

CAPITAL GAINS

AMENDMENTS BY THE FINANCE (No.2) ACT, 2014

(a) Income arising from transfer of security by a foreign portfolio investor (FPI) characterized as capital gains [Section 2(14)]

Effective from: A.Y.2015-16

- (i) Section 2(14) defines "capital asset" to include property of any kind held by an assessee, whether or not connected with his business or profession, but does not include any stock-in-trade or personal assets as provided in the definition.
- (ii) This section has been amended to address –
 - (1) the concern of the foreign portfolio investors (foreign institutional investors) in characterisation of their income arising from transaction in securities (i.e., whether the same is in the nature of capital gain or business income); and
 - (2) the question of whether the presence of fund manager managing the funds of such investor in India is likely to affect such characterization.
- (iii) Accordingly, to address these concerns, section 2(14) has been amended to provide that any securities held by Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992 would be treated as a capital asset.
- (iv) The definition of "capital asset" under section 2(14) would now include –
 - (a) property of any kind held by an assessee, whether or not connected with his business or profession;
 - (b) any securities held by Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992.
- (v) The exclusion of stock-in-trade from the definition of capital asset is only in respect of sub-clause (a) above and not sub-clause (b). This implies that even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.
- (vi) Further, the *Explanatory Memorandum* to the Finance (No.2) Bill, 2014 clarifies that the income arising from transfer of such security by a Foreign Portfolio Investor

(FPI) would be in the nature of capital gain, irrespective of the presence or otherwise in India, of the Fund manager managing the investments of the assessee.

(b) Period of holding of units of debt oriented mutual fund and unlisted securities, to qualify as a long-term capital asset, increased from "more than 12 months" to "more than 36 months" [Section 2(42A)]

Effective from: A.Y.2015-16

- (i) 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. Therefore, a capital asset has to be held for more than 36 months, to qualify as a long-term capital asset.
 - (ii) However, in the case of a share held in a company or any other security listed in a recognised stock exchange in India or a unit of the Unit Trust of India or a unit of a Mutual Fund or a zero coupon bond, the period of holding required for qualifying as a long-term capital asset is "more than twelve months".
 - (iii) Since the shorter period of holding for "more than 12 months" for consideration as long-term capital asset was for the purpose of encouraging investment in stock market, where prices of the securities are market determined, accordingly, clause (42A) of section 2 has been amended to provide that an unlisted security and a unit of a mutual fund (other than an equity oriented mutual fund) shall be a short-term capital asset if it is held for "not more than 36 months".
 - (iv) This implies that an unlisted security and unit of a debt-oriented mutual fund would qualify as a "long-term capital asset" and be eligible for the benefit of indexation and concessional rate of tax@20% only if it is held for "more than 36 months".
 - (v) However, the unlisted securities and units of debt-oriented mutual fund shall be deemed as long-term capital assets if they have been transferred during the period from April 1, 2014 to July 10, 2014, being the date of introduction of the Finance (No.2) Bill, 2014 in the Lok Sabha, after holding them for a period of "more than 12 months" (instead of more than 36 months).
- #### (c) Benefit of concessional rate of tax@10% on long-term capital gains (without indexation) not to be available in respect of units of debt-oriented fund and unlisted securities [Section 112]

Effective from: A.Y.2015-16

- (i) Under section 112, where tax payable on long-term capital gains arising on transfer of a capital asset, being listed securities or unit or zero coupon bond, exceeds 10% of the amount of capital gains before allowing for indexation adjustment, then, such excess shall be ignored.
- (ii) As long-term capital gains is not chargeable to tax in the case of transfer of a unit of an equity oriented fund which is liable to securities transaction tax, the benefit of concessional rate of tax@10% under proviso to section 112(1) in respect of units cover only the unit of a fund, other than an equity oriented fund.

- (iii) Section 112 has been amended to restrict the concessional rate of tax @10% on long term capital gain only to listed securities (other than unit) and zero coupon bonds.
- (iv) Consequently, long term capital gains on transfer of units of debt oriented mutual fund and unlisted securities are not eligible for concessional rate of tax@10% (without indexation benefit). Therefore, the long-term capital gains, in such cases, is taxable@20% (with indexation benefit).
- (v) However, the concessional rate of 10% (without indexation benefit) would be available in respect of long-term capital gains arising on units of debt equity oriented fund transferred during the period from 1st April, 2014 to 10th July, 2014, being the date of introduction of the Finance (No.2) Bill, 2014 in the Lok Sabha.

