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ITAT Ahmedabad* rejects taxpayer's methodology for adjustment of unabsorbed loss vs. depreciation set-off with reference to Explanation 1(iii) to section 115JB

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Facts of the case

- Milan Intermediates LLP (the assessee), filed an appeal before the Income Tax Appellate Tribunal (Tribunal) against the order of the assessing officer (AO) in limiting the claim of the assessee for reduction in book profits by lower of loss brought forward or unabsorbed depreciation, as computed under section 115JB of the Income-tax Act, 1961 (the Act), which was confirmed by the Commissioner of Income Tax (Appeals).
- The assessee had followed the First in First-Out (FIFO) method for setting off the losses, wherein it first adjusted the loss out of brought forward losses accumulations and thereafter out of the remaining unabsorbed depreciation against the book profits in the ensuing Assessment Year (AY) on year to year basis. The said methodology towards adjustment and set-off of brought forward business loss and unabsorbed depreciation was disputed by the AO in the return filed by the assessee for AY 2011-12.
- The assessee also placed its reliance upon the decision of the Delhi High Court in the case of CIT v. Eli Lilly & Company 334 ITR 186 wherein a similar methodology for carry forward and set-off of losses was accepted.
- The assessee contended before the Tribunal that:
  - The Explanation 1(iii) to section 115JB of the Act is limited and operates only for deciding the 'quantum' (and not methodology for set-off) of the amount to be reduced from the net profit as per books in order to arrive at the book profit under section 115JB.
  - The said explanation to section 115JB is silent and does not compel the assessee to reduce the unabsorbed depreciation (where it represents lower amount) instead of unabsorbed loss (by the lower figure) and vice versa. It merely provides for extent of deduction which is quantified to be lower of the two types of unabsorbed items.
  - Accordingly, the methodology consistently followed for adjusting and setting off brought forward losses and unabsorbed depreciation in the books of accounts should not be called for any disturbance.
- The Revenue contended before the Tribunal that:
  - The AO has appreciated the issue in the right perspective which is in line with the ruling delivered by the Authority for Advance Rulings in AAR No. 652 of 2004 in the case of Rashtriya Ispat Nigam Ltd. dated 19.07.2006.

Issue under consideration

- Whether the methodology adopted by the assessee towards adjustment/set- off of brought forward business loss and unabsorbed depreciation while calculating book profit under section 115JB (with reference to 'Explanation 1(iii)') was correct?

Ruling of the Tribunal

- The Tribunal noted that the assessee consistently followed the FIFO method for setting off year-wise brought forward losses, due to which unabsorbed loss of the earliest year, longest outstanding, was first set off against the current year's book profit and thereafter in tandem.

- ITAT further noted that the assessee adopted the methodology of reduction of current year's profit out of brought forward losses accumulations in preference to unabsorbed depreciation (quantified to the extent of lower of the two) irrespective of the fact that unabsorbed depreciation was lower than unabsorbed losses. This method has been adopted consistently on a year-to-year basis.

- ITAT illustrated the above fact by way of an example:
  - the assessee carried forward unabsorbed loss of INR 75 and unabsorbed depreciation of INR 25 from the preceding financial year and the book profit, say, INR 35 in the current year.
  - The assessee reduced INR 25 (being lower of unabsorbed losses and unabsorbed depreciation) from the book profit and adjusted the same under unabsorbed losses and consequently carried forward unabsorbed loss at INR 50 and unabsorbed depreciation at INR 25 in the succeeding year as an available set-off against the book profit of succeeding year.
  - Whereas the Revenue, on the other hand, seeks to reduce the amount so adjusted from unabsorbed depreciation (being lower figure) and thus, grants benefit of carry forward under the head of unabsorbed business loss at INR 75 and unabsorbed depreciation at INR 0.

- The Tribunal observed that notwithstanding that the assessee restricted the quantification of set-off to be lower to the two (i.e., unabsorbed loss and unabsorbed depreciation) however, gave priority to unabsorbed losses in the matter of reduction and quantification of unabsorbed loss in preference, to unabsorbed depreciation available for set-off in the succeeding year.

- In this regard, the Tribunal interpreted the Clause (iii) to Explanation 1 to Sec. 115JB, which provided for deduction of lower of unabsorbed loss or unabsorbed depreciation out of book profits. The Tribunal observed that benefit of Explanation to Clause (iii) was not available in the event of either unabsorbed loss or unabsorbed depreciation becoming NIL. Thus, in the event where either of the two became zero, the assessee would not be entitled for set-off against books profits as beneficially provided in Clause (iii) to Explanation 1.

- ITAT held that the spirit and object of the clause thus requires to be gauged from this restriction placed statutorily. If the methodology adopted by the assessee is accepted, it may defeat a situation where one of the two i.e., unabsorbed loss and unabsorbed depreciation, become NIL. ITAT held that to give effect to the object of Clause (iii), ITAT opined that "like should be reduced from like and not differently". ITAT further clarified that if the lower of the two happened to be unabsorbed depreciation, reduction is to be done from depreciation only and not out of unabsorbed loss.

- In this regard, the Tribunal also placed reliance on the advance ruling in the case of Rashtriya Ispat Nigam Ltd. (AAR No. 652 of 2004) wherein an almost similar view was taken and the Tribunal was persuaded to adopt the view expressed by the authority rendered after objective analysis of facts.

- Thus, on first principles and without going into arithmetical accuracy of working of carry forward of set-off losses etc., ITAT held that the methodology adopted by the assessee to prioritise set-off of unabsorbed loss regardless of unabsorbed depreciation being lower, is not in tune with the aim and object of Clause (iii) to Explanation 1 of Sec. 115JB.
- ITAT remanded back the factual aspects to the AO for determination of quantification of set-off as per the impugned principle after giving proper opportunity to the assessee in this regard.

Conclusion

The issue with respect to carrying forward and setting off of unabsorbed losses and unabsorbed depreciation as per Explanation to section 115JB is a vexed issue and has been a matter of debate before the lower tax authorities. The judicial authorities on very few occasions have dealt with this issue and have not attained finality yet.

In this ruling, the Tribunal interpreted the Explanation to clarify that in the event where either of the two (i.e., brought forward loss or unabsorbed depreciation) becomes zero, the assessee will not be entitled for set-off against book profits as beneficially provided in Clause (iii) Explanation 1 and the Tribunal further clarified that like should be reduced from like and not differently.

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