CHAPTER 7

SET OFF OR CARRY FORWARD AND SET OFF OF LOSSES



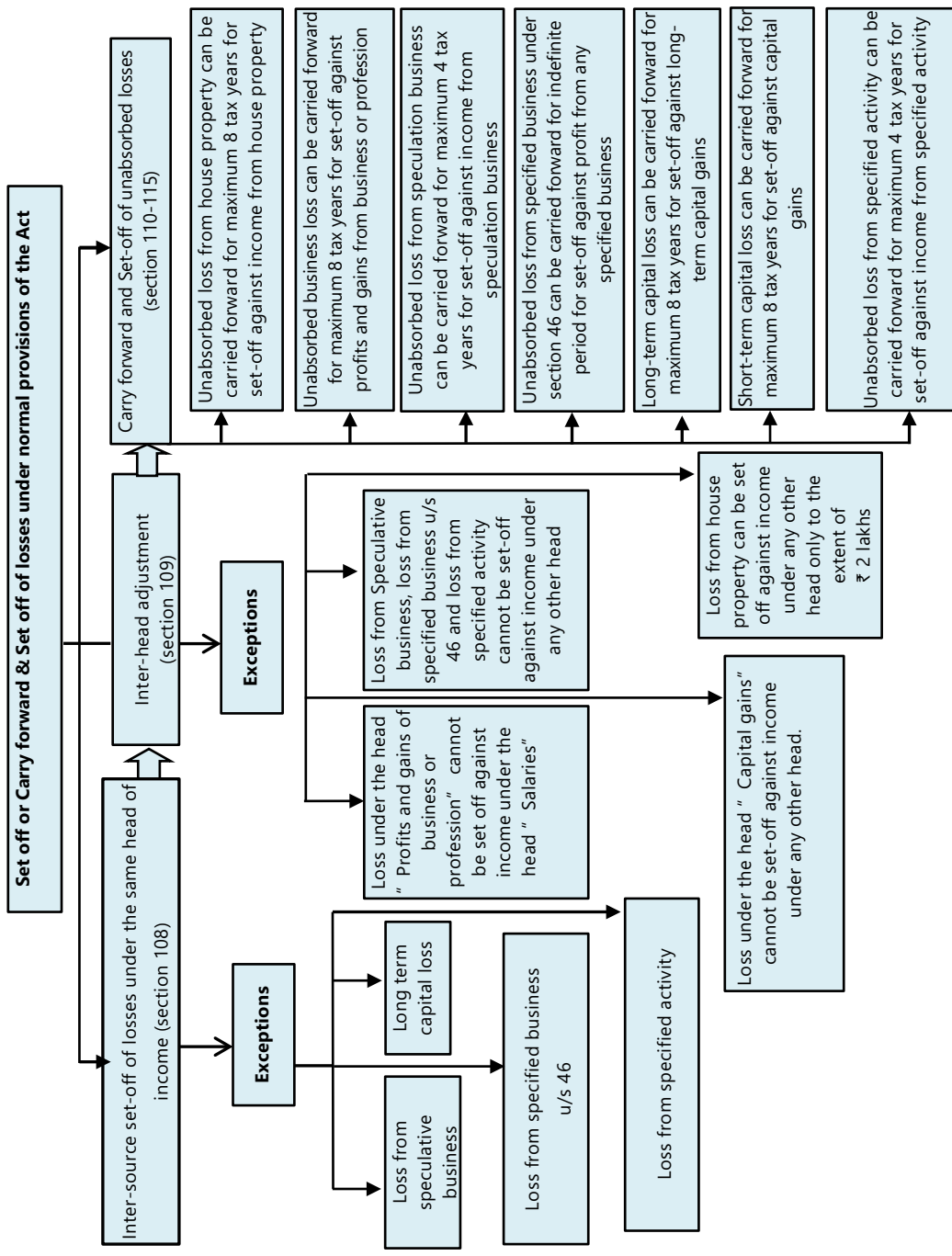
LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **identify** the permissible inter-source and inter-head adjustments for set-off of losses and the restrictions in inter-source and inter-head set-off of losses;
- **determine** the unabsorbed losses which can be carried forward to the subsequent tax year for set-off against income of that year and the maximum period of carry forward of such losses;
- **appreciate** the provisions regarding carry forward and set-off of losses in case of closely held companies and eligible start-ups as also in case of change in constitution of firms;
- **appreciate** the conditions which are required to be satisfied by the amalgamating company and the amalgamated company for carry forward and set-off of loss of the amalgamating company by the amalgamated company;
- **appreciate** the special provisions for carry forward and set-off of losses of a banking company against the profits of a banking institution under a scheme of amalgamation;
- **compute** the gross total income of an assessee after applying the provisions relating to set-off and carry forward and set-off of losses.

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CHAPTER OVERVIEW



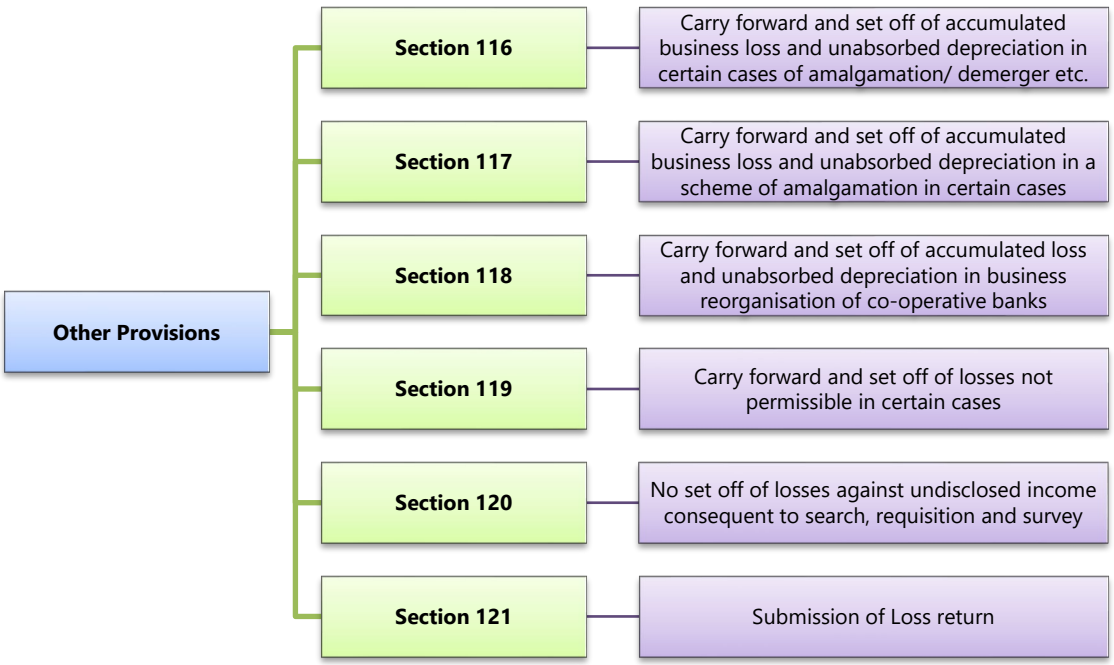
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Notes *- Following brought forward losses/ depreciation is not allowed to be set off while computing total income under the special concessional tax regimes under section 200/201/202/203/204 -*

1. *Brought forward business loss of specified business u/s 46*
2. *Brought forward business loss on account of deduction u/s 45(3)(a)/45(3)(b)/45(3)(c) [or u/s 45(2), in case of computation of total income under sections 200/201, applicable to companies].*
3. *Unabsorbed depreciation attributable to additional depreciation u/s 33(8).*

This is because deductions u/s 46, u/s 45(3)(a)/45(3)(b)/45(3)(c), u/s 45(2) and additional depreciation u/s 33(8) are not allowable under the special concessional tax regimes.