Note - In case of non-corporate non-residents and foreign companies, the benefit of tax@10% (without giving effect to the indexation benefit and conversion of currency) would be available on long-term capital gains arising on transfer of unlisted securities by virtue of the specific provision contained in sub-clause (iii) of section 112(1)(c).

(d) Compensation received in pursuance of an interim order deemed as income chargeable to tax in the year of final order [Section 45(5)]

Effective from: A.Y.2015-16

- (i) Under section 45, any profits or gains arising from transfer of a capital asset is chargeable to tax.
- (ii) Section 45(5)(b) contains the special provisions dealing with capital gains arising from transfer by way of compulsory acquisition where the compensation is enhanced or further enhanced by the Court, Tribunal or any other authority.
- (iii) Where the amount of compensation is enhanced or further enhanced by the court, it shall be deemed to be the income chargeable of the previous year in which such amount is received by the assessee.
- (iv) In order to remove the uncertainty regarding the year in which the amount of compensation received in pursuance of an interim order of the court is to be charged to tax, a proviso has been inserted after clause (b) to provide that such compensation shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such court, Tribunal or other authority is made.

(e) Transfer of Government security outside India by a non-resident to another non-resident not a transfer for charge of capital gains tax [Section 47]

Effective from: A.Y.2015-16

- (i) Section 47 lists out the transactions which are not considered as transfer for the purpose of charging of capital gains.
- (ii) In order to facilitate listing and trading of Government securities outside India, clause (viib) has been inserted in section 47 to provide that any transfer of a capital asset, -

- (1) being a Government Security carrying a periodic payment of interest,
 - (2) made outside India through an intermediary dealing in settlement of securities,
 - (3) by a non-resident to another non-resident
- shall not be considered as transfer for the purpose of charging capital gains.

(f) Rise in Consumer Price Index (Urban) to be the basis for notification of CII [Section 48]

Effective from: A.Y.2016-17

- (i) Section 48 prescribes the mode of computation of income chargeable under the head "Capital gains". Indexation benefit is available for computing cost of acquisition and cost of improvement, where the capital gains are long-term in nature.
- (ii) Clause (v) of the *Explanation* to section 48 defines "Cost Inflation Index" (CII) in relation to a previous year, to mean such index as may be notified by the Government having regard to 75% of average rise in the Consumer Price Index (CPI) for urban non-manual employees (UNME) for the immediately preceding previous year to such previous year.
- (iii) Since the release of CPI for UNME has been discontinued, accordingly, clause (v) of the *Explanation* to section 48 has been amended to provide that "Cost Inflation Index" in relation to a previous year shall mean such index as may be notified by the Central Government having regard to 75% of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year.

(g) Exemption under section 54 and 54F to be available for investment in one residential house situated in India

Effective from: A.Y.2015-16

- (i) As per section 54(1), capital gains, to the extent invested in a residential house, is not chargeable to tax under section 45 where
 - (1) the capital gain arises from the transfer of a long-term capital asset, being a residential house; and
 - (2) the assessee, being an individual or a HUF, within a period of one year before or two years after the date of transfer, purchases, or within a period of three years after the date of transfer constructs, a residential house.
- (ii) Likewise, under section 54F, capital gains, in proportion to the net consideration invested in a new residential house, is not chargeable to tax under section 45 where –
 - (1) the capital gain arises from transfer of a long-term capital asset, not being a residential house; and
 - (2) the assessee, being an individual or a HUF, within a period of one year before or two years after the date of transfer, purchases, or within a period of three years after the date of transfer constructs, a residential house.

- (iii) There have been controversial judicial views interpreting "a residential house" to mean "more than one residential house" on the reasoning that "singular" includes "plural" under the General Clauses Act. Further, another issue which emerged before the Courts was whether investment in a residential house situated outside India would qualify for exemption under these sections.
- (iv) Since the real intent of law was to allow capital gains exemption for investment in one residential house situated in India, sections 54 and 54F have been amended to provide for exemption thereunder in respect of investment made in **one residential house situated in India.**
- (h) Maximum investment in bonds of NHAI & RECL, out of capital gains arising from transfer of one or more capital assets during a financial year, restricted to ₹ 50 lakhs, irrespective of whether the investment is made in the same financial year or in the subsequent financial year or both [Section 54EC]**

