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Tax Flash News

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Grandfathered (exempt) capital gains need not be set off against non-grandfathered losses

Executive summary

In a recent case, the Mumbai Bench of the Tribunal ruled in favour of a Mauritian taxpayer on the issue of determining the set-off of exempt capital gains against losses.

The taxpayer earned capital gains from the transfer of shares acquired before 1 April 2017, which were claimed exempt under the India-Mauritius tax treaty (grandfathering provisions). Simultaneously, the taxpayer incurred capital losses from the transfer of shares purchased after this date and also had brought forward prior years' capital losses.

The tax authorities sought to offset these losses against the exempt gains, allowing only the net loss to be carried forward to the subsequent year.

However, the Tribunal ruled that the exempt gains should not be affected by the losses. As a result, the taxpayer was permitted to carry forward the entire amount of losses without setting them off against the exempt gains.

Facts of the case

The taxpayer is a tax resident of Mauritius.

During the year under consideration ('current year'), the taxpayer had earned capital gains from the transfer of shares acquired prior to 1 April 2017 and also from the sale of derivates. Such gains were claimed to be exempt under the India-Mauritius tax treaty.

Simultaneously, during the current year, the taxpayer has incurred losses from the transfer of shares acquired on or after 1 April 2017. Additionally, the taxpayer had capital losses brought forward from the earlier years.

In its tax return, the taxpayer carried forward the entire loss[1] to the subsequent years following the provisions[2] of the Income-tax Act, 1961 (the Act) i.e., without setting them off with the abovementioned gains claimed to be exempt under the treaty.

The tax officer set off the brought forward and current year losses against the exempt capital gains earned by the taxpayer during the current year before determining the amount exempt under the treaty.

[1] After setting off a part of losses with the current year's taxable gains

[2] Section 74 of the Act

The capital gains article of the India-Mauritius tax treaty provides that gains arising to a Mauritian tax resident from the alienation of shares acquired on or after 1 April 2017 in a company resident in India shall be taxable in India. The capital gains from the alienation of shares acquired prior to that date are not taxable in India.

Taxpayer's contentions

Taxable income/loss construes separate species of income/loss and cannot be set off against the income/loss that is not chargeable to tax.

The capital gains earned from the sale of shares acquired before 1 April 2017 were exempt under the treaty[3].

The losses suffered on the transfer of shares acquired on or after 1 April 2017 and the brought forward capital losses should not be set off against the above-mentioned (exempt) capital gains. Such losses should be carried forward to subsequent years as per the Act.

[3] Article 13(3) and Article 13(4) of the India-Mauritius tax treaty

Revenue's contentions

The methodology for computing capital gains is not provided in the treaty.

The capital gains should be computed as per the provisions of the Act (which includes provisions dealing with set-off and carry-forward) before applying the treaty provisions.

Once the capital gains are computed as per the Act, the treaty benefit, if any, is to be granted if there is a gain in the net result.

The Revenue rejected the taxpayer's selective approach by availing the treaty benefits for gains and the provisions of the Act for carrying forward losses.

Decision

The Mumbai Bench of the Tribunal ruled in favour of the taxpayer by allowing the carry forward of losses without setting them off against the exempt gains.

The brought forward capital losses from the earlier year, (which arose from the transfer of shares acquired on or after 1 April 2017) can only be set off against gains arising from the transfer of shares acquired on or after that date.

These losses cannot be set off against the exempt gains earned from the transfer of shares acquired prior to 1 April 2017.

The taxpayer is entitled to carry forward these losses to subsequent years as per the provisions of the Act.

The exempt gains do not enter into the computation of income as per the Act and thus, are not required to be set off against the losses.

In this regard, the Tribunal referred to the CBDT Circular[4] which dealt with carry forward and set off of non-resident's Indian loss against foreign income. The circular provides that in the case of a non-resident, the foreign income is not included in 'total income'. If the 'total income' is a loss, it has to be carried forward and cannot be set off against any income which does not form part of the 'total income'.

