C. V. O. CHARTERED & COST ACCOUNTANTS' ASSOCIATION
304, Jasmine Apartent, Dada Saheb Phalke Road, Dadar (East), Mumbai - 400 014. Tel.: 2410 5987
E-mail : info@cvoca.org • Website : www.cvoca.org

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# CASE LAW UPDATE

**Compiled by CA Vishesh Sangoi**

***Aditya Balkrishna Shroff v. ITO 16(1)(1)***
***ITA No. 4472/Mum/2019***
*Mumbai ITAT*
*Pronounced on 17 May 2021*

❖ **Summary –**

Foreign exchange fluctuation gains arising upon receiving the repayment of a personal loan, extended by the assessee, denominated in US Dollars is a capital receipt not chargeable to tax.

❖ **Facts –**

- The Assessee had extended a personal interest free loan of US $ 2,00,000 to his cousin in Singapore. The remittance was made under LRS (Liberalized Remittance Scheme) issued by the Reserve Bank of India.
- As on the lending date, the prevailing exchange rate was Rs 45.14 per US $, and, therefore, the assessee paid Rs 90,30,758 for this remittance of US $ 2,00,000.
- The borrower repaid the amount of US $ 2,00,000 to the Assessee on 24th May 2012. On that day, the prevailing exchange rate was Rs 56.18 per US $.
- Accordingly, the Assessee received Rs 1,12,35,326.
- The Assessing Officer was of the view that the difference, in terms of Indian Rupees was of income nature and held that the gain on realization of loan would partake character of an income under the head income from other sources.

❖ **Taxpayers Argument –**

- The loan was not given in the course of business of the assessee and it was on capital account.
- It was further explained that the transaction was in capital field and that, therefore, the gain is in the nature of capital receipt not chargeable to tax.
- It was explained that the loan transaction was in terms of the Liberalized Remittance Scheme of the Reserve Bank of India inasmuch as it was a permitted transaction, and specifically on capital account.

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❖ **Department Argument –**

- CIT(A) upheld the addition on the premise that question no. 4 of FAQs updated on 17.07.2015 issued by RBI has permitted resident to make only rupee loan to the Non Resident Indian/ PIO. Therefore, the permission was only for rupee loan which was remitted to Foreign Residence according to their convenience in foreign currencies but from perusal of scheme, it is evident that loan was in terms of rupees.

- In case of appellant, the loan was for an amount of Rs 90,30,758 against which he received an amount of Rs. 1,12,35,326 resulting into a net surplus of Rs 22,02,286. Since the loan was permitted to make a rupee loan, therefore, any surplus resulting as a result of such loan transaction will be treated as an income resulting out of such loan.

- As per provision of the Income-tax Act if giving and taking loan is not the business of the assessee then income arising out of the loan is treated as interest income or income from other sources.

❖ **Authority Finding –**

- ITAT observed that there is no dispute to the fact that it is a receipt on capital account and not in the course of business. When a receipt is in the capital field, even if that be a gain, it is in the nature of a capital gain, but then, as the definition of income, under section 2(24)(vi) stands, only such capital gains can be brought to tax as are permissible to be taxed under section 45.

- Reliance was placed on the landmark decision in case of Shaw Wallace case [(2001) 71 TTJ 478 (Cal)] wherein it was observed that a capital receipt, in principle, is outside the scope of 'income' chargeable to tax and a receipt cannot be taxed as income unless it is in the nature of a revenue receipt or is specifically brought within ambit of 'income' by way of specific provisions of the Income-tax Act.

- Where the loan is denominated in foreign currency and the amount advanced as loan, as also received back as repayment, is exactly the same, there is no question of interest component at all.

- Under section 2(28A), interest is defined as "interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized". Essentially, therefore, interest is the amount "payable" in any manner in respect of "moneys borrowed or debts incurred" but in the present case nothing more than principal debt has been paid by the borrower, and unless borrower pays an amount in respect of moneys borrowed or debts incurred, the definition of interest does not come into play.

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- Lastly, if this transaction was impermissible under the Foreign Exchange Management Act, 1999, the consequences must flow under that legislation itself. The Income Tax Act, 1961 has nothing to do with the consequences, even if that be so, of impermissibility of such transactions under the FEMA or Liberalized Remittance Scheme framed thereunder- at least in the context of dealing with an income.

- The benefit or gain on account of foreign exchange fluctuation with respect to a transaction in capital field is a capital receipt not chargeable to tax.

