After studying this chapter, you would be able to -

- **identify** the permissible inter-source and inter-head adjustments for set-off of losses and the restrictions in inter-source and inter-head set-off of losses.

- **determine** the unabsorbed losses which can be carried forward to the subsequent assessment year for set-off against income of that year and the maximum period of carry forward of such losses.

- **appreciate** the provisions regarding carry forward and set-off of losses in case of closely held companies and eligible start-ups as also in case of change in constitution of firms.

- **appreciate** the conditions which are required to be satisfied by the amalgamating company and the amalgamated company for carry forward and set-off of loss of the amalgamating company by the amalgamated company.

- **appreciate** the special provisions for carry forward and set-off of losses of a banking company against the profits of a banking institution under a scheme of amalgamation.

- **compute** the gross total income of an assessee after applying the provisions relating to set-off and carry forward and set-off of losses.
10.1 AGGREGATION OF INCOME

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. These are discussed in detail in Chapter 1. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

10.2 CONCEPT OF SET-OFF AND CARRY FORWARD OF LOSSES

Specific provisions have been made in the Income-tax Act, 1961 for the set-off and carry forward of losses. In simple words, “Set-off” means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

10.3 INTER SOURCE ADJUSTMENTS [SECTION 70]

(1) Permissible Inter-source Adjustments

Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

Example 1: Loss from one house property can be set off against the income from another house property.

Example 2: Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set-off against the profits from another business in the same year.

(2) Inter-source adjustments not permissible

(i) Long-term capital loss [Section 70(3)]

(a) Where the net result in respect of any short-term capital asset is a loss, such loss
shall be allowed to be set-off against income, if any, for that assessment year under the head “capital gains” in respect of any other capital asset, and

(b) Where the net result in respect of any long-term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under the head “capital gains” in respect of any other asset not being a short-term capital asset.

Thus, short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set-off only against long-term capital gain and not short-term capital gain.

(ii) Speculation loss [Section 73(1)]

A loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income.

However, losses from other business can be adjusted against profits from speculation business.

(iii) Loss from the activity of owning and maintaining race horses [Section 74A(3)]

Such loss can be set-off only against income from the activity of owning and maintaining race horses.

(iv) Losses from specified business [Section 73A(1)]

A loss in any specified business referred in section 35AD can be set-off only against any other specified business.

However, losses from other business can be set-off against profits from specified business.

(3) It must be noted that loss from an exempt source cannot be set-off against profits from a taxable source of income. For example, long-term capital loss on sale of shares sold through a recognized stock exchange, on which STT is paid at the time of acquisition as well as on sale of such shares, cannot be set-off against long-term capital gains on sale of land.

10.4 INTER HEAD ADJUSTMENTS [SECTION 71]

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

(1) Where the net result of the computation under any head of income (other than ‘Capital Gains’) is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including ‘Capital Gains’.
(2) Where the net result of the computation under the head “Profits and gains of business or profession” is a loss, such loss cannot be set off against income under the head “Salaries”.

(3) Where the net result of computation under the head ‘Capital Gains’ is a loss, such capital loss cannot be set-off against income under any other head.

(4) Where the net result of the computation under the head “Income from house property” is a loss and the assessee has income assessable under any other head of income, the amount of such loss exceeding ₹ 2 lakhs would not be allowable to be set-off against income under the other head. In other words, the maximum loss from house property which can be set-off against income from any other head is ₹ 2 lakhs.

(5) Speculation loss, loss from the activity of owning and maintaining race horses and losses from specified business referred to in section 35AD cannot be set off against income under any other head.

Illustration 1

Mr. A submits the following particulars pertaining to the A.Y.2018-19:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary</td>
<td>4,00,000</td>
</tr>
<tr>
<td>Loss from self-occupied property</td>
<td>(-)70,000</td>
</tr>
<tr>
<td>Loss from let-out property</td>
<td>(-)1,50,000</td>
</tr>
<tr>
<td>Business loss</td>
<td>(-)1,00,000</td>
</tr>
<tr>
<td>Bank interest (FD) received</td>
<td>80,000</td>
</tr>
</tbody>
</table>

Compute the total income of Mr. A for the A.Y.2018-19.

