

TAX FLASH NEWS

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Long term capital loss arising on sale of listed shares (income from which is exempt from tax) can be carried forward and set-off against other long term capital gains

Background

Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of United Investments¹ (the taxpayer) held that long term capital loss arising on sale of listed shares (income from which is exempt from tax) can be carried forward and set-off against other long term capital gains.

Facts of the case

The taxpayer is engaged in the business of horse racing and also acts as commission agent. The taxpayer had deployed its surplus funds by way of investments in listed shares and securities. During the relevant year, the taxpayer had sold its holdings in different listed companies. The taxpayer derived long term capital gain of INR77 thousand and incurred long term capital loss of INR6.05 lakhs. The Assessing Officer (AO) did not allow the carry forward of long term capital loss. The AO observed that when the gain arising on sale of long term listed shares is exempt from tax under Section 10(38) of the Act then by equal measure any loss arising in the hands of the taxpayer from transfer of listed securities should also remain outside the ambit of charging provisions of the Act.

The Commissioner of Income-tax (Appeals) [CIT(A)] observed that the aggregate long term capital gain derived on sale of listed shares fulfilled the conditions prescribed in Section 10(38) of the Act and therefore it was exempt from income-tax. With regard to the claim of long term capital loss, the CIT(A) held that since the gain derived from sale of

long term listed shares was exempt, any loss incurred there from was to be ignored. Accordingly, the CIT(A) denied the taxpayer's claim for carry forward of long term capital loss under Section 74 of the Act. Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Tribunal.

The taxpayer contended that the legislature has not put any embargo to exclude long term capital loss from sale of shares to be set off against long-term capital gain arising on account of sale of other capital asset. It is not a case where the source of income itself is exempt from tax and therefore any gain/loss derived in any manner there from is to be ignored for tax purposes. The taxpayer contended that there was nothing provided in Section 10(38) or for that matter Section 45 to 48 to state that long term capital loss on sale of shares are to be ignored as Section 10(38) exempts the income arising from the transfer of long term capital asset being an equity share or unit. The scope of this specific exemption provision is meant from a particular specie of positive income cannot be enlarged and read into Section 70 or 71 or Sections 45 to 48 of the Act so as to draw an inference that long term capital loss on sale of shares are to be ignored for the purposes of the Act.

However, the tax department contended that the term 'income' is to be understood to include negative income i.e. loss as well and therefore when the profits arises from transfer of shares of listed companies on which STT is paid is exempt under Section 10(38) of the Act, then as a corollary even the loss arising from such source also cannot be set off against any other income which is chargeable to tax.

¹ United Investments v. ACIT (ITA No. 511/Kol/2017) – Taxsutra.com

Tribunal's decision

The Supreme Court in the case of J.H. Gotla² held that the expression 'income' shall include loss because the loss is nothing but negative income. It is cardinal principle of interpretation of statutes that the observations and findings of the Court must be understood in the context of the facts involved in the case decided by the Court. It is not proper to divorce the observation of the Court from the facts involved in the case. The Supreme Court while dealing with clubbing provisions held that if the minor's income was liable for clubbing in the hands of the parent then equally the same principle will apply with respect to loss which was negative income.

The judicial concept that the term 'income' includes loss can be applied only when the entire source of such income falls within the charging provisions of the Act. Accordingly, in a case where the source of income is otherwise chargeable to tax but only a specific specie of income derived from such source is granted exemption, then in such case the proposition that the term 'income' includes loss will not be applicable.

The Tribunal observed that where only one of the streams of income from the 'source' is granted exemption by the Legislature upon fulfillment of specified conditions, then the concept of 'income' includes 'loss' will not apply. Section 45 of the Act which lays down the charge of tax on gain arising on transfer of 'capital asset' covers the long term capital gain derived on sale of equity shares whether or not they are listed on stock exchange and whether or not they are transferred on payment of STT. The manner and mode of computation of long term capital gain on sale of shares is uniformly laid down in Section 48 of the Act. In case the resultant figure is a long term capital loss, the manner for claiming its set off/carry forward has been set out in Section 74 of the Act. Therefore, on conjoint reading of all the applicable Sections, it has been observed that nowhere any exception has been made with regard to long-term capital gain/loss arising on sale of equity shares and it is liable to income-tax like any other item of capital asset. Accordingly, it cannot be said that the source viz., transfer of long term capital asset being equity shares by itself is exempt from tax so as to say that any 'income' from such source shall include 'loss' as well.

It has been observed that the exemption in respect of long term capital gain accruing on transfer of listed securities on payment of STT is granted under Section 10(38) of the Act. The said provision is part of Chapter III of the Act which bears the title 'Income which do not form part of the total income'. If one carefully analyses various sub-sections of Section 10 of the Act then it indicates that each sub-section enlists specific specie of receipt to which exemption from tax is granted if certain conditions

are fulfilled. Section 10 of the Act enlists various species of receipts which are otherwise revenue in nature but they are granted exemption from income-tax by the Legislature. The Legislature can grant exemption only when there is a positive income and not where there is a 'loss' or negative income on which admittedly there cannot be any charge of income-tax. Reference was made to the CBDT Circular³ issued in the context of Section 10A of the Act which grants exemption in respect of profits derived by undertaking located in SEZ/FZE.

The Tribunal observed that in analogous situation arising under Section 10A of the Act which is also part of Chapter III, the CBDT has accepted the legal proposition that even though the income is exempt but the loss arising from the same source can be assessed and set-off as per law. The exemption under Section 10(38) of the Act has been carved out in respect of a specific instance and that too where there is a positive income and upon fulfillment of conditions set out therein. Accordingly, the AO is directed to assess the long term capital loss incurred by the taxpayer on sale of listed shares and allow its carry forward in accordance with law.

Our comments

The issue with respect to the carry forward and set-off of long term capital loss arising on sale of listed equity shares (income from which is exempt from tax) against other long term capital gains has been a subject matter of debate before the Courts/Tribunal.

The Mumbai Tribunal in the case of Asia Pacific Performance SICAV⁴ held that loss on transfer of long term capital assets specified under Section 10(38), on which STT is paid, cannot be set-off against the long term capital gain on sale of land which was not tax exempt.

However, the Mumbai Tribunal in the case of Raptakos Brett & Co. Ltd⁵ held that long-term capital loss on sale of shares/units of mutual fund which were liable for STT (income from which is exempt from tax) can be set off against long term capital gain arising on sale of land.

The present decision affirms that long term capital loss on listed shares can be allowed to set-off against other long term capital gains and can be carried forward. The Tribunal reiterated the principal that if a source of income is completely exempt from tax, the set-off and carry forward of loss shall not be available. However, if the exemption was applicable only to part of the source of income and is subject to fulfillment of some conditions, the loss from such source of income will be allowed to carry forward and set-off.

³ CBDT Circular No.7/2013, dated 16 July 2013

⁴ DDIT v. Asia Pacific Performance SICAV [2015] 55 taxmann.com 333 (Mum)

⁵ Raptakos Brett & Co. Ltd v. DCIT (ITA No. 3317/Mum/2009)

² CIT v. J.H. Gotla [1985] 156 ITR 323 (SC)

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000