THE SPEAKING ARROW

Capital Gains – An Overview

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Introduction:

Income tax is a tax paid by individuals or entities to the government depending on their level of earnings or gains (taxable income) during a financial year. The taxable income earned by an assessee during the financial year is divided into five different heads under Income Tax Act, 1961.

Although all the income earned in India under various heads of income is taxable in India, there are different rules for computing taxable income under each head of income. Income must be computed under each head of income after considering the rules applicable to that particular head of income only. One such head of income is **"Income from Capital Gains"**
As we all know income from capital gains is one of the important heads of computation of income for any taxpayer. Hence, we have tried to elaborate certain things regarding computation of income under capital gains such as meaning of capital gains, capital asset, calculation of indexed cost of acquisition, and indexed cost of improvement, certain important exemptions from long term capital gains, etc.

Charge of tax

Two major conditions to be satisfied for an income to be taxable under head "Income from Capital Gains" are

(i) The asset transferred should be a **capital asset** and

(ii) **It should be taxable transfer**

1. What do you mean by Income from Capital gains?

Ans: Income from Capital gain refers to gain (i.e., the differential amount of the sale price and cost) that arises only when you **transfer** a **Capital asset**.

2. What is a Capital asset and what constructs a transfer?

Ans: Capital gains arises because of transfer of capital asset

Capital Asset means:

i. Property of any kind held by an assessee, whether it is related or not to business or profession

ii. Urban agricultural land in India.

The following table specifies what constitutes the urban area

Shortest distance, measured aerially from the local limits of any municipality or cantonment board	Population according to last census
Up to 2 Kms	>10,000 and < 1 Lakh
Up to 6 Kms	>1 Lakh and < 10 Lakhs
Up to 8 Kms	>10,00,000

but does not include

(i) Any stock-in-trade, consumable stores or raw material held for the purpose of business or profession

E.g., Motor car for a motor car dealer or jewellery for jewellery merchant, are their stock-in-trade and not capital asset.

(ii) Personal effects i.e., movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of family dependent on him, but does not include

(a) Jewellery
(b) Archaeological collections
(c) Drawings
(d) Paintings
(e) Sculptures
(f) Any work of art

"**Transfer**" in relation to a capital asset, includes sale, exchange, relinquishment, extinguishment of any right, compulsory acquisition under any law and conversion of capital asset into stock in trade

3. Does that mean Barter is also a transfer?

Ans: Yes, as barter means exchange of goods for another goods and exchange is a transfer. Barter is treated as a transfer.

4. Now I understood the meaning of Transfer, Capital asset and capital gains. whether capital gains are taxed as short term or long term?

Ans: That is dependent on case-to-case basis and let us understand that from the following table. If the asset is holds for less than below prescribed time limit, then it is taxable as short-term capital gains -

Capital Asset transferred	Period of Holding
(i) Units of equity oriented mutual fund	1 year
(ii) Units of UTI	1 year
(iii)Zero Coupon Bonds	1 year
(iv)Securities (other than units) listed in recognised stock exchange in India.	1 year
(v) Immovable property.	2 years
(vi)Unlisted Shares.	2 years
(vii) Debt oriented Mutual funds; unlisted securities other than shares etc.	3 years

5. Whether we can claim any expenditure as deduction for the sale of capital asset?

Ans: Yes, you can claim any expenditure incurred for the transfer of capital asset while calculating capital gains. The calculations of capital gains can be done in the following manner:

Particulars	**Amount**
Sale consideration	XXX
(-) Expenses related to sale	XXX
Net sale consideration	**XXX**
(-) Cost of construction (Indexation, if applicable)	XXX
(-) Cost of improvement (Indexation, if applicable)	XXX
Capital gain/(loss) (Short Term or Long Term)	XXX

6. After computing capital gains, at what rate the capital gains are taxable?

Ans: The capital gains are taxed at rates that depends on case-to-case basis. From the below tax rate chart, you will get know that what rate it will be taxable. Refer the chart on Page 13 below.

Exemptions:

In today's world sale/transfer of capital asset is common for any assessee and the amount of capital gains whether it is short term or long term is taxed under head "Income from Capital Gains". If there is capital loss, the loss can be carried forward and set off for eight assessment years. Similarly, the Act, allows exemption from capital gains being taxed, if such capital gains are invested in different investment plan option. Thus, one needs to plan benefits/exemption by considering all reliefs available under the law. The reason behind allowing exemptions is that the amount of capital gains as calculated is invested in a new capital asset within prescribed time limit to claim exemption. This exemption is subject to certain conditions. In this regard, we shall discuss the section 54 exemption available under Income tax Act and the various conditions that need to satisfy to claim the same. (Refer Snapshot of all exemptions at Page 9)

Sec 54 – Exemption in respect of LTCG arising on transfer of residential property and investment in residential property in India.

