

Carry Forward and Set-off of Unabsorbed Depreciation

By

Ms.Bhavya Rangarajan, Advocate

Ms.B.Mala, Associate

Subbaraya Aiyar, Padmanabhan & Ramamani (SAPR)

Advocates

Introduction:

Depreciation is the allocation of the cost of an asset over its useful life. Sec 32 of the Income Tax Act (the Act) provides for depreciation on assets used for the purposes of business. Sec 32(2) provides for carry forward and set off of unabsorbed depreciation. This article seeks to cover the original position regarding the carry forward and set-off, the amendment brought about by the Finance Act 1996 restricting the claim, the subsequent 2001 amendment bringing back the original provision and the effects thereof.

Section 32(2) : Pre - Amendment Treatment of Unabsorbed Depreciation

Before the amendment, the provision read as under:

“(2) Where, in the assessment of the assessee, full effect cannot be given to any allowance under clause (ii) of sub- section (1)] in any previous year, owing to there being no profits or gains chargeable for that previous year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of sub- section (2) of section 72 and sub- section (3) of section 73, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed

to be the allowance for that previous year, and so on for the succeeding previous years”

The effect of this provision is that up to AY 1996-97, the unabsorbed depreciation of a year was considered as the depreciation allowance of the succeeding year. Therefore, the unabsorbed depreciation allowance, if any, of assessment year 1996-97 shall be added to the amount of the allowance for depreciation of assessment year 1997-98 and deemed to be part of the allowance for that year. When unabsorbed depreciation is thus carried forward, it shall be deemed as current depreciation and is hence eligible for set off against business income and any other head of income for that year and succeeding years. There were no conditions regarding the continuance of business.

Some judgments which upheld this are:

- (i) **CIT Vs Sahu Rubber Pvt Ltd 179 ITR 29 (Bom)** - the Court relied on **CIT Vs Estate Finance Ltd** and held that unabsorbed depreciation of the asst. yrs. 1950-51 and 1951-52 could be set off in the asst. yr. 1971-72 against income under other heads or income from other sources
- (ii) **CIT Vs Deepak Textile Industries Ltd 210 ITR 1029 (Guj)** - Unabsorbed depreciation brought forward from earlier years has to be adjusted against assessee's income from other sources notwithstanding that the assessee had sold its business of textile mills and ceased carrying on business of manufacture and sale of cloth in the year of account
- (iii) **CIT Vs Virmani Industries Pvt. Ltd. Etc 216 ITR 607 (SC)** - For availing the benefit of s. 32(2), it is not necessary that the same business should be carried on in the following previous year, nor is it necessary that the asset which earned the depreciation in the preceding year should exist and continue to be used in business in the following year nor that the assessee should carry on any business or profession in the following year; therefore, the unabsorbed depreciation allowance relating to the asst.

yr. 1956-57 ought to have been set off against the income for the following assessment years, and after such set off if any depreciation allowance still remained unabsorbed it could have been set off against the income for the accounting period relevant to the asst. yr. 1965-66

Unabsorbed losses:

The Act also provides for carry forward and set-off of unabsorbed business losses in Section 72. Clause (1) says that where during an AY, the assessee has a business loss, and such loss cannot be or is not wholly set off against income under any other head as per the provisions of sec 71, then the unabsorbed losses shall be carried forward to the following AY and set off against the profits and gains of business or profession and where it cannot be wholly so set off, it shall be carried forward to the following AY and so on. Clause (3) says that the unabsorbed losses shall not be carried forward for more than 8 AYs immediately succeeding the AY for which the loss was first computed.

These provisions therefore enabled the assessee to claim unabsorbed losses and unabsorbed depreciation simultaneously. For example, supposing the assessee has business losses and unabsorbed depreciation in Year 1. In Year 2 it has business income and other income. In such a case, the assessee can set off business losses of year 1 against the business income of year 2 but not against other income. However, the assessee can set off unabsorbed depreciation against other income, even if its business losses were not fully set off.

