



## Exemption under Section 54E of the Income-tax Act is eligible to depreciable assets even though for computation of capital gain it is treated as short term

### Background

Recently, the Supreme Court of India in the case of V. S. Dempo Company Ltd<sup>1</sup> (the taxpayer) held that even though the depreciable asset is treated as short term asset under Section 50 of the Income-tax Act, 1961 (the Act) it is eligible for exemption under Section 54E<sup>2</sup> of the Act. The Supreme Court observed<sup>3</sup> that Section 50 of the Act is a special provision for computing the capital gains in the case of depreciable assets. The fiction created in Section 50 has limited application only in the context of mode of computation of capital gains provided in Section 48<sup>4</sup> and 49<sup>5</sup> of the Act. This will not affect the claim of exemption under Section 54E of the Act.

### Facts of the case

- During the Assessment Year (AY) 1989-90, the taxpayer sold its depreciable asset namely loading platform M.V. Priyadarshni on which it had earned some capital gains. On the said capital gains the taxpayer had claimed an exemption under Section 54E of the Act. The asset was purchased in the year 1972 and sold sometime in the year 1989.

- The Assessing Officer (AO) rejected the claim for exemption of the taxpayer under Section 54E of the Act on the ground that the taxpayer had claimed depreciation on the said asset and, therefore, provisions of Section 50 of the Act were applicable.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO. However, Income-tax Appellate Tribunal (the Tribunal) allowed the appeal of the taxpayer holding that the taxpayer shall be entitled to exemption under Section 54E of the Act. The High Court has confirmed the view of the Tribunal and dismissed the appeal of the tax department.

### Supreme Court ruling

- On reference to the definition of the term long-term capital asset<sup>6</sup> it has been observed that the asset held by the taxpayer was admittedly a long-term capital asset.
- The Supreme Court observed that the High Court has relied upon its own decision in the case of ACE Builders Pvt. Ltd.<sup>7</sup>. The High Court has observed that Section 50 of the Act which is a special provision for computing the capital 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) and (2) of Section 50 has limited application only in the context of mode of

<sup>1</sup> CIT v. V. S. Dempo Company Ltd (Civil Appeal No. 4797/2008) – Taxsutra.com

<sup>2</sup> Section 54E of the Act – The taxpayer is eligible to claim exemption where the capital gain arises from the transfer of a capital asset, not being a short-term capital asset, (the capital asset so transferred being hereafter in this section referred to as the original asset) and the taxpayer has, within a period of six months after the date of such transfer, invested or deposited the full value of the consideration or any, part thereof received or accruing as a result of such transfer in any specified asset (such specified asset being hereafter in this section referred to as the new asset).

<sup>3</sup> While referring to the High Court decision in the taxpayer's own case

<sup>4</sup> Mode of computation of capital gain – The income chargeable under the head capital gains shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts namely:-

(i) the expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto

<sup>5</sup> Cost with reference to certain modes of acquisition

<sup>6</sup> Provided under Section 2(29B) of the Act

<sup>7</sup> CIT v. ACE Builders Pvt. Ltd. [2005] 281 ITR 210 (Bom)

computation of capital gains contained in Sections 48 and 49 of the Act. This would have nothing to do with the exemption that is provided in Section 54E of the Act.

- Section 48 of the Act deals with the mode of computation, and Section 49 relates to cost with reference to the certain mode of acquisition. This aspect is analysed in the case of ACE Builders Pvt. Ltd. We are in agreement with the aforesaid view taken by the High Court.
- The Gujarat High Court in the case of Polestar Industries<sup>8</sup> as well as Gauhati High Court in the case of Assam Petroleum Industries<sup>9</sup> has also taken a similar view. Further, no appeal has been filed before the Supreme Court against these decisions. Accordingly, the tax department's appeal has been dismissed.

## Our comments

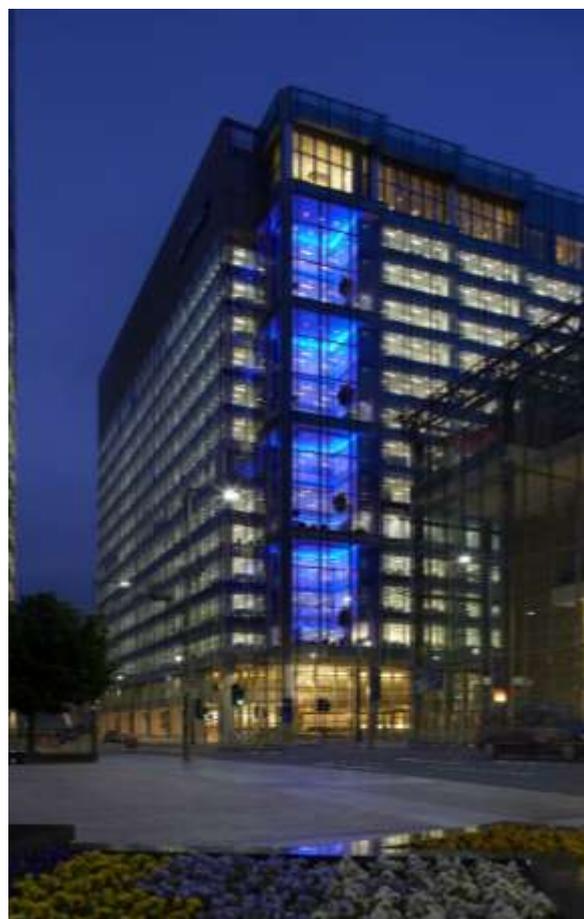
The issue with respect to the claim of exemption on depreciable asset has been debated before the Courts.

The Bombay High Court in the case of ACE Builders Pvt Ltd observed that the legal fiction created by the statute under Section 50 of the Act is to deem the capital gain as short-term capital gain and not to deem the asset as a short-term capital asset. Therefore, it cannot be said that Section 50 converts a long-term capital asset into a short-term capital asset.

Subsequently, the Bombay High Court in the case of Cadbury India Ltd.<sup>10</sup> observed that there was nothing in Section 50 of the Act to suggest that fiction created is not restricted in its application to Sections 48 and 49, but to other provisions as well. The section itself makes it clear that the deeming fiction created in Section 50 is restricted only to the mode of computation of capital gains contained in Sections 48 and 49. Section 50 does not convert a long-term capital asset into a short-term capital asset.

Similarly, the Gujarat High Court in the case of Aditya Medisales Ltd<sup>11</sup> observed that capital gain arising out of a long-term capital asset, if invested in specified asset, the taxpayer is not to be charged capital gains and exemption provided under Section 54EC cannot be denied to the taxpayer only on account of the fact that deeming fiction is created under Section 50 of the Act.

The Supreme Court in the instant case has observed that the fiction created in Section 50 has limited application only in the context of the mode of computation of capital gains contained in Sections 48 and 49 of the Act. This will not affect the claim of exemption under Section 54E of the Act.



<sup>8</sup> CIT v. Polestar Industries [2013] 221 Taxman 423 (Guj)

<sup>9</sup> CIT v. Assam Petroleum Industries (P) Ltd. [2003] 262 ITR 587 (Gauhati)

<sup>10</sup> CIT v. Cadbury India Ltd [2015] 53 taxmann.com 227 (Bom)

<sup>11</sup> CIT v. Aditya Medisales Ltd [2013] 38 taxmann.com 244 (Guj)

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