

SET-OFF, OR CARRY FORWARD AND SET-OFF OF LOSSES

Section 70

General Rule: The loss in respect of any source of income under any head of income shall be set off against the income from any other source under the same head.

Exceptions:

- (1) Losses from speculation business.
- (2) Losses from the activity of owning and maintaining race-horses.
- (3) Long Term Capital Loss cannot be set off against short term capital gains.
- (4) Loss of specified business referred to in section 35AD cannot be set-off except against profits and gains of any other specified business referred to in section 35AD.

KEY NOTES:

1. The following Intra head set-offs are possible:

long-term capital loss against long-term capital gains
short-term capital loss against short-term capital gains
short-term capital loss against long term capital gains

loss from specified business u/s 35AD against profit and gains of specified business under section 35AD

2. Loss from self-occupied house property can be set off against income from let out house property. (Loss from **two** self-occupied **properties** can be on account of interest on borrowed capital to the extent of ₹30,000 **in aggregate**. Where the property is acquired or constructed with capital borrowed and such acquisition or construction is completed within **five years** from the end of the financial year in which capital was borrowed, the **aggregate** deduction of interest shall be to the extent of ₹ 2,00,000). **Total interest on two self-occupied house properties cannot exceed ₹ 2,00,000 in any case.**

(Amendment by Finance Act, 2019)

Section 71

General Rule: Where in respect of any Assessment Year, there is a loss under any head of income, it can be set-off against income under any head of income for that Assessment Year.

Exceptions:

1. Losses from speculation business.

2. Losses from the activity of owning and maintaining race-horses.
3. Losses under the head capital gains.
4. **Losses of P/G/B/P cannot be set-off against salary.**
5. Loss computed in respect of any specified business referred to in section 35AD cannot be set-off against any other income.
6. **Loss under the head "Income from house property" can be set off against any other head of income to the extent of ₹2 lakhs. However, the unabsorbed loss shall be allowed to be carried forward for set-off in subsequent years.**

For example, if assessee has income under the head house property (Let out) say of ₹7,00,000 (loss) and has income under the head P/G/B/P of ₹ 10,00,000, then assessee can set off only the loss of ₹ 2,00,000 from income from house property against the business income of ₹ 10,00,000. Balance loss of ₹ 5,00,000 shall be carried forward to the next assessment year and set off only against the income from house property in the next assessment year.

Note: **Loss of tax exempt activity shall not be set-off under section 70 or 71 and shall not be carried forward.**

SECTION 71B: CARRY FORWARD & SET-OFF OF LOSS FROM HOUSE PROPERTY

Loss under the head house property:

- (i) Can be set-off in current year against any income to the extent of ₹2 lakhs.
- (ii) Balance to be carried forward for 8 Assessment Years and set-off only against "Income from House Property."

Note: **Loss under the head House Property can be carried forward even if ROI is filed after the due date of filing ROI under section 139(1).**

SECTION 72: CARRY FORWARD & SET-OFF OF BUSINESS LOSSES

Loss under the head P/G/B/P:

- (i) Can be set-off in current year against any income except salary.
- (ii) Balance to be carried forward for 8 Assessment Years and set-off only against "P/G/B/P."

Notes:

1. **Loss can be carried forward even if business has been discontinued.**
2. **Condition for set off:** Assessee must be the same i.e. the assessee who incurred the loss and the assessee who claims the carry forward and set-off, must be the same.
3. **J.H. Gotla (SC):** Brought forward business losses of an individual can be set-off against the business income of the spouse/ minor child clubbed under section 64.

EXCEPTIONS TO THE RULE THAT THE ASSESSEE MUST BE THE SAME

1. On inheritance on death of an individual, the legal heir shall carry forward the losses of deceased for the balance number of years.

Madhukant M. Mehta (Supreme Court)

Where sole proprietary (speculation business) of one 'M' was carried on by legal heirs by forming partnership firm, firm could claim carry forward of loss of sole proprietor, as it was found by Tribunal that there was succession to business of deceased.

Pramod Mittal (Delhi)

If a partnership firm was dissolved then, the takeover of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.

