IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "B", MUMBAI

Before Shri R.S.Syal, AM and Smt.AshaVijayaraghavan, JM

ITA No.6646/Mum/2008 : Asst.Year 2005-2006

M/s.Manali Investments Raheja Corner of Main Avenue V.P.Road, Santacruz (West) Mumbai – 400 054. **PAN : AAAFM3052E.**	Vs.	The Asstt.Commissioner of Income-tax Central Circle 34 Mumbai.
(Appellant)		(Respondent)

Appellant by : Shri S.C.Tiwari
Respondent by : Shri Naresh Kumar Balodia

O R D E R

Per R.S.Syal, AM :

This appeal by the assessee arises out of the order passed by the CIT(A) on 13.08.2008 in relation to assessment year 2005-2006.

2. There is a delay of 19 days in presenting this appeal before the Tribunal. Affidavit of the Director of the assessee-company is placed on record explaining the reasons for such delay, being its Accountant proceeding to his home town without informing his successor about the CIT(A)'s order. No serious objection was raised by the ld. DR. We are satisfied with the reasonableness of the cause in presenting the appeal belatedly. As such the delay is condoned and appeal is admitted for hearing on merits.

3. The only issue raised through various grounds is against not allowing set off of long term capital gain on the sale of depreciable assets against the brought forward loss from long term capital assets. Briefly stated the facts of the case are that the assessee was engaged in the business of investment and finance. During the year it sold certain depreciable capital assets in the shape of Meters and transformers for a total consideration of Rs.1,45,99,988. The gain on the same was

shown as long term capital gain, which was set off against the brought forward loss from long term capital assets. During the course of assessment proceedings it was noticed by the Assessing Officer that the assessee had purchased these Meters and transformers in earlier years for a total consideration of Rs.8,75,99,928 on which 100% depreciation was claimed in the respective first years itself. In the backdrop of these facts, the Assessing Officer observed that the said assets sold by the assessee in this year for Rs.145.99 lakhs were in the nature of assets on which depreciation was claimed and allowed. In that view of the matter the assessee was called upon to explain as to why the provisions contained in section 50 be not applied and gain from the sale of said asset be not considered as short term capital gain. The assessee placed reliance on the judgment of the Hon'ble Bombay High Court in *CIT Vs. ACE Builders Pvt. Ltd. [(2006) 281 ITR 210 (Bom.)]* and contended that such profit on the sale of Meters and transformers, which were otherwise long term capital assets, was required to be considered as long term capital gain for the purpose of set off against the brought forward loss on long term capital assets. The Assessing Officer did not agree with the contention put forth on behalf of the assessee and treated such amount of Rs.145.99 lakhs as short term capital gain on sale of assets, which resulted into not allowing of its set off against the brought forward loss from the long term capital assets. The assessee failed to convince the ld. first appellate authority to its line of reasoning.

4. We have heard the rival submissions and perused the relevant material on record. At the very outset it needs to be mentioned that the fact of the assessee having purchased these capital assets at least three years before sale, thereby qualifying as long term capital assets, has not been disputed by any of the authorities below. These assets in respect of which 100% depreciation was claimed in the respective years of purchase, were sold in the current year for a sum of Rs.145.99 lakhs. The assessee claimed such gain to be eligible for set off against the brought forward loss from long term capital assets as per section 74. The view

point of the Assessing Officer is that since depreciation was allowed on these assets, their transfer would attract the provisions of section 50 and resultantly this gain would be deemed to be short term capital gain. Once such gain is held to be short term capital gain, the assessee would not qualify for the benefit of set off in terms of section 74.

5. Section 50 has marginal note : "Special provision for computation of capital gains in case of depreciable assets". This section begins with the non-obstante clause excluding the operation of section 2(42A) and provides that where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under this Act or under the Indian Income-tax Act, 1922, the provisions of section 48 and 49 shall be subject to modifications set out in clauses (1) and (2) of this section. Clause (2) of section 50, which is relevant for our purpose, reads as under:

