

# 'Income' Includes 'Loss' – A Revisit



'Income includes loss' is a phrase found in various judicial precedents in the context of Indian income-tax laws, although commercially 'income' and 'loss' have always been understood to be antonyms. There are various principles concerning ambit of 'income'. One among them is 'income includes loss'. A number of decisions including the apex court ruling in the case of *CIT vs. J.H. Gotla* (1985) 156 ITR 323 (SC) and *CIT vs. Harprasad & Co. Pvt. Limited* (1975) 99 ITR 118 (SC) has flagged this canon. The attempt in this write-up is to re-visit and discern the meaning of the phrase 'income includes losses'. In this journey, the write-up touches upon various instances in the Act when this principle 'appears' to be inapplicable or unworkable. The write-up attempts to initiate a thought whether this principle is to be applied in every situation or this has a restricted application.



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'Income includes loss' is a phrase found in various judicial precedents in the context of Indian income-tax laws, although commercially 'income' and 'loss' have always been understood to be antonyms. The gap between the commercial and tax understanding is intentional. In this context, it is important to know the meaning of the terms 'income' and 'loss' (along with difference between them).

**Income** is a term, though commonly used, is seldom understood. It has always triggered more questions rather than answers. It cannot be understood with recourse to some accepted tenets, beliefs and

established class of propositions. To limit income exclusively to one or any specific sphere would be an unjustified arrest of its reach. Possibly, this is the reason that income-tax statute also has left the definition of income open-ended.

### Definition of income in the Income-tax Act, 1961 ("the Act")

Section 2(24) of the Act provides an inclusive definition of the term 'income'. It does not define 'income' *per se*. Section 2(24), if paraphrased, would read as under: (24) "income" includes

- *profits and gains*
- *dividend*
- *voluntary contributions received by a trust*
- *the value of any perquisite or profit in lieu of salary taxable*
- *any special allowance or benefit, other than perquisite included under sub-clause (iii), specifically granted to the assessee*
- *any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed or to compensate him for the increased cost of living*
- *the value of any benefit or perquisite, whether convertible into money or not, obtained from a company or by a representative assessee*
- *any sum chargeable to income-tax under clauses (ii) and (iii) of section 28 or 41 or 59*
- *any sum chargeable to income-tax under clause (iiia) of section 28(iiia)/ (iiib)/ (iiic)*
- *the value of any benefit or perquisite taxable under clause (iv) of section 28*
- *any sum chargeable to income-tax under clause (v) of section 28*
- *any capital gains chargeable under section 45*
- *the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society*
- *the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members*
- *any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever*
- *any sum received from employees towards ESIC contribution*
- *any sum received from Keyman Insurance policy*

- *Gifts or receipts for inadequate consideration.*

Section 2(24) enlists various instances of income. First among them is 'profits and gains'. The terms 'profits' and 'gains' have not been defined in the Act. It is trite to state that in the absence of statutory definition one could place reliance on the dictionary meaning or normal connotation of term(s). If dictionary meanings are referred, 'profits' means *excess of revenue over expenditure* and 'gains' as *an increase in amount, degree or value*. These twin concepts are indicative of a positive figure. There are judicial precedents to indicate that gains include 'negative gains' and we would keep these judicial precedents aside for the time being [and restrict ourselves to terminologies used in the Act].

Other terms used in the definition are 'received', 'granted', 'winnings', 'obtained' - all these terms also have an element of 'positivity' inbuilt in them. Can these terms be used along with 'losses'? A loss is something different. It is not something which is received or won or granted or obtained. It comes 'ab-extra' from outside. The term loss generally accompanies verbs such as 'incurred', 'sustained', 'computed', 'suffered' etc. The use of these terms in Section 2(24) appears to indicate that the law does not visualise any losses to be listed therein. This becomes more evident on a reading of the remaining instances in the definition which confine themselves to incomes which are chargeable to tax. These are obviously not concerned with losses. To conclude, although Section 2(24) is an inclusive definition, *the instances listed therein do not seem to accommodate 'losses' within its stride*.

Although Section 2(24) is an inclusive definition and its normal meaning should not be curtailed by various items listed therein in its inclusive sweep, it is interesting to observe that the legislature has

**Chapter VI of the Act deals with aggregation of income and set off of loss. Section 70 provides for set off of 'loss' from one source of income against 'income' from another source under the same head. If the losses cannot be fully set-off against income under the same head, they may be set-off against incomes under other heads (Section 71). The balance losses remaining after set off against the incomes computed under other heads is carried forward to the succeeding years as per the relevant provisions of the Act.**

consciously not included a 'single' instance to suggest that income may possibly include a negative face also.

