Simplifying
Capital Gains

IFE Academy

Education Simplified

Investors Financial Education Academy

Phone : 044 - 2814 3044 E-mail : bulletin@ifea.in www.ifea.in

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Capital Gains are one of the heads of Income that attract tax in India.

Capital Gains:

Profits or gains arising from sale / transfer of a capital asset are called "Capital Gains" and are charged to tax under the head "Capital Gains".

Capital Asset:

A capital asset is an item that you own for investment or personal purposes, such as stocks, bonds, Jewellery, Property or stamp collections. When you sell a capital asset, you earn a capital gain or a capital loss, depending on the Sale price.

Categories that falls and does not fall under Capital Asset:

Falls Under Capital Asset	
• Land • Building • House Property • Vehicles • Patents	• Trademarks • Leasehold rights • Machinery • Jewellery

Not an Capital Asset
• Any stock, consumables or raw material, held for the purpose of business or profession. • Personal goods such as clothes and furniture held for personal use. • Agricultural land in rural India • 6½% gold bonds (1977) or 7% gold bonds (1980) or national defence gold bonds (1980) issued by the central government • Special bearer bonds (1991) • Gold deposit bond issued under the gold deposit scheme (1999) or deposit certificates issued under the Gold Monetisation Scheme, 2015 • Sovereign Gold Bonds issued by RBI in tranches

Types of Capital Asset:

Based on the period of holding, an asset is treated as short-term or long term asset.

Asset	Holding period of Capital Asset	
	Short Term	Long Term
Immovable Property e.g. House property	2 years or Less	More than 2 years
Movable Property e.g. Gold/Jewellery	3 years or Less	More than 3 years
Listed Shares	1 year or Less	More than 1 year
Unlisted Shares	2 years or Less	More than 2 years
Equity Oriented Mutual Funds	1 year or Less	More than 1 year
Debt Oriented Mutual Funds	3 years or Less	More than 3 years

Examples: Mr. Raj is a salaried employee. In the month of April, 2019 he purchased gold and sold the same in December, 2020. In this case gold is capital asset for Mr. Raj. He purchased gold in April, 2019 and sold it in December, 2020, i.e., after holding it for a period of less than 36 months. Hence, gold will be treated as Short Term Capital Asset.

Mr. Kumar is a salaried employee. In the month of April, 2019 he purchased equity shares listed in BSE and sold the same in January, 2020. In this case shares are capital assets for Mr. Kumar. He purchased shares in April, 2019 and sold them in January, 2020, i.e., after holding them for a period of less than 12 months. Hence, shares will be treated as Short Term Capital Assets.

Mr. Ravi is a salaried employee. In the month of April, 2019 he purchased equity shares listed in BSE and sold the same in December, 2020. In this case shares are capital assets for Mr. Ravi. He purchased shares in April, 2019 and sold them in December 2020, i.e., after holding them for a period of more than 12 months. Hence, shares will be treated as Long Term Capital Assets.

Short Term Capital Gain and Long Term Capital Gain:

Capital gain arising on sale of short-term capital asset is termed as short-term capital gain and capital gain arising on transfer of long-term capital asset is termed as long-term capital gain.

Examples:

A. In January, 2019 Mr. A sold his residential house property for Rs. 55 lakhs (Cost Inflation Index : 289) which was purchased in May, 2010 for Rs.25 lakhs (Cost Inflation Index :167).

Capital gain on such sale would be computed as follows:

Description	Rs.
Sale Consideration	55,00,000
Less: Cost incurred in relation to transfer	25,000
Less: Indexed* cost of acquisition (25,00,000 x 289 /167)	43,26,347
Capital Gains	11,48,653

In this case the house is sold after holding it for a period of more than 24 months and, hence, capital gain of Rs. 11,48,653 will be charged to tax as Long Term Capital Gain.

* *Indexation is a process by which the cost of acquisition is adjusted against inflationary rise in the value of asset. For this purpose, Central Government has notified cost inflation index. The benefit of indexation is available only to long-term capital assets. For computation of indexed cost of acquisition following factors are to be considered:*

- Year of acquisition/improvement
- Year of transfer
- Cost inflation index of the year of acquisition/improvement
- Cost inflation index of the year of transfer

Indexed cost of acquisition is computed with the help of following formula:

Cost of acquisition × Cost inflation index of the year of transfer of capital asset / Cost inflation index of the year of acquisition

B. In April, 2019 Mr. Ragav sold his residential house property which was purchased in May, 2017. Capital gain on such sale amounted to Rs. 18,40,000. In this case the house property is a short-term capital asset and, hence, gain of Rs. 18,40,000 will be charged to tax as short-term capital gain.

