:

Expenditure should not be covered specifically by any of the provisions of section 30 to 36.

Such expense should be in respect of business carried out by the assessee and the profits of which are to be computed and assessed and should be incurred after the business is set up.

It should not be in the nature of personal expenses of the assessee. d) Such expenses should not be in the nature of capital expenditure.

Such expenses should have been incurred only and exclusively for the purpose of such business.

Such expenses should not be incurred for any purpose which is an offence as prohibited by law.

NO allowance shall be made in respect of expenditure incurred on advertisement in any souvenir, brochure, tract, pamphlet or the likes published by a political party.

### **Income-tax implication**

If expenses are allowable as revenue expenditure under the above sections, then cost of financing gets reduced to the extent of tax saved (At present i.e., 2006-07 corporate tax rate is 33.66 %). On the other hand, if such expenditure is not allowed, then it may be capitalised and on the amount capitalised, depreciation is available if certain conditions are fulfilled.

## **Shut-down or Continue**

**Income-tax provisions are given below:**

### **Carry forward and set off of business losses (Section 72)**

Where the loss under the head 'profit and gains of business or profession' other than loss from speculation business, could not be set off in the same assessment year because either the assessee had no income under any other head or the income was less than the loss, such loss which could not be set off in the same against the profit and gains of business or profession can be carried forward to the next year subject to the following conditions:

Business losses can be adjusted only against business income. The loss can be earned forward to the subsequent assessment year and set off only against business income of the subsequent year.

It may be observed that in the assessment year, loss from a business can be adjusted against income from any other head of income. However, when the loss is to be carried forward to the subsequent year, it can be adjusted only against business income.

Business income may be from the same business in which the loss was incurred or may be any other business. Certain income, though taxable under other heads, constitutes business income for set off of brought forward business loss: The carried forward business loss is to be adjusted against income from any business activity. Such an income may generally be taxed under the head, "profits and gains of business or profession". However, in some cases income from a business activity may also be taxed under other heads. For example, if an assessee, carrying on the business of letting out of house properties received rent from such house properties, it would be an income from business activity though the rent would be taxable

under the head “income from house property”.

Therefore, a business loss of an earlier year can be set off against rental income of house property, although the rental income falls under the head “Income from House Property.”

Business in respect of which a loss is incurred need not be continued

The business or profession, for which the loss was incurred, should be continued to be carried on by him in the previous year in which such loss is sought to be set off. However w.e.f. Assessment Year 2000 – 2001, the Finance Act, 1999 has omitted these conditions and as such now business loss can be carried forward and set off in the subsequent assessment year(s) even if the business in respect of which the loss was originally computed is not carried on by him.

It may be noted that although for carrying forward and set off of business loss, it is now not necessary that the same business should be continued but for unabsorbed depreciation, the condition that the same business must be continued is still not omitted.

Losses can be set off only by the assessee who has incurred loss [Section 78(2)]

The brought forward business losses can be set off only by the same assessee. The assessee, who has suffered the loss and in whose hands the loss has been assessed, is the person who can carry forward the loss and set off the same against his business income of the subsequent year. The following are the exceptions:

Where a business carried on by one person, is acquired by another person through inheritance. For example: X is carrying on a business and there are losses to the extent of Rs. 5,00,000 which can be carried forward and set off against the income of the subsequent years. X dies and his son S against the income from a business activity carried on by S:

Business losses of an amalgamating company can be set off against the income of the amalgamated company if the amalgamation is within the meaning of section 72A of the Income Tax Act.

Where there has been re-organisation of business whereby a proprietary concern or a firm is succeeded by a company and certain conditions are fulfilled, the accumulated business loss and the unabsorbed depreciation of the predecessor firm/proprietary concern shall be deemed to be the loss or allowance for depreciation of the successor company for the previous year in which business re-organisation was effected and carry forward provisions shall be applicable to the successor company.

### **Period of carry forward**

Each year’s loss is a separate loss and no loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first

computed. Therefore, a loss of previous year 1991–92 i.e., assessment year 1992–93 can be carried forward till assessment year 2000–2001. Besides the above, the following can also be carried forward for unlimited period:

Unabsorbed depreciation;

Unabsorbed scientific research expenditure;

Unabsorbed expenditure on family planning.

### **Order of Set Off**

Unabsorbed depreciation, unabsorbed capital expenditure on scientific research and family planning are not part of business losses and they can also be carried forward. However as per section 72(2), the business loss should be set off before setting off unabsorbed depreciation, etc.

Such carried forward loss will be set off against business head only after the current year's depreciation; current

capital expenditure on scientific research and capital expenditure on family planning have been claimed.

Therefore, the order of set off will be as under:

Current year capital expenditure on scientific research and capital expenditure on family planning to the extent allowed;

Current year depreciation [Section 32(1)];

Carried forward business or profession losses [Section 72(1)];

Unabsorbed expenditure on family planning [Section 36(1) (ix)];

Unabsorbed depreciation [Section 32(2)];

Unabsorbed capital expenditure on scientific research [Section 35(4)].