To plug this loophole, the provision relating to unabsorbed depreciation, that is Sec 32(2) was amended. This amendment was brought in to curtail the inter head set off, restrict the carry forward of unabsorbed depreciation to a period of 8 years and lay down a condition that the business should be in existence for the unabsorbed depreciation to be carried forward and set off.

Amendment by way of Finance Act 1996:

Sec 32(2) was amended by the Finance Act, 1996. The relevant extract is as under:

“11.....

(c) for sub- section (2), the following sub- section shall be substituted, namely:-" (2) Where in the assessment of the assessee full effect cannot be given to any allowance under clause (ii) of sub- section (1) in any previous year owing to there being no profits or gains chargeable for that previous year or owing to the profits or gains being less than the allowance, then, the allowance or the part of allowance to which effect has not been given (hereinafter referred to as unabsorbed depreciation allowance), as the case may be,-

(i) shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;

(ii) if the unabsorbed depreciation allowance cannot be wholly set off, under clause (i), the amount not so set off shall be set off from the income under any other head, if any, assessable for that assessment year;

(iii) if the unabsorbed depreciation allowance cannot be wholly set off under clause (i) and clause (ii), the amount of allowance not so set off shall be carried forward to the following assessment year and- (a) it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;

(b) if the unabsorbed depreciation allowance cannot be wholly so set off, the amount of unabsorbed depreciation allowance not so set off shall be carried forward to the following assessment year not being more than eight assessment years immediately succeeding the assessment year for which the aforesaid allowance was first computed:

Provided that the business or profession for which the allowance was originally computed continued to be carried on by him in the previous year relevant for that assessment year:.....”

Therefore, we see that the beneficial provision was curtailed. Clause 3 makes it clear that the unabsorbed depreciation shall be carried forward and set off against the profits and gains of business or profession; if it cannot be wholly so set off, it shall be set off against any other head for that AY; if it still cannot be set off, the balance unabsorbed depreciation shall be carried forward for a period not exceeding 8 years and set off against the profits and gains of business or profession. Moreover, for availing the benefit of carried forward of unabsorbed depreciation, it is essential that the business or profession for which the allowance was originally computed continued to be carried on by the assessee in the previous year relevant for that assessment year as stipulated in the 1st proviso to section 32(2)(iii) as substituted with effect from 1.4.1997.

The amendment therefore treated depreciation on par with unabsorbed losses. This came as a set back as the assessee could not claim set off of unabsorbed depreciation against income under other heads.

Some judgments which were delivered after this amendment are as follows:

(i) **CIT Vs Pioneer Asia Packing (P) Ltd 310 ITR 198** - the Madras High Court held as follows:

“4. as per the amended provisions of s. 32(2) of the Act, w.e.f. 1st April, 1997, if the income from business for the assessment year is insufficient to absorb the depreciation allowance of that assessment year, the amended provision permits absorption of depreciation allowance of a business against profits and gains of any other business of the same assessment year. When the depreciation allowance of a business of the assessment year is not absorbed by any other business of the same assessment year, then the remaining unabsorbed depreciation allowance could be set off against the income under any other head, that is assessable for the same assessment year.

In the event of depreciation allowance of the year is unable to be absorbed by any other business income or from income under any other head in the same assessment year, the remaining unabsorbed depreciation allowance shall be carried forward to the following year and (a) unabsorbed allowance shall be set off against the profits and gains of any business carried by a person; (b) if the unabsorbed depreciation allowance cannot be wholly set off so, it shall be allowed to be carried forward for the following eight assessment years immediately succeeding the assessment year in which it was first computed....”.

