

SET OFF AND CARRY FORWARD OF LOSSES

Question 1

Fill in the blanks having regard to the provisions of the Income-tax Act, 1961:

- (i) Business loss is(eligible/not eligible) for set off against income from salaries.*
- (ii) The maximum period for which speculation loss can be carried forward is years.*
- (iii) The first item in the order of priority of set off as between unabsorbed capital expenditure on scientific research, current year depreciation, and brought forward business loss is.*

Answer

- (i)** not eligible
- (ii)** Four
- (iii)** Current year depreciation.

Question 2

Choose the correct answer with reference to the provisions of the Income-tax Act, 1961:

Mr. B incurred short-term capital loss of Rs.10,000 on sale of shares through the National Stock Exchange. Such loss can be set-off -

- (a) Only against short-term capital gains*
- (b) Against both short-term capital gains and long-term capital gains*
- (c) Against any head of income*
- (d) None of the above.*

Answer

- (b)** Against both short-term capital gains and long-term capital gains

Question 3

Explain the provisions of carry forward and set off of business losses under section 72 of the Income-tax Act, 1961.

Answer

- (i)** Section 72 applies where the net result of the computation under the head "Profits and gains of business and profession" for any assessment year is a loss to the assessee and

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such loss cannot be wholly set off against income under any head of income in accordance with the provisions of section 71. Such unabsorbed business loss can be carried forward to the subsequent assessment year for set off against the business income of that year and so on.

- (ii) However, such loss should not be in the nature of speculation business loss
- (iii) Business loss carried forward can be set off only against the income under the head "Profits and gains of business or profession", though not necessarily against the income from same business in which the loss was incurred.
- (iv) Business loss can be carried forward and set off even if the business in respect of which it was incurred and computed has been discontinued.
- (v) Business loss cannot be carried forward for more than 8 assessment years immediately succeeding the assessment year for which the loss was first computed.
- (vi) Under section 72(2), business loss brought forward should be adjusted first and thereafter unabsorbed depreciation, unabsorbed scientific research expenditure etc. should be adjusted.

Question 4

Write short notes on:

- (a) *Set off and carry forward of loss arising under the head "Income from other sources".*
- (b) *Loss can be carried forward only by the person who has incurred the loss.*
- (c) *Carry forward and set off of losses by closely held companies.*

Answer

- (a) Section 74A deals with set off and carry forward of certain losses under the head "Income from other sources". In the case of an assessee, being the owner of horses maintained by him for running in horse races, the amount of loss incurred by the assessee in such activity cannot be set-off against income from any other source other than the activity of owning and maintaining race horses in that year. However, such loss can be carried forward and set off against income from the same activity in any subsequent assessment year. No such loss can, however, be carried forward beyond 4 assessment years from the end of the assessment year in which the loss was first computed.

For this purpose, the "amount of loss incurred by the assessee in the activity of owning and maintaining race horses" means :

- (i) in a case where the assessee has no income by way of stake money, the amount of revenue expenditure laid out or expended by him wholly and exclusively for the purposes of maintaining race horses ;

- (ii) in a case where the assessee has income by way of stake money, the amount by which such income falls short of the amount of revenue expenditure laid out or expended by the assessee wholly and exclusively for the purposes of maintaining race horses.
- (b) As per section 78(2), where any person carrying on business or profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor cannot have the loss of the predecessor being carried forward and set off against his income. However, there are certain exceptions, which are briefed hereunder:
 - (i) Carry forward and set off of accumulated business loss of the amalgamating company against the income of the amalgamated company, if the amalgamation is within the meaning of section 72A.
 - (ii) Carry forward and set off of accumulated business loss of the demerged company in the hands of the resulting company, in a scheme of demerger, subject to fulfillment of certain conditions which the Central Government may for this purpose notify, to ensure that the demerger is for genuine business purposes ;
 - (iii) In the case of reorganisation of business, where 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), the accumulated loss of the firm or sole proprietor shall be deemed to be the loss of the successor company for the previous year in which the business reorganisation was effected and the carry forward provisions shall be applicable to the successor company ;
 - (iv) Where a business carried on by one person is acquired by another person through inheritance, then the successor can carry-forward and set-off the loss of the predecessor against his income.
 - (v) Carry forward and set off of business loss and unabsorbed depreciation of a predecessor company against the income of successor Limited Liability partnership if the conditions specified in Section 47(xiiib) are fulfilled.
- (c) According to section 79, in the case of a company in which public are not substantially interested, the unabsorbed business loss relating to any assessment year can be carried forward and set-off against the income in a subsequent assessment year subject to the fulfillment of the following condition:-

