SET OFF AND CARRY FORWARD OF LOSSES

Set off and carry forward of losses

S.no.	**Section**	**Type of losses**	**Set of against income**	**Set off against income**	**Can be carry forward for**
			In same assessment year	**In subsequent assessment years**	
1	**2**	**3**	**4**	**5**	**6**
1.	72	Business or Profession (Non-Speculation other than Depreciation)	Business Income Head; or any other head except salaries [Sec. 71(2A)]	Business Income Head (Note 1)	8 years
2.	32	Depreciation	As above	Business Income Head or any other head (Note 2)	Indefinitely
3.	73	Business (Speculation)	Speculation Profit	Speculation Profit	4 years with effect from Assessment Year 2006-07 (8 years up to assessment year 2005-06)
4.	70/74	Short term capital loss	Capital gains	Capital gains	8 years
	70/74	Short term capital loss	Long term capital gain	Long term capital gain	8 years
5.	74A	Running and Maintaining Race Horses	Such income only	Such income only	4 years
6.	71	Other sources	Other sources or any other head	No carry forward	N. A.
7.	71B	House Property: a. Let out property b. Self-occupied Property (On account of interest on borrowed capital)	Income from House property head or any other headAs above	Income from House property As above	8 years 8 years

8.	72A/ 72AA/ 72AB	In case of amalgamation/demerger			
9.	73A	Losses by specified Businesses (Note 5)	-	Business income of specified business	Indefinitely

Notes:

1. Unabsorbed business losses can be carried forward and set off against profits from any business from A.Y. 2000-01. There is no need to continue the same business in which the loss was incurred.
2. Depreciation can be carried forward and set off against the profits from any business in the succeeding assessment year up to A.Y. 2001-02. The business in which the loss was incurred need not be continued in that year.
3. The effect of depreciation, business loss and investment allowance should be given in the following order:

- Current year's Depreciation; • Unabsorbed Business loss; • Unabsorbed Depreciation; • Unabsorbed Investment Allowance.

4. A return of loss is required to be furnished for determining the carry forward of such losses, by the due date prescribed for different assessees u/s. 139(1) of the Act. (S. 80). This condition is however not required to be fulfilled for claiming losses under house property and unabsorbed depreciation.
5. Section 35AD has been inserted w.e.f. 1-4-2010. Specified business has been defined u/s. 35AD. In order to remove any ambiguity, section 35AD has been amended by Finance Act, 2011 to remove the word "new" in case of hotels and hospitals. With this, the loss incurred in any specified business shall be eligible to be set off against profit of any other specified business whether or not the latter is eligible for deduction u/s. 35AD.
6. In case of conversion of company into LLP, the accumulated loss and unabsorbed depreciation of the company shall be allowed to be set off and carried forward by the new LLP.
7. Othersections:
   Section 73 amended by Finance (No. 2) Bill, 2014 w.e.f 1-4-2015 whereby for the words "the principal business of which is the business of banking", the words "the principal business of which is the business of trading in shares or banking" has been substituted.
   Section 78 : Sub-sec. (1) : In case of change in the constitution of the firm, the amount of proportionate loss of the retired or deceased partner which exceeds his share of profits shall not be allowed to be carried forward in the hands of the firm.
   Sub-section (2) : Where any person carrying on business or profession is succeeded by another person otherwise than by inheritance, the benefit carry forward of loss would not be available to the successor.

Section 79: In case of a company (not being a company in which public are substantially interested), where there is a change in the shareholding of the company, the loss shall be allowed to be carried forward only if beneficial owners of the shares entitled to 51% voting power are the same on the last day of the year in which loss is incurred and the relevant previous year.

A) Set off of loss under the same head of income.(section 70) (Intra-head set off)

The process of adjustment of loss from a source under a particular head of income against income from other source under the same head of income is called intra-head adjustment, e.g. Adjustment of loss from business A against profit from business B.

Income of a person is computed under five heads. 'Sources' of income derived by an individual may be many but yet they could be classified under the same head. For instance, an individual may have a dual employment, yet the income would be classified under the head 'Salaries'. However, given the mechanism of computing taxable salary income, it would be safe to say that an individual cannot incur losses under this head of income.