Effective from: A.Y.2015-16

- (i) Under section 54EC(1), where capital gain arises from the transfer of a long-term capital asset and the assessee has, within a period of six months, invested the whole or part of the capital gains in the long-term specified asset, being bonds of National Highways Authority of India (NHAI)/Rural Electrification Corporation Ltd. (RECL), the capital gains so invested in the long-term specified asset, out of the whole of the capital gain, shall not be charged to tax.
- (ii) The proviso to section 54EC(1) restricts the investment which can be made in the long-term specified asset (bonds of NHAI/RECL) during any financial year to ₹ 50 lakh.
- (iii) Since the period available for investing in NHAI/RECL bonds is six months from the date of transfer, and the restriction of ₹ 50 lakh is in relation to a financial year, it was possible for assessee transferring an asset or assets on or after 1st October in a financial year, to invest ₹ 50 lakh in the same financial year and ₹ 50 lakh in the next financial year (within six months from the date of transfer) and claim an exemption of upto ₹ 1 crore under section 54EC. This was, however, not in accordance with the real intent of law to restrict the maximum exemption to ₹ 50 lakh.
- (iv) Accordingly, a second proviso has been inserted in section 54EC(1) to provide that the investment made by an assessee in bonds of NHAI/RECL, out of capital gains arising from transfer of one or more original assets, during the financial year in which the original asset or assets are transferred and in the subsequent financial year does not exceed fifty lakh rupees.

Example

Mr. Ram, working as a CEO with ABC Ltd., furnishes the following particulars of assets transferred by him during the P.Y.2014-15 –

	Particulars	Date of transfer	₹
(1)	A residential house in Bangalore which he had purchased in February, 2000 at a cost of ₹ 15,56,000.	13/1/2015	1,45,00,000
(2)	Listed shares of Indian companies purchased in May 2012 at a cost of ₹ 1 lakh.	14/2/2015	2,00,000
(3)	Unlisted shares purchased in May 2012 at a cost of ₹ 50,000.	14/2/2015	75,000
(4)	Units of equity oriented fund purchased in May 2012 at a cost of ₹ 30,000	14/2/2015	65,000
(5)	Units of debt oriented fund purchased in January 2010 at a cost of ₹ 31,600	14/2/2015	75,000

Mr. Ram made the following investments, out of net consideration arising on sale of residential house -

	Particulars	₹
(1)	Purchased a residential flat in Pune on 21/5/2015	35,00,000
(2)	Purchased a residential flat in Madurai on 14/7/2015	25,00,000
(3)	3 year bonds of NHAI on 20/3/2015	40,00,000
(4)	3 year bonds of RECL on 15/5/2015	30,00,000

Compute the total income and tax liability of Mr. Ram for A.Y.2015-16, if his salary income (computed) is ₹ 24 lakh and interest on fixed deposits with banks is ₹ 1 lakh. Assume that he has contributed ₹ 1,50,000 to PPF and paid medical insurance premium of ₹ 12,000 to insure his health.

Cost Inflation Index of F.Y.1999-2000: 389; F.Y.2009-10: 632; F.Y.2012-13: 852; F.Y.2014-15: 1024.

Answer

Computation of total income of Mr. Ram for A.Y.2015-16

Particulars	₹
Salaries	24,00,000
Capital gains [See Working Note below]	19,52,800
Interest on fixed deposits	1,00,000
Gross Total Income	44,52,800
Less: Deductions under Chapter VI-A	
Under section 80C – PPF	1,50,000
Under section 80D – Mediclaim premium	12,000
Total Income	42,90,800

Tax on total income:	₹
Tax on long-term capital gains [20% of ₹ 19,27,800]	3,85,560
Tax on other income of ₹ 23,63,000 [42,90,800 -19,27,800]	5,33,900
	9,19,460
Add: Education cess@2% and SHEC@1%	27,584
	9,47,044

