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News Alert
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Karnataka High Court rejects notional adjustment of Section 80IA unit's losses prior to initial Assessment Year

In brief

The Karnataka High Court (HC) in the case of Anil H Lad¹ has held that where the depreciation and loss of earlier assessment years (AYs) have already been set off against profit of another source of those AYs, and a deduction under section 80-IA of the Income-tax Act, 1961 (Act) is subsequently claimed by the taxpayer, there is no need for notionally carrying forward and setting off of the earlier depreciation and losses when computing the quantum of deduction available under section 80-IA of the Act.

¹ Commissioner of Income-tax, Bangalore & Deputy Commissioner of Income-tax, Bangalore v. Shri Anil H. Lad [TS-140-HC-2014(KAR)]

Facts

- The taxpayer was engaged in the business of generating energy through wind-mills since 2006. The taxpayer incurred losses from this business up to AY 2007-08 and the unabsorbed depreciation and losses were being appropriately set off against profits from another source.
- In accordance with the option available in section 80-IA(2) of the Act, the taxpayer opted to claim a deduction under section 80-IA(1) of the Act for the first time in AY 2008-09.
- The tax officer (TO) accepted the taxpayer's eligibility to claim a deduction under section 80-IA of the Act. However, the TO diluted the amount of deduction by adjusting the unabsorbed depreciation and losses of prior years

(i.e., up to AY 2007-08) on the basis that section 80-IA(5) of the Act required the profits of the business to be computed on a standalone basis. In doing so, the TO ignored the fact that this unabsorbed depreciation and losses had already been set-off in the prior years against profit from other sources.

- Aggrieved by the TO's order, the taxpayer appealed to the Commissioner of Income-Tax (Appeals) [CIT(A)] who upheld the TO's order on the basis that there needed to be a notional set-off of prior years' unabsorbed depreciation and losses against the profits of eligible business, in accordance with section 80-IA(5) of the Act.
- Aggrieved by this order, the taxpayer appealed to the Income-tax Appellate Tribunal (Tribunal). The Tribunal, relying on the judgment of the Madras HC in the case of *Velayudhaswamy Spinning Mills (P) Ltd.*², decided the matter in favour of the taxpayer.
- Aggrieved by the said order, the Revenue appealed to the HC.

Issue

- Whether the unabsorbed depreciation and losses of the eligible business could be set off against the profits earned by the eligible business for the period prior to the claim for deduction put forth under section 80-IA of the Act?

Revenue's contentions

- According to section 80-IA(5) of the Act, for the purpose of determining the quantum of deduction under section 80-IA(1) of the Act, only the source of income of the taxpayer from the eligible business during the previous year relevant to the AY had to be taken into consideration.
- Accordingly, the loss and depreciation claimed by the taxpayer in respect of the said eligible business from the date the business was commenced (i.e., from 2006) had to be set-off against the profits earned by the taxpayer for any relevant previous year.

² Velayudhaswamy Spinning Mills (P) Ltd. v. ACIT [2010] 38 DTR 57 (Mad)

Taxpayer's contentions

- Section 80-IA(5) of the Act had to be read along with section 80-IA(2) of the Act. Thus, only when the taxpayer made a claim for the said benefit in the returns filed would he be entitled to the said benefit for a period of ten consecutive AYs.
- Before putting forth such a claim, all losses and depreciation that the taxpayer could claim must be set-off against the profits of the taxpayer from other business sources. However, once a claim was put forth, a standalone basis of income computation of the eligible business had to be made.

High Court's ruling

- The Supreme Court, in the case of *Liberty India*³ held that section 80-IA of the Act essentially belonged to the category of profit-linked incentives and when section 80-IA of the Act referred to profits derived from eligible business, it was not the ownership of that business which attracted the incentives, but the generation of profits.
- Section 80-IA(2) of the Act provided an option to the taxpayer to choose any ten consecutive years out of 15 years from the date of establishment of the undertaking. Section 80-IA(5) of the Act determined quantum of deduction. However, claiming of deduction would arise only when profit was earned by the eligible taxpayer; before any profit was earned, the question of determining the quantum of deduction would not arise.
- Section 80-IA(5) of the Act came into the picture only when a claim for deduction was put forth. If no claim was put forth, and the taxpayer was carrying on other business, loss and depreciation incurred by him from this business could be set-off against other sources in the same year. Once the taxpayer had set off his profits against the depreciation and loss suffered in the eligible business, these could not be set-off against the profits derived from the eligible business, if and when a claim for deduction under section 80-IA of the Act was made.

³ Liberty India v. CIT [2009] 317 ITR 218 (SC)

- The Madras HC, while interpreting this provision in another case² held that the phrase, “initial AY” employed in section 80-IA(5) of the Act, was different from the phrase, “beginning from the year” referred to in section 80-IA(2) of the Act. Section 80-IA(5) of the Act started with a *non obstante* clause; thereby a fiction was created that the eligible business was the only source of income during the previous year relevant to the initial AY and during every subsequent AY.
- When the taxpayer exercised the option, only the losses of the years beginning from the initial AY were to be brought forward, and not the losses of earlier years which had already been set off against the taxpayer's income. The fiction created in 80-IA(5) of the Act did not contemplate notional adjustment of the amount already set off.

- The Tribunal's finding was thus in accordance with law, and the TO and the CIT(A) committed an error in setting off the profit earned by the taxpayer under section 80-IA of the Act against the losses and depreciation of the eligible business, as it had already been set-off from other sources before such a claim was put forth.

PwC's comments

In interpreting the incentive provisions of section 80-IA of the Act, the HC decision cited above has held that the trigger of the *non obstante* clause in section 80-IA(5) of the Act is only pursuant to the taxpayer exercising the option as provided in section 80-IA(2) of the Act. This is not the first decision on the entire controversy related to “initial assessment year” versus “beginning of the year” created by the Revenue authorities. The consistent approach followed by Courts should help the taxpayer who has not claimed a deduction from the first year of its operations.

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