### Scope and Charge of Total Income

Section 4 is the charging provision under the Act. The charge is in respect of the total income of a person for any year. The scope of total income is outlined by Section 5 which has two sub-sections - one dealing with residents and other with non-residents. It enlists incomes which are includible in total income. It recognises those incomes which are to be included in total income on 'receipt' or 'accrual' or 'deemed accrual' basis. Cumulatively, these sections seek to include income within the scope of total income to levy a charge of tax. The question is whether losses can be charged to tax? Can losses be accrued or received or deemed so? The answer is negative.

This is because, the term(s) 'accrue or arise' connotes 'legal right to receive'. It is generally a stage prior to actual receipt (except for advances). The gap between accrual and actual receipt is only a matter of timing difference. It needs no explanation to state that losses cannot be 'received'. When they cannot be received; how can there be a right to receive them? - Readers may deliberate.

### Provisions of Clubbing of Income

Explanation 2 to Section 64 reads - 'For the purposes of this section, "income" includes loss.' This explanation was inserted by Finance Act 1979 whose objective is explained by Circular No. 258, dated 14-6-1979; relevant portion of which is as under:

*"17.2 Under the provisions of section 64, the income of the specified persons is liable to be included in the total income of the individual in certain circumstances. The Finance Act, 1979 has inserted a new Explanation 2 below section 64(2) to provide that the term "income" for the purposes of section 64 would include a loss. Hence, for example, where the individual and his spouse are both partners in a firm carrying on a business and the firm makes a loss, the share of loss attributable to the spouse will be included in determining the total income of the individual." (emphasis supplied)*

The intention of the aforesaid amendment/ insertion was to include losses in determining total income of the person in whose hands the income gets clubbed. The inclusion was, therefore, sought to be made in 'total income' determination. Losses of one person (whose income/ loss get clubbed) were sought to be set-off

against the income of another person (in whose hands the income is getting clubbed). The explanation seeks to enable set-off of losses of one person in another's hand. To effectuate this principle the legislature inserted explanation 2 whereby income for the purposes of this Section includes loss. The important aspect here is the limited scope of this explanation. The content of this explanation is limited to the context of Section 64 only. It does not travel beyond this. The explicit mention of such an aspect goes on to substantiate that *under general principles income does not include losses*. This is a unique provision with a special purpose.

Some of the circulars on the aspect of considering losses for the purpose of set-off against income provide some insight into the purpose of such legislation. In addition to circular 258 dated 14-6-1979 (referred above) one may refer the C.B.R. Circular No. 20 of 1944 - C. No. 4(13)-I.T/ 44 dated the 15th July, 1944 which reads as under:

*Subject : Section 16(3)(a) - Loss incurred by wife or minor child - Right of set off under section 24(1) and (2).*

*Attention is invited to the Boards Circular No. 35 of 1941, on the above subject. It was laid down therein that where the wife or minor child of an individual incurs a loss which if it were income would be includible in the income of that individual under section 16(3), such loss should be set off only against the income, if any, of the wife or minor child and if not wholly set off should be carried forward, subject to the provisions of section 24(2). The Board has reconsidered the question and has decided that, although this view may be tenable in law, the other and more equitable view is at least equally tenable that such loss should be treated as if it were a loss sustained by that individual. Thus if the wife or minor child has a personal income of Rs. 5,000 which is not includible in the individual's income and sustains a loss of Rs. 10,000 from a source the income of which would be includible in the income of the individual, the loss should be set off against the income of the individual under section 24(1), and if not wholly set off should be carried forward under section 24(2). The wife or the minor child, would, therefore, be assessable on the personal income of ₹ 5,000. If in any case the wife or minor child claims a set-off of the loss against the personal income, it should be brought to the notice of the Board. Boards Circular No. 35 of 1941 is hereby cancelled." (emphasis supplied)*

Thus, losses are included to enable set-off

against income. The inclusion is in the total income computation and not in income as such. The inclusion is for the limited purpose of computation. The Direct Tax Law Committee 1978, in its final report, also made some observations on this provision:

*"The provisions for aggregating income of the spouse under clause (i) of section 64(1) has led to a dispute in regard to the treatment of losses which may fall to the share of the spouse from the partnership. The Gujarat High Court in Dayalbai Madhavji Vadera v. CIT [1966] 60 ITR 551 has ruled that the section contemplates inclusion of income and, accordingly, the share of loss arising to the spouse cannot be set off against the total income of the other spouse. The Karnataka High Court in Kapadia v. CIT [1973] 87 ITR 511 has dissented from this view and has held that income in this section includes a loss. On general principles, income from membership in a firm would include a loss and the context of clause (i) of sub-section (1) does not warrant the contrary construction. The liability to assessment cannot alternate from year to year between the individual and the spouse depending on whether there is a profit or a loss...". (emphasis supplied)*

The Committee has categorically said that income 'in this section' includes loss. To state negatively, otherwise (or under normal circumstances) income does not include loss. The reason for such inclusion is to ensure consistency in the process of aggregating the profit or loss with the spouse's income. It does not indicate income to include loss in all circumstances.