Solution

Computation of total income of Mr. A for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary</td>
<td>4,00,000</td>
<td></td>
</tr>
<tr>
<td>Loss from house property of ₹ 2,20,000 to be restricted to ₹ 2 lakhs by virtue of section 71(3A)</td>
<td>(-)2,00,000</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>
### Income from other sources (interest on fixed deposit with bank)
80,000

### Business loss set-off
- **Business loss set-off**
- **Business loss of ₹20,000 to be carried forward**: (-) 1,00,000

### Gross total income [See Note below]
2,00,000

### Less: Deduction under Chapter VI-A
Nil

### Total income
2,00,000

**Note:** Gross Total Income includes salary income of ₹2,00,000 after adjusting loss of ₹2,00,000 from house property. The balance loss of ₹20,000 from house property will be carried forward. Business loss of ₹1,00,000 is set off against bank interest of ₹80,000 and remaining business loss of ₹20,000 will be carried forward as it cannot be set off against salary income.

### 10.5 SET-OFF AND CARRY FORWARD OF LOSS FROM HOUSE PROPERTY [SECTION 71B]

1. In any assessment year, if there is a loss under the head ‘Income from house property’, such loss will first be set-off against income from any other head to the extent of ₹2,00,000 during the same year.

2. The unabsorbed loss will be carried forward to the following assessment year to be set-off against income under the head ‘Income from house property’.

3. The loss under this head is allowed to be carried forward up to 8 assessment years immediately succeeding the assessment year in which the loss was first computed.

4. For example, loss from one house property can be adjusted against the profits from another house property in the same assessment year. Any loss under the head ‘Income from house property’ can be set off against any income under any other head to the extent of ₹2,00,000 in the same assessment year. However, if after such set off, there is still any loss under the head “Income from house property”, then, the same shall be carried forward to the next year.

5. It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

### 10.6 CARRY FORWARD AND SET-OFF OF BUSINESS LOSSES [SECTION 72]

Under the Act, the assessee has the right to carry forward the losses under the business and profession in cases where such loss cannot be set-off due to the absence or inadequacy of income.
under any other head in the same year. The loss so carried forward can be set-off against the profits of subsequent previous years.

Section 72 covers the carry forward and set-off of losses arising from a business or profession.

**Conditions**

The assessee’s right to carry forward business losses under this section is, however, subject to the following conditions:

1. The loss should have been incurred in business, profession or vocation.
2. The loss should not be in the nature of a loss in the business of speculation.
3. The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred.
   However, a loss carried forward cannot, under any circumstances, be set-off against the income from any head other than “Profits and gains of business or profession”.
4. The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor except in the case of succession by inheritance.
5. A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.
6. **Rehabilitation of business [Proviso to section 72(1)]**
   
   If there is a loss sustained of a business which is discontinued in the circumstances mentioned under section 33B and such business is re-established, reconstructed or revived by the assessee within 3 years from the end of previous year of discontinuation, the loss attributable to such business
   
   (i) shall be allowed to be set off against the profits and gains, if any, of that business or any other business carried on by him and assessable for that assessment year, and
   
   (ii) if the loss cannot be wholly so set off, the amount of balance loss to be carried to the following assessment year and so on for 7 assessment years immediately succeeding provided such re-established business is continued to be carried by the assessee.

**Note: Circumstances referred to in section 33B**

The business is formed as re-establishment, reconstruction or revival by the assessee of the business of such industrial undertaking which is discontinued by reason of extensive
damage to or destruction of, any building, machinery, plant or furniture owned by the assessee and used for the purpose of such business.

Such damage or destruction should be affected as a direct result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature or riot or civil disturbance or accidental fire or explosion or action by an enemy or action taken in combating an enemy.

Illustration 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y.2017-18:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salary (Net)</td>
<td>45,000</td>
</tr>
<tr>
<td>Income from house property</td>
<td>(24,000)</td>
</tr>
<tr>
<td>Income from business – non-speculative</td>
<td>(22,000)</td>
</tr>
<tr>
<td>Income from speculative business</td>
<td>(4,000)</td>
</tr>
<tr>
<td>Short-term capital losses</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Long-term capital gains</td>
<td>19,000</td>
</tr>
</tbody>
</table>

What is the total income chargeable to tax for the A.Y.2018-19?

