CHAPTER 7: CONCEPTS IN TAXATION

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Key concepts of Taxation
- Residential Status
- Five Heads of Income and Clubbing of Income
- Set off and carry forward of losses
- Exemptions, Deductions and Rebate
- Double Tax Avoidance Agreement
- Taxation Regime, Maximum Marginal Rate of Tax and Effective Rate of Tax

7.1 Framework

Income tax in India is governed by the provisions of the Income Tax Act, 1961 (the Act) and comes under the Ministry of Finance. The matters relating to administration of the Act are assigned to the Central Board of Direct Taxes (CBDT).

The Income tax Rules, 1962 are framed to carry out the purposes of the Act. In addition to this, the CBDT also issues Circulars and Notifications as and when required. It becomes very important to understand the income tax implications while trading or investing in securities market. Gains arising on sale of securities may have different tax treatments depending on various factors such as the type of security, holding period, whether the transaction was done in capacity of trader or investor etc.

7.2 Key concepts

7.2.1 Previous year v/s Assessment year

India follows Financial Year (FY) (i.e. April 1 to March 31) for calculation of income for various purposes – be it for preparation of annual accounts or calculation of income tax.

Any particular financial year for which one wants to calculate the tax liability is termed as 'previous year' for the purposes of Income Tax Act. For instance, if one needs to calculate his taxable income for FY 2021-22, the Previous Year (PY) here will be the period from April 1, 2021 to March 31, 2022.

The financial year following relevant previous year is called the 'Assessment Year' (AY). Hence, in the above example, assessment year will be AY 2022-23.

Section 2(9) of the Act defines 'assessment year' as a period of 12 months commencing on the 1st day of April every year. Section 3 of the Act defines 'Previous year' as the financial year immediately preceding the assessment year.

7.2.2 Person

Section 2(31) of the Act defines person to include the following:

a) Individual
b) Hindu undivided family (HUF)
c) Company
d) Partnership firm including Limited Liability Partnership (LLP)
e) Association of Person (AOP) or Body of Individual (BOI), whether incorporated or not
f) Local authority
g) Artificial juridical person, not falling within any of the above categories.

Persons referred in (e), (f) and (g) above, shall be deemed as a person even if it is not formed or established or incorporated with the object of deriving income, profits or gains.

7.2.3 Assessee

Section 2(7) of the Income Tax Act defines the term assessee as the person who is liable for payment of taxes or any other sum of money under the Act. It also includes the person in respect of whom any proceeding has been initiated under this Act. Such proceedings may be in respect of income, loss or refund.

7.3 Income

Section 2(24) of the Income Tax Act provides an inclusive definition of income. It means, while any sum of money mentioned in the section 2(24) will be considered as income, any other sum which is not covered in this section can also be taxed if it is in the nature of income.

There are many clauses in the above mentioned section 2(24). The more relevant are:

- Profits and gains from business or profession
- Dividend
- Capital gains
- Gifts received from a non-relative which is covered by section 56
- Any movable or immovable property received at below the market price as per the provisions of section 56
- Certain perquisites arising out of employment

7.4 Residential status[17]

Residential Status of an Individual versus Citizenship:

In common parlance citizenship and residential status are often seen as one and the same concept. However, both of them are very different from each other. Also, residential status under Income Tax Act and that under FEMA needs to be seen separately.

[17]https://www.incometaxindia.gov.in/Tutorials/9.%20Non-resident.pdf

For instance, an individual may be a citizen of any other country but still can be a resident of India under the Income Tax Act. Again, basis the criteria given in FEMA, he may qualify as resident or a non-resident under FEMA. In this course, we will restrict our scope to residential status under the Income Tax Act.

In case of individuals, particularly non-residents, one needs to take all the three aspects i.e. citizenship, residential status under Income Tax Act and that under FEMA, before making investment decisions.

Below table summarises the broad differences in residential status of an individual under the Income Tax Act and under FEMA and its impact:

In India only	**FEMA**	**Income Tax Act**
When is the status to be determined	From day to day at the time of making an investment/remittance	Every financial Year
Based on	Number of days stayed in India in the preceding financial year but can be changed by the displayed intention at the current moment	- Stay in India during the concerned financial year as well as prior financial years - The number of days and tests can be different for Indian Citizens and/or PIOs
What does it Impact	Where and what he can invest in and remittances that he can make from India and bank accounts that he can open	Tax to be paid and tax deducted at source

Hence forth whenever we refer to a person as resident in India we would be referring to the residential status for income tax purposes only.

7.4.1 Residential Status of an individual under the Income Tax Act

Residential status for Income Tax Act has to be determined as per the provisions of section 6 of the Act. Income-tax liability of an assessee is calculated on basis of his *'Total Income'*. What is to be included in total income of assessee is greatly influenced by his residential status in India. *For example*, a person resident in India (irrespective of their citizenship) is liable to pay tax in India on his worldwide income. On the other hand, a person, who is a non-resident in India (may be a citizen of India) during the year, is liable to pay tax only on his Indian income. Total Income of an assessee can be computed only after determining his residential status as per provisions of section 6.

Hitherto, the residential status of an Individual was determined on the basis of his period of stay in India. However, with effect from Financial Year 2020-21, the residential status of an Individual is determined on basis of his citizenship, period of stay in India and total income from Indian sources.[18]

An individual can be categorized into following residential status during the previous year:

a) Resident and ordinarily resident in India
b) Resident but not ordinarily resident in India
c) Non-Resident in India

An additional test has been introduced for Indian citizens under '**deemed resident**' category under *clause (1A)* of Section 6 with effect from Financial Year 2020-21. As per Section 6(1A) an Indian citizen is deemed as resident in India irrespective of his stay in India if his total income, excluding income from foreign sources, [hereinafter referred to as 'Indian Income'] exceeds Rs. 15 lakh during the previous year and he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. Here, 'income from foreign sources' means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India. A deemed resident is always treated as Resident but Not-Ordinarily Resident.

7.4.2 Residential status of an Individual

The residential status of an Individual is categorised as follows:

Resident in India

Part 1: For Indian Citizens the following conditions to be considered for determining residential status:

An Indian Citizen is treated as resident in India:

(a) If he stays in India for 182 days or more during the relevant previous year; **or**

(b) If, being outside India, who comes on a visit to India during the previous year and his Indian Income is upto Rs. 15 lakhs and has been in India for 182 days or more or who leaves India during the previous year for the purpose of employment; or

(c) who leaves India during the previous year as a member of the crew of an Indian Ship and has been in India for 182 days or more and has been in India for 365 days or more in 4 preceding years;

(d) If, being outside India, who comes on a visit to India during the previous year and his Indian Income is exceeding Rs. 15 lakhs and has been in India for 120 days or more and has been in India for 365 days or more in 4 preceding years;

[18]The Finance Act, 2020 substituted the provisions for determination of residential status with effect from Financial Year 2020-21 (Assessment Year 2021-22).

(e) If not visiting India or leaving India and not covered by (a) above, been in India in a particular financial year for 60 days and has been in India in the four years preceding that year for a period amounting to 365 days or more;

(f) In case he is not covered by either of the 5 clauses above and Total income (excluding income from foreign sources) exceeds Rs. 15 lakhs and he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature

Part 2: Foreign nationals being a Person of Indian origin (defined as such if he or either of his parents or any of his grandparents were born in undivided India) will be treated as a resident in India:

(a) If he stays in India for 182 days or more during the relevant previous year; **or**

(b) If, being outside India, who comes on a visit to India during the previous year and his Indian Income is upto Rs. 15 lakhs and has been in India for 182 days or more and has been in India for 365 days or more in 4 preceding years; or

(c) If, being outside India, who comes on a visit to India during the previous year and his Indian Income is exceeding Rs. 15 lakhs and has been in India for 120 days or more and has been in India for 365 days or more in 4 preceding years;

(d) If not visiting India and not covered by (a) above has been in a particular financial year for 60 days and has been in the four years preceding that year for a period amounting to 365 days or more

Part 3: All other foreign nationals (other than persons of Indian origin) will be treated as a resident in India:

(a) If he stays in India for 182 days or more during the relevant previous year; **or**

(b) If he has been in India for 60 days or more (but less than 182 days) during the relevant previous year and for 365 days or more in 4 years preceding the previous year.

Resident but Not Ordinarily Resident

A resident individual will be treated as Not Ordinarily Resident (NOR) in India if he satisfies any one condition specified below:

a) He has been a non-resident in India for at least 9 out of 10 years immediately preceding the relevant previous year; or
b) He has been in India for 729 days or less during the period of 7 years immediately preceding the previous year; or
c) He has become a resident by virtue of clause (f) discussed in Part 1 under Resident in India section above.

If he does not satisfy any of the above-mentioned conditions, he is treated as Resident and Ordinarily Resident (ROR) in India.

Tax effect: Tax effect of being a resident and ordinarily resident, resident but not ordinarily resident or a non-resident is explained under Section 7.4.5 of this chapter.

7.4.3 Residential Status of HUF

The residential status of a HUF depends upon its place of control and management and residential status of its Karta.

Resident in India

An HUF is said to be resident in India in any previous year in every case except where during the year the control and management of its affairs are situated wholly outside India. If principal decision-makers of the HUF take even a single decision in India, the HUF will be considered a resident as 'part of its control and management' will be deemed to be situated in India.

Non-Resident

A HUF is deemed as a non-resident in India if during the previous year, the control and management of its affairs are situated wholly outside India.

Resident and Not-Ordinarily Resident

A resident HUF is further categorised into Not-Ordinarily Resident in India if any one of the following conditions is satisfied:

1. Manager of HUF has been a non-resident in India for at least 9 years out of 10 years preceding the previous year; or
2. Manager of HUF has been in India for 729 days or less during the period of 7 years preceding the previous year.

If neither of the above conditions is satisfied, the resident HUF will be treated as resident and ordinarily resident.

7.5 Scope of Income

Scope of total income according to the residential status of an assessee shall be as under:

Resident and Ordinary Resident

A resident assessee (Individual and HUF) shall be liable to pay tax in India on the following incomes:

a) Income received or is deemed to be received by him in India in the previous year by or on his behalf;
b) Income that accrues or arises or is deemed to accrue or arise to him in India during such year; and
c) Income accrues or arises to him outside India during such year.

In other words, its worldwide income will be taxable in India.

Resident and not Ordinary Resident

A resident but not ordinarily resident assessee (individual and HUF) shall be liable to pay tax in India on the following incomes:

a) Income received or deemed to be received in India in the previous year by or on his behalf;
b) Income accrues or arises or is deemed to accrue or arise to him in India during such year; and
c) Income accrues or arises to him outside India during such year if it is derived from a business controlled from India or from a profession set up in India.

   In other words, only Indian income will be taxable in India.

Non-Resident

In case of a non-resident assessee, following incomes shall be taxable in India:

a) Income received or is deemed to be received in India in the previous year by or on his behalf; and
b) Income accrues or arises or is deemed to accrue or arise to such person in India during such year.

In other words, only Indian income will be taxable in India. Table 7.1 summarizes the Taxation of Income based on residential status of an assessee.

Table 7.1: Taxation of income based on residential status

Nature of income	**Resident and ordinarily resident**	**Resident but not ordinarily resident**	**Non-resident**
Income received or is deemed to be received in India	Taxable	Taxable	Taxable
Income accrues or arises or is deemed to accrue or arise to him in India	Taxable	Taxable	Taxable
Income accrues or arises outside India if it is derived from a business controlled from India or from a profession set up in India	Taxable	Taxable	Not-taxable
Any other Income that accrues or arises outside India (including income from a business controlled from outside India or from a profession set up outside India)	Taxable	Not-taxable	Not-taxable

Let us understand the residential status concept with a few examples:

Example 1: Mr. C, being an Indian Citizen, was working in London for some years. He returned to India in FY 2024-25. The details of his stay are given below:

Sr. No	**Financial Year (i.e. April 01 to Mar 31)**	**Physical stay in India (no. of days)**
1.	2024-25	298
2.	2023-24	264
3.	2022-23	70
4.	2021-22	70
5.	2020-21	50
6.	2019-20	50
7.	2018-19	34
8.	2017-18	40
9.	2016-17	60
10.	2015-16	52
11.	2014-15	40

Determine his residential status for FY 2024-25.

Answer:
Mr. C's stay in FY 2024-25 is more than 182 days. Hence, he is a resident. Now to check whether he is a not-ordinarily resident, he needs to satisfy any one of the following conditions:
Stayed 729 days or less in last seven years **or**

Being a non-resident in 9 out of 10 preceding years.

Mr C has spent 578 days in the 7 years preceding the financial year and hence satisfies the first condition. Mr. C is also a non-resident in nine out of ten preceding financial years. Hence, he is a resident but not ordinarily resident in India for FY 2024-25.

Example 2: Mr. A is a resident and ordinarily resident in India during the Financial Year 2024-25. He has a bank account in USA. There is an interest income on the balance lying in the offshore bank account. Will this account be taxable in India?

Answer:
Yes. Since, Mr. A is a resident and ordinarily resident, he will be liable to tax on his worldwide income in India.

(a) Will your answer be different if Mr. A was resident but not ordinarily resident in India in FY 2024-25?

Answer:
In that case, the interest income from USA bank account will not be taxed in India.

Example 3: Mr. Vilayati (a foreign national who is a person of Indian origin) who was overseas for 20 years and was non-resident in all these years, comes to India for employment on 1st April, 2024. After he came to India he will continue to stay in India for the entire year (s). He has been spending around 30 days in India in each of these years. He has bonds in that foreign country on which he earns interest in that foreign country.

(a) What is his residential status for FY 2024 -25, FY 2025-26 and FY 2026-27?

Answer:
Mr. Vilayati has stayed for more than 182 days in FY 2024-25. Hence, he is a resident. Now to check whether he is a "not-ordinarily resident", he needs to satisfy any one of the following conditions:

- Stayed 729 days or less in last seven years **or**
- Being a non-resident in 9 out of 10 preceding years.

Mr. Vilayati is a non-resident in nine out of ten preceding financial years. He has also spent less than 730 days during the preceding 7 years. Hence, he is a resident but not ordinarily resident in India for FY 2024-25 since he is required to satisfy only one of these conditions to be regarded as Not ordinarily resident.

The same position would continue for FY 2025-26. Hence, he would be resident but not ordinarily resident for FY 2025-26 as well.

Now, in FY 2026-27 his stay in India will be more than 182 days. As regards, the secondary tests, he will not be satisfying the condition of being non-resident in 9 out 10 preceding years since he is a resident in both FY 2024-25 and 2025-26. He has also spent more than 730 days in the preceding 7 financial years. He does not satisfy either of the 2 conditions laid down. Hence, he will be a resident and ordinarily resident for FY 2026-27.

(b) Is interest on bond taxable in India for FY 2024-25, FY 2025-26 and FY 2026-27?

Answer:
He is Resident but not ordinarily resident for FY 2024-25 and FY 2025-26, during which years the bond Interest is not taxable in India. From FY 2026-27, it will become taxable in India.

Example 4: Mr. Gora is a non-Indian Origin citizen of UK. He has been working in a permanent job in India since 2005. He has an appropriate work visa and has not travelled outside India since that time.

(a) Mr. Gora will become an Indian Citizen automatically after 10 years of staying in India. State whether True or False. Provide reason for the answer.

Answer:

False: Citizenship never comes automatically, no matter how many years one stays in a country.

(b) He is a "resident and ordinarily resident" in Financial Year 2024-25 for the purposes of Indian Income Tax Act, 1961. State whether True or False. Provide reason for the answer.

Answer:

True: As he stayed for more than 182 days for many years now.

(c) Mr Gora has rental income in UK. As a foreigner he will not pay any taxes on such Income in India. State whether True or False. Provide reason for your answer.

Answer:

False: As Resident and ordinarily resident (Tax) pays tax on their global income in India.

7.6 Five Heads of Income

In the Income Tax Act, income is classified under five heads of income, namely, salary, house property, business or profession, capital gain and other sources. Total income is an aggregate of income computed under these heads.

7.6.1 Income from Salary

Income Tax Act, 1961 defines the term 'Salary' under Section 17(1) to include wages, annuity, pension, gratuity, any fees, commission, advance of salary, perquisite or profits in lieu of salary, salary advance, leave encashment, employers' contribution to provident fund in excess of 12% of salary and contribution to pension scheme, contribution to Agniveer corpus, etc. The employers' contribution to NPS upto 14% of salary is deductible under section 80CCD (2) and Governments contribution to Agniveer corpus is deductible under section 80CCH even under the new Tax regime.

Certain important concepts under salary:

- Taxability of an income under this head pre-requisites existence of employee and employer relationship. In the absence of the employer-employee relationship, the income shall be assessable either as business income or income from other sources. It is pertinent to note that any benefit, whether monetary or otherwise derived by an employee in connection with his employment will be taxed under this head.
- The income under this head shall be taxable on due basis or receipt basis, whichever is *earlier*. Salary due from an employer to an employee shall be chargeable to tax even if it is not paid during the year. However, taxation of Employee Stock Options Plans (ESOPs) is an exception to this principle. Taxation of ESOPs is discussed in detail in Chapter 12.

Applicable deductions and exemptions on income from salary:

		Old Tax regime	New tax regime
12.	Standard deduction	Rs. 50,000	Rs. 75,000
13.	National Pension Scheme	Entire employer's contribution will be taxed as salary	Entire employer's contribution made will be taxed as salary
		Employee's contribution to NPS – section 80CCD(1B) – available upto Rs. 50,000	Not available
		Deduction u/s 80CCD (2) – upto 10% of the salary for private sector employees 14% for Government employees	Deduction u/s 80CCD(2) – upto 14% of the salary for private sector employees 14% for Government employees
14.	Employee's Provident Fund	Employer's contribution above 12% of salary is taxable Employees' contribution: section 80C	Employer's contribution above 12% of salary is taxable Section 80C is not available
15.	Superannuation	Where employer's contribution to all these three funds exceed Rs. 7,50,000 in aggregate, the excess will be taxed as salary income	
16.	Employee's Provident Fund		
17.	National Pension Scheme		
18.	Gratuity	**The computation of exempted amount of gratuity under section 10(10) for both the regimes is same:** • In the case of a government employee – any death-cum-retirement gratuity received by a Central Government / State government / local authority employee is fully exempt from tax (section 10 (10) • In case of employee covered under the Payment of Gratuity Act – Gratuity received is exempt to the extent of the least of the following – o 15days' salary based on salary last drawn for every completed year of service or o Rs. 20,00,000 or o Gratuity actually received • In any other case not covered by the above, gratuity received on retirement, incapacitation, death, termination, resignation is exempt to the extent of the least of the following: o Half month's salary for each completed year of service	

		○ Rs. 20,00,000 ○ Gratuity actually received	
19.	House Rent allowance	Exemption of house rent allowance is available to the extent of the least of the following: • House rent allowance received • Excess of rent paid over 10% of the salary • 50% of salary – (where the residential house is situated in Bombay, Calcutta, Delhi or Madras) or 40% of salary – in any other case	Not allowed under new regime
20.	Leave Travel Allowance	Allowed	Not allowed

There are many other allowances and perquisites which are taxable. The taxable value of the same is to be arrived at, based on the calculation formula given in the Income Tax Act and the Rules.

Example 1:

For instance, Mr. A is private sector employee with basic salary of Rs. 1 crore. His employer makes the following contributions:

Employer's contribution to:

EPF: 12,00,000

NPS: 14,00,000

Total contribution = Rs. 26,00,000

Employee's contribution to:

EPF is Rs. 12,00,000 for the year

NPS is Rs. 50,000 for the year

	Old Tax regime (Rs.)	**New tax regime (Rs.)**
Salary	1,00,00,000	1,00,00,000
Add: Employer's contribution to NPS [s. 17(1) (viii)]	14,00,000	14,00,000
Add: Employer's contribution to EPF	Nil	Nil

(since employer's contribution is upto 12% of salary, the taxable amount is Nil – section 17(1)(vi)		
Add: Aggregate of employer's contribution to superannuation fund, EPF and NPS to the extent to which it exceeds Rs. 750,000 [section 17(2)(vii)] (Rs. 26,00,000 – Rs. 7,50,000)	18,50,000	18,50,000
Gross salary	**1,32,50,000**	**1,32,50,000**
Less: Standard deduction	(50,000)	(75,000)
Net Salary (A)	**1,32,00,000**	**1,31,75,000**
Less: Employee's contribution to EPF u/s 80C	(1,50,000)	Nil
Less: Employee's contribution to NPS (section 80CCB(1B))	(50,000)	Nil
Less: Employer's contribution to NPS (10% of salary for old regime, 14% of salary for new regime) (section 80CCD(2))	(10,00,000)	(14,00,000)
Total deduction (B)	**(12,00,000)**	**(14,00,000)**
Taxable income (A-B)	**1,20,00,000**	**1,17,75,000**

Effectively the employer's contribution to NPS has been fully taxed since it has been added back two times while calculating salary (once as salary and another time as perquisite) and deduction has been allowed only once.

