INCOME TAX: Income from sale of Carbon Emission Reduction Certificates is capital receipt

[2019] 109 taxmann.com 333 (Jaipur - Trib.)

IN THE ITAT JAIPUR BENCH 'A'

Assistant Commissioner of Income Tax

v.

Ginni Global (P.) Ltd.*

VIJAY PAL RAO, JUDICIAL MEMBER
AND VIKRAM SINGH YADAV, ACCOUNTANT MEMBER
IT APPEAL NOS. 403 AND 404 (JP) OF 2019
CO. NOS. 11 & 12 (JP) OF 2019
[ASSESSMENT YEARS 2010-11 & 2011-12]
JULY 30, 2019

Section 4 of the Income-tax Act, 1961 - Income - Chargeable as (Carbon Emission Reduction Certificates Sales) - Assessment years 2010-11 and 2011-12 - Whether amount received on sale of Carbon Emission Reduction Certificates is capital receipt - Held, yes [Para 5] [In favour of assessee]

FACTS

- The assessee-company was engaged in the business of generation of electricity through hydro electric power plant. Its claim for deduction under section 80-IA was allowed in assessment.
- Subsequently, the Assessing Officer reopened the assessment by issuing notice under section 148 on the ground that the assessee had claimed deduction under section 80-IA in respect of Carbon Emission Reduction Certificates (CERs) sales which was not eligible for the deduction under section 80-IA. While passing the reassessment order under section 143(3), read with section 147 the Assessing officer disallowed the claim of deduction under section 80-IA in respect of the income from sale of Carbon Emission Reduction Certificates (CERs).
- On appeal, the Commissioner (Appeals) following the decision of Jurisdictional High Court in case of *Pr. CIT* v. *Rajasthan State Mines & Minerals Ltd*. [D.B. IT Appeal No. 151 of 2016, 13-10-2017] allowed the claim of the assessee by holding that the income from sale of Carbon Emission Reduction Certificates (CERs) was capital receipt.
- On revenue's appeal:

HELD

- The Commissioner (Appeals) has followed the decision of Jurisdictional High Court in case of *Rajasthan State Mines & Minerals Ltd.* (*supra*). No contrary decision had been brought on record. Further as per proviso to section 28(va) a sum received as compensation on account of measure taken to curb the use or emission of substance

that deplete the Ozone layer under the United Nations Environment Programme is excluded from business income. Thus, any sum received on account of carbon credit or protecting the environment is not included in the business income. However, subsequently there is an amendment by the Finance Act, 2017, whereby section 115BBG has been inserted in the statute with effect from 1-4-2018. Thus, the income by way of transfer of carbon credit has been given a special treatment as chargeable to tax at the rate of 10 per cent and not as part of the normal business income of the assessee. The said amendment is prospective in nature and, therefore, cannot be applied to the assessment years under consideration. In view of the above discussion as well as fact and circumstances of the case, there is no error or illegality in the impugned order of the Commissioner (Appeals). [Para 5]

CASES REFERRED TO

Pr. CIT v. *Rajasthan State Mines & Minerals Ltd.* [D.B. IT Appeal No. 151 of 2016, dated 13-10-2017] (para 4) and *CIT* v. *Shree Cement Ltd.* [II Appeal No. 85 of 2014, dated 22-8-2017] (para 4).

J.C. Kulhari, JCIT *for the Appellant.* **V.P. Gupta**, Adv. *for the Respondent.*

ORDER

1. These two appeals by the Revenue and Cross Objection by the assessees are directed against two separate orders of ld. CIT(A), Alwar dated 07.01.2019 & 18.01.2019 for the assessment year 2010-11 & 2011-12 respectively. The Revenue has raised solitary common ground for both the years except quantum of addition/disallowance as under :—

Revenue-s Ground (ITA No. 403/JP/2019)

'Appeal is filed on the following grounds against the order of ld. CIT(A), Alwar in appeal No. 353/2015-16 dated 09.08.2018 in the case of M/s Ginni Global Pvt. Ltd., SP-2/1A & 2/2, RIICO Industrial Area, Neemrana, Disst. Alwar (PAN AAACG 3006H) for the A.Y. 2010-11:—

"1. Whether on the facts and circumstances of the case, the ld. CIT(A), Alwar was justified in holding the income from sales of Carbon Emission Reduction Certificates (CERs)) of Rs. 1,53,30,540/- as 'capital receipt- without appreciating the facts that the same is revenue receipt and even the assessee has claimed benefit u/s80IA of the IT Act"

That the appellant craves leave to add, amend or alter the grounds of appeal on or before the date the appeal is finally heard for disposal.'