FAQ's:

1. ***Who can avail this exemption?***

Ans: An Individual or HUF transferring residential house property which qualifies as Long-Term Capital Asset.

2. ***Is there any time limit for investment and what amount should invest to get exemption under this section?***

Ans: Yes, Time limit for investment is Purchase of property must be made 1 year before transfer or 2 years after transfer. If a house property is being constructed, then such construction should be completed within 3 years from transfer of original property.

Exemption: Amount of exemption is **capital gains** or amount of investment, whichever is lower.

3. ***Whether assessee can invest in any kind property? What is the amount of exemption under this section?***

Ans: No, assessee need to invest in Residential property to claim exemption. Amount of exemption is **capital gains** or amount of investment, whichever is lower.

4. ***Before filing of income tax return, Do I need to invest in residential property?***

Ans: If the assessee is not able to purchase or construct the property before the due date for filing of income tax return, then the assessee can avail exemption if the unutilized capital gain amount is deposited in capital gains account scheme (CGAS).

5. ***Taxability if assessee is not able to utilize the amount deposited in capital gains account scheme within prescribed time limits?***

Ans: If the amount deposited in CGAS is not utilized within above prescribed time or has been utilized for purposes other than construction or for purchase of property, defaulted amount (up to the amount not taxed earlier) shall be taxed as LTCG in year of default i.e., either the year when period expires or the year where such amount was used for another purpose.

Example: Mr. A sold his residential house on 1-5-2017. Sale consideration is ₹100 lakhs and cost of asset was ₹40 lakhs (after indexation). Amount of Rs. 60 Lakhs was deposited in CGAS before filing of income tax return to get exemption under this section. Amount deposit in CGAS was not utilized before 1-5-2020. Hence it shall be considered as deemed income for the FY 2021-22 and taxed as LTCG in that FY at a rate applicable in that FY.

6. ***What is the time limit to hold the investment? And what is the taxability if assessee not hold the asset for prescribed time limit?***

Ans: The asset purchased or constructed should be held for at least 3 years from date of purchase or completion of construction.

Withdrawal of exemption:

If new asset is sold within 3 years, amount earlier exempted under this section will be reduced from its COA to calculate capital gains thereon.

Example: Mr. A sold his residential house on 1-5-2018. Sale consideration is ₹100 lakhs and cost of asset was ₹40 lakhs (after indexation). The amount invested in purchase of new house property was ₹70 lakhs by utilizing ₹60 lakhs of LTCG on 1-6-2019. New house property was later transferred for ₹150 lakhs.

Case 1: New house property was transferred on 1-12-2022.

Analysis: The new house property was to be held till 1-6-2022 to complete the 3 years lock-in-period from purchase of property to satisfy the conditions as per sec. 54. Since the asset was sold on 1-12-2022, there is no default, and such sale would now attract fresh capital gain.

Case 2: New house property was transferred on 1-12-2021.

As mentioned previously, the assessee should hold the property till 1-6-2022. In the above case, the assessee has transferred the new house property before 1-6-2022 and has therefore defaulted. But the asset was held for more than 24 months. So, capital gain to be taxed shall be computed as follows:

Particulars	**Amount (₹ in lakhs)**	**Amount (₹ in lakhs)**
Sale		150
Cost	70	
(-) Benefit claimed earlier	60	
Cost after default		10

Suppose Indexed cost for ₹10 lakhs is ₹15 lakhs, Capital gains of ₹135 lakhs shall be taxed in FY 2021-22

Case 3: New house property was transferred on 1-12-2020.

As mentioned previously, the assessee should hold the new property till 1-6-2022. Since the assessee has transferred the new house property before 1-6-2022, he has defaulted. However, in this case the assessee has held the new asset for a period lesser than 24 months. The capital gains computation shall be as follows:

Particulars	**Amount (₹ in lakhs)**	**Amount (₹ in lakhs)**
Sale		150
Cost	70	
(-) Benefit claimed earlier	60	
Cost after default		10

Capital gains of 140 lakhs taxed in FY 20-21

7. Is there any Interest or Penalty on withdrawal of Exemption?

Ans: No, Interest or Penalty if we sell the asset before prescribed time limit.