In addition, in case of persons covered under section 202(1), loss from house property cannot be set off against income under other head and the same cannot be carried forward. Also, brought forward loss from self-occupied house property is not allowed to be set-off while computing total income for tax year 2026-27 under the default tax regime thereunder.



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7.1 CONCEPT OF SET OFF AND CARRY FORWARD OF LOSSES

Specific provisions have been made in Chapter VII of the Income-tax Act, 2025 for set-off and carry forward of losses.

- "Set-off" means adjustment of losses against the eligible income from another source/head of income in the same tax year.
- If losses cannot be set-off in the same year due to inadequacy of eligible income, then such losses are carried forward to the next tax year for adjustment against the eligible income of that year.
- The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

7.2 INTER SOURCE ADJUSTMENTS [SECTION 108]

Inter-source set-off of losses

Under this section, the losses incurred by the assessee in respect of any source under any head of income (other than Capital gains) shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head.

In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.



Loss from one house property can be set off against the income from another house property.



Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set off against the profits from another business in the same tax year.

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Impermissible inter-source set-off

Inter-source set-off, however, is not permissible in the following cases –



Long-term capital loss [Section 108(2)]

- Short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain.
- However, long-term capital loss can be set-off only against long-term capital gain and not against short-term capital gain.

Loss from speculation business [Section 113(1)]

- A loss in speculation business can be set-off only against the profits and gains of another speculation business and not against any other business or professional income.
- However, losses from other business or profession can be adjusted against profits from speculation business.





Loss from specified activity (Activity of owning and maintaining race horses) [Section 115(1)]

- Loss from specified activity can be set-off only against income from specified activity (Activity of owning and maintaining race horses)

Losses from Specified business [Section 114(1)]

- In case an assessee opts out of the default tax regime, loss in any specified business u/s 46 can be set-off only against profits and gains of another specified business.
- However, losses from other business can be set-off against profits and gains from specified business.





No loss can be set off against casual income i.e., 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 [Section 94].

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7.3 INTER HEAD ADJUSTMENTS [SECTION 109]

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

Loss under any head other than "Capital gains"

Loss under any head other than capital gains can be set-off against income of the assessee under any other head, including "Capital Gains".

Loss under the head "Profits and gains of business or profession"

Loss under the head "Profits and gains of business or profession" cannot be set off against income under the head "Salaries".

It shall be allowed to set off from income under any other head except "Salaries".

Loss under the head "Capital Gains"

Loss under the head 'Capital Gains', whether short term or long term, cannot be set off against income under any other head.

Loss under the head "Income from house property"

- **If assessee opts out of the default tax regime** - Loss under the head "Income from house property" can be set off against income under any other head to the extent of ₹ 2,00,000. The rest shall be carried forward to next year for set off.
- **If assessee pays tax under concessional rates u/s 202(1)** – Loss under the head "Income from House Property" is not allowed to be set off against income under any other head.

Loss from speculation business and loss from specified activity

Loss from speculation business and loss from specified activity cannot be set off against income under any other head.

Losses from specified business u/s 46

- In case the assessee opts out of the default tax regime, loss from specified business under section 46 can be set off only against income from any other specified business. Such loss cannot be set off against income under any other head.

- However, losses from other business can be set off against profits from specified business.



If the income from a source is exempt from tax, loss from that exempt source cannot be set off against taxable income from a different source or taxable income under a different head.

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7.4 CARRY FORWARD AND SET OFF OF LOSS FROM HOUSE PROPERTY [SECTION 110]

Set-off and Carry Forward & Set-off of losses

If the assessee, being an individual, HUF, AoP (other than Co-operative Society), BoI or Artificial Juridical Person shifts out of the default tax regime	- In any tax year, if there is a loss under the head "Income from house property", such loss will first be set-off against income from any other head to the extent of ₹ 2,00,000 during the same tax year. - The unabsorbed loss will be carried forward to the following tax year to be set-off against income under the head "Income from house property".
If the assessee, being an individual, HUF, AoP (other than Co-operative Society), BoI or Artificial Juridical Person pays tax under default tax regime	- In any tax year, if there is a loss under the head "Income from house property", such loss is not allowed to be set-off against income under any other head. - The unabsorbed loss cannot be carried forward to the following tax year.
In case of other assessees (Companies/Firms/Co-operative Societies)	- In any tax year, if there is a loss under the head "Income from house property", such loss will first be set off against income from any other head to the extent of ₹ 2,00,000 during the same year. - The unabsorbed loss will be carried forward to the following tax year to be set off against income under the head "Income from house property". - This is irrespective of whether or not the company opted for section 200/201 and whether or not the co-operative society opted for section 203/204.

Maximum period for carry forward & set-off of losses

Any unabsorbed loss under the head "Income from house property" is allowed to be carried forward to the following tax year up to **8 tax years** immediately succeeding the tax year for which the loss was first computed.



Once a loss is carried forward, it can be set off only against the income from the same head in the succeeding tax years.

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ILLUSTRATION 1

Mr. Kamal (aged 35 years) submits the following particulars pertaining to the tax year 2026-27:

Particulars	*₹*
Income from salary (computed)	*4,20,000*
Loss from let-out property	*(-) 2,30,000*
Business loss	*(-)1,20,000*
Bank interest (FD) received	*85,000*

Compute the total income of Mr. Kamal for the tax year 2026-27, assuming that

(i) He has exercised the option of shifting out of the default tax regime.

(ii) He pays tax under the default tax regime.

SOLUTION

(i) Computation of total income of Mr. Kamal for the tax year 2026-27 under the normal provisions of the Act

Particulars	Amount (₹)	Amount (₹)
Income from salary	4,20,000	
Less: Loss from house property of ₹ 2,30,000 to be restricted to ₹ 2 lakhs by virtue of section 109(1)	(-) 2,00,000	2,20,000
Balance loss of ₹ 30,000 from house property to be carried forward to following tax year		
Income from other sources (interest on fixed deposit with bank)	85,000	
Less: Business loss of ₹ 1,20,000 set-off to the extent of ₹ 85,000	(-) 85,000	-
(Business loss of ₹ 35,000 to be carried forward for set-off against business income of the following tax year)		
Gross total income [See Note below]		**2,20,000**
Less: Deduction under Chapter VIII		Nil
Total income		**2,20,000**

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Notes –

(i) Gross Total Income includes salary income of ₹ 2,20,000 after adjusting loss of ₹ 2,00,000 from house property. The balance loss of ₹ 30,000 from house property to be carried forward to the following tax year for set-off against income from house property of that year.

