



Capital gains Taxation

– A Quick Referencer



Capital Gains

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**



Capital asset

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.

(i) 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

1. 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

1. Period OF Holding :

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

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

Various judicial pronouncements that PMS expenses are not in the nature of “expenditure incurred wholly and exclusively in connection with such transfer;” as prescribed u/s. 48 of the Income tax Act, 1961.

•However, with the recent judgement made in favour of Assessee, it instils confidence on the stand that PMS expenses are allowed while calculating income earned from such services

SUDHA NARAYANAMURTHYVSDEPUTY
COMMISSIONER OF INCOME TAX -

•[TS-5486-ITAT-2020(BANGALORE)-O]

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 5 years (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

Exemptions

Section	Type of assessee	Type of asset transferred	LT or ST	Amount of investment	Time limit for investment	Withhold of investment
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 from the date of acquisition of shares or purchase of asset

1) 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
- (vii) Sale of NFT(Non-fungible token.)

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.




Taxability of Capital Gains under DTAA

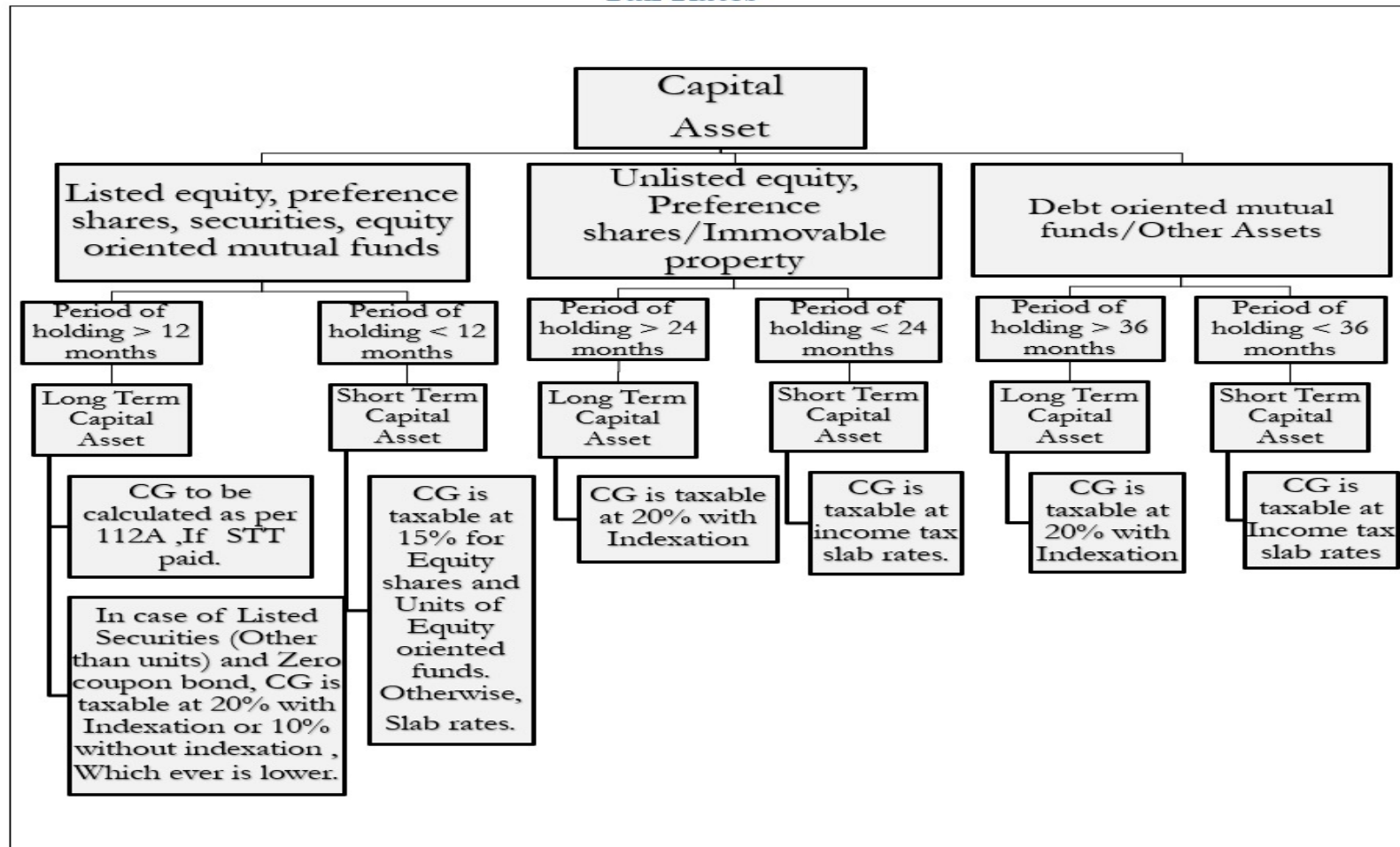
India has entered into Double Tax Avoidance Agreements (DTAA) with several countries. As per Section 90(2), taxability for non-residents is determined as per the provisions of the Act or the applicable DTAA, whichever are more beneficial. Capital gains under the DTAA are generally taxed in a different 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 shall pay tax in Source country and claim Tax credit for the same in the country of their residence. It depends on the Tax event in Residence country to determine the timing for credit.



