# Controversies

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**Issue: Whether loss from an exempt source can be set-off for the purpose of capital gains?**

**Proposition:**

It is proposed that long-term capital loss on sale of equity shares which is subject to securities transaction tax(STT) is possible to be set-off against long-term capital gain on sale of any asset as per the provisions of the Act .

**View against the Proposition:**

It is a settled law if the income from any source is exempt from tax for any reason, then loss arising from said source shall not be considered in computation of total income. Let me refer to section 70 and section 71 which read as under:

Section 70 of the Act contains provisions relating to set-off of loss from one source against the income from another source under the same head of income, whereas section 71 of the Act encompasses set-off of loss from another head. In the instant case, section 70 was more relevant since the assessee had set-off losses arising from transfer of one asset against the income by way of capital gains from transfer of another asset (both losses and income fall within the same head, i.e. Capital Gains.)The relevant sub-section (3) under the section 70 of the Act states that where result of the computation made for any assessment year under section 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the assessment year in respect of any other capital asset not being the short-term capital asset.

It is decided by Madras High Court in the case of **CIT v. S.S. Thiyagrajan 129 ITR 115** that loss from a source, the income from which is exempt under section 10 cannot be set-off against taxable income. It is submitted that as per the decision of their Lordships of Madras High Court, loss from a source income from which is exempt under section 10 cannot be set-off against the taxable income. However, loss from a source income from which enjoys 100% tax holiday is eligible for set-off against taxable income. It was held by their Lordships of Madras High Court that the provision of Section 70 and 71 relating to set-off of loss from one head against income from another contemplate loss from a source, the income from which is liable to tax. If income from a source is altogether exempt from tax, loss from that source cannot be set off against the income from a different source or income under a different head. However, if the entire source is exempt or is considered not to be included while computing the total income then the profit/loss resulting from such a source does not enter into the computation at all. However, if a part of the source is exempt by virtue of particular provision of the Act for providing benefit to the assessee, then it cannot be held that the entire source will not enter into computation of total income.

Let me now refer to the decision of Mumbai ITAT in the case of Schrader Duncan Ltd. [2012] 50 SOT 68, the issue involved there was, whether the loss on transfer of capital asset being units in US 64 Scheme of Unit Trust of India can be allowed and entitled to carry forward the same for set off of in subsequent assessment years, when the income arising from such transfer of unit is exempt u/s. 10(33). The Tribunal held that the source both capital gain and capital loss on sale of units US 64 is itself excluded and not only the income arising from capital gain. The Hon'ble Tribunal have noted the history of US64 scheme and purpose for which

scheme was launched. In this context transfer of US64 scheme the tribunal held that the provision were not meant to enable the assessee to claim loss by indexation for set off against other capital gain chargeable to tax.

**View in favour of the assessee:**

The definition of capital asset as provided in section 2(14) of the Act does not provide any exclusion for equity shares and other securities which are exempt under section 10(38).Section 45 which is the charging section for capital gains arising on transfer of capital asset. Section 47 prescribes certain transactions that are not considered as transfers and therefore such transactions do not result in taxable capital gains. And the mode of computation has been mentioned in section 48. However, nothing has been mentioned in section 45 to 48 that capital gains/ loss are to be excluded as section 10(38) of the Act exempts the income arising from transfer of long-term capital asset being securities.

It is held in the case of **Royal Calcutta Turf Club V. CIT 144 ITR 709** that although in computing income certain incomes are not included under section 10, it would depend on a particular case whether it is the income from a certain source which would not enter into the computation of the total income or it is the source of income itself is specifically excluded by the legislature and in such a case one must look to the specific exclusion that has been made. In the instant case their Lordships of Calcutta High court held that exemption under the section in dispute merely excluded income derived from the specified business and not the entire business from the operation of the Act.