Solution

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salaries</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>(24,000)</td>
<td>21,000</td>
</tr>
<tr>
<td><strong>Profits and gains of business and profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business loss to be carried forward [Note 1]</td>
<td>(22,000)</td>
<td></td>
</tr>
<tr>
<td>Speculative loss to be carried forward [Note 2]</td>
<td>(4,000)</td>
<td></td>
</tr>
</tbody>
</table>

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10.8  DIRECT TAX LAWS

<table>
<thead>
<tr>
<th>Capital Gains</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term capital gain</td>
</tr>
<tr>
<td>Short term capital loss</td>
</tr>
<tr>
<td>Short term capital loss to be carried forward [Note 3]</td>
</tr>
<tr>
<td>Taxable income</td>
</tr>
</tbody>
</table>

**Note 1:** Business loss cannot be set-off against salary income. Therefore, loss of ₹ 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

**Note 2:** Loss of ₹ 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

**Note 3:** Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set-off against long-term capital gains to the extent of ₹ 19,000. The balance short term capital loss of ₹ 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

10.7  CARRY FORWARD AND SET-OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN CERTAIN CASES OF AMALGAMATION/ DEMERGER, ETC. [SECTION 72A]

(1) **Amalgamation**

**Applicability:** This section applies where there has been an amalgamation of –

(i) a company owning an industrial undertaking or a ship or a hotel with another company; or

(ii) an amalgamation of a banking company with a specified bank; or

(iii) public sector companies engaged in the business of operation of aircrafts.

**Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by amalgamated company in case of amalgamation:** It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward shall also apply accordingly.
Conditions for availing benefit under this section

(i) Conditions to be fulfilled by the amalgamating company

(a) The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.

(b) The amalgamating company has held continuously as on the date of amalgamation, at least 3/4th of the book value of the fixed assets held by it, 2 years prior to the date of amalgamation.

(ii) Conditions to be fulfilled by the amalgamated company

(a) The amalgamated company should hold at least 3/4th in the book value of fixed assets of the amalgamating company acquired as a result of amalgamation for a minimum period of 5 years from the effective date of amalgamation.

(b) The amalgamated company continues the business of the amalgamating company for at least 5 years.

(c) The amalgamated company must also fulfill such other conditions prescribed under Rule 9C for the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose -

(1) The amalgamated company shall achieve the level of production of at least 50% of the installed capacity (capacity as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.

(2) The amalgamated company shall furnish to the Assessing Officer a certificate in the prescribed form verified by a Chartered Accountant in this regard.

(iii) Consequences of non-fulfillment of specified conditions: In case the above specified conditions are not fulfilled, that part of carry forward of loss and unabsorbed depreciation remaining to be utilized by the amalgamated company shall lapse and such loss or depreciation as has been set-off shall be treated as the income in the year in which there is a failure to fulfill the conditions.

(2) Demerger

Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by resulting company in case of demerger: Where there has been a demerger of an undertaking,

- the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company shall be allowed to be carried forward and set off in the hands of the resulting company.
• if the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets have been transferred.

**Conditions for availing benefit under this section:** The Central Government is empowered to notify such conditions as it considers necessary to ensure that the demerger or amalgamation is for genuine business purpose.

**(3) Re-organisation of business [Section 72A(6)]**

**Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by company in case of succession:** In case of re-organisation of business, whereby a firm is succeeded by a company as per the provisions of section 47(xiii), or a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv), then the accumulated business loss and the unabsorbed depreciation of the firm / proprietary concern, as the case may be, shall be deemed to be the loss or depreciation allowance of the successor company for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set-off and carry forward will apply accordingly.

**Consequences of non-fulfillment of specified conditions:** If it is found that any of the conditions laid down in the corresponding sub-sections (xiii) or (xiv) of section 47 have not been complied with, the set-off of loss or allowance of depreciation made in any previous year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which the conditions have been violated.

