Set Off and Carry Forward of Losses

<table>
<tr><th colspan="4">Key Points</th></tr>
<tr><td colspan="4"><u>Inter-source and Inter-head Set-off [Sections 70 & 71]</u></td></tr>
<tr><th>Section</th><th>Provision</th><th colspan="2">Exceptions</th></tr>
<tr><td rowspan="4">70</td><td rowspan="4"><u>Inter-source set-off under the same head of income</u>
Any loss in respect of one source shall be set-off against income from any other source under the same head of income.</td><td>(i)</td><td>Loss from speculative business</td></tr>
<tr><td>(ii)</td><td>Loss from specified business under section 35AD</td></tr>
<tr><td>(iii)</td><td>Long term capital loss and</td></tr>
<tr><td>(iv)</td><td>Loss from the activity of owning and maintaining race horses</td></tr>
<tr><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="3">71</td><td rowspan="3"><u>Inter head adjustment</u>
Loss under one head of income can be set-off against income assessable under any other head of income.</td><td>(i)</td><td>Loss under the head “Profits and gains of business or profession” cannot be set off against income under the head “Salaries”</td></tr>
<tr><td>(ii)</td><td>Loss under the head “Capital gains” cannot be set-off against income under any other head.</td></tr>
<tr><td>(iii)</td><td>Speculation loss and loss from the activity of owning and maintaining race horses cannot be set-off against income under any other head.</td></tr>
</table>

Carry forward and Set-off of brought forward losses

Section	Nature of loss to be carried forward	Income against which the brought forward loss can be set-off	Maximum permissible period [from the end of the relevant assessment year] for carry forward of losses
71B	Unabsorbed loss from house property	Income from house property	8 assessment years
72	Unabsorbed business loss	Profits and gains from business or profession	8 assessment years
73	Loss from speculation business	Income from speculation business	4 assessment years
73A	Loss from specified business under section 35AD	Profit from any specified business	Indefinite period
74	Long-term capital loss	Long-term capital gains	8 assessment years
	Short-term capital loss	Short-term/Long-term capital gains	8 assessment years
74A	Loss from the activity of owning and maintaining race horses	Income from the activity of owning and maintaining race horses.	4 assessment years

Order of set-off of losses

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)]

Question 1

Mr. Batra furnishes the following details for year ended 31.03.2014:

Particulars	`
Short term capital gain	*1,40,000*
Loss from speculative business	*60,000*
Long term capital gain on sale of land	*30,000*
Long term capital loss on sale of shares (securities transaction tax not paid)	*1,00,000*
Income from business of textile (after allowing current year depreciation)	*50,000*
Income from activity of owning and maintaining race horses	*15,000*
Income from salary	*1,00,000*
Loss from house property	*40,000*

Following are the brought forward losses:

(i) Losses from activity of owning and maintaining race horses-pertaining to A.Y. 2011-12 ` 25,000.

(ii) Brought forward loss from business of textile ` 60,000 - Loss pertains to A.Y. 2006-07.

Compute gross total income of Mr. Batra for the Assessment Year 2014-15. Also state the eligible carry forward losses for the Assessment Year 2014-15.

Answer

Computation of Gross Total Income of Mr. Batra for the A.Y. 2014-15

Particulars	`	`
Salaries	1,00,000	
Less: Current year loss from house property	(40,000)	60,000
Profit and gains of business or profession		
Income from textile business	50,000	
Less: Loss from textile business brought forward from A.Y. 2006-07	60,000	
Balance business loss of A.Y. 2006-07 [See Note-1]	(10,000)	NIL
Income from the activity of owning and maintaining race horses	15,000	
Less: Loss from activity of owning and maintaining race horses brought forward from A.Y. 2011-12	25,000	
Loss to be carried forward to A.Y. 2015-16 [See Note-2]	(10,000)	NIL
Capital Gain		
Short term capital gain		1,40,000
Long term capital gain on sale of land	30,000	

Less: Long term capital loss on sale of shares	1,00,000	
Loss to be carried forward to A.Y. 2015-16 [See Note-3]	(70,000)	NIL
Gross Total Income		**2,00,000**

Losses to be carried forward to A.Y. 2015-16

Particulars	`
Current year loss from speculative business [See Note-4]	60,000
Current year long term capital loss on sale of shares	70,000
Loss from activity of owning and maintaining of race horse pertaining to A.Y.2011-12	10,000

Notes:-

(1) As per section 72(3), business loss can be carried forward for a maximum of eight assessment years immediately succeeding the assessment year for which the loss was first computed. Since the eight year period for carry forward of business loss of A.Y. 2006-07 expired with the A.Y. 2014-15, the balance unabsorbed business loss of ` 10,000 cannot be carried forward to A.Y. 2015-16.

