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TAXABILITY OF DEEP DISCOUNT BONDS

Deep Discount Bonds (DDBs): A bond on which no interest is paid at intervals, but on maturity lump sum amount is received.

CIRCULAR NO. 2/ 2002, DATED 15-02-2002

Tax Treatment of DDBs issued upto 15th Feb, 2002

On transfer of bonds before maturity

Sale Consideration – Cost of Acquisition = Capital Gain / Business Income

- If held as investment, Capital Gain (Short term/ Long term) shall arise.
- If held as stock-in-trade, then assessable as Business Income.

On final redemption

Redemption price – Face value = Interest income

- Interest income is assessable as Income from other sources / Business Income as the case may be.
- However, no capital gains will arise.

Tax deduction at source

TDS will be deducted on the difference between the Face value and the redemption price at the time of maturity.

Tax Treatment of DDBs issued after 15th Feb, 2002

In the year of purchase of bond

Market Value of bond as on 31st March of current financial year	–	***Purchase Price***	=	***Interest Income*** (Taxable as Income from other source/ PGBP)

Every year when bonds are held

Market Value of bond as on 31st March of current financial year	–	***Market Value of bond as on 31st March of last financial year***	=	***Interest Income*** (Taxable as Income from other source/ PGBP)

On Transfer before maturity

Sale Consideration	–	***Market Value of bond as on 31st March of last financial year***	=	Capital Gain (Always Short Term) / Business Income

- Period of Holding shall be reckoned from the date of purchase/ subscription, or the last valuation date in respect of which the transferor has offered income to tax, whichever is later.

On Redemption

Redemption Price	–	***Market Value of bond as on 31st March of last financial year***	=	Interest Income / Business Income

Tax deduction at source

- TDS will be deducted on the difference of the face value and redemption value.
- **TDS will be deducted only at the time of redemption of such bonds, irrespective of whether the income from the bonds has been declared by the bond holder on accrual basis from year to year or is declared only in the year of redemption.**
  However, the investor can take an exemption certificate from A.O. u/s 197A if he has declared income on bonds on year to year basis.

Option to investors

- Investors holding Deep Discount Bonds upto an aggregate face value of Rs. 1,00,000, have an option to, continue to offer income for tax in accordance with the earlier clarifications i.e., Tax full amount in the year of maturity.