Whether business loss and unabsorbed depreciation of an undertaking governed by section 10A or 10B, could be carried forward and adjusted against the profits and gains, for assessment years falling beyond the eligible period.

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- By S. K. Tyagi

As per the provisions of Section 10A(6) or 10B (6) of the Income-tax Act, 1961, before their amendment, vide Finance Act, 2003, the undertakings were not permitted to carry forward their business losses and unabsorbed depreciation for set-off against the profits and gains of an assessment year (AY) immediately succeeding the last of the relevant assessment years or subsequent assessment years, viz. AY 2010-11 and subsequent assessment years. The term 'relevant assessment year', as per Explanation 2 (vi) to Section 10A, means any AY falling within the period of ten consecutive AYs referred to in Section 10A. As per fourth proviso to Section 10A(1), the last of the relevant AYs as referred to in Section 10A, is the AY 2009-10.

The aforesaid restrictions on the carry-forward of business losses and unabsorbed depreciation were removed, vide amendment of Sections 10A(6) and 10B(6) of the Income-Tax Act, by the Finance Act, 2003, with retrospective effect from 1.4.2001, viz. AY 2001-02.

The query which is often referred to me for my opinion is whether an undertaking can carry forward and adjust such business loss and unabsorbed depreciation against the profits and gains of AY 2010-11 and subsequent assessment years, irrespective of the fact that there are positive profits and gains for subsequent relevant assessment years falling within the eligible period of ten consecutive AYs, which are claimed as deduction under Section 10A(1) or 10B(1) of the Income-Tax Act. The answer to this query is an emphatic **Yes**.

Before we proceed further, it may be reiterated that the benefit of deduction under Section 10A or 10B is permissible only up to AY 2009-10. This benefit is permissible for a period of ten consecutive assessment years up to the AY 2009-10. This block of ten assessment years is known as 'relevant assessment years'. The aforesaid query relates to the issue whether the business loss and / or unabsorbed depreciation for any of the relevant assessment years, could be carried forward and adjusted against the profits and gains of the assessment years beyond the eligible period of relevant assessment years viz. for the AY 2010-11 and subsequent assessment years. It may be stated here that the provisions of Section 10A and Section 10B are exactly the same in this regard and therefore, what is applicable to the provisions of Section 10A will equally apply to the provisions of Section 10B.

In order to answer the aforesaid queries, it would be necessary to closely examine the relevant provisions of the Income-Tax Act, 1961, meaning of certain expressions and words and relevant case-law. The same are dealt with as follows-

1. Correct implication of the deduction under section 10A

As per Section 10A (1), subject to the provisions of Section 10A, a deduction of profits and gains derived by an undertaking, shall be allowed from the total income of the assessee. Before the substitution of Section 10A by the Finance Act, 2000, with effect from 1.4.2001, the profits and gains derived by an assessee from an undertaking were not to be included in the total income of the assessee. Thus, after substitution of Section 10A, instead of **exemption,** a **deduction** in respect of the profits and gains of the undertaking, is allowed. However, inspite of the aforesaid change, Section 10A still continues to be a part of Chapter-III, the heading of which is 'Incomes which do not form part of total income'. Thus, the provisions of Section 10A are to be interpreted as if they are at par with the provisions of other Sections under Chapter-III, viz. Sections 10,11,12 and 13A, etc. In view of the aforesaid reasons, it is clear that income of an undertaking eligible for deduction under Section 10A will not form part of the total income of the assessee. This will be so, inspite of the fact that with effect from the AY 2001-02, the erstwhile sub-section (3) of Section 10A, has been omitted. As per the erstwhile sub-section (3) of Section 10A, the profits and gains referred to in sub-section (1), would not be included in the total income of the assessee.

It may also be seen that the profits and gains referred to in Section 10A are the profits and gains of an undertaking and not of undertakings. It implies that the deduction under Section 10A(1) in respect of the profits and gains of each undertaking, would be quite independent of one another, in case an assessee owns more than one such undertakings. It is, therefore, not clear as to what could be the purpose of changing the term **'exemption'** to **'deduction'** in Section 10A(1). It is also relevant to note that the deduction under Section 10A(1) is subject to the provisions of Section 10A only and not subject to the provisions of the Income-Tax Act, 1961.