**(4) Conversion of a company into LLP [Section 72A(6A)]**

**Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by LLP in case of conversion:** In case of re-organisation of business, whereby a private company or unlisted company is succeeded by a LLP as per the provisions of section 47(xiiiib), then the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company.

**Consequences of non-fulfillment of specified conditions:** If the entity fails to fulfill the conditions specified in section 47(xiiiib), the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions.
### Meanings of certain terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Particulars</th>
</tr>
</thead>
</table>
| **Accumulated loss**        | It means so much of the loss of  
- the predecessor firm or  
- the proprietary concern or  
- the private company or unlisted company or  
- the amalgamating company or  
- the demerged company, as the case may be,  
under the head “Profit and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72, if the re-organisation of business or amalgamation or demerger had not taken place |
| **Industrial undertaking**  | It means any undertaking which is engaged in  
(i) the manufacture or processing of goods;  
(ii) the manufacture of computer software;  
(iii) the business of generation or distribution of electricity or any other form of power;  
(iv) providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band network and internet services.  
(v) mining;  
(vi) the construction of ships, aircraft or rail systems. |
| **Unabsorbed depreciation** | Unabsorbed depreciation means so much of the allowance for depreciation of  
- the predecessor firm or  
- the proprietary concern or  
- the private company or unlisted company or  
- the amalgamating company or |
10.8 CARRY FORWARD AND SET-OFF OF LOSSES OF A BANKING COMPANY AGAINST THE PROFIT OF A BANKING INSTITUTION UNDER A SCHEME OF AMALGAMATION [SECTION 72AA]

(1) **Applicability**: This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance of a banking company against the profits of a banking institution under a scheme of amalgamation sanctioned by the Central Government.

(2) **Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by banking institution in case of amalgamation**: Where a banking company has been amalgamated with a banking institution under a scheme sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, the accumulated loss and unabsorbed depreciation of the amalgamating banking company shall be deemed to be the loss or the allowance for depreciation of the banking institution for the previous year in which the scheme of amalgamation is brought into force, and all the provisions contained in the Income-tax Act, 1961, relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.

(3) **Meaning of certain terms**:

<table>
<thead>
<tr>
<th>Term</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated loss</td>
<td>It means so much of the loss of the amalgamating banking company under the head “Profits and gains of business or profession” (not</td>
</tr>
</tbody>
</table>
being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of section 72 if the amalgamation had not taken place.

| Banking company | It has the same meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949 |
| Banking institution | It has the same meaning assigned to it in sub-section (15) of section 45 of the Banking Regulation Act, 1949. |
| Unabsorbed depreciation | It means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if the amalgamation had not taken place. |

10.9 CARRY FORWARD AND SET-OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION IN BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 72AB]

(1) **Allowability of carry forward and set-off of accumulated loss and unabsorbed loss by a co-operative bank in case of reorganisation**: Under this section, in a case where the amalgamation has taken place during the previous year, set-off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.

(2) **Conditions for availing benefit under this section**

(i) **Conditions to be fulfilled by the predecessor co-operative bank**

- It should have been engaged in the business of banking for three or more years; and
- It has held at least 3/4th of the book value of fixed assets as on the date of the business reorganisation, continuously for 2 years prior to the date of business reorganisation;
(ii) **Conditions to be fulfilled by the successor co-operative bank**

(a) It should hold at least $\frac{3}{4}$ of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of 5 years immediately succeeding the date of business reorganisation;

(b) It continues the business of the predecessor co-operative bank for a minimum period of 5 years from the date of business reorganisation; and

(c) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

(3) **Quantum allowed of accumulated loss and unabsorbed depreciation**: The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

(i) **In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank** - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.

(ii) **In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank** - the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.

For example, if A Co-op Bank is the demerged co-operative bank and B Co-op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

\[
\frac{\text{Unabsorbed business loss/depreciation of A Co-op bank}}{\text{Assets of A Co-op bank}} \times \frac{\text{Assets of the undertaking transferred to B Co-op bank}}{\text{Assets of A Co-op bank}}
\]

(4) **Additional conditions for availing benefit under this section**: The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.