The scope of clubbing section is limited. It provides for clubbing of one's income in the total income of another. By defining income to include loss, it is suggesting that loss of one person (along with income) may also be included in the total income of another person. The inclusion of loss is expanding the scope of 'clubbing' and not 'income'.

### Set-off and Carry Forward of Losses

Chapter VI of the Act deals with aggregation of income and set off of loss. Section 70 provides for set off of 'loss' from one source of income against 'income' from another source under the same head. If the losses cannot be fully set-off against income under the same head, they may be set-off against incomes under other heads (Section 71). The balance losses remaining after set off against the incomes computed under other heads is carried forward to the succeeding years as per the relevant provisions of the Act. Thus,

**In author's opinion, the term 'income' is not a polymorphous term having an open texture. Income which indicates 'coming in' is an embodiment of positivity. It signifies pecuniary enrichment or accumulation. Loss is indicative of opposite emotions (to income). Loss may take various forms but would always result in deterioration. Indian tax provisions (keeping the judicial precedents aside) actually do not seek to hold these contradictory terms synonymous in every situation. At best, loss can be defined to be 'loss of income' and not 'loss includes income'.**

the Act recognises loss to be different from income. Loss has an effect of reducing income in the process of set-off against income. An increase in loss would reduce the income. They are inversely proportional. The opening portion of Section 70 and 71 is broadly similar language which is reproduced below:

Section 70	<i>(1) Save as otherwise provided in this Act, where the net result for any assessment year in respect of any source falling under any head of income, other than "Capital gains", <u>is a loss, the assessee shall be entitled to have the amount of such loss set off against his income</u> from any other source under the same head.</i>
Section 71	<i>(1) Where in respect of any assessment year the net result of the computation under any head of income, other than "Capital gains", is a loss and the assessee has no income under the head "Capital gains", he shall, subject to the provisions of this Chapter, be <u>entitled to have the amount of such loss set off against his income</u>, if any, assessable for that assessment year under any other head.</i>

Both the Sections deal with set off of loss against income. The legislature itself recognises income and loss to be different and distinct. They are different outcomes having opposite characters. They cannot co-exist. This being the case, can one say that income includes loss?



The term 'include' means - 'to Comprise or contain as part of a whole'. Say for instance, if A includes B, then, A either consists of B wholly or partially. On the contrary, if the presence of B negates or diminishes the existence of A, then can we say that A includes B? In the context of clubbing, the legislature required losses (of one person) to be clubbed along with income (of another). This clubbing is to facilitate total income computation. Thus, the inclusion is only 'quantitative' and not 'qualitative'. This being the case, such limited quantitative inclusion of the legislature cannot be understood to be 'qualitative' to paint all the incomes with such understanding.

In the context of Section 70 and 71, 'loss' is a mere outcome in the process of computing income. This is apparent from the language used in these twin sections which read - 'where the net result....'. Loss is a net result or consequence. The other alternative outcome is 'income'. To elucidate further, one may look at the structure of the Income-tax Act.

Section 4 creates a charge on total income. Section 5 (read with Section 7 and 9) outline the scope for such total income. While computing total income certain incomes are excluded by section 10 (along with 11). Section 14 classifies income into 5 heads for the purpose of total income computation (and charge of income-tax). Sections 15 to 59 compute incomes under various heads. Section 60 to 64 include (or club) certain incomes to assessee's total income. The focus is thus on total income computation since the charge under section 4 is on it. While making such computation, when the income is insufficient to absorb the costs/expenditures/other outlays; an assessee ends up with a situation of unabsorbed costs/expenditures. This event of income falling short of outflows is called 'loss'. Can such a situation be termed as 'income'? Loss and

Income are names of opposite fiscal situation(s) and cannot be equated with one another.

'Loss' is conceptually different from income. It is not defined in the Act. Black's law dictionary defines 'loss' as - 'An undesirable outcome of a risk; disappearance or diminution in value; usually in an unexpected or relatively unpredictable way'. The definition appears to reflect attributes of involuntary happening. Although Companies Act of 1956 does not define 'loss' there is an indirect inference one could draw from Section 210(2) therein which reads -

(2) *In the case of a company not carrying on business for profit, an income and expenditure account shall be laid before the company at its annual general meeting instead of a profit and loss account, and all references to "profit and loss account", "profit" and "loss" in this section and elsewhere in this Act, shall be construed, in relation to such a company, as references respectively to the "income and expenditure account", "the excess of income over expenditure", and "the excess of expenditure over income". (emphasis supplied)*

The meaning of loss has been explained to be 'excess of expenditure over income'. It is a differential between expenditure and income. It is an outcome when income is unable to absorb all the expenditure/costs. In other words, unabsorbed cost is loss. The interplay between income and expenditure results in loss. While computing income, loss could arise if the income falls short of expenditure. Loss is thus a status or situation wherein expenditure exceeds income. It is not a part of income. Something to be included in income, it should be a part of it. Income (net) or losses are two alternatives. They are outcomes. One denotes surplus and other is an epitome of deficit. From an income-tax standpoint, marriage of these two extremes is impossible sans specific situations such as clubbing or set-off provisions (referred above).