Working Note – Computation of Capital Gains chargeable to tax for A.Y.2015-16

	Particulars	₹
(1)	Residential house	
	Gross Sale consideration	1,45,00,000
	Less: Indexed cost of acquisition [15,56,000 × 1024/389]	40,96,000
		1,04,04,000
	Less: Exemption under section 54	
	Investment in one residential house (it is more beneficial to claim exemption in respect of investment in residential flat at Pune)	35,00,000
	Investment in bonds of NHAI/RECL (aggregate investment to be restricted to ₹ 50 lakh)	50,00,000
	Long-term capital gains taxable@20% u/s 112	19,04,000
(2) & (4)	Listed equity shares and units of equity oriented fund	
	Capital gains on sale of listed equity shares and units of equity oriented fund held for more than 12 months is a long-term capital gain exempt under section 10(38).	Nil
(3)	Unlisted shares	
	Sale consideration	75,000
	Less: Cost of acquisition	50,000
	Short-term capital gains taxable at normal rates of tax [Since held for less than 36 months]	25,000
(5)	Units of debt-oriented fund	
	Sale consideration	75,000
	Less: Indexed cost of acquisition [31,600 × 1024/632]	51,200
	Long-term capital gains taxable at 20% u/s 112 [Since held for more than 36 months]	23,800

Taxable Capital Gains:	₹
Long-term capital gains taxable@20% u/s 112 [(1) + (5)]	19,27,800
Short-term capital gains taxable at normal rates [3]	25,000
	19,52,800

SIGNIFICANT NOTIFICATIONS/CIRCULARS

1. Notification of Cost Inflation Index for F.Y.2014-15 [Notification No. 31/2014 dated 11.06.2014]

Clause (v) of *Explanation* to section 48 defines “Cost Inflation Index”, in relation to a previous year, to mean such Index as the Central Government may, by notification in the Official Gazette, specify in this behalf, having regard to 75% of average rise in the Consumer Price Index for urban non-manual employees.

Accordingly, the Central Government has, in exercise of the powers conferred by clause (v) of *Explanation* to section 48, specified the Cost Inflation Index for the financial year 2014-15 as 1024.

S. No.	Financial Year	Cost Inflation Index	S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100	18.	1998-99	351
2.	1982-83	109	19.	1999-2000	389
3.	1983-84	116	20.	2000-01	406
4.	1984-85	125	21.	2001-02	426
5.	1985-86	133	22.	2002-03	447
6.	1986-87	140	23.	2003-04	463
7.	1987-88	150	24.	2004-05	480
8.	1988-89	161	25.	2005-06	497
9.	1989-90	172	26.	2006-07	519
10.	1990-91	182	27.	2007-08	551
11.	1991-92	199	28.	2008-09	582
12.	1992-93	223	29.	2009-10	632
13.	1993-94	244	30.	2010-11	711
14.	1994-95	259	31.	2011-12	785
15.	1995-96	281	32.	2012-13	852
16.	1996-97	305	33.	2013-14	939
17.	1997-98	331	34.	2014-15	1024

2. Reverse Mortgage Scheme amended to include within its scope, disbursement to an annuity sourcing institution for periodic payments by way of annuity to the Reverse Mortgagor [Notification No.79/2013 dated 07.10.2013]

The Central Government had notified the Reverse Mortgage Scheme, 2008 in exercise of the powers conferred by clause (xvi) of section 47 of the Income-tax Act, 1961. Reverse Mortgage means mortgage of a capital asset by an eligible person against a loan obtained by him from an approved lending institution. Such kind of a transaction is not regarded as transfer under section 47(xvi) and amounts received by the Reverse Mortgagor as loan, either in lump-sum or in installment, are exempt under section 10(43).

The Central Government has, vide this notification, amended the Reverse Mortgage Scheme, 2008, to include within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.

An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.

Maximum Period of Reverse Mortgage Loan

	Mode of disbursement	Maximum period of loan
(a)	Where the loan is disbursed directly to the Reverse Mortgagor	20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution.
(b)	Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse mortgagor	The residual life time of the borrower.

3. Foreign Institutional Investors notified as per section 115AD [Notification No. 9/2014 dated 22.01.2014]

Section 115AD contains the special provisions for taxation of income of foreign institutional investors (FIIs) from securities or capital gains arising from transfer of securities. As per clause (a) of *Explanation* to section 115AD, the expression "Foreign Institutional Investor" means such investor as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Accordingly, the Central Government has specified Foreign Portfolio Investors (FPIs) registered under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, as FII for the purposes of section 115AD. Hence, the special provisions for taxation of income of FIIs from securities and capital gains arising from transfer of securities, as contained in section 115AD, would apply to such income of Foreign Portfolio Investors registered under SEBI (FPI) Regulations, 2014.