(5) **Period before and after business reorganization to constitute two different previous years**: The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be
deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

For example, if the date on which business re-organisation took place is 1.11.2017, then the period between 1.4.2017 and 31.10.2017 and the period between 1.11.2017 and 31.3.2018 would be deemed to be two different previous years for the purposes of set-off and carry forward of unabsorbed business losses and depreciation.

(6) **Consequences of non-fulfilment of specified conditions**: In a case where the conditions specified in (ii) above or notified under (iv) above are not complied with, the set-off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

(7) **Meaning of Accumulated loss**: It means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such amalgamating co-operative bank or the demerged co-operative bank, would have been entitled to carry forward and set-off under the provisions of section 72 as if the business reorganisation had not taken place.

(8) **Meaning of unabsorbed depreciation**: It means so much of the allowance for depreciation of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, which remains to be allowed and which would have been allowed to such bank as if the business reorganisation had not taken place.

### 10.10 LOSSES IN SPECULATION BUSINESS [SECTION 73]

(1) The meaning of the expression ‘speculative transaction’ as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head “Profits and gains of business or profession”.

(2) Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years.

(3) Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee.

(4) The loss in speculation business can be carried forward only for a maximum period of 4 years from the end of the relevant assessment year in respect of which the loss was computed.
Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

(5) The *Explanation* to this section provides that where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply to the following companies –

(i) A company whose gross total income consists of mainly income chargeable under the heads “Interest on securities”, “Income from house property”, “Capital gains” and “Income from other sources”;

(ii) A company, the principal business of which is –

(a) the business of trading in shares; or
(b) the business of banking; or
(c) the granting of loans and advances.

Thus, these companies would be exempted from the operation of this *Explanation*. Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business.

### 10.11 Carry Forward & Set-Off of Losses by Specified Businesses [Section 73A]

(1) Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business.

(2) The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.

(3) There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

(4) **However, return of loss has to be filed on or before the due date of filing of return under section 139(1) for carry forward of loss from specified business.**

**Note** - The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. An assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with at least 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.
10.12 LOSSES UNDER THE HEAD ‘CAPITAL GAINS’

[SECTION 74]

Section 74 provides that where for any assessment year, the net result under the head ‘Capital gains’ is short term capital loss or long term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

1. Where the loss so carried forward is a short-term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.

2. Where the loss so carried forward is a long-term capital loss, it shall be set off only against long term capital gain arising in that year.

3. Net loss under the head capital gains cannot be set off against income under any other head.

4. Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Illustration 3

During the P.Y. 2017-18, Mr. C has the following income and the brought forward losses:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term capital gains on sale of shares</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Long term capital loss of A.Y.2016-17</td>
<td>(96,000)</td>
</tr>
<tr>
<td>Short term capital loss of A.Y.2017-18</td>
<td>(37,000)</td>
</tr>
<tr>
<td>Long term capital gain</td>
<td>75,000</td>
</tr>
</tbody>
</table>

What is the capital gain taxable in the hands of Mr. C for the A.Y.2018-19?

Solution

Taxable capital gains of Mr. C for the A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term capital gains on sale of shares</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td>Less: Brought forward short term capital loss of the A.Y.2017-18</td>
<td>(37,000)</td>
<td>1,13,000</td>
</tr>
</tbody>
</table>

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10.18 DIRECT TAX LAWS

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long term capital gain</td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Brought forward long term capital loss of A.Y.2016-17</td>
<td>(75,000)</td>
</tr>
<tr>
<td>[See Note below]</td>
<td>Nil</td>
</tr>
<tr>
<td>Taxable short-term capital gains</td>
<td>1,13,000</td>
</tr>
</tbody>
</table>

**Note:** Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y.2016-17 of ₹ 21,000 (i.e. ₹ 96,000 – ₹ 75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

### 10.13 LOSSES FROM THE ACTIVITY OF OWNING AND MAINTAINING RACE HORSES [SECTION 74A(3)]

1. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.

2. Such loss can be carried forward for a maximum period of 4 assessment years immediately succeeding the assessment year for which the loss was first computed, for being set-off against the income from the activity of owning and maintaining race horses.

