

HIGH COURT OF GUJARAT
Commissioner of Income-tax-I

v.

Aditya Medisales Ltd.

M.R. SHAH AND MS. SONIA GOKANI, JJ.
TAX APPEAL NO. 730 OF 2013
SEPTEMBER 2, 2013

JUDGMENT

Ms. Sonia Gokani, J. - The Tax Appeal has been preferred by the revenue challenging the order of the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') dated 11/01/2013 proposing the following substantial questions of law for our consideration;

- "(A) Whether on the facts and in the circumstances of the case and in law, the Tribunal was correct in law in not appreciating that 'long term assets' referred in Section 54EC of the Act can only yield long term capital gains and that gain on sale of depreciable asset can only be short term capital gain?
- (B) Whether the Tribunal was correct in allowing exemption under Section 54EC of the Act of Rs.30,28,732/- on the capital gain in respect to Automatic Electrical Load Monitoring System, included in the depreciable assets under the meaning of Section 50 of the Act, without appreciating that exemption under Section 54EC of the Act was not allowable in the case of assets covered by the provisions of Section 50 of the Act, since, Section 50 of the Act being special provision cannot be overridden by provisions of Section 54EC of the Act?
- (C) Whether the Tribunal was right in law in not appreciating that benefit under Section 54EC is granted on capital gains and not on sale proceeds of capital assets and that capital gain in respect of depreciable assets can be arrived at only under Section 50 of the Act and therefore, deeming provisions of Section 50 cannot be ignored for the purpose of Section 54EC of the Act?"

2. We have heard learned Counsel, Mr. K.M. Parikh for the Department and also examined closely the material on record as also the law on the subject.

3. The only question that deserves to be addressed by this Court is, whether the exemption available under Section 54EC of the Income-tax Act ('Act' hereinafter) on long term capital gain is also available in respect of short term capital gain when such capital gain is from transfer of 'long term capital assets' in wake of deeming fiction created under Section 50 of the Act?

4. The brief facts necessary for the purpose of adjudicating the issue are as follows;

4.1 The assessee-respondent for the Assessment Year 2007-08 had filed the return of income. Assessee Company had sold 'Automatic Electric Load Monitoring System' for the sum of Rs.240 lakh and the assessee had invested the gain amount in Rural Electrification Bonds and claimed exemption under Section 54EC. On scrutiny of the assessment under Section 143(3) of the Act, the Assessing Officer found that short term capital gain was offered by the assessee in respect of Automatic Electric Load Monitoring System under Section 50 of the Act being the amount of Rs.30,28,732/-. It had also claimed exemption under Section 54EC of the Act for investing the said amount in Rural Electrification Bond. The Assessing

Officer disallowed such exemption on the ground that the same was not available on short term capital gain and invocation of Section 54EC was permissible only on long term capital gain.

4.2 Aggrieved by such disallowance the assessee preferred appeal before the CIT(A), which deleted the above addition and allowed the appeal partly preferred by the assessee seeking reliance upon the decision of the Bombay High Court in the case of *CIT v. ACE Builders (P.) Ltd.* [\[2006\] 281 ITR 210](#).

4.3 This was challenged by the revenue before the Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal') and the Tribunal vide its impugned order held in favour of the assessee and against the revenue. Therefore, the present appeal is preferred raising the aforementioned proposed questions of law.

4.4 The question therefore to be addressed is whether the exemption permitted by the statute under Section 54EC for the depreciable assets can also be claimed for short term capital gain.

4.5 Section 50 of the Act is the deeming provision made for the purpose of computation of capital gain as far as depreciable assets are concerned.

4.6 Section 50 of the Act is being reproduced at this stage profitably along with Section 54EC of the Act.

"50. *Special provision for computation of capital gains in case of depreciable assets:*— Notwithstanding anything contained in clause (42A) of Section 2, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under this Act or under the Indian Income-tax Act, 1922 (11 of 1922), the provisions of Sections 48 and 49 shall be subject to the following modifications:—

(1) Where the full value of the consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year, exceeds the aggregate of the following amounts, namely:—

- (i) expenditure incurred wholly and exclusively in connection with such transfer or transfers;
- (ii) the written down value of the block of assets at the beginning of the previous year; and
- (iii) the actual cost of any asset falling within the block of assets acquired during the previous year,

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets;

(2) where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the assessee during the previous year and the income received or accruing as a result of such transfer or transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

54EC. *Capital gain not be charged on investment in certain bonds.*— (1) Where the capital gain arises from the transfer of a long-term capital asset (the capital asset so transferred being hereafter in this Section referred to as the original asset) and the assessee has, at any time within a period of six months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset, the capital gain shall be dealt with in accordance with the following provisions of this Section, that is to say,—

