

**IN THE HIGH COURT OF GUJARAT AT AHMEDABAD****TAX APPEAL NO. 747 of 2013**

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COMMISSIONER OF INCOME TAX V....Appellant(s)

Versus

POLESTAR INDUSTRIES....Opponent(s)

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Appearance:

MR MR BHATT, LD.SENIOR COUNSEL WITH MRS MAUNA M BHATT,  
ADVOCATE for the Appellant(s) No. 1

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CORAM: **HONOURABLE MR.JUSTICE M.R. SHAH**  
and  
**HONOURABLE MS JUSTICE SONIA**  
**GOKANI**

Date : 07/10/2013

ORAL ORDER

(PER : HONOURABLE MS JUSTICE SONIA GOKANI)

1. The Revenue has preferred the present Tax Appeal under section 260A of the Income-tax Act, 1961 (hereinafter referred to as 'the Act'), raising the following proposed substantial questions of law, aggrieved by the order dated January 31, 2013 of the Income-tax Appellate Tribunal, Ahmedabad (hereinafter referred to as 'the Tribunal') :

*“(A) Whether Appellate Tribunal is correct in holding that the deduction available u/s 54EC of the Act shall be available in the case of capital gains arising out of transfer of depreciable asset ?*

*(B) Whether the interpretation of sections 50(1) and 50(2) by the Appellate Tribunal that it creates a deeming fiction only for mode of computation of capital gains u/s 48 and 49 of the Act and not for other provisions, is correct ?”*

2. The brief facts are as follows :

2.1 The respondent-assessee sold a property bearing Plot No.252 with superstructure, plant and machinery for the total sale consideration of Rs.24,99,000/-. Yet another Plot bearing No.254 was also sold along with the same for sale consideration of Rs.4,93,104/-. The respondent-assessee purchased REC bond of Rs.41,70,000/- to claim deduction under section 54EC of the Act. The long term capital gain in respect of property bearing Plot No.252 was computed by the Assessing Officer after allowing the cost of inflation index at Rs.2,35,266/-. In respect of the other property being Plot No.254, no deduction under section 54EC was allowed. However, the capital gain was computed at Rs.41,53,722/-. The short term capital gain was assessed at the ends of the respondent-assessee.

2.2 The Commissioner of Income-tax (Appeals) [hereinafter referred to as ‘the CIT (A)’] relying on the decision of the Bombay High Court and Gauhati High Court allowed the deduction under section 54EC of the Act on the sale of depreciable assets, which according

to it was held by the respondent-assessee for more than 36 months.

2.3 When challenged before the Tribunal, it confirmed such findings of the CIT (A) by its impugned order and, therefore, it is challenged by way of present Tax Appeal.

3. The learned Senior Advocate Mr.M.R. Bhatt appearing with the learned advocate Mrs.Mauna Bhatt for the appellant-Revenue has forcefully submitted that the Tribunal's order is erroneous inasmuch as the view taken by the Bombay High Court and Gauhati High Court and thereafter, followed by this Court, is not a correct approach. He further urged that no double benefits can be made available to the respondent-assessee, who has already enjoyed a long term capital gain. He further urged that for computation of capital gain arrived at on sale of depreciable assets a method is introduced to disentitle indexing to such owners. And, as section 54EC of the Act is applicable in transfer of long term capital assets, the respondent-assessee is not entitled to claim exemption under section 54EC of the Act. He has also relied on the decision of the Supreme Court in the case of **Common Wealth Trust Ltd. v. Commissioner of Income-tax, reported in 228 ITR 1**, wherein the Supreme Court has held thus :

*“Section 55(2), however, makes it clear that the option is available only for the purposes of Section 48 and 49 and it is not available for a case falling under*

*Section 50. Though the provisions of Section 55(2) would be available to every kind of capital asset whether the same has enjoyed the depreciation allowance or not whether in the hands of the assessee or the previous owner, the assessee in whose case depreciation allowance has been availed of before the transfer of the capital asset the meaning of "cost of acquisition" as stated in Section 48 and 49 would appear to have been modified in the manner stated in Section 50. Thus, where the assessee has not availed of depreciation allowance in respect of the capital asset Section 50 has no application. In this view of the matter there does not appear to be any conflict between the provisions of Section 50 and 55(2). Section 55(2) would be applicable to all assets depreciable or non-depreciable for the purposes of arriving at the cost of acquisition under Section 48 and 49 but Section 50 carves out a category of those capital assets which have been subjected to grant of depreciation allowance and this section 50 therefore provides a special method for determining the cost of acquisition in such cases. Provision of Section 55(2) is not subject to the provision of Section 50. These are the provisions of Section 50(2) which only are subject to the provisions of Sections 55(2), 48 and 49. Now to sections 48 and 49 the provision of Section 55(2) would apply as modified by those of Section 50."*