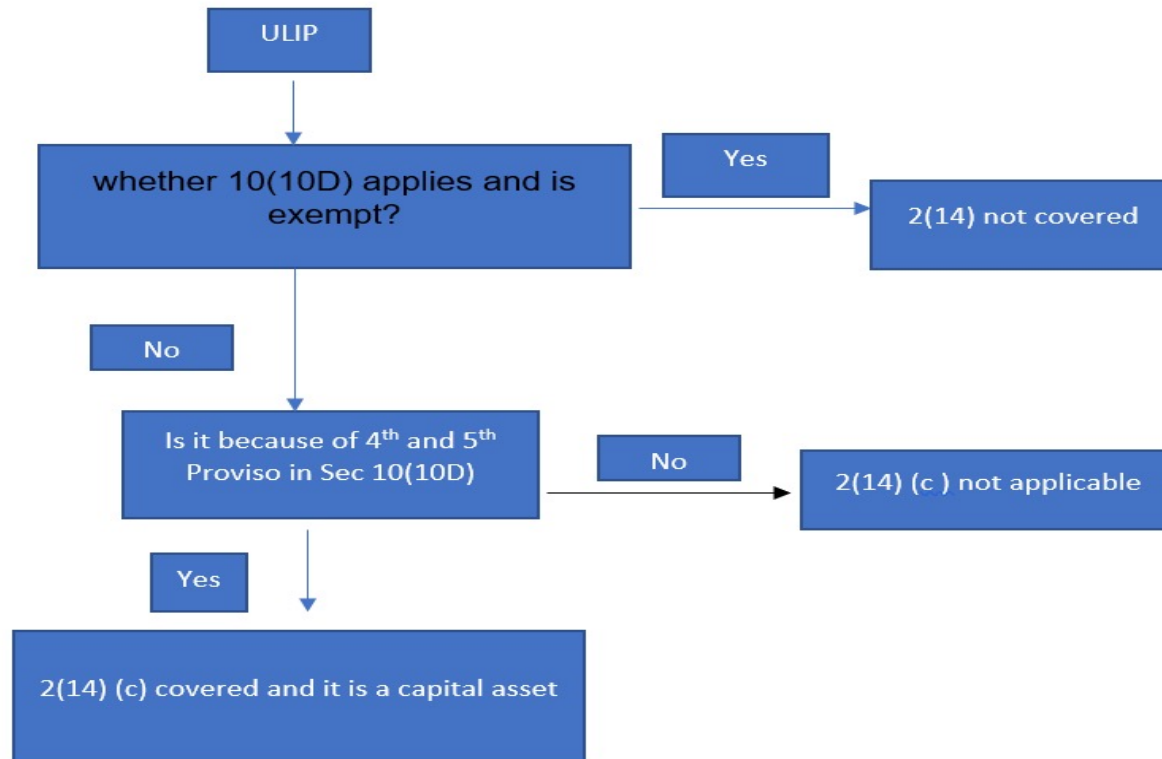
Tax Rates





Special Cases

ULIP – FA 2021 w.e.f. AY 21-22



Tax Implication on Conversion of Preference Share into Equity Shares

- As per clause (xb) of section 47, conversion of preference shares of a company into equity shares of that company is **not** treated as transfer, hence no capital gains arises on the same.
- Section 49(2AE) has been inserted to provide that cost of acquisition of preference shares shall be treated as cost of acquisition for equity shares (received on conversion).
- Further, to find out whether such equity shares received on conversion are long term capital assets or not, the period of holding shall be determined from the date of acquisition of preference shares of such company – Explanation 1 to section 2(42A)
- The benefit of indexation will start from the date of acquisition of preference shares of the company
- The difference between the market value of the equity shares issued and the subscription price paid for the preference shares is taxable u/s 56(2)(x) of the Income Tax Act.