- (ii) **CIT Vs S & S Power Switchgear Ltd 318 ITR 187** - the Madras High Court held as under:

“5. As per the amended provisions of s. 32(2) of the Act, w.e.f. 1st April, 1997, if the income from business for the assessment year is insufficient to absorb the depreciation allowance of that assessment year, the amended provision permits absorption of depreciation allowance of a business against profits and gains of any other business of the same assessment year. When the depreciation allowance of a business of the assessment year is not absorbed by any other business of the same assessment year, then the remaining unabsorbed depreciation allowance could be set off against the income under any other head, that is assessable for the same assessment year. In the event of depreciation allowance of the year is unable to be absorbed by any other business income or from income under any other head in the same assessment year, the remaining unabsorbed depreciation allowance shall be carried forward to the following year and (a) unabsorbed allowance shall be set off against the profits and gains of any business carried by a person. (b) If the unabsorbed depreciation allowance cannot be wholly set off so, it shall be allowed to be carried forward for the following eight assessment years immediately succeeding the

assessment year in which it was first computed. The proviso provides that the business to which depreciation allowance is related to must be carried on in the succeeding year so as to allow such set off. Thus, by the amendment, the deeming fiction of treating the earlier years' unabsorbed depreciation as current year depreciation was removed. The period available for absorbing the unabsorbed depreciation against the profit of the succeeding years was limited to eight years.....”

Subsequently, this amended section 32(2) as substituted by the Finance (No. 2) Act, 1996 (with effect from 1.4.1997) was **again substituted** by the Finance Act, 2001, with effect from 1.4.2002 and status quo ante was restored with effect from assessment year 2002- 03. The new sub-section (2) of section 32 as substituted by the Finance Act, 2001 has restored the sub- section (2) of section 32 as it stood in the assessment year 1996-97. In other words, the restrictions imposed by the Finance (No. 2) Act, 1996 in the matter of set- off of unabsorbed depreciation have been dispensed with and the original provision has been restored. This amendment was also given effect to by the **Circular 14 of 2001 dt 22.11.2001**. The relevant portion reads as under:

“30. Modification of provisions relating to depreciation

30.1 Under the existing provisions of section 32 of the Income-tax Act, carry forward and set off of unabsorbed depreciation is allowed for 8 assessment years.

30.2 With a view to enable the industry to conserve sufficient funds to replace plant and machinery, specially in an era where obsolescence takes place so often, the Act has dispensed with the restriction of 8 years for carry forward and set off of unabsorbed depreciation. The Act has also clarified that in computing the profits and gains of business or profession for any previous year, deduction of depreciation under section 32 shall be mandatory.

.....

.....
[Section 21]”

Therefore, the position today is that unabsorbed depreciation can be carried forward to subsequent years and set off. The restrictions that it can be set off only against business income and that the business should be in existence have been removed.

Controversy:

One issue which has cropped up with respect to this provision and the various amendments to it is regarding the set-off of depreciation that remained unabsorbed during AY 1996-97 and the treatment of unabsorbed depreciation of AY 1997-98 and the carry forward of such unabsorbed depreciation to the period subsequent to 2002.

This was the main issue in the case of **DCIT Vs Times Guaranty Limited (2010) 131 TTJ (Mumbai)(SB) 257**. The Special Bench gave a detailed order covering various aspects of this issue. To put it briefly, the Mumbai Bench held that:

- the 1996 amendment restricts the set off of unabsorbed depreciation to income under the head ‘Profits and Gains of business or profession’
- the cumulative unadjusted brought forward depreciation as on 1st April, 1997 could still be set off against taxable income under any head in eight assessment years
- the period of eight years would commence from asst. yr. 1997-98 irrespective of the year to which such unadjusted depreciation related
- the substantive provision contained in s. 32(2) as substituted by the Finance Act, 2001 w.e.f. 1st April, 2002, is prospectively applicable to asst. yr. 2002-03 onwards
- the use of the present tense in negative terms while referring to the allowance to which effect ‘cannot be’ and ‘has not been’ given implies

that it is only when the assessment of the assessee from asst. yr. 2002-03 onwards is made in which depreciation allowance for the current year under s. 32 (1) cannot be given full effect to owing to the inadequacy of the profit, that the directive of the deeming provision under s. 32(2) shall apply