2. The assessee is a company and engaged in the business of generation of electricity through hydro electric power plant. The assessee filed its return of income U/s 139(1) of the Act for both the years which were completed U/s 143(3) of the Act whereby the AO allowed the claim of deduction U/s 80IA of the Act. Subsequently, The AO reopened the assessment by issuing notice U/s 148 of the Act on the ground that the assessee has claimed deduction U/s 80IA of the Act in respect of Carbon Emission Reduction Certificates (CERs) sales which is not eligible for the deduction U/s 80IA of the Act and therefore, the income assessable to tax has escaped assessment. While passing the reassessment order passed U/s 143(3) r.w.s. 147 of the Act the AO disallowed the claim of deduction U/s 80IA of the Act in respect of the income from sale of Carbon Emission Reduction Certificates (CERs) of Rs. 1,53,30,540/- and 68,43,549/- for the assessment years 2010-11 & 2011-12 respectively. The assessee challenged the action of the AO before the ld. CIT(A) and contended that even otherwise the said receipt is capital receipt that not chargeable to tax. The ld. CIT(A) allowed the claim of the assessee by holding that the

income from sale of Carbon Emission Reduction Certificates (CERs) is capital receipt.

3. We have heard the ld. DR as well as the ld. AR and considered the relevant material on record. The ld. DR has relied upon the orders of the Assessing Officer and submitted that the assessee itself as included the said income in the total income however, claimed deduction U/s 80IA of the Act which is not applicable on such income. The ld. CIT(A) has deleted the disallowance made by the AO by holding that amount received on sale of Carbon Emission Reduction Certificates (CERs) is capital in nature which was not the claim of the assessee.

4. On the other hand, ld. AR has submitted that the issue is covered by the decision of Hon'ble jurisdictional High Court in case of *Pr. CIT* v. *Rajasthan State Mines & Minerals Ltd.* dated 13.10.2017 in D.B. ITA No. 151/2016 as well as judgment dated 22.08.2017 in case of *CIT* v. *Shree Cement Ltd.* in ITA No. 85/2014.

5. We have considered the rival submissions as well as the relevant material on record. At the outset we note that the ld. CIT(A) has decided this issue in para 6.4 & 6.5 as under:—

> "6.4 I have considered the above mentioned facts of the case. The moot point here is whether the carbon credit receipts should be treated as capital receipts or revenue receipts. In this regard, the jurisdictional Rajasthan High Court in the case of *Pr. CIT* v. *Rajasthan State Mines & Minerals Ltd.* ITA 151/2016 dated 13.102017
>
> Merely an application of fund and not an expenditure?
>
> 3. Whether the Tribunal was justified in deleting the addition of Rs. 2,34,990/- made by disallowing the contribution to Social Welfare Activities u/s 37(1) of the Act, despite the fact that the same was not incurred exclusively for the purposes of business and hence not allowable?
>
> 4. Whether the Tribunal was justified in reversing the order of CIT(A) as well as Assessing Officer and holding the income from sale of Carbon Emission Reduction Certificates (CERs) of Rs. 36,24,742/- as capital income, ignoring that the same was specifically a revenue receipt and even the assessee hs claim benefit u/s 80IA of the Act?
>
> 5. Whether the Tribunal was justified in allowing deduction of Rs. 2,94,04,000/- in respect of mines closure expenses by reversing the orders of CIT(A) and Assessing Officer, even when the said expenditure was not even debited in the books of accounts and is also not an ascertained liability?"
>
> 3. Now, the issue no. 1,2 & 3 are covered by the decision of this court in the case of assessee in ITA No. 147/2015 on 12.10.2017.
>
> 4. For issue no. 4 counsel for the respondent has relied on the decision of this court in ITA No. 85/2014 wherein it has been held as under:-
>
> "28. The issue No. 3 is with regard to sale proceeds received by the company from the sale of certified Emission Reduction (CER) pertaining the Carbon credit shown as capital receipt.
>
> 29. In view of the decision rendered by the Supreme Court in *Vodafone International* (*supra*), it has to be taken as capital account and it cannot be taxed under the Income Tax Act since it was taxable under direct tax and the Tribunal has given the finding which reads as under:-
>
> "We have heard the rival submissions and perused the evidence on record. We find that the Appellate Tribunal in My *Home Power Ltd.* v. *DCIT* (*Supra*), have after detailed examination, concluded that the receipts from Carbon credit are capital in nature. We are inclined to follow the said decision and the other two decisions of Chennai Tribunal in Sri *Velayudhaswamy Spinning Mills (P.) Ltd.* v. *DCIT* (*supra*) and *Ambika Cotton Mills ltd.* v. *DCIT* (*supra*), where also it has

