

## **KARNATAKA HC APPROVES SET OFF OF CAPITAL GAIN AGAINST BROUGHT FORWARD BUSINESS LOSS**

The short controversy that recently came up for consideration before the Karnataka High Court was whether the Special Bench of the Tribunal was right in denying set-off of brought forward business loss against income from transfer of capital assets of business offered to tax as 'long-term capital gains' under section 72 of the Income Tax Act, 1961 ('the Act').

### **Facts:**

The assessee (Nandi Steels Limited) is a company engaged in the business of manufacture of iron and steel. During assessment year 2003-04, the assessee reported long-term capital gains on sale of land and building used for the purpose of business, out of which depreciation was claimed on building. In the return, the assessee declared income of Rs.98,27,270 under the head 'capital gains', after setting off brought forward business loss under section 72 of the Act.

Though the aforesaid claim stood allowed under section 143(1), subsequently, in reassessment proceedings, the aforesaid claim of set off of carried forward business loss against capital gains was held to be inadmissible by the assessing officer under section 72 of the Act. The action of assessing officer was upheld by first appellate authority [CIT(A)].

On further appeal at the instance of the assessee, the aforesaid issue was referred by the Division Bench of the Income Tax Appellate Tribunal (Tribunal) to the Special Bench considering that the co-ordinate Bench in the case of Steelcon Industries vs ITO: ITA No.571/Bang./1989 upheld the claim following decisions of the Supreme Court in case of CIT vs Cocanada Radhaswami Bank: 57 ITR 306 (SC) and CIT vs Chugandas & Co: 55 ITR 17 (SC), despite contrary decision of the Supreme Court in case of CIT vs Express Newspapers Ltd: 53 ITR 250 (SC).

### **Decision of Special Bench of Tribunal**

The Special Bench of the Tribunal reported in 143 TTJ 521 (Bang.) succinctly held that gain or loss on transfer of capital asset, though depreciable, cannot be referred as business income and thus, brought forward business loss from earlier years cannot be set off against the income from capital gains in terms of section 72 of the Act. The Tribunal, placing reliance on the decision of Express Newspapers, decided the issue of 'set off of brought forward business loss against income from capital gains under section 72 of the Act' in favour of the Revenue and against the assessee.

The Tribunal held that: (a) the primary contention of assessee that assets transferred had direct nexus with business carried out by the assessee and hence gains from its sale would also assume character of business income, is not acceptable; (b) the capital is to be used for the purpose of carrying on the business of the assessee and it shall remain in the business of the assessee till it is either converted into stock-in-trade; (c) income earned from carrying on the business by use of stock in trade only is the business income of the assessee; and (d) section 72 of the Act provides that only business loss can be carried forward and allowed as set off against the business income of the assessee, be it from same business or any other business.

Aggrieved, the assessee preferred an appeal before the Karnataka High Court which was registered as ITA No.103/2012.

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**Decision of High Court**

The Hon'ble High Court, vide order dated 23.02.2021, followed the fundamental exposition of law by the Supreme Court in case of Cocanada Radhaswami (cited supra) where it was held that business income is segregated under different heads only for the purpose of computation of total income and by such break-up the income does not cease to be income of business. The Court, disagreeing with the Special Bench of the Tribunal, held that the assessee is entitled to set off brought forward loss against income, which has attributes of business income, even though the same is assessable to tax under a head other than 'profits and gains from business or profession'.

The Court taking guidance from the legal maxim expression '*unius est exclusion alterius*' meaning express mention of one thing implies the exclusion of another; dealt by the Apex Court in case of GVK Industries vs ITO: 332 ITR 130 (SC) held that '*Section 72(1) employs the expression "under the head Profits and gains of business or profession" whereas Section 72(1)(i) does not use the expression "under the head". Thus, the "legislature has consciously left it open that any income from business though classified under any other head can still be entitled to the benefit of set off"*'.

In view of the aforesaid, the High Court allowed the benefit of set off of brought forward business loss against long-term capital gains on transfer of capital assets of business even though such gain was assessable under the head 'capital gain'.

**VA Comments/ Key Takeaways:**

The Hon'ble High Court has reiterated the fundamental principle that inherent character of income is not lost simply because the same may be assessable under a different head. The decision, thus, fortifies the view taken by the Courts in CIT vs S&S Power Switchgear Ltd: 415 ITR 376 (Mad.) and Digital Electronics Ltd vs ACIT: 49 SOT 65 (Mum) upholding similar principle relying on the decision of Cocanada Radhaswami Bank (cited supra).

For example, dividend income from share held in the course of business shall not lose the character of being business income merely because the same is assessed under the residuary head 'other sources' on account of specific mandate of section 56 of the Act.

In Cocanada Radhaswami, Western States Trading (P) Limited: 80 ITR 21 (SC), CIT vs Excellent Commercial Enterprises & Investments Ltd: 282 ITR 423 (Del) and series of other decisions, the Courts, distinguishing the decision in Express Newspaper (cited above), held that brought-forward business losses under section 72 may be set off against dividend income arising out of shares held as trading asset/ stock-in-trade.

In somewhat similar context, the Courts have held that merely because income from transfer of depreciable assets is, by legal fiction, regarded as short term capital gains under section 50, that however, cannot be a valid ground to deny benefit of exemption under section 54E/ 54EC, so long as the asset transferred is a long-term asset. [refer: DCIT v. Himalaya Machinery (P.) Ltd.: 214 Taxman 291 (Guj.), CIT vs ACE Builders: 281 ITR 210 (Bom.)]

The Delhi High Court in the case of Lavish Apartments (P) Ltd vs ACIT: 210 Taxman 9 (Del) upheld set off of brought forward business loss against income assessed under the head "income from house property", where the assessee was engaged in the business of letting out properties, applying the principle expounded in the above referred decisions of the apex Court.

The aforesaid judgment of the Karnataka High Court assumes significance since the Court upholds set off of business loss against capital gains arising from transfer of capital asset (and not trading asset) used for the purpose of business and assessable under the head 'capital gains'.

Though the aforesaid judgment may be contested by the Revenue before the Supreme Court, the view taken by the High Court appears to be in accord with the strict reading of the language of section 72 and is also in conformity with the aforesaid fundamental principles reiterated time and again by the Courts.

The principle laid down by the Karnataka High Court shall be of great assistance and boon to various loss-making taxpayers/ companies, including a corporate debtor undergoing insolvency resolution process under the Insolvency and Bankruptcy Code (IBC), who may have to undertake distress sale of business capital assets to mobilise resources. Such taxpayers may now be able to take advantage of brought forward business losses for setting of resultant capital gains on transfer of capital asset.

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