AMENDMENTS MADE BY FINANCE ACT, 2014- RELEVANT FOR MAY 2015/NOV 2015 EXAM

FEW AMENDMENTS RELATING TO CAPITAL GAINS

1. SECTION 2(14)-EFFECTIVE FROM A.Y. 2015-16

Income arising from transfer of security by a foreign portfolio investor (FPI) characterized as capital gains

PRACTICAL

PQR Inc. from USA is a registered Foreign Institutional Investors (FII) as per Central Government Notification. It provides following information for the previous year 2014-15.

Sr. No.	Particulars	Holding period	Amount (Rs. in Lacs)
1.	Surplus on sale of listed Debentures of Indian Companies	< 12 months	22
2.	Surplus on sale of listed shares of Indian Companies	> 12 months	352
3.	Surplus on sale of listed shares of Indian Companies	Average 3 to 5 days	50
4.	Surplus on sale of listed Debentures of Indian Companies	> 12 months	108
5.	Debenture Interest Income	-	12
6.	Interest income which is subject to provisions of Section 194LD	-	50

Note:- Further, all the transactions are subject to Securities transaction tax wherever applicable.
PQR Inc. seeks your advice on following issues:

(i) Surplus on sale of listed shares where average holding period is of 3 to 5 days - under which head it shall be offered to tax?

(ii) For computation regular tax liability.

Before, we go to the solution, let us comprehend the provisions of section 2(14) in detail.

Provisions of Section 2(14)

The expression "capital asset" means

(a) property of any kind held by an assessee, whether or not connected with his business or profession.

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 (Amendment made by FA 2014)

However, the following assets are excluded from the definition of "capital assets"

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

(ii) personal effects of the assessee, that is to say, movable property including wearing apparel and furniture held for his personal use or for the use of any member of his family dependent upon him. However, following personal effects are treated as capital asset.

i. jewellery
ii. archaeological collections
iii. drawings
iv. paintings
v. sculptures
vi. work of any art

(iii) agricultural land in India;

(iv) 6 ½ per cent Gold Bonds 1977, 7 per cent Gold Bonds, 1980, National Defence gold Bonds 1980;

(v) Special Bearer Bonds, 1991 ; and

(vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999.

Provisions of Section 115AD (Chapter XII)

SECTION	ASSESSEE	NATURE OF INCOME	TAX RATE
115A(1)(a)	FII or QFI	***Interest referred to in section 194LD***	5%
115AD	Foreign Institutional Investors (FIIs)	(i) Long term capital gains on transfer of securities (other than units covered by section 115AB)	10%
		(ii) Income in respect of securities ***(except covered by 115A)***	20%
		(iii) Any short term capital gain on transfer of securities (except covered by section 111A)	30%

SOLUTION

(i) Considering the amendment made by Finance Act, 2014, ***any securities held by a Foreign Institutional Investor*** **is treated as capital asset** irrespective of period of holding. Therefore, surplus arising therefrom shall be taxed under the head "Capital Gain".

(ii) Considering the provision of section 115AD and other provisions of Income Tax Act, 1961, computation of regular tax liability of PQR Inc. is as under:-

Particulars	Nature of Income	Section applicable	Income (Rs. in Lakhs.)	Tax Rate Applicable	Tax Liability (Rs. In Lakhs)
Surplus on sale of listed Debentures of Indian Companies	STCG	115AD	22	30%	6.60
Surplus on sale of listed shares of Indian Companies	LTCG	10(38)	Exempt	Nil	Nil
Surplus on sale of listed shares of Indian Companies	STCG	111A	50	15%	7.50
Surplus on sale of listed Debentures of Indian Companies	LTCG	115AD	108	10%	10.80
Debenture Interest	Other Source	115AD	12	20%	2.40
Interest subject to section 194LD	Other Source	115A(1)(a)	50	5%	2.50
Total Add :Surcharge (2% of Income Tax)					29.80 0.60
Sub-total Add Education Cess					30.40 0.91
Regular Tax Liability					**31.31**

2. SECTION 2(42A)-EFFECTIVE FROM A.Y. 2015-16

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"

PRACTICAL

Mr. Menon had transferred following capital assets during previous year 2014-15.