Consider a situation where Harsh has two properties – one, occupied by him and the other, let out. Harsh pays interest on loan of Rs 1.50 lakh on the property occupied and derives net rental income of Rs 1.50 lakh from the let-out property. In case of a self-occupied property, income is computed as nil and interest expenditure results in loss. The loss of Rs 1.50 lakh can be set off against rent income of Rs 1.50 lakh; the income chargeable under the head 'House property' will be 'Nil'.

With effect from the assessment year 2018-19, loss under the head "house property" shall be allowed to be set -off against any other head of income only to the extent of Rs. 2,00,000 for any assessment year.

An exception to intra head set off is loss under the head '**Capital gains**', which may arise from transfer of any capital asset. Long-term capital loss arises from transfer of shares or units where holding period is more than 12 months and in respect of other assets holding period is more than 36 months prior to sale. Transfer of assets held for less than prescribed period results in short-term capital loss. Long-term capital loss cannot be set off against short-term capital gains.

Further, loss incurred from speculation loss (eg. from shares or commodities) cannot be set off against any other income.

Also, it is unlikely that the benefit of set off of loss under an activity or source will be available, where the income from an activity or source is exempt from taxation.

Summary of exceptions to Intra-head set off:

1. Loss from speculation business cannot be set of against profit from an non speculation business

(Interpretation: Loss from non speculative business can be set-off against speculation income)

2. LTCL can only be set off against LTCG and cannot be set off against STCG

(Interpretation: STCL can be set off against LTCG)

3. No loss can be set-off against casual income i.e. Income from l**otteries, crossword puzzles, race including horse race, card game**, and any other game of any sort or from gambling or betting of any form or nature.

4. No expenses can be claimed against casual income

5. Loss from the business of owning and maintaining race horses cannot be set off against any income other than income from the business of owning and maintaining race horses.

6. Loss from an exempted source cannot be set off against taxable Income- If income from a particular source is exempt from tax, then loss from such source cannot be set off against any other income which is chargeable to tax. E.g., Agricultural income is exempt from tax, hence, if the taxpayer incurs loss from agricultural activity, then such loss cannot be adjusted against any other taxable income.

7. Loss from business specified under section 35AD cannot be set off against any other income except income from specified business (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc.).

8. With effect from the assessment year 2018-19, loss under the head "house property" shall be allowed to be set -off against any other head of income only to the extent of Rs. 2,00,000 for any assessment year. However, unabsorbed loss shall be allowed to be carried forward for set-off in subsequent years as per the existing provisions of section 71B.

B) Set off Loss from one head against Income from another Head (Inter head set off)

After making intra-head adjustment (if any) the next step is to make inter-head adjustment. If in any year, the taxpayer has incurred loss under one head of income and is having income under other head of income, then he can adjust the loss from one head against income from other head, E.g., Loss under the head of house property to be adjusted against salary income.

A person may have various sources of income computed under different heads of income. Loss under one head of income is generally allowed to be set off against income under another head.

For instance, X has only one property, which is occupied by him and the loss is Rs 1.50 lakh. He derives salary of Rs 10 lakh during the year. Here, he can set off the loss of Rs 1.50 lakh against his salary income by making appropriate declarations to his employer, thereby making his net taxable income Rs 8.50 lakh.

Certain exceptions to the provisions are that the loss from business or profession cannot be set off against salary income. Capital loss, whether long term or short term, can be set off only against capital gains income.

With effect from the assessment year 2018-19, loss under the head "house property" shall be allowed to be set -off against any other head of income only to the extent of Rs. 2,00,000 for any assessment year. However, unabsorbed loss shall be allowed to be carried forward for set-off in subsequent years as per the existing provisions of section 71B.

Where during a given year, there is no sufficient income to absorb the loss, unabsorbed loss can be carried forward and set off against income, in the future years as explained here.