Example 2:

Mr. B is a private sector employee with basic salary of Rs. 15,00,000. His employer makes the following contributions:

Employer's contribution to:

EPF: 21,600

NPS: 210,000

Total contribution = Rs. 390,000

Employee's contribution to EPF is Rs. 21,600 for the year

Employee contributes to NPS Rs. 50,000 and to PPF Rs. 150,000

	Old Tax regime (Rs.)	**New tax regime (Rs.)**
Salary	15,00,000	15,00,000
Add: Employer's contribution to EPF (since employer's contribution is upto 12% of salary, the taxable amount is Nil – section 17(1)(vi)	Nil	Nil
Add: Employer's contribution to NPS [s. 17(1) (viii)]	2,10,000	2,10,000

Add: Aggregate of employer's contribution to superannuation fund, EPF and NPS to the extent to which it exceeds Rs. 750,000 [section 17(2)(vii)] (since aggregate of contribution is within the limit of Rs. 7,50,000, there will be no addition)	Nil	Nil
Gross salary	**17,10,000**	**17,10,000**
Less: Standard deduction	(50,000)	(75,000)
Taxable Salary (A)	**16,60,000**	**16,35,000**
Less: Employee's contribution to EPF u/s 80C and contribution to PPF	(1,50,000)	Nil
Less: Employee's contribution to NPS (section 80CCB(1B))	(50,000)	Nil
Less: Employer's contribution to NPS (10% of salary for old regime, 14% of salary for new regime) (section 80CCD(2))	(1,50,000)	(2,10,000)
Total deduction (B)	**(3,50,000)**	**(2,10,000)**
Taxable income (A-B)	**13,10,000**	**14,25,000**

Computation of Salary Income

The salary income shall be computed in the following manner:

Particulars	*Amount*
Basic Salary	xxx
Add: Additions	
a) Allowances (to the extent of taxable amount) (will depend on new tax regime or old tax regime)	xxx xxx
b) Perquisites	xxx
c) Profit in Lieu of Salary	xxx
d) Retirement benefits (to the extent of taxable amount)	xxx
e) Pension	
Less: Deductions	(xxx)
a) Entertainment Allowance	(xxx)
b) Employment Tax	(xxx)
c) Standard Deduction	
Income chargeable under the head Salary	**Xxx**

7.6.2 Income from House Property

Income is taxable under the head 'house property' if it arises from a property consisting of any building or lands appurtenant thereto. For the computation of income under this head, a house property is classified into three categories of (a) self-occupied, (b) let-out, and (c) deemed let-out house property.

The rental income from immovable property is taxable under the head 'Income from house property' if the following conditions are satisfied:

Building or land appurtenant thereto

Income is taxable under this head if it arises from a property which consists of any building or lands appurtenant thereto. Though the word 'property' has a wide meaning, but for chargeability of income under this head, the property must consist of any building or land appurtenant thereto.

Example, if any income is derived from a vacant land then such income shall not be chargeable to tax under the head 'Income from house property' as the property does not consist of any building. Such rental income is chargeable to tax under the head 'profits and gains from business or profession' or 'Income from other sources'.

Under construction property is not a building and any income pertaining to it cannot be taxed under this head, but has to be taxed as Income from business or profession or income from other sources.

Ownership of property

Income from a building and land appurtenant thereto is chargeable to tax under the head 'house property' only in the hands of an owner. If a person, deriving rental income from a property, is not the owner of such property, then the income so derived shall be chargeable to tax either as business income or income from other sources but not as income from house property.

To become an owner of a property, a person must hold the legal title of the property in his name. He should be able to exercise the rights of the owner, not on behalf of the owner but in his own right. However, in a certain situation, despite not holding the legal ownership of a property, a person is considered as deemed owner of the property, and income from such property is chargeable to tax in his hands.

The most common example of such a case is where the building (and land appurtenant thereto) is owned by a cooperative housing Society and the member has a right to reside and enjoy the benefits of a specific unit in the building including the right to transfer that right of enjoyment.

Use of property

The annual value of the property is chargeable to tax under this head if the owner does not utilize the property to carry on his business or profession. Even if an assessee is engaged in the business of letting out of residential property, the rental income earned from such business is taxable as income from house property.

Computation of income from house property

For the computation of income from house property, a house property has to be classified into the following categories: (a) Self-occupied; (b) Let out and (c) Deemed let-out.

An assessee can at his option select any two houses (which are not actually let out) as self-occupied properties for tax purposes. Once this selection is done, any other house property will be considered as 'deemed let-out', if it is not actually let out

For instance, Mr. P owns four house properties – say house A, house B, house C and house D. He stays in house A, house B is let out. House C and D are not let out. In such scenario, House B will be treated as let out and rental income from the same will be taxed. Out of house A, C and D, he can select any two houses as 'self-occupied' house. Say he selects house A and D as self-occupied, then, house C will be considered as deemed let-out. Reasonable rent expected from house C will have to be offered to tax. In a situation where the tax payer has to make a choice of which two non let-out properties to choose as "self-occupied" it will be in their interest to choose those self-occupied properties where the reasonable rent is the highest. Another way to choose these properties could also depend on the interest payable on a loan taken to acquire the said property.

Broadly, the income from such house property is computed in the following manner:

Particulars	*Let-out*	*Self-occupied*	*Deemed Let-out*
Annual Value of the property (A)	xxx	-	xxx
Less: (-) Municipal taxes (B)	(xxx)	-	(xxx)
Net Annual Value [C = A – B]	**xxx**	**-**	**xxx**
Share in Net Annual Value [D = C * share in property]	**xxx**	**-**	**xxx**
Less: Standard Deduction (E) {30% of D above}	(xxx)	-	(xxx)
Less: Share of Interest on home loan (F)	(xxx)	(xxx)*	(xxx)
Income from house property [G = D – E – F]	**Xxx*****	**Xxx****	**Xxx*****

* Limited to Rs. 2,00,000 under old tax regime. No deduction is allowed in the new tax regime. ** It will always be a loss equivalent to the amount of interest allowed as a deduction in the old tax regime. will always be Nil in the new tax regime.
*** If this results in a loss then upto Rs. 2 lakhs can be adjusted against other other heads of income under the Old tax regime. Under the New Tax regime, the set off of Rs. 2,00,000 against other heads of Income is not allowed.

Annual value:

- The annual value in case of a property treated as a self-occupied house property will be Nil
- Where the property is actually let out, the annual value is the reasonable expected rent receivable from the property or the rent actually received whichever is higher.
- Where the property is considered as deemed let-out, the annual value will be reasonable expected rent.
- Annual value in case of deemed let out property or let out property is calculated after deduction of Municipal taxes actually paid by the owner.
- Interest on home loan can be claimed as deduction as mentioned in subsequent paragraph. This deduction is not available in respect of self-occupied property under the new tax regime.

- Consequently, under the old tax regime the income from self-occupied property will be negative as the annual value will be nil minus the interest payable on the loan taken to acquire such property subject to a maximum of Rs. 2,00,000. This negative value equal to the loan interest is widely thought of as a deduction from income. It is actually a calculation of negative "Income from House Property" that is allowed to be set-off against salary or business income or any other income. This deduction for self-occupied property is not available under the new tax regime and hence the calculation of Income from house property for self-occupied properties will always be Nil under the New tax regime

Deductions allowed from annual value:

1. **Municipal taxes:** As already mentioned earlier, any taxes levied by the local authority are allowed as deduction for let-out properties and for deemed let-out properties provided they are actually paid by the owner of the property.
2. **Net annual value:** It is defined as Annual Value minus Municipal Taxes to the extent allowed.
3. **Standard deduction (section 24(a)):** A standard deduction upto 30% of the net annual value is available.
4. **Interest on borrowed capital (section 24(b)):** Interest on capital borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of house property will be allowed as deduction. In respect of self-occupied property – it is limited to Rs. 2,00,000 under the old tax regime and is not available under the new tax regime.

    - In case of let out or deemed let out properties, there is no maximum limit on allowability subject to set-off and carry forward provisions relating to the same.
    - Interest on self-occupied property is subject to following limits under the old tax regime
        - Where the self-occupied property is acquired or constructed on or after April 1, 1999 and the construction or acquisition is completed within 5 years of taking loan, the interest on such loan will be allowed to the maximum of Rs. 200,000. In such case, the assessee needs to furnish a certificate from the lender specifying the amount of interest payable.
        - However, for the tax payer, If the under-construction period exceeds five financial years (as happens many times), the interest allowed as deduction under the old tax regime on the self-occupied property will be allowed only upto Rs. 30,000 even after the construction is completed

    Interest during construction period: Interest during construction period refers to the interest paid on capital borrowed for the period prior to the financial year in which the property was acquired / purchased. Such pre-construction period interest is allowed in 5 equal instalments starting from the year when the property is acquired / constructed

Deemed owner

In certain situations, an assessee will be treated as owner of the property even when the property may not be in his / her name. Certain important ones are listed below:

- An individual who transfers the property to his or her spouse otherwise than for adequate consideration and which is not in connection with an agreement to live apart, will be treated as deemed owner of the said property for the purpose of this calculation of income from house property.
- The above provisions of deemed owner will also apply where the individual transfers the property to his / her minor child.

Example 1:
Facts: Mr. A is a salaried employee and owns a house property which is taken on loan as follows:

	Amount (Rs.)
Taxable salary income	15,00,000
Interest on Home loan for self-occupied property	5,00,000
EPF/Life Insurance/School Fees for Children	1,80,000

Determine his taxable income.

Answer:

Particulars	**Old tax regime Amt (Rs.)**	**New tax regime Amt (Rs.)**
Income from salary	15,00,000	15,00,000
Income from House Property:		
Self-occupied Property		
Annual Value (taken as NIL)	NIL	
Less:		
Standard Deduction @ 30% of Annual Value	-	
Interest payable on Home Loan is Rs. 5,00,000		-
Maximum deduction (interest on loan taken for self-occupied property is not allowed under new tax regime)	(2,00,000)	Nil
Gross Total Income	13,00,000	
Less: Deduction under section 80C (Rs. 180,000, subject to maximum of Rs. 150,000)	(1,50,000)	
Taxable Income	**11,50,000**	**15,00,000**

Example 2:
Mr. A is a salaried employee owning a house which he has given on rent. His income details are as follows:

	Amount (Rs.)
Taxable salary income	Rs.15,00,000
Rental from the property	Rs.2,20,000
Interest on Home loan for the rented property	Rs.5,00,000
EPF/Life Insurance/School Fees for Children	Rs.1,80,000

Determine his taxable income and amount to be carried forward.

Answer:
Taxable Income

Particulars	**Taxable Income**		
	Amt (Rs.)	**Old tax regime Amt (Rs.)**	**New tax regime Amt (Rs.)**
Income from salary (A)		15,00,000	15,00,000
Income from House Property:			
Rented Property			
Annual Value		2,20,000	2,20,000
Less:			
Standard Deduction @ 30% of Annual Value		66,000	66,000
Interest payable on Home Loan	5,00,000	(5,00,000)	(5,00,000)
No restriction on deduction of interest on let out property			
Income from house property		(3,46,000)	(3,46,000)
Maximum loss allowed to be set off during the current year against other head of income (B)		(2,00,000)	0*
Gross Total Income (A-B)		13,00,000	15,00,000
Less: Deduction under section 80C restricted to Rs. 1,50,000		1,50,000	Nil
Maximum Allowed			
Taxable Income		**11,50,000**	**15,00,000**
Balance loss from house property carried forward* (3,46,000 - 2,00,000 = 1,46,000)	1,46,000		

* Interest on house properties: Carry forward of the loss of the same amount (i.e. Rs. 1,46,000 in this example) is allowed under old regime and new regime as well. However, carried forward loss under the head house property can be set off only against income from house property in subsequent years under the new tax regime. The concept of carry forward of losses is explained in later section of this chapter.

7.6.3 Profit and Gains from Business or Profession

When an assessee carries on any business or profession, the income arising from such business or profession shall be calculated and taxed under the head 'Profit and Gains from Business or Profession'.

Meaning of business

Income Tax Act provides an inclusive definition of a business under Section 2(13) that "Business includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

However, the term business does not necessarily mean trade or manufacture only. The word 'business' has a comprehensive meaning and may be used in many different connotations. Business connotes some real, substantial and systematic or organised course of activity or conduct with a set purpose. It means an activity carried on continuously and systematically by a person by the application of his labour and skill to earn an income.

Computation of business income

As a general rule, all revenue receipts arising in the course of business shall be taxable under the head profits and gains from business or profession. Section 28 of the Income Tax Act provides an inclusive list of all receipts or income which is chargeable to tax under this head. The business profits shall be computed according to the method of accounting regularly employed by the assessee. Thus, if assessee follows the cash system of accounting, profits shall be computed on a receipts basis, while in the mercantile system, it should be computed on an accrual basis.

Income Tax Act allows certain types of assessees to compute income from business or profession on a presumptive basis. However, a person earning income in nature of commission or brokerage cannot opt for such a presumptive taxation scheme.

The business income under the normal provision shall be computed in the following manner:

Particular	*Amount*
Revenue receipts	xxx
Capital receipts which are specifically covered	xxx
Less:	
1. Revenue Expenditures	xxx
2. Capital Expenditures which are specifically allowed as a deduction	xxx
3. Depreciation	xxx
4. Expenditures allowed on payment basis	xxx
5. Expenditures allowed on fulfilment of certain conditions	xxx
Taxable Income from business or profession	**xxx**

The business income under the presumptive scheme shall be computed in the following manner:

Particulars	*Amount*
Total turnover or gross receipts of business or profession	xxx
Presumptive income as a percentage of turnover or receipts or otherwise	xxx
Less:	
Expenditures which are specifically allowed as a deduction	xxx
Presumptive Income from business or profession	**xxx**

Speculative and Non-speculative business income

While computing the income under the head 'profits and gains from business or profession', a business transaction has to be classified into 'speculative' and 'non-speculative'. As per Section 43(5) of the Act, a transaction of purchase or sale of any commodity (including stock and shares) is considered as a 'speculative transaction' if it is periodically or ultimately settled otherwise than through the actual delivery. However, where a transaction is entered into to safeguard against losses (i.e., hedging transaction) or a transaction in derivatives (including commodity derivatives) is also not considered as a speculative transaction.

Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, such business is treated as speculative business. The provisions for computation of profit and tax rates are the same in case of a speculative and non-speculative business except treatment of losses. If any loss is suffered from speculative business, it cannot be set off or adjusted against any profit from the non-speculative business. Further, such losses can be carried forward for 4 years only in contrast to 8 years allowed for non-speculative business losses.

7.6.4 Income from Capital Gains

Any profit or gain arising from the transfer of a capital asset is taxable under the head 'capital gains' in the previous year in which such transfer takes place. Determination of income taxable under the head capital gains depends upon various factors such as period of holding, cost of acquisition, full value of consideration, nature of asset etc. The nature of capital gain, that is, short-term or long-term, is determined on the basis of period of holding of the capital asset. (refer *Chapter 8* for detailed discussion*)*
However, every transfer of a capital asset does not give rise to taxable capital gain because some transactions are either not treated as 'transfer' under Section 47 or they are excluded from the meaning of a capital asset (i.e., rural agricultural land), or they enjoy exemption under Sections 54 to 54GB.

The short-term and long-term capital gain arising from transfer of a capital asset is computed in the following manner:

Computation of short-term capital gain	
Full value of consideration	xxx
Less:	

a) Expenditure incurred wholly and exclusively in connection with the transfer *b)* Cost of acquisition *c)* Cost of improvement *d)* Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution *e)* *f)* Exemption under Sections 54B, 54D, 54G and 54GA	(xxx) (xxx) (xxx) (xxx) (xxx)
Short-term capital gain or loss	**Xxx**
Computation of long-term capital gain	
Full value of consideration *Less:* *a)* Expenditure incurred wholly and exclusively in connection with transfer *b)* Cost of acquisition *c)* Cost of improvement *d)* Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution *e)* Exemption under Sections 54 to 54GB	Xxx (xxx) (xxx) (xxx) (xxx) (xxx)
Long-term capital gain or loss	**Xxx**

7.6.5 Income from Other Sources

Where a particular income cannot be categorised under any of the four heads of income, it will be taxed under this head, provided the said income is otherwise not exempt from tax. However, certain income are always taxable under the head 'income from other sources'. Thus, income taxable under this head is an aggregate of certain incomes which are specifically taxed under this head and other incomes which are not chargeable under any other head, hence, chargeable under this head. *(refer Chapter 9 for detail discussion)*

Income taxable under the head 'income from other sources' shall be computed in the following manner:

Nature of Income	*Amount*
1. Dividend Income	xxx
2. Winning from lotteries, etc.	xxx
3. Winning from online games (in the nature of lotteries, etc.)	xxx
4. Interest on securities	xxx
5. Rental income of machinery, plant or furniture	xxx
6. Composite rental income from letting out of plant, machinery, furniture and building	xxx
7. Sum received under Keyman insurance policy	xxx
8. Interest on compensation or enhanced compensation	xxx
9. Advance money received in the course of negotiations for the transfer of a capital asset	xxx xxx
10. Gifts to the extent taxable	
11. Compensation on termination of employment or modification of terms of employment	xxx xxx
12. Any money, immovable property or movable property received without consideration or at a consideration less than the prescribed stamp duty value/fair market value	xxx

13. Sum received under a life insurance policy (other than ULIP and keyman insurance policy) in excess of the aggregate premium paid during the policy term 14. Specified sum received (other than interest/dividend from SPV and rental income from REITs) by a unitholder from a business trust 15. Any other income not taxable under any other head *Less:* Attributable expenses (to the extent allowable)	xxx xxx xxx xxx (xxx)
Income from other sources	**xxx**

7.7 Clubbing of Income

A taxpayer is generally taxed in respect of his own income. However, the Income Tax Act deviates from this general provision in some cases and clubs income of other persons in taxpayer' income. The clubbing provisions have been enacted to counteract a generally prevalent and growing tendency on the part of the taxpayers to dispose of their property or income in favour of other persons in such manner that their tax-liability may either be avoided or reduced.

The income will first be computed in the hands of recipient under the relevant head after allowing all exemptions and deductions permissible under that head of income. Then the resultant income shall be clubbed in the hands of the transferor or beneficiary as per the provisions of section 60 to 64 of the Income Tax Act. The income computed under the relevant head in the hands of the recipient will be included in the total income of the transferor or beneficiary under the same head of Income. Thus, the clubbed income shall be retained under the same head in which it is earned. If the net result of the computation of income in the hands of the recipient is a loss, it shall also be clubbed.[19]

The provisions relating to clubbing of income are contained in Sections 60 to 64 of the Income Tax Act. These provisions are as follows:

a) Income from assets transferred to another person [Sections 60 to 63]
b) Income of another person to be included in the taxpayer's income [Section 64]

7.7.1 Income from assets transferred to another person

Transfer of Income without transferring the Asset [Section 60]

If any person transfers the income from any asset without transferring the asset, such income is included in the total income of the transferor.

Example: E holds 100, 10% redeemable debentures in Z Ltd. E assigns right to receive interest from 50 debentures in favour of his nephew 'N' and gifts 50 Debentures to his son 'P'. Since, E has transferred only the right to receive the income in favour of 'N' while as the income-producing asset remains his property. Therefore, interest income in respect of 50 Debentures shall be clubbed with the income of E as per provisions of Section 60. However, the interest earned from remaining 50 Debentures shall not be clubbed with the income of E as he has transferred both—the asset as well as the income from the asset.

[19]Circular No. 104, dated 19-02-1973

Section 60 has no application in this case. If son is a minor child, such income shall be clubbed with income of E as per provisions of Section 64.

7.7.2 Income of another person to be included in taxpayer's income [Section 64]

Income Tax Act contains provisions for clubbing of income of other person with the income of taxpayer. These situations arise when a minor child earns some income or when taxpayer transfers his asset to his spouse, son's wife, etc.

The clubbing provisions have been introduced to stop taxpayers from diverting a part of their income to the relatives in order to reduce tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated, subject to certain exceptions, in respect of the income of the following persons:

a) Income of Spouse
b) Income of Son's Wife
c) Minor's Income
d) Income of any person or Association of persons
e) Income from property gifted to HUF

Example: Mr. A gifted Rs. 30,00,000 to his wife. Mrs. A earned interest income of Rs. 150,000 on the same. This interest is to be clubbed in the total income of Mr. A thereby offering it in his return of income. The tax rate on the same will be as per the income tax slabs of Mr. A and not his wife.

7.8 Set off and Carry forward of Losses

7.8.1 Loss under the head Capital Gains

Capital losses can be of two types – Short-term Capital Loss and Long-term Capital Loss. Though both the losses are computed under the same head of income, yet distinct provisions have been prescribed for set-off of these losses. Both the losses are computed and disclosed separately in the Income-tax Returns.

Intra-head Adjustment (within the head Capital Gains)

As a general rule, if there are several sources of income, falling under any head of income, the loss from one source of income may be set-off against the income from another source, falling under the same head of income.