2. **Section 72A:** The unabsorbed losses and the unabsorbed depreciation of the amalgamating company shall be deemed to be the unabsorbed loss and depreciation of the amalgamated company subject to the fulfillment of certain conditions referred to in Section 72A.
3. **Section 72A:** Firm succeeded to by a company fulfilling the conditions laid down in section 47(xiii).
4. **Section 72A:** Conversion of Company into LLP fulfilling the conditions laid down in section 47(xiiib).
5. **Section 72A:** Proprietorship concern succeeded to by a company fulfilling the conditions laid down in section 47(xiv).
6. **Section 72A:** Loss of the demerged company can be carried forward by the resulting company subject to the fulfillment of certain conditions.
7. **Section 72AA:** Loss of the banking company amalgamated with a banking institution or Loss of a nationalised bank amalgamated with another nationalised bank or Loss of Government insurance company amalgamated with any other Government insurance company can be carried forward by the amalgamated entity.
8. **Section 72AB:** Loss of the amalgamating co-operative bank can be carried forward by the amalgamated co-operative bank subject to fulfillment of certain conditions.
9. **Section 72AB:** Loss of demerged co-operative bank can be carried forward to the resulting co-operative bank subject to the fulfillment of certain conditions.
10. **Section 72AB:** Loss of primary co-operative bank which has been succeeded as a result of conversion can be carried forward by such converted banking company subject to the fulfillment of certain conditions.

EXCEPTIONS TO THE RULE THAT LOSSES CAN BE CARRIED FORWARD FOR 8 ASSESSMENT YEARS

1. **Section 35AD:** Loss of business which is specified under section 35AD can be carried forward without any time limit.
2. If business was discontinued and there is income chargeable under section 41(1)/(3)/(4) in respect of such discontinued business, then business loss of the previous year in which business was discontinued can be set-off against such incomes.

3. Where business is discontinued in circumstances given in section 33B and is re-established within the period given in section 33B, then the losses of such business including bought forward losses shall be:
 - (i) Carried forward to Assessment Year in which business is re-established and set-off against P/G/B/P;
 - (ii) Balance carried forward to next 7 Assessment Years.
4. **Section 72A:** In case of amalgamation, referred to in section 72A, the loss gets carried forward for more than 8 Assessment Years.
5. **Section 72A:** In case proprietorship concern is succeeded by a company and conditions of section 47(xiv) are satisfied, then the loss gets carried forward for more than 8 Assessment Years.
6. **Section 72A:** In case of partnership firm is succeeded by a company and conditions of section 47(xiii) are satisfied, then the loss gets carried forward for more than 8 Assessment Years.
7. **Section 72A:** In case of Company is succeeded by a LLP and conditions of section 47(xiib) are satisfied, then the loss gets carried forward for more than 8 Assessment Years.
8. **Section 72AA:** In case of amalgamation referred to in section 72AA, the loss gets carried forward for more than 8 Assessment Years.

SECTION 73: LOSSES IN SPECULATION BUSINESS

Losses of speculation business can be set-off **against profits of speculation business**. Such losses can be carried forward for **4 Assessment Years** and set-off against **speculation income only**.

Section 43(5): defines a speculative transaction to mean a transaction in which a contract for purchase or sale of any commodity, including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scrip.

Note: An eligible transaction in respect of trading in derivatives in securities and currency futures and commodity derivative carried out on a recognised stock exchange shall not be treated as speculative transaction even if no deliveries are effected if following conditions are satisfied:

- it is carried out electronically on screen based system
- it is carried out through a duly registered stock-broker or sub-broker.
- it is carried out on a recognized stock exchange
- it is supported by a duly stamped contract note issued by such stock broker or sub-broker to its client
- the contract note indicates the unique client identity number
- the contract note indicates the PAN.

- 1. Purchase and sale of shares where deliveries have been effected**
 - The profit / loss is assessable as Capital Gains if shares are held as capital assets i.e., investments.
 - The profit / loss is assessable as Business Income if shares are held as stock-in-trade.

- 2. Purchase and sale of shares where deliveries have not been effected i.e., INTRA-DAY-TRADING** i.e., the transaction of purchase / sale is squared off in the same day [Cash Segment of Share Market]
 - The profit / loss is assessable as Speculation Income.

- 3. Purchase and sale of securities Derivatives / Futures & Options i.e. without delivery**
 - The profit / loss is assessable as Business Income.

- 4. Purchase and sale of commodities derivatives in Futures Markets i.e., without delivery**
 - The profit / loss is assessable as Business income/ loss.

- 5. Purchase and sale of commodities in Cash Market i.e., with delivery**
 - The profit / loss is assessable as Business Income if commodities are held as stock-in-trade.
 - The profit / loss is assessable as Capital Gains if commodities are held as capital assets i.e., investments.

- 6. Purchase and sale of currency futures at Recognised Stock Exchange**
 - The profit / loss is assessable as Business Income.

