Unabsorbed Depreciation under Section 32(2) *vis-a-vis* the Computation of Presumptive Income under Section 44AD and 44AE

Under Section 44AD, Section 44AE and the erstwhile Section 44AF of the Income-tax Act, 1961 (hereinafter 'the Act'), the assessees with small businesses are given the benefit of determining the chargeable income on presumptive basis. The Act provides them relief from the rigours of the Computation provisions of Chapter IV-D. As per these provisions, an assessee is expected to offer the minimum prescribed amount as income. In case the assessee intends to offer income lesser than the amount prescribed therein, the assessee has to maintain proper books of accounts and get it audited by a Chartered Accountant under Section 44AB. These provisions are one of the few provisions which have stood in the Statute, without much controversy for around 25 years. However, there is an interesting controversy, being decided, as to *whether unabsorbed depreciation allowable under Section 32(2) is also deemed to have been allowed under Section 44AD(2) or 44AE(3), if the assessee determines income on a presumptive basis.*

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The Issue

The issue for consideration is *whether unabsorbed depreciation allowable under Section 32(2) is also deemed to have been allowed, if the assessee determines income on a presumptive basis.*

Decision Already Rendered:

In DCIT, *Nasik vs. Sunil M. Kankariya (2008) 298 ITR (A.T.) 205 [ITAT Pune]: (2008) 112 ITD 170 (Pune),* the issue came up for consideration. The facts of the case as put out by the Tribunal are:

> *The assessee, a transporter, claimed set off of brought forward depreciation loss against the current year's income which was to be assessed under Section 44AE. The Assessing Officer held that, under Section 44AE of the Act, the claimed set off was deemed to have been given effect and could not be allowed to be set off against the current year's income. Accordingly, the total income of the assessee was assessed at ₹1,78,000 in terms of the provisions of Section*

44AE of the Act. The Commissioner (Appeals) directed the Assessing Officer to allow the claim of set off which, according to him, was otherwise permissible under the law.

It was held by the Tribunal in that case that the benefit of set-off of unabsorbed depreciation allowance is not *available to an assessee*. The major observations of the Tribunal in the said case have been reproduced hereinafter.

First, on the distinction between the unabsorbed depreciation allowance under Section 32(2) and unabsorbed business loss under Section 72(2):

The important feature is that either up to the assessment year 1996-97, i.e., pre-amendment, or operative from the assessment year 1997-98, i.e., post amendment, the law is unambiguous that where there is current depreciation, then, the unabsorbed depreciation carried over from the succeeding year is to be added to the current depreciation and deemed to be a part thereof. So, the provisions of Section 32(2) and other sub-sections have no ambiguity that unabsorbed depreciation is to be treated as per these provisions alone. Next comes the provisions of Section 72 which deals with the carry forward of "unabsorbed business loss" other than losses on account of depreciation and i.e., so because the carry forward of depreciation has already been provided in the statute in Section 32(2) of the Income-tax Act. The area of operation and the manner of carry forward of these two types of losses in these two provisions are different and distinct. As far as the issue in hand is concerned, the unabsorbed depreciation is carried forward and added to the depreciation of the following year. The total amount of depreciation thus arrived at is deemed to be the depreciation of the year. Otherwise also, this distinction is quite visible in the statute itself because it provides that if any assessee has unabsorbed depreciation under Section 32(2) as well as unabsorbed business loss carried forward under Section 72(1), then, Section 72(2) provides that the unabsorbed losses shall have precedence and to be set off first, so far as the sufficiency of the income to be set off against permits. It is only after the carried forward business loss is set off and there yet remains positive income then the unabsorbed depreciation would come in for set off. This method and way of set off of two types of losses are beneficial to the assessee in as much as the unabsorbed business loss have a time bar of eight years while the unabsorbed depreciation as referred by the learned Departmental representative has no time bar because it integrates with and is treated as depreciation allowable for the subsequent year itself.

It is not clear that why the legislature intended that an assessee should lose the benefit of 'unabsorbed depreciation allowance' only and not the 'brought forward business losses' also for having not maintained the proper books of accounts. In author's view, this could not be the real intention of the Legislature. It seems that it is only a drafting error.

Second, on the applicability of Section 44AE(3):

Finally comes the applicability of sub-section (3) of Section 44AE, and the issue basically revolves around the applicability of section, hence reproduced below:

"44AE.—(1) . . . .