(ii) Business loss of ₹ 1,20,000 is set off against bank interest of ₹ 85,000 and remaining business loss of ₹ 35,000 will be carried forward as it cannot be set off against salary income.

(ii) Computation of total income of Mr. Kamal for the tax year 2026-27 under default tax regime

Particulars	Amount (₹)	Amount (₹)
Income from salary		4,20,000
Income from other sources (interest on fixed deposit with bank)	85,000	
Less: Business loss of ₹ 1,20,000 set-off to the extent of ₹ 85,000	(-) 85,000	-
(Business loss of ₹ 35,000 to be carried forward for set-off against business income of the following tax year)		
Gross total income/ Total Income		**4,20,000**

Notes –

(i) Under the default tax regime, loss from house property cannot be set off against income under any other head and cannot be carried forward to the following tax year.

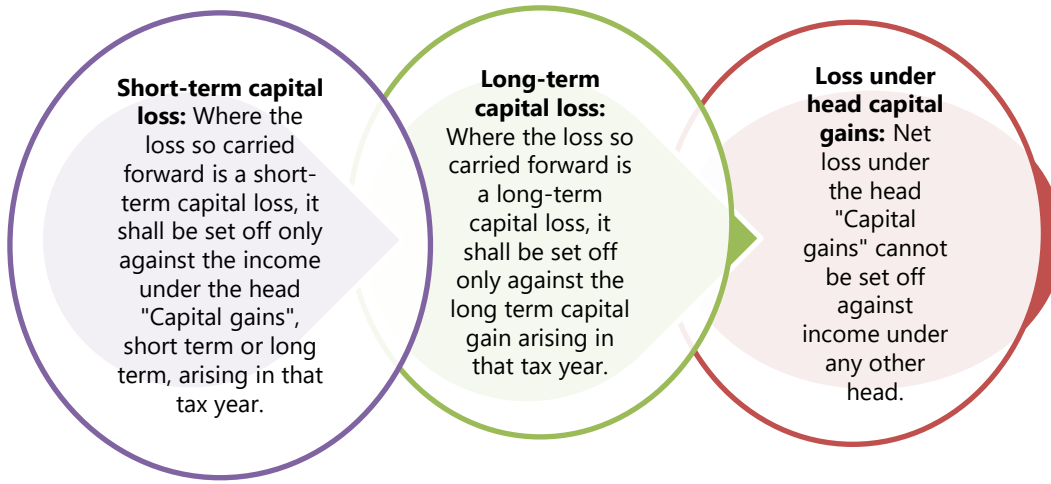
(ii) Business loss of ₹ 1,20,000 is set off against bank interest of ₹ 85,000 and remaining business loss of ₹ 35,000 will be carried forward as it cannot be set off against salary income.

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7.5 CARRY FORWARD & SET OFF OF LOSSES FROM CAPITAL GAINS [SECTION 111]

Carry Forward & Set-off of losses

Section 111 provides that where for any tax year, unabsorbed loss under the head 'Capital gains' is short term capital loss or long-term capital loss, the loss shall be carried forward to the following tax year for set off in the following manner:



Note - *Long-term capital gain exceeding ₹ 1,25,000 arising on sale of equity shares or units of equity-oriented fund or unit of business trust on which STT is paid*

- *in respect of equity shares, both at the time of acquisition and sale and*
- *in respect of units of equity-oriented fund or unit of business trust, at the time of sale*

is taxable under section 198 @12.5%. Long-term capital loss on sale of such shares/units can, therefore, be set-off and carried forward for set-off against long-term capital gains by virtue of section 108(2) and section 111.

Maximum period for carry forward & set-off of losses

Any unabsorbed loss shall be carried forward to the following tax year up to a maximum of **8 tax years** immediately succeeding the tax year for which the loss was first computed.

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ILLUSTRATION 2

During the tax year 2026-27, Mr. Chetan has the following income and brought forward losses:

Particulars	*₹*
Short term capital gains on sale of shares	*1,75,000*
Long-term capital loss of tax year 2025-26	*(96,000)*
Short term capital loss of tax year 2025-26	*(42,000)*
Long term capital gain u/s 197	*85,000*

What is the capital gain taxable in the hands of Mr. Chetan for the tax year 2026-27?

SOLUTION

Taxable capital gains of Mr. Chetan for the tax year 2026-27

Particulars	₹	₹
Short term capital gains on sale of shares	1,75,000	
Less: Brought forward short-term capital loss of tax year 2025-26	(42,000)	1,33,000
Long term capital gain	85,000	
Less: Brought forward long-term capital loss of tax year 2025-26 of ₹ 96,000 set-off to the extent of ₹ 85,000 **[See Note below]**	(85,000)	Nil
Taxable short-term capital gains		**1,33,000**

Note - *Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of tax year 2025-26 of ₹ 11,000 (i.e., ₹ 96,000 – ₹ 85,000) has to be carried forward to the next tax year to be set-off against long-term capital gains of that year.*

7.6 CARRY FORWARD AND SET OFF OF BUSINESS LOSSES [SECTION 112]

Under the Act, the assessee has the right to carry forward the loss from business and profession in cases where such loss cannot be fully set-off in the same year

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against income from any head (other than salary) as per section 109. The loss so carried forward can be set-off only against the business or professional income of subsequent years.

Section 112 covers the carry forward and set off of losses arising from a business or profession.

Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions: -

(1) The loss should be a loss under the head "Profits and gains of business or profession".

(2) The loss should not be a loss from speculation business.

(3) Loss from one business can be carried forward & set off against the income from any other business: The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred.

However, a loss carried forward cannot, under any circumstances, be set off against the income from any head other than "Profits and gains of business or profession".

(4) Person who incurred the loss alone is entitled to carry forward & set-off the loss: The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward and set off the same. Consequently, the successor of a business cannot carry forward and set off the losses of his predecessor except in the case of succession by inheritance.

(5) Maximum period for carry forward & set-off of losses: Any unabsorbed business loss can be carried forward to the following tax year for a maximum period of **8 tax years** immediately succeeding the tax year for which the loss was first computed.

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ILLUSTRATION 3

Mr. Vikas, a resident individual, furnishes the following particulars for the tax year 2026-27:

Particulars	*₹*
Income from salaries (computed)	*8,50,000*
Income from house property	*(24,000)*
Profits from non-speculative business	*(24,000)*
Profits from speculative business	*(6,000)*
Short-term capital losses	*25,000*
Long-term capital gains taxable u/s 197	*21,000*

What is the total income chargeable to tax for the tax year 2026-27, assuming that he pays tax under section 202(1)?

SOLUTION

Total income of Mr. Vikas for the tax year 2026-27

Particulars	Amount (₹)	Amount (₹)
Income from salaries		8,50,000
Income from house property		
Loss from house property can neither be set off nor can be carried forward, since Mr. Vikas is paying tax under the default tax regime u/s 202(1)	Nil	
Profits and gains of business and profession		
Business loss to be carried forward **[Note (i)]**	(24,000)	
Speculative loss to be carried forward **[Note (ii)]**	(6,000)	
Capital Gains		
Long term capital gain taxable u/s 197	21,000	
Short term capital loss of ₹ 25,000 set-off against long-term capital gains to the extent of ₹ 21,000	(21,000)	
	Nil	

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Balance short term capital loss of ₹ 4,000 to be carried forward **[Note (iii)]**		
Taxable income		**8,50,000**

Notes –

(i) Business loss cannot be set off against salary income. Therefore, loss of ₹ 24,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next tax year for set off against business profits, if any.