3. For this purpose, the “amount of loss incurred by the assessee in the activity of owning and maintaining race horses” means the amount by which such income by way of stake money falls short of the amount of revenue expenditure incurred by the assessee for the purpose of maintaining race horses. i.e. Loss = Stake money – revenue expenditure for the purpose of maintaining race horses.

4. Further, the expression ‘horse race’ means a horse race upon which wagering or betting may be lawfully made.

5. “Income by way of stake money” means the gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning or being placed second or in any lower position in horse races.

**Illustration 4**

*Mr. D has the following income for the P.Y.2017-18-*

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from the activity of owning and maintaining the race horses</td>
<td>75,000</td>
</tr>
</tbody>
</table>
What is the total income in the hands of Mr. D for the A.Y. 2018-19?

Solution

<table>
<thead>
<tr>
<th><strong>Particulars</strong></th>
<th><strong><code>\text{\textcurrency{\text{\textacr{rupee}}}}</code></strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from the activity of owning and maintaining race horses</td>
<td>75,000</td>
</tr>
<tr>
<td>Less: Brought forward loss from the activity of owning and maintaining race horses</td>
<td>96,000</td>
</tr>
<tr>
<td>Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2019-20</td>
<td>(21,000)</td>
</tr>
<tr>
<td>Income from textile business</td>
<td>85,000</td>
</tr>
<tr>
<td>Less: Brought forward business loss from textile business.</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td><strong>35,000</strong></td>
</tr>
</tbody>
</table>

**Note:** Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

### 10.14 CARRY FORWARD AND SET-OFF OF LOSSES IN CASE OF CHANGE IN CONSTITUTION OF FIRM OR SUCCESSION [SECTION 78]

1. **Change in constitution of firm:** Where there is a change in the constitution of a firm, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward.

2. **Succession otherwise by inheritance:** Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by
inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.

(3) **Succession by inheritance**: Where there is a succession by inheritance, the legal heirs are entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

### 10.15 CARRY FORWARD AND SET-OFF OF LOSSES IN CASE OF CLOSELY HELD COMPANIES [SECTION 79]

(1) **Carry forward and set-off of losses in case of closely held company not being an eligible start-up referred to in section 80-IAC**

In the case of a company in which the public are not substantially interested and not being an eligible start-up referred to in section 80-IAC, no loss incurred in any year prior to the previous year shall be carried forward and set-off against the income of the previous year, unless

- on the last day of the previous year, the shares of the company carrying not less than 51% of the voting power were beneficially held by persons
- who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred.

(2) **Carry forward and set-off of losses in case of closely held company being an eligible start-up referred to in section 80-IAC**

In case of a company in which the public are not substantially interested but being an eligible start-up as referred to in section 80-IAC, any unabsorbed loss of the company shall be allowed to be carried forward and set off against the income of the previous year only if

- all the shareholders of such company who held shares carrying voting power on the last day of the previous year or years in which the loss was incurred continue to hold those shares on the last day of such previous year in which the loss is to be set-off and
- such loss has been incurred during the period of 7 years beginning from the year of incorporation of such company.

(3) **Non-applicability of restriction**

This restriction shall, however, not apply in the following two cases:

(i) where a change in the voting power and shareholding takes place consequent upon the death of a shareholder or on account of transfer of shares by way of gift by a shareholder to his relative; and
(ii) where the change in shareholding takes place in an Indian company, being a subsidiary of a foreign company, as a result of amalgamation or demerger of the foreign company. However, this is subject to the condition that 51% of the shareholders of the amalgamating/demergered company continue to be shareholders of the amalgamated/resulting foreign company.

(4) **Meaning of eligible start-up:**

- A business which involves –
  - Innovation
  - Development
  - Deployment
  - Commercialization
  - Of new products, processes or services
  - Driven by technology or intellectual property

(5) **Meaning of eligible business:**

- Company engaged in eligible business
  - Incorporated during the period 1.4.2016-31.3.2019
  - Total turnover ≤ ₹ 25 crores in any P.Y. from P.Y.2016-17 to P.Y.2020-21
  - Holds a certificate of eligible business from the notified Inter Ministerial Board of Certification

