

Various Issues under Section 50 – Capital Gains – Depreciable Capital Asset

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In this article, we shall discuss various issues under section 50 of Income Tax Act, 1961 ('ITA') which deals with computation of gain arising from the transfer of depreciable capital asset.

Introduction:

Section 50 of ITA states that when there is a transfer of capital asset which forms part of block of assets in respect of which depreciation has been allowed, gain or loss arising from transfer of such depreciable capital asset shall be treated as gain or loss arising from transfer of short-term capital asset.

Issue #1: Discontinuation in claiming of depreciation:

Section 50 as stated above are applicable in respect of capital asset in respect of which depreciation is claimed by the assessee. The question that arises is whether it is mandatory to claim depreciation in the year of transfer to calculate capital gain as per section 50 or it is sufficient to satisfy that condition, if depreciation is claimed in any year.

For example, the assessee may discontinue the claim of depreciation due to discontinuation of commercial activity because of which he may not be able to claim depreciation and subsequently such person transfers such capital asset.

The Hon'ble Kerala High Court in the case of Sakthi Metal Depot¹ has held that once the asset forms part of 'block of assets' as defined under section 2(11), it continues to be a part of block of assets as long as assessee continues its business. Accordingly, the High Court has held that gain arising from transfer of such asset, even though depreciation is not claimed during the current year, shall be treated as

gain arising from transfer of short-term capital asset.

While analysing the provisions of Section 50, the High Court has referred to Section 50A which states that, in the case of capital on which depreciation is claimed under section 32 *in any previous year*, Written Down Value (WDV) of such asset as defined under Section 43(6) shall be considered as cost of acquisition for the purpose of Section 49.

As the provisions of Section 50A states that claiming of depreciation in any previous year, makes the WDV of such capital asset as cost of acquisition, and by referring to provisions of Section 2(11), Hon'ble High Court has held that gain arising from such type of asset is short term in nature. This case has been affirmed by the Hon'ble Supreme Court². The same view has been held by the Bombay High Court in the case of Smt. Meena Pamnani³.

Issue #2: Transfer of capital asset being a Land and Building:

To invoke provisions of Section 50, capital asset shall be a part of 'block of assets' and depreciation should be claimed on that asset. However, as land is not a depreciable asset, the question arises is, whether provisions of Section 50 are applicable for transfer of capital asset being a building along with land.

As stated earlier, to invoke provisions of Section 50 for computing the short-term capital gain, the first and foremost condition to be satisfied is underlying asset should be a capital asset which forms part of 'block of assets' as defined under Section 2(11) i.e., group of assets in respect of which same rate of depreciation has been provided in the Act, and depreciation has been allowed on that asset.

¹ [2010] 189 Taxman 329 (Kerala)

² [2021] 130 taxmann.com 238 (SC)

³ [2017] 86 taxmann.com 175 (Bombay)

However, in the case of land, even it is assumed, that said asset forms part of block of asset, as no depreciation is allowed, it does not satisfy the definition of 'block of assets' and accordingly on sale of such land, provisions of Section 50 cannot be invoked.

Further, if land is acquired along with building (where land value can be ascertained) which is used for the purpose of business and depreciation is claimed in respect of building, such asset being a land portion cannot be treated as forming part of block of assets and gain arising on transfer of such land need not be computed as per provisions of section 50. This view has been upheld by various High Courts and Tribunals.

Issue #3 - Section 50 vs. Section 41(2):

Section 41(2) of ITA states that gain, to the extent not exceeding difference between actual cost and WDV, arising from sale, discard, demolition or destruction of building, machinery, plant or furniture, on which depreciation under section 32(1)(i) is claimed, is treated as income from business.

These provisions are applicable in respect of asset on which depreciation is allowed under section 32(1)(i) i.e., depreciation in respect of generation or generation and distribution of power ('specified asset').

When the specified asset is transferred, gain to the extent of depreciation allowed under section 32(1)(i) (balancing charge) is treated as business income under Section 41(2).

On the other hand, Section 50 states that gain arising from transfer of capital asset on which depreciation is allowed under **any provisions** of the Act is treated as short term in nature. On reading of these two provisions, it seems that there is an overlap between the provisions of Section 41(2) and Section 50 in respect of taxing the gain arising from transfer/sale of specified assets.

The harmonious interpretation is that Section 50 and Section 41(2) cannot apply to the same

amount. This view has been upheld by the Hon'ble Supreme Court in the case of Urmila Ramesh⁴. The court has observed that provisions of Section 41(2) are incorporated to withdraw the excess depreciation allowed more than normal wear and tear under the Act in respect of specified asset. The amount more than such balancing charge has to be considered as capital gain under section 50.

Issue #4 - Claiming of Exemption under Section 54, Section 54F or Section 54EC:

As stated above, gain arising from transfer of depreciable asset is treated as short term in nature. The question that arises is whether assessee can claim exemption under section 54/54F/54EC on transfer of depreciable capital asset which is held for period more than 24/36 months.

Section 54/54F/54EC states that "*the capital gain arises from the transfer of a long-term capital asset...*".

However, the provisions of Section 50 start with "*Notwithstanding anything contained in clause (42A) of section 2...*" which means that without considering the provisions of section 2(42A), the gain is deemed to be the gain arising from short term capital asset.

This fiction has been incorporated to consider the gain arising from depreciable capital asset as short term in nature, despite, such asset being a long-term capital asset by virtue of section 2(42A). The legal fiction created under section 50 has to be restricted to tax the gain and cannot be extended to other provisions of the Act.

The Hon'ble Supreme Court in the case of V.S. Dempo Company Ltd.⁵ has agreed with the Bombay High Court⁶ where in the High Court has observed that Section 50 of the Act which is a special provision for computing the capital

⁴ [1998] 96 Taxman 533 (SC)

⁵ [2016] 74 taxmann.com 15 (SC)

⁶ ACE Builders (P.) Ltd. [2006] 281 ITR 210

gains in the case of depreciable assets is not only restricted for the purposes of Section 48 or Section 49 of the Act as specifically stated therein and the said fiction created in sub-section (1) & (2) of Section 50 has limited application only in the context of mode of computation of capital gains contained in Sections 48 and 49 and would have nothing to do with the exemption that is provided in a totally different provision i.e. Section 54E of the Act. After referring to the Bombay High Court judgment in the above case and after considering the judgement of Gujarat High Court⁷ and Guahati High Court⁸, the Supreme Court has held that exemption cannot be denied on gain arising from depreciable capital asset.

Issue #5 - Setoff of loss from Long Term Capital Asset against gain under Section 50:

The next issue that arises is, whether loss arising from long term capital asset can be setoff against gain arising from transfer of depreciable asset under Section 50.

In this regard, following the principles laid in the case of Ace Builders (supra), the Mumbai Tribunal in the case of Komac Investments & Finance (P.) Ltd⁹ has held that although the gain is short-term capital gain due to the fiction created by provisions of section 50(2), the asset remained as long-term capital asset. Hence, loss arising from the transfer of long-term capital asset can be set off against gain arising from depreciable capital asset if such depreciable capital asset has been held for 24/36 month.

⁷ Polestar Industries [2014] 41 taxmann.com 237

⁸ Assam Petroleum Industries (P.) Ltd. [2003] 262 ITR 587

⁹ [2011] 13 taxmann.com 185 (Mumbai)