- it is nowhere laid down that the 'unabsorbed depreciation allowance' of the second period is to be given the character of current depreciation in the third period. The function of the deeming provision in s. 32(2) is restricted only to giving the current year's unabsorbed depreciation the status of current depreciation in the following year

This judgment laid down the legal position in para 38 as under:

"38. The legal position of current and brought forward unadjusted/ unabsorbed depreciation allowance in the three periods, is summarized as under :

A. In the first period (i.e. upto asst. yr. 1996-97)

- (i) Current depreciation, that is the amount of allowance for the year under s. 32(1), can be set off against income under any head within the same year.
- (ii) Amount of such current depreciation which cannot be so set off within the same year as per (i) above shall be deemed as depreciation under s. 32(1), that is depreciation for the current year in the following year(s) to be set off against income under any head, like current depreciation.

B. In the second period (i.e. asst. yrs. 1997-98 to 2001-02)

- (i) Brought forward unadjusted depreciation allowance for and upto asst. yr. 1996-97 (hereinafter called the 'First unadjusted depreciation allowance'), which could not be set off upto asst. yr. 1996-97, shall be carried forward for set off against income under any head for a maximum period of eight assessment years starting from asst. yr. 1997-98.

(ii) Current depreciation for the year under s. 32(1) (for each year separately starting from asst. yr. 1997-98 upto 2001-02) can be set off firstly against business income and then against income under any other head.

(iii) Amount of current depreciation for asst. yrs. 1997-98 to 2001-02 which cannot be so set off as per (ii) above, hereinafter called the 'Second unabsorbed depreciation allowance' shall be carried forward for a maximum period of eight assessment years from the assessment year immediately succeeding the assessment year for which it was first computed, to be set off only against the income under the head 'Profits and gains of business or profession'.

C. In the third period (i.e. asst. yr. 2002-03 onwards)

(i) 'First unadjusted depreciation allowance' can be set off upto asst. yr. 2004-05, that is, the remaining period out of maximum period of eight assessment years (as per B(i) above) against income under any head.

(ii) 'Second unabsorbed depreciation allowance' can be set off only against the income under the head 'Profits and gains of business or profession' within a period of eight assessment years succeeding the assessment year for which it was first computed.

(iii) Current depreciation for the year under s. 32(1), for each year separately, starting from asst. yr. 2002-03 can be set off against income under any head. Amount of depreciation allowance not so set off (hereinafter called the 'Third unadjusted depreciation allowance') shall be carried forward to the following year.

(iv) The 'Third unadjusted depreciation allowance' shall be deemed as depreciation under s. 32(1), that is depreciation for the current year in the following year(s) to be set off against income under any head, like current depreciation, in perpetuity

However, we see that this judgment has been impliedly overruled by other subsequent judgments. Some of the judgments which clarify the position with

respect to the carry forward and set off of pre-amendment unabsorbed depreciation during the post amendment period, hold that by the Finance Act, 2001 w.e.f. 1st April, 2002, the old provisions were revived by dispensing with the restriction of eight years for carry forward and set off of unabsorbed depreciation.

- (i) **General Motors India (P). Ltd. Vs DCIT (2013) 354 ITR 244 (Guj)** - one issue was whether unabsorbed depreciation pertaining to A.Y. 1997–98 could be allowed to be carried forward and set off after a period of eight years or it would be governed by Section 32 as amended by Finance Act 2001. The Gujarat High Court held that:

“37. The CBDT Circular clarifies the intent of the amendment that it is for enabling the industry to conserve sufficient funds to replace plant and machinery and accordingly the amendment dispenses with the restriction of 8 years for carry forward and set off of unabsorbed depreciation. The amendment is applicable from assessment year 2002-03 and subsequent years. This means that any unabsorbed depreciation available to an assessee on 1st day of April, 2002 (A.Y. 2002-03) will be dealt with in accordance with the provisions of section 32(2) as amended by Finance Act, 2001 and not by the provisions of section 32(2) as it stood before the said amendment. Had the intention of the Legislature been to allow the unabsorbed depreciation allowance worked out in A.Y. 1997-98 only for eight subsequent assessment years even after the amendment of section 32(2) by Finance Act, 2001 it would have incorporated a provision to that effect. However, it does not contain any such provision. Hence keeping in view the purpose of amendment of section 32(2) of the Act, a purposive and harmonious interpretation has to be taken”

- (ii) **DCIT Vs Andhra Petrochemicals Ltd 123 ITD 89** - the Tribunal held that:

“15. The only other issue remains for the asst. yr. 2002-03 is with regard to the entitlement to carry forward depreciation pertaining to the asst. yr. 1994-95. The provisions as applicable for the asst. yr. 1994-95 do not restrict carry forward of depreciation for any specified period and as per the provisions as they existed then, the depreciation carried forward from the earlier years has to be treated as current year’s depreciation in which event, the depreciation of the asst. yr. 1994-95 has to be treated as the current year’s depreciation for the asst. yr. 1995-96 and so on. However, by virtue of the amendment to the provisions w.e.f. 1st April, 1997 carried forward depreciation is available for set off only for a period of eight years and the CBDT has clarified the amended provisions by stating that the limitation of eight years shall start from the asst. yr. 1997-98 by which the assessee would be entitled to carry forward the unabsorbed depreciation upto the asst. yr. 2004-05. However, by the Finance Act, 2001 w.e.f. 1st April, 2002, the old provisions were revived by dispensing with the restriction of eight years for carry forward and set off of unabsorbed depreciation. As on 1st April, 2002 the assessee’s right to carry forward the depreciation of the asst. yr. 1994-95 being alive and available for set off, the amended provisions come into play, in which event the same has to be determined since it has to be carried forward to the next year. In our considered opinion, the AO as well as the CIT(A) have not considered the plain meaning of the provisions in correct perspective. We, therefore, set aside the orders passed by the tax authorities on this issue and direct the AO to permit the assessee to carry forward the depreciation referable to the asst. yr. 1994-95”

- (iii) **KMC Speciality Hospitals India Ltd. Vs ACIT dt 5th May, 2014** - the issue was with respect to the carry forward of unabsorbed depreciation relating to AYs 1989-90 to 1998-99. The Chennai Tribunal held as under:

“8. Therefore, it is to be seen that wherever unabsorbed depreciation was not allowed to be set off against the profits arising after the period of eight years, should be again considered to be set off, after the amendment. When the quantum of unabsorbed depreciation is computed after the amendment, whatever balance of unabsorbed depreciation is available to the credit of the assessee, must be determined as unabsorbed depreciation eligible for carry forward and set off. The interregnum restriction of limiting of the claim for eight-year period does not take away the right of an assessee to claim the balance of unabsorbed depreciation, forever. The balance of unabsorbed depreciation revives back into life and becomes eligible for carry forward and set off along with the other part unabsorbed depreciation available to the credit of the assessee.”

- (iv) **Karnataka Co-operative Milk Producers’ Federation Ltd. Vs. DCIT (2011) 53 DTR (Kar) 81** - the issue in this case was with respect to the adjustment of unabsorbed depreciation for AY 1993-94 in AY 2006-07. The Karnataka High Court held that :

“7. The order passed at Annex. Q by the CIT that the unabsorbed depreciation incurred for the asst. yr. 1993-94 gets lapsed on 31st March, 2002. The said order has affected the petitioner, since according to the petitioner, prior to the amendment introduced during 1996-97, it was permissible to carry forward the unabsorbed depreciation and from 1993-94 to 1996-97, the unabsorbed depreciation has been carried forward. The amendment introduced limiting the time for carrying forward for a period of eight years has to be reckoned not from 1993-94 but from 1996-97 and the same was carried forward and by the year 2006-07 since again there is an amendment introduced during 2002 making this period of eight years as unlimited, from 2002 onwards even till 2006-07, it is permissible to carry forward the unabsorbed

depreciation in view of the change in position of law. This aspect has not been considered by the revisional authority as such, the impugned order passed at Annex. Q is without taking into consideration the provisions under s. 32(2) of the Act which came to be introduced limiting/extending the period from eight years for an unlimited period.”