Sr. No.	Capital Asset	Date of Purchase	Date of sale
1.	Equity shares of Mars Ltd. (listed but sold outside the recognized stock exchange)	02.02.2011	25.04.2014
2.	Equity shares of ABC Pvt. Ltd.	05.08.2012	06.06.2014
3.	Equity shares of ABC Pvt. Ltd.	05.08.2011	15.09.2014
4.	Debentures of Jupiter Ltd.(Listed)	25.03.2013	25.04.2014
5.	Units of Reliance Income Fund (other than equity oriented mutual fund) (Unlisted)	28.03.2013	27.04.2014
6.	Units of Reliance Income Fund (other than equity oriented mutual fund) (Unlisted)	28.03.2011	12.07.2014
7.	Units of Reliance Growth fund [Equity oriented mutual fund) (Unlisted)	28.03.2013	12.07.2014

From the above information, determine the nature of capital asset.

Before, we go to the solution, let us comprehend the provisions of section 2(42A) in detail.

A short-term capital asset means capital asset held by an assessee for not more than 36 months immediately prior to its date of transfer. However, in the following cases an asset, held for not more than 12 months, is treated as short-term capital asset-

If transfer takes place on or before July 10, 2014	If transfer takes place after July 10, 2014
Equity or preference shares in a company **(Whether shares are listed or not)**	Equity or preference shares in a company **(Listed in a recognized stock exchange)**
Securities listed in a recognized stock exchange in India.	Securities listed in a recognized stock exchange in India.
Units of UTI (whether listed or not)	Units of UTI (whether listed or not)
Units of mutual funds specified under section 10(23D) (whether listed or not)	**Units of an equity oriented fund** (whether listed or not)
Zero Coupon Bonds (whether listed or not)	Zero Coupon Bonds (whether listed or not)

Asset other than short-term capital asset is regarded as **long-term capital asset.**

SOLUTION

Statement showing Nature of capital asset

Sr. No.	Capital Asset	Date of Purchase	Date of sale	Nature of Capital Asset	Remarks
1.	Equity shares of Mars Ltd. (listed)	02.02.2011	25.04.2014	Long term capital asset	Here, period of holding is more than 12 months.
2.	Equity shares of ABC Pvt. Ltd.	05.08.2012	06.06.2014	Long term capital asset	Here, period of holding is more than 12 months. [12 months rule is applicable for unlisted shares if transfer takes place on or before 10th July, 2014]
3.	Equity shares of ABC Pvt. Ltd.	05.08.2011	15.09.2014	Long term capital asset	Here, period of holding is more than 36 months. [36 months rule is applicable for unlisted shares if transfer takes place after 10th July, 2014]

4.	Debentures of Jupiter Ltd. (Listed)	25.03.2013	25.04.2014	Long term capital asset	Here, period of holding is more than 12 months.
5.	Units of Reliance Income Fund (other than equity oriented mutual fund) (Unlisted)	28.03.2013	27.04.2014	Long term capital asset	Here, period of holding is more than 12 months. [12 months rule is applicable for units of mutual funds if transfer takes place on or before 10th July, 2014]
6.	Units of Reliance Income Fund (other than equity oriented mutual fund) (Unlisted)	28.03.2011	12.07.2014	Long term capital asset	Here, period of holding is exceeding 36 months. [36 months rule is applicable for units of mutual funds other than equity oriented mutual funds if transfer takes place after 10th July, 2014]
7.	Units of Reliance Growth fund [Equity oriented mutual fund] (Unlisted)	28.03.2013	12.07.2014	Long term capital asset	Here, period of holding is more than 12 months.