(ii) Loss of ₹ 6,000 from the speculative business can be set off only against the profits from the speculative business. Hence, such loss has to be carried forward.

(iii) Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set off against long term capital gains to the extent of ₹ 21,000. The balance short term capital loss of ₹ 4,000 cannot be set-off against any other income and has to be carried forward to the next tax year for set off against capital gains, if any.

7.7 LOSSES IN SPECULATION BUSINESS [SECTION 113]

Meaning of Speculation business

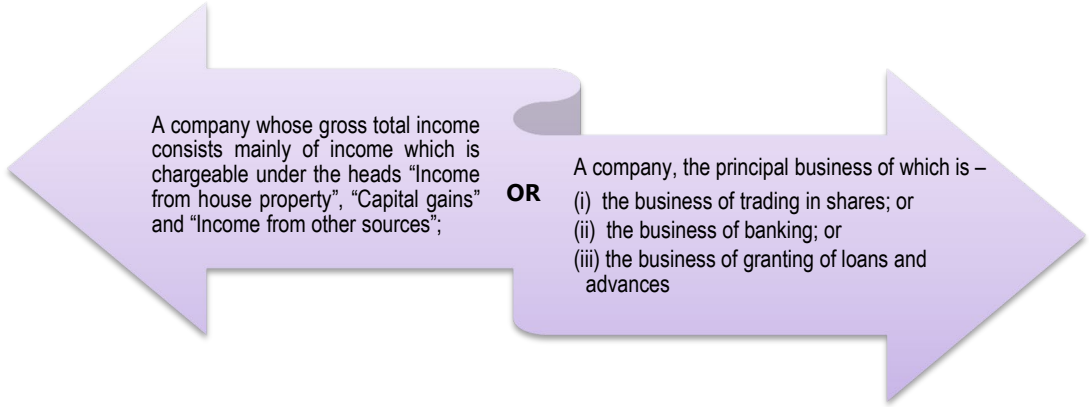
The meaning of the expression 'speculative transaction' as defined in section 66(31) and the treatment of income from speculation business has already been discussed under the head "Profits and gains of business or profession".

When a business of a company deemed to be carrying on a speculation business

Where any part of the business of a company consists of purchase and sale of shares of other companies, then such company shall be deemed to be carrying on speculation business, to the extent to which its business consists of purchase and sale of such shares.

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However, this deeming provision does **not** apply to the following companies –



Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business.

Set-off or carry forward & set-off of loss from speculation business

Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation business can neither be set off in the same tax year against any other non-speculation income nor be carried forward and set off against other income in the subsequent tax years.

Maximum period for carry forward & set-off of losses

Any unabsorbed loss in speculation business can be carried forward to the following tax year for a **maximum period of 4 tax years** immediately succeeding the tax year for which the loss was first computed.

Therefore, if the losses sustained by an assessee in a speculation business cannot be fully set-off in the same tax year against any other speculation profit, they can be carried forward to subsequent tax years and set-off only against profits from any speculation business carried on by the assessee.



Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

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7.8 CARRY FORWARD & SET OFF OF LOSSES FROM SPECIFIED BUSINESSES [SECTION 114]

Set-off and Carry forward & set-off of losses of specified business

Any loss computed from specified business referred to in section 46 can be set off only against profits and gains of any other specified business.

The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following tax year and so on.



The loss of an assessee claiming deduction under section 46 in respect of a specified business can be set-off against the profit and gains of another specified business under section 114, irrespective of whether the latter is eligible for deduction under section 46. An assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 46, against the profits and gains of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 46.

Loss can be set-off indefinitely

There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against profits and gains from specified business.



(i) Companies who have opted for section 200/201 and co-operative societies who have opted for section 203/204 are not eligible for deduction under section 46.

(ii) An assessee, being an Individual/HUF/AOP/BOI, paying tax under the default tax regime under section 202(1) would not be entitled to deduction under section 46. However, such person exercising the option of shifting out of the default tax regime and carrying on specified business, can claim deduction u/s 46 in respect of capital expenditure (other than land, goodwill and financial instruments) incurred in respect of such business, subject to fulfillment of specified conditions.

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7.9 LOSSES FROM THE SPECIFIED ACTIVITY [SECTION 115]

Set-off or carry forward & set-off of losses

According to the provisions of section 115, the losses incurred by an assessee from the specified activity shall be set-off only against income from specified activity.

Maximum period for carry forward & set-off of losses

If loss from the specified activity cannot be fully set off in the same tax year, the amount of loss not so set off shall be carried forward to the next tax year and set off only against income from that same activity.

Such loss can be carried forward to the following tax year for a **maximum of 4 tax years** immediately succeeding the year for which the loss was first computed.

Meaning of certain terms

Term	Meaning
Specified activity	The activity of owning and maintaining race horses.
Horse race	A horse race upon which wagering or betting may be lawfully made.
Income by way of stake money	The gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning a particular position in horse race.
Loss incurred by the assessee in specified activity	The amount by which the income by way of stake money, if any, falls short of the expenditure, not being capital expenditure, incurred wholly and exclusively for maintaining race horses. Loss = Stake money – revenue expenditure for the purpose of owning and maintaining race horses.

Note - *Loss from owning and maintaining race horses should not be confused with casual winnings from horse races (i.e. betting). No loss shall be allowed to be set off against income from such casual income such as 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.*

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ILLUSTRATION 4

Mr. Dinesh has the following income for the tax year 2026-27:

Particulars	*₹*
Income from the activity of owning and maintaining the race horses	*75,000*
Income from textile business	*95,000*
Brought forward textile business loss (relating to tax year 2025-26)	*50,000*
Brought forward loss from the activity of owning and maintaining the race horses (relating to tax year 2025-26)	*96,000*

What is the total income in the hands of Mr. Dinesh for the tax year 2026-27?

SOLUTION

Total income of Mr. Dinesh for the tax year 2026-27

Particulars	₹	₹
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss of ₹ 96,000 from the activity of owning and maintaining race horses set-off to the extent of ₹ 75,000	75,000	
	Nil	
Balance loss of ₹ 21,000 (₹ 96,000 – ₹ 75,000) from the activity of owning and maintaining race horses to be carried forward to tax year 2027-28		
Income from textile business	95,000	
Less: Brought forward business loss from textile business	50,000	45,000
Total income		**45,000**

Note - *Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.*

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7.10 CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN AMALGAMATION OR DEMERGER, ETC. [SECTION 116]

Amalgamation

Applicability

This section applies where there has been an amalgamation of –

(i) a company owning an industrial undertaking or a ship or a hotel with another company; or

(ii) a banking company with a specified bank; or

(iii) one or more public sector company or companies with one or more public sector company; or

(iv) an erstwhile public sector company (i.e., a company which was a public sector company in earlier tax years and ceases to be so due to strategic disinvestment by the Government) with one or more company or companies, if the share purchase agreement entered into under strategic disinvestment restricted immediate amalgamation of the said public sector company and the amalgamation is carried out within five year from the end of the tax year in which the restriction on amalgamation in the share purchase agreement ends.