(2) As per section 74A(3), the loss incurred on maintenance of race horses cannot be set-off against income from any 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.

(3) Long term capital gains on sale of shares on which securities transaction tax is not paid is not exempt under section 10(38). Therefore, long-term capital loss on sale of such shares can be set-off against long-term capital gain on sale of land. The balance loss of ` 70,000 cannot be set-off against short term capital gain or against any other head of income. The same has to be carried forward for set-off against long-term capital gain of the subsequent assessment year. Such long-term capital loss can be carried forward for a maximum of eight assessment years.

(4) Loss from speculation business cannot be set-off against any income other than profit and gains of another speculation business. Such loss can, however, be carried forward for a maximum of four years as per section 73(4) to be set-off against income from speculation business.

Question 2

The following are the details relating to Mr. Srivatsan, a resident Indian, aged 57, relating to the year ended 31.3.2014:

Particulars	`
Income from salaries	*2,20,000*
Loss from house property	*1,90,000*
Loss from cloth business	*2,40,000*
Income from speculation business	*30,000*

Loss from specified business covered by section 35AD	*20,000*
Long-term capital gains from sale of urban land	*2,50,000*
Long-term capital loss from sale of listed shares in recognized stock exchange (STT paid)	*1,10,000*
Loss from card games	*32,000*
Income from betting (Gross)	*45,000*
Life Insurance Premium paid	*1,20,000*

Compute the total income and show the items eligible for carry forward.

Answer

Computation of total income of Mr. Srivatsan for the A.Y.2014-15

Particulars	`	`
Salaries		
Income from salaries	2,20,000	
Less: Loss from house property	1,90,000	30,000
Profits and gains of business or profession		
Income from speculation business	30,000	
Less: Loss from cloth business set off	30,000	Nil
Capital gains		
Long-term capital gains from sale of urban land	2,50,000	
Less: Loss from cloth business set off	2,10,000	40,000
Income from other sources		
Income from betting		45,000
Gross total income		**1,15,000**
Less: Deduction under section 80C (life insurance premium paid)		30,000
Total income		**85,000**

Losses to be carried forward:

Particulars	`
(1) Loss from cloth business **(` 2,40,000 - ` 30,000 - `2,10,000)**	Nil
(2) Loss from specified business covered by section 35AD	20,000

Notes:

(i) Long-term capital gains from sale of listed shares in a recognized stock exchange is exempt under section 10(38). Loss from an exempt source cannot be set off against profits from a taxable source. Therefore, long-term capital loss on sale of listed shares cannot be set-off against long-term capital gains from sale of urban land.

(ii) Loss from specified business covered by section 35AD can be set-off only against profits and gains of any other specified business. Therefore, such loss cannot be set off against any other income. The unabsorbed loss has to be carried forward for set-off against profits and gains of any specified business in the following year.

(iii) Business loss cannot be set off against salary income. However, the balance business loss of ` 2,10,000 (` 2,40,000 – ` 30,000 set-off against income from speculation business) can be set-off against long-term capital gains of ` 2,50,000 from sale of urban land. Consequently, the taxable long-term capital gains would be ` 40,000.

(iv) Loss from card games can neither be set off against any other income, nor can it be carried forward.

(v) For providing deduction under Chapter VI-A, gross total income has to be reduced by the amount of long-term capital gains and casual income. Therefore, the deduction under section 80C in respect of life insurance premium paid has to be restricted to ` 30,000 [i.e., Gross Total Income of ` 1,15,000 – ` 40,000 (LTCG) – ` 45,000 (Casual income)].

(vi) Income from betting is chargeable at a flat rate of 30% under section 115BB and no expenditure or allowance can be allowed as deduction from such income, nor can any loss be set-off against such income.