Taxation benefits on Short Term Capital Gains:

For the purpose of determination of tax rate, short-term capital gains are classified as follows:

- Short-term capital gains covered under section 111A.
- Short-term capital gains other than covered under section 111A.

Tax Rates on STCG:

1. Tax rates of STCG covered under section 111A is charged to tax @ 15% (plus surcharge and cess as applicable)
2. Normal STCG, i.e., STCG other than covered under section 111A is charged to tax at normal rate of tax which is determined on the basis of the total taxable income of the taxpayer.

Criteria for section 111A:

- STCG arising on sale of equity shares listed in a recognised stock exchange, which is chargeable to STT.
- STCG arising on sale of units of equity oriented mutual fund sold through a recognised stock exchange which is chargeable to STT.

With effect from Assessment Year 2017-18, benefit of concessional tax rate of 15% shall be available even where STT is not paid, provided that:

- Transaction is undertaken on a recognised stock exchange located in any International Financial Service Centre, and Consideration is paid or payable in foreign currency.

Illustrations:

Mr. A is a salaried employee. In the month of December, 2019 he purchased 100 equity shares of X Ltd. @ Rs. 1,400 per share through Bombay Stock Exchange. These shares were sold through BSE in August, 2020 @ Rs. 2,000 per share (securities transaction tax was paid at the time of sale). Let us understand the STCG.

Shares were purchased in December, 2019 and were sold in August, 2020, i.e., sold after holding them for a period of less than 12 months and, hence, the gain will be short term capital gain. Also shares were sold through a recognised stock exchange and the STCG will be charged to tax at 15%.

STCG other than covered under section 111A [As amended by Finance Act, 2018]

- STCG arising on sale of equity shares other than through a recognised stock exchange.
- STCG arising on sale of shares other than equity shares.
- STCG arising on sale of units of non-equity oriented mutual fund (debt oriented mutual funds).
- STCG on debentures, bonds and Government securities.
- STCG on sale of immovable property, Gold, Silver, etc.

Computation of Short-Term Capital Gains arising on account of transfer of short-term capital asset is computed as follows:

Particulars	Rs.
Full value of consideration (i.e Sale value of the asset)	XXXXXX
Less: Expenditure incurred wholly and exclusively in connection with transfer of capital asset (Eg Brokerage, commission)	XXXXXX
Net Sale of Consideration	XXXXXX
Less: Cost of acquisition	XXXXXX
Less: Cost of Improvement	XXXXXX
SHORT TERM CAPITAL GAINS	XXXXXX

Adjustment of STCG against the basic exemption limit:

1. Basic exemption limit means the level of income up to which a person is not required to pay any tax. The basic exemption limit applicable in case of an individual for the financial year 2020-21 is as follows:
    - For resident individual of the age of 80 years or above, the exemption limit is Rs. 5,00,000.
    - For resident individual of the age of 60 years or above but below 80 years, the exemption limit is Rs. 3,00,000.
    - For resident individual of the age below 60 years, the exemption limit is Rs. 2,50,000.

- For non-resident individual irrespective of the age of the individual, the exemption limit is Rs. 2,50,000.
- For HUF, the exemption limit is Rs. 2,50,000.

2. A resident individual/HUF can adjust the STCG covered under section 111A against the basic exemption limit but such adjustment is possible only after making adjustment of other income. In other words, first income other than STCG covered under section 111A is to be adjusted against the exemption limit and then the remaining limit (if any) can be adjusted against STCG covered under section 111A.

Illustration:

Mr. Aatish, age 65 years is a resident individual. He purchased equity shares of SBI Ltd. in March, 2020 and sold the same in May, 2020 (sold in Bombay Stock Exchange and STT is levied). Taxable STCG amounted to Rs. 1,20,000. Apart from gain on sale of shares he is not having any income. Let us compute his tax liability for the year 2020-21.

For resident individual of the age of 60 years and above but below 80 years, the basic exemption limit is Rs. 3,00,000. Further, a resident individual can adjust the basic exemption limit against STCG covered under section 111A. In this case, STCG of Rs. 1,20,000 is covered under section 111A; hence, the adjustment of such gain against the exemption limit is allowed only to a resident. In this case, Mr. Aatish is a resident and, hence, he can adjust the STCG of Rs. 1, 20,000 against the exemption limit. Considering the above discussion, the tax liability of Mr. Aatish for the year 2020-21 will be NIL.