3.	**SECTION 112-EFFECTIVE FROM A.Y. 2015-16** **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**

PRACTICAL

For the above sum, find out tax rate applicable to Mr. Menon.

Before, we go to the solution, let us comprehend amendment first.

In following cases option is available to tax long term capital gain at 10% instead of 20%	
If transfer takes place on or before July 10, 2014	**If transfer takes place after July 10, 2014**
(a) Listed shares **(b)** Listed securities ***(c)*** *Units of mutual fund (whether listed or not)* **(d)** Zero coupon bond (whether listed or not)	**(a)** Listed shares **(b)** Listed securities **(c)** Zero coupon bond (whether listed or not)
Option I- **Compute capital gain** as per general rule and tax capital gain @20% *Option II-***Compute capital gains** without indexation and tax capital gain @10%	

SOLUTION

Statement showing Tax Rate applicable

Sr. No.	Capital Asset	Nature of Capital Asset	Section applicable for tax computation	Tax rate applicable	Remarks
1.	Equity shares of Mars Ltd. (listed)	Long term capital asset	112	Regular tax rate under section 112 is 20% but option is available to pay tax @10% (if no indexation claimed)	Here shares are listed therefore, benefit of 10% tax rate is available.
2.	Equity shares of ABC Pvt. Ltd.	Long term capital asset	112	20%	Here shares are not listed therefore, benefit of 10% tax rate is not available.
3.	Equity shares of ABC Pvt. Ltd.	Long term capital asset	112	20%	Here shares are not listed therefore, benefit of 10% tax rate is not available.

4.	Debentures of Jupiter Ltd.(Listed)	Long term capital asset	112	Regular tax rate under section 112 is 20% but option is available to pay tax @10% (if no indexation claimed)	Here, debentures are listed therefore benefit of 10% tax rate is available. And it is advised to opt for 10% tax rate because it is always beneficial.
5.	Units of Reliance Income Fund (other than equity oriented mutual fund) (Unlisted)	Long term capital asset	112	Regular tax rate under section 112 is 20% but option is available to pay tax @10% (if no indexation claimed)	Benefit of 10% tax rate is available if transfer takes place on or before 10th July, 2014
6.	Units of Reliance Income Fund (other than equity oriented mutual fund) (Unlisted)	Long term capital asset	112	20%	Benefit of 10% tax rate is not available if transfer takes place after 10th July, 2014
7.	Units of Reliance Growth fund [Equity oriented mutual fund] (Unlisted)	Long term capital asset	10(38)	NIL	For equity oriented mutual fund, securities transaction tax is applicable and therefore long term capital gain is exempt under section 10(38)

SECTION 45(5)-EFFECTIVE FROM A.Y. 2015-16

4. Compensation received in pursuance of an interim order deemed as income chargeable to tax in the year of final order

PRACTICAL

The Central Government acquires a house property owned by Mr. Manish on October 17, 2005 fixing compensation at Rs. 32,00,000. The indexed cost of acquisition of this house property is Rs. 28,00,000. The Government paid Rs. 20,00,000 partly on May 13, 2010 and balance on March 11, 2012. Being aggrieved against the award, Mr. Manish filed an appeal. The Court, by an interim order dated July 19, 2014 ordered Central Government to pay Rs. 5,00,000 which was paid on 15th September,2014. However, Court passed final order dated 11th August, 2015 fixing enhanced compensation of Rs. 17,00,000. The Central Government paid 12,00,000 (Rs. 5,00,000 has already been paid) on 12th December, 2015. Legal expenses incurred by Mr. Manish were Rs.45,000. Compute the income of Mr. Manish under the head “Capital gains”.

Before, we go to the solution, let us take an overview of section 45(5).

When section 45(5) is applicable- In any of the following cases, section 45(5) is applicable —

1. When the transfer of a capital asset is by way of compulsory acquisition under any law.
2. When a capital asset is transferred (not by way of compulsory acquisition) and the consideration is approved or determined by the Central Government (not by a State Government) or the Reserve Bank of India.