8. How should we calculate Capital gains, if income is received in foreign currency?

Ans: The capital gains chargeable should be converted into Indian currency as per SBI TT Buying rate (Rule 115 of Income tax act 1961) as on last day of the month immediately preceding the month in which the capital asset is transferred.

9. Whether both property transferred and property to be acquired should be in India?

Ans: No, Property transferred can be anywhere on the planet. However, House to be acquired for the purpose of claiming the exemption should be in India.

10. Whether we can invest in two properties to get claim exemption under this section?

Ans: Yes, With effect from 1-4-2020. If the amount of capital gain does not exceed 2 crores, the assessee may at his option to purchase or construct two residential properties in India and this benefit is available only once to an assessee in his lifetime.

11. What is the cost of acquisition of asset if it is purchased before 1-04-2001?

Ans: If the asset is acquired before 1-04-2001 then we need to consider FMV as on 1-04-2001 or cost of acquisition whichever is higher as the cost of acquisition, and we should have a proper supporting document like valuation certificate in case of Immovable asset etc.

12. What is Cost Inflation Index (CII)?

Ans: CII is a measure of inflation that is used for computing long-term capital gains on sale of capital assets. It is a method of recalculating the Purchase price of capital asset. Cost Inflation Index for FY vide notification dated June15,2021 is **317.**

Snapshot of all exemptions

Section	Type of assessee	Type of asset transferred	LT or ST	Amount of investment	Time limit for investment	Withhold of investment
54	Individual & HUF	Building or land apparent to building	LT	Capital gains	1 year before/ 2 years after for purchase and 3 years for construction	3 years from date of purchase / Construction
54B	Individual & HUF	Urban agricultural land	LT or ST	Capital gain	Within 2 years from date of transfer of asset	3 years from date of purchase
54D	Any assessee	Land or building or both or rights in Land or Building or both	LT or ST	Capital gain	Within 3 years from date of transfer of asset	3 years from date of purchase
54EC	Any assessee	Land or building or both	LT	Capital gain	Within six months or before filing of return, whichever is earlier.	3 years (purchased before 1-4-2018) or 5years (purchased after 1-4-2018)
54EE	Any assessee	Any asset	LT	Capital gain	Within six months or before filing of return, whichever is earlier	3 Years from date of purchase of specified asset
54F	Individual & HUF	Any asset other residential property	LT	Net sale consideration	1 year before/ 2 years after for purchase and 3 years for construction	3 years from date of purchase / Construction
54G	Any assessee	Land or plant Building or Machinery	LT or ST	Capital gain	1 year before or 3 years after the date of transfer	3 years from date of purchase
54GA	Any assessee	Land or plant Building or Machinery	LT or ST	Capital gain	1 year before or 3 years after the date of transfer	3 years from date of purchase
54GB	Individual & HUF	Residential property	LT	Net sale consideration	Before filing of return, shares need to be subscribed and within one-year new asset should be purchased	5 years form the date of acquisition of shares or purchase of asset

Special areas of Capital Gains

The broad outline is as follows:
I) Taxability in India on Financial Instruments
II) Taxability in India of capital gains earned by Non-residents
III) Taxability of capital gains under DTAA
IV) Indirect transfers- Taxability and Issues

I) Financial Instruments
A financial instrument is defined as a contract between individuals/parties that holds a monetary value. They can either be created, traded, settled, or modified as per the involved parties' requirement.

Classification of Financial Instruments:
a) Derivative instruments
b) Equity based financial instruments
c) Debt based financial instruments

Sub- classification:
(i) Bonds
(ii) Debentures, convertible debentures
(iii) Shares- Equity / Preference shares
(iv) Options, derivatives.

Different Transactions Leading to Capital Gains
(i) Share liquidation
(ii) Asset Sale
(iii) IPO
(iv) Secondary sale
(v) Mergers
(vi) Cryptocurrency like Bitcoin

Cryptocurrency

The taxation of cryptocurrencies depends upon the nature of investment, whether it is held as in the form of "currency" for trading purpose or in the form of "Capital asset" for investment purposes. We need to determine whether gains from sale of cryptocurrency would be categorized into business income or as capital gains depending upon the intention to trade / hold the asset for investment purpose.

