Revenue generated from sale of carbon credit is capital receipt not liable to tax: HC

Summary – The High Court of Karnataka in a recent case of Subhash Kabini Power Corporation Ltd., (the Assessee) held that where Commissioner, exercising his powers under section 263, revised order of assessment and held that sale proceeds arising out of sale of carbon credit by assessee was revenue in nature, receipt from sale of carbon credit was capital receipt and not business income and hence not liable to tax

Facts

- The Commissioner, exercising his powers under section 263, revised the order of assessment and held that the sale proceeds arising out of sale of the carbon credit by the assessee was revenue in nature.
- The Tribunal following the decision of the Hyderabad Bench of the Tribunal, which had been upheld by the Andhra Pradesh High Court in the case of *CIT* v. *My Home Power Ltd.* [2014] 46 taxmann.com 314/225 Taxman 8 (Mag.)/365 ITR 82, held that sale of carbon credit would result capital receipt which was not taxable. It further following the ratio laid down by the Karnataka High Court in the case of *CIT* v. *D.G. Gopala Gowda* [2013] 354 ITR 501/34 taxmann.com 154 held that in the instant case the second condition for taking action under section 263 did not exist inasmuch as the assessment order was not prejudicial to the interests of the revenue. It, therefore, allowed the appeal of the assessee and quashed the order of the Commissioner passed under section 263.
- On appeal to High Court:

Held

- The principal question which arises for consideration is as to whether by sale of carbon credit capital receipt is generated or a profit out of the business activity of the assessee.
- The Andhra Pradesh High Court in the case of *My Home Power Ltd.* (*supra*) has confirmed the view of the Tribunal that 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. It was also found that the carbon credit is not even directly linked with the power generation and the income is received by sale of the excess carbon credit. It was found that the Tribunal has rightly held that it is capital receipt and not business income.
- As such when the issue is already covered by the decision of the Andhra Pradesh High Court, one may say that no substantial question of law would arise for consideration.
- However, the revenue relied upon the provisions of section 28 and contended that if any benefit or perquisite or credit is generated from the business, the same would be a profit from business and is taxable. Therefore, the same cannot be termed as capital receipt, but business income. In

submission, it was stated that on account of running the business of power generation, carbon credit is earned, which is marketable and, therefore, it is an income out of business.

- One cannot accept the submission for the simple reason that earning of carbon credit is not the business of the assessee nor the same is generated as a by-product on account of business activity of power generation, but it is generated on account of employment of good and viable practices by the assessee.

- When the carbon credit is generated out of environmental concerns and it is not having the character of trading activity, the Tribunal has rightly held that receipt from sale of carbon credit is capital receipt and it is not income out of business and hence not liable to income tax.

- Once it is found that the amount realised by sale of carbon credit is not taxable as profit, naturally it will have no adverse effect on the revenue. It is settled legal position that one of the requirements for exercise of power under section 263 is that the order passed by the lower authority should not only be erroneous, but should also be prejudicial to the interest of the revenue, which is lacking in the instant case and rightly found so by the Tribunal.

- Therefore, the order passed by the Tribunal deserved to be upheld.