Illustration 1:

	Case I	Case II
F & O Commodities derivatives	-6,00,000	+7,00,000
STCG	<u>+7,00,000</u>	<u>-6,00,000</u>
Total Income	<u>+1,00,000</u>	<u>+7,00,000</u>
	Set off possible since F & O commodities derivative is treated as normal business income	Set off not possible since loss under the Head capital gains cannot be set-off against business income

Illustration 2:

	Case I	Case II
F & O Commodities derivatives being agricultural commodities	-5,00,000	+6,00,000
Manufacturing Business	<u>+6,00,000</u>	<u>-5,00,000</u>
Total Income	<u>+1,00,000</u>	<u>+1,00,000</u>
	Set off possible since F & O on agricultural commodities derivative is not treated as speculation income as per Finance Act, 2018	Set off possible since business loss can be set-off against business income

CBDT CIRCULAR ON FOREX DERIVATIVES

1. In case of forex derivatives, where no sale or settlement has actually taken place and the loss on Marked to Market basis has resulted in reduction of book profits, such a notional loss would be contingent in nature and cannot be allowed to be set off against the taxable income. The same should therefore be added back for the purpose of computing the taxable income of an assessee.
2. In a case where a loss on a forex-derivative transaction arises on actual settlement/conclusion of contract and is not a notional or marked to market book entry then such loss will be treated as normal P/G/B/P loss if the transaction is carried on electronically on recognised stock exchange.

EXPLANATION TO SECTION 73

Where **any part of the business** of a company consists of sale and purchase of shares, such company for the purposes of section 73, be deemed to be carrying on a speculation business to the extent to which the business **consists of sale and purchase of shares**.

This shall not apply to the following companies:

- (a) Investment Company i.e., the company whose total income mainly consists of income from house property, capital gains and income from other sources.
- (b) Company whose principal business is of banking or of granting loans and advances.
- (c) **Company whose principal business is the business of trading in shares.**

KEY NOTES:

1. Explanation to section 73 is applicable only to a company. **It is applicable only when the part of the business of the company consist of purchase and sale of shares** i.e., the company must be carrying on some other business in addition to the business of purchase and sale of shares. In such a case, the business of purchase and sale of shares shall be deemed to be speculation business **EVEN IF DELIVERIES OF SHARES HAVE BEEN AFFECTED. If the principal business of the company is business of trading in shares, then the Explanation to section 73 shall not apply even if company is also carrying on some other business.**
2. Explanation to section 73 is applicable only for sale and purchase of shares. The said Explanation is not applicable for sale and purchase of units, debentures.
3. **Explanation to section 73 is not applicable to purchase and sale of derivative in shares.**

SECTION 73A: CARRY FORWARD AND SET OFF OF LOSSES BY SPECIFIED BUSINESS REFERRED IN SECTION 35AD

Loss of specified business of section 35AD can be set-off in current year and future years only against the profits of any specified business referred to in section 35AD. Loss of specified business referred in 35AD can be carried forward indefinitely and restriction of carry forward of loss for 8 Assessment Years is not applicable.

SECTION 74: LOSSES UNDER THE HEAD CAPITAL GAINS

- (i) Brought forward Long Term Capital Loss → Can be set off against current year LTCG
- (ii) Brought forward Long Term Capital Loss → Cannot be set off against current year STCG
- (iii) Brought forward Short Term Capital Loss → Can be set off against current year STCG
- (iv) Brought forward Short Term Capital Loss → Can be set off against current year LTCG

SECTION 74A: LOSS FROM THE ACTIVITY OF OWNING AND MAINTAINING RACE-HORSES

1. Loss from the activity of owning and maintaining race horses shall only be set-off against the income from the activity of owning and maintaining race horses.
2. The loss to the extent not set-off shall be carried forward to the next assessment year and set-off against the income from the activity of owning and maintaining race horses.
3. **Carry forward is permissible for 4 years.**

SECTION 79: CARRY FORWARD AND SET-OFF OF LOSSES IN THE CASE OF CERTAIN COMPANIES

1. This section applies notwithstanding anything contained in Chapter VI, i.e., Chapter of set-off, carry forward and set-off of losses.
2. The section applies to closely held company.
3. The following changes in shareholdings shall not be considered as a change in shareholding for the purpose of section 79.
 - (i) where the change takes place consequent upon the **death** of the shareholder.
 - (ii) where the change takes place by way of **gift** of shares to any **relative** of the shareholder making the gift.
 - (iii) **where any change in shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of the foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.**
 - (iv) **where any change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016.**
 - (v) **Where a change in shareholding of a company and its subsidiary and subsidiary of such subsidiary takes place when NCLT has suspended the Board of Directors of such company and appointed new directors and change in shareholding takes place pursuant to resolution plan approved by NCLT.**

(vi) Where a change in shareholding of a company takes place on account of relocation referred to in Explanation to section 47(viac)/ (viad).

