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Appeal to Revisit Amendments in Section 112 with Respect to Capital Loss Set-off under Sections 74 and 80

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Subject: Request for Revisiting Amendments in Section 112 – Preservation of Capital Loss Set-off under Sections 74 and 80

Respected Madam,

Most respectfully I wish to bring to your kind notice certain unintended consequences that have arisen out of the amendments made in the Finance Bill 2024–25 presented on 23rd July 2024.

The amendment to Section 112 reduced the long-term capital gains (LTCG) tax rate from 20% to 12.5%, along with corresponding amendment in Section 48, which removed the benefit of indexation. While the reduction in tax rate is welcome, the complete withdrawal of indexation has caused widespread concern among taxpayers as most of it is felt now in using the income tax utilities at the time of submitting of returns of income.

In response, a revised formula was hastily inserted in Section 112 to grant limited indexation benefits for land or building or both acquired before 23rd July 2024. Unfortunately, this corrective step, though well-intentioned, has led to serious disruptions in the harmonious functioning of the Act. The new formula in Section 112, by restricting indexation and re-computing gains in a non-standard manner, has thus effectively rendered Sections 74 and 80 dysfunctional and capital losses that taxpayers are otherwise entitled to set-off or carry forward are lapsing into thin air as shown below:

particulars	Scenario 1	Scenario 2	Scenario 3
Sale price (A)	5000000	4000000	3500000
Original cost (B)	2500000	2000000	1750000
Indexed cost (C)	7000000	5000000	3000000
Capital Gains with Indexation (D=A-C)	(2000000)	(1000000)	500000
Tax @20% (E)	0	0	100000
Capital Gains w/o Indexation (F=A-B)	2500000	2000000	1750000
Tax @12.5% (G)	312500	250000	218750
Excess of liability under G over E to be ignored	312500	250000	118750

Notes:

1. Where indexation results in a loss, tax liability under 20% regime is NIL.
2. In such cases, the 12.5% regime without indexation becomes relevant.
3. The taxpayer can choose the method beneficial to him as per amended Section 112 but cannot carry forward losses in scenario 1 and 2 of 2000000 and 1000000. In other words losses too have to be ignored or stand lapsed.

1. Impact on Capital Loss Set-off

Section 74 allows set-off of brought forward capital losses. Section 80 further enables their lawful carry forward for future adjustment. However, due to the modified formula in Section 112, capital losses that have been carried forward are no longer being given effect while filing returns. Instead, they are lapsing without adjustment, creating a direct conflict with the statutory scheme.

2. Conflict with Legislative Scheme

The Income-tax Act is designed to work as an integrated whole, where provisions relating to income, gains, losses, set-off and carry forward must function seamlessly. By restricting indexation in a manner that indirectly nullifies the application of Sections 74 and 80, the amendment creates an inconsistency within the Act. This appears to be ultra vires the scheme of the law, as taxpayers' legitimate and accrued rights are being extinguished without express authority of Parliament.

3. Way Forward

The intent behind lowering the LTCG rate is laudable and taxpayer-friendly. However, the current drafting needs to be recast so that:

- Provisions of Sections 74 and 80 operate in their full spirit, without artificial restrictions or limitations.
- Carry forward and set-off of capital losses are recognized, held intact and enforceable and not rendered redundant due to computational anomalies.

A balanced approach would be to restore full compatibility between Section 112 and the loss set-off framework under Sections 74 and 80, ensuring that taxpayers' legitimate losses are recognized. The artificial limitation created by the July 23 formula disrupts this balance, selectively denies indexation, alters the base of computation and nullify substantive rights under such provisions. I earnestly request that the Government kindly revisit the amendment to Section 112 (Section 197(3) of the new 2025 Act) and consider redesigning the formula and the income tax utilities so that it does not override or dilute the application of Sections 74 and 80 in filing of returns. Such a step will preserve consistency, fairness, and taxpayer's confidence in our tax laws.

Yours faithfully,

CA Gopal Nathani

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