3. Deductions under section 80C to 80U and STCG

No deduction under sections 80C to 80U is allowed on short-term capital gains referred to in section 111A. However, such deductions can be claimed from STCG other than covered under section 111A.

Illustration:

Mr. Anil (age 57 years and resident) is a retired person. He purchased a piece of land worth Rs. 8,84,000 in March, 2018 and sold the same in April, 2019 for Rs. 12,84,000. Apart from gain on sale of land he is not having any other income. He deposited Rs. 1,00,000 in Public Provident Fund (PPF) and Rs.50,000 in NSC.

Deduction under section 80C to 80U can be claimed on short-term capital gains other than STCG covered under section 111A. In this case, the gain is on sale of land and, hence, is not covered under section 111A. Hence, Mr. Anil can claim deduction under section 80C of Rs. 1,50,000 from STCG of Rs. 4,00,000. The taxable income of Mr. Anil will be computed as follows:

Particulars	Rs.
Short-Term Capital Gains (Rs. 12,84,000 less Rs. 8,84,000)	4,00,000
Gross Total Income	4,00,000
Less: Deduction under section 80C to 80U	(1,50,000)
Total Income or Taxable Income	2,50,000

Taxation benefits on Long Term Capital Gains:

Long-term capital gains are charged to tax @ 20% (plus surcharge and cess as applicable), but in certain special cases, the gain may be charged to tax @ 10% (plus surcharge and cess as applicable). The benefit of charging long-term capital gain @ 10% is available only in following cases:

- Long-term capital gains arising from sale of listed securities and it exceeds Rs. 1,00,000 (Section 112A);
- Long-term capital gains arising from transfer of any of the following asset:
  - o Any security which is listed in a recognised stock exchange in India.
  - o Any unit of UTI or mutual fund.
  - o Zero coupon bonds.

Criteria for Section 112A:

As per the section 112A capital gains arising from transfer of a long term capital asset being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust shall be taxed at the rate of 10% of such capital gains exceeding Rs. 1,00,000.

This concessional rate of 10 % will be applicable if:

- In a case of an equity share in a company, securities transaction tax has been paid on both acquisition and transfer of such capital asset; and
- In a case a unit of an equity oriented fund or a unit of a business trust, STT has been paid on transfer of such capital asset.

The cost of acquisitions of a listed equity share acquired by the taxpayer before February 1, 2018, shall be deemed to be the higher of following:

- The actual cost of acquisition of such asset; or
- Lower of following:
    - o Fair market value of such shares as on January 31, 2018; or
    - o Actual sales consideration accruing on its transfer.

Long-term capital gains arising from transfer of specified asset:

A taxpayer who has earned long-term capital gains from transfer of any listed security or any unit of UTI or mutual fund (whether listed or not), not being covered under Section 112A, and Zero coupon bonds shall have the following two options:

- Avail of the benefit of indexation; the capital gains so computed will be charged to tax at normal rate of 20% (plus surcharge and cess as applicable).
- Do not avail of the benefit of indexation; the capital gain so computed is charged to tax @ 10% (plus surcharge and cess as applicable).

The selection of the option is to be done by computing the tax liability under both the options, and the option with lower tax liability is to be selected.

Illustration:

Mr. Ashok is a salaried employee. In the month of January, 2015 he purchased 100 shares of X Ltd. @ Rs. 1,400 per share through Bombay Stock Exchange. These shares were sold through BSE in April, 2019 @ Rs. 2,600 per share. The highest price of X Ltd. share quoted on the stock exchange on January 31, 2018 was Rs. 1,800 per share. Let us understand the nature of capital gain in this case.

Shares were purchased in January, 2015 and were sold in April, 2019, i.e., sold after holding them for a period of more than 12 months and, hence, the gain will be long-term capital gain (LTCG).

The cost of acquisition of X Ltd. shares shall be higher of:

Cost of acquisition i.e., 1, 40,000 (1,400 × 100);

Lower of:

- o Highest price quoted as on 31-1-2018 i.e., 1,80,000 (1,800 × 100);
- o Sales consideration i.e., 2,60,000 (2,600 × 100)

the cost of acquisition of shares shall be Rs. 1,80,000.Accordingly, Long-term capital gains in hands of Mr. Ashok would be Rs. 80,000 (i.e., 2,60,000 – 1,80,000). Since a long-term capital gain doesn't exceed Rs. 1, 00,000, nothing is taxable in hands of Mr. Ashok.