However, it needs to be noted that, where the profits from sale of Crypto Currency is regarded as 'business income', then the income shall be taxed as per the applicable income tax slab rates. If the crypto currency is held for investment purpose, then the income shall be taxed as capital gains. Considering the income to be taxed as capital gains, and the asset has been sold after holding it for 3 years, the income shall be taxable as long-term capital gains attracting a tax rate of 20% with applicable surcharge and cess. Indexation benefit can be claimed if applicable. However, if the sale happens within 3 years from the date of investment, then the income shall be taxed as short-term capital gain and taxed according to the relevant income tax slabs will be applicable.

Transfer of crypto from one wallet to the another will not be considered as a taxable event.

II) Taxability in India on Capital Gains earned by Non-residents

Non-residents are liable to pay income tax on capital gains on sale of immovable property (land/ building/ land or building or both) or on equity shares listed/ unlisted Indian companies, debentures listed nonconvertible debentures etc. subject to treaty provisions. Special provisions of Chapter XIIA of Section 115C to Section 115I are applicable for taxation of certain incomes earned by NR such as:

Case 1: A Resident individual who has been holding Equity shares in an Indian company, has permanently moved to Singapore and became non-resident in India. Tax implications in his hands on the transfer of the Indian company shares.

Case 2: An individual, being resident of USA, receives a property situated in India by way of inheritance. Tax implications in his hands on the transfer of the Indian property.

III) Taxability of Capital Gains under DTAA

India has entered into Double Tax Avoidance Agreements (DTAA) with several countries. As per Section 90(2), taxability for non-residents is determined as per the provisions of the Act or the applicable DTAA, whichever are more beneficial. Capital gains under the DTAA are generally taxed in a different manner than other incomes.

Issue under Indian DTAA: Situation where there is no Article for Capital Gain in a DTAA

As per the treaty, the Non-resident can pay tax at either of the countries or pay the tax in both the countries and claim tax relief in the country of their residence.

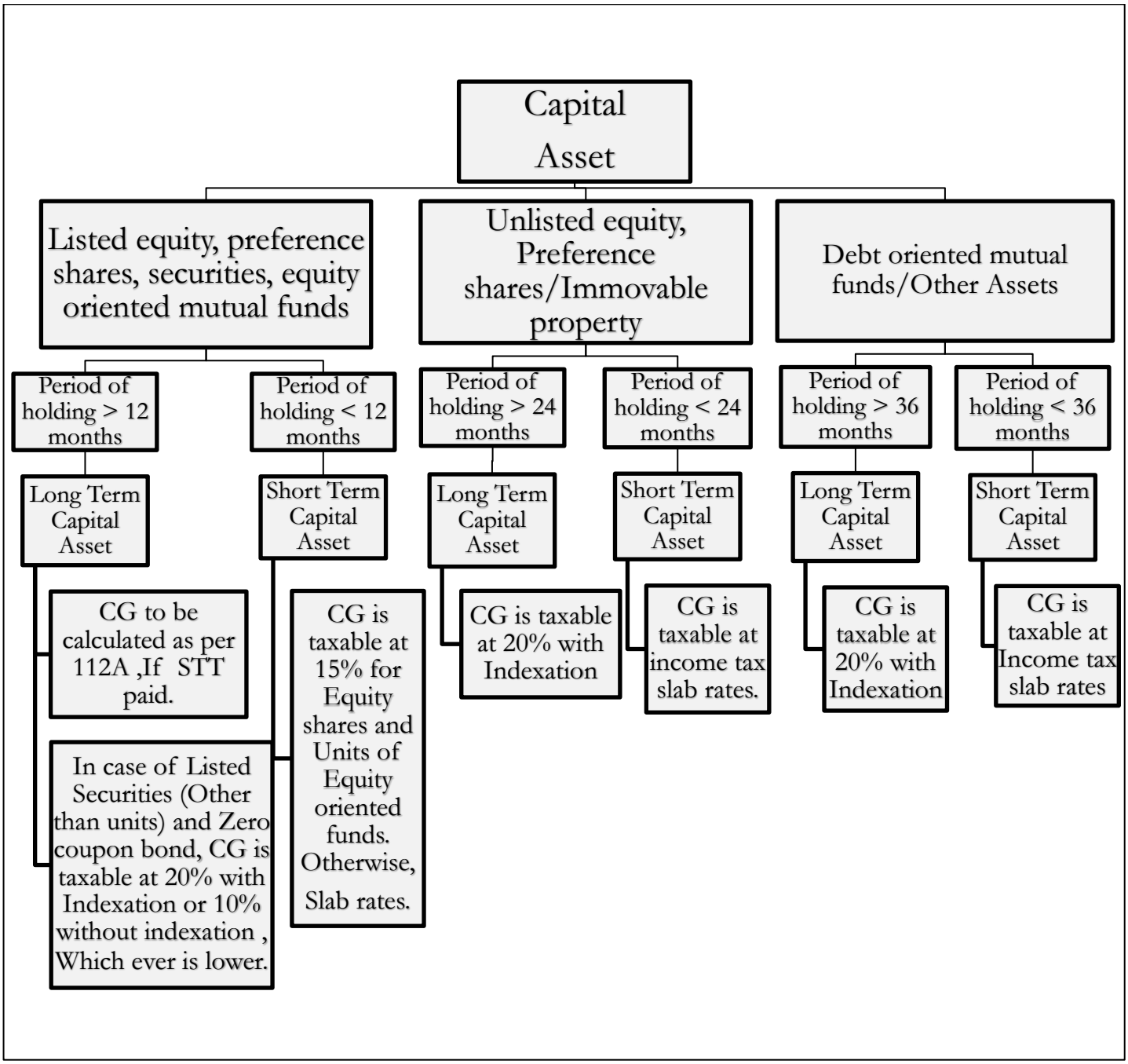
IV) Indirect Transfer- Taxability and issues