been held that receipt on account of Carbon Credit is capital in nature & neither chargeable to tax under the head business income nor liable to tax under the head capital gains. Our above view is also supported by the decision of Supreme Court in the case of *Vodafone International Holdings* v. *UOI* (*supra*) wherein Supreme Court has held that treatment of any particular item in different manner in the 1961 Act and DTC serves as an important guide in determining the taxability of said item. Since DTC by virtue of the deeming provisions specifically provides for taxability of carbon credit as business receipt and income Tax Act does not do so, our view gets duly fortified by the principles stated in the above decision of Supreme Court. Accordingly, this ground of the assessee is allowed and the addition made by the AO is deleted.

6.1 Regarding no. 5, it is not reflected in the books of accounts without takint closure of a mining is a statutory liability and the same is for the subsequent year reflected, therefore, in view of the decision rendered by the Tribunal, we are of the opinion that the Tribunal has not committed any error.

6.2 In that view of the matter, all the issue are answered in favour of the assessee and against the department.

The appeal stand dismissed. Hon'ble Rajasthan High Court in the case of *CIT* v. *Shree Cement Ltd. ITA* No. 86/2014 dated 22/08/2017 has reiterated that the carbon credit receipt is capital receipt.

The Hon'ble Supreme Court in the Vodafone case has sought to distinguish between DTC and Income Tax Act, 1961. The Income Tax Act, 1961 does not say about the taxability of carbon credit. Although now with the insertion of new section 115BBJ where the carbon credit has been brought income the tax net at the rate of 10% and this new section is applicable with effect from A.Y. 2018-19 but since this case particular pertains to A.Y. 2011-12 therefore the Hon'ble Rajasthan High Court judgment that the cardbon credit receipt is a capital receipt holds valid for A.Y. 2011-12.

6.5 I have taken into account the Hon'bleITAT, Delhi Bench Judgment in the case of *Malana power Co. Pvt. Ltd.* v. *DCIT* New Delhi, 27th April, 2018, where the Hon'ble ITA says as under;

6.1 Further, ITAT Hyderabad Bench in the case of *CIT* v. *My Home Power Ltd*. Hyderabad in ITA No. 1114/Hyd/2009 held that carbon credit receipts are capital in nature. This order of ITAT Hyderabad Bench was subsequently upheld by the Hon'ble Andhra Pradesh High Court in 365 ITR 82. The relevant portions of the order of ITAT Hyderabad Bench are as under-

"24. We have heard both the parties and perused the material on record. Carbon credit is in the nature of "an entitlement" received to improve world atmosphere and environment reducing carbon, heat and gas emissions. The entitlement earned for carbon credits can, at best, be regarded as a capital receipt and cannot be taxed as a revenue receipt. It is not generated or created due to carrying on business but it is accrued due to "world concern". It has been made available assuming character of transferable right or entitlement only due to world concern. The source of carbon credit is world concern and environment. Due to that the assessee gets a privilege in the nature of transfer of carbon credits. Thus, the amount received for carbon credits has no element of profit or gain and it cannot be subjected to tax in any manner under any head of income. It is not liable for tax for the assessment year under consideration in terms of sections 2(24), 28, 45 and 56 of the Income-tax Act, 1961. Carbon credits are made available to the assessee on account of saving of energy consumption and not because of its business. Further, in our opinion, carbon credits cannot be considered as a by-product. It is a credit given to the assessee under the Kyoto Protocol and because of international understanding. Thus, the assessees who have surplus carbon credits can sell them to other assessees have capped emission commitment under the Kyoto Protocol. Transferable carbon

