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CAPITAL GAINS – BASIC CONCEPTS

SECTION 45(1): CHARGING SECTION

- Any profits and gains arising from
- ***transfer***
- of a ***capital asset***
- effected in the previous year
- shall be chargeable to income-tax under the head capital gains
- ***in the previous year in which transfer took place.***

SECTION 2(14): DEFINITION OF CAPITAL ASSET

"Capital asset" means **property of any kind** held by an assessee whether or not connected with his business or profession, ***but does not include*** -

(i) any **stock-in-trade,** consumable stores or raw materials held for the purposes of his business or profession;

(ii) **personal effects**, that is to say, ***movable property*** (including wearing apparel and furniture*)* held for personal use by the assessee or any member of his family dependent on him, ***but excludes—***

(a) jewellery;
(b) archaeological collections;
(c) drawings;
(d) paintings;
(e) sculptures; or
(f) any work of art.

Note:

1. ***CIT v. Benarshilal Katarika 54 Taxman 300****:* silver utensils constitute personal affects and no capital gains will arise on the sale of silver utensils.

(iii) **rural agricultural land** in India. "Rural land" means land situated in any area where:

Population ***within area of the jurisdiction of municipality*** not exceeding 10,000
or
Situated beyond 8 k.m. from the local limit of any municipality.

(iv) ***Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government***

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SECTION 2(47): DEFINITION OF TRANSFER

"Transfer", in relation to a capital asset, includes, -

(i) the **sale**, **exchange** or **relinquishment** of the asset; or

(ii) the **extinguishment of any rights** therein; or

(iii) the **compulsory acquisition** thereof under any law; or

(iv) **conversion of capital asset into stock in trade**; or

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act; or

(vi) any transaction which has the effect of transferring, or enabling the enjoyment of any immovable property (Flats in societies).

(vii) the **maturity or redemption of a Zero Coupon bond** .

Notes:

1. ***ANARKALI SARABHAI (SUPREME COURT)***
   Redemption of preference shares amount to transfer and will result in capital gains in the hands of the preference shareholder.

SECTION 48: METHOD OF COMPUTATION OF CAPITAL GAINS

Sale Consideration received or accruing as a result of transfer of capital asset.		xxx
Less:	cost of acquisition of the asset. (COA)	xxx
Less:	cost of any improvement to the asset. (COI)	xxx
Less:	expenditure incurred wholly and exclusively in connection with such transfer	xxx
	Income chargeable under the head "Capital Gains"	**xxx**

FIRST PROVISO TO SECTION 48: CAPITAL GAINS IN CASE OF NON-RESIDENTS

- In case of an assessee who is a ***non-resident***,
- the capital gains arising from the
- transfer of ***shares*** or ***debentures***
- ***in an Indian company***,
- shall be computed by converting
  (i) the cost of acquisition of the asset
  (ii) the expenditure incurred wholly and exclusively in connection with such transfer and
  (iii) sale consideration received or accruing as a result of transfer of capital asset

- into the same ***foreign currency*** as was initially utilised in the purchase of such shares or debentures.
- The capital gains so computed in the foreign currency shall be reconverted into Indian currency.

The abovesaid manner of computation of capital gains shall apply to capital gains arising from every reinvestment thereafter in and the sale of, shares or debentures in Indian company.

For the applicability of the first proviso, the shares or debentures should be purchased in the foreign currency or it should be a case of re-investment.

RULE 115A: METHOD OF CONVERSION – Telegraphic Transfer Buying /Selling Rate

(a)	COA	Average of TTBR and TTSR	on the date of acquisition
(b)	Expenditure	Average of TTBR and TTSR	on the date of transfer
(c)	Sale Consideration	Average of TTBR and TTSR	on the date of transfer
(d)	CG into Indian Currency	TTBR	on the date of transfer

SECOND PROVISO TO SECTION 48: INDEXATION

While computing long term capital gains:

(a) "Indexed Cost of Acquisition" shall be taken instead of "Cost of Acquisition" and

(b) "Indexed cost of any improvement" shall be taken instead of" "cost of any improvement".