Section 45(5)(a):- *Tax Treatment of initial compensation–*
Initial compensation is chargeable to tax in the previous year in which such compensation (or part thereof) is first received.

Further, for computing capital gain, initial compensation shall be taken as full value of consideration.

Section 45(5)(b):-*Tax Treatment of enhanced compensation* **-** If any compensation is enhanced by a court, tribunal or any authority, then tax treatment shall be as under—

1. It shall be taxable in the previous year in which enhanced compensation is received by the assessee.
2. In this case, the cost of acquisition and the cost of improvement shall be taken as *nil*.
3. Litigation expenses for getting the compensation enhanced are deductible as an expense in connection with transfer.
4. Enhanced compensation can be short-term capital or long-term capital depending upon the nature of original capital gain.

Proviso to Section 45(5)(b) *:-*<u>*Tax Treatment of compensation received under interim order of a court, tribunal etc.*</u> ***[inserted by Finance Act, 2014 effective from A.Y. 2015-16]***

This proviso states *that any amount of compensation received in pursuance of an interim order of a court, Tribunal or other authority shall be deemed to be income chargeable under the head "Capital gains" of the previous year in which the final order of such court, Tribunal or other authority is made*

SOLUTION

Computation of Capital Gain at the time of Initial compensation

		Previous Year: 2010-11 **Assessment Year: 2011-12**
	Particulars	**Amount Rs.**
	Initial Compensation	32,00,000
Less:	Indexed cost of acquisition	28,00,000
	Long Term Capital Gain	4,00,000

Computation of Capital Gain at the time of enhanced compensation

		Previous Year: 2015-16
		Assessment Year: 2016-17
	Particulars	**Amount Rs.**
	Enhanced Compensation due to interim order of court [Note (i)]	5,00,000
	Balance Enhanced Compensation due to final order of court [Note (ii)]	12,00,000
Less:	Expenses on transfer	45,000
Less:	Indexed cost of acquisition / Cost of Improvement	Nil
	Long Term Capital Gain	16,55,000

NOTE:

(i) Though enhanced compensation of Rs. 5,00,000 has been received due to an interim order of a court during previous year 2014-15, considering the effect of amendment, same shall be taxed in the previous year in which the final order of court is made. (In this example, final order is made on 11th August, 2015 therefore, this Rs. 5,00,000 shall be taxed in the previous year 2015-16)

(ii) As per section 45(5)(b), Enhanced Compensation Rs. 12,00,000 shall be taxed in the year of receipt. (In this example, Rs.12,00,000 has been received on 12th December, 2015 therefore, it shall also be taxed in the previous year 2015-16)

SECTION 47-EFFECTIVE FROM A.Y. 2015-16

5. Transfer of Government security outside India by a non-resident to another non-resident not a transfer for charge of capital gains tax

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

SECTION 54 & 54F-EFFECTIVE FROM A.Y. 2015-16

6. Exemption under section 54 and 54F to be available for investment in one residential house situated in India

PRACTICAL

Mr. Ghanshyam, 62 years sold out his residential house property being long term capital asset. He seeks your advice on following issues while claiming exemption under section 54.

(a) He wants to purchase three residential houses in India out of sale proceeds of his old property. Can he claim exemption under section 54 for all these three residential properties?

(b) Further, he wants to buy one more residential house at USA. Can this house be eligible for exemption under section 54?

Before, we go to the solution, let us take an overview of section 54 and section 54F first.