As on the last day of the previous year in which the loss is sought to be set off, the shares of the company carrying not less than 51% of the voting power are continued to be held by the persons who held 51% of the total voting power on the last day of the previous year in which the loss was incurred. For example, if 60% of shareholders of the previous year 2006-07 continue to hold shares without interruption up to the previous year 2010-11 i.e. on 31.03.2011, then the loss of assessment year 2007-08 (previous year 2006-07) is eligible for set off against the income of the assessment year 2011-12.

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This restriction is not applicable if the change in the said voting power takes place due to the death of a shareholder or transfer of shares by way of gift by a shareholder to his relative. Further, the restriction placed under section 79 is not applicable where there is a change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company, provided 51% of the shareholders of the amalgamating or demerged foreign company continue to be shareholders of the amalgamated or the resulting foreign company.

Question 5

State the conditions to be fulfilled by an amalgamated company for carry forward of the accumulated losses and unabsorbed depreciation of the amalgamating company.

Answer

Refer to page 6.8 of Study Material.

Question 6

What are the consequences of demerger as to the accumulated loss and unabsorbed depreciation?

Answer

Refer to page 6.8 of Study Material.

Question 7

Discuss about set off and carry forward of losses under the head Capital Gains.

Answer

Refer to section 74 in page 6.14 of Study Material.

Question 8

State the factors to be borne in mind relating to carry forward and set off of losses in case of change in constitution of firm or succession under section 78.

Answer

Refer to page 6.17 of Study Material.

Question 9

Discuss in brief the provisions relating to set off and carry forward of losses in speculation business.

Answer

Refer to section 73 in page 6.13 of Study Material.

Question 10

Mr. A furnishes you the following information for the year ended 31.03.2011.

- | | |
|--|----------|
| (i) Income from plying of vehicles (computed as per books)
(He owned 5 heavy goods vehicle throughout the year) | 2,10,400 |
| (ii) Income from retail trade of garments
(Computed as per books) (Sales turnover Rs.21,70,000) | 75,000 |
| (iii) He has brought forward depreciation relating to A.Y. 2010-11 | 1,00,000 |
| (iv) He deposited Rs.70,000 into his PPF account on 6.1.2011 and Rs. 30,000 in 5 year bank fixed deposit | |

Compute taxable income of Mr. A and his tax liability for the assessment year 2011-12 with reasons for your computation.

Answer

Computation of total income of Mr. A for the A.Y. 2011-12.

Particulars	Rs.
Income from retail trade – as per books (See Note 1 below)	75,000
Income from plying of vehicles – as per books (See Note 2 below)	2,10,400
	2,85,400
Less : Set off of brought forward depreciation relating to A.Y. 2010-11	1,00,000
Gross total income	1,85,400
Less: Deduction u/s.80C - Contribution to PPF and bank fixed deposit	1,00,000
Taxable income	85,400

Note :

1. Income from retail trade

Presumptive business income under section 44AD is Rs.1,73,600 i.e. 8% of turnover of Rs.21,70,000. However, the income computed as per books is Rs.75,000 which is to be further reduced by the amount of unabsorbed depreciation. Since the income computed as per books is lower than the income deemed under section 44AD, the assessee can adopt the income as per books. However, he should maintain books of account as per section 44AA and get his accounts audited and furnish an audit report as required under section 44AB.