Question 3

Mr. Soohan submits the following details of his income for the assessment year 2014-15:

Particulars	`
Income from salary	*3,00,000.00*
Loss from let out house property	*40,000.00*
Income from sugar business	*50,000.00*
Loss from iron ore business b/f (discontinued in 2007-08)	*1,20,000.00*
Short term capital loss	*60,000.00*
Long term capital gain	*40,000.00*
Dividend	*5,000.00*
Income received from lottery winning (Gross)	*50,000.00*
Winnings from card games	*6,000.00*
Agricultural income	*20,000.00*
Long term capital gain from shares (STT paid)	*10,000.00*
Short term capital loss under section 111A	*10,000.00*
Bank interest	*5,000.00*

Calculate gross total income and losses to be carried forward.

Answer

Computation of gross total income of Mr. Soohan for the A.Y.2014-15

Particulars	`	`
Salaries		
Income from salary	3,00,000	
Less: Loss from house property set-off against salary income as per section 71	(40,000)	2,60,000
Profits and gains of business or profession		
Income from sugar business	50,000	
Less: Brought forward loss from iron-ore business set-off as per section 72(1)	(50,000)	Nil
Balance business loss of ` 70,000 of P.Y.2007-08 carried forward to A.Y.2015-16		
Capital gains		
Long term capital gain	40,000	
Less: Short term capital loss set-off	(40,000)	Nil
Balance short-term capital loss of ` 20,000 to be carried forward		
Short-term capital loss of ` 10,000 under section 111A also to be carried forward		
Income from other sources		
Winnings from lottery	50,000	
Winnings from card games	6,000	
Bank interest	5,000	61,000
Gross Total Income		**3,21,000**
Losses to be carried forward to A.Y.2015-16		
Loss of iron-ore business	70,000	
Short term capital loss (` 20,000 + ` 10,000)	30,000	

Notes:

1. The following income are exempt under section 10 –
   - (i) Dividend income [Exempt under section 10(34)], assuming that dividend is received from a domestic company.
   - (ii) Agricultural income [Exempt under section 10(1)].
   - (iii) Long-term capital gains on which STT is paid [Exempt under section 10(38)].
2. It is presumed that loss from iron-ore business relates to P.Y.2007-08, the year in which the business was discontinued.

Question 4

Mr. Rajat submits the following information for the financial year ending 31st March, 2014. He desires that you should:

(a) Compute the total income and

(b) Ascertain the amount of losses that can be carried forward.

	Particulars		`
(i)	*He has two houses :*		
	(a)	*House No. I – Income after all statutory deductions*	*72,000*
	(b)	*House No. II – Current year loss*	*(30,000)*
(ii)	*He has three proprietary businesses :*		
	(a)	*Textile Business :*	
		(i) Discontinued from 31st October, 2013 – Current year loss	*40,000*
		(ii) Brought forward business loss of A.Y.2010-11	*95,000*
	(b)	*Chemical Business :*	
		(i) Discontinued from 1st March, 2012 – hence no profit/loss	*Nil*
		(ii) Bad debts allowed in earlier years recovered during this year	*35,000*
		(iii) Brought forward business loss of A.Y. 2012-13	*50,000*
	(c)	*Leather Business : Profit for the current year*	*1,00,000*
	(d)	*Share of profit in a firm in which he is partner since 2003*	*16,550*
(iii)	*(a)*	*Short-term capital gain*	*60,000*
	(b)	*Long-term capital loss*	*35,000*
(iv)	*Contribution to LIC towards premium*		*10,000*

Answer

Computation of total income of Mr. Rajat for the A.Y. 2014-15

Particulars	`	`
1. Income from house property		
House No.1	72,000	
House No.2	(-) 30,000	42,000
2. Profits and gains of business or profession		
Profit from leather business	1,00,000	
Less: Current year loss of textile business	(-) 40,000	
	60,000	
Bad debts recovered taxable under section 41(4)	35,000	
	95,000	

Less: Brought forward business loss of textile business for A.Y.2010-11 set off against the business income of current year	95,000	Nil
3. Capital Gains		
Short-term capital gain		60,000
Gross Total Income		**1,02,000**
Less: Deduction under Chapter VI-A		
Under section 80C – LIC premium paid		10,000
Total Income		**92,000**

Statement of losses to be carried forward to A.Y. 2015-16

Particulars	`
Business loss of A.Y. 2012-13 to be carried forward under section 72	50,000
Long term capital loss of A.Y. 2014-15 to be carried forward under section 74	35,000

Notes:

(1) Share of profit from firm of ` 16,550 is exempt under section 10(2A).

(2) Long-term capital loss cannot be set-off against short-term capital gains. Therefore, it has to be carried forward to the next year to be set-off against long-term capital gains of that year.