Summary of exceptions to Inter-head set off:

1. Before making inter-head adjustment, the taxpayer has to first make intra-head

2. Loss from speculative business cannot be set off against any other income. However, non-speculative business loss can be set off against income from speculative business. For Example: House property loss can be set-off against Speculative Incomes but speculation loss cannot be set off against House property)

3. Business loss cannot be set-off against salary income. (It can be set-off against other incomes)

4. Loss under the head Capital Gains (LTCL or STCL) cannot be set-off against any other head.

(Interpretation: Loss from other heads can be set-off against Capital Gains)

For Example: HP loss can be set-off against CG but LTCL or STCL cannot be set off against HP

5. No loss can be set off against Casual income from winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.

6. No expenses can be claimed against casual income

7. Loss from the business of owning and maintaining race horses cannot be set off against any other income.

8. Loss from an exempted source cannot be set off (e.g. Share of loss of firm, agricultural income, cultivation expenses)

9. Loss from business specified under section 35AD cannot be set off against any other income (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building housing projects, etc.)

10. With effect from the assessment year 2018-19, loss under the head "house property" shall be allowed to be set -off against any other head of income only to the extent of Rs. 2,00,000 for any assessment year. However, unabsorbed loss shall be allowed to be carried forward for set-off in subsequent years as per the existing provisions of section 71B.

C) Carry forward and set off of losses

Carry forward of unadjusted loss for adjustment in next year

Many times it may happen that after making intra-head and inter-head adjustments, still the loss remains unadjusted. Such unadjusted loss can be carried forward to next year for adjustment against subsequent year(s)' income Separate provisions have been framed under the Income-tax Law for carry forward of loss under different heads of income.

Unabsorbed loss under house property, capital loss and business loss can be carried forward for 8 years. Unabsorbed speculation business loss can be carried forward only for a period of 4 years.

Loss can be carried forward and set off even if the business in respect of which it was incurred has been discontinued. However, such loss cannot be set off against income under any other head. An exception exists in respect of unabsorbed depreciation from business which can be set off against any other source of income in the absence of business income and can be carried forward indefinitely, even if the business through which depreciation was incurred has ceased to exist.

Carry forward of losses (other than loss from house property and unabsorbed depreciation) is permissible if the return of income for the year, in which loss is incurred, is filed in time. The late filing of return should not impact the status of carry forward of loss of previous years.

When clubbing provisions apply, loss is required to be clubbed in the same manner as income. Such clubbed loss can be set off and carried forward, as if it is loss determined in the taxpayer's own case. The successor of business can carry forward and set off the loss of his predecessor, if such succession is by way of inheritance.

In light of the above, taxpayers are advised to be mindful of the relevant provisions and seek guidance, where required, to effectively utilise their losses and achieve optimum tax results.

Conditions in brief related to carry forward and set-off of losses :-

1. Past year losses can be set-off against income from that respective head of income (Inter head adjustment is not possible)

(e. g. Unadjusted loss of HP for the year 2004-05 c/f Rs. 20,000. This loss can be set-off only against HP income of the year 2007-08 and not under any other head)

2. The above rule (1) is not applicable to unabsorbed depreciation, which can be set-off against any other head

3. All losses (Except loss due to owning and maintaining of race horses) can be carried forward and set-off for 8 subsequent financial years following the Previous Year in which such loss arose.

4. Unadjusted loss due to owning and maintaining of race horses can be carried forward and set-off for 4 subsequent financial years following the Previous Year in which such loss arose.

5. Unabsorbed depreciation can be carried forward for an unlimited period.

D) Order of Set-off of losses

In case where profits are insufficient to absorb brought forward losses, current depreciation and current business losses, the same should be deducted in the following order

- Current scientific research expenditure [Sec. 35(1)].
- Current depreciation [Sec. 32(1)].
- Brought forward business losses [Sec. 72(1)].
- Unabsorbed family planning promotion expenditure [Sec. 36(1)(*ix*)].
- Unabsorbed depreciation [Sec. 32(2)].
- Unabsorbed scientific research capital expenditure [Sec. 35(4)].
- Unabsorbed development allowance [Sec. 33A(2)(*ii*)].
- Unabsorbed investment allowance [Sec. 32A(3)(*ii*)].