The total unabsorbed depreciation is Rs.1,00,000. Out of this, Rs.75,000 can be set-off against income from retail trade. The balance of Rs.25,000 remains to be set-off from income from plying of vehicles.

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2. Income from plying of vehicles

Income calculated under section 44AE(1) would be Rs.5,000 x 12 x 5 which is equal to Rs.3,00,000. However, the income from plying of vehicles as per books is Rs.2,10,400 less Rs.25,000, being the balance unabsorbed depreciation remaining to be set-off under section 32(2). Therefore, the income from plying of vehicles as per books is Rs.1,85,400, which is lower than the presumptive income of Rs.3,00,000 calculated as per section 44AE(1). Hence, the assessee can adopt the income as per books i.e. Rs.1,85,400, provided he maintains books of account as per section 44AA and gets his accounts audited and furnishes an audit report as required under section 44AB.

It is to be further noted that in both the above cases, had presumptive income provisions been opted, all deductions under sections 30 to 38, including depreciation would have been deemed to have been given full effect to and no further deduction under those sections would be allowable.

If the assessee opted for income to be assessed on presumptive basis, his total income would be as under:

Particulars	Rs.
Income from retail trade u/s 44AD [Rs.21,70,000 @ 8%]	1,73,600
Income from plying of vehicles u/s 44AE [Rs.5,000 x 12 x 5]	3,00,000
	<u>4,73,600</u>
Less: Set off of brought forward depreciation – not possible and it is deemed that it has been allowed and set off.	Nil
Gross total income	<u>4,73,600</u>
Less: Deduction u/s.80C - Contribution to PPF and bank fixed deposit	<u>1,00,000</u>
Taxable income	<u>3,73,600</u>
Tax thereon	21,360
Add : Education cess @ 2% and Secondary and higher education cess @ 1%	640
Total tax liability	<u>22,000</u>

Note:

If the assessee has not maintained books of account as required under section 44AA for the business of plying of vehicles or for retail trade, then, he has to offer income only on presumptive basis given above.

Question 11

Compute the tax liability of Mr. Madhavan for the Assessment year 2011-12 from the following particulars:

Set off and Carry Forward of Losses

	Rs.
(i) Net house property income as computed under the head "Income from house property"	2,70,000
(ii) Income from business before adjusting the following	90,000
(a) Brought forward business loss	70,000
(b) Current depreciation	30,000
(c) Brought forward unabsorbed depreciation	1,40,000
(iii) Short term capital gain – jewellery	1,60,000
(iv) Long term capital loss –listed equity shares (STT paid)	40,000
(v) Long term capital gains – Debentures	2,00,000
(vi) Dividend on shares held as stock in trade	10,000
(vii) Dividend from a company carrying on agricultural operation	12,000
(viii) Income from growing and manufacturing coffee (cured and roasted)	1,00,000

During the previous year 2010-11, the assessee has donated Rs.35,000 to an approved local authority for the promotion of family planning and purchased NSC VIII issue for Rs.1,00,000.

Answer

Computation of taxable income of Mr. Madhavan for the A.Y 2011-12

	Rs.	Rs.
I. Net income from house property		2,70,000
II. Income from business		
Income from business	90,000	
Income from coffee (cured and roasted) @ 40%	40,000	
	1,30,000	
Less :Current year depreciation [Section 32(1)]	30,000	
	1,00,000	
Less : Brought forward business loss	70,000	30,000
III Capital gains		
Long term capital gain – debentures	2,00,000	
Short term capital gain – Jewellery	1,60,000	
		3,60,000