Accounting standards also differentiate the two. Accounting Standard 22 [Disclosure and computation

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of deferred tax] defines *taxable income (tax loss)* as the amount of the *income (loss)* for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined. Income and loss have been recognised as alternatives. Loss is an antonym of income. The question is whether such parallel and unlike concepts overlap under the income-tax regime?

As stated in the beginning of this write-up, various courts held that income includes 'losses'. It appears to be a fairly settled proposition. Whether this proposition is applicable in every situation? Does 'income', which is inherently positive, include losses?

In author's opinion, the term 'income' is not a polymorphous term having an open texture. Income which indicates 'coming in' is an embodiment of positivity. It signifies pecuniary enrichment or accumulation. Loss is indicative of opposite emotions (to income). Loss may take various forms but would always result in deterioration. Indian tax provisions (keeping the judicial precedents aside) actually do not seek to hold these contradictory terms synonymous in every situation. At best, loss can be defined to be 'loss of income' and not 'loss includes income'.

Having gone through the various instances and indications in the Act, the question still persists. The mystery around relationship between income and loss still lingers. Can these instances in the statute shake the law of land (Apex Court rulings)? Readers may deliberate whether Income Really Includes Loss?

If this proposition is accepted, can a daring attempt be made to claim that 'losses emanating from sources of income which are exempt can be set-off against other income'? Although this proposition is well settled by the Apex Court in the case of *CIT vs. Harprasad & Co. Pvt. Limited* (1975) 99 ITR 118 (SC), the attempt is to just explore an alternate school of thought:

### Loss is Not a Part of Total Income

Section 2(45) defines total income to mean total amount of income referred to in Section 5 and computed in the manner laid down in the Act. The definition thus contains two limbs which are as follows:

- (a) The income includible in total income must be ascertained as per Section 5; and
- (b) The income must be computed as per provisions of the Act.

'Total income' defined in Section 2(45) presupposes an existence of 'income' referred to in Section 5. For the reasons mentioned above, Section 5 does not appear to cover losses. Therefore, Section 2(45) can

never include loss (since they cannot be ascertained as per section 5). Section 10 seeks to exclude certain incomes from total income. When a loss is never included in total income, how can section 10 exclude something which never existed?

### Section 10 Can Never Exempt a Loss

Section 10 contains provisions for exemption of certain incomes. It never exempts a loss. In fact, courts have held that exemptions provided by the legislature itself may furnish an infallible clue to the income character of a particular receipt [Refer All India Defence Accounts Association, In re: *Shailendra Kumar vs. UOI* (1989) 175 ITR 494 (All)]; although not conclusive.

The apex court in the case of *UOI vs. Azadi Bachao Andolan and Another* 263 ITR 706 (SC) held that the 'liability to tax' is a legal situation; whereas 'payment of tax' is a fiscal fact. A taxing statute does not always proceed to charge and levy tax. Exemption provisions provide exemption from payment of tax. One among them is Section 10. The incomes enumerated therein exclude income from the total income. However, it does not annul the charge of tax. An exemption cannot dispense with the very levy created under the Act [Refer *B.K. Industries vs. UOI* (1993) 91 STC 548]. Support for this proposition can be drawn from the apex court decision in the case of *Peekay Re-Rolling Mills vs. Assistant Commissioner - 2007* (219) ELT 3 (SC) - In this case, the court observed:

*"In our opinion, exemption can only operate when there has been a valid levy, for if there is no levy at all, there would be nothing to exempt. Exemption does not negate a levy of tax altogether."*

*"Despite an exemption, the liability to tax remains unaffected, only the subsequent requirement of payment of tax to fulfill the liability is done away with."* (emphasis supplied)

Taking cue from the aforesaid decision (although rendered in the context of central excise), one could argue that exemption section could operate on only those income which can come within the ambit of income-tax levy. Loss can never be subject to income-tax levy; so there is no occasion to take relief of exemption provisions. Moreover, it is a settled principle that exemption provisions have to be construed liberally. The tax relief granted by a statute should not be whittled down by importing limitations not inserted by the legislature [Refer *CIT vs. K. E. Sundara Mudaliar* (1950) 18 ITR 259 (Mad) and others]. ■