Thus, perhaps, the only purpose of the aforesaid change from 'exemption' to 'deduction' could be to imply that the profits and gains would be computed as laid down under the Income-Tax Act, 1961, viz. Chapter IV-D, the heading of which is 'Profits and gains of business or profession'.

In the normal course, shorn of the aforesaid qualifications, the expression 'profits and gains' as contemplated in Section 10A(1) should mean true commercial profits of an undertaking. The true commercial profits for an assessment year will be as per the Profit and Loss Account and the Balance Sheet

of the entity. To arrive at such profits, the depreciation shown in the balance sheet will be deducted and not the depreciation admissible under the Income-Tax Act, 1961.

2. Provisions of Section 10A(6), with respect to carry-forward and adjustment of business losses and unabsorbed depreciation

The provisions of Section 10A(6) are very relevant for our purpose. Clauses (i) and (ii) of sub-section (6) of Section 10A, have been amended, vide Finance Act, 2003, with retrospective effect from 1.4.2001, viz. the AY 2001-02. In order to correctly appreciate the aforesaid amendment, Section 10A (6) is reproduced with the emphasis on the amended portions, as follows-

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(6) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years, or of any previous year, relevant to any subsequent assessment year,—

(i) section 32, section 32A, section 33, section 35 and clause (ix) of sub-section (1) of section 36 shall apply as if every allowance or deduction referred to therein and relating to or allowable for any of the relevant assessment years **ending before the 1st day of April, 2001***, in relation to any building, machinery, plant or furniture used for the purposes of the business of the undertaking in the previous year relevant to such assessment year or any expenditure incurred for the purposes of such business in such previous year had been given full effect to for that assessment year itself and accordingly sub-section (2) of section 32, clause (ii) of sub-section (3) of section 32A, clause (ii) of sub-section (2) of section 33, sub-section (4) of section 35 or the second proviso to clause (ix) of sub-section (1) of section 36, as the case may be, shall not apply in relation to any such allowance or deduction;*

(ii) no loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, in so far as such loss relates to the business of the undertaking, shall be carried forward or set off where such loss relates to any of the relevant assessment years **ending before the 1st day of April, 2001;**

(iii) no deduction shall be allowed under section 80HH or section 80HHA or section 80-I or section 80-IA or section 80-IB in relation to the profits and gains of the undertaking; and

(iv) in computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the business of the undertaking shall be computed as if the assessee had claimed and been actually allowed the deduction in respect of depreciation for each of the relevant assessment year.

As already explained, the aforesaid portions in bold, have been inserted / added, vide Finance Act, 2003, with retrospective effect from 1.4.2001, viz. from AY 2001-02. From the aforesaid provisions the following legal propositions may be derived-

(a) As per Section 10A(6)(i), the provisions of Section 32(2) etc., will not apply to any of the relevant assessment years ending before the first day of April 2001. It means that unabsorbed depreciation, etc. relating to the assessment years upto the AY 2000-01, will not be allowed to be carried forward and adjusted against the profits and gains of AY 2010-11 and subsequent assessment years, but the aforesaid benefit of carry-forward of unabsorbed depreciation in respect of AY 2001-02 and subsequent assessment years up to 2009-10, and adjustment of the same against the profits and gains of AY 2010-11 and subsequent assessment years, shall be allowed.

(b) As per Section 10A(6)(ii), no loss relating to the assessment years up to the AY 2000-01, will be allowed to be carried forward and adjusted under Section 72(1) or Section 74 (1), against the profits and gains of AY 2010-11 and subsequent assessment years.

It means that the aforesaid benefit of carry-forward of business loss in respect of AY 2001-02 and subsequent assessment years up to 2009-10, and adjustment of the same against the profits and gains of AY 2010-11 and subsequent assessment years, shall be allowed.

(c) As per Section 10A(6)(iv), in computing the depreciation allowance under Section 32, the W.D.V. of any asset used for the purposes of the business of the undertaking shall be computed as if the assessee had claimed and been actually allowed the deduction in respect of depreciation for each of the relevant AYs.

It means that in respect of an undertaking claiming deduction under Section10A, the depreciation under Section 32 will be deemed to have been allowed and the W.D.V. of the assets in question, shall be worked out, accordingly.