Taxation

IV Income from other sources

Dividend on shares (including shares in company carrying on agricultural operations)– exempt u/s.10(34)	Nil
	<u>6,60,000</u>
Less: Brought forward unabsorbed depreciation	<u>1,40,000</u>
Gross total income	5,20,000
Less :Chapter VI-A deductions	
Section 80C : NSC VIII issue purchase	<u>1,00,000</u>
	4,20,000
Section 80G : Donation to a local authority for family planning. Amount donated Rs.35,000 donation is to be restricted to 10% of gross total income as adjusted below	
Gross total income	4,20,000
Less :Long term capital gain	<u>2,00,000</u>
	<u>2,20,000</u>
Deduction limited to 10% of gross total income Rs.22,000 @ 100%	22,000
Total income	<u>3,98,000</u>

Computation of tax liability after applying the aggregation of agricultural income with non-agricultural income

Agricultural income + non agricultural income = Total income = 60,000 + 3,98,000	4,58,000
Tax on LTCG of Rs.2,00,000 @ 20%	40,000
Tax on the remainder at slab rate	<u>9,800</u>
	49,800
Less : Tax on income of basic limit Rs.1,60,000 plus Rs.60,000 towards agricultural income. Tax on Rs.2,20,000	<u>6,000</u>
Tax liability	43,800
Add : Education cess and Secondary and higher education cess @ 3%	<u>1,314</u>
Total tax liability	<u>45,114</u>
Total tax liability (rounded off)	45,110

Note: Loss from an exempt source cannot be set-off against gains from a taxable source. Therefore, long-term capital loss on sale of listed equity shares cannot be set-off against long-term capital gains on sale of debentures.

Question 12

Simran, engaged in various types of activities, gives the following particulars of her income for the year ended 31.3.2011:

	Rs.
(a) Profit of business of consumer and house-hold products	50,000
(b) Loss of business of readymade garments	10,000
(c) Brought forward loss of catering business which was closed in Asst. Year 2010-11	15,000
(d) Short-term loss on sale of securities and shares	15,000
(e) Profit of speculative transactions entered into during the year	12,500
(f) Loss of speculative transactions of Asst. Year 2006-07 not set off till Asst. Year 2010-11	15,000

Compute the total income of Simran for the A.Y. 2011-12.

Answer

Computation of total income of Simran for the A.Y. 2011-12

Particulars	Rs.	Rs.
Profit of business of consumer and house-hold products	50,000	
Less: Loss of business of readymade garments for the year adjusted under section 70(1)	<u>10,000</u>	
	40,000	
Less: Brought forward loss of catering business closed in A.Y. 2010-11 set off against business income for the current year as per section 72(1)	<u>15,000</u>	25,000
Profit of speculative transaction		<u>12,500</u>
Total Income		<u>37,500</u>

Notes :

1. Loss of speculative transaction of A.Y. 2006-07 is not allowed to be set off against the profit of speculative transaction of the A.Y.2011-12, since, as per the provisions of section 73(4), such loss can be carried forward for set-off for a maximum period of 4 years only i.e. up to A.Y.2010-11.

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2. Short term capital loss of Rs.15,000 on sale of securities and shares has to be carried forward as per section 74 since there is no income under the head Capital Gains for the A.Y.2011-12. The loss is to be carried forward for set off in future years against income chargeable under the head Capital Gains. Such loss can be carried forward for a maximum period of 8 assessment years.

Question 13

M/s. Vivitha & Co., a partnership firm, with four partners A, B, C and D having equal shares, furnishes the following details, summarized from the valid returns of income filed by it:

Assessment year	Item eligible for carry forward and set off
2009-10	Unabsorbed business loss Rs. 1,20,000
2010-11	Unabsorbed business loss Rs. 1,90,000
2010-11	Unabsorbed depreciation Rs. 1,20,000
2010-11	Unabsorbed long-term capital losses:
	-from shares Rs. 1,10,000
	-from building Rs. 1,90,000

C who was a partner during the last three years, retired from the firm with effect from 1.4.2010.