3. Any deduction allowable under the provisions of Sections 30 to 38 shall, for the purposes of sub-section (1), be deemed to have been already given full effect to and no further deduction under those sections shall be allowed."

This sub-section thus debars an assessee to again claim any deduction which falls under Sections 30 to 38. This is a deeming provision, stating that the deductions which had fallen under these sections shall be deemed to have already been given full effect and no further deduction shall be allowed. As we have discussed above, *since the unabsorbed depreciation falls under Section 32(2) of the Income-tax Act, which is within the debarred claims as per sub-section (3) of Section 44AE, therefore, the assessee is not entitled for set off of unabsorbed depreciation, while computing the income under Section 44AE of the Income-tax Act*. For the sake of clarification, the learned Departmental representative has also argued that the assessee has not claimed the applicability of sub-section (7) of Section 44AE because of non-maintenance of books of account of the transport business. The assessing officer has also remarked

that the profits as computed by the assessee were not based upon any books of account. Be that as it was, for the purpose of settling this issue, we have already held that the assessee is not entitled for set off of unabsorbed depreciation, because he has opted to compute the transport business income under Section 44AE of the Income-tax Act in the absence of maintenance of books of account. The Revenue has also relied upon a decision of the honourable Supreme Court in the case of *CIT Vs. Jaipuria China Clay Mines Pvt. Ltd.* [1966] 59 ITR 555, for the proposition as held by the honourable court that the unabsorbed depreciation of past years had to be added to depreciation of the current year and the aggregate unabsorbed and current year's depreciation had to be deducted from the total income of the previous year.

Finally, it held:

In view of the foregoing discussion, in the light of the interpretation of the applicable provision of the statute, we hereby reverse the finding of the learned Commissioner of Income-tax (Appeals) and confirm the action of the assessing officer. Grounds of the Revenue are allowed.

Impact of the Decision

Let us take the following two cases for assessment year 2011-12:

Particulars	Case 1	Case 2
Number of Lorries (Heavy Vehicles) owned	7 Nos.	7 Nos.
Brought Forward Business Loss	₹1,90,000	₹3,00,000
Brought Forward Unabsorbed Depreciation	₹3,00,000	₹1,90,000
Income from Other Sources	₹30,000	₹30,000

Scope of Section 44AE ends with the determination of current year profits of the business of the assessee and thereafter Section 32(2) acts independently, subject to the provisions of Section 72(2). Legal fiction created that deductions under Sections 30 to 38 are deemed to be allowed, would operate only upto the determination of current year's profits.

Applying the decision of Pune Tribunal in the case of DCIT, *Nasik Vs. Sunil M. Kankariya (2008) 298 ITR (A.T.) 205 [ITAT Pune]: (2008) 112 ITD 170 (Pune),* the Total Income would be:

Particulars	Case 1	Case 2
	₹	₹
Presumptive income for 7 heavy vehicles (₹5,000 p.m. x 12 months x 7 Nos.)	4,20,000	4,20,000
Adj: Brought forward unabsorbed depreciation deemed to have been set-off under Section 44AE(3)	Nil	Nil
	4,20,000	4,20,000
Income from Other Sources	30,000	30,000
	4,50,000	4,50,000
Less: Brought forward business loss set-off	1,90,000	3,00,000
Total income	2,60,000	1,50,000
Loss amount to be carried forward	Nil	Nil
Indirectly, this would mean that income from 7 vehicles charged to tax is the presumptive income + unabsorbed depreciation deemed to have been set-off as per Section 44AE(3)	7,20,000	6,10,000

Analysis of the Impact

It is not clear as to why the legislature intended that an assessee should lose the benefit of *unabsorbed depreciation allowance* only and not the *brought forward business losses* also, for not having maintained the proper books of accounts.

In my view, this could not be the real intention of the Legislature. It seems that it is only a drafting error.

From the title of the Section 44AE of the Act, it could be seen that provision is *special provision for computing profits and gains of business of plying, hiring or leasing goods carriages*. Therefore, the provision is intended to determine the current year's income only and does not deal with the set-off of losses.