Indirect transfers are used to describe transactions where overseas assets are transferred leading to a transfer in value of the underlying Indian Capital assets.

In case of transfer of any assets being share or interest in company situated outside by non-resident can lead to capital gain in India if the underlying assets driving its **substantial value from the assets situated in India or supports business operations and transactions from India.**

Example: A company in Italy purchases shares of a Singapore entity (holding substantial assets in India) from a company in Japan. Analysis has to be done to assess the taxation, if any.

Tax Rates


Capital Asset
Listed equity, preference shares, securities, equity oriented mutual funds
Unlisted equity, Preference shares/Immovable property
Debt oriented mutual funds/Other Assets
Period of holding > 12 months
Period of holding < 12 months
Period of holding > 24 months
Period of holding < 24 months
Period of holding > 36 months
Period of holding < 36 months
Long Term Capital Asset
Short Term Capital Asset
Long Term Capital Asset
Short Term Capital Asset
Long Term Capital Asset
Short Term Capital Asset
CG to be calculated as per 112A ,If STT paid.
In case of Listed Securities (Other than units) and Zero coupon bond, CG is taxable at 20% with Indexation or 10% without indexation , Which ever is lower.
CG is taxable at 15% for Equity shares and Units of Equity oriented funds. Otherwise, Slab rates.
CG is taxable at 20% with Indexation
CG is taxable at income tax slab rates.
CG is taxable at 20% with Indexation
CG is taxable at Income tax slab rates

Summary

- Capital gains tax is a tax levied on the gains or profits that an assessee earns from selling certain specified capital assets.

- The tax is levied only when the capital asset has been transferred and not when it is still in the hands of an investor.

- Capital gains tax depends upon the holding period of the Capital asset transferred and nature of capital gains earned. Fundamentally, there are two types of gains that arise from the transfer of a Capital asset - long-term and short-term capital gain

- Irrespective of the nature of Capital asset that an assessee proposes to transfer, there are a few approaches to mitigate / plan the capital gains tax liability such as:
  - *Claiming various exemptions provided in the Income tax law*
  - *Planning the timing of capital gains with the capital losses*
  - *Holding assets for a longer period to avail concessional tax rates*

Accordingly, prudent tax planning is essential for managing the capital gains taxation.

Way forward

Given the above, all the taxpayers shall essentially evaluate the following key considerations while planning for their capital gains taxation:

- Determining the residential status of the taxpayer
- Nature of the capital asset proposed to be transferred
- Evaluating the charge of tax in India in respect of foreign assets
- Period of holding of the capital asset
- Analysis of computation rules and check for any deeming taxation
- Applicability of withholding provisions and special tax rates
- Availability of treaty benefits in case of non-residents
- Rules for repatriation of proceeds from sale of capital assets for NR

Final word…

Earning income in the nature of capital gains is much optimal with special tax rates and various positive investment options in the market. Further, if reinvestments are planned appropriately, tax incurred on capital gains can be mitigated ensuring higher monies with the taxpayers.

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