In this context, emphasis is to be laid on the amendment of Section 10A(6) (i) and Section 10A (6) (ii), vide Finance Act, 2003, with retrospective effect from 1.4.2001, viz. from AY 2001-02. In this connection, para 20 of the Explanatory Notes on the Finance Act, 2003, vide Circular No.7 of 2003, dated 5.9.2003, issued by the CBDT, provides us the legislative intent behind the aforesaid amendments. The same is reproduced as follows-

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20. Providing for carry forward of business losses and unabsorbed depreciation to units in Special Economic Zones and 100 per cent Export Oriented Units:

Under the existing provisions of sections 10A and 10B, the undertakings operating in a Special Economic Zone (under section 10A) and 100 per cent Export Oriented Units (EOU's) (under Section 10B) are not permitted to carry forward their business losses and unabsorbed depreciation.

With a view to rationalize the existing tax incentives in respect of such units sub-section (6) in sections 10A and 10B has been amended to do away with the restrictions on the carry forward of business losses and unabsorbed depreciation.

The amendments have been brought into effect retrospectively from April 1, 2001, and have been made applicable to business losses or unabsorbed depreciation arising in the assessment year 2001-02 and subsequent years.

From the aforesaid provisions of Section 10A(6), it is quite evident that an undertaking claiming deduction under Section 10A, is entitled to carry-forward its business loss and unabsorbed depreciation relating to the AYs 2001-02 to 2009-10 and adjust the same against profits and gains relating to the AY 2010-11 and subsequent assessment years.

It may also be stated here that under Section 32(2), unabsorbed depreciation is allowed to be carried forward without any restriction of time. On the other hand, business loss under Section 72, is allowed to be carried forward for a period of eight assessment years following the relevant assessment year.

3. For computation of 'profits and gains', brought forward losses and unabsorbed depreciation, will not be required to be deducted

As already explained in earlier para (1), the meaning of the expression 'profits and gains', of a previous year, as contemplated in Section 10A(1), would mean, commercial profits of the undertaking for the relevant previous year. In order to arrive at such profits and gains, the depreciation shown in the Profits and Loss Account will be deducted and not the depreciation admissible under the Income-Tax Act.

This clearly implies that the business losses and unabsorbed depreciation brought forward from earlier years, will not be required to be set-off against the profits and gains of the relevant previous year. Thus, the business losses and unabsorbed depreciation in relation to the relevant assessment years, will not be required to be set-off and adjusted against the profits and gains of the following assessment years, falling within the eligible period of ten consecutive assessment years. The same may be carried forward beyond the eligible period for set-off against the profits and gains of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years or any previous year, relevant to any subsequent assessment year. In other words, such brought forward losses and unabsorbed depreciation may be carried forward and set off against the profits and gains of the previous year relevant to the AY 2010 -11 and subsequent assessment years. The aforesaid legal position will entitle the undertaking to an immense tax benefit, because the undertaking would be entitled to claim whole of its profits and gains for the intervening relevant assessment years as exempt and at the same time the brought forward losses and unabsorbed depreciation of earlier years out of the eligible period of relevant assessment years, will be allowed to be carried forward and set-off against the profits and gains of the previous years relevant to the assessment years beyond the eligible period viz. AY 2010-11 and subsequent assessment years.

As already explained in earlier para (1) and (2), in view of the fact that it is a deduction and not exemption which is allowed in respect of the profits and gains under Section 10A(1), one may argue that such profits and gains should mean the profits and gains as computed in accordance with the provisions of the Income-Tax Act,1961. For this purpose the provisions of Sections 28 and 29 will have to be examined.

4. Meaning of the expression 'profits and gains of business or profession' under Chapter IV-D, of the I.T. Act

It may be stated here that 'income' is more general term than 'profits and gains' and the word 'income' is not limited by the words 'profits and gains'. A receipt may be taxable as income, although it may contain no element of 'profits and gains'.

The expression '**profits and gains of business or profession'** is defined under Section 28 of the Income-tax Act, in an inclusive manner. Besides, income from the profits and gains of business or profession is to be computed as per the provisions of Section 29 of the I.T. Act.

Section 29 of the I.T. Act, lays down as to how income from profits and gains of business or profession, is to be computed. As per Section 29, the income referred in Section 28 is to be computed in accordance with the provisions contained in Sections 30 to 43D.