(v) ITO Vs Suraj Solvent & Vanaspati Industries Ltd 16 DTR (Asr)(Trib) 492

- the issue in this case is with respect to the set off of unabsorbed depreciation relating to asst. yr. 1997-98 with the income from other sources in the asst. yrs. 2004-05 and 2005-06. The Tribunal held that:

“5. As discussed earlier, there was an amendment to s. 32(2) by the Finance Act, 2001, which is applicable from 1st April 2002, whereby s. 32(2) as stood in asst. yr. 1996-97 was restored and in the present case, in our humble opinion, the amended provision of s. 32(2) which was effective from 1st April, 2002 is applicable to the asst. yrs. 2004-05 and 2005-06. As per new provision, s. 32(2) which came into effect from 1st April, 2002, the unabsorbed depreciation of the previous year was treated as current year depreciation and the same is to be allowed to be set off against income from any other head. Though the Finance Act, 1996 has taken away the treatment given to the unabsorbed depreciation of the earlier years as the current year depreciation, the original section as stood for asst. yr. 1996-97 was restored by the Finance Act, 2001. A new amended s. 32(2) is applicable to the present case as stood in the statute as on 1st April, 2003 for the asst. yr. 2004-05 and as stood on 1st April, 2004 for the asst. yr. 2005-06. Accordingly, s. 32(2) amended by the Finance Act, 2001, which is in force w.e.f. 1st April, 2002 is applicable for these two assessment years and as per this section, the assessee is entitled to set off of unabsorbed depreciation relating to asst. yr. 1996-97 with the income from other

sources of these two assessment years i.e. 2004-05 and 2005-06. Accordingly, the appeals of the Revenue are dismissed.”

(vi) **DCIT Vs Tamil Nadu State Transport Corporation (Villupuram) Limited dt 18.01.2012** - the Chennai Tribunal held as under:

“In view of the above circular, and also in view of the decision of the jurisdictional High Court, in the case of CIT Vs S & S Power Switchgear Ltd., (218 CTR 701)(Mad) the entire depreciation that was brought forward to the A.Y. 1996-97 and the net unabsorbed depreciation computed for the A.Y. 1996-97 and carried forward to the A.Y.1997-98 becomes the depreciation allowance of A.Y. 1997-98. The unabsorbed depreciation allowance after set off against the income of the current year, will become the unabsorbed depreciation allowance of A.Y. 1997-98 and the limitation of 8 years, as per the amended provisions of sec.32(2), starts from the A.Y.1997-98. Therefore, all the depreciation allowances that are brought forward from the earlier years and were available during the A.Y. 1997-98 can be carried forward for another period of 8 years i.e., up to A.Y.2005-06. In any case, with the change in the provisions of sec.32(2) w.e.f. 01.04.2002 the unabsorbed depreciation once again was made available to the assessee indefinitely by clubbing with the current depreciation allowance.”

Conclusion:

Therefore, we see that the above decisions have held that the amendment by Finance Act 2002 was a return back to the original provision, to make the claim simple.

The old position has been restored, which allows set off of unabsorbed depreciation against any head of income and the restrictive period of 8 years for claiming the set off has been deleted, thereby extending the claim period.

The Government, in order to avoid unnecessary litigation and administrative costs, should direct the Assessing Authorities not to disallow the claim of carry forward of unabsorbed depreciation since the position has been made clear by the CBDT circular.