However, long-term capital loss can be set-off only against long-term capital gains. It cannot be set-off against short-term capital gains, though both of them fall under the same head 'Capital Gains'. However, short-term capital loss can be set-off against any capital gain, whether short-term or long-term.

Inter-head Adjustment (against other heads of Income)

As a general rule, if after intra-head adjustment the net result under a head of income is a loss, the same can be set-off against the income from other heads in the same previous year. However, a capital loss, whether short-term or long-term, cannot be set-off against income taxable under any other head.

Carry forward of losses

If capital loss could not be set-off against the eligible capital gains because of the inadequacy of income during the current year, it can be carried forward and set-off against the relevant capital gains of the subsequent year. The short term and long-term capital loss, which could not be set-off during the year, shall be carried forward separately. In subsequent years, the short-term capital loss can be set-off against the short term or long-term capital gain but the brought forward long-term capital loss shall be set-off only against long term capital gains.

The losses can be carried forward for 8 Assessment Years immediately following the year for which the loss was first computed.

The losses can be carried forward only if the return of income is filed on or before the due date of filing original return under section 139(1). However, the assessee can apply to the Assessing Officer or the CBDT for condonation of delay in filing of return of income. (see Table 7.2)

Table 7.2: Loss under the head Capital Gains

Type of Loss	**How to Set-off the loss?**	**Adjustment Against**	**Time Limit**
Long-term Capital Loss	Intra-head Adjustment of loss	Long-term Capital Gains	Same Year
Long-term Capital Loss	Inter-head Adjustment of loss	Not Allowed	-
Long-term Capital Loss	Carried Forward Losses	Long-term Capital Gains	Within 8 Years
Short-term Capital Loss	Intra-head Adjustment of loss	Any capital gains, whether short term or long term	Same Year
Short-term Capital Loss	Inter-head Adjustment of loss	Not Allowed	-
Short-term Capital Loss	Carried Forward Losses	Any capital gain, whether short term or long term	Within 8 Years

7.8.2 Loss under the head profits and gains from business or profession

Income Tax Act provides distinct provisions for set-off and carry forward of speculative loss and non-speculative loss. Loss from speculative transactions can be set-off only against profit from speculative transactions. Whereas, the normal business loss can be set-off from any income other than salary and income from gambling activities.

If the loss couldn’t be set-off in the current year due to inadequacy of profit under other heads of income, same shall be carried forward for set-off in the subsequent year. Speculative loss and non-speculative loss can be carried forward for 4 years and 8 years respectively. In subsequent years, the speculative loss can be set-off only against speculative profit. Whereas, the normal business loss can be set-off against non-speculative as well as speculative income. (see Table 7.3). While computing business loss, unabsorbed depreciation will be treated as a separate item and will be allowed to be carried forward for any number of years and can be set-off against any income except salary.

7.8.3 Losses under the head 'income from house property'

Loss from one house property can be set off against income from another house property during the same year.

Where the house property loss cannot be set off under the same head during the year, it can be set off against incomes under other heads but set off is restricted to Rs. 2 lakhs for any financial year in the old tax regime. The set off against the other heads of income is not allowed under the New Tax regime but is deemed to have been allowed. Please refer to the section on house property for practical examples on the same.

The unadjusted loss can be carried forward till next 8 years and can be set off only against income from house property in the subsequent year.

7.8.4 Loss under the head other sources

The loss under the head other sources can be set-off against any income under any head except income from gambling activities. However, if loss under the head other sources cannot be set-off in the current year due to inadequacy of income under other heads then the same shall not be allowed to be carried forward to subsequent years. Table 7.4 lays out a comprehensive summary of set-offs and carry forward of losses.

Table 7.4: Set-off and Carry Forward of Losses

Sr. No	Type of loss	Set off in the same financial year	Maximum period upto which unadjusted loss can be carried forward	Set off in subsequent previous year allowed against
1.	House Property	Old Tax regime - Any income under any head of Income (set off restricted to Rs. 200,000) New Tax regime - This set off is not available if the assessee opts for new tax regime u/s 115BAC but is deemed to have been set off	8 years	Income from House Property
2.	Business or Profession (other than speculation/specified	Any income under any head except salaries	8 years	Business income only

Sr. No	Type of loss	Set off in the same financial year	Maximum period upto which unadjusted loss can be carried forward	Set off in subsequent previous year allowed against
	business or depreciation)			
3.	Speculation Loss	Speculation Profit Only	4 years	Speculation Profit Only
4.	Short-term Capital Loss	Any Capital Gain	8 years	Any Capital Gains
5.	Long-term Capital Loss	Long-term Capital Gain	8 years	Long-term Capital Gains
6.	Other Sources	Any income under any head of income (except income from gambling activities)	Cannot be carried forward	Unutilized loss not allowed for carry forward

7.9 Exempt incomes

Under Chapter III of the Income Tax Act, there are certain incomes which are exempt and are not to be included in computing the total income of the assessee. Chapter III of the Act covers section 10 to section 13B. (Refer annexure 2 for the partial list of exempt income)

7.10 Deductions under Chapter VI-A

In computing the total income, certain deductions are allowed from the gross total income. These deductions are allowed to encourage saving habits in individuals and pursue institutions to take part in social activities. These deductions are prescribed in Chapter-VIA of the Income Tax Act. (see Table 7.5)

Table 7.5: Deductions under Chapter VI-A of the Income Tax Act, 1961

Section	Nature of payment/income	Available to	Permissible deduction	Whether available in new regime
80C	Deduction for investments in insurance policies, repayment of principal portion of housing loan, contribution to certain small saving schemes, taxpayer contribution to pension funds, or fixed deposits.	Individual and HUF	Rs. 1,50,000*	No
80CCD(1)	Employee's or self-employed individual’s contribution towards NPS	Individual	10% of salary in case of an employee	No

			otherwise 20% of gross total income	
80CCD(1B)	Contribution towards NPS by any individual	Individual	Rs. 50,000	No
80CCD(2)	Employer's contribution towards NPS	Individual	• Central or State Government employees: 14% of salary • Others: 10% of Salary	Yes 14% of Salary
80CCH	Contribution to Agniveer Corpus	Individual	100%	Contribution by Central Government allowed
80D	1. Medical Insurance 2. Contribution to Central Government Health Scheme (CGHS) 3. Preventive Health Check-up 4. Medical Expenditure	Individual and HUF	• Rs. 75,000 [where individual (incl. his family) is less than 60 years of age and his parents are senior citizen)] • Rs. 1,00,000 [where both individual (incl. his any member of family) and his parents are senior citizens]	No
80DD	Expenditure on medical treatment or pays an insurance premium for the benefit, of a family member suffering from disability.	Individual and HUF	Rs. 75,000 (Rs.1,25,000 in case of severe disability)	No
80DDB	Medical treatment of specified diseases	Individual and HUF	Rs. 40,000 (Rs. 1,00,000 for senior citizen)	No
80E	Interest on education loan for the higher education	Individual	Amount paid as interest on loan without limit	No
80EEB	Interest on loan to purchase an electric vehicle	Individual	Rs. 1,50,000	No

80G	Donations to specified institution or funds	All assessees	50%/100% of the net qualifying amount	No
80GG	Rent paid	Individual not receiving HRA	Rent paid in excess of 10% of total income or Rs. 5,000 per month or 25% of total income whichever is less	No
80QQB	Royalty (authors)	Individual-Author	Rs. 3,00,000	No
80RRB	Royalty (patents)	Individual	Rs. 3,00,000	No
80TTA	Interest on deposits in saving account	Individual and HUF	Rs. 10,000	No
80TTB	Interest on deposits with bank/ post office/co-operative societies	Senior citizen	Rs. 50,000	No
80U	Medical disability	Individual	Rs. 75,000 (Rs.1,25,000 in case of severe disability)	No

*Note 1: As per section 80CCE, the aggregate amount of deduction under section 80C, 80CCC and 80CCD(1) shall not, in any case, exceed Rs. 1,50,000.

7.11 Rebate under section 87A

Section 87A of the Income Tax Act provides a tax rebate of up to Rs. 12,500 to a **resident individual** whose total income during the previous year does not exceed Rs. 5,00,000. However, from Assessment Year 2024-25 onwards, if a resident individual opts for the new tax regime under Section 115BAC and his total income is up to Rs. 7,00,000, he can claim a higher amount of tax rebate of up to Rs. 25,000. It is proposed to further increase to a maximum of Rs. 60,000 by the Finance Bill 2025. If the total income just exceeds Rs. 7,00,000, marginal relief is allowed to the extent of the increase in tax payable by the total income exceeding Rs. 700000. This amount is proposed to be increased to Rs. 12,00,000.

Effectively, for incomes upto Rs. 7,28,000 the tax payable will be the amount by which the income exceeds Rs. 7 lakhs. Proposed in the Finance Bill 2025, it will be that for incomes upto Rs. 12,71,250 the tax payable will not exceed the amount by which the taxable income exceeds Rs. 12,00,000/-

The rebate under Section 87A is not available from tax payable as per section 112A in respect of long-term capital gains arising from the transfer of equity shares, units of equity-oriented mutual funds, certain ULIPs or units of business trust which are chargeable to STT and tax on the accumulated balance of a recognised provident fund as referred under Section 111.

7.12 Gross Total Income

Section 80B(5) of the Income Tax Act provides that 'Gross Total Income' means the total income computed in accordance with the provisions of the Income Tax Act before making any deduction under Chapter VI-A. (refer Table 7.1) Gross total income of an assessee is computed in the following steps:

Step 1: Calculate income under five heads of income

In the Income Tax Act, the income is computed in the following five heads of income:

a) Salary
b) House Property
c) Profits and gains from business or profession
d) Capital Gain
e) Income from Other Sources

Step 2: Club income of other persons

A taxpayer is generally taxed in respect of his own income. However, in respect of certain income, the Income Tax Act deviates from this general provision and clubs income of other persons in taxpayer's income. Hence, an assessee has to add the income of another person with his own income if clubbing provisions apply in his case.

Step 3: Set-off the losses of the current year or earlier years

If the assessee has incurred losses under any head of income then he is allowed to make the following adjustments subject to relevant provisions relating to set-off and carry forward of losses:

a) Intra-head adjustment, i.e., set-off of losses from one source of income against income from another source taxable under the same head of income as described earlier.
b) Inter-head adjustment, i.e., set-off of losses from one head of income against income taxable under another head of income as described earlier.

If losses cannot be set-off in the same year due to inadequacy of eligible income, then such losses are carried forward to the next assessment year as described earlier.

7.13 Total Income

An assessee is allowed to claim various deductions from the 'Gross Total Income' on account of investments and savings made by him. The balance income remaining after claiming the deductions is called 'Total Income', which shall be the base for calculation of tax liability.

7.14 Computation of Tax Payable

7.14.1 Non-corporate Assessee

For calculation of tax in respect of income of the non-corporate assessees, the tax shall be calculated as per the applicable tax rates and special tax rates. (refer Annexure 1 for tax rates) Assessee being an Individual, HUF has an option to compute tax at the concessional tax rates prescribed under Section 115BAC, as the case may be, subject to fulfilment of certain conditions.

The tax so computed on total income is further increased by surcharge (if applicable) and Health & Education Cess and reduced by the amount of AMT credit, relief under section 89 or foreign tax credit to arrive at net tax liability. The net tax payable by the assessee shall be increased by the amount of interest and late filing fees (if any). Thereafter, the taxes already paid by the taxpayer in the form of Advance Tax, TDS, TCS or Self-assessment tax shall be deducted from the aggregate tax liability to compute the amount of tax payable by or refundable to taxpayer.

7.15 Double Tax Avoidance Agreement

Different countries may have a different mechanism for levy of tax on the income of a person. Generally, countries follow the principle of residence-based taxation or source-based taxation for levy of income-tax. The principle of 'Residence based Taxation' gives primary taxing rights to the country of residence of the assessee whereby worldwide income of an assessee is taxed in the country in which he is a resident. The 'Source-based Taxation' rule confers right to tax to a particular income to the country where the source of the said income is located. To elaborate, the source, a country seeks to tax the income within its territory even when such income belongs to a person who is not the resident of such a country. India follows the dual approach whereby on one hand, a person resident in India is liable to pay tax in India on his total worldwide income. On the other hand, a person, who is non-resident in India during the year, is liable to pay tax only on his Indian income.

Because of these taxation principles, it might be possible that same income of a person is charged to tax in two different countries, i.e., residence country as well as source country which gives rise to double taxation of income.

For example, Mr. A, resident of India, has a house property in the US which is being let-out for Rs. 1,00,000 per month. Mr. A does not have any other income in India as well as in the US.

In this case, as Mr. A is resident of India, he shall be liable to pay tax in India on his world-wide income. Thus, rental income shall be charged to tax in India even though the source of income, i.e., the property is located in the US. Similarly, the US may also impose a tax on such income if it applies the concept of source-based taxation. Thus, the same income may be taxed in both the countries resulting in double taxation of income.

To avoid double taxation of income, countries enters into Double Taxation Avoidance Agreement (DTAA).

DTAA is basically an agreement which is entered into between two or more countries to avoid double taxation of income. With DTAA, countries can avoid double taxation by allocating the taxing rights or by giving credit for taxes paid in the source state by the residence state.

In most cases DTAAs provide relief from double taxation by the residence country giving right to claim credit for taxes paid to the source country.

Example 1: Mr. IS (Indian Student) is an Indian Citizen, 24 years of age, leaves India in December of 2024 for France to study a 2-year MBA course. He is a resident and ordinarily resident for FY 2024-25. He has never been outside India before. After his studies, he intends to work in France as long as he can in case he gets appropriate work Visa. Mr. IS earns money in France during the financial year 2024-25 doing odd jobs. He will be paying taxes on income in France. Will he have to again pay tax on such income in India?

Answer: Mr. IS is a resident and ordinarily resident in India for FY 2024-25. Hence, his global income will be taxable in India. His income earned in France will be taxed in India but he will also be entitled to credit of taxes paid in France, since India is his country of residence.

Example 2: Mr. Vilayati who is in overseas, say UK for 20 years and was non-Resident (Tax) in all these years, comes to India for employment on 1st April, 2024. He has bonds in that foreign country on which he earns interest in that foreign country. As discussed earlier, he will be resident and ordinarily resident in the FY 2026-27. Hence interest on bonds in UK will be taxed in India as well. Since, the interest income arises in UK, UK has the primary right to tax the interest income as it is the source country. The residence country i.e. India, will tax the interest income but will also allow credit of taxes paid in UK while computing total taxes payable in India.

7.16 Taxation Regime

EEE, EET and ETE are three basic terms which are commonly used in reference to the tax-saving investments. Where 'E' denotes Exempt and 'T' denotes Taxable. Investment is generally made with an intention to grow the capital which involves 3 stages:

Stage 1: When a person invests in any security.

Stage 2: When such investment yields interest or returns.

Stage 3: When a person transfers the security or withdraws the amount of principal *plus* interest.

So, if an investment provides tax benefit at all three stages, it will fall under the category of 'EEE' where the first exempt means that the investment qualifies for a deduction; the second exempt means that the return/interest on investment shall be exempt from tax; the third exempt means that no tax shall be levied at the time of transfer or at the time of withdrawal of principal or interest.

Similarly, if an investment provides tax benefit at the time of deposit and withdrawal but return on such investment is chargeable to tax then it will fall under the category of "ETE". Whereas, if an investment is chargeable to tax only at the time of transfer or withdrawal, then it will fall under the category of "EET". With the new tax regime disallowing most deductions many erstwhile EEE investments have turned into TEE investments.

The examples of EEE, EET and ETE investment are as follows:

Category	**Investment**
EEE	Public Provident Fund*
EET	Equity Linked Saving Schemes (ELSS)*
ETE	Tax saving Bank Fixed deposit for 5 years or more; Senior Citizen Savings Scheme*

* The first leg of E is not available under the new tax regime

7.17 Maximum Marginal Rate of Tax

Section 2(29C) of the Income Tax Act defines 'maximum marginal rate' as the rate of Income-tax (including surcharge and health & education cess) applicable in relation to the highest slab of income in the case of an individual, Association of Person or Body of Individual, as the case may be, as specified in the Finance Act of the relevant year. Thus, the Maximum Marginal Rate (MMR) shall be as under:

Particulars	***Rate (in %)***
Highest slab rate applicable in case of Individual	30
Add: Surcharge [(B) = (A) * 37%]	11.1
Add: Health & Education cess [(C) = {(A)+(B)} * 4%]	1.644
Maximum Marginal Rate (MMR)	**42.744**

7.18 Effective Rate of Tax

The term 'effective tax rate' is not defined under the Income Tax Act. In general, effective tax rate means a rate inclusive of surcharge and health & education cess which is leviable on the income of an assessee. The effective tax rate can be computed with the help of the following formulae:

Effective tax rate = Applicable tax rate × (1 + Rate of Surcharge) × (1 + Rate of Health & Education Cess)

Example: Effective tax rate in case of a partnership firm having income in excess of Rs. 1 crore would be 34.944% [i.e. 30% x (1 + 12%) x (1 + 4%)]

In case of an individual, who is liable to pay tax as per slabs, the effective tax rate shall be total income-tax as a percentage of total taxable income.

Example: Effective tax rate in case of an individual having an income of Rs. 20 lakhs and income tax payable of Rs. 4,29,000 would be 21.45% [Rs. 4,29,000/Rs. 20,00,000].

CHAPTER 8: CAPITAL GAINS

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Basic concepts of Capital Gains
- Capital Asset and types of Capital Assets
- Transfer
- Computation of Capital gains from transfer

8.1 Basic Concepts

Any income arising from **transfer** of a **capital asset** is chargeable to tax under the head **'capital gains'**.

The important constituents under this head are – capital asset, transfer, sale consideration, cost of acquisition and the date of purchase and transfer.

8.2 Capital asset

Meaning of Capital Asset

As per Section 2(14) of the Income Tax Act, 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 (FII) which has invested in such securities in accordance with the SEBI Regulations.[20]
c. Any unit linked insurance policy (ULIP) to which exemption under section 10(10D) does not apply on account of the applicability of the fourth and fifth proviso thereof hereinafter referred to as 'high premium ULIP').[21]

Specific inclusions

All kind of properties, whether movable, immovable, tangible or intangible including rights of management or control of an Indian company is a capital asset. A capital asset could also include business undertaking, partner's share in a firm, a route permit, a leasehold right, right to get conveyance executed, right to subscribe shares of a company, goodwill, license to manufacture, gold, jewellery, securities, etc.

Exclusions

The following assets have been excluded from the definition of capital assets.

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[20] The concept of Foreign Institutional Investor (FII) has been substituted by Foreign Portfolio Investor (FPI) by SEBI (Foreign Portfolio Investors) Regulations, 2014 which has also been substituted by the SEBI (Foreign Portfolio Investors) Regulations, 2019.

[21] Inserted by the Finance Act 2021 with effect from Assessment year 2021-22

- **Stock-in-trade** - Any stock-in-trade, consumable stores or raw material held for the purpose of business or profession have been excluded from the purview of capital asset.

- **Personal Effects** - Movable property held for personal use of the assessee or any member of his family, dependent on him, is not treated as capital asset. Example, wearing apparel, furniture, car, scooter, TV, refrigerator, musical instruments, gun, revolver, generator, etc., are personal effects, thus, they are not treated as capital assets.

  An article is considered as personal effects if it is intended for personal or household use by the assessee and not merely because these articles are capable of being put to personal or household use. All personal effects need not be used daily. So long as they are meant for personal use, they are considered as personal effects.

  However, the following assets, even if are meant for personal use, shall not be considered as personal effects and any gain arising from their sale shall be charged to tax:

  i. Jewellery (including ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals whether or not worked or sewn into any wearing apparel)
  ii. Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel
  iii. Archaeological collections
  iv. Drawings
  v. Paintings
  vi. Sculptures
  vii. Any work of art

- **Agricultural land in India** - Any agricultural land situated in any rural area in India is not a capital asset. Thus, the following agricultural lands shall be considered as capital assets:

  a) Agricultural land situated in an urban area in India or within the prescribed limits from municipalities;
  b) Agricultural land situated in any foreign country.

- **Bonds** - Following Bonds have been excluded from the purview of capital asset:

  i. 6.5% Gold Bonds, 1977
  ii. 7% Gold Bonds, 1980
  iii. National Defense Gold Bonds, 1980
  iv. Special Bearer Bonds, 1991
  v. Gold Deposit Bonds issued under Gold Deposit Scheme, 1999
  vi. Deposit certificates issued under the Gold Monetization Scheme, 2015

Depending on the period of holding, an asset can be classified as long term capital asset or short-term capital asset.

8.3 Types of Capital Asset

For the purpose of computing capital gain, capital assets are classified into short-term capital assets or long-term capital assets. This distinction is important as incidence of tax is higher on short-term capital gains as compared to the long-term capital gains. The distinction between a long-term and short-term capital asset is based on the period for which an asset is held by the owner before transfer.

