

Lost money in stocks? Use it to save tax

An important rule of investing is not to be swayed by market volatility. If you panic and sell your stocks when they are down, you may repent later. However, if the stocks you bought a few months ago are running into losses, the best thing to do is sell them and buy them back. This simple, two-step strategy can help you save a neat packet in tax.

Here's how it works. Your losses are notional till you don't sell your stocks. If you sell them, you can book short-term capital losses, which can be adjusted against profits from other assets. If you have run up losses of Rs 1 lakh and sell your stocks, you will be allowed to adjust this Rs 1 lakh against gains from certain investments, including short-term capital gains from stocks. So your losses from stock A can be adjusted against profits from stock B, thus nullifying your tax liability. What's more, the unadjusted losses can be carried forward and set off against future profits for up to eight financial years. This also applies to equity mutual funds.

Here are a few things you ought to keep in mind while booking losses.

Short-term losses only

When it comes to stock investments, tax rules allow only short-term capital losses to be carried forward. This means that the stocks you bought more than a year ago will not be eligible. Long-term capital losses from stocks cannot be adjusted or carried forward if the securities transaction tax has been paid. The logic is that since there is no tax on the long-term capital gains from stocks and equity-oriented mutual funds, there should be no provision to adjust their losses against other gains. It is possible to carry forward long-term capital losses from stocks only if you strike an off-market deal with the buyer and the transaction is not routed through a stock exchange. However, it's not easy finding someone who is ready to agree to such a transaction. Besides, long-term capital losses can be set off only against long-term capital gains.



First in, first out rule

It's important to remember that the sale of stocks and funds is on a first in, first out basis. The shares you bought first will be sold first. So, if you have been buying small quantities of a stock for more than a year and sell some of your holdings now, be careful when you calculate the short-term losses. For, what you assume to be a short term loss can actually be a long-term loss, which cannot be carried forward.

Let's assume that starting January 2010, an investor started buying 50 shares of a company in the first week of every month. By now, he would have accumulated 750 shares of the company. If he sells 250 of these now, he can book short-term losses only for the 100 shares he bought in April and May 2010. The 150 shares bought in the first three months of 2010 will be treated as long-term capital assets since they have completed a year.

How to go about it

When you buy and sell shares on the same day, you don't actually take delivery of the stocks. Such transactions are treated as speculative by the taxman and can be disputed by the tax department if you want to book losses. In some countries, such as the US, if a taxpayer wants to book losses, there should be a 30-day gap between the sale and subsequent purchase of shares. Though there is no such rule in India, it is best to wait for a day or two before you buy back the shares. This will ensure that the shares bought previously are out of your demat account before the new shares come in. If you think the share price might rise after you have sold, buy more shares of the company first and then sell them a few days later. The first in, first out rule will ensure that the shares that were already

in your account are treated as sold. Also, keep the contract notes of the transactions handy. You will need to mention the details of the transactions in the tax form when you file your returns.

File by due date

The most important thing is that you can carry forward short-term losses only if you file your income tax return by the due date. Though you can safely file your return by the end of the assessment year without fear of penalty, you will not be allowed to carry forward the losses. That's one more reason to file before 31 July this year.

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