Note 1: "Indexed Cost of acquisition" means:

$$\text{Cost of Acquisition} \times \frac{\text{Cost Inflation Index for the year in which asset is transferred}}{\text{Cost Inflation Index for the } \textit{first year in which asset was held} \text{ by the assessee or for the year beginning on 1-4-81, whichever is later.}}$$

Note 2: "Indexed Cost of any Improvement" means:

$$\text{Cost of Improvement} \times \frac{\text{Cost Inflation Index for the year in which the asset is transferred}}{\text{Cost Inflation Index for the year in which the improvement to the asset took place.}}$$

Note 3: **No indexation where First Proviso applies.**

THIRD PROVISO TO SECTION 48: SECOND PROVISO TO SECTION 48 NOT TO APPLY

Benefit of indexation is not available:

- for **bonds/ debentures** of any company.
- for **bonds issued by Government**.

FIFTH PROVISO TO SECTION 48: STT NOT TO BE ALLOWED AS DEDUCTION

Accordingly the securities transaction tax (STT) paid on sale of shares/units shall not be reduced from the sale price and the STT paid on purchase of shares/units shall not be added to the cost of acquisition.

SECTION 55: "COST OF ACQUISITION"

(A)

	Cost of Acquisition	
Capital Asset	**Acquired**	**Self generated**
Goodwill of a ***business***	Purchase price	NIL
Trade mark or brand name associated with a business	Purchase price	NIL
Tenancy rights	Purchase price	NIL
Stage carriage permits (Route Permits)	Purchase price	NIL
Loom hours	Purchase price	NIL
Right to manufacture, produce or process any article or thing	Purchase price	NIL
Right to carry on any business	Purchase price	NIL

Note: **B.C. Srinivasa Setty (SC)** and **Suman Tea & Plywood Industries (P) Ltd.**
Cost of acquisition of self generated assets other than those mentioned in section 55, is indeterminate. Therefore no capital gains shall arise. E.g., on sale of spontaneously grown trees, goodwill of profesion.

Note: The option to take cost of acquisition as FMV as on 01-04-81 is not available even if such assets were acquired before 01-04-81.

(B)

Capital Asset	**Cost of Acquisition**	**Period of Holding**
Original Shares/securities	Purchase price	From the date of purchase or allotment
Right Shares/securities purchased	Price actually paid under the right issue	From the date of allotment
Right to subscribe shares/ securities:		
- in the hands of the person who renounces the right	NIL	From the date of offer (Always short term)
- in the hands of the purchaser of right.	Price paid to the person who renounce the right **and** amount paid to the company to acquire the right shares	From the date of allotment
Bonus shares/ securities	NIL	From the date of allotment

Note: 1. The option to take FMV as on 1-4-81 is available.

Note: 2. Section 2(42A) defines a short term capital asset to mean a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer.

However, in case of
- ***share held in a company or***
- ***any security listed on a recognised stock exchange or***
- ***a unit of Unit Trust of India or***
- ***a Unit of Mutual Fund specified in section10(23D) or***
- ***a Zero coupon bond***

the period of holding should be 12 months or less to qualify as short-term capital asset.

(C) Under a scheme for ***demutualisation or*** corporatisation approved by the SEBI in relation to a capital asset, being:

	Cost of Acquisition
Equity share or shares allotted to a shareholder of a recognised stock exchange in India	Cost of acquisition of his original membership of the exchange
Trading or clearing rights of the recognized stock exchange acquired by a shareholder	NIL

Note: The option to take FMV as on 1-4-81 is not available.

(D) <u>in relation to other capital assets</u>

(1) Where the capital asset is acquired by the assessee or the previous owner before 1.4.1981:
- Cost of acquisition to the assessee or the previous owner, or
- FMV as on 1.4.1981

whichever is higher.