credit is not a result or incidence of one's business and it is a credit for reducing emissions. The persons having carbon credits get benefit by selling the same to a person who needs carbon credits to overcome one's negative point carbon credit. The amount received is not received for producing and/or selling any product, by-product or for rendering any service for carrying on the business. In our opinion, carbon credit is entitlement or accretion of capital and hence income earned on sale of these credits is capital receipt. For this proposition, we place reliance on the judgment of the Supreme Court in the case of *CIT* v. *Maheshwari Devi Jute Mills Ltd.* (57 ITR 36) wherein it was held that transfer of surplus loom hours to other mill out of those allotted to the assessee under an agreement for control of production was capital receipt and not income. Being so, the consideration received by the assessee is similar to consideration received by transferring of loom hours. The Supreme Court considered this fact and observed in M/s. Perpetual Energy Systems Limited, Hyderabad that taxability of payment received for sale of loom hours by the assessee is on account of exploitation of capital asset and it is capital receipt and not an income. Similarly, in the present case the assessee transferred the carbon credits like loom hours to some other concerns for certain consideration. Therefore, the receipt of such consideration cannot be considered as business income and it is a capital receipt. Accordingly, we are of the opinion that the consideration received on account of carbon credits cannot be considered as income as taxable in the assessment year under consideration. Carbon credit is not an offshoot of business but an offshoot of environmental concerns. No asset is generated in the course of business but it is generated due to environmental concerns. Credit for reducing carbon emission or greenhouse effect can be transferred to another party in need of reduction of carbon emission. It does not increase profit in any manner and does not need any expenses. It is a nature of entitlement to reduce carbon emission, however, there is no cost of acquisition or cost of production to get this entitlement. Carbon credit is not in the nature of profit or in the nature of income. 25. Further, as per guidance note on accounting for Selfgenerated Certified Emission Reductions (CERs) issued by the Institute of Chartered Accountants of India (ICAI) in June, 2009 states that CERs should be recognised in books when those are created by UNFCCC and/or unconditionally available to the generating entity. CERs are inventories of the generating entities as they are generated and held for the purpose of sale in ordinary course. Even though CERs are intangible assets those should be accounted as per AS-2 (Valuation of inventories) at a cost or market price, whichever is lower. Since CERs are recognised as inventories, the generating assessee should apply AS-9 to recognise revenue in respect of sale of CERs. 26. Thus, sale of carbon credits is to be considered as capital receipt. This ground is allowed."

In view of the above judgments from the jurisdictional Rajasthan High Court as reproduced in forgone paras, the receipt on account of Carbon credit it to be treated as capital receipt. Accordingly the ground of appeal no. 2(a) is adjudicated in favour of the assessee. In view of this adjudication there is no need to adjudicate on ground of appeal no. 2(b)& 2(c) as the capital receipt is not liable to be taxed"

Thus, it is clear that the ld. CIT(A) has followed the decision of Hon'ble Jurisdictional High Court in case of *Rajasthan State mines & Mineral Ltd.* (*supra*) & *Minerals Ltd.* (*supra*) as well as decision of Tribunal in case of *Malana power Co. Pvt. Ltd.* v. *DCIT*. We further note that the Hon'ble jurisdictional High Court in case of *Shree Cement Ltd.* (*supra*) has also considered this issue in para 28 to 30 are as under:—

"28. The issue No. 3 is with regard to sale proceeds received by the company from the sale of certified emission Reduction (CRE) pertaining to Carbon Credit shown as capital receipt.