4. The Madras High Court in the case of **M. Raghavan v. Assistant Commissioner of Income-tax, reported in (2004) 266 ITR 145 (Madras)**, has held in favour of the Revenue by saying that the said provision was never meant to avail multiple benefits to the respondent-assessee, who sells depreciable assets, by holding thus :

*".. .. The object of introducing section 50 in the Income-tax Act, 1961, in order to provide different methods of computation of capital gain for depreciable assets, is to disentitle the owners of such depreciable assets from claiming the benefit of indexing, as, if indexing were to be applied, there would be no capital gain available in most cases, for being brought to taxation. The result of allowing indexing is to regard the cost of acquisition as being very much higher than what it actually is, to the assessee. If such boosted cost of acquisition is required to be deducted from the amount realised on sale, in most cases, it will result in the assessee being enabled to claim a capital loss. It could not have been the legislative intent to confer such multiple benefits to assessees selling depreciable assets. .. ..*

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*.. .. The fact that the assessee had the benefit of depreciating his asset in full in the year of acquisition itself, did not render the benefit received by the assessee something other than depreciation. The asset that the assessee acquired was a depreciable*

*asset. The written down value of the asset was the cost of acquisition less the quantum of depreciation actually allowed. Hundred per cent of the cost having been allowed as depreciation, the written down the amount received by the assessee from that sale was to be treated as capital gain arising from the transfer of short-term capital asset. Since the assets were depreciable assets the assessee as not entitled to indexing the cost of acquisition by invoking sections 48 and 49.”*

5. As we can notice from the order of the Tribunal, it followed the decision of Bombay High Court and Gauhati High Court by holding that section 54E does not make any distinction between the depreciable assets and non-depreciable assets and, therefore, investment under section 54E is a permissible investment. It would be profitable to reproduce relevant paragraph 4 of the decision of the Tribunal as under :

*“4. With this factual as also legal background, we have heard both the sides. We are of the considered view that the issue as raised by the Revenue Department in the grounds of appeal that whether the capital gain as computed u/s 50 of IT Act qualifies for the exemption if investment is made out of the sale proceeds towards prescribed bonds u/s 54EC of I.T. Act. Now, this question is very well settled by the Hon’ble Court and following the said decision we hereby confirm that there was no fallacy*

*in the finding of CIT (A), the same is hereby confirmed and the grounds are dismissed.”*

6. We notice that this Court in ***Tax Appeal No.730 of 2013, in the case of Commissioner of Income-tax v. Aditya Medisales Limited***, dealt with an identical issue and also discussed both the decisions of Bombay High Court and that of Gauhati High Court. It would be profitable to reproduce the relevant paragraphs of the said decision as under :

*“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 alongwith 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 longterm 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 longterm 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 terms 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 longterm 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 longterm 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 longterm specified asset*

*by an assessee during any financial year does not exceed fifty lakh rupees]*

*(2) Where the longterm 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 longterm 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 longterm capital asset of the previous year in which the longterm 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 longterm 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 longterm specified asset has been taken into account for the purposes of clause (a) or clause (b) of subsection (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 longterm 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) "longterm 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) "longterm 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 Incometax Act grants exemption from payment of capital gains tax, where the whole or part of the net consideration received from the transfer of a longterm 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 fulfills 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 subsections (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 Vs. D. Hanumantha Rao reported in [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 nondepreciable 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 longterm 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 Incometax 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 longterm 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 shortterm 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 Incometax 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 longterm capital asset has been converted into a shortterm capital asset is also without any merit. As stated hereinabove, the legal fiction created by the statute is to deem the capital gain as shortterm capital gain and not to deem the asset as shortterm capital asset. Therefore, it cannot be said that Section 50 converts a longterm capital asset into a shortterm 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 Vs. Assam Petroleum Industries (P.) Ltd.* reported in [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."*

7. The questions raised in the present Tax Appeal are also answered along the same line.
8. For the foregoing reasons, the present Tax Appeal fails and is, accordingly, dismissed.

**(M.R.SHAH, J.)**

**(MS SONIA GOKANI, J.)**

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