Different questions	***Section 54***	***Section 54F***
1. Who can claim exemption?	Individual/Hindu undivided family	Individual/Hindu undivided family
2. What is the nature of capital asset which has been transferred?	Long-term	Long-term
3. Which specific asset is eligible for exemption?	A residential house property	Any long-term capital asset (other than a residential house property) provided on the date of transfer the taxpayer does not own more than one residential house property
4. Which asset the tax-payer shall acquire to avail exemption?	"A Residential house" (up to A.Y.2014-15) **"One residential house in India"** ***(From A.Y. 2015-16 and onwards)***	"A Residential house" (up to A.Y.2014-15) **"One residential house in India"** ***(From A.Y. 2015-16 and onwards)***
5. What is time-limit for acquiring another residential house property?	*For Purchase:1* year back-ward or 2 years forward *For Construction:* 3 years forward	*For Purchase:1* year back-ward or 2 years forward For *construction: 3 years forward*
6. How much capital gain is exempt?	Investment in the another residential house property or capital gain whichever is lower	Investment $\times \frac{\text{Capital Gain}}{\text{Net Sale Consideration}}$

SOLUTION

(a) Considering the amendment, Mr. Ghanshyam can avail exemption under section 54 in respect of one residential house property only. Therefore, he shall be advised to select any one house which carries highest investment while claiming exemption under section 54.

(b) Further, Ghanshyam can take exemption under section 54 in respect of investment made in "one residential house **in INDIA".** Therefore, house property to be purchased at USA will not qualify for exemption under section 54.

SECTION 54EC-EFFECTIVE FROM A.Y. 2015-16

7. **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 Rs. 50 lakhs, irrespective of whether the investment is made in the same financial year or in the subsequent financial year or both**

PRACTICAL 1

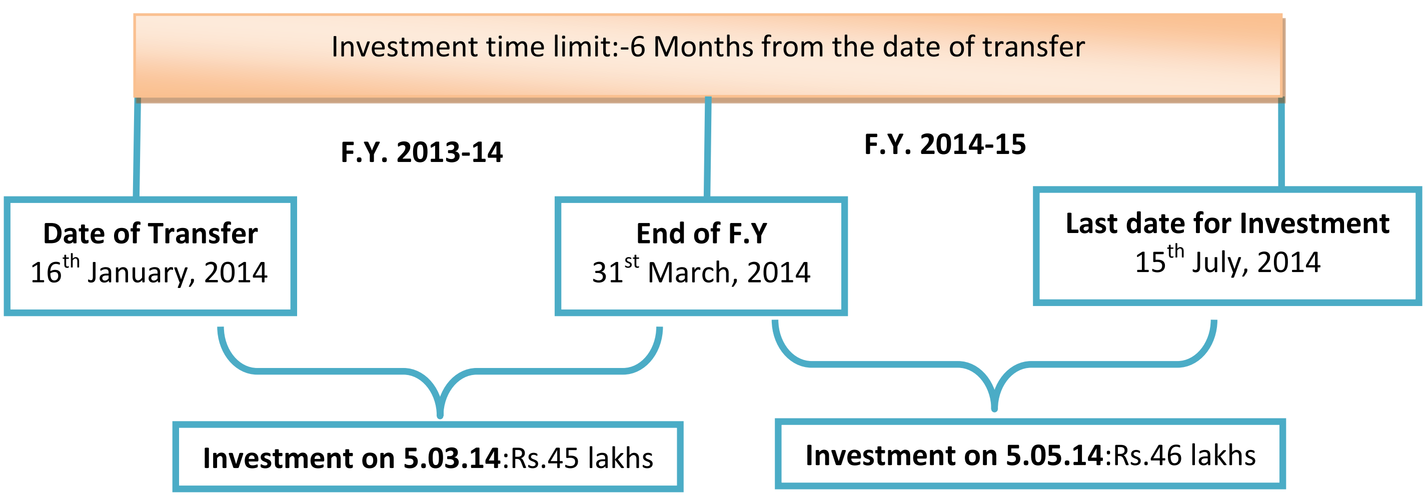
Mrs. X, resident woman, transfers (Date of transfer:-January 16, 2014) a house property resulting into long term capital gain of Rs. 1,01,50,000. She invests a sum of Rs. 45,00,000 in capital gains bonds specified in section 54EC on March 5, 2014. She further invests a sum of Rs. 46,00,000 in the same bonds on May 5, 2014. Accordingly, she wants to claim exemption of Rs. 91,00,000 under 54EC. Advise her suitably.

