Direct Tax Code and Capital Gain

"There is nothing permanent except change".
– Heraclitus

Introduction:

This is what we are going to face due to Introduction of Direct Tax Code in place of Income Tax Act, 1961, IFRS in place of Indian Accounting Standard, Goods and Service Tax in place of Excide Duty, VAT and Service Tax and New Company Bill in place of Existing Companies Act, 1956. We have to keep our minds updated on day to day basis to cope up with the drastic change in Tax regime of our Country.

In this Article, I am going to discuss the taxation of capital gains under provisions of the Direct Taxes Code Bill, 2010. The earlier draft of the Direct Taxes Code (DTC) had hinted at taxing both long-term and short-term capital gains at the normal rates. Discussed below are some of the important provisions of the proposed scheme of capital gains taxation under Direct Tax Code, 2010.

1. Introduction of Concept of Investment asset

The DTC replaces the term 'capital asset' as used under the existing Income Tax Act, 1961 with the term 'Investment Asset' and is being defined as under:
"investment asset" means,—
(a) any capital asset which is not a business capital asset;
(b) any security held by a Foreign Institutional Investor;
(c) any undertaking or division of a business;

2. Holding period for investment asset

Though the wording of the DTC seeks to remove the classification of an asset as long or short term, the concept has been retained in substance as the effective tax rate is still influenced by the period for which the asset is held.

The provisions for the period of holding of equity shares or units — where securities transaction tax is paid — under the DTC is similar to the provisions existing under the current Income-Tax Act, 1961.

Whereas for other Investment assets except mentioned as above, the period of holding will be considered from the end of the Financial year in which the Investment asset was purchased instead of the date of purchase which is at present considered under the Income Tax Act, 1961.

For Example:

If the security was purchased on, say, 1st April 2010 it will be deemed to have been held for one year only on 30th March of 2012.

Moreover, Investment Assets, held for more than a year from the end of the financial year in which Investment Assets was purchased, are eligible to avail the indexation benefits. So this would result into availment of indexation benefit within a shorter period. However, it also converts a part of the long term gain under the present system into short term gain under the new system, resulting in more revenue to the exchequer.

3. Rates of taxation

The provision of tax exemption for long-term capital gains on listed equity (subject to STT) has been retained in substance, as the proposed DTC provides for a 100% deduction on listed equity shares or units of an equity-oriented fund where the period of holding is more than a year from the date of acquisition and on which STT has been paid.

Where such assets are held for less than a year, deduction is limited to 50% of the gains and the effective tax rate for an individual, on these amounts, could be 5%, 10% or 15%, depending on the tax slab assessee falls into. This is much more equitable than the current provisions where the reduced tax rate for short-term capital gains is 15%.

The positive change is that all capital losses can be set off against each other and a carry-forward allowed indefinitely for all losses. In the Income-Tax Act as it stands today, there are limitations on carry-forward and setoff of capital losses.

Where as, in case of Long Term Capital Gain on Sale of Investment Assets other than mention in First Para will be added to the income of the investor and charged at the applicable rate.

4. Base Date

The base date for determining the cost of acquisition has been shifted from 1 April 1981 to 1 April 2000. Consequently, all unrealized capital gains on assets for the period between 1 April 1981 and 31 March 2000 not to be liable to tax.

5. Set off and Carry Forward of Losses:

Capital loss to be allowed to set off only against capital gains. The capital loss can be carried forward for an indefinite period.

In the case of short-term capital losses, only 50 per cent of such losses can be set off against the total short-term capital gains.

In other words, if an investor had say a Rs 50 short-term capital loss, only Rs 25 would be allowed to be set-off against the short-term gains. In the present tax regime, the entire losses would be allowed as set-off.

Source:

1. Direct Tax Bill, 2010.
2. http://www.taxrates.cc/html/06l-dtc-capital-gains.html
3. http://economictimes.indiatimes.com/opinion/policy/Direct-Taxes-Code-Capital-gains-tax-is-investor-friendly/articleshow/6477547.cms
4.http://www.thehindubusinessline.com/2010/08/31/stories/2010083152641000.htm
5. http://fivecentnickel.com