Meaning of Strategic disinvestment

It means sale of shareholding by the Central Government or State Government or a public sector company, in a public sector company or in a company, which results in

- reduction of its shareholding to below 51% and
- transfer of control to the buyer.

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The condition of reduction of shareholding to below 51% would apply only where shareholding of the Central Government or the State Government or the public sector company exceeded 51% before the sale of shareholding.

Further, the requirement of transfer of control to the buyer may be effected by the Central Government or the State Government or the public sector company or any two or all of them.

Allowability of carry forward and set off of accumulated loss and unabsorbed loss by amalgamated company in case of amalgamation

It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation, as the case may be, of the amalgamated company for the tax year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward of loss and unabsorbed depreciation shall also apply accordingly.

However, in case of an amalgamation of erstwhile public sector company, with one or more company or companies, the accumulated loss and the unabsorbed depreciation of the amalgamating company, which is deemed to be the loss or unabsorbed depreciation, as the case may be, of the amalgamated company, shall not exceed the accumulated loss and unabsorbed depreciation of the public sector company as on the date on which the public sector company ceases to be a public sector company due to strategic disinvestment.

Conditions for availing benefit under this section

(i) <u>Conditions to be fulfilled by the amalgamating company</u>

(a) The amalgamating company should have been **engaged in the business**, in which the accumulated loss occurred or depreciation remains unabsorbed, **for 3 or more years**.

(b) The amalgamating company has held continuously as on the date of amalgamation, **at least 3/4th of the book value of the fixed assets held by it 2 years preceding** the date of amalgamation.

(ii) <u>Conditions to be fulfilled by the amalgamated company</u>

(a) The amalgamated company should **hold continuously for a minimum of 5 years** from the date of amalgamation **at least 3/4th of**

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the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation.

(b) The amalgamated company **continues the business** of the amalgamating company for a minimum of **5 years** from the date of amalgamation.

(c) The amalgamated company must also fulfill such other conditions* prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

Consequences of non-fulfillment of specified conditions

In case the above specified conditions are not complied with, the set off of loss or unabsorbed depreciation made in any tax year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax in the year in which there is a failure to fulfill the conditions.

Demerger

Allowability of carry forward and set off of accumulated loss and unabsorbed depreciation by resulting company in case of demerger

The accumulated loss and the unabsorbed depreciation of the demerged company shall

- If directly relatable to the undertaking transferred by the demerged company to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company.
- if not directly relatable to the undertaking transferred by the demerged company to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company.

** Refer Rule 60 of Income-tax Rules, 2026 for prescribed conditions.*

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Conditions for availing benefit under this section

The Central Government is empowered to notify such conditions to ensure that the demerger is for genuine business purposes.

Re-organisation of business

Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation by company in case of succession

If there has been re-organisation of business, where

- a firm is succeeded by a company as per the provisions of section 70(1)(zd), or
- a sole proprietary concern is succeeded by a company as per the provisions of section 70(1)(zf),

then the accumulated business loss and the unabsorbed depreciation of the firm/proprietary concern, as the case may be, shall be deemed to be the loss or unabsorbed depreciation of the successor company for the tax year in which the business re-organisation took place. Other provisions of the Act relating to set off and carry forward of loss and unabsorbed depreciation shall also apply accordingly.

Consequences of non-fulfillment of specified conditions

In case the conditions laid down in section 70(1)(zd) or 70(1)(zf) have not been complied with, the set off of loss or unabsorbed depreciation made in any tax year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which the conditions have been violated.

Conversion of a company into LLP

Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation by LLP in case of conversion

If there has been re-organisation of business whereby a private company or unlisted public company is succeeded by a LLP as per the provisions of section 70(1)(ze), then the accumulated business loss and the unabsorbed depreciation of

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the company shall be deemed to be the loss or unabsorbed depreciation of the successor LLP for the tax year in which the business re-organisation took place. Other provisions of the Act relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.

Consequences of non-fulfillment of specified conditions

In case the conditions laid down in section 70(1)(ze) have not been complied with, the set off of loss or unabsorbed depreciation made in any tax year in the hands of the successor LLP shall be deemed to be the income of the LLP chargeable to tax in the year in which the conditions have been violated.

Carry forward of accumulated loss in case of amalgamation or business re-organisation effected on or after 1.4.2025

In case of an amalgamation or business re-organisation as per point (3) and (4) above took place on or after 01.04.2025, any accumulated loss of the predecessor entity, being -

a) the amalgamating company; or

b) the firm or proprietary concern; or

c) the private company or unlisted public company,

which is deemed to be the loss of the successor entity, being-

i) the amalgamated company; or

ii) the successor company; or

iii) the successor LLP,

shall be carried forward for not more than eight tax years immediately succeeding the tax year for which such loss was first computed for original predecessor entity.

Meanings of certain terms

Term	Particulars
Accumulated loss	It means so much of the loss of - the predecessor firm or - the proprietary concern or

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	- the private company or unlisted public company or - the amalgamating company or - the demerged company under the head "Profit and gains of business or profession" **(excluding loss in a speculation business)** which would have been eligible for carry forward and set off to such predecessor entity under section 112, had the reorganisation of business or conversion or amalgamation or demerger not occurred.
Industrial undertaking	It means any undertaking which is engaged in - (i) the manufacture or processing of goods; (ii) the manufacture of computer software; (iii) the business of generation or distribution of electricity or any other form of power; (iv) the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; (v) mining; (vi) the construction of ships, aircraft or rail systems.
Original predecessor entity	It means predecessor entity in respect of first amalgamation or first business reorganization.
Unabsorbed depreciation	Unabsorbed depreciation means so much of the allowance for depreciation of - the predecessor firm or - the proprietary concern or - the private company or unlisted public company or - the amalgamating company or - the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor entity under this Act, had the re-organisation of business or conversion or amalgamation or demerger not occurred.

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CIT v. KBD Sugars and Distilleries Ltd. [2023] 454 ITR 800 (SC)

Issue: Can a resulting entity set off and carry forward the losses of the dysfunctional unit of demerged entity?

Relevant provision of Law: Section 2(35)(f) lays down a condition that demerger in relation to companies means the transfer, pursuant to a scheme of arrangement under section 230 to 232 of the Companies Act, 2013 by a demerged company of its one or more undertakings to any resulting company in such a manner that the transfer of the undertaking is on a going concern basis.

Assessing Officer's Contentions: The Assessing Officer contented that the assessee was ineligible to the benefit of brought forward loss under section 116(6) for the reason that the demerged company was dysfunctional since 1999 and, therefore, does not qualify to be a 'going concern'. Since the undertaking not being a 'going concern', the condition laid down in section 2(35)(f) for demerger stands violated.

Analysis and Decision: The Tribunal opined that the words used 'on a going concern basis' in section 2(35)(f) only means that the transfer should be based on a 'going concern', and it does not mean that the undertaking being transferred should be a 'going concern' as on the date of transfer.

The 'scheme of demerger', which stands approved by the High Courts and the jurisdictional Court, clearly establishes the fact that the transfer of the undertaking is indeed on a 'going concern basis'. The assets, liabilities, employees, debts, obligations, rights, etc., of the undertaking, immediately prior to the demerger, stand entirely vested with the assessee upon 'demerger'. This amounts to 'transfer of the undertaking on a going concern basis'.