### 10.16 ORDER OF SET-OFF OF LOSSES

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

1. Current year depreciation / Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed.
2. Brought forward loss from business/profession [Section 72(1)]
3. Unabsorbed depreciation [Section 32(2)]
4. Unabsorbed capital expenditure on scientific research [Section 35(4)].
5. Unabsorbed expenditure on family planning [Section 36(1)(ix)]
Illustration 5

Mr. E has furnished his details for the A.Y.2018-19 as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salaries</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Income from speculation business</td>
<td>60,000</td>
</tr>
<tr>
<td>Loss from non-speculation business</td>
<td>(40,000)</td>
</tr>
<tr>
<td>Short term capital gain</td>
<td>80,000</td>
</tr>
<tr>
<td>Long term capital loss of A.Y.2016-17</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Winning from lotteries</td>
<td>20,000</td>
</tr>
</tbody>
</table>

What is the taxable income of Mr. E for the A.Y.2018-19?

Solution

Computation of taxable income of Mr. E for the A.Y.2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from salaries</td>
<td></td>
<td>1,50,000</td>
</tr>
<tr>
<td>Income from speculation business</td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td>Less: Loss from non-speculation business</td>
<td></td>
<td>(40,000)</td>
</tr>
<tr>
<td>Short-term capital gain</td>
<td></td>
<td>80,000</td>
</tr>
<tr>
<td>Winnings from lotteries</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td></td>
<td>2,70,000</td>
</tr>
</tbody>
</table>

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.
Illustration 6

Compute the gross total income of Mr. F for the A.Y.2018-19 from the information given below –

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income from house property</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Income from business (before providing for depreciation)</td>
<td>1,35,000</td>
</tr>
<tr>
<td>Short term capital gains on sale of shares</td>
<td>56,000</td>
</tr>
<tr>
<td>Long term capital loss from sale of property (brought forward from A.Y.2015-16)</td>
<td>(90,000)</td>
</tr>
<tr>
<td>Income from tea business</td>
<td>1,20,000</td>
</tr>
<tr>
<td>Dividends from Indian companies carrying on agricultural operations</td>
<td>80,000</td>
</tr>
<tr>
<td>Current year depreciation</td>
<td>26,000</td>
</tr>
<tr>
<td>Brought forward business loss (loss incurred six years ago)</td>
<td>(45,000)</td>
</tr>
</tbody>
</table>

Solution

Gross Total Income of Mr. F for the A.Y. 2018-19

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from house property</td>
<td></td>
<td>1,25,000</td>
</tr>
<tr>
<td><strong>Income from business</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profits before depreciation</td>
<td></td>
<td>1,35,000</td>
</tr>
<tr>
<td><strong>Less: Current year depreciation</strong></td>
<td></td>
<td>26,000</td>
</tr>
<tr>
<td><strong>Less: Brought forward business loss</strong></td>
<td></td>
<td>45,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>64,000</td>
</tr>
<tr>
<td>Income from tea business (40% is business income)</td>
<td></td>
<td>48,000</td>
</tr>
<tr>
<td><strong>Income from the capital gains</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term capital gains</td>
<td></td>
<td>56,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td></td>
<td>2,93,000</td>
</tr>
</tbody>
</table>
Notes:

(1) Dividend from Indian companies of ₹ 80,000 is exempt from tax under section 10(34).

(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;

(3) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from A.Y.2015-16 cannot be set-off in the A.Y.2018-19. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2019-20.

10.17 SUBMISSION OF RETURN FOR LOSSES [SECTION 80]

As per section 80, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off of:

- business loss to be carried forward under section 72(1)
- speculation business loss to be carried forward under section 73(2)
- loss from specified business to carried forward under section 73A(2)
- loss under the head “Capital Gains” to be carried forward under section 74(1) and
- loss incurred in the activity of owning and maintaining race horses to be carried forward under section 74A(3).

In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the above specified losses sustained by him. Such a return should be filed within the time allowed under section 139(1).

However, this condition does not apply to a loss from house property to be carried forward under section 71B and unabsorbed depreciation can be carried forward even if return of loss has not been filed as required under section 139(3).
Question 1

X carrying on a business as sole proprietor, died on 31st March, 2017. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2017, a determined business loss of ₹5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case CIT v. Madhukant M. Mehta (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹5 lacs of X.