The summarized results of the firm for the assessment year 2011-12 are as under:

	Rs.
Income from house property	70,000
Income from business:	
Speculation	2,20,000
Non-speculation	(-) 50,000
Capital gains	
Short-term (from sale of shares)	40,000
Long-term (from sale of building)	2,10,000
Income from other sources	60,000

Briefly discuss, how the items brought forward from earlier years can be set off in the hands of the firm for the assessment year 2011-12, in the manner most beneficial to the assessee. Also show the items to be carried forward.

Set off and Carry Forward of Losses

Answer

According to section 78(1), where there is a change in the constitution of the firm, the loss relatable to outgoing partner (whether by way of retirement or death) has to be excluded for the purposes of carry forward. However, this provision does not apply in the case of unabsorbed depreciation.

Accordingly, M/s. Vivitha & Co. is entitled to carry forward the losses to the extent detailed herebelow :

Item	Loss (Rs.)	Relatable to C (Rs.)	Balance eligible for carry forward (Rs.)
Business loss of A.Y.2009-10	1,20,000	30,000	90,000
Business loss of A.Y.2010-11	1,90,000	47,500	1,42,500
Long term capital loss of A.Y.2010-11	3,00,000	75,000	2,25,000

Set off of items in the hands of M/s. Vivitha & Co. for the A.Y. 2011-12

Particulars	Amount (Rs.)	Amount (Rs.)
1. Income from house property		
Current year income	70,000	
Less: Brought forward unabsorbed depreciation (See Note 1)	<u>70,000</u>	NIL
2. Profits and gains of business or profession		
Current year speculative business profits	2,20,000	
Less: Current year Non-speculation loss set off (See Note 2)	<u>50,000</u>	
	1,70,000	
Less: Brought forward business losses of earlier year (2009-10 Rs. 90,000 and 2010-11 Rs. 80,000) (See Note 3)	<u>1,70,000</u>	NIL
3. Capital gain		
Short term (from sale of shares)		40,000
Long-term (from sale of building)	2,10,000	
Less: Brought forward long term capital loss of A.Y.2010-11 (See Note 4)	<u>2,10,000</u>	NIL
4. Income from other sources		
Current year before set off	60,000	
Less: Brought forward depreciation (See Note 1)	<u>50,000</u>	10,000
Total Income		50,000

Taxation

Losses to be carried forward to A.Y. 2012-13

Business loss (Rs. 1,42,500 - Rs. 80,000)	62,500
Long term capital loss (Rs. 2,25,000 – Rs. 2,10,000)	15,000
Both these losses relate to A.Y. 2010-11.	

Notes:

- (1) Unabsorbed depreciation can be set off against income from any head. Hence, it will be advantageous to set off unabsorbed depreciation against income from house property and income from other sources.
- (2) In the current year, non-speculation business loss can be set off against speculation business income.
- (3) Brought forward non-speculation business loss can also be set off against speculation business income of current year.
- (4) According to section 74, brought forward long-term capital losses shall be set off only against long-term capital gains of current year.
- (5) The set-off and carry forward of losses should be most beneficial to the assessee. If the students set off brought forward depreciation against current year's business income first, then the quantum of brought forward business loss which can set off against current year's business income will be lower. This will not be beneficial to the assessee.

Question 14

Mr. P, a resident individual, furnishes the following particulars of his income and other details for the previous year 2010-11:

	Rs.
(i) Income from salary	18,000
(ii) Net annual value of house property	70,000
(iii) Income from business	80,000
(iv) Income from speculative business	12,000
(v) Long term capital gain on sale of land	15,800
(vi) Loss on maintenance of race horse	9,000
(vii) Loss on gambling	8,000

Depreciation allowable under the Income-tax Act, 1961, comes to Rs.8,000 for which no treatment is given above.

