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ZERO COUPON BONDS

Meaning of Zero Coupon Bond

As per ***Section 2(48)***, "Zero coupon bond" means a bond **–**

(a) Issued by any infrastructure capital company or infrastructure capital fund or public sector company on or after 1.06.2005;

(b) In respect of which no payment or benefit in received or receivable before maturity or redemption and

(c) Which the Central Government notifies in the Official Gazette.

Tax treatment in the hands of investor

i. ***Maturity/Redemption of zero coupon bonds will amount to transfer under section 2(47)(iva)***

ii. ***If period of holding is more than 12 months, such bonds would be long-term capital asset under section 2(42A).***

iii. ***Long Term capital Gains would be taxable at the rate of 10% (plus surcharge plus Education Cess) without indexation under section 112.***

Tax treatment in the hands of company issuing such bonds

i. ***Discount is deductible on pro rata basis u/s 36(1)(iiia) over the life of Zero Coupon Bond..***

ii. ***Tax will not be deducted at source under section 194A by the payer company.***

Computation of pro-rata amount of discount on a zero coupon bond

For the purposes of section 36(1)(iiia), the pro-rata amount of discount on a zero coupon bond shall be computed as under:

- Convert period of life of the bond into number of calendar months.
- For each previous year pro-rata amount of discount shall be calculated as under:

$$\text{Pro-rata Amount of Discount} = \frac{\text{Total Discount}}{\text{No. of calendar months falling within the previous year}}$$