Question 5

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 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 6

Write short notes on:

(a) Loss can be carried forward only by the person who has incurred the loss.

(b) Carry forward and set off of losses by closely held companies.

Answer

(a) 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 reorganization 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 reorganization 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.

(b) 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 carried forward and set off, the shares of the company carrying not less than 51% of the voting power continue 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 company as on 31st March, 2010 continue to hold shares without interruption up to end of the previous year 2013-14 i.e. as on 31.03.2014, then, the loss of A.Y. 2010-11 (previous year 2009-10) is eligible for set off against the income of the A.Y.2014-15.

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 7

Mr. A furnishes you the following information for the year ended 31.03.2014:

		(`)
(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 ` 21,70,000)*	*75,000*
(iii)	*He has brought forward depreciation relating to A.Y. 2013-14*	*1,00,000*
(iv)	*He deposited ` 70,000 into his PPF account on 6.1.2014 and ` 30,000 in 5 year bank fixed deposit*	

Compute taxable income of Mr. A and his tax liability for the assessment year 2014-15 with reasons for your computation.

Answer

Computation of total income of Mr. A for the A.Y. 2014-15

Particulars	`
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. 2013-14	1,00,000
Gross total income	**1,85,400**
Less: Deduction under section 80C – Contribution to PPF and bank FD	1,00,000
Taxable income	**85,400**
Tax liability	**Nil**

Note :

1. **Income from retail trade:** Presumptive business income under section 44AD is ` 1,73,600 i.e. 8% of turnover of ` 21,70,000. However, the income computed as per books is ` 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.

   The requirement to maintain books of accounts under section 44AA and to get them audited under section 44AB in case the assessee claims the profit and gains of business to be lower than the presumptive income determined under section 44AD, would arise only if the total income exceeds the basic exemption limit. In this case, since the total income does not exceed the basic exemption limit, this mandatory requirement does not arise.

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

2. **Income from plying of vehicles:** Income calculated under section 44AE(1) would be ` 5,000 x 12 x 5 which is equal to ` 3,00,000. However, the income from plying of vehicles as per books is ` 2,10,400 less ` 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 ` 1,85,400, which is lower than the presumptive income of ` 3,00,000 calculated as per section 44AE(1). Hence, the assessee can adopt the income as per books i.e. ` 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	`
Income from retail trade under section 44AD [` 21,70,000 @ 8%]	1,73,600
Income from plying of vehicles under section 44AE [` 5,000 x 12 x 5]	3,00,000
	4,73,600
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	**4,73,600**
Less: Deduction under section 80C - Contribution to PPF and bank FD	1,00,000
Taxable income	**3,73,600**

Tax thereon	17,360
Less: Rebate under section 87A	2,000
	15,360
Add : Education cess @ 2% and Secondary and higher education cess @ 1%	461
Total tax liability	**15,821**

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

Question 8

Compute the tax liability of Mr. Madhavan for the Assessment Year 2014-15 from the following particulars:

Sl. No.	*Particulars*	`
(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 year 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 2013-14, the assessee has purchased NSC VIII issue for ` 1,00,000.

Answer

Computation of taxable income of Mr. Madhavan for the A.Y 2014-15

	Particulars	`	`
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
IV.	**Income from other sources**		
	Dividend on shares (including shares in company carrying on agricultural operations)– exempt under section 10(34)		Nil
			6,60,000
	Less: Brought forward unabsorbed depreciation (set-off against long-term capital gains)		1,40,000
Gross total income			**5,20,000**
Less : Chapter VIA deduction			
	Section 80C : NSC VIII issue purchase		1,00,000
Total income			**4,20,000**

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

Particulars	`	`
Agricultural income + non agricultural income = Total income = ` 60,000 + ` 4,20,000		4,80,000
Tax on LTCG of ` 60,000 @ 20%	12,000	
Tax on the remainder at slab rate	22,000	34,000
Less: Tax on ` 2,60,000 being basic exemption limit ` 2,00,000 plus ` 60,000 agricultural income		6,000
Tax liability		28,000
Less: Rebate under section 87A		2,000
		26,000
Add : Education cess and Secondary and higher education cess @ 3%		780
Total tax liability		**26,780**

Notes: (1) 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.

(2) Brought forward unabsorbed depreciation can be adjusted against any head of income. However, it is most beneficial to set-off unabsorbed depreciation against long-term capital gains, since it is taxable at a higher rate of 20% (the other income of the assessee falling in the 10% slab rate).