Short-term vs. Long Term Capital Asset

The Finance Act, 2024 w.e.f. 23rd July, 2024 has significantly amended provisions relating to capital gains taxation including period of holding and rates of taxation which will be discussed in the subsequent paragraphs. These provisions will be applicable for transfer of capital assets after 23rd July, 2024. For transfer of capital asset before the said date, the erstwhile provisions shall apply. For the purposes of this content we have assumed transaction on or after July 23, 2024.

Transfer of capital asset after 23rd July, 2024:

In general, a capital asset is deemed as ‘short-term’ if it is held by an assessee for a period of not more than 24 months, immediately preceding the date of its transfer. Similarly, a capital asset is considered as ‘long-term’ if it is held by an assessee for a period of more than 24 months, immediately preceding the date of its transfer.

Exception 1: Period of holding 12 months:

Following capital assets are treated as short-term capital asset if they are held for not more than 12 months immediately preceding the date of transfer:

a. Listed Shares of a company (equity shares or preference shares)
b. Listed securities (Debentures, Bonds, Derivatives, Government securities, units etc.)
c. Units of UTI (Listed or Unlisted)
d. Units of Equity Oriented Fund (Listed or Unlisted)
e. Zero Coupon Bonds (Listed or Unlisted)
f. High Premium Equity Oriented ULIP

Exception 2: No criteria of period of holding

- A depreciable asset is always treated as a short-term capital asset irrespective of period of holding.
- Further, irrespective of the period of holding, the capital gains arising from the transfer, redemption or maturity of Market Linked Debentures (MLDs) or unit of Specified Mutual Funds (SMFs) acquired on or after 1st April, 2023 shall be taxable as short-term capital gains.

- Also, in view of the amendment brought by the Finance Act, 2024 where an unlisted bond or unlisted debenture is transferred, redeemed or matures after 23rd July, 2024, the gains on the same shall be taxable as short-term capital gains under section 50AA.

Table 8.1 summarizes the required holding period of various capital assets to be termed as long-term capital assets.

Table 8.1: Overview of holding periods of capital assets in respect of transfer made on or after July 23, 2024

Nature of Security	***Holding should be more than the following period to be treated as long term capital asset***	
	Listed	*Unlisted*
Equity shares	12 months	24 months
Units of Equity Oriented Funds	12 months	12 months
Units of REIT / InvIT	12 months	24 months
Other Units (other than schemes investing 65% or more in debt or money market instruments directly or indirectly)	12 months	24 months
Schemes investing 65% or more in debt or money market instruments directly or indirectly (Specified Mutual Fund (SMF) – type 1)	Always short term	Always short term
Schemes investing 35% or less directly in listed domestic equity in India and bought on or after April 1, 2023 and **sold before April 1, 2025 – and not part of above (SMF – type 2)**	Always short term	Always short term
Schemes investing 35% or less directly in listed domestic equity in India and bought on or after April 1, 2023 and **sold on or after April 1, 2025 – and not part of above**	12 months	24 months
Market linked debentures	Always short term	Always short term
Preference Shares	12 months	24 months
Debentures	12 months	Always short term
Government Securities in the form of bonds or debentures	12 months	Always short term
Zero coupon bonds	12 months	Always short term
Other Bonds	12 months	Always short term

Immovable property (Land and building both)	24 months
High Premium Equity Oriented ULIP	12 months
Any other asset (e.g. physical gold etc.)	24 months
Note: Gains arising from transfer of Market linked debentures (MLDs), specified mutual funds (SMFs) and depreciable assets, unlisted debentures or bonds are always treated as short-term capital gains, irrespective of the period of holding.	

8.3.1 Calculating Period of Holding

The period of holding of a capital asset is calculated from the date of its purchase or acquisition till the date of its transfer. However, in certain cases, the period of holding of a capital asset is determined in accordance with special provisions which are enumerated in the following table: (Table 8.2)

Table 8.2: Special provisions for calculating period of holding of capital assets

Type of Security	Period of Holding
Listed Shares sold through broker	Date of broker's note to be considered as date of purchase and sale provided it is followed up by delivery of shares and transfer of deed.
Listed shares transferred directly between parties (not through stock exchange)	Period of holding to be counted from date of purchase to date of contract of sale as declared by the parties, provided it is followed by actual delivery of shares and transfer deed.
Securities held in Demat form	Period of holding is determined as per First-in-First-out (FIFO) method, i.e., the securities that first entered into the Demat account is deemed to be the first sold out.
Bonus shares	Period of holding is reckoned from date of allotment of bonus shares.
Sweat Equity shares or ESOPs	Period of holding is reckoned from date of allotment of Sweat equity shares or shares issued on exercise of ESOPs.
Conversion of preference shares into equity shares	The period for which the preference shares were held by the assessee is also included in the period of holding of equity shares.
Conversion of bonds/ debentures/ debenture - stock/ deposit certificates into shares or debentures of that company	The period of holding of the original asset shall also be taken into consideration while determining the period of holding of converted assets.
Right Shares	Period of holding is counted from date of allotment of right shares.
Renouncement of right to subscribe to shares or any other security of a company	Period of holding is reckoned from the date of offer made by the company to the date of renouncement.
Shares of an amalgamated company	Period of holding of the original shares, held in the amalgamating company, is also included in computing the period of holding of the shares in the amalgamated company.

Type of Security	Period of Holding
Shares of a resulting company in case of demerger	Period of holding is counted from the date of holding of the shares in the demerged company and not from the date of allotment of the shares in the resulting company.
Acquisition by operation of law in the circumstances specified in Section 49(1) *[See Note 1]*	Period of holding of the last previous owner who acquired the asset by way of purchase is also included to determine the period of holding by the assessee.
Units of business trust allotted on account of transfer of shares of special purpose vehicle (SPV)	The period for which the shares of SPV were held is also included in counting the period of holding of the units of business trust.
Consolidation scheme of mutual fund	The period for which units were held under consolidating scheme shall also be included.
Consolidation plan of mutual fund	The period for which units were held under consolidating plan shall also be included.
Segregation of portfolio of mutual fund	The period for which original units were held in main portfolio shall also be included.
Gold converted into an Electronic Gold Receipt (EGR) and vice-versa	The period for which the Gold was held before converting into EGR shall be included for computing the period of holding of the EGR and vice-versa.

Note 1: some of the Circumstances specified in section 49(1) are as follows:

(a) Distribution of assets on total or partial partition of an HUF;
(b) Under a gift or will;
(c) By way of succession, inheritance or devolution;
(d) Transfer to a revocable or irrevocable trust;

8.4 Transfer of Capital Asset

In general sense, the expression 'transfer' of property connotes the passing of a property or rights in a property from one person to another. The meaning of transfer has been defined under Section 2(47) of the Income Tax Act. It includes various means by which the property may be passed from one person to another which would get covered under the definition of 'transfer'. Following are some of the examples of transfer of asset:

Sale of asset: The word 'sale' construes a transaction voluntarily entered into between two persons, commonly known as the buyer and seller, by which the buyer acquires property of the seller for an agreed consideration, commonly known as 'price'.

Exchange of asset: Under Section 118 of the Transfer of Property Act, 1882, 'exchange' is defined to mean when two persons mutually transfer the ownership of one thing for the ownership of another thing, neither thing nor both things being money only.

Receipt of shares of a company in exchange of shares of another company at the time of business reconstruction which are not otherwise excluded from the definition of transfer will be covered in the definition of exchange of asset.

Relinquishment of asset: The word 'relinquishment' has not been defined in the Act. A relinquishment is said to have taken place when the owner withdraws himself from the property and abandons his/her rights thereto.

For example, Mr A and Mr B entered into a partnership and contributed some assets. After 2 years, Mr A retired from such a firm and relinquished his rights and interest in such property in favour of Mr B. In this case, such relinquishment of rights would amount to transfer and chargeable to tax under the head capital gains.

Extinguishment of rights: The word 'extinguishment' has also not been defined in the Act. It refers to the case where rights of a person in a capital asset have extinguished and not the extinguishment of the capital asset as such. If the asset has irretrievably lost, it cannot be said that the assessee suffered loss under the head 'capital gains'. The extinction or loss of the asset does not fall within the import of the expression 'extinguishment of the right'.

Maturity or redemption of zero-coupon bonds: Redemption or maturity of zero-coupon bond, issued by any infrastructure capital company or infrastructure capital fund will be treated as transfer.

8.4.1 Transactions not regarded as transfer

The Income Tax Act has listed certain transactions, which are not regarded as transfers for the purpose of capital gains. Consequently, no capital gain may arise from such transfers. Some of these transactions are listed in Section 46 and 47 of the Income Tax Act, which have been enumerated below.

(i) Distribution of capital asset on the total and partial partition of a Hindu undivided family;

(ii) **Any transfer of a capital asset under a gift or will or irrevocable trust**

Any transfer of a capital asset under a gift or will or an irrevocable trust is excluded from the ambit of transfer, except shares, debentures or warrants allotted by a company directly or indirectly to its employees under any Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with prescribed guidelines.

(iii) **Transfer among non-residents**

Transfer of following securities by a non-resident to another non-resident is not charged to capital gains:

i. Transfer of bonds or GDRs of an Indian company or public sector company as referred under Section 115AC by a non-resident to another non-resident outside India;

ii. Transfer of Rupee Denominated Bond of an Indian company by one non-resident to another non-resident outside India;
iii. Transfer of bonds, GDR, Rupee Denominated Bond, derivatives, foreign currency-denominated bond, unit of a Mutual Fund, unit of a business trust, foreign currency-denominated equity shares of a company, unit of Alternative Investment Fund or Bullion Depository Receipt with underlying bullion by a non-resident on a recognised stock exchange located in any International Financial Services Centre provided the consideration is paid or payable in foreign currency; or
iv. Transfer of Government Security, carrying periodic payment of interest, outside India through an intermediary dealing in settlement of securities by a non-resident to another non-resident.

(iv) **Redemption of Sovereign Gold Bonds**

Redemption of Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, by an individual will not be regarded as transfer.

(v) **Conversion of securities**

The following conversion of securities shall not be deemed as transfer of securities:

i. Conversion of bonds, debentures, debenture-stock or deposit certificate of a company into shares or debentures of that company;
ii. Conversion of Foreign Currency Exchange Bonds (FCEB), issued to non-residents by Indian companies, into shares of any company; and
iii. Conversion of preferences shares into equity shares of that company.

(vi) **Consolidation of mutual fund**

To promote consolidation of different similar scheme of transfer of mutual fund, Income Tax Act provides that consolidation of units shall not be treated as transfer.

(vii) **Lending of securities**

Under Securities Lending Scheme of SEBI, a person can lend his securities to a borrower through approved intermediary for a specified period with the condition that the borrower would return equivalent securities of the same type or class at the end of the specified period along with interest. The CBDT has clarified that any lending of scrips or security is not treated as transfer even if lender does not receive back same distinctive numbers of scrip or security certificate.[22] Hence, such transaction shall not be subject to capital gains tax.

(viii) **Rollover of fixed maturity plans**

Fixed Maturity Plans (FMP) are closed ended funds having a fixed maturity date wherein the duration of investment is decided upfront. The funds collected by FMPs

[22]Circular No. 751, dated February 10, 1997

are invested by the Asset Management Companies (AMCs) in securities having similar maturity period. To enable the FMPs to qualify as a long-term capital asset, some AMCs administering mutual funds offer extension of the duration of the FMPs to a date beyond 24 months from the date of the original investment by providing to the investor an option of roll-over of FMPs. The CBDT has clarified that the rollover of FMPs in accordance with the SEBI regulation will not amount to transfer as the scheme remains the same.[23] This was prevalent when listed debt mutual funds enjoyed treatment as long-term capital asset on completion of a certain period. In respect of schemes that invest 65% or more in debt or money market instruments, the gains are always treated as short term now due to the provisions of section 50AA. Hence this exemption is no longer relevant.

(ix) **Distribution in case of liquidation**

Any distribution of assets in kind by a company to its shareholders at the time of liquidation is not treated as transfer of asset by the Company. However, in this case, the shareholders are liable to pay tax on any capital gains arising there from in accordance with Section 46.

(x) **Conversion of Gold into Electronic Gold Receipt or vice versa**

Conversion of Gold into Electronic Gold Receipt (EGR) issued by a vault manager, or conversion of EGR into Gold**,** is not treated as transfer for the purpose of computing capital gain.[24]

Electronic Gold Receipt (EGR) is an electronic receipt which is issued based on the deposit of underlying physical gold in accordance with the regulations made by SEBI. EGR is covered under the definition of securities.[25]

Vault Manager means any person who stores and safe-keeps gold deposited by the depositor, for the purpose of trading in EGR and providing services incidental thereto.[26]

8.5 Computation of Capital Gains from Transfers

Any profit or gain arising from transfer of a capital asset is taxable on accrual basis during the previous year in which such transfer takes place. The mechanism for computation of capital gain from transfer of a short-term capital asset is different from the one applicable in case of long-term capital asset. In case of a long-term capital asset the indexation benefit is no longer available except as a parallel calculation to determine capital gains tax liability in respect of long-term capital gains arising from sale of land and building bought before July 23, 2024.

[23]Circular No. 6/2015, dated April 9, 2015
[24] Inserted by the Finance Act, 2023 with effect from assessment year 2024-25.
[25] Regulation 2(1)(h) of the SEBI (Vault Managers) Regulations, 2021 read with Notification No. S.O. 5401(E), dated 24.12.2021 issued in exercise of the powers conferred by Section 2(h)(iia) of section 2 of the Securities Contracts (Regulation) Act, 1956.
[26] Regulation 2(1)(l) and 2(1)(m) of SEBI (Vault Managers) Regulations, 2021.

1. In case of short-term capital gains

Particulars	*Rs.*
Full value of consideration	xxx
Less:	
a) Expenditure incurred wholly and exclusively in connection with transfer	(xxx)
b) Cost of acquisition	(xxx)
c) Cost of improvement	(xxx)
Short-term capital gain or loss	**Xxx**

2. In case of long-term capital gains

Particulars	*Rs.*
Full value of consideration	xxx
Less:	
a) Expenditure incurred wholly and exclusively in connection with transfer	(xxx)
b) Cost of acquisition	(xxx)
c) Cost of improvement	(xxx)
Long-term capital gain or loss	**xxx**

For computation of capital gains, an assessee has to compute various figures which have been explained below.

1. Full value of consideration

The Act has not defined the term 'full value of consideration'. Therefore, it has to be understood in commercial sense according to the prevalent usage. It is the amount of consideration received or receivable by the owner of asset in lieu of transfer of such assets. Such consideration may be received in cash or in kind. If it is received in kind, then fair market value of such assets is taken as full value of consideration.

However, in the cases explained below, the full value of consideration shall be calculated in contrast to the general principle enumerated above. (see Table 8.3)

Table 8.3: Calculation of full value of consideration in special cases

Nature of security	**Full value of consideration**
Conversion of capital asset into stock-in-trade	Fair market value of capital asset on the date of conversion.
Transfer of securities allotted under ESOPs as gift or under irrevocable trust	Market value of such securities on the date of transfer.
Redemption of rupee denominated bonds by non-resident	An amount equal to the value of appreciation of rupee against a foreign currency from the date of issue to the date of redemption shall be excluded for the purpose of computing the full value of consideration.
Unquoted shares transferred for less than its fair market value	Fair market value of such shares on the date of transfer.
Consideration Where the transfer is not ascertainable	Fair market value of asset on date of transfer.

2. Expenditure incurred in connection with transfer

Any expenditure, incurred wholly and exclusively, in connection with transfer of a capital asset is allowed as a deduction in computing capital gain. Thus, the brokerage or commission, stamp duty, registration fee, travelling expenses and legal expenses, etc., incurred in connection with transfer are allowed to be deducted in computing capital gain. However, no deduction is allowed in respect of any sum paid on account of Securities Transaction Tax (STT), Commodities Transaction Tax (CTT) while calculating the capital gains from sale of securities.

Whether Fees payable to Investment adviser is allowed as a deduction? – Most likely not allowed unless it is directly related to the specific asset and can be directly connected with the transfer (such as stamp duty or brokerage payable for the transfer).

3. Cost of acquisition

As a general principle, cost of acquisition of an asset is the value for which it was acquired by the assessee. It includes all expenses which are incurred by the assessee in acquiring the capital asset. However, in the following circumstances, the cost of acquisition of a capital asset shall be different from its actual cost (see Table 8.4):

Table 8.4: Calculation of cost of acquisition

Situation	Cost of Acquisition
Shares acquired by way of purchase on or after 01-04-2001	Price actually paid for acquisition (subject to certain exceptions, i.e., price as on January 31, 2018 in accordance with Section 112A, etc.)
Shares acquired on or before 31-03-2001	Price actually paid for the acquisition or Fair Market Value as on 01-04-2001, whichever is *higher*
Equity shares, units of equity oriented mutual fund or units of business trust (being long-term capital asset) chargeable to STT acquired on or before 31-01-2018 and sold after 01-04-2018	Higher of following: a) Actual cost of acquisition b) Fair Market value as on 31-01-2018 or full value of consideration, whichever is *lower*
Right Shares	Price actually paid for acquisition.
Renouncement of right	*Nil*
Bonus share	If bonus shares issued on or before 31-03-2001: Fair Market value of share as on 01-04-2001 If bonus shares issued on or after 01-04-2001: *Nil*
Sweat Equity Shares or shares allotted under ESOP	Fair Market Value of shares on the date of exercise of option which has been considered for perquisite valuation u/s 17(2)(vi).
Units of business trust allotted in consideration of transfer of shares of special purpose vehicle (SPV)	Cost of acquisition of shares of SPV.
Securities held in Demat form	Security that first entered into the Demat account is deemed to be the first sold out, and, accordingly, cost of acquisition is computed.

Situation	Cost of Acquisition
Conversion of bonds/ debentures/ debenture-stock/ deposit certificates into shares or debentures of that company	Cost of converted shares or debentures is taken at the price paid for the acquisition of original bonds, debentures or debenture certificate.
Shares of a company acquired on redemption of Global Depository Receipts (GDRs) by non-resident	Price of such share prevailing on any recognized stock exchange on the date on which a request for redemption of GDRs was made.
Conversion of preference shares to equity shares	Cost of acquisition of preference shares shall be deemed to be the cost of acquisition of equity shares.
Stock or share becoming property of the assessee on consolidation, conversion etc.	Cost of acquisition of the shares or stock from which such asset is derived.
Consolidation of mutual fund scheme or plan	Cost of acquisition of units held in consolidating scheme or plan.
Conversion of Gold into Electronic Gold Receipt (EGR)	Cost of acquisition of gold shall be considered as the cost of acquisition of such EGR.
Conversion of EGR into Gold	Cost of acquisition of EGR shall be considered as the cost of acquisition of such gold.
Segregation of portfolio of mutual fund	Amount which bears, to the cost of acquisition of a unit held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios. Further, the cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the cost of acquisition of units in the segregated portfolio.
Allotment of shares of amalgamated company in lieu of shares held in amalgamating company	Price paid for acquisition of shares in amalgamating company.
Shares acquired in resulting company in case of demerger	The cost of acquisition of shares held by the assessee in demerged company in proportion to the net book value of assets transferred in demerger bear to the net worth of the demerged company, immediately before the specified date of demerger.
Shares remained in demerged company after demerger	Cost of acquisition of the shares held by the shareholders in the demerged company is reduced by the cost of acquisition of shares, acquired from resulting company.
Cost of acquisition by operation of law i.e. on Partition of HUF, under a gift or will, by succession, inheritance or devolution, Transfer of property by a member to HUF	Cost of acquisition of previous owner. However, if such cost cannot be determined cost of acquisition will be the fair market value of such asset on the date on which such asset was acquired by previous owner.
Stock-in-trade converted into capital asset	Fair market value of stock on date of conversion.

4. *Indexed cost of acquisition*

As mentioned in previous paragraphs, the Finance Act, 2024 has made significant changes to capital gains chapter. Where a transfer of long-term capital has taken place before 23rd July, 2024, the benefit of indexation will be available on all asset class baring certain exceptions.

For any transfer of long-term capital asset on or after 23rd July, 2024, indexation benefit will not be available except for land or building or both acquired before 23rd July, 2024.

For this limited purpose, the concept of indexation is explained below:

Imagine a situation, where Mr. A has acquired a house in Mumbai out of inheritance from his father. His father had purchased the house for a sum of say Rs. 50,00,000 in the F.Y. 2002-03. The market value of that house, in present time has jumped manifold. It is now somewhere around Rs. 3.5 crore. Does this mean, the capital gain on sale of the house is Rs. 3 crore? Naturally, one would tend to think that appreciation in the price of house is due to several factors one of which is the inflation in the economy.

In order to nullify the effect of inflation while calculating capital gains, the Income Tax Act provides a facility to the tax payer in the form of Indexation. A Cost Inflation Index (CII) is notified by the Central Board of Direct Taxes (CBDT) every year.

