



Tax Flash News



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Tax rate for long-term capital gains applicable to gains from transfer of depreciable assets held for more than 36 months: ITAT Special Bench

Executive summary



The Income-tax Act, 1961 (the Act) follows a 'block of assets' concept for tax depreciation purposes. It provides a specific mechanism for computing capital gains on transfer of such depreciable assets. Also, such gains are deemed to be arising from the transfer of short-term capital assets, irrespective of the period of holding.

There has been a debate on whether other provisions applicable to long-term capital assets i.e., deductions, loss set-off, tax rate can be applied to gains from the transfer of depreciable assets which are held for more than 36 months, even though deemed as arising from short-term capital assets for the purposes of income computation.

In the context of tax rate applicable to such assets, due to conflicting decisions, a special bench of the Income Tax Appellate Tribunal ('ITAT' or 'Tribunal') was constituted in a recent case¹, and by a 2:1 majority, the bench accepted the taxpayer's position of applying tax rate applicable to the gains from transfer of long-term capital asset in respect of depreciable assets held for more than 36 months.

¹ ITA No. 7544/Mum/2011. Source: Taxsutra

Background



A capital asset is characterised as long-term or short-term, depending upon the period of its holding. For instance, a capital asset held for more than 36 months is characterised as a long-term capital asset.

However, there is a specific provision in the Act (Section 50) dealing with the computation of the gains from the transfer of a depreciable asset² and deeming the gains to be arising from the transfer of a short-term capital asset, irrespective of the period of holding.

This provision overrides the provision characterising the asset as long-term or short-term. Secondly, it modifies the computation provisions normally applicable to other capital asset³ as it prescribes its own computation mechanism.

The issue arises with regard to the applicability of concessional tax rate under section 112 which is applicable to the gains from the transfer of a long-term capital asset – whether one can apply such tax rates to the gains from the transfer of depreciable asset which is held for more than 36 months, even when the specific provision deems such gain to be arising from the transfer of a short-term capital asset.

The short-term capital gain (STCG) is ordinarily taxable at a higher rate (30 per cent), while the long-term capital gains (LTCG) is taxable at a concessional rate (20 per cent).

In view of the divergent opinion of coordinate benches of the Tribunal, a special bench was constituted for deciding the issue.

The majority ruled in the favour of taxpayer. The judgment contains the order of one dissenting member as well.

² A capital asset forming part of a block of asset in respect of which depreciation has been allowed under the Act

³ Section 48 and 49 of the Act

Special Bench decision



The deeming fiction is restricted to the computation of capital gains and a fiction created by the legislature has to be confined to the purpose for which it is created.⁴

The non-obstante clause in it overrides the provision characterising the asset as long-term or short-term. It does not extend to other provisions of the Act.

The legal fiction created is to deem the capital gain as a short-term capital gain and not to alter the character of the asset i.e., the deeming fiction does not convert long-term capital asset into short term capital asset for other purposes of the Act. A depreciable asset held for more than 36 months continues to be a long-term capital asset.

Thus, if a provision deals with gains from the transfer of a long-term capital asset, the gains from the transfer of a depreciable asset held for more than 36 months should be covered by that provision, even if such gains has been computed and deemed as short-term capital gains as per section 50 of the Act.

The Bombay High Court has treated the gains from the transfer of a depreciable asset held for more than

36 months as gains from the transfer of long-term capital asset for the purposes of other provisions of the Act, such as set-off long-term capital loss⁵ or deduction which is available in respect of gains from the transfer of a long-term capital asset⁶. The same has been approved by the Supreme Court in the case of *Dempo Company*⁷.

Similarly, section 112 is applicable to the capital gains from the transfer of a long-term capital asset, whether depreciable or not. As the asset involved in the instant case was held for more than 36 months and thus, qualifies as a long-term capital asset, the concessional tax rate should be applicable.

Dissenting member order



The following conditions must be satisfied for the applicability of section 112 of the Act: (a) the gain must arise from transfer of a 'long-term capital asset'; (b) it must be chargeable under the head 'capital gain' as 'long-term capital gain'; (c) the long-term capital gain so computed should be part of the 'total income'.

⁴ *CIT v. Ace Builders (P) Ltd* [2006] 281 ITR 210 (Bom)

⁵ *CIT v. Parys (Eastern) Pvt Ltd* [2016] 384 ITR 264 (Bom)

⁶ *CIT v. Ace Builders (P) Ltd* [2006] 281 ITR 210 (Bom)

⁷ *CIT v. Dempo Company Ltd* [2016] 387 ITR 354 (SC)

In the instant case, income arising from transfer of depreciable asset has been computed and included in the total income as 'short term capital gain' by virtue of the specific provision.

Section 112 deals with the application of the concessional tax rate. It does not alter the character of the income itself. The chargeability of the income is governed by the provisions under the head 'capital gain' and not by the section relevant for invoking the tax rate.

The legislative intention of section 50 is to deny the benefit of concessional rate of LTCG to the depreciable asset which has been exploited for the business purposes and depreciation has already been claimed as revenue expenditure. The capital gain from the transfer of such depreciable asset should be subjected to normal tax rates as STCG.

The application of section 112 in the instant case would undermine the purpose of section 50 which is to deny multiple benefits in case of depreciable assets.

In the decisions rendered by the High Court and the Supreme Court, the issue relating to the tax rate has not been decided.

Our comments



This issue impacts tax positions taken by a large number of taxpayers. It would be interesting to see how the Courts would deal with the dissenting arguments and whether the view taken by the Bombay High Court and the Supreme Court in the context of loss set-off and deduction from gains on transfer of depreciable long-term capital assets can be distinguished in determining applicable tax rate.



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