Computation of Long-term capital gains:

Particulars	Rs.
Full value of consideration (i.e., Sales consideration of asset)	XXXXXX
Less: Expenditure incurred wholly and exclusively in connection with transfer of capital asset (Eg Brokerage, commission, advertisement expenses, etc.)	XXXXXX
Net Sale of Consideration	XXXXXX
Less: Indexed Cost of acquisition	XXXXXX
Less: Indexed cost of improvement if any (*)	XXXXXX
LONG TERM CAPITAL GAINS	XXXXXX

Indexed cost of acquisition is computed with the help of following formula:

$$\frac{\text{Cost of acquisition} \times \text{Cost inflation index of the year of transfer of capital asset}}{\text{Cost inflation index of the year of acquisition}}$$

Indexed cost of improvement is computed with the help of following formula:

$$\frac{\text{Cost of improvement} \times \text{Cost inflation index of the year of transfer of capital asset}}{\text{Cost inflation index of the year of improvement}}$$

Adjustment of LTCG against the basic exemption limit:

1. Basic exemption limit means the level of income up to which a person is not required to pay any tax. The basic exemption limit applicable in case of an individual for the financial year 2020-21 is as follows:

    - For resident individual of the age of 80 years or above, the exemption limit is Rs. 5,00,000.
    - For resident individual of the age of 60 years or above but below 80 years, the exemption limit is Rs. 3,00,000.
    - For resident individual of the age of below 60 years, the exemption limit is Rs. 2,50,000.
    - For non-resident individual, irrespective of the age of the individual, the exemption limit is Rs. 2,50,000.
    - For HUF, the exemption limit is Rs. 2,50,000.

2. A resident individual can adjust the LTCG but such adjustment is possible only after making adjustment of other income. In other words, first income other than LTCG is to be adjusted against the exemption limit and then the remaining limit (if any) can be adjusted against LTCG.

Illustration:

Mr. Amit (age 67 years and resident) is a retired person. He purchased a piece of land in December, 2012 and sold the same in April, 2019. Taxable long-term capital gain on such sale amounted to Rs. 1,84,000. Apart from gain on sale of land, he is not having any other income. His tax liability for the year 2020-21 would be computed as follows.

For resident individual of the age of 60 years and above but below 80 years, the basic exemption limit is Rs. 3,00,000. Further, a resident individual can adjust the basic exemption limit against LTCG. In this case, LTCG of Rs. 1,84,000 can be adjusted against the basic exemption limit. In other words, Mr. Amit can adjust the LTCG on sale of land against the basic exemption limit. Considering the above discussion, the tax liability of Mr. Amit for the year 2020-21 will be nil.

3. Deductions under sections 80C to 80U and LTCG

No deduction under sections 80C to 80U is allowed from long-term capital gains.

EXEMPTIONS FOR CAPITAL GAINS ARISING ON TRANSFER OF RESIDENTIAL HOUSE PROPERTY:

Section 54 gives relief to a taxpayer who sells his residential house and from the sale proceeds he acquires another residential house. The detailed provisions in this regard are discussed below.

Basic Conditions to be followed under Section 54:

- The benefit of section 54 is available only to an individual or HUF.
- The asset transferred should be a long-term capital asset, being a residential house property.
- Within a period of one year before or two years after the date of transfer of old house, the taxpayer should acquire another residential house or should construct a residential house within a period of three years from the date of transfer of the old house.

- In case of compulsory acquisition the period of acquisition or construction will be determined from the date of receipt of compensation.
- Exemption can be claimed only in respect of two residential house properties purchased/constructed in India. (If gains is above Rs. 2 Crores , only one house).
- No exemption can be claimed in respect of house purchased outside India.

Illustration:

Mr. Arun purchased a residential house in April, 2014 and sold the same in April 2020 for Rs. 8,40,000. Capital gain arising on sale of the house amounted to Rs. 1,00,000. Let us find out whether he can claim benefit of section 54 by purchasing/constructing another residential house from the capital gain of Rs. 1,00,000.

Mr. Arun can claim the benefit of section 54 by purchasing/ constructing a residential house within the time-limit as provided under section 54.

Amount of Exemption under Section 54:

Exemption under section 54 will be lower of following:

- Amount of capital gains arising on transfer of residential house; or
- Amount invested in purchase/construction of new residential house property including the amount deposited in Capital Gains Deposit Account Scheme.