PRACTICAL 2

Suppose in the above problem, **year "2014" is replaced by year "2015".** Advise Mrs. X.

SOLUTION 1

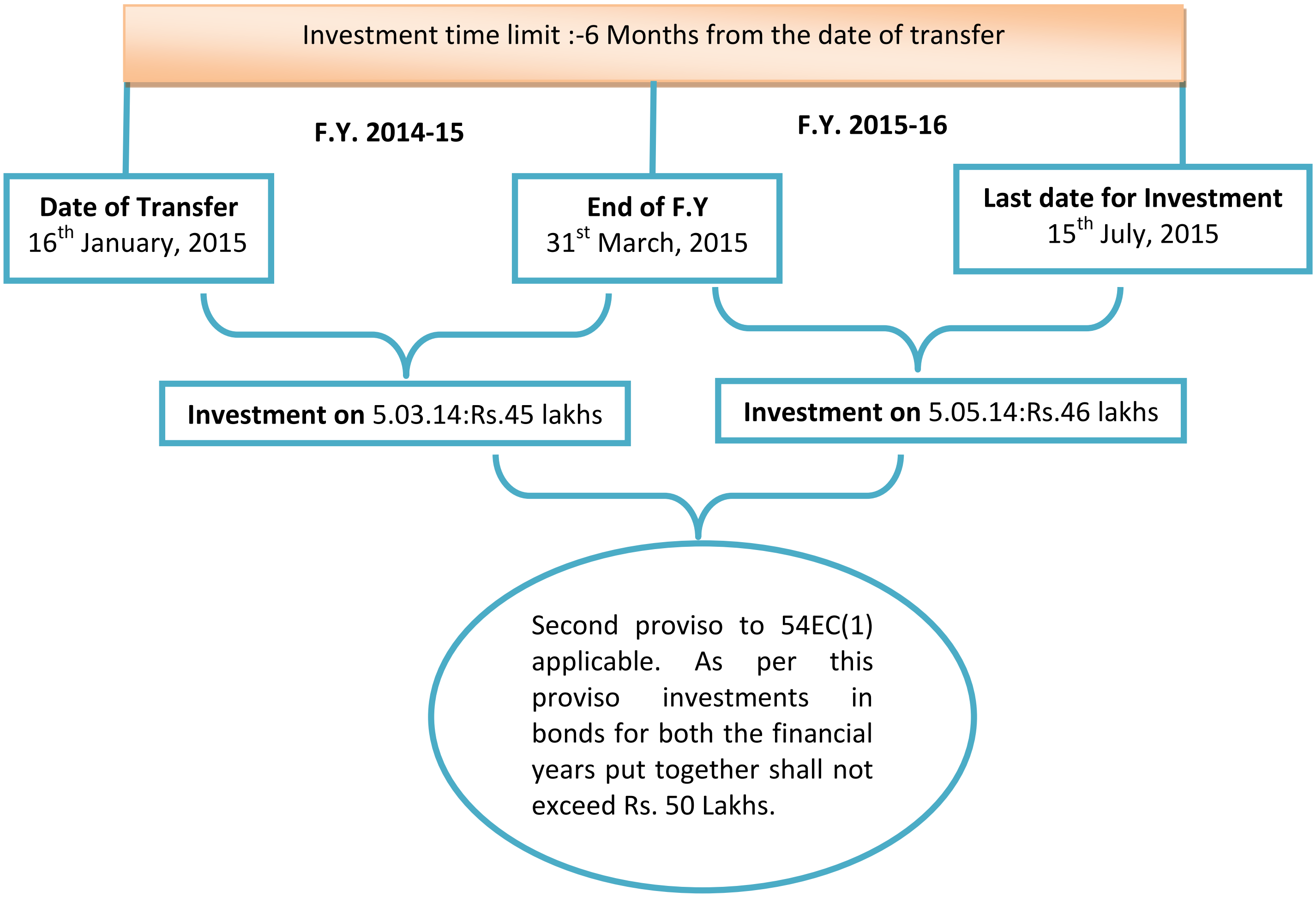
Applicable Assessment Year is 2014-15.