(vii) Where a change in Shareholding occurs consequent to a strategic disinvestment in an erstwhile public company, subject to the condition that the ultimate holding company continues to hold, directly or through its subsidiary(ies), at least 51% of the voting power of such public sector company in aggregate.

(Clause Added by Finance Act, 2022)

4. If, after completion of strategic disinvestment, condition mentioned in '(vii)' above is not complied with, in any year, the provisions of section 79(1) shall apply for such previous year and subsequent previous years.

**(Sub-section Added by Finance Act, 2022)
(Amendments discussed in Chapter of Amalgamation)**

5. It may be noted that section 79 is applicable notwithstanding anything contained in Chapter VI. Therefore, the provisions of section 79 are applicable only in case of carry forward of losses. The carry forward of depreciation allowance is governed by section 32(2) and therefore, section 79 will not restrict carry forward and set off of depreciation. [CIT v. Concord Industries Ltd., DECIDED BY THE SUPREME COURT].

CARRY FORWARD OF LOSSES BY CLOSELY HELD COMPANY PURSUANT TO CHANGE IN SHAREHOLDING

1. A closely held company not being an eligible start up can carry forward the losses in case of change in shareholding if **condition I** is satisfied.
2. A closely held company being an eligible start up can carry forward the losses in case of change in shareholding if either **condition I or condition II** is satisfied.

CONDITION I APPLICABLE TO ALL CLOSELY HELD COMPANIES INCLUDING AN ELIGIBLE START UP.

- In case of a closely held company, where a change in shareholding has taken place in a previous year, then no loss incurred in any year prior to such previous year shall be carried forward and set off against the income of the previous year unless on the last day of the previous year and on the last day of the year in which loss was incurred, the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

• Previous Year	31.03.2021	31.03.2022	31.03.2023
Current Year - P/G/B/P	(-) ₹ 2 Lakhs	(-) ₹ 3 Lakhs	₹ 10 Lakhs

Change in shareholding takes place on 30.06.2022.

- Loss of Previous Year 31.03.2021 shall be carried forward to previous year 31.03.2023, if as on 31.03.2021 and 31.03.2023, 51% of more of the voting power is beneficially held by the same persons.
- Loss of Previous Year 31.03.2022 shall be carried forward to previous year 31.03.2023, if as on 31.03.2022 and 31.03.2023, 51% or more of the voting power is beneficially held by the same persons.

CONDITION II APPLICABLE TO A CLOSELY HELD COMPANY BEING AN ELIGIBLE START UP IF CONDITION I IS NOT SATISFIED

- Where a change in shareholding has taken place in a previous year in the case of a closely held company
- being an eligible start-up,
- the loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year,
- if, all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred,—
 - (i) continue to hold those shares on the last day of such previous year; and
 - (ii) such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated.

Suppose a company was incorporated in June, 2020 as an eligible start up and is a closely held company. The paid-up Capital of the Company is ₹ 10,00,000 which is held by Mr. A and Mrs. A. The company incurred losses as under:

In Previous Year 31.03.2021	₹ 15,00,000
In Previous Year 31.03.2022	₹ 21,00,000

Now the company is in need of funds. The company issues shares of paid up value of ₹ 50,00,000 to M/s Robot on 30.04.2022. Now shareholding pattern is as under:

Mr. A & Mrs. A	: Paid up shares of ₹ 10,00,000
M/s Robot	: Paid up shares of ₹ 50,00,000

Shareholding of Mr. A and Mrs. A which was 100% upto 31.03.2022 now falls to 16.67%.

Now condition I is not satisfied since as on

- i. 31.03.2021 being last day of previous year in which loss of ₹ 15,00,000 was incurred and on 31.03.2023, being the last day of previous year in which change in shareholding takes place, 51% shares were not beneficially held by same persons.
- ii. 31.03.2022 being last day of the previous year in which loss of ₹ 21,00,000 was incurred and on 31.03.2023 being last day of the previous year in which change in shareholding takes places, 51% shares were not beneficially held by same person.