> *"(2) where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets."*

6. In the instant case we are concerned with section 50(2) because on the sale of capital assets in the shape of Meters and transformers, the block of assets under which these were placed, ceased to exist. Clause (2) provides that where any block of assets ceases to exist as such, for the reasons that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the

previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short term capital assets. The sum and substance of this provision is that when all the assets in a particular block of assets are transferred and such the block of assets ceases to exist, then the excess of sale price over the opening written down value together with the cost of assets purchased during the year, shall be deemed to be the capital gains arising from the transfer of short term capital assets. In the opening part of section 50, the provisions of section 2(42A) have been made non-operative by means of the non obstante clause. Section 2(42A), in turn, defines "short term capital asset", to the extent we are concerned in the present appeal, to mean a capital asset held by an assessee for not more than 36 months immediately proceeding the date of its transfer. The effect of section 50 is that once depreciation has been allowed under this Act on a capital asset which forms part of a block of asset then capital gain on the transfer of such assets shall not be computed in accordance with the provisions of section 48 and 49, but the income so resulting shall be deemed to be the capital gains arising from the transfer of short term capital assets in the manner provided in the latter section. It is this provision on which a great deal of emphasis has been placed by the authorities below for concluding that the assessee is not entitled to set off of brought forward loss on the transfer of long term capital assets against the income from the sale of assets of the block amounting to Rs.145.99 lakhs.

7. When we view section 50, it becomes apparent that it contains a special provision for "computation of capital gains" in case of depreciable assets. Further it is a deeming provision and only by legal fiction income from the transfer of otherwise long term capital assets (held for a period of more than 36 months) is treated as capital gains arising from the transfer of short term capital assets. A deeming provisions is one, the mandate of which does not exist but for such

provision. It is only as a result of such legal fiction contained in the provision that imaginary state of affairs is taken as actuality notwithstanding the fact that it is at variance with the otherwise legal position. It is trite that a deeming provision cannot be extended beyond the purpose for which it is enacted. The Hon'ble Supreme Court in *CIT Vs. Amarchand N Shroff [(1963) 48 ITR 59 (SC)]* dealt with the scope of a deeming provision and laid down that the fiction cannot be extended beyond the object for which it is enacted. The same view has been reiterated by the Hon'ble Apex Court in *CIT Vs. Mother India Refrigeration Industries P. Ltd. [(1985) 155 ITR 711 (SC)]* holding that : "*legal fictions are created only for some definite purpose and this must be limited to that purpose and should not be extended beyond their legitimate field*". The enunciation of law by the highest Court of land in the above case divulges that the operation of a deeming provision cannot be extended beyond the purpose for which it is enacted.

8. We have noted above that section 50 is a deeming provision as is evident from clauses (1) and (2) of this section, which end by providing that the income "shall be deemed to be capital gains arising from the transfer of short term capital assets". Thus we have to restrict such deeming provision only up to the point which has been covered within the purview of section 50. It can be easily noticed that this section contains a `special provision for **computation of capital gains** in case of depreciable assets'. It, therefore, follows that the prescription of section 50 is to be extended only up to the computation of capital gains. Once the amount of capital gain is determined in case of depreciable assets as per this section, ignoring the mandate of sections 48 and 49 which otherwise deal with the mode of computation of capital gains, the function of this provision shall come to an end and the capital gain so determined shall be dealt with as per the other provisions of the Act.

9. Coming back to the facts of the instant case it is seen that the opening written down value of the otherwise long term capital assets, being Meters and

transformers, was Nil. No new asset within the block of asset was purchased during the year and all the existing assets of this block were sold for Rs.145.99 lakhs. By applying the command of clause (2) of section 50, the income from the sale of these depreciable assets was determined by the assessee inasmuch as the amount of sale consideration of Rs.145.99 lakhs was reduced from Nil, being the opening written down value of the block of assets and thus income as a result of transfer of all the assets of this block was found out accordingly at Rs.145.99 lakhs. It is not the case of the Department that the assessee made out a claim for computing capital gain as per section 48 and 49 by claiming any artificial cost of acquisition of such assets or taking the benefit of indexation etc., thereby lowering the amount of capital gain. The assessee strictly followed the prescription of section 50 and worked out income accruing as a result of transfer of capital assets at Rs.145.99 lakhs. Up to this stage the action of the assessee is in accordance with the provisions of section 50, being the computation of capital gain in case of depreciable assets. The Assessing Officer has also not disputed the computation of capital gain by the assessee at Rs.145.99 lakhs on the transfer of depreciable assets.

10. The dispute is about setting off of brought forward loss from long term capital assets against this income. Whereas the assessee is contending that the amount in question be considered as eligible for set off against the brought forward loss from long term capital assets as per section 74, the Revenue has held against this claim. At this juncture it would be relevant to note that the short term capital gain has been defined u/s 2(42B) to mean “capital gain arising from the transfer of a short term capital asset”. `Long term capital asset’ has been defined in section 2(29A) to mean `a capital asset which is not a short term capital asset’ and `long term capital gain’ has been defined in section 2(29B) to mean `capital gain arising from the transfer of a long term capital asset’. When we closely read these provisions, it becomes apparent that the transfer of a long term capital asset resulting into gain leads to “long term capital gain” and the profit on the transfer of

a short term capital asset results into `short term capital gain'. It, therefore, emerges that if any capital asset of the nature, not covered in proviso to sec. 2(42A), is sold by the assessee after holding for a period of 36 months or more, the capital gain arising there from shall be characterized as "long term capital gain".