Illustration:

Mr. Atul purchased a residential house in April, 2015 and sold the same on 25th April, 2020 for Rs. 84,00,000. Capital gain arising on sale of house amounted to Rs. 25,00,000. Out of the sale proceeds of old house, he purchased another residential house for Rs. 18,00,000. This house was purchased in May, 2020. The amount of exemption under section 54 claimed by Mr. Atul will be:

Exemption under section 54 will be lower of following:

- Amount of capital gain, i.e., Rs. 25,00,000.
- Amount of investment in new house, i.e., Rs. 18,00,000

Thus, exemption will be Rs. 18,00,000. Taxable capital gain will come to Rs. 700000 (Rs. 25,00,000 less exemption under section 54 of Rs. 18,00,000).

Consequences if the new house is transferred:

If a taxpayer purchases/constructs a house and claims exemption under section 54 and then transfers the new house within a period of 3 years from the date of its acquisition/completion of construction, then the benefit granted under section 54 will be withdrawn. The ultimate impact of the restriction is as follows:

- The restriction will be attracted, if after claiming exemption under section 54, the new house is sold before a period of 3 years from the date of its purchase/completion of construction.
- If the new house is sold before a period of 3 years from the date of its purchase/completion of construction, then at the time of computation of capital gain arising on transfer of the new house, the amount of capital gain claimed as exempt under section 54 will be deducted from the cost of acquisition of the new house.

Capital Gains Deposit Account scheme:

- If the asset is sold in the previous year, and the seller intends to, but is yet to purchase the new house property as the time limit of 2 years or 3 years has not yet expired, then the assessee is required to deposit the amount of gains in the Capital gains account scheme (in any branch of public sector, bank) before the due date for filing income tax returns.
- The amount already incurred towards purchase/construction along with the amount deposited in the capital gains account scheme can be claimed as cost while claiming the deduction.
- However, if the amount deposited in the Capital Gains Account Scheme is not utilized within the time limit mentioned, then it shall be treated as income of the previous year in which 3 years expire (from the date of transfer of the original asset).

SECTION 54EC bonds:

- Section 54EC bonds, or capital gains bonds, are one of the best ways to save long-term capital gain tax arising from house property.
- Tax deduction is available under section 54EC of the Income Tax Act. 54EC bonds do not allow any tax exemption on short-term capital gains tax.
- Investing in 54EC bonds would get benefits of tax deduction. The maximum limit for investing in 54EC bonds is Rs. 50,00,000.

- The eligible bonds under Section 54EC are REC (Rural Electrification Corporation Ltd), PFC (Power Finance Corporation Ltd) and NHAI (National Highways Authority of India) and IRFC (Indian Railways Finance Corporation Limited).

Key features of Section 54EC bonds:

- *Safe and secure:* 54EC bonds are AAA rated.
- *Interest:* Interest on 54EC bonds is taxable. No TDS is deducted on interest from 54EC bonds and wealth tax is exempted.
- *Tenure:* 54EC bonds come with a lock-in period of 5 years and are non-transferable.
- *Investment amount:* Minimum investment in 54EC bonds is 1 bond amounting to Rs. 10,000 and the maximum investment

in 54EC bonds is 500 bonds amounting to Rs 50 lakhs in a financial year.

- *Interest Rate:* 54EC bonds offer 5% rate of interest payable annually.

References: Tutorials issued by Income Tax Department.

Disclaimer:

Tax Rates mentioned in the booklet relates to financial year 2020-21. The rates are subject to change, depending on the amendments to be introduced by the Govt.

The information is collated and presented to readers for better understanding of the subject and this does not amount to Tax advice. Readers are requested to consult their Tax Consultants before deciding on the Capital Gains computation for Income Tax purposes.

About IFE Academy

IFE Academy was established in 2011 as a Not-for-Profit entity to promote Financial Education. IFE Academy conducts Investor Awareness Programs across the country with the support of other market participants. www.ifea.in is a comprehensive website on Financial Education. It has various sections such as Videos, Puzzles & Games, Financial Calculators and Library. It gives a holistic view on financial education combining various aspects such as Savings, Investments, Credit, Insurance and Pension at a single place. IFE Academy periodically publishes Investor Educational materials and distributes it to general public.

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Regd. office : Park View, Basement, 85/17, G.N.Chetty Road, T.Nagar, Chennai - 600 017.
email : bulletin@ifea.in www.ifea.in