The Indexed Cost of acquisition shall be calculated in a two-step process. The first step is to calculate the cost of acquisition of capital asset. In the second step, such cost of acquisition is multiplied by the CII of the year in which capital asset is transferred and divided by CII of the year in which asset is first held by the assessee or CII of 2001-02, whichever is later. (refer Annexure 3 for notified CII)

Indexed Cost of Acquisition	=	Cost of Acquisition	x	CII of the year in which asset is transferred / CII of the year in which asset is first held by assessee or CII of 2001-02, whichever is later

Applying this formula to our above illustration, the indexed cost of acquisition will be as follows:

$$\text{Rs. } 50{,}00{,}000 \times \frac{\text{CII of 2020-21}}{\text{CII of 2002-03}}$$

$$\text{i.e. } 50{,}00{,}000 \times \frac{301}{105} = \text{Rs. } 1{,}43{,}33{,}333$$

5. *Cost of improvement*

'Cost of Improvement' means all expenditure of a capital nature incurred on or after 01-04-2001 in making any addition or alterations to the capital asset either by the assessee or the previous owner. Therefore, all capital expenditure incurred on or after 01-04-2001 shall be deducted while calculating the capital gains. In case capital asset is acquired by the assessee before 01-04-2001, any cost of improvement incurred prior to 01-04-2001, shall be ignored.

The cost of improvement in relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing or right to carry on any business or profession shall be taken to be nil. Further, in relation to the Market Linked Debentures (MLDs) or Specified Mutual Funds (SMFs), the cost of improvement is not allowed to be deducted, notwithstanding whether it has been incurred by the assessee himself or by the previous owner.

However, cost of improvement shall not include such expenditure, which is deductible in computing the income chargeable under the head 'Income from House Property', 'Profits and Gains from Business or Profession', or 'Income from Other Sources'.

6. Indexed cost of improvement

The Indexed Cost of improvement shall be calculated in the same manner in which indexed cost of acquisition is computed.

8.5.1 Conversion of capital gain earned in foreign currency into Indian rupees

If any income accrues or arises to a resident or non-resident person in foreign currency, it shall be converted into Indian Rupees. The conversion shall be done as per the conversion rate as prevalent on the relevant dates.

For any other shares or debentures, the computation is as follows:

Where a non-resident assessee (except FII) acquires shares or debentures of an Indian company in foreign currency, the capital gain arising from the transfer of such shares or debentures shall be first computed in foreign currency, initially utilised in purchase of the securities, then it shall be converted into Indian currency. This provision of computation of capital gain shall be applicable in respect of capital gain accruing or arising from sale of every re-investment thereafter in shares or debentures of an Indian company. Also, the benefit of foreign currency conversion in the computation of capital gains will not be available to unlisted securities or shares of a closely held company transferred by a non-resident (except for non-residents choosing to be governed by special provisions of chapter XII-A)

Different provisions have been prescribed by Rule 115A for conversion of cost of acquisition, expenditure in connection with transfer and the capital gains and this provision shall apply to every re-investment of sale consideration into shares or debenture of an Indian company.

These provisions are explained below:

1. Sales Consideration

The sales consideration shall be converted at the average rate of foreign currency as on the date of transfer. Average rate is computed by dividing the aggregate of Telegraphic Transfer (TT) buying and selling rate as adopted by the State Bank of India (SBI).

2. Cost of Acquisition

The cost of acquisition shall be converted into foreign currency at the average rate of foreign currency as on the date of acquisition of share or debenture. Average rate is computed by dividing the aggregate of TT buying and selling rate as adopted by the SBI. In this case, the benefit of indexation shall not be available.

3. Expenditure in connection with transfer

The expenditure incurred wholly and exclusively in connection with transfer of the capital asset shall be converted at the average rate of foreign currency as on the date of transfer. Average rate is computed by dividing the aggregate of Telegraphic Transfer (TT) buying and selling rate as adopted by the State Bank of India (SBI).

4. Capital Gains

The resultant capital gains computed in foreign currency shall be re-converted into INR at TT buying rate of such currency on the date of transfer of the capital asset.

- *In case of other Capital Gains*

The capital gains arising to a resident or non-resident person in foreign currency shall be converted into Indian Rupees at the telegraphic transfer buying rate of such currency as it existed on the last day of the month immediately preceding the month in which the capital asset is transferred.

Example, if on May 15, 2022 an Indian resident transfers a plot of land situated in Dubai, the capital gains arising there from shall be converted into Indian Rupee at the rate of exchange as it existed on April 30, 2022

8.5.2 Tax rates on capital gains

As mentioned earlier, the Finance Act, 2024 has brought about significant changes to capital gains taxation chapter. Along with changes in the provisions of period of holding, there are amendments made in tax rates of short term and long-term capital gains.

The new provisions will be applicable for transfers on or after 23rd July, 2024.

Short term capital gains:

- Short term capital gains covered under section 111A of the IT Act will be taxed at the rate of 20%. Section 111A is applicable when there is transfer of equity shares, units of equity oriented mutual funds, equity oriented High Premium ULIPS or units of business trust, and such transaction is chargeable to Securities Transaction Tax (STT).

- All other short term capital gains will be taxed at applicable slab rates of the assessee.

Long term capital gains:

- Long term capital gains will be taxed at the rate of 12.5% in respect of all categories of assets.

- In case of transfer of listed equity shares, units of the equity-oriented fund, equity oriented high premium ULIPs or units of business trust where such transaction has suffered STT, long term capital gains exceeding Rs. 1,25,000 will be taxed at the rate of 12.5%.

- Long term capital gains in respect of immovable property held as long term capital asset:
    - In case of immovable property, one needs to check if the property was acquired before 23rd July, 2024. If such property is transferred also before 23rd July, 2024 itself, old provisions will apply i.e. it will be eligible for indexation and long-term capital gains will be taxed at the rate of 20%.

    - If such property is acquired before 23rd July, 2024 but transferred after this date, a parallel calculation has to be done taking indexation into account and if the tax payable (@20%) under that method is lower than 12.50% payable on the capital gains calculated without indexation then the calculation based on indexation will apply. Effectively, any loss calculated due to indexation will no longer be allowed.

    - Where such property is acquired after 23rd July, 2024, and transferred on any date which makes it long term capital asset, any long-term capital gains arising on such transfer will be chargeable to tax at the rate of 12.5% without any indexation benefit.

8.5.3 Exemption for capital gains

The Income Tax Act allows exemption from capital gains tax if the amount of capital gains or consideration, as the case may be, is further invested in specified new assets. These exemptions are available subject to certain key conditions. A summary of these provisions is given below: (see Table 8.5)

Table 8.5: Exemption for Capital Gains

Section	Type of Assessee	Type of original capital asset	Nature of original capital asset	Nature of new capital asset	Time-limit allowed for investment	Capital Gain Account Scheme (CAGS)	Amount of exemption
Section 54	Individual and HUF	Long-term Capital Asset	Residential House Property	Amount of capital gains to be re-invested in - . One Residential House in India If capital gains do not exceed INR 2 crore, new capital asset can be 2 houses instead of 1	*To Buy:* 1 Year before and 2 Years from the date of transfer *To Construct:* 3 Years from the date of transfer	Applicable	Lower of the following: - Rs. 10 crores - Aggregate of amount invested in new house property and deposited in capital gain account scheme
Section 54B	Individual and HUF	Short-term or Long-term	Agriculture land, used for agriculture for 2 years	Amount of capital gains to be re-invested in - Agriculture land	2 Years from the date of transfer	Applicable	Aggregate of amount invested in new agricultural land and deposited in capital gain account scheme
Section 54D	Any Assessee	Short-term or Long-term	Land or Building forming part of Industrial Undertaking used in business for 2 years, acquired by way of compulsory acquisition	Amount of capital gains to be re-invested in - Land or Building to shift or set up a new Industrial Undertaking	*To Buy or construct:* 3 Years from the date of compulsory acquisition	Applicable	Aggregate of amount invested in new land or building and deposited in capital gain account scheme
Section 54EC	Any Assessee	Long-term Capital Asset	Land or Building	Amount of capital gains to	6 months from the date of transfer	Not Applicable	Lower of the following:

Section	Type of Assessee	Type of original capital asset	Nature of original capital asset	Nature of new capital asset	Time-limit allowed for investment	Capital Gain Account Scheme (CAGS)	Amount of exemption
				be re-invested in - Bonds of NHAI or REC			- Rs. 50,00,000 - Amount invested in specified bonds
Section 54EE	Any Assessee	Long-term Capital Asset	Any Capital Asset	Units of notified Fund (no Notification has been issued yet)	6 months from the date of transfer	Not Applicabl e	Lower of the following: - Rs. 50,00,000 - Amount invested in notified funds
Section 54F	Individual and HUF	Long-term Capital Asset	Any Capital Asset other than residential house	Amount of net consideration to be re-invested in - One Residential House in India, subject to prescribed conditions	*To Buy:* 1 Year before and 2 Years from the date of transfer *To Construct:* 3 Years from the date of transfer	Applicabl e	Exemption is computed as per following formula: Eligible Investment * Long-term capital gain/Net sale consideration Note: The amount of eligible investment cannot exceed Rs. 10 crores.
Section 54G	Any Assessee	Short-term or Long-term	Specified assets of Industrial Undertaki ng in urban area	Amount of capital gains to be re-invested in - Assets of Industrial Undertaking in non-urban area	1 Year before and 3 Years from the date of transfer	Applicabl e	Aggregate of amount invested in new asset or transfer of establishmen t and deposited in capital gain account scheme

Section	Type of Assessee	Type of original capital asset	Nature of original capital asset	Nature of new capital asset	Time-limit allowed for investment	Capital Gain Account Scheme (CAGS)	Amount of exemption
Section 54GA	Any Assessee	Short-term or Long-term	Specified assets of Industrial Undertaking in urban area	Amount of capital gains to be re-invested in - Specified assets of Industrial Undertaking in SEZ	1 Year before and 3 Years from the date of transfer	Applicable	Aggregate of amount invested in new asset or transfer of establishment and deposited in capital gain account scheme
Section 54GB	Individual and HUF	Long-term Capital Asset	Residential Property, i.e., house or plot of land	Amount of net consideration to be re-invested in- Equity shares of eligible company or eligible start-up	*To Buy shares:* Before the due date for furnishing of return *To Buy new assets by the company:* Within 1 year from the date of subscription of shares	Applicable	Exemption is computed as per following formula: Investment in new asset by eligible company * Capital gain/Net sale consideration
Section 115F	Non-Resident Indian	Long-term Capital Asset	Shares of an Indian company, Debentures/Deposits of Indian Public Company or Government Securities purchased in foreign currency	Shares of an Indian company, Debentures/Deposits of Indian Public Company or Government Securities	6 months from the date of transfer	Not Applicable	Exemption is computed as per following formula: Investment in new asset * Capital gain/Net sale consideration

Note: As per Section 54H, if the transfer of original asset with respect to Section 54, 54B, 54D, 54EC and 54F occurs by way of compulsory acquisition and the consideration is not received on date of transfer, the timelines provided above shall be considered from the date of receipt of the consideration.

Example: Mr. A purchased a house on 14th April, 2011 for Rs. 1 crore. He sold the said house in December 2024 for Rs. 3 crore. He now intends to purchase a new house for Rs. 1.5

crore. The Cost Inflation Index for financial year 2011-12 was 184 and Cost Inflation Index for FY 2024-25 was 363. Compute his capital gains liability:

	Old provisions (Rs.)	**New provisions (Rs.)**
Sale consideration	3,00,00,000	3,00,00,000
Less: Cost of acquisition (for new provisions)		(1,00,00,000)
Less: Indexed cost of acquisition (for old provisions) (1,00,00,000 x 363 / 184)	(1,97,28,260)	
Long term capital gains	**1,02,71,740**	**2,00,00,000**
Exemption under section 54	(1,50,00,000)	(1,50,00,000)
Capital gains after exemption u/s 54	Nil	50,00,000
Tax payable @ 20% on indexed cost under old provisions	Nil	
Tax payable @ 12.5%		6,25,000

In this case, the lower of the tax payable under the old provisions and new provisions will be the final tax liability i.e. Nil in this example.

CHAPTER 9: INCOME FROM OTHER SOURCES

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Introduction to Income from Other Sources
- Dividend Income
- Interest on securities
- Gift of securities

9.1 Introduction

Any income, which is not exempt from tax and has to be included in the total income, shall be chargeable to tax under the head 'Income from other sources', if it is not chargeable to income-tax under other four heads of income, i.e. Salaries, Income from House Property, Profits and Gains from business or profession and Capital gains. However, there are certain incomes that are always taxable under the head 'income from other sources'.

Income taxable under the head 'income from other sources' shall be computed in the following manner:

Nature of Income	*Amount*
1. Dividend Income (including buy back proceeds received by shareholder from company on buy back of shares)	xxx
2. Winning from lotteries, etc.	xxx
3. Winning from online games (in the nature of lotteries, etc.)	xxx
4. Interest on securities**	
5. Rental income of machinery, plant or furniture**	xxx
6. Composite rental income from letting out of plant, machinery, furniture and building**	xxx
7. Sum received under Keyman insurance policy++	xxx
8. Interest on compensation or enhanced compensation	xxx
9. Advance money received in the course of negotiations for transfer of a capital asset which has been forfeited and negotiation do not result in transfer of such capital asset	xxx
10. Deemed Income in certain cases	xxx
11. Compensation on termination of employment or modification of terms of employment	xxx xxx
12. Sum received under a life insurance policy (other than ULIP and keyman insurance policy) in excess of the aggregate premium paid during the policy term	xxx
13. Specified sum received (other than interest/dividend from SPV and rental income from REITs) by a unitholder from a business trust	xxx
14. Any other income not taxable under any other head	xxx
Less: Attributable expenses	(xxx)
Income from other sources	**xxx**

** If such income is not chargeable to income-tax under the head "Profits and gains of business or profession".

++ If such income is not chargeable to income-tax under the head "Profits and gains of business or profession" or under the head "Salaries".

Income arising from securities which are always chargeable to tax under the head other sources are as follows:

a) Dividend income from securities;
b) Interest income from securities held as an investment;
c) Advance money received in the course of negotiations for transfer of a capital asset which has been forfeited and negotiation do not result in transfer of such capital asset;
d) Deemed Income in certain cases specified under section 56(2); and
e) Specified sum received by a unitholder from a business trust.

9.2 Dividend Income

Meaning of Dividend

Dividend usually refers to the distribution of profits by a company to its shareholders. However, certain receipts are also deemed as a dividend. The deemed dividend, as defined in Section 2(22) of the Income Tax Act, includes the following:

a) Distribution of accumulated profits to shareholders entailing release of the company's assets;
b) Distribution of debentures, debenture-stock, or deposit certificates to shareholders out of the accumulated profits of the company and issue of bonus shares to preference shareholders out of accumulated profits;
c) Distribution to shareholders of the company on its liquidation out of accumulated profits;
d) Distribution to shareholders out of accumulated profits on the reduction of its capital by the company;
e) Loan or advance by a closely held company to its shareholder out of accumulated profits; and
f) Payment made by company on buy back of its own shares from a shareholder in accordance to relevant provisions of Companies Act, 2013.

Scheme of Taxation

Upto Assessment Year 2020-21, domestic companies and mutual funds were liable to pay Dividend Distribution Tax (DDT) on dividend. Therefore, shareholders or unit-holders were exempt from paying tax on the dividend income (subject to certain conditions). After abolition of DDT by the Finance Act, 2020 with effect from Assessment Year 2021-22, if a company, mutual fund, business trust or any other fund distributes dividend to its shareholders or unit-holders then such dividend income is taxable in the hands of such shareholder or unit-holders under the head 'income from other sources' and will be taxable at applicable slab rate of the shareholder subject to residential status of the shareholders and quantum of income. In case of a non-resident shareholder, the provisions of Double Taxation Avoidance Agreements (DTAAs) and Multilateral Instrument (MLI) shall also come into play.

With effect from 1st October 2024, buy back proceeds received by shareholder shall be taxed as dividend under the head 'income from other sources'. No deduction for expenses shall be available from such dividend while determining the income from other sources. The cost of acquisition of shares which are bought back by the company will be treated as capital loss in the hands of the shareholder and will be eligible for set-off as per the applicable provisions.

Applicability of TDS provision

The tax is required to be deducted from dividend in accordance with Section 194 or Section 194K of the Act, as the case may be.

9.3 Interest on Securities

The income in the nature of interest on securities is taxable in the hands of the assessee under the head 'income from other sources'. This income is taxable as other sources if it is not in the nature of business income.

Meaning of 'interest on securities'

As per Section 2(28B) of the Income Tax Act, 'interest on securities' means:

a) Interest on any security of the central government or a state government;
b) Interest on debentures/other securities for money, issued by or on behalf of a local authority or a company or a corporation established by a central or state or provincial Act.

Meaning of 'securities'

As the word 'security' is not defined under the Income Tax Act. Therefore, the reference can be taken from Section 2(h) of the Securities Contracts (Regulation) Act, 1956. Thus, the interest on securities can arise from the following securities:

a) Bonds;
b) Debentures or debenture stock;
c) Security receipt;
d) Government securities;
e) Pooled investment vehicle.

Basis of charge

In view of Section 145 of the Income Tax Act, income in the nature of interest on securities shall be computed in accordance with the method of accounting regularly employed by the assessee. Two methods of accounting are allowed to be followed under the Income Tax Act, *namely*, the mercantile system and cash system. If assessee follows mercantile system of accounting, interest on securities is taxable on accrual basis. If he follows the cash system of accounting, it is taxable on receipt basis.

Interest exempt from tax

Section 10 of the Income Tax Act provides exemption to certain interest incomes. (refer *Annexure 2)*

*9.1-1.**Computation of taxable income***

The taxable income in the nature of interest on securities shall be computed in the following manner:

Particulars	*Amount*
Gross interest from securities	xxx
Less: Permissible deductions	
a) Collection charges	(xxx)
b) Interest on borrowings obtained to purchase securities	(xxx)
c) Any other revenue expenditure laid out or expended wholly and exclusively for the purpose of earning such income	(xxx)
Taxable income from securities	**xxx**

Taxability of income

If securities are held as stock-in-trade, any profit arising from the sale of securities is chargeable to tax under the head profits and gains from business or profession. If securities are held as an investment, any profit arising from the sale of such securities is chargeable to tax under the head capital gains.

Conversion of income from securities earned in foreign currency into Indian rupees

If any income from securities, earned in foreign currency, is taxable in India it shall be converted into Indian Rupees at SBI telegraphic transfer buying rate that existed on the last day of the month immediately preceding the month in which income is due. In case the income payable in foreign currency is subject to TDS, as per the provision of the Income Tax Act, the date of conversion will be date on which tax is required to be deducted.

Rate of tax

The interest shall be chargeable as per tax rates applicable to the assessee. However, in case of non-residents, certain interest incomes are taxable at concessional rates. (refer to Special tax rates section under Annexure 1)

9.4 Gift of Securities

Where any person receives a movable property from any person without consideration or for inadequate consideration, then the tax shall be chargeable in the hands of the recipient as income from other sources. However, no tax shall be charged if the aggregate amount of difference between the fair market value of properties received during the year and the amount of consideration paid in respect thereof, if any, does not exceed Rs. 50,000. The movable property, for this provision, shall include shares and securities.

9.4.1 Computation of income

Where shares and securities are received from any person without consideration, the whole of the aggregate fair market value of such properties received during the year shall be chargeable to tax if the aggregate fair market value thereof exceeds Rs. 50,000

Where shares and securities are received for inadequate consideration, the difference between the fair market value and consideration shall be chargeable to tax if the aggregate amount of difference between the fair market value of properties received during the year and consideration paid in respect thereof exceeds Rs. 50,000.

9.4.2 Computation of fair market value

The fair market value of share and securities is computed as per Rule 11UA of the Income Tax Rules, 1962. Rule 11UA prescribes the different method for computing the fair market value of quoted and unquoted shares and securities.

9.4.3 Cases when income is not chargeable to tax

Where shares and securities are received without consideration or for inadequate consideration, no tax shall be charged in the following cases:

Due to specified event

Income shall not arise under this provision if any sum of money or any property is received:

a) on the occasion of the marriage of the individual;
b) under a will or by way of inheritance;
c) in contemplation of death of the payer or donor;

Due to status of donor/payer

Income shall not arise under this provision if any sum of money or any property is received:

a) from any specified relative;

b) from any local authority;
c) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C);
d) from any trust or institution registered under section 12A/12AA/12AB;
e) from an individual by a trust created or established solely for the benefit of relative of such individual.