(2) Where the capital asset is acquired by the assessee or the previous owner on or after 1.4.1981:
   - Cost of acquisition to the assessee or the previous owner.

SECTION 55: "COST OF IMPROVEMENT"

(a) The cost of improvement of the following shall be taken to be **NIL**:
   (i) Goodwill of Business.
   (ii) Right to manufacture, produce or process any article or thing.
   (iii) Right to carry on any business.

(b) in relation to other capital assets
   (i) Where the capital asset is acquired by the assessee or the previous owner on or after 1.4.1981:
      - Cost of improvement means all capital expenditure incurred on improvement by the assessee *and* the previous owner.
   (ii) Cost of improvement incurred before 1.4.1981 is to be ignored in all cases.

SECTION 50C: SPECIAL PROVISION FOR FULL VALUE OF CONSIDERATION IN CERTAIN CASES

- Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being **land or building or both**,
- is **less than**
- the **value adopted** by the stamp valuation authority for the purpose of payment of stamp duty in respect of such transfer,
- the **value so adopted** or assessed shall **deemed** to be the **sale consideration** for the purpose of computation of capital gains.

- Where the **assessee claims** that
- the **value so adopted exceeds** the **FMV** of the property as on the date of transfer; **and**
- the **value so adopted has not been disputed** in any appeal or revision or no reference has been made before any authority/ Court,
- the **A.O. may refer** the valuation of the capital asset **to a Valuation Officer**.

- Where the value ascertained by the Valuation officer
- exceeds
- the value adopted by the stamp valuation authority
- the **value so adopted** shall be taken to be the **sale consideration** for the purpose of computation of capital gains.

SECTION 155(15): RECTIFICATION

- Where Capital gains are computed as per the provisions of section 50C
- by taking the value adopted by stamp valuation authority
- and subsequently such value is revised in any appeal or revision or reference,
- the Assessing Officer shall amend the order of assessment and recompute the capital gain by taking revised value
- and the provisions of section 154 shall, apply thereto,
- and the period of 4 years shall be reckoned from the end of the previous year in which the order revising the value was passed in that appeal or revision or reference.

SECTION 111A: TAX ON SHORT-TERM CAPITAL GAINS IN CERTAIN CASES

Section 111A shall be applicable to **all assessees**, if all the following conditions are fulfilled:

- The gains arise from transfer of a **short term capital asset**;
- being an **equity share** in a company or a **unit of an "Equity Oriented Fund"**,
- the transaction of sale is entered into on or after 1.10.2004, and
- is chargeable to Securities Transaction Tax (STT).

➢ Tax payable on such STCG shall be **@ 10%.**

➢ Benefit of slab rate is available on such short term capital gains in case of **resident** Individual or HUF. i.e., not available to non-resident.

<u>IN CASE OF AN INDIVIDUAL OR HUF RESIDENT OF INDIA</u>

WHERE (Total Income – STCG referred in section 111A) <Rs.1,10,000/-

then tax under section 111A @ 10% shall be on the following amount:

STCG referred
In section 111A - [Rs.1,10,000/- – (Total income – STCG referred to in section 111A)]

➢ Chapter VI-A deduction shall not be allowed on STCG referred to in section 111A.

SECTION 112: TAX ON LONG TERM CAPITAL GAINS

- Section 112 shall apply to **all assessee.**
- On **long term capital gain** tax is payable **@ 20%.**

➢ Benefit of slab rate is available on such long term capital gains in case of **resident** Individual or HUF. i.e., not available to non-resident.

➢ Chapter VI-A deduction shall be allowed on LTCG.

PROVISO TO SECTION 112: TAX ON LTCG FROM LISTED SECURITIES OR UNITS

- Any **long term capital gain** arising
- on transfer of
- ***listed securities or***
- ***units or***
- ***Zero coupon bond.***
- Tax on LTCG payable by the assessee shall be **lower** of:
  - 20% of LTCG after indexation, or
  - 10% of LTCG without indexation