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Sharp Insights

LTCL on sale of equity shares and mutual funds units (subject to securities transaction tax) not to be ignored in view of section 10(38) exemption, but can be set-off against taxable LTCG as per Section 70(3)

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Synopsis

The Mumbai Tribunal in Raptakos Brett & Co. Ltd. has held that even though the long-term capital gains [LTCG] on sale of equity shares and mutual funds units [subject to Securities Transaction Tax ('STT')] is exempt from tax under section 10(38), the long-term capital loss [LTCL] on sale of shares can be set-off against taxable LTCG on sale of another asset.

Facts

- Raptakos Brett & Co. Ltd., the taxpayer company, is a pharmaceutical company engaged in manufacturing and sale of pharmaceuticals, formulations, dietetic specialties and animal husbandry.
- The taxpayer had set off LTCL on sale of shares and mutual fund units on which STT was paid against the LTCG arising on the sale of land in the computation of income.
- The Assessing Officer held that since income from LTCG on sale of shares and mutual funds (subject to STT) are exempt under section 10(38), claim for similar LTCL cannot be allowed.
- The Commissioner of Income-tax (Appeals) confirmed the decision of the Assessing Officer and held that exempt profit and losses construes separate species of income or loss and such exempt species of income or loss cannot be set off against the taxable species of income or loss. It further upheld that tax exempt losses cannot be deducted from taxable income.
- Subsequently, the taxpayer filed an appeal with the Tribunal.

Issue before the Mumbai Tribunal

Whether LTCL on sale of equity shares (subject STT) can be set off against LTCG arising on sale of land, given the fact that income from LTCG on sale of such shares are exempt under section 10(38) of the Act ?

Ruling of the Mumbai Tribunal

The Mumbai Tribunal observed that:

- shares in a company are treated as capital asset and no exception has been carved out in section 2(14) for excluding the equity shares and unit of equity oriented funds from being considered as capital asset.
- any gains arising from transfer of long-term capital asset is treated as capital gain which is chargeable under section 45.
- section 47 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 and section 48 provides for computation of capital gain, which is arrived at after deducting cost of acquisition i.e. 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 & 71 elaborates the mechanism for set off of capital loss. Nowhere, any exception has been made/ carved out with regard to LTCL arising on sale of equity shares (subject to STT).
- Concept of income including loss will apply only when the entire source is exempt from tax and not in the cases where only one particular stream of income falling within a source is falling within exempt provisions.
- Section 10(38) 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 securities transaction tax and whether the transaction of 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) is only a part of the source of capital gain arising on sale of equity

shares and only a limited portion of source is treated as exempt and not the entire capital gain (on sale of equity shares).

The Tribunal relied on Calcutta High Court decision[1] which further relied on Supreme Court decision[2] and concluded that income contemplated in section 10(38) 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).

The Tribunal also distinguished the adverse decisions[3] relied upon by the tax authorities.

The Tribunal held that section 10(38) excludes in expressed terms only the income arising from transfer of long-term capital asset being equity share or unit of equity oriented mutual fund which is chargeable to STT and not entire source of income from capital gains arising from transfer of shares. It further held that it does not lead to exclusion of computation of capital gain of long-term capital asset or short-term capital asset being equity shares.

Accordingly, the Tribunal held that LTCL on sale of shares would be allowed to be set off against LTCG on sale of land in accordance with section 70(3) of the Act.

[1] Royal Calcutta Turf Club v. CIT (1983) 144 ITR 709 (Cal) (HC)
[2] CIT vs. Karamchand Premchand Ltd (1960) 40 ITR 106 (SC)
[3] CIT vs. Hariprasad & Company Pvt. Ltd. (1975) 99 ITR 118 (Supreme Court), Schrader Duncan Ltd vs. Addl. CIT (2012) 50 SOT (Mumbai ITAT) and Kishorebhai Bhikhabhai Virani vs. Asst. CIT (2014) 367 ITR 261 (Guj) (HC)

Comments

This decision of the Tribunal has affirmed the concept that income includes loss only when specified and where the entire source is exempt from tax, and not in the cases where only one particular stream of income falling within a source is falling within exempt provisions.
The Bombay High Court in the case of Fort Properties Pvt. Ltd. vs Commissioner Of Income-Tax (1994) 208 ITR 232 (Bom) held that "Source" means the real source of the income. Every income must have a source which cannot change and the source of income was the transfer of the property.
The Special Bench of the Mumbai Tribunal in the case of Joint Commissioner Of Income-Tax vs Montgomery Emerging Markets Fund (2006) 100 ITD 217 (Mum), held that every transaction is, for that matter, a source of income with reference to transfer of that asset.
The Hon'ble Bombay High Court, in the case of CIT vs. Life Insurance Corporation of India (338 ITR 212) held vide judgement dated 2nd August, 2011, that while determining the surplus/(deficit) from the insurance business for the purpose of section 44 of the Act, loss from Pension Fund has to be considered irrespective of the fact that income from such fund is exempt under section 10(23AAB) of the Act.
However, the Mumbai Tribunal in DDIT (International Taxation) v Asia Pacific Performance Sicav (2015) 55 Taxmann.com 333, vide order dated 27 December 2013 confirmed the levy of penalty under section 271(1)(c) for setting off LTCL on sale of equity shares subject to STT against other taxable LTCG arising on sale of equity shares. The Tribunal in that case held that if STT paid long-term capital gain is exempt under section 10(38), so is the loss from the same class of assets i.e., long-term capital assets, being equity shares etc., specified under section 10(38). where STT is paid. This decision of the Tribunal is distinguishable and has not been referred to by the Tribunal in Raptakos Brett &Co. Ltd.

Source: Mumbai Tribunal decision dated 10 June 2015, in the case of Raptakos Brett & Co. Ltd [ITA No. 3317/Mum/2009 and 1692/Mum/ 2010]

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