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CAPITAL GAINS – CHARGEABILITY

SECTION 45(1A): CAPITAL GAINS ON INSURANCE CLAIMS FOR DAMAGE OR DESTRUCTION OF CAPITAL ASSETS

- Where ***insurance claim is received*** in respect of ***capital asset damage or destroyed***, as a result of–
  - (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, or
  - (ii) riot or civil disturbance, or
  - (iii) accidental fire or explosion; or
  - (iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war).
- **value of any money** or

- the **FMV of other assets** on the date of such receipt shall be deemed to be sale consideration for computing capital gains.

- ***Capital Gain shall be taxable in the year of receipt of insurance claim.***

- If no claim is received on destruction of capital asset, no capital gain shall arise. The cost of the asset destroyed shall be a capital loss i.e. dead loss which has no tax treatment.

- For the purposes of computing the nature of capital gains, the date of transfer of the capital asset destroyed should mean the date of destruction.

SECTION 45(2) AND SECTION 2(47): CAPITAL GAINS ON CONVERSION OF CAPITAL ASSETS INTO STOCK-IN-TRADE

- ***Section 2(47)***: Transfer includes the conversion of a capital asset into stock in trade of the business carried on by the assessee.

- ***Section 45(2): Capital Gain shall be taxable in the year in which such stock-in trade is sold.***

  Capital Gain = FMV of the asset on the date of conversion – Cost of acquisition

  PGBP = Sale price – FMV of the asset on the date of conversion

- The amount recorded in the books of account of the business as the value of stock-in-trade is not relevant.

- **Capital Gains shall be computed as per the provisions of law applicable in the previous year in which stock-in-trade is sold.**

SECTION 45(2A): TRANSFER OF SECURITIES BY DEPOSITORIES

- Any profits or gains arising from transfer made by the depository (being registered owner of securities)
- shall deemed to be the income of the beneficial owner
- of the previous year in which transfer took place
- and for the purposes of section 48 and section 2(42A),
- the **cost of acquisition** and the **period of holding** of any securities
- shall be determined on the basis of the **first-in-first-out method**.

CIRCULAR NO. 768, DATED 24th JUNE, 1998

This primary position as regards the `date of transfer' and "period of holding" does not change even when the securities are held in dematerialised form. The only problem when securities are held in the dematerialised form is that the distinct trail linking every share to a certificate and its unique distinctive number linking it with its subsequent sale is not available. It is clarified that:

(a) FIFO method will be applied only in respect of the dematerialised holdings because in case of sale of dematerialised securities, the securities held in physical form cannot be construed to have been sold as they continue to remain in possession of the investor and are identified separately.

(b) In the Depository system, the investor can open and hold multiple accounts. In such a case, where an investor has more than one security account, FIFO method will be applied accountwise.

(c) If in an existing account of dematerialised stock, old physical stock is dematerialised and entered at a later date, under the FIFO method, the basis for determining the movement out of the account is the date of entry into account.

SECTION 45(3): CAPITAL GAIN ON TRANSFER OF A CAPITAL ASSET BY A PARTNER/ MEMBER TO FIRM/ AOP/ BOI

- The Capital gains arising from the transfer of a capital asset
- by a person to a firm in which he is or in which he becomes a partner,
- by way of capital contribution or otherwise,
- shall be chargeable to tax in the previous year in which such transfer takes place.
- The **amount recorded in the books of account** of the firm as the value of capital asset, shall be deemed to be the **sales consideration** for the purposes of section 48.

Note1: The same provisions will apply where a member of AOP/BOI, transfers a capital asset to AOP/BOI.

Note2: Section 50C shall apply.

SECTION 45(4): CAPITAL GAIN ON TRANSFER OF A CAPITAL ASSET BY WAY OF DISTRIBUTION ON DISSOLUTION OF A FIRM/ AOP/ BOI OR OTHERWISE

- The capital gains arising from the transfer of a capital asset
- by way of distribution of capital assets on the dissolution of a firm or ***otherwise***
- shall be chargeable to tax as the income of the firm
- in the previous year in which such distribution takes place.
- The ***fair market value*** of the capital asset on the date of distribution shall be taken as the sales consideration for the purposes of section 48.

Note: Same provisions will apply where the assets are distributed by AOP/BOI to its members.

Note: **Commissioner of Income-tax v. A. N. Naik Associates (2004) 136 Taxman 107 (Bom.)**
The word "otherwise" in section 45(4) also covers retirement.

FROM THE JUDICIARY

1. ***A.L.A. FIRM (SUPREME COURT)***

   Where a firm is dissolved, its stock-in-trade must be valued at the fair market value. The difference between the fair market value of stock and the book value of stock is assessable as P/G/B/P in the hands of the firm. This case applies where the business of firm is not continued by anyone.

2. ***Where, on dissolution following death of one partner, assessee-firm was reconstituted with remaining partners without discontinuation of business, closing stock of firm was to be valued at cost or market price whichever was lower.***

   Sakthi Trading Co. v. CIT [2001] 250 ITR 871/118 Taxman 301 (Supreme Court)

   Therefore if a firm is dissolved and its business is also discontinued, then the judgement of Supreme Court in A.L.A. Firm shall apply and the stock shall be valued as per the fair market value. If however, the firm is dissolved but the business of the firm is continued by some-one, then the judgement of Supreme Court in SAKTHI TRADING CO. shall apply and the stock shall not be valued at market price. The stock shall be valued as per normal accounting practices.

3. *CIT v. R. Lingmallu Raghukumar [2001] 247 ITR 801 (Supreme Court)*
   Excess amount received by the assessee on retirement from the firm is not assessable to capital gains.

SECTION 45(5): CAPITAL GAIN ON TRANSFER BY WAY OF COMPULSORY ACQUISITION OF AN ASSET

- Transfer of capital asset
- by way of **compulsory acquisition** under any law or
- the transfer is the one for which,
- the consideration is determined or approved by the Central Government or the RBI.

then

- the capital gains arising from the transfer of the capital asset shall be dealt with as under:

In respect of:	
Original Compensation	- Taxable in the year in which it is **first received** by the assessee. (even part thereof). - Period of holding shall be taken upto the date when asset was compulsorily acquired.
Enhanced Compensation	- Taxable in the year in which it is **received** by the assessee. - Nature of capital gain shall be same as the nature of capital gain with reference to the original compensation. - Cost of acquisition shall be taken to the NIL.
Reduced Compensation	- Rectification is to be made to give effect to the reduced compensation.

Note: Where by reason of the death of the person who made the transfer or for any other reason, the enhanced compensation is received by any other person, then the amount so received shall be deemed to be the income under the head Capital gains of the person who receives the same.

SECTION 155(16): RECTIFICATION

- In case of compulsorily acquisition under any law, of any capital assets

- either original compensation or enhanced compensation

- has been subsequently reduced by any court, Tribunal or other authority,

- the Assessing Officer shall amend the order of assessment so as to compute the capital gain by taking the compensation as so reduced by the court, Tribunal or any other authority to be the full value of consideration;

- and the provisions of section 154 shall apply thereto, and the period of four years shall be reckoned from the end of the previous year in which the order reducing the compensation was passed by the court, Tribunal or other authority.