11. Adverting to the facts of the instant case, it is noted that the assessee claimed the benefit of set off of the brought forward loss from the long term capital assets against the income from the transfer of Motors and transformers, which were admittedly held for a period more than 36 months. Section 74(1) provides that where in respect of any assessment year, the net result of the computation under the head `Capital gains' is a loss to the assessee, the whole loss shall, subject to the other provisions of this chapter, be carried forward to the following assessment years and further clause (b) provides that insofar as such loss relates to a long term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset not being a short term capital asset. The effect of this provision is that the brought forward loss from long term capital assets can be set off only against long term capital gain within the period prescribed in sub-section (2) of section 74. Consequently it becomes manifest that there is no provision for allowing set off of such brought forward loss against the short term capital gain in the following years.

12. The core of controversy is about the determination of the character of Rs.145.99 lakhs for the purpose of section 74, as to whether it is a short term capital gain or long term capital gain. The assessee has placed reliance on the judgment of the Hon'ble jurisdictional High Court in the case of *ACE Builders (supra)* in which that assessee was a partner in firm which was dissolved in the year 1984 and the assessee was allotted a flat towards its credit in the capital account with the firm. The assessee showed the flat as capital asset in its books of

account and depreciation was claimed and allowed from year to year. In the previous year relevant to the assessment year 1992-93 the assessee sold the flat and invested the net sale proceeds in a scheme eligible u/s.54E of the Act and accordingly declared Nil income under the head "Capital gains". The Assessing Officer opined that since the block of buildings ceased to exist on account of sale of flat during the year, the written down value of the flat was liable to be taken as cost of acquisition u/s.50(2) of the Act. He further held that since the assessee had availed depreciation on such asset, which was otherwise a long term capital asset, the deeming provision u/s.50 would apply and it would be treated as capital gain on the sale of short term capital asset and resultantly no benefit u/s.54E was admissible. When the matter came up before the Hon'ble Bombay High Court it was noticed that section 50 contains a deeming provision and such fiction was restricted only to the mode of computation of capital gain contained in sections 48 and 49 and hence it did not apply to other provisions. Consequently the assessee was held to be eligible for exemption u/s.54E in respect of capital gain arising on transfer of capital asset on which depreciation was allowed. The relevant observations of the Hon'ble High Court are as under:-

> *"It is true that s. 50 is enacted with the object of denying multiple benefits to the owners of depreciable assets. However, that restriction is limited to the computation of capital gains and not to the exemption provisions. In other words,* ***where the long-term capital asset has availed depreciation, then the capital gain has to be computed in the manner prescribed under s.50*** *and the capital gains tax will be charged as if such capital gain has arisen out of a short-term capital asset but if such capital gain is invested in the manner prescribed in s. 54E, then the capital gain shall not be charged under s. 45 of the IT Act. To put it simply,* ***the benefit of s. 54E will be available to the assessee irrespective of the fact that the computation of capital gains is done either under ss. 48 and 49 or under s. 50.*** *The contention of the Revenue that by amendment to s. 50, the long-term capital asset has been converted into a short-term capital asset is also without any merit. As stated hereinabove, the legal fiction created by the statute is to deem the capital gain as*

> *short-term capital gain and not to deem the asset as short-term capital asset. Therefore, it cannot be said that s. 50 converts long-term capital asset into a short-term capital asset."*
>
> (Emphasis supplied by us)

13. From the above extracted portion of the judgment of the Hon'ble jurisdictional High Court it is discernible that the provisions of section 50 are applicable only up to the stage of computation of capital gain in case of depreciable assets. Hence where depreciation has been allowed on a long term capital asset, the capital gain shall be computed in the manner prescribed u/s.50 and it shall be considered as arising out of a short term capital asset. Once capital gain is computed on depreciable asset as per section 50, which is a long term capital asset, the operation of such section is ousted. If the assessee is otherwise eligible for any benefit under the Act which is attached to a long term capital asset, the same shall remain intact. It cannot be denied simply for the reason that, on the transfer of such a long term capital asset, the short term capital gain has been computed as per sec. 50 In the case of *ACE Builders (supra),* the assessee has been allowed the benefit u/s.54E, which is otherwise available only against long term capital gain. In the same manner there cannot be any rejection of any benefit which is associated with the character of otherwise long term capital gain notwithstanding the fact that capital gain on its transfer has been computed u/s.50 by deeming it as a short term capital gain.