As per **proviso** to section 54EC(1), **total investment** made by assesse **in bonds** of NHAI/REC **shall not exceed Rs. 50 Lakhin each financial year**. Looking to the above chart, the investment made by Mrs. X in each financial year does not exceed Rs. 50 lakh and both the investments are made within six months from transfer of a house property. Therefore, she is entitled to claim exemption of Rs. 91,00,000 under section 54EC.

SOLUTION 2

Applicable Assessment Year is 2015-16.



Amendment:-With effect from A.Y. 2015-16, one more proviso has been inserted to section 54EC(1) (called "**second proviso"**)which provides that the **investment** made by an assessee **in bonds** of NHAI/REC, out of capital gains arising from transfer of one or more capital assets **during the financial year in which such asset** or assets are **transferred**

and

in the subsequent financial year does not exceed fifty lakh rupees.

Therefore, considering the above amendment, Mrs. X is entitled to claim exemption of Rs. 50,00,000 under section 54EC instead of Rs 91,00,000.

SECTION 56(2), 2(24) & 51-EFFECTIVE FROM A.Y. 2015-16

8. Advance forfeited due to failure of negotiations for transfer of a capital asset to be taxable as "Income from other sources"

PRACTICAL 1

Mr. Rakesh purchased a house property on 14th April, 2012 for Rs.21,05,000. He entered into an agreement with Mr. Bobby for the sale of house on 15thSeptember, 2013 and received an advance of Rs.2,00,000. Since Mr. Bobby did not remit the balance amount, Mr. Rakesh forfeited the advance.

Later on, he sold out this house property to Mr. Aakash on 15th March, 2015 for Rs. 28,00,000. Mr. Rakesh incurred brokerage expense Rs. 28,000.

Discuss tax consequences.

PRACTICAL 2

What would have been your answer if Mr. Rakesh forfeited Rs. 2,00,000 on 15th September, 2014 instead of 15th September, 2013?

Before, we go to the solution, let us understand section 51 and section 56(2) (ix).

- **Section 51 (applicable for advance received up to 31.03.2014)**

  Where any capital asset was on any previous occasion the **subject of negotiations for its transfer**, **any advance** or other money **received and retained by the assessee** in respect of such negotiations **shall be deducted from the cost** for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

- **Section 56(2)(ix) (applicable to advance received after 31.03.2014)**

  Any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if,—
  (a) such sum is forfeited; and
  (b) the negotiations do not result in transfer of such capital asset;
  shall be treated as income as per section 2(24)(xii) and to be taxed under the head "Income From Other Sources" and it shall not be reduced from cost of acquisition or written down value, as the case may be.

SOLUTION 1

Computation of income under the head "Capital Gains"

Particulars		Amount Rs.
	Full Value of Consideration	28,00,000
Less:	Expenses incurred in connection with transfer	28,000
		27,72,000
Less:	Cost of Acquisition [Rs.21,05,000-Rs.2,00,000]	19,05,000
	Short Term Capital Gain	**8,67,000**

SOLUTION 2

Computation of income under the head "Capital Gains"

Particulars		Amount Rs.
	Full Value of Consideration	28,00,000
Less:	Expenses incurred in connection with transfer	28,000
		27,72,000
Less:	Cost of Acquisition	21,05,000
	Short Term Capital Gain	**6,67,000**

Further, as per amendment, Rs.2,00,000 forfeited on 15th September, 2014 shall be taxed under the head "Income From other Sources" and shall not be deducted from cost of acquisition.

Few more files on amendments made by Finance Act 2014 will be made available soon on CA CLUB website.