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News Alert  
17 October, 2012



## **Unabsorbed depreciation allowed to be set off against long-term capital gains**

### **In brief**

In a recent decision in the case of Suresh Industries Pvt Ltd<sup>1</sup>, the Mumbai bench of the Income-tax Appellate Tribunal (the Tribunal), following the Supreme Court (SC) decision in the case of Virmani Industries Pvt Ltd and Others<sup>2</sup>, has held that unabsorbed depreciation can be set-off against capital gains income and that the set-off is not restricted to business income earned after the amendment to section 32(2) of the Act, effective from assessment year (AY) 2002-03.

### **Background**

Up to AY 1996-97, unabsorbed depreciation of a particular year was considered as the depreciation allowance of the succeeding year and thus was eligible for inter-head set-off for that year and succeeding years.

For the period between AY 1997-98 and AY 2001-02, the law was amended to permit unabsorbed depreciation to be carried forward only for a period of eight years. Further, the set-off in the subsequent years was restricted to profits and gains from business or profession. In other words, unabsorbed depreciation was treated on par with business loss.

<sup>1</sup> Suresh Industries Pvt Ltd v. ACIT [TS-771-ITAT-2012 (Mum)]

<sup>2</sup> CIT v. Virmani Industries Pvt Ltd and Others [1995] 216 ITR 607 (SC)

The law existing prior to AY 1997-98 was reinstated by the Finance Act, 2001, with effect from AY 2002-03.

## Facts

The assessee is engaged in the business of manufacturing automotive parts. The assessee, in its return of income for AY 2007-08, had disclosed long-term capital gains of 13 million INR, against which it claimed set-off of current year losses of 1,748,195 INR and unabsorbed depreciation of 232,059 INR, as well as brought-forward unabsorbed depreciation of 643,220 INR pertaining to earlier years.

During the course of the assessment proceedings, the Assessing Officer (AO) disallowed the assessee's claim on the basis that unabsorbed depreciation is not part of business losses and hence should not be included in the set-off of current year's business loss against other heads of income. The AO was of the view that since business loss can be carried forward for eight years and unabsorbed depreciation can be carried forward without limitation, they were required to be treated differently.

The assessee contended that as per section 32(2) of the Income-tax Act, 1961 (the Act), unabsorbed depreciation was required to be merged with the current year's depreciation and hence is available for inter-head set-off.

On appeal, the Commissioner of Income-tax (Appeals) (CIT(A)) upheld the order of the AO. Aggrieved, the assessee appealed before the Tribunal, which ruled in favour of the assessee.

## Tribunal ruling

- On a comparison of the provisions of section 32(2) of the Act before and after the amendment in 2001, the Tribunal noted that prior to the amendment, the set-off of unabsorbed depreciation was restricted to profits and gains from

business or profession. However, after the amendment, the set-off is available against all other heads.

- The Tribunal relied on the SC decision in the case of Virmani Industries Pvt Ltd and Others (above) and held that the liberal regime prior to AY 1997-98 had been restored from AY 2002-03 onwards.
- The Tribunal examined the provisions pertaining to unabsorbed depreciation and business loss, and concluded that post the amendment brought into section 32(2) of the Act in 2001, business loss and unabsorbed depreciation were to be considered on the same footing. It is only because business loss cannot be carried forward beyond a period of eight years that it is given priority in set off against subsequent years' income. Accordingly, current year's unabsorbed depreciation should be available for set-off against the other heads of income.
- Further, owing to the legal fiction in section 32(2) of the Act, the brought forward depreciation is treated as current year's depreciation and accordingly the treatment given to current year depreciation with regard to the carry-forward and set-off should apply to the brought-forward unabsorbed depreciation as well. Thus, the brought-forward unabsorbed depreciation is also available for set-off against other heads of income, including capital gains.

## Unabsorbed depreciation pertaining to pre-amendment years

While the Tribunal has addressed the issue of set-off of unabsorbed depreciation against capital gains, the larger issue of the availability of set-off of the brought forward unabsorbed depreciation that arose between AY 1997-98 to AY 2001-02 (wherein unabsorbed depreciation was treated at par with business loss) was not raised in this ruling.

The Gujarat High Court (HC), in a recent ruling in the case of General Motors India Pvt Ltd<sup>3</sup>, had addressed this issue and ruled that the limitation of eight years for carrying forward and set-off would no longer apply to the unabsorbed depreciation that arose during AY 1997-98 to AY 2001-02, after the amendment restoring the earlier law was made. The HC relied on Circular 14 of 2001 while rendering its decision.

### Conclusion

- With change in the law in 2001, unabsorbed depreciation now stands on the same footing as current year's business loss and is eligible for set-off against other heads of income in the current and subsequent years.
- There is also clarity now on the carry forward and set-off of the unabsorbed depreciation pertaining to the pre-amendment assessment years (AY 1997-98 to AY 2001-02), beyond a period of eight years, owing to the Gujarat HC ruling.

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<sup>3</sup> General Motors India Pvt Ltd v. DCIT [TS-641-HC-2012(Guj)]

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<b>Ahmedabad</b> President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	<b>Bangalore</b> 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	<b>Bhubaneswar</b> IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296	<b>Chennai</b> 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006, India	<b>Hyderabad</b> #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600
<b>Kolkata</b> 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-033 - 2357 9101/4400 1111 Fax: (91) 033 - 2357 2754	<b>Mumbai</b> PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	<b>Gurgaon</b> Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	<b>Pune</b> GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, pwctr.knowledgemanagement@in.pwc.com

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