29. In view of the decision rendered by the Supreme Court in *Vodafone International* (*supra*), it has to be taken as capital account and it cannot be taxed under the Income Tax Act since it was taxable under direct tax and the Tribunal has given the finding which reads as under:—

"We have heard the rival submissions and perused the evidence on record. We find that the Appellate Tribunal in My *Home Power Ltd.* v. *DCIT* (*Supra*), have, after detailed examination, concluded that the receipts from Carbon credit are capital in nature. We are inclined to follow the said decision and the other two decisions of Chennai Tribunal in Sri *Velayudhaswamy Spinning Mills (P.) Ltd.* v. *DCIT* (*supra*) and *Ambika Cotton Mills ltd.* v. *DCIT* (*supra*) where also it has been held that receipt on account of Carbon Credit is capital in nature & neither chargeable to tax under the head business income nor liable to tax under the head capital gains. Our above view is also supported by the decision of Supreme Court in the case of *Vodafone International Holdings* v. *UOI* (*supra*) wherein Supreme Court has held that treatment of any particular item in different manner in the 1961 Act and DTC serves as an important guide in determining the taxability of said item. Since DTC by virtue of the deeming provisions specifically provides for taxability of carbon credit as business receipt and income Tax Act does not do so, our view gets duly fortified by the principles stated in the above decision of Supreme Court. Accordingly, this ground of the assessee is a allowed and the addition made by the AO is deleted.

30. In that view of the matter, the third issue is also required to be answered in favour of the assessee. All the issue are therefore answered in favour of the assessee against the department."

No contrary decision has been brought before us. Before parting with this issue it is pertinent to note that as per proviso to Section 28(va) of the Act a sum received as compensation on account of measure taken to curb the use or emission of substance that Deplete the Ozone layer under the United Nations Environment Programme is excluded from business income. For ready reference, we produce clause (va) to Section 28 with proviso as Under:-

"(*va*) any sum, whether received or receivable, in cash or kind, under an agreement for—

(*a*) not carrying out any activity in relation to any business [93][or profession]; or

(*b*) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services:

Provided that sub-clause (a) shall not apply to—

(*i*) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business 93[or profession], which is chargeable under the head "Capital gains";

(*ii*) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation.—For the purposes of this clause,—

(*i*) "agreement" includes any arrangement or understanding or action in concert,—

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;

(*ii*) "service" means service of any description which is made available to potential users and includes the provision of services in connection with

business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging;"

Thus, any sum received on account of carbon credit or protecting the environment is not included in the business income however, subsequently there is an amendment by Finance Act, 2017 whereby Section 115BBG has been inserted in the statute w.e.f 01.04.2018 which reads as under:—

"Following section 115BBG shall be inserted after section 115BBF by the Finance Act, 2017, w.e.f. 1-4-2018 :

Tax on income from transfer of carbon credits.

115BBG. (1) Where the total income of an assessee includes any income by way of transfer of carbon credits, the income-tax payable shall be the aggregate of—

(*a*) the amount of income-tax calculated on the income by way of transfer of carbon credits, at the rate of ten per cent; and

(*b*) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the amount of income referred to in clause (a).

(2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a)of sub- section (1).

Explanation.—For the purposes of this section "carbon credit" in respect of one unit shall mean reduction of one tonne of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price."

Thus, the income by way of transfer of carbon credit has been given a special treatment as chargeable to tax @ 10% and not as part of the normal business income of the assessee. The said amendment is prospective in nature and therefore, cannot be applied to the assessment years under consideration. In view of the above discussion as well as fact and circumstances of the case, we do not find any error or illegality in the impugned order of the ld. CIT(A) qua this issue.

6. In the C.O. of the assessee has challenged the validity of reopening by raising common ground as under:—

"That the CIT(A) erred in holding that the re-assessment proceedings were validity initiated by the Assessing Officer without correctly appreciating the facts and circumstances of the case and the submissions made before him and particularly the facts that there was no failure on the part of the company to disclose fully and truly all materials facts necessary for assessment and proceedings were initiated on account of change of opinion and in any case there has been no escapement of income."

7. The only addition made by the AO in the reassessment proceedings has been deleted by the ld. CIT(A) which we have upheld in our findings on the merits of the issue in the Revenue-s appeals. Thus the issue raised in the Cross Objection becomes academic in nature. Accordingly, C.O. of the assessee are dismissed being infructuous.

In the result, Revenue-s appeals as well as Cross Objections of the assessee are dismissed.

Varsha

---

*In favour of assessee.