It is a well-settled rule of interpretation on title that the headings prefixed to a section acts as a guide to the interpretation of the section especially when they are ambiguous. The following paragraphs extracted

from Justice G. P. Singh's *Principles of Statutory Interpretation* (8e, 2002 reprint) gives clarity on the importance of reading the section along with the *Headings* to that section:

> *In this somewhat conflicting state of authorities what role do cross-headings play? In my opinion, it is wrong to confine their role to the resolution of ambiguities in the body of the Act. When the Court construing the Act is reading it to understand it, it must read the cross-headings as well as the body of the Act and that will always be a useful pointer as to the intention of Parliament in enacting the immediately following sections. When the cross-heading is no more than a pointer or label or is helpful in assisting to construe or even in some cases to control the meaning or ambit of those sections must necessarily depend on the circumstances of each case and I do not think it is possible to lay down any rules.*
>
> **(Page 145 of the Book)**

> *The heading prefixed to sections or set of sections in some modern statutes are regarded as preambles to those sections. They cannot control the plain words of the statute but they may explain ambiguous words.*
>
> **(Page 146 of the Book)**

Hence, upon reading the title to the section, it would be preferable to state that the legislature could have overlooked this error, if at all, rather to state that the legislature intended that, because of non maintenance of books of accounts, the assessee has to forego the benefit of set-off of unabsorbed depreciation.

When the literal interpretation leads to an irrational result, the Tribunal ought to have taken the intentional interpretation.

As was held by Justice P. N. Bhagwati in *Varghese (K.P.) Vs. ITO (1981) 131 ITR 597 (SC)*:

> *It is now a well-settled rule of construction that where the plain literal interpretation of a statutory provision produces a manifestly absurd and unjust result which could never have been intended by the Legislature, the court may modify the language used by the Legislature or even "do some violence" to it, so as to achieve the obvious intention of the Legislature and produce a rational construction: Vide Luke Vs. IRC [1963] AC 557; [1964] 54 ITR 692. The court may also in such a case read into the statutory provision a condition which, though not expressed, is implicit as constituting the basic assumption underlying the statutory provision.*

Section 44AE(4) deems that only the depreciation for each of the relevant assessment year has been allowed while computing income under Section 44AE(1). This would mean that only the depreciation amount determined under Section 32(1) should be deemed to have been deducted and not the brought forward unabsorbed depreciation under Section 32(2) relating to previous Assessment Years.

Intentional Interpretation – Scope of Section 44AE

At the cost of repetition, I wish to reiterate that Section 44AE is only for determining the current year income. It starts with the words *Notwithstanding anything to the contrary contained in Sections 28 to 43C*. Sections 28 to 43C of the Act deal with the determination of the business income of an assessee.

Therefore, it is clear that the intention of the legislature is to determine the current income from the business of the assessee. Hence, it should be seen as covering the scope of deductions only up to the stage of determining the current business income. It is unwarranted to extend this legal presumption beyond this point of determining current year's profits.

In the case of *CIT Vs. Mother India Refrigeration Industries Private Limited (1985) 155 ITR 711 (SC)*, it was clarified that a legal fiction created cannot be extended beyond the purpose for which the legal fiction was created. It observed:

> *... it is well settled, as has been observed by this court in Bengal Immunity Company Limited Vs. State of Bihar [1955] 2 SCR 603, 606; 6 STC 446, that the legal fictions are created only for some definite purpose and these must be limited to that purpose and should not be extended beyond that legitimate field.*

When does the provisions of set-off of *unabsorbed depreciation allowance* commence? Is it while determining the current year profits or after

determining the income from all the heads of income? Can it be stated that, since the *unabsorbed depreciation allowance* has been considered as *current year depreciation* this should be adjusted from the current year profits? Is the restriction placed by Section 72(2) on Section 32(2) would have any impact?

All these issues have been clearly analysed by the Supreme Court in the case of *CIT Vs. Mother India Refrigeration Industries Private Limited (1985) 155 ITR 711 (SC)*. This decision states:

> *At the outset, it may be stated that a close scrutiny of the relevant provisions of the 1922 Act as also the 1961 Act clearly shows that the computation of income under the head "Profits and gains of business" of any particular assessment year is required to be done after making certain allowances specified in sub-section (2) of Section 10 of the 1922 Act and after allowing certain deductions in accordance with the provisions contained in sub-section 30 to 43A of the 1961 Act; in other words, it is the net profits and gains after the specified deductions are made that are subjected to tax; one of such deductions pertains to depreciation allowance at the prescribed rate of percentage of the written down value of the business asset; and this is provided in Section 10(2)(vi) of the 1922 Act and in Section 32(1) of the 1961 Act.*
>
> *Up to this stage of computation, no question of either carry forward of unabsorbed depreciation of the earlier years or carry forward of unabsorbed business losses of earlier years arises.* ***In other words, the normal accountancy principle has to be applied in arriving at the net income from business for that year by debiting the current year's depreciation.*** *The question is whether any deviation from this normal rule of accountancy is contemplated by proviso (b) to Section 10(2)(vi) read with proviso (b) to Section 24(2) of the 1922 Act or by Section 32(2) read with Section 72(2) of the 1961 Act, and it is here that the aspect of proper construction of these provisions arises. Dealing with the provisions of the 1922 Act first, it will be clear that proviso (b) to Section 10(2)(vi) is in two parts and provides for two things; its first part provides for a carry forward of unabsorbed depreciation and its second part provides for clubbing the said carried forward depreciation with the current year's depreciation and deeming the aggregate to be the current year's depreciation. However,* ***carrying forward of the unabsorbed depreciation and the deeming provision in proviso (b) are not absolute but are subject to the proviso (b) to Section 24(2). Had proviso (b) to Section 24(2) not been enacted by the Legislature, the result would have been that the aggregate depreciation would have been deducted first out of the profits and gains in preference to unabsorbed business losses which might have been carried forward under Section 24(2) but as such losses can be carried forward only for limited number of years, the assessee would in certain circumstances have in his books losses which he might not be able to set off even within the time-limit during which the set off is permitted. In order to prevent such a situation, the Legislature enacted the proviso (b) to Section 24(2).*** *And proviso (b) to Section 24(2) expressly states "where depreciation allowance is, under clause.(b) of the proviso to clause (vi) of sub-section (2) of Section 10, also to be carried forward, effect shall first be given to the provisions of this sub-section". In other words, it clearly provides that in the matter of set off, the unabsorbed business losses of the earlier years will have preference over unabsorbed depreciation that is required to be carried forward under proviso (b) to Section 10(2)(vi) and no preference over the current depreciation is intended.*

Therefore, it is absolutely clear that, ignoring other set-off of losses like Section 35(4), etc., the order of preference amongst the three items, viz. current year depreciation, brought forward unabsorbed depreciation and the brought forward business

In computing, the presumptive income, only current year's depreciation is to be allowed. The unabsorbed depreciation has to be considered separately, only after the presumptive income has been determined under Section 44AE.

loss is:

- Current year depreciation
- Determine current year profit
- Determine all the heads of income
- Adjust brought forward business loss
- Adjust brought forward unabsorbed depreciation allowance

This has been categorically held by the Supreme Court in the Mother India's case:

> *In other words, the normal accountancy principle has to be applied in arriving at the net income from business for that year by debiting the current year's depreciation.*
>
> *... carrying forward of the unabsorbed depreciation and the deeming provision in proviso (b) are not absolute but are subject to the proviso (b) to Section 24(2). Had proviso (b) to Section 24(2) not been enacted by the Legislature, the result would have been that the aggregate depreciation would have been deducted first out of the profits and gains in preference to unabsorbed business losses which might have been carried forward under Section 24(2) but as such losses can be carried forward only for limited number of years, the assessee would in certain circumstances have in his books losses which he might not be able to set off even within the time-limit during which the set off is permitted. In order to prevent such a situation, the Legislature enacted the proviso (b) to Section 24(2).*

This means that in determining the current year's income only the current year depreciation has to be considered. The set-off of business losses and unabsorbed depreciation would take effect only after the current year profit has been determined.

This being the case, *the deduction under Section 32(2) should be considered only after the current year profits has been determined under Section 44AE.*

Scope of Section 44AE ends with the determination of current year profits of the business of the assessee and thereafter Section 32(2) acts independently, subject to the provisions of Section 72(2). Legal fiction created that deductions under Sections 30 to 38 are deemed to be allowed would operate only upto the determination of current year's profits.

Therefore, it is true that Section 44AE(3) states that: -

> (3) Any deduction allowable under the provisions of Sections 30 to 38 shall, for the purposes of sub-section (1), be deemed to have been already given full effect to and no further deduction under those sections shall be allowed.
>
> Provided that where the assessee is a firm, the salary and interest paid to its partners shall be deducted from the income computed under sub-section (1) subject to the conditions and limits specified in clause (b) of Section 40.

But its scope ends with determining the current year's profits. The legal fiction for which Section 44AE was created is to determine the current year's profits and therefore the impact of Section 44AE(3) should end with it. It cannot extend beyond its role and create impact on the set-off and carry forward of losses.