❖ **Authors Comments –**

This decision reiterates the principle that a capital receipt, in principle, is outside the scope of income chargeable to tax and a receipt cannot be taxed as income unless, it is in the nature of a revenue receipt or is specifically brought within the ambit of income by way of specific provisions of the Income Tax Act.

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## *Nandi Steels Ltd. v. ACIT, Circle-12(2), Bangalore*

*128 taxmann.com 267 (Karnataka High Court)*

❖ **Summary –**

Karnataka High Court approves set off of brought forward business loss against capital gains arising on sale of assets used for business.

❖ **Facts –**

- The Assessee Company was engaged in the business of manufacture/production of Iron and Steel. During the previous year relevant to AY 2003-04, the Assessee sold the land, building and bore well used for its business purposes for a consideration of Rs. 1.55 Crore and earned capital gains on the same.

- While filing the income tax return, the Assessee Company claimed set off of the carried forward business loss pertaining to earlier years, against the income reported under the head 'Capital gains' which was arising out of sale of the aforesaid land and building.

- The Assessing Officer (AO) during re-assessment proceedings disallowed the set-off of brought forward business loss against the Capital Gains.

- The Commissioner of Income-tax (Appeals) and ITAT (SB) upheld the AO's order.

- Thereafter, the Assessee filed an appeal before the Karnataka High Court against the ITAT (SB) order.

❖ **Taxpayers Argument –**

- Claim of set-off was in accordance with the proposition that an assessee is entitled to set-off of brought forward loss against the income, which has the attributes of business income even though the same is assessable to tax under the head other than 'profits and gains from business'.

- Reliance was placed on the ratio laid down by Supreme Court in CIT v. Express Newspapers Ltd . [1964] 53 ITR 250 and CIT v. Cocanada Radhaswami Bank Ltd [1965] 57 ITR 306.

❖ **Department Argument –**

- The asset sold by the Assessee was a capital asset and consideration had been offered to tax under the head 'capital gains' therefore, the question of treating the consideration from transfer of a capital asset as business income does not arise.

- In order to consider the business income, the land which was the subject matter of the sale, should have been held as stock-in-trade, whereas, the same was considered as capital asset and the consideration had been rightly treated under the head of capital gains.

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- The business loss claimed to be set-off by the Assessee, was carried forward business loss of the earlier years and the same could be set-off only in terms of section 72 (relating to carry forward and set-off of business), which permits only set-off of business loss against the profits and gains of business or profession. Therefore, section 72 does not apply to the facts of the case under consideration.

- Section 72(1)(i) mandates that carried forward business loss can be set-off against the profit and gains from business which is assessable for that AY, whereas, in the case under consideration, the Assessee had not offered any income under the head profits and gains, and it was established that the Assessee had not carried on any business either in the AY under consideration or in the immediately preceding year and therefore, section 72 was not applicable.

- The word employed by the legislature viz. 'set-off against profits and gains' 'if any' of any business or profession carried on by him, and assessable for that AY, clearly mandated that unabsorbed carried forward losses could be set-off only against the income from the business carried on by the Assessee which was assessable under the head profits and gains alone and not against any other head. If any other interpretation was given, the aforesaid expression would be rendered redundant.

❖ **Authority Finding -**

- The proviso to section 72(1)(i) was omitted by Finance Act, 1999 with effect from 1 April 2000. Therefore, for AY 2003-04 (i.e. the AY in the case under consideration), the Assessee was not required to have carried on the business for the purpose of set-off of brought forward business.

- High 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 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".

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- High Court relied on the decision of the Supreme Court in case of Cocanada Radhaswami 57 ITR 306 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'.

- In view of above, the HC allowed the benefit of set off brought forward business loss against income which had the attributes of business income, even though the same was assessable to tax under 'Capital Gains'.

❖ **Authors Comments -**

This decision allowing set-off of carried forward business loss against capital gains arising on sale of assets used for business, has reaffirmed the following principles:

- Integral character of income is not lost simply because the same may be assessable under a different head.

- Business income is broken up under different heads only for the purpose of computation of the total income; by that break-up the income does not cease to be the income of the business.

- Assessee is not required to carry on the business for the purpose of set-off of brought forward business.

The principle laid down by the High Court shall be of some help to loss-making companies, especially companies undergoing insolvency process under the IBC Code, who may have to undertake distress sale of business assets to generate funds. Such companies may take advantage of brought forward business losses for setting of capital gains on transfer of capital asset.