Brought forward loss is not to be deducted from the current year's profits and gains

The profits and gains as referred to in Sections 28 and 29 are to be computed in accordance with provisions contained in Sections 30 to 43D of the I.T. Act. In this context, we have to refer to Section 72 of the Act, which deals with the carry-forward and set-off of brought-forward losses. Section 10A(6)(ii) also refers to Section 74(1) or Section 74(3). Section 74 deals with losses under the head 'capital gains'.

It may also be stated here that Section.74 (3) has been omitted, vide Finance Act, 2002, with effect from 1.4.2003. What is important to note in this context is the fact that Sections 72 and 74, fall under Chapter–VI. In other words provisions of Sections 72 and 74 will not have any impact on the computation of profits and gains of business or profession under Sections 28 and 29.

From the aforesaid discussion, it is quite evident that for the computation of profits and gains of a previous year, as contemplated under Section 10A(1), the brought-forward losses of earlier years, are not required to be deducted therefrom.

Unabsorbed depreciation is also not required to be deducted from the current year's profits and gains

In this context, we have to refer to the provisions of Section 32, which falls within Sections 30 to 43D. As per Section 32(1), current year's depreciation is required to be deducted for the computation of profits and gains. Besides, as per Section 32(2), the unabsorbed depreciation allowance is deemed to be the part of current year's depreciation allowance. However, as per normal accountancy principles for the computation of currents year's profits and gains, only current year's depreciation allowance is to be deducted and not the unabsorbed depreciation allowance of earlier years.

In this context, it would be relevant to refer to the judgement of the Apex Court in the case of *CIT Vs. Mother India Refrigeration Industries Pvt. Ltd. [1985] 155 ITR 711 (S.C.).* It has been held in this case that the normal accountancy principle has to be applied in arriving at the net income from business for a particular year, by debiting the current year's depreciation. It is further held that Section 32(2) is a legal fiction, according to which the unabsorbed depreciation is deemed to be the current year's depreciation and it is well settled that the legal fictions are created only for some definite purpose and these must be limited to that purpose and should not be extended beyond their legitimate field. The avowed purpose of the legal fiction created by the deeming provisions of Section 32(2), is to make the unabsorbed carried forward depreciation, partake of the same character as the current depreciation in the following year, so that it is available unlike unabsorbed carried forward business loss, for being set off against other heads of income of that year.

Thus, the aforesaid judgement of the Apex Court, clearly lays down that the unabsorbed depreciation of earlier years, is not required to be deducted for the purpose of computation of profits and gains of a previous year.

In this connection, a reference may also be made to the judgement in the case of *Dy.CIT Vs. I.T.C. Hotels Ltd. [2004] 82 TTJ 652 (Bang.-T).* One of the issues before the Hon. Tribunal was computation of profits and gains of business or profession for the purpose of deduction under Section 80-HHD. It has been held that the profits and gains of business or profession, are to be computed in terms of Sections 28 to 44D. Therefore, '**profits of business**' of the current year, in terms of Sections 28 to 44D, can be understood as profits after allowing deduction for the current year's depreciation alone and before reducing the brought forward unabsorbed depreciation of earlier years. The Hon.Tribunal has relied upon the judgement of the Apex Court in the case of *Mother India Refrigeration Industries Pvt. Ltd.* (*Supra*).

From the aforesaid discussion, it is quite evident that for the computation of profits and gains of a previous year as contemplated under Section 10A(1), the unabsorbed depreciation of earlier years is not required to be deducted therefrom.

5. An incentive provision needs to be liberally construed

When the Legislature brings in the statute an incentive provision for the encouragement or advancement of a specific purpose, activity or objective, then such provision has to be liberally interpreted so as to advance the purpose behind it. In this context, one may rely on the following judgements:

(i) *CIT Vs. Bharat Sea Foods [1999] 237 ITR 46 (Ker.)(FB)*

The judgement in this case related to the interpretation of the provisions of Ss.80-J and 80-HH.

It was held that Ss.80-J and 80-HH of the I.T. Act, 1961, are intended to encourage the setting up of new industrial enterprises and must be construed liberally and in a manner that will promote the object of the Legislature.