In case of HUF, every member of HUF will be treated as relative. However, in case of an individual, the following persons are treated as a relative for the purpose of this provision:

Husband/Wife	
Son/Daughter (Including Stepchild and Adopted child)	Daughter-in-Law/Son-in-Law
Father/Mother Step-father/mother	Mother-In-Law Father-In-Law
Brother (and his wife)/ Sister (and her husband) Half-brother/Sister	Brother-in-Law (and his wife) Sister-in-law (and her husband)
Grandfather Grandmother	Spouse's Grandfather Spouse's Grandmother
Grandson (and his wife) Granddaughter (and her husband)	Great Grandson (and his wife) Great Granddaughter (and her husband)
Great Grandfather Great Grandmother	Spouse's Great Grandfather Spouse's Great Grandmother
Father's Brother (Chacha – Tau) (and his wife) Father's Sister (Bua) (and her husband)	Mother's Brother (Mama) (and his wife) Mother's Sister (Mausi) (and her husband)
The following persons are not deemed as 'relatives' for this provision: a) Step-brother/sister b) Nephew/Niece c) Cousins	

Due to transactions not regarded as transfer

Income shall not arise under this provision if any sum of money or any property is received under the following transactions not regarded as transfer under Section 47:

a) Any distribution of capital assets on total or partial partition of a HUF. [Section 47(i)]

CHAPTER 10: TAXATION OF DEBT PRODUCTS

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Sources of income from debt products
- Types of Debt products
- Types of Mutual funds
- Tax liability of NRIs

Debt instruments are used by many entities to raise funds from the market. Debt instruments are similar to giving a loan to the issuing entity by the investor. The person holding the debt instrument of an entity would not hold any voting power or dividend claim. However, he is entitled to receive interest and redemption value at the time of maturity from the entity.

10.1 Sources of Income from Debt Products

Periodic income earned from debt instruments is classified as interest income. Whereas, the gain or loss arising from transfer or redemption of debt instruments is classified as capital gains and taxed as such.

10.1.1 Interest income

The income in the nature of interest on securities is taxable in the hands of the assessee under the head 'income from other sources' if the same is not taxable under the head business income.

As per Section 145 of the Income-tax Act, income chargeable to tax under the head 'income from other sources' or business income shall be computed in accordance with the method of accounting regularly employed by the assessee. Two methods of accounting are allowed under the Income-tax Act, *namely*, the mercantile system and cash system, whichever is regularly employed by the assessee. If the assessee regularly follows mercantile system of accounting, interest on securities is taxable on an accrual basis. If he regularly follows the cash system of accounting, it is taxable on a receipt basis.

Section 10 of the Income-tax Act provides exemption from certain interest income and, accordingly, no tax is charged thereon.

10.1.2 Capital gains

Gain or loss arising from transfer or redemption of any security including debt securities is chargeable to tax under the head capital gain if same is held by the assessee as a capital asset, that is, as an investment. Securities held by the foreign portfolio investors (FPIs) are always treated as a capital asset. Therefore, income arising from transfer or redemption of securities by FPIs shall always be taxed under the head capital gain. Tax on capital gain depends upon many factors such as nature of security, the period of holding, residential status of the assessee, etc.

10.2 Types of Debt Products

10.2.1 Coupon Bonds

Bonds are generally issued and redeemed at face value and carry interest which is paid to the investor over the tenure of the Bond. Thus, the principal features of a bond are maturity (i.e., tenure), coupon (i.e., interest), and principal (i.e., face value). In many cases, the name of the bond itself conveys the key features of a bond. Example, 7.4% CG Bond 2027 refers to a Central Government Bond maturing in the year 2027 and paying a coupon of 7.40%.

Coupon Bonds are the bonds which carry coupon rate and, thus, lender is entitled to periodic interest payments on such bonds.

The market value of a bond is determined by computing the present value of all future cash flows. Interest rate at which present value of future cash flows is determined is known as 'Yield-to-maturity'.

Tax on interest arising from bonds

Interest arising from bonds is taxable under the head other sources and generally taxable at a normal rate as applicable in case of an assessee. The assessee is allowed to deduct all expenditures laid out or expended wholly and exclusively to earn such interest income and the amount of commission or remuneration paid to a banker or any other person to realise such interest.

However, there are some cases where interest arising from bonds is chargeable to tax at concessional rate and no deduction (including deduction under sections 80C to 80U) is allowed from such interest income. (refer Annexure 1)

Example 1: Mr. A, a person resident in India, purchased 1,000 bonds of an Indian Company at Rs. 100 each on 01-01-2024. The face value, coupon rate and date of maturity of such bonds are as follows:

Face Value	Rs. 100 each
Coupon Rate	7.50% per annum
Date of Maturity	31-12-2029

The interest on bonds is paid half-yearly on June 30 and Dec 31 every year. Compute the amount of interest income chargeable to tax in the hands of Mr. A for the financial year 2024-25.

Answer*:* As per Section 145 of the Income Tax Act, income in the nature of interest on securities shall be computed in accordance with the method of accounting regularly employed by the assessee *namely*, the mercantile system and cash system.

The amount of interest on bonds chargeable to tax in the hands of Mr. A for financial Year 2024-25 shall be follows:

Particulars	Interest received	Interest chargeable to tax if Mr. A follows		Taxability arises in the financial year
		Mercantile System	Cash System	
Interest for the period Jan, 2024 to March, 2024 (received on June 30, 2024)	-	1,875	-	2023-24
Interest for the period April, 2024 to June, 2024 (received on June 30, 2024)	3,750	1,875	3,750	2024-25
Interest for the period July, 2024 to December, 2024 (received on December 31, 2024)	3,750	3,750	3,750	2024-25
Interest for the period Jan, 2025 to March, 2025 (received on June 30, 2025)	-	1,875	-	2024-25
Interest for the period April, 2025 to June, 2025 (received on June 30, 2025)	3,750	1,875	3,750	2025-26

Tax on long-term capital gain arising to a resident person from transfer or redemption of bonds

Where a person earns any profit or gains from transfer or redemption of bonds held as capital assets, it shall be chargeable to tax under the head capital gain. Taxability of capital gain arising from the transfer of bonds depends upon the nature of the bond, period of holding thereof and the status of assessee.

The period of holding in case of coupon bonds can be explained with the help of following table (see Table 10.1):

Table 10.1: Holding period of Coupon Bonds and tax rates thereon:

	Holding period to qualify as long term capital asset	Rate of tax
Listed bonds or debentures	12 months	Long term capital gains: 12.5% (without indexation benefit) Short term capital gains: applicable rates
Unlisted bonds or unlisted debentures or Market linked debentures	Not applicable	Irrespective of the period of holding, gains arising on transfer will be considered as short-term capital gains and will be taxed at applicable rates

The long-term capital gain in case of transfer of listed bonds shall be computed as under:

Particulars	*Rs.*
Full value of consideration (in case of transfer) or Redeemable Value (in case of redemption)	xxx
Less: a) Cost of acquisition	(xxx)
b) Expenditure incurred wholly and exclusively in connection with transfer	(xxx)
c)Exemption under Sections 54EE to 54F	(xxx)
Long-term capital gain or loss	**Xxx**

***Example 2**:* Mr. A purchased 400 listed bonds of ABC Ltd. at Rs. 1,200 each on 01-01-2016. The face value of the bond is Rs. 1,000. It carries a coupon rate of 7% per annum. The interest on bonds is paid half-yearly on June 30 and December 31 every year. The bonds are redeemable on 31-12-2026. However, Mr. A sold such bonds on 31-07-2024 at Rs. 2,000 each. Compute the amount of interest and capital gain chargeable to tax in the hands of Mr. A for the financial year 2024-25. Assume that Mr. A follows the mercantile system of accounting.

***Answer**:*

1. Computation of interest on bonds chargeable to tax for the financial year 2024-25

Particulars	*Amount*
Half yearly interest received on June 30, 2024 (400 * Rs. 1,000 * 7% * 6/12)	14,000
Interest accrued for the month of April 2024 to June 2024	7,000
Interest chargeable to tax for financial year 2024-25	**7,000**

2. Computation of capital gain chargeable to tax for financial year 2024-25

Computation of capital gain	
Period of holding (from 01-01-2016 to 31-07-2024)	8 years and 7 months
Nature of capital gain (held for more than 12 months)	Long-term capital gain
Full value of consideration (400 bonds * Rs. 2,000)	800,000
Less: Cost of acquisition (400 Bonds * Rs. 1,200)	(480,000)
Long-term capital gain	3,20,000
Tax rate on capital gain	12.50%

***Example 3**:* Suppose in the above Example 2, the bonds are unlisted.

***Answer**:*

The capital gains arising from unlisted bonds are always taxed as short-term capital gains irrespective of holding period. Hence the capital gains of Rs. 3,20,000 will be taxed at normal slab rates applicable to the tax payer.

Tax on long-term capital gain arising to a non-resident person from transfer or redemption of bonds

Tax on long-term capital gain arising to a non-resident person from transfer or redemption of listed bonds is always taxable at the rate of 12.50% and no benefit of indexation is allowed. The calculation of long-term capital gains as per foreign currency fluctuation is allowed in certain cases while computing the capital gain.

The relevant provisions of the Income Tax Act for taxability of long-term capital gain arising to a non-resident from the transfer of bonds are summarized in the following table (see Table 10.3):

Table 10.3: Long term Capital Gains Tax to NRIs

Section	Assessee	Particulars	Tax Rate
Section 115E	Non-resident Indian	Long-term capital gains arising from the transfer of Government securities or listed debentures of an Indian Public Company purchased in foreign currency	12.50% (without indexation and foreign exchange fluctuation benefit)
Section 112(1)(c)(iii)	Non-resident	Long-term capital gain arising from any unlisted security other than a bond or a debenture	12.50% (without indexation and foreign exchange fluctuation benefit)

Tax on short-term capital gain from bonds

Short-term capital gain arising from the transfer of bonds is generally taxable at normal rates as applicable in case of an assessee. Any capital gains arising on unlisted bonds or debentures or market linked Debentures (even if listed) shall always be taxed as short-term capital gains irrespective of holding period.

Example 4*:* Mr. A acquired 9% Listed Bond having face value of Rs. 10,000 on April 1, 2024, for Rs. 10,500. Such bond provides for quarterly payment of interest. After receiving interest for first 2 quarters, that is, quarter ending on June 30, 2024 and September 30, 2024, he transferred such bond on November 1, 2024 for Rs. 13,000 inclusive of interest accrued till the date of transfer.

Compute the amount of interest and capital gain chargeable to tax in hands of Mr. A

Answer*:*

Computation of interest income	
Particulars	*Amount*
Interest received for the quarter ending on 30-06-2024 (Rs. 10,000 * 9% * 1/4) [A]	225
Interest received for the quarter ending on 30-09-2024 (Rs. 10,000 * 9% * 1/4) [B]	225
Interest accrued till 31-10-2024 (Rs. 10,000 * 9% * 1/12) [C]	75
Total taxable interest income	**525**

Computation of capital gains	
Period of holding (from 01-04-2024 to 31-10-2024)	7 Months
Nature of capital gain (period of holding of less than 12 months)	Short term capital gain
Sales consideration [D]	13,000
Interest accrued but not received before the date of sale [E = C]	75
Adjusted sales consideration [F = D – C]	12,925
Less: Cost of Acquisition [G]	10,500
Short term capital gain [H = F - G]	2,425
Tax rate on capital gain	Applicable tax rate

10.2.2 Government Securities

A Government Security (G-Sec) is a tradable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. Securities which are issued for short term (i.e., with a maturity of less than 1 year) are usually called as treasury bills or cash management bills. Whereas, long term securities i.e., Government securities with a maturity of 1 year or more, are called Government bonds or dated securities. In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called as State Development Loans (SDLs).

G-Secs are considered as the safest investment instrument as they carry the Sovereign's commitment for payment of interest and repayment of principal. They carry practically no risk of default and, therefore, they are also called as risk-free gilt-edged securities. Investors have the option to hold G-Secs in a dematerialized account with a depository (NSDL/CDSL). This facilitates the trading of G-Secs on the stock exchanges. Thus, G-Secs can be sold easily in the secondary market to meet cash requirements.

Types of Government Securities

G-Secs are available in a wide range of maturities ranging from less than 91 days to as long as 40 years to suit the duration of varied liability structure of various institutions. Depending upon the maturity period, G-Secs are classified into the following types:

a) Cash Management Bills

Cash Management Bills (CMBs) are issued for a very short period usually less than 91 days. These are highly flexible bills and are issued as per the cash requirements of the Government. CMBs are issued at a discounted price to its investors and are redeemed at the face value.

b) Treasury Bills

Treasury Bills (T-Bills) are the short-term debt instruments which are issued at a discounted price by the Government of India. These bills are issued in 3 tenors, namely, 91 days or 182 days or 364 days. The maturity period of T-Bills doesn't exceed 1 year.

These bills do not offer any interest to its investors. The return on a T-Bill is the difference between the issue price and the redemption value being the face value.

c) Dated Government Securities (Dated G-Secs)

Dated G-Secs are the type of bonds issued by the RBI on behalf of the government which carry a fixed or floating coupon (interest rate) which is paid on the face value, on a half-yearly basis. Generally, the tenor of dated securities ranges from 5 years to 40 years.

d) State Development Loans

State Governments also raise loans from the market which are called as State Development Loans (SDLs). Like Dated G-secs, interest on SDLs is serviced at half-yearly intervals and the principal is repaid on the maturity date.

Taxability of Cash Management Bills and T-bills

Cash Management Bills and Treasury Bills (T-Bills) are issued for a maturity period of less than 1 year, and they do not offer any interest to the investor. The income of a person investing in such instruments is the difference between the issue price and the face value. Profit arising on redemption or transfer of these bills shall be considered as a short-term capital gain which shall be chargeable to tax at the rates applicable in case of an assessee.

Taxability of Dated G-Secs and SDLs

Dated Government securities (Dated G-Secs) and State Development Loans (SDLs) are issued in the form of bonds by Central Government and State Governments, respectively. The taxability of these securities shall be the same as in case of listed bonds, discussed earlier.

No tax is required to be deducted under section 193 from the payment of interest to a resident person in respect of securities of Central Government or State Government except in case of 8% Savings (Taxable) Bonds, 2003 and 7.75% Savings (Taxable) Bonds, 2018. Further, tax on interest paid in respect of 8% Savings (Taxable) Bonds, 2003 and 7.75% Savings (Taxable) Bonds, 2018 is required to be deducted by the payer only when the amount of interest paid during the year exceeds Rs. 10,000.

Example 9: XYZ Bank invested Rs. 50 lakh in Dated G-Secs on 01-01-2015. The bonds are not listed on any recognized stock exchange in India. The details regarding face value, issue price, coupon rate, date of maturity and number of bonds issued are as follows:

Face Value	Rs. 100 each
Issue price	Rs. 125 each
No. of Bonds issued	40,000
Coupon Rate	7.50% per annum
Date of Maturity	31-12-2027

The interest on bonds is paid half-yearly on June 30 and December 31 every year. The Bank transferred such bonds on 01-01-2025 at Rs. 150 each. Compute the amount of interest income and capital gain chargeable to tax in the hands of XYZ Bank for the financial year 2024-25.

***Answer**:*

1. Computation of interest on Dated G-Secs chargeable to tax for the financial year 2024-25

Particulars	*Amount*
Interest accrued for the month of April, 2024 to Dec, 2024 (40,000 * Rs. 100 * 7.50%* 9/12)	225,000
Interest chargeable to tax for financial year 2024--25	**225,000**

2. Computation of capital gain chargeable to tax for the financial year 2024-25

Computation of capital gain	
Period of holding (from 01-01-2015 to 31-12-2024)	10Years
Nature of capital gain	Always short term irrespective of holding period
Full Value of Consideration (40,000 bonds * Rs. 150 each)	60,00,000
Less: Cost of Acquisition (40,000 Bonds * Rs. 125)	50,00,000
Short term capital gains	10,00,000
Tax rate on capital gain	Applicable tax rate

10.2.3 Tax Free Bonds

As the name suggests, the tax-free bonds are the bonds which provide tax-free income. The interest paid on these bonds is tax-free in the hand of the investor. Section 10 of the Income Tax Act provides various exemptions for the income earned from bonds issued by various organizations.

However, the capital gains arising on transfer or redemption of tax-free bonds shall be chargeable to tax. The taxability of such capital gains is same as in the case of Coupon bonds.

Example 10: Mr. X is issued 5,000 tax free bonds of NABARD at the rate of Rs. 120 each in Year 00. The bonds are listed on recognized stock exchange in India and carrying the interest rate of 5% per annum. The bonds are redeemable in Year 02 at the rate of Rs. 150 each. Discuss the tax implications.

***Answer**:*

The tax implications in the hands of Mr. X shall be as follows:

1. Interest on bonds

Interest on tax free bonds is exempt under section 10 of the Income Tax Act. Thus, no tax shall be payable by Mr. X on interest income.

2. Capital gain arising on redemption of bonds

Capital gain arising on redemption of bonds shall be computed as follows:

Particulars	*Rs.*
Full value of consideration (Rs. 150 * 5000)	750,000
Less:	
Cost of acquisition (Rs. 120 * 5000)	(600,000)
Long-term capital gain	**1,50,000**
Tax rate	**12.50%***
***Note:** As bonds are listed on a stock exchange and the period of holding is more than 12 months, the resultant long term capital gain shall be chargeable to tax at the rate of 12.50%.*	

10.3 Mutual Funds

Mutual Funds are the funds which collect money from the investor and invest the same in the capital market. Mutual Funds invest in a variety of instruments such as equity, debt, bonds, etc.

10.3.1 Types of Mutual Funds

Mutual funds are classified into the following categories based on their investment portfolios:

a) Equity Oriented Funds

These funds invest majorly in shares of companies. They allow investors to participate in the equity market. Though categorised as high risk, these schemes also have a high return potential in the long run.

b) Debt Oriented Funds

These funds invest in debt securities, or interest-bearing instruments like government securities, bonds, debentures, etc. These funds provide low return but considered as safe for investment as compared to equity funds.

c) Money Market Funds or Liquid Funds

These funds invest in liquid instruments such as Treasury Bills and Commercial Papers, etc. having high liquidity. These funds are suitable for conservative investors who want to invest their surplus funds over a short-term for a reasonable return.

d) Balanced or Hybrid Funds

These funds invest in all kinds of assets, that is, equity, debt and money market instruments. Some funds invest their major portion into the equity and the lesser in the debts whereas some opt for the other way around based on their needs for return and risk appetite.

e) Gold fund or Silver fund: Invests in gold or silver.

f) International securities fund: Invests in International securities
g) Fund of Funds: Invest in other funds including all the funds mentioned from (a) to (f) above

Each of the fund types can be listed on the exchange and are referred as exchange traded funds (ETFs). In the case of ETFs, the buyers have to buy or sell the units on the stock exchange. For other mutual funds the investor has to buy or redeem through the Asset Management Company.

10.3.2 Tax on income from mutual funds

Mutual Funds offer investors two main sources of earnings: Capital Gains and Dividends (called as Income Distribution and Capital Withdrawal or IDCW option). The taxation of dividend incomes, from different types of mutual funds, are governed by common provisions under the Income Tax Act. However, the taxation of capital gains resulting from the transfer or redemption of mutual fund units depends on the type of fund.

Until Financial Year 2022-23, mutual funds were categorized into two types for taxation purposes: 1) Equity-oriented Mutual Funds and 2) Other Funds. However, with effect from Financial Year 2023-24 and subsequent amendments, mutual funds are now classified into four types for taxation purposes:

1) Equity-oriented Mutual Funds
2) Specified Mutual Funds (that invest 65% or more of the proceeds in debt or money market instruments, directly or indirectly, and are bought after April 1, 2023)
3) Specified Mutual Funds (mutual funds other than mentioned in 2 above, which invested less than 35% of the proceeds in equity shares of Indian companies directly and were bought after April 1, 2023 but sold before April 1, 2025) These typically include: debt-oriented hybrid mutual funds not covered by point 2 above, gold or silver funds, international securities funds or fund of funds bought and sold during the relevant period.
4) All Other Mutual Funds

In this chapter, we will focus on explaining the taxation provisions related to serial numbers 2, 3 and 4.

10.3.3 Tax on dividend from Mutual Funds

Dividend received by a resident unit-holder from a mutual fund shall be taxable in his hands as per applicable tax rates. An investor is allowed to claim a deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of the total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person to realise such dividend.

Where the dividend is received by a non-resident person, the dividend shall be taxable at 20% (subject to the provisions of the DTAA). However, in such cases, the assessee shall not be allowed to deduct any expenditure from such income. Further, deduction under Chapter VIA (i.e., section 80C to 80U) shall not be allowed from such income even under the old tax regime.

***Example 11**:* Mr. A (resident in India) invested Rs. 50 lakhs in debt oriented mutual funds. He received dividend of Rs. 500,000 in respect of such units. He paid interest of Rs. 150,000 on the amount borrowed for making investment in mutual funds. Determine the taxability of dividend in the hands of Mr. A. Also comment whether the taxability will remain same if Mr. A is a non-resident in India?

***Answer**:*

The amount of dividend income taxable in the hands of Mr. A shall be as follows:

Particulars	*Amount (in Rs.)*
Amount received as dividend [A]	500,000
Expenses incurred for realising dividend [B]	150,000
Maximum amount which can be claimed as expenses [C = A * 20%]	100,000
Taxable dividend income [D = A - C]	400,000

Since Mr. A is resident in India, dividend income will be taxable in his hands at the normal tax rates. However, if he is non-resident in India then he would not be allowed to claim deduction for expenses and entire dividend income of Rs. 500,000 shall be taxable at the rate of 20% (subject to the provisions of DTAA).