Question 2

ABC Limited was amalgamated with XYZ Limited on 01.04.2017. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2017-18:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Speculative Loss</td>
<td>4</td>
</tr>
<tr>
<td>(ii) Unabsorbed Depreciation</td>
<td>18</td>
</tr>
</tbody>
</table>
XYZ Limited has computed a profit of ₹ 140 lacs for the financial year 2017-18 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹ 150 lacs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per income-tax record of ABC Limited as on 31st March, 2017 was ₹ 100 lacs.

The above profit of XYZ Limited includes speculative profit of ₹ 10 lacs.

Compute the total income of XYZ Limited for Assessment Year 2018-19 and indicate the losses/other allowances to be carried forward by it.

**Answer**

**Computation of total income of XYZ Limited for the A.Y. 2018-19**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹ (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business income</strong></td>
<td></td>
</tr>
<tr>
<td>Business income before setting-off brought forward losses of ABC Ltd.</td>
<td>140</td>
</tr>
<tr>
<td><strong>Add:</strong></td>
<td></td>
</tr>
<tr>
<td>Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.</td>
<td></td>
</tr>
<tr>
<td>Value at which assets are transferred by ABC Ltd.</td>
<td>150</td>
</tr>
<tr>
<td>WDV in the books of ABC Ltd.</td>
<td>100</td>
</tr>
<tr>
<td>Excess accounted</td>
<td>50</td>
</tr>
<tr>
<td>Excess depreciation claimed in computing taxable income of XYZ Ltd. [₹ 50 lacs × 15 %] [Explanation 2 to section 43(6)]</td>
<td>7.50</td>
</tr>
<tr>
<td>**Set-off of brought forward business loss of ABC Ltd. (See Notes 2 &amp; 4)</td>
<td>(120.00)</td>
</tr>
<tr>
<td><strong>Set-off of unabsorbed depreciation under section 32(2) read with section 72A (See Notes 2 &amp; 4)</strong></td>
<td>(18.00)</td>
</tr>
<tr>
<td><strong>Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) (See Note 5)</strong></td>
<td>(2.00)</td>
</tr>
<tr>
<td></td>
<td>7.50</td>
</tr>
</tbody>
</table>
Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.

2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.

3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of ₹ 4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.

4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.

5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2018-19.

Question 3

Examine in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2018-19:

A loss of ₹ 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.
Answer

Sec 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

Question 4

M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2017. The assessed business loss of the firm for the assessment year 2017-18 which it is entitled to carry forward amounts to `3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2017 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.

Compute the amount of business loss relating to the assessment year 2017-18, which the firm is entitled to set off against its business income for the assessment year 2018-19. The business income of the firm for the assessment year 2018-19 is `3,30,000. Your answer should be supported by reasons.

Answer

The firm is entitled to set off its brought forward business loss amounting to `3,60,000 relating to the assessment year 2017-18 to the extent of `3,30,000 against its business income of `3,30,000 for the assessment year 2018-19, as per the provisions of section 72(1).

The balance unabsorbed business loss of `30,000 relating to the assessment year 2017-18 will be carried forward to assessment year 2019-20.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners. Therefore, section 78(1) is not applicable to the case of M/s. JKLM.
Question 5

An assessee sustained a loss under the head “Income from house property” in the previous year relevant to the assessment year 2017-18, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2018-19?

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads “Profits and gains of business or profession” or “Capital gains” should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head “Income from house property” in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.
Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?

**Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)**

**Facts of the case:** In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in *CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC)* and *Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC)*, claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer. The Tribunal concurred with the Assessing Officer's view.

**High Court’s Observations:** The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole-proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case
of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in Madhukant M. Mehta’s case and Saroj Aggarwal’s case cannot be applied since this is not a case of succession by inheritance.

**High Court’s Decision:** Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it is not a case of succession by inheritance. The assessee sole-proprietor is, therefore, not entitled to set-off the loss of the erstwhile partnership firm against his income.

**Note** - In Madhukant M. Mehta’s case, the sole proprietor had expired and after his death the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned under section 78(2), i.e., a case of succession by inheritance.

Also, in Saroj Aggarwal’s case, upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.