The Tribunal also relied on various other decisions.[5]

[4] CBDT Circular No. 22 dated 29 July 1944

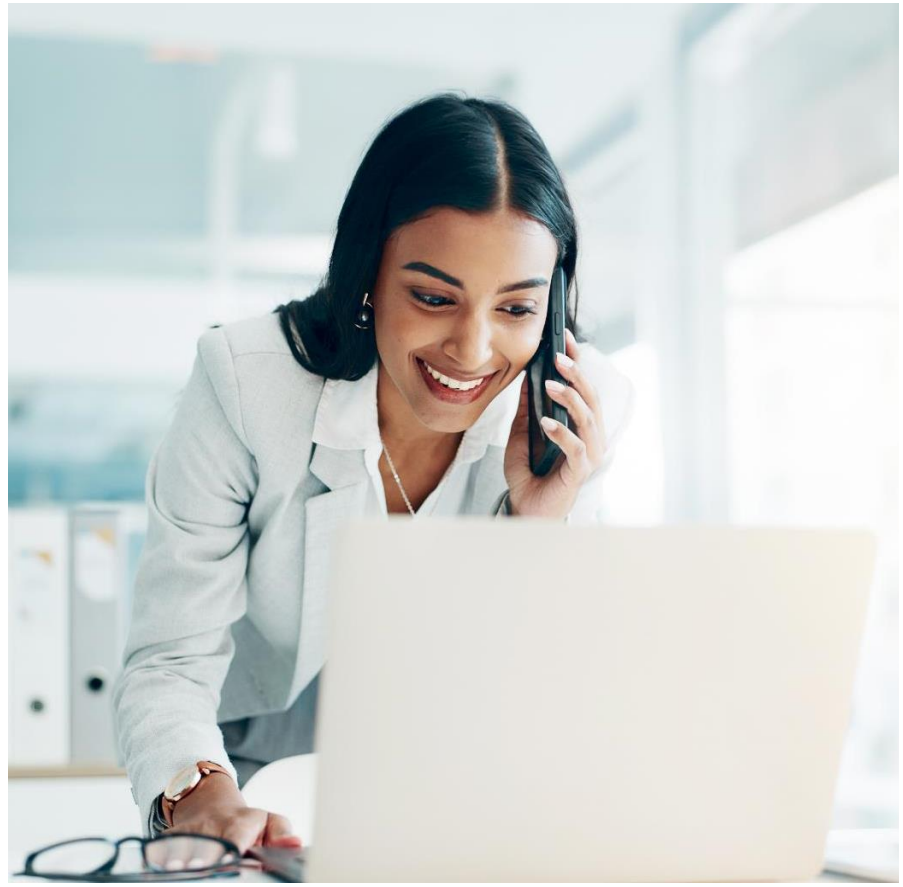
[5] *Goldman Sachs Investments (Mauritius) Ltd*. v. *DCIT* [2021] 187 ITD 184 (Mumbai), *DCIT* v. *Patni Computer Systems Ltd*. [2008] 114 ITD 159 (Pune), *Flagship Indian Investment Co. (Mauritius) Ltd.* v. *ADIT* [2010] 38 SOT 426 (Mum)

Our comments

It is a well-established principle that taxpayers can choose to apply either the provisions of the Act or the treaty, depending on which is more beneficial.

The contention arises over whether taxpayers can selectively apply treaty provisions to certain income/losses while allowing the rest to be taxed under the Act. Conversely, the Revenue has been arguing that income should first be calculated according to the Act, and only after determining the total income should taxpayers decide whether to apply the treaty or continue to be governed by the provisions of the Act.

This judgment ruled that it was not necessary to first compute the total income and then, decide between applying the treaty or the Act.



KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Hyderabad
Salarpuria Knowledge City, 6th Floor, Unit 3,
Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road,
Bengaluru – 560071 Tel: +91 80 6833 5000

Jaipur
Regus Radiant Centre Pvt Ltd., Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Pune
9th floor, Business Plaza,
Westin Hotel Campus,
36/3-B, Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
2nd Floor, Block T2 (B Wing),
Lodha Excellus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi,
Mumbai- 400011 Tel: +91 22 3989 6000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club,
Vijayawada, Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000