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Loss on sale of depreciable assets is allowable business loss

The Madras High Court gave its decision that loss on sale of depreciable assets is allowable as a business loss under section 41(2) of the Income-tax Act, 1961.

Background:

- The taxpayer[1] is a share transfer agent and registrar.
- During the Financial Year (FY) 2000-01, corresponding to Assessment Year (AY) 2001-02, the taxpayer was in the process of winding up and accordingly, sold depreciable assets (assets) at a price lower than the written down value (WDV) of the assets. The taxpayer claimed loss on sale of assets as business loss under section 41(2) of the Income-tax Act, 1961 (ITA) in the return of income.

  Section 41(2) of the ITA provides for taxing the amount received in excess of WDV of depreciable asset limited to the difference between WDV and actual cost at the time of disposal as 'business income'.
- The Assessing Officer (AO) denied the loss claimed by the taxpayer, as being a business loss under section 41(2) of the ITA, and classified the same as capital loss under section 50 of the ITA on the following basis:
  - After the introduction of block of asset concept for depreciation purpose, the provisions of section 41(2) of ITA were applicable only to assets of an industrial undertaking engaged in generation, or generation and distribution of power.
  - The provisions of section 50 of the ITA (being specific provisions for computation of capital gains on depreciable assets) were applicable in respect of loss incurred on sale of other depreciable assets.

  As per section 50 of the ITA, if a capital asset forming part of block of assets (building, machinery etc.) has been sold on which depreciation has been allowed under ITA, then income arising from such capital asset is treated as a short-term capital gain.
- In appeal proceedings, the matter reached the Madras High Court (HC).

Decision of the HC:

- The HC noted that the only issue which required its consideration was whether the taxpayer was entitled to claim loss on sale of assets as a business loss under section 41(2) of the ITA or as capital loss under section 50 of the ITA.

[1]Share Aids Private Limited v. ITO (Tax case (Appeal) no 381 of 2009) (Madras HC)

- The HC noted the following:
  - The provisions of section 41(2) and section 50 of the ITA gave reference to only deemed income and deemed capital gains on sale of depreciable assets. The said provisions of section 41(2) and section 50 of the ITA did not provide for the treatment of loss incurred on sale of such depreciable assets
  - The taxpayer before winding up in the year under consideration sold the assets in the regular course of business, and therefore the situation of carry forward loss under section 70(1) of the ITA was not relevant.
- Taking note of the above, the HC held as under:
  - The assessment of income also implied assessment of loss in the hands of the taxpayer.
  - Even if the provisions of section 41(2) and section 50 of the ITA talked only of taxability on the excess received by the taxpayer over the WDV of the assets, it could not exclude or ignore the minus figure or loss occurring on such sale transactions.
  - Since, the sale of block of assets (not being immovable property), were sold during the regular course of business, before it was wound up during the relevant previous year, the loss occurring on such sale of assets at a figure less than the WDV should be treated as business loss under section 41(2) of the ITA.
  - The taxpayer could not be denied the loss by misconstruing the relevant provisions of the ITA.

  In view of the above, the HC answered the substantial question of law in favour of the taxpayer and accordingly allowed the taxpayer’s appeal.

Comment:

- This ruling lays down the principle that loss on sale of depreciable assets at a price less than the WDV is in the nature of business loss under section 41(2) of the ITA. Taxpayers having loss on sale of depreciable assets may want to evaluate the impact of this ruling to the facts of their specific cases.