10.3.4 Tax on capital gain from Specified Mutual Funds (being a mutual fund that invests 65% or more of the proceeds in debt or money market instruments directly or indirectly and are bought after April 1, 2023)

The specified mutual fund (SMF) is a mutual fund where at least 65% of the total proceeds are invested in debt or money market instruments either directly or indirectly through another fund and has been bought after April 1, 2023. The taxation of capital gain from such SMF is governed by the provision of Section 50AA.[27]

Section 50AA applies prospectively to such SMFs acquired on or after 01-04-2023. This means the SMFs acquired on or before 31-03-2023 will be subject to taxation as per the normal provisions as applicable in the case of any other mutual fund (outlined in section 4.3.6 below). Section 50AA will not apply to such specified mutual funds acquired on or before 31-03-2023.

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute the capital gain arising from its transfer or redemption. However, as per Section 50AA, the capital gains arising from the transfer, redemption or

[27] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25 and amended by the Finance no 2 Act, 2024 with effect from Assessment Year 2026-27.

maturity of such SMFs shall be taxable as short-term capital gains irrespective of the period of holding.

The short-term capital gains from SMFs shall be computed in the following manner:

Particulars	*Rs.*
Full value of consideration	xxx
Less:	
(a) Cost of acquisition of units	(xxx)
(b) Expenditure incurred wholly and exclusively in connection with the transfer or redemption or maturity of SMFs	(xxx)
Short-term capital gain or loss	**xxx**

The short-term capital gain so computed shall be taxable at normal tax rates as applicable in the case of the assessee.

4.3.5 Tax on capital gain from Specified Mutual Funds (being any mutual fund other than mentioned in 4.3.4 above, which had invested less than 35% of the proceeds in equity shares of Indian companies directly and were bought on or after April 1, 2023, but sold before April 1, 2025)

These typically include: debt-oriented hybrid mutual funds, gold or silver funds, international securities funds or fund of funds bought and sold during the relevant period.

This is a very limited edition Specified Mutual Fund (SMF) that is applicable only during the relevant period as mentioned in the heading of this section. The taxation of capital gain from this limited edition Specified Mutual Fund is governed by the provisions of Section 50AA[28] and is same as 4.3.4, i.e. all gains are taxed as short-term capital gains at applicable rates.

10.3.5 Tax on capital gains from Other Mutual Funds

Long-term capital gain from Other Mutual Fund

The difference, between the value at which an investor purchased the units of a mutual fund scheme and the value at which these units are sold or redeemed, shall be taxable under the head capital gains.

Units of a such mutual funds which are listed are treated as a long-term capital asset if they are held for more than 12 months immediately preceding the date of transfer. Where the mutual fund is unlisted, the period of holding needs to be 24 months to qualify as long term capital asset.

Long-term capital gain arising from the transfer of such funds is chargeable to tax at the rate of 12.50%.

[28] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25 and amended by the Finance no 2 Act, 2024 with effect from assessment year 2026-27.

Short-term capital gain from Other Mutual Fund

Short-term capital gains arising from the sale of units of such mutual funds is chargeable to tax as per the rate applicable in case of an assessee.

Example 12: Mr. A acquired 1,000 units of a debt-oriented mutual fund at Rs. 150 per unit on 01-01-2017. He sold such units on 15-03-2025 at Rs. 300 per unit. Compute the amount of capital gain chargeable to tax in hands of Mr. A.

Answer:

Computation of capital gain	
Period of holding (from 01-01-2017 to 14-03-2025)	8+ Years
Nature of capital gain (period of holding is more than 24 months)	Long-term capital gain
Full Value of Consideration (1,000 units * Rs. 300)	300,000
Less: Cost of Acquisition	(1,50,000)
Long-term capital gain	**1,50,000**
Tax rate on capital gain	**12.50%**

10.4 Taxation of Non-residents

Non-residents are generally exposed to double taxation due to tax liability in two or more countries. Consider a case of Mr. A who is non-resident in India and resident of USA. He derives interest income of Rs. 10,00,000 from debentures held in India. Under normal provisions of the Indian Income Tax Act, 1961, his interest income will be taxed as per his slab rates. Since he is a resident of USA, he will be taxed again in USA. This can put him in adverse position affecting his returns on investment.

In order to avoid this, the countries all over the world, including India, have entered into Double Taxation Avoidance Agreements (DTAAs) with other countries. Accordingly, where a non-resident is eligible for DTAA benefits, he will be taxed at a rate mentioned in the relevant DTAA or the Income Tax Act, whichever is more beneficial to him.

In the given example, as per Article 11 of the India-USA DTAA, interest income in the hands of Mr. A will be taxed at a concessional rate of 15%. Also, Mr. A will be eligible for tax credit in USA to the extent of Indian taxes paid.

The income tax rates in case of various incomes may be different for non-residents. For instance, dividends on shares are taxed at normal slab rates for resident individuals. In case of non-residents, the tax rate on dividends from shares is 20% (plus applicable surcharge and cess).

For instance, in the above example, consider that Mr. A also has dividend income of Rs. 220,000 from shares of Indian companies. The tax rate as per the Indian Income Tax Act is 20%. The tax rate as per the India-USA DTAA is 25%. Since the rate as per the Income Tax Act is lower, Mr. A can opt for tax rate under Income Tax Act i.e. 20%.
Now, if Mr. A is a tax resident of UK rather than USA - In that case, the India-UK DTAA provides a rate of 10%. Here, Mr. A can opt for rate as per the said DTAA.

In order to claim any relief under the DTAAs, the non-resident will be required to obtain Tax Residency Certificate (TRC) of the country of its residence. In addition to TRC, the non-resident payee also needs to furnish Form 10F which is a self-declaration giving prescribed details.

In case of Non-resident individuals who are Indian citizens or Persons of Indian Origin, they also have an option to avail the provisions of chapter XII-A of the Income Tax Act which provide concessional rate of tax.

The relevant provisions of Chapter XII-A are given below:

- Available to Indian Citizens or Persons of Indian Origin who are non-resident under the Indian Income Tax Act. For the purposes of this chapter, an individual shall be considered as Person of Indian origin if he, or either of his parents or any of his grand- parents, was born in undivided India.
- Investments should be made in convertible foreign exchange while being non-resident.
- Eligible Investments:
    - Shares in an Indian Company
    - Debentures and Deposits in an Indian company which is not a private company under the Companies Act
    - Certain Government securities
- No indexation benefit is available.
- Tax on Investment income is capped at 20% (plus applicable surcharge and cess) and long-term capital gains is at 12.50% (plus applicable surcharge and cess).
- Where the assessee, while he is a non-resident Indian, transfers the above-mentioned assets and re-invests the whole or part of the net consideration within a period of six months in the above-mentioned assets, the long-term capital gains arising out of the same can be claimed as exempt as follows:
    - Where entire net consideration is re-invested, the whole of the long-term capital gains is exempt
    - Where a part of the net consideration is re-invested, the proportionate amount of long-term capital gains will be exempted
- In case the new asset so purchased, is transferred within three years from the date of acquisition, the capital gains which were claimed exempted earlier, will be taxed in the year when the new asset is so transferred.
- The assessee can opt to be taxed at 20% on investment income related to Debentures & deposits in non-private companies and government securities even after he becomes a resident in India. He can exercise such option in the return of income.
- As long as he remains non-resident, he can choose not to be governed by the provisions of this chapter.

Finance Act 2021 brought in amendments to address the mismatch in taxation of income from notified overseas retirement fund:

Earlier, non-residents, who later on settle down in India, used to face a typical issue of double taxation in case of their overseas retirement funds. Earlier the withdrawal from such funds was taxed on receipt basis in such foreign countries, while on accrual basis in

India. In order to address this mismatch and remove this genuine hardship, section 89A to the Act was inserted to provide that the income of a specified person from specified account shall be taxed in the manner and in the year as prescribed by the Central Government. Section 89A defined the expression - specified person, as a person resident in India who opened a specified account in a notified country while being non-resident in India and resident in that country. Specified account is defined as an account maintained in a notified country which is maintained for retirement benefits and the income from such account is not taxable on accrual basis and is taxed by such country at the time of withdrawal or redemption. The countries notified so far are: United States of America, Canada and United Kingdom. For Indian residents, the income from the specified retirement accounts in these countries will be taxed at the time of withdrawal of funds from those retirement accounts and not on accrual basis.

10.5 Taxation of Market Linked Debentures

Market Linked Debentures (MLDs) are financial instruments regulated in India by various laws and regulations.[29] These debentures differ from traditional fixed-income investments as their returns are not fixed, instead linked to the performance of an underlying market index or security. The movement of the underlying asset determines the returns on MLDs. MLDs can be of two types: 1) Principal Protected MLDs and 2) Principal Non-Protected MLDs.

Principal Protected MLDs guarantee the return of the investor's principal amount at maturity, regardless of the underlying asset's performance. Whereas, Principal Non-Protected MLDs do not guarantee the return of the principal amount at maturity. The coupon rates vary based on the performance of the underlying asset.

The key features of MLDs are as follows:

(a) Computation of Coupon Rate: The returns on MLDs are variable and depend on the performance of the underlying index or security. If the underlying asset performs well, the MLDs will provide a higher return at maturity, but if it performs poorly, the returns may be lower or result in a loss of principal.

(b) Issuers and Investors: MLDs can be issued by companies with a minimum net worth of Rs. 100 crores. Investors, typically high-net-worth individuals (HNIs) or ultra HNIs, can invest in MLDs.

(c) Tenure and Repayment: The maximum tenure for MLDs is generally between 12 to 36 months. Unlike traditional debentures that provide periodic interest payments, MLDs offer returns only upon maturity, comprising the principal sum plus earned interest.

10.5.1 Tax on income from MLDs

Upto Financial Year 2022-23, income from market-linked debentures was taxable similarly to regular debentures or coupon bonds. However, with effect from the Financial Year 2023-

[29] SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, SEBI Circular No. SEBI/HO/DDHS/P/CIR/2021/613, dated 10-08-2021, Section 71 of the Companies Act, 2013 and Income-tax Act, 1961

24, a new section 50AA is inserted under the Income Tax Act, which governs the taxability of income arising from MLDs held as capital assets.

Section 50AA defines MLD as a security which has an underlying principle component in the form of debt security and where the returns are linked to the market returns on other underlying securities or indices and includes any security classified or regulated as an MLD by SEBI.

MLDs transferred, redeemed or matured on or after 01-04-2023 shall be subject to taxation under Section 50AA, even if such MLDs were issued or acquired before that date.

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute the capital gain arising from its transfer or redemption. However, as per Section 50AA, the capital gains arising from the transfer, redemption or maturity of MLDs shall be taxable as short-term capital gains irrespective of the period of holding.

The short-term capital gains from MLDs shall be computed in the following manner:

Particulars	*Rs.*
Full value of consideration	xxx
Less:	
(c) Cost of acquisition of MLDs	(xxx)
(d) Expenditure incurred wholly and exclusively in connection with the transfer, redemption, or maturity of MLDs	(xxx)
Short-term capital gain or loss	xxx

The short-term capital gain so computed shall be taxable at normal tax rates as applicable in the case of the assessee.

10.6 Benefits not allowed from capital gain arising from Market Linked Debentures (MLDs) or the 2 types of Specified Mutual Funds (SMFs) (mentioned in 4.3.4 and 4.3.5) under Section 50AA

No benefit of period of holding

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute capital gain. However, irrespective of the period of holding, the capital gains arising from the transfer, redemption or maturity of MLDs or SMFs shall be taxable as short-term capital gains.

No deduction for the cost of improvement

In relation to the MLDs or SMFs, the cost of improvement shall be taken to be nil, notwithstanding whether it has been incurred by the assessee himself or by the previous owner.

10.7 Summary of Taxation of Debt Products

[Sale assumed to be after July 23, 2024]

Product	***Period of holding to qualify for long-term capital asset (in months)***	***Tax on short-term capital gain***			***Tax on long-term capital gain***	
		In case of resident	*In case of non-resident*		*In case of resident*	*In case of non-resident*
Sovereign Gold Bond (Listed) *[Note 1]*	12	Normal tax rate	Normal tax rate		12.50%	12.50
Any other Bond (Listed)	12	Normal tax rate	Normal tax rate		12.50%	12.50%
Any other Bond (Unlisted)	Not applicable	Normal tax rate	Normal tax rate		-	-
Treasury Bills (T-Bills)	-	Normal tax rate	Normal tax rate		-	-
Dated Government Securities (Dated G-Secs) (Listed)	12	Normal tax rate	Normal tax rate		12.5%	12.5%
Dated Government Securities (Dated G-Secs) (Unlisted)	NA	Normal tax rate	Normal tax rate			
Municipal Debt Securities (listed)	12	Normal tax rate	Normal tax rate		12.50%	12.50%
Debentures (Listed)	12	Normal tax rate	Normal tax rate		12.50%	12.50%
Debentures (Unlisted)	-	Normal tax rate	Normal tax rate		Normal Tax rate	Normal Tax rate
Market Linked Debentures (MLDs)	-	Normal tax rate	Normal tax rate		Normal tax rate	Normal tax rate
Specified Mutual Funds (SMFs) Type 1 *[Note 2 and 3]*	-	Normal tax rate	Normal tax rate		Normal tax rate	Normal tax rate
Specified Mutual Funds (SMFs) Type 2 *[Note 2 and 3]*	-	Normal tax rate	Normal tax rate		Normal tax rate	Normal tax rate
Other Mutual Funds *[Note 2]*	24 / 12	Normal tax rate	Normal tax rate		12.50%	12.50%

Note 1: Capital gain arising to an Individual on redemption of Sovereign Gold Bond shall not be chargeable to tax under section 47 of the Income-tax Act. The rates mentioned are only for capital gains arising from sale other than on redemption.

Note 2: A resident shareholder is allowed deduction of interest expenditure incurred to earn dividend income from specified or debt-oriented mutual funds to the extent of 20% of total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend. However, a non-resident person, shall not be allowed to deduct any expenditure from dividend income. Further, deduction under Chapter-VIA (i.e., section 80C to 80U) shall not be allowed from such income.

Note 3: Specified Mutual Funds (Type 1) are those which invest more than 65% in debt and money market instrument. Specified Mutual Funds (Type 2) are those that have invested less than 35% in equity shares, purchased after April 1, 2023 and sold before April 01, 2025.

CHAPTER 11: TAXATION OF EQUITY PRODUCTS

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Tax treatment for Listed and Unlisted Equity Shares
- Taxation of Preference Shares/Share Warrants
- Taxation of Equity Oriented Mutual Funds
- Tax treatment for Derivatives
- Bonus Stripping

The equity market, often called a stock market or share market, is a place where shares of companies or entities are traded. The market allows sellers and buyers to deal with equity shares and other securities on the same platform. Equity share represents the ownership of a person in the company. Equity investments are generally considered as risky as compared to debt instruments. There are many types of equity-related products available in the market, but they are not the same. Tax rules applicable to these products also differ. Taxes can reduce the overall returns that an investor gets from a product. Thus, it is important to understand the taxability of equity products before making an investment therein.

11.1 Sources of Income

An equity investment generally refers to the buying and holding of shares by an investor in anticipation of the return of income. Two types of income are earned from investment in the equity products - Capital gains and Dividend Income. Capital Gains arise when a capital asset is sold at a price higher than its cost of acquisition. The dividend is the sum paid by the company out of its profits to shareholders which, in turn, reduce the retained profits of the company.

Taxability of both types of incomes has been discussed in detail in the forthcoming paragraphs of this chapter.

11.1.1 Dividend Income

Dividend usually refers to the distribution of profits by a company to its shareholders. The dividend is paid by a company out of its profits. Thus, a share of profit received by a shareholder out of the profits of the company, proportionate to his shareholding, is termed as ‘Dividend’.

Dividend declared at an annual general meeting is deemed to be the income of the previous year of the shareholder in which it is declared. The date of receipt by the assessee is not material. The interim dividend is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the shareholder. In other words, it is chargeable to tax on receipt basis.

The tax treatment of the dividend in the hands of shareholders depends on whether the dividend is received from a foreign company or a domestic company.

Tax on dividend

After the abolition of dividend distribution tax by the Finance Act, 2020 with effect from Financial Year 2020-21, if a company, mutual fund, business trust or any other fund distributes dividend to its shareholders or unit-holders then such dividend income is taxable in the hands of such shareholder or unit-holders. The taxability of dividend and tax rate thereon shall depend upon the residential status of the shareholders and quantum of income. In case of a non-resident shareholder, the provisions of Double Taxation Avoidance Agreements (DTAAs) and Multilateral Instrument (MLI) shall also come into play.

11.1.2 Capital Gains

Any profit or gain arising from the sale of a 'capital asset' is chargeable to tax as a capital gain.

Income from Capital Gains is computed as under:

Particulars	*Amount*
Full Value of Consideration	xxx
Less:	
a) Expenses incurred wholly and exclusively in connection with transfer	(xxx)
b) Cost of Acquisition/	(xxx)
c) Cost of Improvement/	(xxx)
Less:	
Exemption under Sections 54 to 54GB to the extent of the net result of above calculation	(xxx)
Short-term or Long-term Capital Gains	**xxx**

The capital gains from the sale of equity shares can be either long-term capital gains or short-term capital gains depending upon the period of holding of capital assets. This distinction is important as the incidence of tax is higher on short-term capital gains as compared to the long-term capital gains. Generally, the period of holding of a capital asset is calculated from the date of its purchase or acquisition till the date of its transfer.

Rate of tax on capital gains differs according to the nature of capital gain. Long-term capital gains are taxable at concessional rates of 12.50%. Short-term capital gains are generally added to total taxable income and are chargeable to tax as per tax rate applicable according to the status of the assessee. However, in a few cases, short-term capital gains are also taxable at concessional rate of 20%

In this chapter, we will discuss the tax treatment of capital gains arising from the following equity products:

i. Listed Equity Shares
ii. Unlisted Equity Shares
iii. Preference shares
iv. Share warrants
v. Equity Oriented Mutual Funds
vi. Equity Derivatives

11.2 Listed Equity Shares

Equity shares represent ownership of a person in a company. Any company offering its shares to the public for subscription is required to be listed on the stock exchange and has to comply with the conditions as provided in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (commonly known as SEBI (ICDR), Regulations).

Listing of securities with stock exchange is a matter of great importance for companies and investors because this provides the liquidity to the securities in the market. The two major stock exchanges of India in which shares of a company can be listed are Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

11.2.1 Charges & Taxes

Various taxes and charges are payable to purchase and sell equity shares through stock exchanges, which have been explained below.

Brokerage

Brokerage is charged by the share broker who maintains the share trading account of the investor. The amount of brokerage depends upon the broker and nature of the order placed.

Security Transaction Tax (STT)

The securities transaction tax is a tax levied on sale/purchase of securities (other than debt securities or debt mutual fund). Every recognised stock exchange or trustee of a mutual fund or lead merchant banker (in case of IPO) is required to collect the STT from purchaser or seller of the securities, as the case may be, and, subsequently remitt the same to the Central Government. STT collected during a calendar month is required to be paid to the Central Government by 7th day of the month immediately following the said calendar month.

Stamp Duty

Stamp duty is levied for transferring shares and securities from one person to another. Stamp duty is levied by States, thus, the rate of duty varies from state to state. However, with effect from April 1, 2020, stamp duty are levied at unified rates across India in respect of listed securities. The same rate applies even in case of off-market transactions.

Exchange Charges

This charge is levied by the stock exchanges of India. Transaction charges are levied on both sides of the trading and are same for both intraday and delivery.

SEBI Turnover Charges

Securities Exchange Board of India (SEBI) is the security market regulator, which forms rules and regulations for the stock exchanges. Turnover charge of Rs. 10 per crore is levied by SEBI for regulating the markets. This charge is levied on both sides of transaction, i.e., while buying and selling.

Depository Participant (DP) Charges

NSDL (National Securities Depository Limited) and CDSL (Central Depository Services Limited) are two stock depositories in India. The depositaries hold shares and securities in electronic form on behalf of the shareholder and facilitate exchange thereof between buyer and seller. When a person buys shares, such shares are credited in DEMAT account of that person and when he sells such shares to someone else, they are debited from his DEMAT account. Depositories levy a charge plus GST (irrespective of quantity) for this facility on the day the securities are debited from DEMAT Account.

The depository participants form the bridge between the investors and the depository as investors cannot directly approach the depository. Therefore, the depository charges fee from the depository participant and who in turn, charge the investors.

Goods and Services Tax (GST)

It is levied on the amount of brokerage, exchange transaction charges and clearing charges. At present, the GST is charged at the rate of 18% on the amount of brokerage, transaction and clearing charges.