The Hon'ble High Court was besieged with the following question

"Whether under s.10(27) read with s.70 of the I.T. Act, 1961, was the assessee entitled to set off the loss on the two heads, namely, Broodmares Account and the Pig Account, against its income of other sources under the head "Business""

Their Lordships after analyzing the provisions of section 70 and section 10(27) observed in the following manner:

"In this case it is important to bear in mind that set-off is being claimed under Section 70 of the 1961 Act which permits set off of any income falling under any head of income other than the capital gain which is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head. We have noticed that in the instant case the exclusion has been conceded in computing the business income or the source of income from the head of business and in computing that business income, the loss from one particular source, that is, broodmares account and the pig account, had been excluded contrary to the submission of the assessee. The assessee wanted these losses to be set off. The Revenue contends that as the sources of the income are not to be included in view of the provisions of Clause (27) of s. 10 of the 1961 Act, the loss suffered from this source could also not merit the exclusion. Under the I.T. Act, there are certain incomes which do not enter into the computation of the total income at all. In this connection we have to bear in mind the scheme of the charging section which provides that the incomes shall be charged and s. 4 of the Act provides that the Central Act enacts that the incomes shall be charged for any assessment year and in accordance with and subject to the provisions of the 1961 Act in respect of the total income of the previous year or years or whatever the case may be. The scheme of "total income" has been explained by s. 5 of the Act which provides that subject to the provisions of the Act, the total income of the previous year of a person who is a resident includes all income from whatever source it is derived. In computing the total income, certain incomes are not included under s. 10 of the Act. It depends on the particular case where certain income, in respect of which the Act is made inapplicable to the scheme of the Act, and in such a case, the profit and loss resulting from such a source do not enter into the computation at

all. But there are other sources which for certain economic reasons are not included or excluded by the will of the Legislature. In such a case we must look to the specific exclusion that has been made. The question is in this case whether s. 10(27) is a source which does not enter into the computation at all or is a source the income in respect of which is excluded in the computation of total income. How this question will have to be viewed, has been looked into by the Supreme Court in several decisions to some of which our attention was drawn."

After discussing the various decisions of the Hon'ble Supreme Court specifically the decision of in the case of *Karamchand Premchand Ltd.* (*supra*), the Hon'ble High Court came to the following conclusion:

"cl.(27) of s.10 excludes in express terms only "any income derived from a business of live-stock breeding or poultry or dairy farming. It does not exclude the business of livestock breeding or poultry or dairy farming from the operation of the Act. Therefore, the losses suffered by the assessee in the broodmares account and in the pig account were admissible deductions in computing its total income"

**Summation**

Section 10(38) of the Act provides for exemption of positive income only. Therefore, losses shall not come within the purview of the said section. The set-off of LTCL has been clearly provided in section 70 and 71 of the Act, wherein Legislation has not put any embargo to exclude LTCL from sale of shares to be set-off against LTCG arising on account of sale of other capital asset. In fact none of the provisions of the Act creates an embargo on allowing LTCL from STT paid shares/mutual funds to be set-off against the LTCG from other assets and section 70(3) is an enabling provision to set – off such losses. Section 10(38) excludes in express terms only the income arising from transfer of long-term capital asset being equity shares or equity fund which is chargeable to STT, which is part of source of income and not the entire source of income from capital gains arising from transfer of shares.

It is interesting to refer to the decision of Hon'ble ITAT Mumbai Bench 'D' in the case of Raptakos Brett & CO. Ltd. reported in [2015] 58 taxmann.com 115. It is to be noted that as per this decision the gain is not taxable while losses will have the benefit of set off against other taxable gains. This may sound surprising but the Hon'ble ITAT has clearly given verdict on the same. However, this decision also brings out distinction between exemption of entire source of income and exemption of part of the source of income. According to Hon'ble ITAT the exemption of part of an income from the source is required to be included and the set off cannot be denied.

The Hon'ble ITAT clearly laid down that the concept of income including loss will apply only when the entire source is exempt and not where only one particular stream of income falling within a source is falling within exempted provisions. The whole genre of income under 'capital gain' on transfer of shares is a source, which is taxable under the Act. If an equity share is sold within the period of twelve months, then it is chargeable to tax and only if it falls within definition of long-term capital asset and further fulfills the conditions mentioned in sub-section (38) of section 10 then only such portion of income is treated as exempt.

Finally the Hon'ble ITAT concluded that section 10(38) excludes in expressed terms only income arising from transfer of long-term capital asset being equity share or equity fund which is chargeable to STT and not the entire source of income from capital gains arising from transfer of shares and accordingly, long-term capital loss on sale of shares would be allowed to be set off against long-term capital gain on sale of land in accordance with section 70(3).

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