- (a) if the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under Section 45;
- (b) if the cost of the long-term specified asset is less than the capital gain arising from the transfer of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the long-term specified asset bears to the whole of the capital gain, shall not be charged under Section 45:

Provided that the investment made on or after the 1st day of April, 2007 in the long-term specified asset by an assessee during any financial year does not exceed fifty lakh rupees

(2) Where the long-term specified asset is transferred or converted (otherwise than by transfer) into money at any time within a period of three years from the date of its acquisition, the amount of capital gains arising from the transfer of the original asset not charged under Section 45 on the basis of the cost of such long-term specified asset as provided in Clause (a) or, as the case may be, clause (b) of Sub Section (1) shall be deemed to be the income chargeable under the head "Capital gains" relating to long-term capital asset of the previous year in which the long-term specified asset is transferred or converted (otherwise than by transfer) into money.

Explanation.— In a case where the original asset is transferred and the assessee invests the whole or any part of the capital gain received or accrued as a result of transfer of the original asset in any long-term specified asset and such assessee takes any loan or advance on the security of such specified asset, he shall be deemed to have converted (otherwise than by transfer) such specified asset into money on the date on which such loan or advance is taken.

(3) Where the cost of the long-term specified asset has been taken into account for the purposes of clause (a) or clause (b) of sub-section (1)—

- (a) a deduction from the amount of income-tax with reference to such cost shall not be allowed under Section 88 for any assessment year ending before the 1st day of April, 2006;
- (b) a deduction from the income with reference to such cost shall not be allowed under Section 80C for any assessment year beginning on or after the 1st day of April, 2006.

Explanation.— For the purpose of this section—

- (a) "cost", in relation to any long-term specified asset, means the amount invested in such specified asset out of capital gains received or accruing as a result of the transfer of the original asset;
- (b) "long-term specified asset" for making any investment under this Section during the period commencing from the 1st day of April, 2006 and ending with the 31st day of March, 2007, means any bond, redeemable after three years and issued on or after the 1st day of April, 2006, but on or before the 31st day of March, 2007—
 - (i) by the National Highways Authority of India constituted under Section 3 of the National Highways Authority of India Act, 1988 (68 of 1988); or
 - (ii) by the Rural Electrification Corporation Limited, a company formed and registered under the Companies Act, 1956 (1 of 1956),

and notified by the Central Government in the Official Gazette for the purposes of this Section with such conditions (including the condition for providing a limit on the amount of investment by an assessee in such bond) as it thinks fit;

Provided that where any bond has been notified before the 1st day of April, 2007, subject to the conditions specified in the notification, by the Central Government in the Official Gazette under the provisions of clause (b) as they stood immediately before their amendment by the Finance Act, 2007, such bond shall be deemed to be a bond notified under this Clause;

(ba) "long-term specified asset" for making any investment under this Section on or after the 1st day of April, 2007 means any bond, redeemable after three years and issued on or after the 1st day of April, 2007 by the National Highways Authority of India constituted under Section 3 of the National Highways Authority of India Act, 1988 (68 of 1988) or by the Rural Electrification Corporation Limited, a company formed and registered under the Companies Act, 1956 (1 of 1956).'

4.7 Section 45 of the Act is a charging Section, which provides that in any profit or gains arising from the transfer of a capital asset effected in the previous year, shall, save as otherwise provided in Sections 54, 54B, 54D and 54E, chargeable to income tax under the head 'capital gains' and shall be deemed to be the income of the previous year in which the transfer took place.

4.8 Sections 48 and 49 are machinery Sections for computation of capital gains.

4.9 Section 50 is an exception in relation to the depreciable assets and provides that where depreciation is claimed and allowed on the assets the computation of capital gain on transfer of such asset under Sections 48 and 49 shall be modified under Section 50. Thus, Section 50 is meant for computation of capital gains in case of depreciable assets. It provides for a method of computation of capital gains in relation to capital assets on which depreciation is allowable.

4.10 As could be noted from the findings of the Tribunal it has essentially relied upon the decision of the Bombay High Court and concurred with the finding of the CIT(A) by holding that the exemptions under Section 54EC is to be allowed subject to the verification by the Assessing Officer that investment in long term capital asset was made by the assessee-respondent within the period prescribed under Section 54EC(1) of the Act from which short term capital gain is offered for the tax. The Tribunal also held that exemption available under Section 54EC of the Act is available on short term capital gain arising from transfer of long term capital assets. There is no condition in the provision, which would preclude such interpretation. Admittedly, depreciable assets sold by the assessee were held by it for 10 years and therefore on such sale, investment in Rural Electrification Bond was made.

