

TAX FLASH NEWS

Long-term capital loss on sale of shares/units liable to securities transaction tax is allowed to be set-off against long-term capital gain on sale of land

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Raptakos Brett & Co. Ltd.¹ (the taxpayer) held that long-term capital loss on sale of shares/units of mutual fund which are liable to Securities Transaction Tax (STT) can be set-off against the long-term capital gain arising on sale of land.

Facts of the case

- The taxpayer is a pharmaceutical company engaged in manufacturing and sale of pharmaceuticals.
- For the financial year 2006-07, the taxpayer had set-off long-term capital loss on sale of shares and on sale of mutual fund units against the long-term capital gains arising from sale of land.
- The Assessing Officer (AO) held that the losses claimed cannot be allowed since the income from long-term capital gain on sale of shares and mutual funds are exempt under Section 10(38) of the Income-tax Act, 1961 (the Act).

Tribunal's ruling

- Plain reading and understanding of the relevant Sections² indicate:
 - Shares in the company are treated as capital asset and no exception has been carved out in

Section 2(14) of the Act, for excluding equity shares and unit of equity oriented funds. Any gains arising from transfer of long-term capital asset is treated as capital gain which is chargeable under Section 45 of the Act.

- Section 47 of the Act does not enlist any such exception that transfer of long-term equity shares/funds are not treated as transfer for the purpose of Section 45 of the Act. Section 48 provides for computation of capital gain, which is arrived at after deducting cost of acquisition, cost of any improvement and expenditure incurred in connection with transfer of capital asset, even for arriving of gain in transfer of equity shares.
- Section 70 and 71 elaborates the mechanism for set-off of capital gain.
- Nowhere, any exception has been made with regard to long-term capital gain arising on sale of equity shares.
- The whole genre of income under the head capital gain on transfer of shares is a source, which is taxable under the Act. If the entire source is exempt or is considered as not to be included while computing the total income, then in such a case the profit or loss resulting from such a source do not enter into the computation at all.
- However, if a part of the source is exempt by virtue of a particular provision of the Act for providing benefit to the taxpayer, then it cannot be held that the entire source will not enter into computation of total income.
- The concept of income, including loss, will apply only when the entire source is exempt and not in the cases where only one particular stream of income falling within a source is covered in exempt provisions.

¹ Raptakos Brett & Co. Ltd. v. DCIT (ITA Nos.3317/Mum/2009 & 1692/Mum/2010; AY: 2007-08) – Taxsutra.com

² Section 2(39A), Section 2(14), Section 45, Section 47, Sections 48 to 55, Section 70 and Section 71 of the Act

- Section 10(38) of the Act provides exemption of income only from transfer of long-term equity shares and equity oriented fund and not only that, there are certain conditions stipulated for exempting such income i.e. payment of STT and whether the transaction on sale of such equity share or unit is entered into on or after the date on which chapter VII of Finance (No.2) Act, 2004 comes into force. If such conditions are not fulfilled then exemption is not given.
- Thus, the income contemplated in Section 10(38) of the Act is only a part of the source of capital gain on shares and only a limited portion of source is treated as exempt and not the entire capital gain (on sale of shares).
- Section 10 of the Act provides that certain income are not to be included while computing the total income of the taxpayer and in such a case the profit or loss resulting from such a source of income do not enter into computation at all.
- However, a distinction has been drawn where the entire source of income is exempt or only a part of the source is exempt. It needs to be seen whether Section 10(38) is a source of income which does not enter into computation at all or is a part of the source, the income in respect of which is excluded in the computation of total income.
- For instance, if the taxpayer has an income from short-term capital gain on sale of shares, long-term capital gain on debt funds, and long-term capital gain from sale of equity shares, then while computing the taxable income, the whole income would be computed in the total income and only the portion of long-term capital gain on sale of equity shares would be removed from the taxable income as the same is exempt under Section 10(38) of the Act.
- In the case of Hariprasad & Company Pvt. Ltd.³, the Supreme Court held that if loss was from the source or head of income not liable to tax or exempt from tax, neither the taxpayer was required to show the same in the return nor was the AO under any obligation to compute or assess it much less for the purpose of carry forward.
- The ratio and the principle laid down by the Supreme Court would not apply in the present case, because the concept of income includes loss will apply only when the entire source is exempt or is not liable to tax, and not in the case where only one of the income falling within such source is treated as exempt.
- Accordingly, Section 10(38) of the Act excludes, in expressed terms, only the 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. It does not lead to exclusion of computation of capital gain of long-term capital asset or short term capital asset being shares.
- The ratio laid down by the Calcutta High Court in the case of Royal Turf Club⁴ is applicable and accordingly the same is followed in the present case. The Calcutta High Court discussed the aforesaid decision of the Supreme Court and held that the same will not apply to facts of the case. While pronouncing the order, the Calcutta High Court discussed the issue in detail after relying upon series of decisions. Also, the Calcutta High Court's decision has not been referred to or distinguished by the Gujarat High Court in the case of Kishorebhai Bhikhabhai Virani⁵ which had decided this issue against the taxpayer.
- Accordingly, the long-term capital loss on sale of shares would be allowed to be set-off against the long-term capital gain on sale of land in accordance with Section 70(3) of the Act.

Our comments

The issue with respect to set-off of long-term capital loss on equity shares on which STT has been paid against the long-term capital gains which are taxable has been a matter of debate before Courts and the Tribunal.

The Mumbai Tribunal in the case of Asia Pacific Performance SICAV⁶ held loss on transfer of long-term capital assets specified under Section 10(38), on which STT is paid, cannot be set-off against the income under the head long-term capital gains on which no STT is paid.

However, in the present case, the Tribunal held that loss on transfer of long-term capital assets specified under Section 10(38), on which STT is paid, can be set-off against the long-term capital gain on sale of land which is not tax exempt.

Note: The present case covers certain other issues which have not been considered in this Flash News.

³ CIT v. Hariprasad & Company Pvt. Ltd. [1975] 99 ITR 118 (SC)

⁴ Royal Calcutta Turf Club v. CIT [1983] 144 ITR 709 (Cal)

⁵ Kishorebhai Bhikhabhai Virani v. Asst. CIT [2014] 367 ITR 261 (Guj)

⁶ DDIT v. Asia Pacific Performance SICAV [2015] 55 taxmann.com 333 (Mum)

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