A simple reading of the same makes it very clear that the assessee is eligible for the benefits under section 116(6). The Act does not state that the undertaking being demerged ought to be a going concern at the time of demerger. It only states that the undertaking being demerged should stand transferred in a manner similar to the manner in which a 'going concern' is transferred.

Accordingly, the High Court held that if a unit were running and profitable, the same would not be available for demerger. It would be incongruous to construe section 2(35)(f) to mean a running unit. The scheme of demerger had been approved by the High Courts. Therefore, the assessee was entitled to set off the brought forward losses under section 116(6).

The Apex Court affirmed the decision of the High Court.

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7.11 CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN SCHEME OF AMALGAMATION IN CERTAIN CASES [SECTION 117]

Applicability

This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance where there has been an amalgamation of -

(i) one or more banking company with

- any other banking institution under a scheme sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949; or
- any other banking institution or a company following a strategic disinvestment, wherein the amalgamation occurs within 5 years from the end of the tax year during which such strategic disinvestment is carried out; or

(ii) one or more corresponding new bank or banks with any other corresponding new bank under a scheme brought into force by the Central Government[1], or

(iii) one or more Government company or companies with any other Government company under a scheme sanctioned and brought into force by the Central Government[2].

---

[1] *under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or both*

[2] *under section 16 of the General Insurance Business (Nationalisation) Act, 1972*

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Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation in case of amalgamation

The accumulated loss and unabsorbed depreciation of such banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies shall be deemed to be the loss or unabsorbed depreciation of such banking institution or company or amalgamated corresponding new bank or amalgamated Government company for the tax year in which the scheme of amalgamation was brought into force.

Other provisions of the Act relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.

Carry forward of accumulated loss in case of amalgamation effected on or after 1.4.2025

Where any scheme of amalgamation is brought into force on or after 01.04.2025, any accumulated loss of predecessor entity, being -

a) the banking company or companies; or

b) the amalgamating corresponding new bank or banks; or

c) the amalgamating Government company or companies,

which is deemed to be the loss of successor entity, being-

i) the banking institution or company; or

ii) the amalgamated corresponding new bank or banks; or

iii) the amalgamated Government company or companies,

shall be carried forward in the hands of the successor entity for not more than eight tax years immediately succeeding the tax year for which such loss was first computed for original predecessor entity.

Meaning of certain terms

Term	Meaning
Accumulated loss	It means so much of the loss of the amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating

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	Government company or companies under the head "Profits and gains of business or profession" (excluding losses of a speculation business) which such predecessor entity, would have been entitled to carry forward and set off under section 112 had the amalgamation not occurred.
Government company	It means a Government company as defined in section 2(45) of the Companies Act, 2013, engaged in the general insurance business and established under section 4 or 5 or 16 of the General Insurance Business (Nationalisation) Act, 1972.
Original predecessor entity	It means predecessor entity in respect of the first amalgamation.
Unabsorbed depreciation	It means the allowance for depreciation of the amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies which remains to be allowed and which would have been allowed to such predecessor entity, had the amalgamation not occurred.

7.12 CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION IN BUSINESS REORGANISATION OF CO-OPERATIVE BANKS [SECTION 118]

Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation by a co-operative bank in case of amalgamation

Under this section, in a case where the amalgamation has taken place during the tax year, the assessee (successor co-operative bank) shall be allowed to set off the accumulated loss and the unabsorbed depreciation, if any, of the predecessor co-operative bank as if the amalgamation had not taken place.

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Other provisions of the Act relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.

Conditions for availing benefit under this section

(i) Conditions to be fulfilled by the predecessor co-operative bank

(a) It should have been engaged in the business of banking for three or more years; and

(b) It has held at least 3/4th of the book value of fixed assets as on the date of the business reorganisation, continuously for 2 years before the date of business reorganisation;

(ii) Conditions to be fulfilled by the successor co-operative bank

(a) It should hold at least 3/4th of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum 5 years immediately succeeding the date of business reorganisation;

(b) It continues the business of the predecessor co-operative bank for a minimum 5 years from the date of business reorganisation; and

(c) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation by a co-operative bank in case of demerger

In case of a co-operative bank where demerger takes place during the tax year, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

(i) **In a case where the accumulated loss or unabsorbed depreciation of the demerged co-operative bank is directly relatable to the undertaking transferred to the resulting co-operative bank -** the whole of such accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be carried forward and set-off against the income of the resulting co-operative bank.

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(ii) **In a case where the accumulated loss or unabsorbed depreciation of the demerged co-operative bank is not directly relatable to the undertaking transferred to the resulting co-operative bank -** such accumulated loss or unabsorbed depreciation shall first be apportioned between the demerged co-operative bank and the resulting co-operative bank in the same proportion in which assets of the undertaking are distributed between them. The amount so apportioned shall be allowed to be carried forward and set off against their respective incomes.



If A Co-op Bank is the demerged co-operative bank and B Co-op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

$$\text{Unabsorbed business loss / depreciation of A Co-op bank} \times \frac{\text{Assets of the undertaking transferred to B Co-op bank}}{\text{Assets of A Co-op bank}}$$

Additional conditions for availing benefit under this section

The Central Government may specify other conditions by notification as it may consider necessary, to ensure that the business reorganisation is for genuine business purposes.

Period before and after business reorganization to constitute two different tax years

The period commencing from the beginning of the tax year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the tax year shall be deemed to be two different tax years for the purposes of set off and carry forward of loss and allowance for depreciation.



If the date on which business re-organisation took place is 1.11.2026, then the period between 1.4.2026 and 31.10.2026 and the period between 1.11.2026 and 31.3.2027 would be deemed to be two different tax years for the purposes of set off and carry forward of unabsorbed business losses and depreciation.

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Consequences of non-fulfillment of specified conditions

In a case where the conditions specified above and conditions specified by the Central Government, if any, are not complied with, the set-off of accumulated loss or unabsorbed depreciation made in any tax year in the hands of successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

Meaning of certain terms

Term	Particulars
Accumulated loss	It means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank as referred to in section 112 in the hands of predecessor co-operative bank, which such predecessor co-operative bank would have been entitled to carry forward and set-off under the said section, as if the business reorganisation had not taken place.
Unabsorbed depreciation	It means so much of the allowance for depreciation in the hands of amalgamating co-operative bank or demerged co-operative bank, which remains to be allowed and which would have been allowed to such bank, if the business reorganisation had not taken place.

7.13 CARRY FORWARD AND SET OFF OF LOSSES NOT PERMISSIBLE IN CERTAIN CASES [SECTION 119]

Carry forward and set-off of losses in case of change in constitution of firm

In case of change in constitution of a firm during a tax year, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed (i.e., so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the tax year) shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward without such restriction.

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Carry forward and set-off of losses in case of succession otherwise by inheritance

Where any person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.

Carry forward and set-off of losses in case of succession by inheritance

Where there is a succession by inheritance, the legal heirs are entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.



Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)

Issue: Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?

Analysis & Decision: The partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor for set-off against his income is not allowed.

Note - *In CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC), the sole proprietor had expired and after his death, the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned u/s 119(2), i.e., a case of succession by inheritance.*

Also, in Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC), upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

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In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.