5. We notice that the Bombay High Court was dealing with somewhat identical question where the long term capital gain arose on transfer of a depreciable long term capital asset. The Court questioned whether the assessee could be denied exemption under Section 54E only on the ground that Section 50 of the Act provides for computation of long term capital gains and capital gain offered was arising from the transfer of depreciable capital asset?

6. The Bombay High Court dealt with the entire issue in the following manner;

"24. Section 54E of the Income-tax Act grants exemption from payment of capital gains tax, where the whole or part of the net consideration received from the transfer of a long-term capital asset is invested or deposited in a specified asset within a period of six months after the date of such transfer. In the present case it is not in dispute that the assessee fulfils all the conditions set out in Section 54E to avail of the exemption, but the exemption is sought to be denied in view of fiction created under

Section 50.

25. In our opinion, the assessee cannot be denied exemption under Section 54E, because, firstly, there is nothing in Section 50 to suggest that the fiction created in Section 50 is not only restricted to Sections 48 and 49 but also applies to other provisions. On the contrary, Section 50 makes it explicitly clear that the deemed fiction created in sub-sections (1) and (2) of Section 50 is restricted only to the mode of computation of capital gains contained in Sections 48 and 49. Secondly, it is well-established in law that a fiction created by the Legislature has to be confined to the purpose for which it is created. In this connection, we may refer to the decision of the Apex Court in the case of *State Bank of India v. D. Hanumantha Rao* [1998] 6 SCC 183. In that case, the Service Rules framed by the bank provided for granting extension of service to those appointed prior to July 19, 1969. The respondent therein who had joined the bank on July 1, 1972, claimed extension of service because he was deemed to be appointed in the bank with effect from October 26, 1965, for the purpose of seniority, pay and pension on account of his past service in the army as Short Service Commissioned Officer. In that context, the Apex Court has held that the legal fiction created for the limited purpose of seniority, pay and pension cannot be extended for other purposes. Applying the ratio of the said judgment, we are of the opinion, that the fiction created under Section 50 is confined to the computation of capital gains only and cannot be extended beyond that. Thirdly, Section 54E does not make any distinction between depreciable asset and non-depreciable asset and, therefore, the exemption available to the depreciable asset under Section 54E cannot be denied by referring to the fiction created under Section 50. Section 54E specifically provides that where capital gain arising on transfer of a long-term capital asset is invested or deposited (whole or any part of the net consideration) in the specified assets, the assessee shall not be charged to capital gains. Therefore, the exemption under Section 54E of the Income-tax Act cannot be denied to the assessee on account of the fiction created in Section 50.

26. It is true that Section 50 is enacted with the object of denying multiple benefits to the owners of depreciable assets. However, that restriction is limited to the computation of capital gains and not the exemption provisions. In other words, where the long-term capital asset has availed of depreciation, then the capital gain has to be computed in the manner prescribed under Section 50 and the capital gains tax will be charged as if such capital gain has arisen out of a short-term capital asset but if such capital gain is invested in the manner prescribed in Section 54E, then the capital gain shall not be charged under Section 45 of the Income-tax Act. To put it simply, the benefit of Section 54E will be available to the assessee irrespective of the fact that the computation of capital gains is done either under Sections 48 and 49 or under Section 50. The contention of the Revenue that by amendment to Section 50 of the long-term capital asset has been converted into a short-term capital asset is also without any merit. As stated hereinabove, the legal fiction created by the statute is to deem the capital gain as short-term capital gain and not to deem the asset as short-term capital asset. Therefore, it cannot be said that Section 50 converts a long-term capital asset into a short-term capital asset."

7. We also notice that while doing so it has concurred with the decision of the Gauhati High Court in the case of *CIT v. Assam Petroleum Industries (P.) Ltd.* [2003] 262 ITR 587. We are in agreement with both the decisions of the Gauhati High Court as well as the Bombay High Court in holding that capital gain arising of long term capital asset, if invested in specified asset, the assessee is not to be charged capital gains and exemption provided under Section 54EC of the Act cannot be denied to the assessee only on account of the fact that deeming fiction is created under Section 50 of the Act. In other words, legal fiction created under Section 50 of the Act is though restricted to computation of capital gains, such deeming fiction cannot restrict application of Section 54EC which allows exemption of capital gains, if assessee makes investment in the specified assets. Thus, the assessee cannot be charged to capital gains when short term gains of long terms capital assets get invested in the areas specified under the law.

8. Neither the Tribunal nor the CIT(A) committed any error applying these judgments to the facts of the instant case. The questions of law since is accordingly answered, this Tax Appeal is disposed of.

RITESH

*In favour of assessee.

†Arising out of order of ITAT, dated 11-1-2013.