However, since condition II is satisfied:

- i. Loss of previous year 31.03.2021 of ₹ 15,00,000 shall be carried forward to previous year 31.03.2023 since all the shareholders of the company who held shares as on 31.03.2021 continue to hold those shares on 31.03.2023. Mr. A and Mrs. A were holding 1,00,000 shares of ₹ 10 each on 31.03.2021 and they continue to hold 1,00,000 shares of ₹ 10 each on 31.03.2023.

Loss of previous year 31.03.2022 of ₹ 21,00,000 shall be carried forward to previous year 31.03.2023 since all the shareholders of the company who held shares on 31.03.2022 continue to hold those shares on 31.03.2023. Mr. A and Mrs. A were holding 1,00,000 shares of ₹10 each on 31.03.2022 and they continue to hold 1,00,000 shares of ₹ 10 each on 31.03.2023.

- ii. Loss relates to seven years beginning from the year the company was incorporated i.e. loss is of previous year 31.03.2021 to previous year 31.03.2027.

Note: The losses shall be carried forward in the above case if shares are transferred to Mr. X and Mr. Z on death of Mr. A and Mrs. A since such change in shareholding is not considered as change in shareholding. Similarly losses shall be carried forward in the above case if Mr. A and Mrs. A gifts the shares to their relatives as such a change is not considered as change in shareholding.

SECTION 79A: NO SET OFF OF LOSSES CONSEQUENT TO SEARCH, REQUISITION AND SURVEY

In sections 70 to 80, there are specific provisions relating to set off or carry forward and set-off of losses while computing the income under various heads and with respect to different classes of persons. However, currently, there is no provision to disallow claim of set off of losses/unabsorbed depreciation against undisclosed income (corresponding to difference in stock, undervaluation of stock, unaccounted cash payment, etc.) which is detected during the course of search or survey proceedings. Moreover, no distinction is made between undisclosed income which was detected owing to search and seizure or survey or requisition proceedings and income assessed in scrutiny assessment in the regular course of assessment though for incomes falling in section 68, section 69, section 69B, etc., such restriction is there.

To disallow aforesaid adjustment of losses, section 79A has been inserted with effect from the assessment year 2022-23. It provides for the following-

1. Section 79A is applicable notwithstanding anything contained in the Act.
2. There is a search initiated under section 132 for a requisition made under section 132A or a survey conducted under section 133A, other than under sub-section (2A) of section 133A].
3. Total income of the concerned assessee includes any undisclosed income.

If the above conditions are satisfied, the assessee will not be eligible to set off, against such undisclosed income, of any loss [whether brought forward or otherwise, or unabsorbed depreciation under section 32(2)]

Undisclosed income is defined for the above purpose as -

- (a) any income of the previous year represented, either wholly or partly, by any money, bullion, jewellery or other valuable article or thing or any entry in the books of account or other documents or transactions found in the course of a search under section 132 or a requisition made under section 132A or a survey conducted under section 133A [other than that conducted under sub-section (2A)], which has-

- not been recorded on or before the date of search or requisition or survey, in the books of account or other documents maintained in the normal course relating to such previous year; or
 - not been disclosed to the PCCIT/CCIT/PCIT/CIT before the date of search or requisition or survey, or
- (b) any income of the previous year represented (either wholly or partly) by any entry in respect of an expense recorded in the books of account or other documents maintained in the normal course relating to the previous year which is found to be false and would not have been found to be so, had the search not been initiated or the survey not been conducted or the requisition not been made.

GENERAL NOTES

1. **Losses cannot be set-off against the incomes referred to in section 115BB i.e. lottery income, crossword puzzles, incomes in TV shows, etc.**
2. **Losses must be set-off in the immediate succeeding year and the loss not so set-off shall lapse.**

LOSSES TO BE CARRIED FORWARD ONLY IF RETURN IS FILED ON OR BEFORE THE DUE DATE OF FILING OF RETURN UNDER SECTION 139(1)

The following losses shall not be carried forward if return of income is not furnished on or before the due date of filing of return under section 139(1):

1. Losses under the head "Profits and gains of Business or Profession" (Section 72)
2. Speculation losses. (Section 73)
3. Losses of specified businesses referred in section 35AD. (Section 73A)
4. Losses under the head "Capital gains". (Section 74)
5. Losses from the activity of owning and maintaining race horses. (Section 74A)

KEY NOTE:

It may be noted that losses under the head "Income from House Property" and "Unabsorbed depreciation" shall be carried forward even if return of income is furnished after the due date specified under section 139(1).

SUMMARY OF RULES FOR SET-OFF AND CARRY FORWARD

Heads of Income