Carry forward and set-off of losses in case of closely held company not being an eligible start-up referred to in section 140

In case of a change in shareholding during the tax year of a company in which the public are not substantially interested and not being an eligible start-up referred to in section 140, no loss incurred in any year prior to the tax year shall be carried forward and set-off against the income of the tax year, unless

- on the last day of the tax year, the shares of the company carrying not less than 51% of the voting power were beneficially held by persons
- who beneficially held shares of the company carrying not less than 51% of the voting power on the last day of the year or years in which the loss was incurred.

Carry forward and set-off of losses in case of closely held company being an eligible start-up referred to in section 140

In case of a change in shareholding during the tax year of a company in which the public are not substantially interested but being an eligible start-up as referred to in section 140, the loss incurred in any year prior to the tax year shall be allowed to be carried forward and set off against the income of the tax year if –

(a) all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred, continue to hold those shares on the last day of such tax year; and

(b) such loss has been incurred during the period of 10 years beginning from the year in which such company is incorporated.

Non-applicability of restriction on carry forward and set-off of losses in case of closely held company

The restrictions on carry forward and set-off of losses in case of closely held company shall, however, not apply:

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(i) where a change in the voting power and shareholding takes place in a tax year due to death of a shareholder or transfer of shares by way of gift to any relative of the shareholder;

(ii) where any change in shareholding of Indian company, being a subsidiary of a foreign company, takes place due to amalgamation or demerger of the foreign company and 51% of the shareholders of the amalgamating/ demerged company are shareholders of the amalgamated or resulting foreign company.

(iii) where a change in shareholding takes place in a tax year consequent to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, and a reasonable opportunity of being heard was afforded to the jurisdictional Principal Commissioner or Commissioner.

(iv) to a company, its subsidiary and subsidiary of such subsidiary, if

(a) the Board of Directors of such company were suspended by the Tribunal on an application moved by the Central Government under section 241 of the Companies Act, 2013 and new directors were appointed by the Central Government under section 242 of the said Act; and

(b) the change in shareholding of such company and its subsidiary, and subsidiary of such subsidiary has taken place consequent to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 and a reasonable opportunity of being heard was afforded to the jurisdictional Principal Commissioner or Commissioner; or

(v) to a company to the extent that a change in the shareholding has taken place during the tax year on account of relocation referred to in section 70(2) (Table: Sl. No. 5);

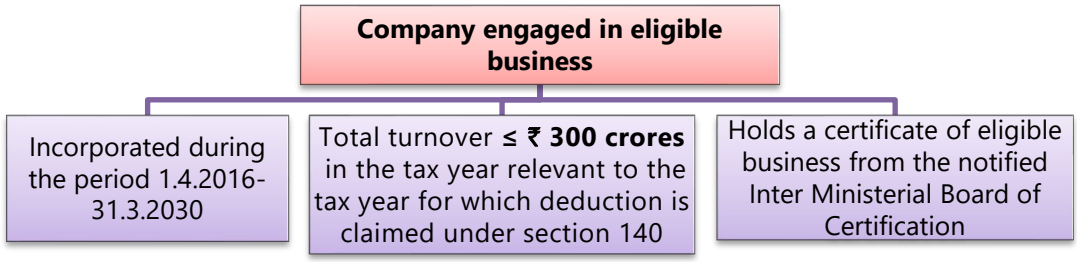
(vi) to an erstwhile public sector company where ultimate holding company of such company, immediately after the completion of strategic disinvestment, continues to hold, directly or through its subsidiary or subsidiaries, at least 51% of the voting power of such company in aggregate.

However, if the above condition is not complied with in any tax year after the completion of strategic disinvestment, the restriction on carry forward and set-off of losses in case of closely held company as mentioned above shall apply for such tax year and subsequent tax years.

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A company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company.

Meaning of eligible start-up



Meaning of eligible business

A business carried out by an eligible start-up engaged in –

- Innovation, development or improvement of products or processes or services or
- a scalable business model with a high potential of employment generation or wealth creation.

7.14 NO SET OFF OF LOSSES AGAINST UNDISCLOSED INCOME CONSEQUENT TO SEARCH, REQUISITION AND SURVEY [SECTION 120]

No set-off of losses or unabsorbed depreciation against undisclosed income

Any loss, whether brought forward or otherwise or unabsorbed depreciation, shall not be allowed to be set off against any undisclosed income which is included in the total income of any tax year, consequent to

- a search conducted under section 247 or
- a requisition under section 248 or
- a survey conducted under section 253, not being a survey under section 253(4).

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Meaning of undisclosed income

As per section 301 undisclosed income includes any money, bullion, jewellery, virtual digital asset or other valuable article or thing or any expenditure or any income based on any entry in the books of account or other documents or transactions, where such money, bullion, jewellery, virtual digital asset, valuable article, thing, entry in the books of account or other document or transaction represents wholly or partly income or property which has not been or would not have been disclosed for the purposes of this Act, or any expense, exemption, deduction or allowance claimed under this Act which is found to be incorrect, in respect of the block period.

7.15 ORDER OF SET OFF OF LOSSES

As per the provisions of section 112, brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

(1) Current year depreciation under section 33(1);

(2) Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed;

(3) Brought forward loss from business/profession [Section 112(1)];

(4) Unabsorbed depreciation [Section 33(11)];

(5) Unabsorbed capital expenditure on scientific research [Section 45(7)];

(6) Unabsorbed expenditure on family planning [Section 32(i)].



Is brought forward unabsorbed depreciation treated as brought forward business loss as per section 112?

No, as per section 33(11)(b), the unabsorbed depreciation brought forward from the previous tax year is added to the current year's depreciation and is deemed to form part of the depreciation allowance of the current year. Consequently, the entire depreciation (current year's depreciation plus the brought-forward unabsorbed depreciation) is allowable as deduction in the computation of income for the year. In accordance with section 109, such depreciation being treated as current year's depreciation may be set off against

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income assessable under any head of income, except income under the head "Salaries".

Since brought-forward unabsorbed depreciation is not treated as a business loss as per section 112, the provisions governing the carry forward and set-off of business losses do not apply to it.

ILLUSTRATION 5

Mr. Varun has furnished his details for the tax year 2026-27 as under:

Particulars	*₹*
Income from salaries (computed)	*1,70,000*
Income from speculation business	*60,000*
Loss from non-speculation business	*(40,000)*
Short term capital gain	*90,000*
Long term capital loss of tax year 2024-25	*(30,000)*
Winning from lotteries (gross)	*20,000*

What is the taxable income of Mr. Varun for the tax year 2026-27?