(ii) *Bajaj Tempo Ltd. Vs. CIT [1992] 196 ITR.188 (SC)*

This judgement related to S.15C of the old Act (S.80J of the new Act). The relevant part of the of the judgement may be summarized, as follows.

A provision in a taxing statute granting incentives for promoting growth and development should be construed liberally; and since a provision for promoting economic growth has to be interpreted liberally, the restriction on it too has to be construed so as to advance the objective of the provision and not to frustrate it.[p.194 of the Report]

(iii) *AGS Timber and Chemicals Industries Pvt. Ltd. Vs. CIT [1998] 233 ITR 207 (Mad.)*

This judgement also related to the interpretation of S.80J.

It was held that the provision in a taxing statute granting incentive for promoting growth and development should be construed liberally.

From the aforesaid judgements, it is quite evident that an incentive provision like S.10A should be construed in a liberal and purposive manner, meaning thereby that the AO, in such cases, should adopt a liberal and broad-minded approach, so as to fulfil the objective of the legislation and not in a manner as to snatch away the benefit intended to be given by the Legislature.

6. An exemption provision is required to be liberally construed

As per *CIT Vs. Gujarat Aluminium Extrusions Pvt. Ltd. [2003] 263 ITR 453 (Guj.)*, it is a settled legal position that the provision for exemption or relief should be construed liberally and in favour of the assessee. As already pointed out, S.10A is an exemption provision and therefore, the same is required to be construed liberally and in favour of the assessee.

7. Even if there is an ambiguity, a view favourable to the assessee must be accepted

If there is any ambiguity regarding the interpretation of the statute, a view favourable to the assessee must be accepted. Reliance for this proposition is placed on the following judgements of the Apex Court.

(a) C.I.T Vs Vegetable Products Ltd, [1973] 88 I.T.R p.192 (S.C)

The relevant part of the judgement may be summarized, as follows :

If the court finds that the language of a taxing provision is ambiguous or capable of more meaning than one, then the court has to adopt that interpretation which favours the assessee

(b) C.I.T Vs Naga Hills Tea Co. Ltd, [1973] 89 I.T.R p.236 (S.C)

The relevant part of the judgement may be summarized, as follows :

If a provision of a taxing statute can be reasonably interpreted in two ways that interpretation which is favourable to the assessee has got to be accepted.

(c) *C.I.T Vs Poddar Cement P Ltd, [1997] 226 I.T.R p.625 (S.C)*

It was '*inter alia'* held in this case that in case of ambiguity, a construction of the statute, beneficial to the assessee has to be preferred**.**

Therefore, if there is any ambiguity regarding the interpretation of the relevant provisions of Section 10A of the I.T. Act, a view favourable to the tax-payer must be accepted.

8. Therefore, the business losses and unabsorbed depreciation of earlier years, are not required to be deducted for the computation of current year's profits and gains

From the aforesaid discussion in paras (1) to (7), it is quite clear that for the computation of profits and gains of a previous year relating to any of the relevant assessment years under Section 10A, the business losses and/or unabsorbed depreciation of earlier years may be carried forward and set off against the profits and gains of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years or any previous year, relevant to any subsequent assessment year, viz. AY 2010-11 or subsequent assessment years.

9. Conclusion

From the aforesaid discussion, it may be summarized that-

(i) for the computation of profits and gains of a previous year, as contemplated under Section 10A(1), the brought forward business losses of earlier years are not required to be deducted therefrom.

(ii) for the purpose of computation of profits and gains of a previous year, as contemplated under Section 10A(1), the unabsorbed depreciation of earlier years is not required to be deducted therefrom.

(iii) the profits and gains of a previous year can be claimed as deduction under Section 10A(1), irrespective of the fact that there are brought forward business losses and unabsorbed depreciation from earlier AYs falling within the eligible period of ten consecutive AYs.

(iv) the aforesaid brought-forward business losses and unabsorbed depreciation, will be allowed to be carried forward and set off against the profits and gains of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years or of any previous year, relevant to any subsequent assessment year, viz. AY 2010-11 or subsequent assessment years.

S. K. TYAGI
M.Sc., LL.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor

☎ Office : (020) 2613 3012
Fax : (020) 2612 1131
Residence : (020) 2668 2032
: (020) 2668 2444
E-mail : sktyagidt@vsnl.com

Flat No.2, (First Floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE - 411 001