14. The learned Departmental Representative relied on another judgment of the Hon'ble Bombay High Court in *CIT Vs. Citibank N.A [(2003) 261 ITR 570 (Bom.)].* In this case the assessee purchased a plot of land and constructed a banglow on it. The entire property was sold for Rs.30 lakhs. In the conveyance the price was allocated as Rs.14 lakhs for plant, Rs.9 lakhs for building and Rs.7 lakhs for air-conditioning plant etc. The assessee returned short term capital gain on the

sale of house property and long term capital gain on the sale of land. This working was not accepted by the A.O., who took the view that the house property had been constructed on land and therefore the gain arising on the transfer resulted into short term capital gain. The Tribunal came to hold that the land was a distinct and separate capital asset *vis-à-vis* the building and hence the profit was to be computed by viewing building as separate capital asset from land. Therefore, profit arising from the sale of land was held to be long term capital gain and from the sale of building as short term capital gain. The view of the Tribunal was upheld by the Hon'ble High Court by holding that section 50 provides for determination of the cost of acquisition of depreciable asset and since the land is not a depreciable asset, section 50 did not apply to that. We are unable to find as to how this judgment helps the Revenue in the instant case. There can be two stages, viz., firstly, the computation of capital gain on the transfer of otherwise long term capital assets u/s 50 and secondly, when such capital gain has been so computed, the applicability of other provisions dealing with the short term or long term capital assets. The case relied by the ld. DR is confined only up to the first stage of computation of capital gain in case of depreciable and non-depreciable assets. We have no controversy on the applicability of section 50 in the present case inasmuch as the assessee itself declared capital gain of Rs.145.99 lakhs in accordance with the terms of section 50. The issue before us is of the above stated second stage, arrived at after the computation of capital gain in the case of depreciable assets as per the first stage. In the case of *ACE Builders (supra)* also, the controversy was on the second stage of allowing of benefit u/s.54E after having successfully applied section 50. Same is the position before us inasmuch as the assessee has itself computed capital gain in case of depreciable asset in terms of section 50 which is the first stage but the controversy has arisen on the second stage towards the allowing of setting off of brought forward loss from long term capital assets against the resultant computation u/s.50. The view point of the learned Departmental Representative as well as the authorities below that by virtue of the operation of section 50, the capital gain so computed becomes that arising from the transfer of a short term capital asset for all purposes, is incorrect as has been held in *ACE Builders (supra).* We have already held that section 50 contains a deeming provision and the same has to be restricted only for the purpose of which it is enacted. Since this deeming provision involves only the computation part of the capital gain in the case of depreciable assets, once this computation part is over, the operation of section 50 is also stopped. The amount so computed has to be dealt with in accordance with the relevant provision. If we accept the view point of the Department and hold that capital gain of Rs.145.99 lakhs be considered as short term capital gain for all purposes including section 74, then it would violate the judgment of the Hon'ble jurisdictional High Court in the case of *ACE Builders (supra)*. In that case also there was capital gain on the transfer of depreciable asset held by the assessee for period of more than three years which was determined u/s.50. The Hon'ble High Court held that the assessee is entitled to the benefit u/s.54E which is available only against long term capital gain. Despite the fact that no long term capital gain entered into the computation of total income of that assessee, still the benefit u/s.54E was granted. Similar is the position in the instant case also. Capital gain has resulted from the transfer of an asset which was held for a period of more than three years and no long term capital gain has entered into the computation of total income of the assessee on this transaction. This amount would also retain the character of long term capital gain for all other provisions and consequently qualify for set off against the brought forward loss from the long term capital assets. In our considered opinion, the facts of the instant case are fully covered by the judgment of the Hon'ble jurisdictional High Court in ACE Builders (supra), which is binding on all the authorities acting under its jurisdiction. We, therefore, overturn the impugned order on this score and hold that the assessee is entitled to such set off in terms of section 74.

15. In the result, the appeal is allowed.

Order pronounced on this **13th day of April, 2011**.

Sd/-	Sd/-
(AshaVijayaraghavan)	**(R.S.Syal)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai : **13th April, 2011.**
Devdas*

Copy to :
1. The Appellant.
2. The Respondent.
3. The CIT concerned
4. The CIT(A) Central VI, Mumbai.
5. The DR/ITAT, Mumbai.
6. Guard File.

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By Order

Assistant Registrar, ITAT, Mumbai.