SOLUTION

Computation of taxable income of Mr. Varun for the tax year 2026-27

Particulars	₹	₹
Income from salaries		1,70,000
Income from speculation business	60,000	
Less: Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		90,000
Winnings from lotteries		20,000
Taxable income		**3,00,000**

Note - *Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next tax year.*

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ILLUSTRATION 6

Compute the gross total income of Mr. Fadnis for the tax year 2026-27 from the information given below –

Particulars	*₹*
Income from house property (computed)	*1,25,000*
Income from business (before providing for depreciation)	*1,35,000*
Short-term capital gains on sale of shares	*56,000*
Long-term capital loss from sale of property (brought forward from tax year 2023-24)	*(90,000)*
Income from tea business	*1,20,000*
Dividend from Indian companies carrying on agricultural operations (Gross)	*1,20,000*
Current year depreciation	*26,000*
Brought forward business loss (loss incurred six years ago)	*(45,000)*

SOLUTION

Gross Total Income of Mr. Fadnis for the tax year 2026-27

Particulars	₹	₹
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
Less: Current year depreciation	26,000	
	1,09,000	
Income from tea business (40% is business income)	48,000	
	1,57,000	
Less: Brought forward business loss	45,000	1,12,000
Income from the capital gains		
Short-term capital gains		56,000
Income from Other Sources		
Dividend from Indian companies is chargeable to tax in the hands of shareholders		1,20,000
Gross Total Income		**4,13,000**

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Notes -

(1) Dividend from Indian companies of ₹ 1,20,000 is taxable in the hands of shareholders at normal rate of tax.

(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax.

(3) Long-term capital loss can be set off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from tax year 2023-24 cannot be set-off in the tax year 2026-27. It has to be carried forward for set-off against long-term capital gains, if any, during the tax year 2027-28.

7.16 SUBMISSION OF RETURN OF LOSSES [SECTION 121]

As per section 121,

- loss under the head "Capital Gains" under section 111(1),
- business loss under section 112(1),
- speculation business loss under section 113(2),
- loss from specified business under section 114(2) and
- loss from specified activity i.e., activity of owning and maintaining race horses under section 115(2)

which has not been determined in pursuance of a return filed under section 263(1) cannot be carried forward and set off. Thus, the assessee must have filed a return of loss under section 263(1) in order to carry forward and set off of such losses. Such a return of loss should be filed within the time allowed under section 263(1).

In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the above specified losses sustained by him. Such a return should be filed within the time allowed under section 263(1).



This condition does not apply to a loss from house property carried forward under section 110 and unabsorbed depreciation carried forward under section 33(11).

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TEST YOUR KNOWLEDGE

Questions

1. *X carrying on a business as sole proprietor, died on 31st March, 2027. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2027, a determined business loss of ₹ 5 lakhs is to be carried forward under the Income-tax Act, 2025.*

   Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

2. *ABC Limited owning an industrial undertaking was amalgamated with XYZ Limited on 01.04.2026. All the conditions of section 2(6) were satisfied.*

   ABC Limited has the following losses as assessed in the Tax year 2025-26 which is carried forward to tax year 2026-27:

	Particulars	₹ (in lakhs)
(i)	Speculative Loss	4
(ii)	Unabsorbed Depreciation	18
(iii)	Unabsorbed expenditure of capital nature on scientific research	2
(iv)	Business Loss	120

   XYZ Limited has computed a profit of ₹ 140 lakhs for the tax year 2026-27 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on ₹ 150 lakhs, being the consideration at which plant and machinery were transferred to XYZ Limited. The written down value as per Income-tax record of ABC Limited as on 1st April, 2026 was ₹ 100 lakhs.

   The above profit of XYZ Limited includes speculative profit of ₹ 10 lakhs.

   Compute the total income of XYZ Limited for Tax year 2026-27 and indicate the losses/ other allowances to be carried forward by it.

3. *Examine in brief the treatment to be given in the following case under the Income-tax Act, 2025, for tax year 2026-27:*

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A loss of ₹ 85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

4. *M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2026. The assessed business loss of the firm for the tax year 2025-26 which it is entitled to carry forward amounts to ₹ 3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2026 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.*

   Compute the amount of business loss relating to the tax year 2025-26, which the firm is entitled to set off against its business income for the tax year 2026-27. The business income of the firm for the tax year 2026-27 is ₹ 3,30,000. Your answer should be supported by reasons.

5. *An assessee sustained an unabsorbed depreciation in the tax year 2026-27, which could not be set off against income from any other head in that tax year. The assessee did not furnish the return of loss within the time allowed under section 263(1) in respect of the relevant tax year. However, the assessee filed the return within the time allowed under section 263(4). Can the assessee carry forward such unabsorbed depreciation for set off against income of the tax year 2027-28?*

Answers

1. Section 119(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case *CIT v. Madhukant M. Mehta (2001) 247 ITR 805*, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

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In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 119(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of ₹ 5 lakhs of X.

2. Computation of total income of XYZ Limited for the Tax year 2026-27

Particulars	(₹ in lakhs)	
Business income before setting off brought forward losses of ABC Ltd.		140.00
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [₹ 50 lakhs × 15%] [Section 41(2)]		7.50
		147.50
Set off of brought forward business loss of ABC Ltd. **(See Notes 2 & 4)**		(120.00)
Set off of unabsorbed depreciation under section 33(11) read with section 116 **(See Notes 2 & 4)**		(18.00)
Set off of unabsorbed capital expenditure under section 45(1)(a) read with section 45(7) **(See Note 5)**		(2.00)
Business income		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 116 of the Income-tax Act, 2025.

2. In the case of amalgamation of companies, the accumulated losses and unabsorbed depreciation of the amalgamating company i.e., ABC Limited shall be deemed to be the loss or unabsorbed

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depreciation of the amalgamated company i.e., XYZ Limited for the tax year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by XYZ Limited for a period of 8 tax years immediately succeeding the tax year in which such loss was first computed for ABC Ltd. and indefinitely, respectively.

3. As per section 116(13), the accumulated loss to be carried forward specifically excludes loss in a speculative business. Therefore, speculative loss of ₹ 4 lakhs of ABC Limited cannot be carried forward by XYZ Limited.

4. Section 112(3) provides that where any allowance or part thereof unabsorbed under section 33(11) (i.e., unabsorbed depreciation) or section 45(7) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 112.

5. Section 45(7) provides that the provisions of section 33(11) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 45(1)(a) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set off and carried forward in the same manner as unabsorbed depreciation.

6. The restriction contained in section 113 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 2025 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by XYZ Limited to the tax year 2027-28.

3. Section 115 lays down the provisions for set-off and carry forward of loss from specified activity i.e., the activity of owning and maintaining race horses. According to provisions of section 115, the losses incurred by an assessee from the specified activity cannot be set-off against the income from any other source other than the income from specified activity. Since

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the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and maintaining camels is not covered under section 115.

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 112 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 tax years immediately succeeding the tax year in which the loss was incurred.

4. The firm is entitled to set off its brought forward business loss amounting to ₹ 3,60,000 relating to the tax year 2025-26 to the extent of ₹ 3,30,000 against its business income of ₹ 3,30,000 for the tax year 2026-27, as per the provisions of section 112(1).

The balance unabsorbed business loss of ₹ 30,000 relating to the tax year 2025-26 will be carried forward to tax year 2027-28.

Section 119(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. **It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners.** Therefore, section 119(1) is not applicable to the case of M/s. JKLM.

5. Section 263(1)(viii) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 263(1). There is no reference to "unabsorbed depreciation" in section 263(1)(viii). The assessee, in the instant case, has filed the return showing unabsorbed depreciation within the time prescribed under section 263(4). The assessee is, therefore, entitled to carry forward such unabsorbed depreciation for set off against the income of the subsequent tax year i.e., tax year 2027-28.

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