Intentional Interpretation – Aid from Section 44AE(4)

In spite of having Section 44AE(3), it has to be noted that Section 44AE(4) deals with the *depreciation and written down value* separately. It states:

> *(4) The written down value of any asset used for the purpose of the business referred to in sub-section (1) shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.*

Depreciation allowance under Section 32(1) also falls within the range of Sections 30 to 38, as envisaged to have been allowed under Section 44AE(3). This would mean that Section 43(6) would automatically take care of the determination of the *Written Down Value* of the *Block of Assets* of the business, once depreciation, which falls within the range of Sections 30 to 38, is deemed to have been deducted.

What was the necessity of the Legislature to introduce Section 44AE(4), when even without it, the deduction allowable under Section 32(1) could be deemed to have been claimed and allowed in determining the presumptive income and under Section 43(6) the Written Down Value would, correspondingly, have got adjusted.

The Legislature does not enact any provision without intent or purpose. It does not enact a provision to be called redundant.

Therefore, the sub-section (4) should be treated

as having been introduced, and should be read, with a specific purpose. Section 44AE(4) has used the words the assessee had claimed and *had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.*

Hence, as observed by Respected Justice P. N. Bhagwati in Varghese's case, Section 44AE(4) should be *read with a condition which, though not expressed, is implicit as constituting the basic assumption underlying the statutory provision.*

Section 44AE(4) deems that only the depreciation for each of the relevant assessment year has been allowed while computing income under Section 44AE(1). This would mean that only the depreciation amount determined under Section 32(1) should be deemed to have been deducted and not the brought forward unabsorbed depreciation under Section 32(2) relating to previous Assessment Years.

Intentional Interpretation – Intention of Section 32(2)

Even otherwise, though Section 32(2) falls within the range of 'Sections 30 to 38', it is an inoperative provision till Section 72(2) gives the right to claim set-off under Section 32(2). This is because, when Section 72(2) clearly says that the deduction under Section 32(2) should be allowed only after giving preference for the loss under Section 72(2), the Section 32(2) would be redundant till the set-off provisions are taken, i.e. Section 32(2) allowance would take effect only when Section 72(2) has considered and set-off, and if any profit is left over.

Therefore, though the 'unabsorbed depreciation allowance' is brought forward and set-off under Section 32(2), it does not operate simultaneously when Section 44AE operates or for that matter any of the Sections 30 to 38 operates. The deduction available under Section 32(2) operates independently after the computation of income under Chapter IV is complete.

This would be more abundantly clear if it is noticed that brought forward unabsorbed depreciation allowance can be set-off against other heads of income also, as clarified by the decision of the *CIT Vs. Virmani Industries Private Limited (1995) 216 ITR 607 (SC)*, which would be possible only when Section 32(2) is considered for set-off after determining the income under all the heads of income.

Hence, the deduction under Section 32(2) is allowable as deduction after the presumptive income has been determined under Section 44AE.

Revised Computation

Let us take the aforesaid two cases for assessment year 2011-2012:

Particulars	Case 1	Case 2
Number of Lorries (Heavy Vehicles) owned	7 Nos.	7 Nos.
Brought Forward Business Loss	₹1,90,000	₹3,00,000
Brought Forward Unabsorbed Depreciation	₹3,00,000	₹1,90,000
Income from Other Sources	₹30,000	₹30,000

The Total Income would be:

Particulars	Case 1	Case 2
	₹	₹
Presumptive Income for 7 Heavy Vehicles (₹5,000 p.m. x 12 months x 7 Nos.)	4,20,000	4,20,000
Income from Other Sources	30,000	30,000
	4,50,000	4,50,000
Less: Brought Forward Business Loss Set-off (to be restricted to the business income available)	1,90,000	3,00,000
	2,60,000	1,50,000
Less: Brought Forward Unabsorbed Depreciation – restricted to Total Income available	2,60,000	1,50,000
Total Income	Nil	Nil
Unabsorbed Depreciation amount to be carried forward	40,000	40,000

Conclusion

To conclude, in computing the presumptive income, only current year's depreciation is to be allowed. The unabsorbed depreciation has to be considered separately only after the presumptive income has been determined under Section 44AE.

Though, Section 32(2) appears amongst the computation provisions of Chapter IV-D, it acts independently, as a set-off provision only after the income of all the five heads under Chapter IV has been computed. ■