Set off and Carry Forward of Losses

The other details of unabsorbed depreciation and brought forward losses are:

	Rs.
(i) Unabsorbed depreciation	9,000
(ii) Loss from speculative business	16,000
(iii) Short term capital loss	7,800
(iv) Unrealised rent	17,000

Compute the gross total income of Mr. P, for the Assessment year 2011-12, and the amount of loss that can or cannot be carried forward.

Answer

Computation of Gross Total Income of Mr. P for the A.Y. 2011-12.

	Rs.	Rs.
(i) Income from salary		18,000
(ii) Income from House Property		
Net annual value	70,000	
Less : Deduction under section 24 (30% of Rs.70,000)	21,000	49,000
(iii) Income from business and profession		
(a) Income from business	80,000	
Less : Current year depreciation	8,000	
	72,000	
Less : Unabsorbed depreciation	9,000	63,000
(b) Income from speculative business	12,000	
Less : Brought forward loss from speculative business	12,000	Nil
(Balance loss of Rs.4,000 (i.e. Rs.16,000 – Rs.12,000) can be carried forward to the next year)		
(iv) Income from capital gain		
Long term capital gain on sale of land	15,800	
Less : Brought forward short term capital loss	7,800	8,000
Gross total income		1,38,000

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Amount of loss to be carried forward to the next year

Particulars	Rs.
Loss from speculative business (to be carried forward as per section 73)	4,000
Loss on maintenance of race horses (to be carried forward as per section 74A)	9,000

Notes :

- (i) Loss on gambling can neither be set-off nor be carried forward.
- (ii) As per section 74A(3), the loss incurred on maintenance of race horses cannot be set-off against income from any other source other than the activity of owning and maintaining race horses. Such loss can be carried forward for a maximum period of 4 assessment years.
- (iii) Speculative business loss can set off only against income from speculative business of the current year and the balance loss can be carried forward to A.Y. 2012-13. It may be noted that speculative business loss can be carried forward for a maximum of four years as per section 73(4).

Question 15

Ms. Geeta, a resident individual, provides the following details of her income / losses for the year ended 31.3.2011:

- (i) *Salary received as a partner from a partnership firm Rs. 7,50,000.*
- (ii) *Loss on sale of shares listed in BSE Rs. 3,00,000. Shares were held for 15 months and STT paid on sale.*
- (iii) *Long-term capital gain on sale of land Rs. 5,00,000.*
- (iv) *Rs. 51,000 received in cash from friends in party.*
- (v) *Rs. 55,000, received towards dividend on listed equity shares of domestic companies.*
- (vi) *Brought forward business loss of assessment year 2010-11 Rs. 12,50,000.*

The return for assessment year 2010-11 was filed in time.

Compute gross total income of Ms. Geeta for the Assessment Year 2011 -12 and ascertain the amount of loss that can be carried forward.

Answer

Computation of Gross Total Income of Ms. Geeta for the Assessment Year 2011-12

Particulars	Rs.
Profits and gains of business and profession	
Salary received as a partner from a partnership firm is taxable under the head "Profits and gains of business and profession"	7,50,000
Less: brought forward business loss of Assessment Year 2010-11 to be set-off against business income	7,50,000
	Nil
Capital Gains	
Long term capital gain on sale of land – (See Note 2)	5,00,000
Income from other sources	
Cash gift received from friends - since the value of cash gift exceeds Rs.50,000, the entire sum is taxable	51,000
Dividend received from a domestic company is exempt under section 10(34)	Nil
	51,000
Gross Total Income	5,51,000

Notes :

- Balance brought forward business loss of assessment year 2010-11 of Rs.5,00,000 has to be carried forward to the next year.
- Long-term capital loss on sale of shares cannot be set-off against long-term capital gain on sale of land since loss from an exempt source cannot be set-off against profit from a taxable source. Since long-term capital gain on sale of listed shares on which STT is paid is exempt under section 10(38), loss on sale of listed shares is a loss from an exempt source. So, it cannot be set-off against long-term capital gain on sale of land, which is a profit from a taxable source.