Tax Implication for Derivatives

- A Derivative means an instrument whose value is derived. It has no value of its own. Its price is based on the underlying asset. Derivatives of stocks and indices can be traded on Indian stock exchanges. The most popular form of derivatives are futures & options (F&O).
- Income from F&O deals is almost always treated as business income. This treatment is irrespective of the frequency or volume of transactions.
- But in case of foreign institutional investor, income arising from transfer of securities is considered as short term or long term. For this, we have relied on the judgment of **Platinum Investment Management Ltd. Vs DDIT (International Taxation) -4 (2) , Mumbai**, where it was held that Sec. 43(5) has no application to FIIs in respect of “securities” as defined in Explanation to sec. 115AD, income from whose transfer is considered as short term or long term capital gains.

Tax Implication for Alternative Investment Funds

- Alternative Investment Fund or AIF means any fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors
- There are three categories:
 - **Category I AIF** - Venture Capital Funds (including Angle Funds), SME Funds, Social Venture Funds, Infrastructure Funds.
 - **Category II AIF**
 - **Category III AIF**
- The Category I and Category II AIFs registered with the SEBI have been accorded a pass through status, which means income under the head 'capital gains' and 'income from other sources' shall be taxable in the hands of the investors in the same manner as if it were the income accruing or arising to, or received by, such person had the investments, made by the investment fund, been made directly by him.
- The Category III has still not been accorded to be pass through status.
- The Finance Bill 2019 has proposed to allow losses incurred by such AIFs to be passed through to its investors to be able to set-off or carry forward such losses while computing their income.

Tax Implication for ESOP

- ESOP is the option that a company provides to its employees to purchase the company's shares on future dates at a pre-determined price
- ESOPs are taxed at 2 instances:
 - **At the time of exercise – as a perquisite** - When the employee has exercised the option, basically agreed to buy; the difference between the FMV (on exercise date) and exercise price is taxed as perquisite.
 - **At the time of sale by employee – as a capital gain** - The difference between sale price and FMV on the exercise date is taxed as capital gains.
- Capital gains can further be classified as 'Short Term Capital Gains' and 'Long Term Capital Gains' depending upon the period of holding of such shares.

Tax Implication on Subsequent Listing

- Shares acquired prior to Listing in Stock Market, Securities transactions Tax(STT) is not applicable.
- Post listing, Shares would attract STT on sale/Purchase of the shares.
- Question as to whether it will be taxable as unlisted securities or listed securities?
- Section 112A(1) says -
 - (iii) securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004) has,—*
 - (a) in a case where the long-term capital asset is in the nature of an equity share in a company, been paid on acquisition and transfer of such capital asset;*
- Notification 60/2018 issued by CBDT to clarify transactions which will be allowed for preferential rate of taxes u/s. 112A

Crypto – Characteristics for Tax Purpose

Most of the countries treat Crypto as a Property
i.e as an asset

US has given guidelines vide Notice 2014-21 of
IRS


UK has given guideline vide Crypto Manual of
HRMC

India CBDT Chairman has commented it will be
an asset

It is not treated on par with Real Currency



Crypto-Broad taxation

- Gain from Crypto held as investment is Capital Gains
 - Crypto Trading can result in business income
 - Crypto received from Mining, for services , for employment etc as regular income
 - Crypto received on airdrop is regular income
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Taxation of Investment in Tax vehicles incorporated outside India

- Popularly in Limited Partnerships (LPs) and Limited Liability Corporations (LLCs)
- Investments in LPs are considered as Association of Persons for taxation of income from such vehicle in India. The income is offered in like manner as reported in Form K1s issued by such entities.
- Investments in LLCs are considered as investments in Body Corporates. Distributions from LLC, to the extent characterised as divided, shall be taxable on accrual basis u/s 56(2)(i), i.e. in the year of allocation in the member account, even though there is no actual withdrawal by the member.
- Where capital repayment is regarded as 'capital reduction', will be considered as 'deemed dividend' to the extent of accumulated profits and the balance amount as capital gains. If repayment is considered as buyback, the income would be considered 'capital gains'.



CA Chirag Solanki

Mail - chirag.Solanki@sureshandco.com

Cell - 9972030195

Kiran A

Mail - kiran.a@sureshandco.com

Cell - 9980388722

Thank You