11.2.2 Tax on dividend

Dividend received by a resident shareholder is taxable in his hands at the applicable rates. A resident shareholder is allowed a deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend.

Where the dividend is received by a non-resident person or foreign company (including foreign portfolio investors (FPIs) and Non-resident Indian Citizens), the dividend shall be taxable in their hands at special rates, subject to provisions of DTAA. However, no expenditure shall be allowed to be deducted from such income. Further, deduction under Chapter-VIA, *that is*, Sections 80C to 80U, shall not be allowed from such income.

As per DTAA, dividend income is generally chargeable to tax in the source country as well as the country of residence of the assessee and, consequently, country of residence provides a credit of taxes paid by the assessee in the source country. Thus, the dividend income shall be taxable in India as per provisions of the Act or as per relevant DTAA, whichever is more beneficial.

As per most of the DTAAs India has entered into with foreign countries, the dividend is taxable in the source country in the hands of the beneficial owner of shares at the rate ranging from 5% to 15% of the gross amount of the dividends.

11.2.3 Some important aspects

Period of holding

The tax treatment of gains or losses arising from the sale of listed equity shares depends upon whether the gains are long-term or short-term. Shares which are listed on the recognised stock exchange in India are treated as a short-term capital asset if they are held for not more than 12 months immediately preceding the date of transfer. In other cases, they are treated as long term capital assets.

Securities held in Physical Form

If listed shares or securities are sold through brokers, the date of the broker's note is treated as date of transfer, provided the contract is followed up by delivery. Thus, the period of holding should be counted from the date of purchase to the date of the broker's note.

In case the transaction takes place directly between the parties and not through the stock exchange, the date of the contract of sale as declared by the parties is treated as the date of transfer, provided it is followed by the actual delivery of shares and the transfer deeds.[30]

Securities held in Demat Form

As per Section 45(2A) the period of holding of securities held in Demat Form shall be determined as per First-In-First-Out (FIFO) Method.[31] It implies that the securities that first entered into the Demat account are deemed to be the first to be sold out. In other words, the securities acquired last will be taken to be remaining with the assessee while securities acquired first will be treated as sold. For determining the period of holding, the contract note or Broker's note shall be considered provided such transactions are followed by delivery of shares and transfer deeds.

In the depository system, the investor can open and hold multiple accounts. In such a case, where an investor has more than one security account, FIFO method will be applied account-wise. This is because where a particular account of an investor is debited for sale of securities, the securities lying in his other account cannot be construed to have been sold as they continue to remain in that account.

[30]Circular No. 704, dated 28.04.1995
[31]Circular No. 768, Dated June 24, 1998

If in an existing account of Demat stock, the old physical stock is dematerialized and entered at a later date, under the FIFO method, the basis for determining the movement out of the account is the date of entry into the account.

Example 1:

Date of credit in Demat account	*Date of purchase*	*Particulars*	*Quantity*
1-6-2020	25-05-2020	Purchased directly in Demat Form	2,000
5-6-2020	01-11-2005	Shares certificates Dematerialized	5,000
10-6-2020	10-6-2020	Purchased directly in Demat form	4,000
15-6-2020	01-05-2001	Shares certificates Dematerialized	3,000

If 2,500 shares are sold from this account, then the cost of acquisition of first 2,000 shares shall be calculated from 25-5-2020, whereas the balance 500 shares will be treated as having been acquired on November 1, 2005, at the relevant cost. This is the effect of the FIFO method.

11.2.4 Tax on long-term capital gains as per section 112A

Earlier the long-term capital gains arising from the sale of listed equity shares were exempt under section 10(38) of the Income Tax Act. In Finance Act, 2018, the long-term capital gains arising from the sale of listed equity shares were made taxable. Such long-term capital gain is chargeable to tax at different rates depending upon the year of acquisition and the payment of STT.

Rate of tax

As per the Finance Act 2024, where the total income of the assessee includes long-term capital gain arising from transfer of listed equity shares, no tax shall be charged on such long-term capital gain if the aggregate amount of such gain during the year is upto Rs. 1,25,000. If the amount of capital gain exceeds Rs. 1,25,000 then the excess amount shall be chargeable to tax at concessional rate of 12.50% (plus applicable surcharge and cess) under section 112A of the Income Tax Act. However, this section applies only when securities transaction tax is paid at the time of acquisition and at the time of transfer of equity shares except in the following cases:

Exception 1: Transaction undertaken on a stock exchange located in IFSC

The condition of payment of STT shall not be applicable if the transfer is undertaken on a recognised stock exchange located in an International Financial Services Centre (IFSC). This concession is available only when the consideration for such transaction is received or receivable in foreign currency.

Exception 2: If STT is not paid at the time of acquisition

The benefit of the concessional tax rate is available in case of transfer of equity shares if STT is chargeable both at the time of transfer and at the time of acquisition of shares. The CBDT[32] has relaxed this condition of payment of STT at the time of acquisition in the following scenarios:

a) Shares are acquired before 1-10-2004;
b) The acquisition has been approved by the Supreme Court, High Court, NCLT, SEBI or RBI;
c) The acquisition by any non-resident is in accordance with FDI guidelines issued by the Government of India;
d) The acquisition is done by an Investment Fund or Venture Capital Fund or a Qualified Institutional Buyer;
e) The acquisition is done through a preferential issue to which SEBI (Issue of Capital and Disclosure Requirements) Regulations does not apply;
f) The acquisition is done through an issue of share by a company;
g) The acquisition of shares is made by the scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;
h) The acquisition is done under the ESOP or ESPS scheme framed under SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999
i) The acquisition of shares is made as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;
j) The acquisition is made from the Government; and
k) The acquisition is made by mode of transfer referred to in Section 47 or Section 50B or Section 45(3) or Section 45(4) of the Income Tax Act, if the previous owner or transferor of such shares has acquired shares by any of the modes given in this list.

Cost of acquisition of shares acquired on or before 31-01-2018

The Finance Act 2018 grand-fathered the investments made on or before 31-01-2018 as the long-term capital gains arising from the sale of equity shares chargeable to STT were previously exempt from tax. The concept of grandfathering under this provision works as per the following mechanism.

If equity shares were acquired on or before 31-01-2018, the cost of acquisition of such shares or units shall be higher of the following:

a) The actual cost of acquisition of equity shares; or
b) *Lower* of the fair market value of such asset as on 31-01-2018 or full value of the consideration received as a result of the transfer of equity shares.

In case of listed equity shares, the highest price of share quoted on a recognized stock exchange as on 31-01-2018 is taken as the fair market value. If there is no trading in such share on such exchange on 31-01-2018, the highest price of such share on a date

[32]Notification No. 60/2018, dated 01-10-2018

immediately preceding 31-01-2018 when such share was traded shall be the fair market value.

However, the fair market value of the following equity shares will be the cost of acquisition indexed by the cost inflation index of financial year 2017-18 and divided by the cost inflation index of the year in which the shares were acquired or the FY 2001-02. whichever is *later*:

(a) Shares are not listed on recognised stock exchange on 31-01-2018 but listed on such exchange on the date of transfer; or
(b) Shares listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31-01-2018 by way of transaction not regarded as transfer under Section 47.

In general, cost of acquisition of the bonus shares are taken to be *nil*, however, if bonus shares are complying with the conditions prescribed in section 112A, the cost of acquisition shall be computed in the manner described above.

Let's understand how to compute long-term capital gains with the help of the following examples.

Scenario 1: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 200 on 31-01-2018 and it is sold on 01-01-2025at Rs. 250.

As the actual cost of acquisition is less than the fair market value as on 31-01-2018, the fair market value of Rs. 200 will be taken as the cost of acquisition and the long-term capital gain will be Rs. 50 (Rs. 250 - Rs. 200).

Scenario 2: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 200 on 31-01-2018 and it is sold on 01-01-2025 at Rs. 150.

In this case, the actual cost of acquisition is less than the fair market value as on 31-01-2018. However, the sale value is also less than the fair market value as on 31-01-2018. Accordingly, the sale value of Rs. 150 will be taken as the cost of acquisition and the long-term capital gain will be *nil* (Rs. 150 - Rs. 150). In other words, grandfathering cannot result in a long-term capital gain turning into a long-term capital loss, just because the sale price is lower than the fair market value as on 31-01-2018, but higher than the original cost of acquisition.

Scenario 3: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 50 on 31-01-2018 and it is sold on 01-01-2025 at Rs. 150.

In this case, the fair market value as on 31-01-2018 is less than the actual cost of acquisition, and therefore, the actual cost of Rs. 100 will be taken as the actual cost of acquisition and the long-term capital gain will be Rs. 50 (Rs. 150 - Rs. 100).

Scenario 4: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 200 on 31-01-2018 and it is sold on 01-01-2025 at Rs. 50.

In this case, the actual cost of acquisition is less than the fair market value as on 31-01-2018. The sale value is less than the fair market value as on 31-01-2018 and also the actual cost of acquisition. Therefore, the actual cost of Rs. 100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be Rs. 50 (Rs. 50 - Rs. 100) in this case.

Cost of acquisition of shares acquired on or after 01-02-2018

The cost of acquisition of equity shares, which are acquired on or after 01-02-2018, shall be computed as per general principles of Section 55, i.e., the actual cost for which it is acquired by the assessee.

11.2.5 Tax on long-term capital gain as per section 112

Long-term capital gains arising from the sale of equity shares that are not covered under section 112A (listed Equity shares) are taxable at the same rate of 12.50% under section 112. Long term capital gains on Listed equity shares satisfying the conditions mentioned in section 112A (primarily that securities transaction tax has been paid both on acquisition and sale or transaction is undertaken in foreign currency on a recognized stock exchange located in an IFSC) pay the same rate of tax @12.50% but with the first Rs. 1.25 lakh not being charged in that case.

11.2.6 Tax on short-term capital gains as per section 111A

Short-term capital gains arising from the sale of listed equity shares satisfying the conditions mentioned there (primarily that securities transaction tax has been paid both on acquisition and sale or transaction is undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre) is chargeable to tax at concessional rate of 20% if the transaction is chargeable to Securities transaction tax or transaction is undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre.

However, no deduction under Sections 80C to 80U shall be allowed from short-term capital gains covered under section 111A.

11.2.7 Tax on normal short-term capital gain

Short-term capital gain arising from the sale of equity shares is chargeable to tax at normal rates as applicable in case of an assessee if it is not taxable at the concessional rate of 20% under section 111A. This case arises if conditions specified under Section 111A aren’t satisfied.

Tax treatment of Listed Equity Shares is enumerated in the below table (see Table 11.1):

Table 11.1: Capital Gains Tax on Listed Equities

Nature	***Rate of Tax (If STT is paid)***	***Rate of Tax (If STT is not paid)***	
Long Term	12.50% with the first Rs. 1.25 lakhs not being taxed		12.50%
Short Term	20%		As per applicable rate of tax

Rate of surcharge on the capital gains arising from the transfer of listed equity shares by an Individual, HUF, is enumerated in the below table.

Total Income	*Capital gains covered under Section 112, 112A and 111A*	*Other Income*
Up to Rs 50 lakhs	Nil	Nil
Rs 50 lakhs – Rs 1 crore	10%	10%
Rs 1 crore – Rs 2 crore	15%	15%
Rs 2 crore – Rs 5 crore	15%	25%
Above Rs 5 crore	15%	25% if opts for new tax regime of Section 115BAC otherwise 37%

Example 3: Mr. X (resident in India) made investment in equity shares of the following listed companies:

Company	*No. of shares*	*Date of Purchase*	*Purchase cost (Per share)*
ABC Ltd.	1,000	01-06-2023	Rs. 105
XYZ Ltd.	1,500	01-10-2023	Rs. 120

During the Financial Year 2024-25, he sold the shares as follows:

Company	*No. of shares*	*Date of sale*	*Selling price (Per share)*
ABC Ltd.	1,000	24-07-2024	Rs. 107
XYZ Ltd.	1,000	01-08-2024	Rs. 135

Answer:

The computation of capital gain from sale of shares by Mr. X during the financial year 2024-25 shall be as follows:

Particulars	*ABC Ltd.*	*XYZ Ltd.*

Date of Purchase	01-06-2023	01-10-2023
Date of sale	24-07-2024	01-08-2024
Period of holding	13 + Months	10 Months
Nature of Capital Gain	Long term capital gains	Short term capital gains
Full Value of Consideration [A]	Rs. 107,000 (1,000 shares * Rs. 107)	Rs. 135,000 (1,000 shares * Rs. 135)
Cost of Acquisition [B]	Rs. 105,000 (1,000 shares * Rs. 105)	Rs. 120,000 (1,000 shares * Rs. 120)
Amount of capital gain [A-B]	Rs. 2,000	Rs. 15,000
Tax rate	12.50% under Section 112A (on capital gains in excess of Rs. 1.25 lakhs). So, if these are the only long-term capital gains chargeable under section 112A then there will be no long-term capital gains tax payable.	20% under Section 111A

11.3 Tax Treatment of Unlisted Equity Shares

Unlisted shares or unquoted shares are the shares which are not listed on any recognised Stock Exchange in India. The tax treatment of gains or losses arising from the sale of unlisted equity shares depends upon whether the gains are long term or short term. Unlisted shares of a company are treated as short-term capital asset if they are held for not more than 24 months immediately preceding the date of transfer; whereas, if the shares are held for more than 24 months then long-term capital gain arises.

11.3.1 Tax on dividend from unlisted shares

The taxability of dividend income arising from unlisted equity shares shall be same as in case of listed equity shares.

11.3.2 Tax on long-term capital gains from unlisted shares

Long-term capital gains arising from the sale of unlisted equity shares shall be taxable at the rate of 12.50% *plus* surcharge and health & education cess

Where unlisted equity shares are offered for sale under an initial public offer (IPO), gain arising therefrom shall be chargeable to tax in accordance with the provisions contained under Section 112A.

11.3.3 Tax on short-term capital gains from unlisted shares

Short-term capital gain arising from the transfer of unlisted shares shall be taxable at the normal rate as applicable in case of an assessee.

Example 4*:* If in Example 3, shares of ABC Ltd. and XYZ Ltd. are not listed on a stock exchange. Will there be any difference in tax implications in the hands of Mr. X?

Answer:
Unlisted shares are treated as long-term capital asset if they are sold after holding for a period of more than 24 months. Whereas, capital gain arising from transfer of listed shares is treated as long-term capital gain if they are sold after holding for more than 12 months.

As shares of ABC Ltd. and XYZ Ltd. were sold within 24 months, the resultant capital gain shall be taxable as short-term capital gains. Further, as the shares are not listed on a stock exchange, the short-term capital gain shall be taxable at normal slab rate.

11.4 Tax Treatment of Preference Shares

Preference shares are those shares which carry certain special or priority rights. The preference share-holders get a right of fixed dividend, whose payment takes priority over ordinary dividends. Capital raised by the issue of preference shares is called preference share capital.

Preference share capital, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right to:

a) Payment of dividend, either as a fixed amount or at a fixed rate, and
b) Repayment in the case of a winding-up or repayment of capital specified in the memorandum or articles of the company.

11.4.1 Tax on dividend from preference share

The taxability of dividend income arising from preference shares shall be same as in case of equity shares.

11.4.2 Tax on long-term and short-term capital gain from preference share

	Holding period to qualify as long term capital asset	**Rate of tax**
Listed shares	12 months	Long term capital gains: 12.50% Short term capital gains: applicable rates
Unlisted shares	24 months	Long term capital gains: 12.50% Short term capital gains: applicable rates

Example 5: Mr. X (resident in India) acquired 1,000 preference shares of ABC Ltd. at Rs. 105 each on 01-07-2018. The shares are listed on a stock exchange. He transferred such shares on 25-07-2024 at Rs. 120 per share. Compute the amount of capital gain chargeable to tax in hands of Mr. X.

Answer:

As the preference shares are listed on a stock exchange and transferred by Mr. X after holding for more than 12 months, the gain arising from transfer shall be treated as long-term capital gain and will be taxed at 12.50%.

The computation of capital gain shall be as follows:

Particulars	*Calculation*
Full Value of Consideration [A]	Rs. 1,20,000 (1,000 shares * Rs. 120)
Cost of Acquisition [B]	Rs. 1,05,000 (1,000 shares * Rs. 105)
Indexed Cost of Acquisition [B]	-
Capital gain/loss [A-B]	Rs. 15,000
Tax rate	12.50%
Tax	Rs. 1,875

11.5 Tax Treatment of Shares Warrants

Share warrant is an option issued by the company which gives the warrant holder a right to subscribe to equity shares at a pre-determined price on or after a pre-determined time period.

Stock warrant is issued with a "strike price" and an expiration date. The strike price is the price at which the warrant becomes exercisable, that is, the price at which warrant holder is entitled to subscribe for equity shares of the company. As per Regulation 13 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR), the warrant holder is required to pay at least 25% of the strike price upfront. The tenure of share warrants shall not exceed 18 months from the date of their allotment in the IPO or Right Issue or FPO, as the case may be.

In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within 3 months from the date of payment of full consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

In case of share warrants, the following transactions are possible:

a) Conversion of share warrants into shares
b) Transfer of share warrants to another person
c) Forfeiture of the share warrant

11.5.1 Tax on conversion of share warrants into shares

The conversion of share warrants into shares shall be treated as a transfer of share warrants. The resultant capital gains arising from such transfer will always be treated as short-term capital gains if the share warrant is listed and has been converted within 12 months. If the conversion is done after 12 months it will be treated as long-term capital gains. The short-term capital gains shall be excess of the full value of consideration arising from such conversion over the strike price of share warrant. In view of Section 50D of the

Income Tax Act, the full value of consideration is the fair market value of shares on the date of conversion of warrants into shares.

The short-term capital gains shall be taxable as per applicable tax rates. The long-term capital gains will also be calculated in the same way but will be taxed at 12.50%.

11.5.2 Tax on transfer of share warrants

The transfer of share warrants to another person shall be treated as a transfer of a capital asset. The resultant capital gains arising from such transfer will always be treated as short-term capital gains if the share warrants are listed and are transferred within 12 months. They will be treated as long term if the transfer is done after 12 months. The short-term capital gains shall be excess of the full value of consideration arising from such transfer over the upfront payment or price paid for share warrant. The full value of consideration is the sum received from the buyer of the warrant.

The short-term capital gains shall be taxable as per applicable tax rates. Long term capital gains from listed share warrants will also be calculated in the same manner except that it will be taxed at 12.50%.

Forfeiture of premium paid for share warrants

In case a warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within 3 months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer. The loss arising from such forfeiture of the premium will have no tax treatment and it will be ignored for calculation of taxable income.

Example 7: ABC Ltd. issued 1,00,000 warrants of Rs. 200 each aggregating to Rs. 2 crores to Mr. X on 29-12-2023. Share warrants are exercisable into equal number of equity shares of face value of Rs. 10 each. The warrants are listed on the stock exchange. The company received a sum of Rs. 50 lakh from Mr. X towards 25% subscription against the said warrants on the same date.

What shall be the tax implications in the hands of Mr. X in the following scenarios?

(1) Mr. X exercised warrants and paid the entire consideration of Rs. 2 crore to ABC Ltd. on 29-03-2025. On the same day, the company allotted 1,00,000 equity shares of face value of Rs. 10 each to Mr. X at a premium of Rs. 190 per share. The fair market value of the share on date of allotment was Rs. 250 share.
(2) Mr. X transferred share warrants to Mr. Y on 15-08-2024 for Rs. 75 per warrant.

Answer:

The tax implications in the hands of Mr. X shall be as follows:

Scenario 1: Tax on conversion of share warrants into shares

The conversion of share warrants into shares shall be treated as a transfer of share warrants. The resultant capital gains arising from such transfer will be deemed as long-term capital gains. As the period of holding exceeds 12 months. The computation of long-term capital gain arising on conversion of share warrants into shares shall be as follows:

Particulars	*Amount*
Period of Holding	***15 months***
Full value of consideration (FMV of shares on the date of allotment)	Rs. 2,50,00,000 (100,000 shares* Rs. 250)
Less: Cost of Acquisition (strike price of share warrants)	Rs. 2,00,00,000 (100,000 warrants * Rs. 200)
Long-term capital gain	50,00,000
Tax rate	12.50%

Scenario 2: Tax on transfer of share warrants

The transfer of share warrants to another person shall be treated as a transfer of a capital asset. The resultant capital gains arising from such transfer will be short term as the warrants have been held for less than 12 months. The computation of short-term capital gain arising on transfer of share warrants shall be computed as follows:

Particulars	*Amount*
Period of Holding	*7 -8 months*
Full Value of Consideration (sale price of share warrants)	Rs. 75,00,000 (100,000 warrants * Rs. 75)
Less: Cost of Acquisition (i.e., upfront payment made for share warrants)	50,00,000
Short-term capital gain	25,00,000
Tax rate	Normal Slab Rate

11.6 Tax Treatment of Mutual Funds

Mutual funds are the funds which collect money from the investor and invest the same in the capital market for their benefit. Mutual funds invest in a variety of instruments such as equity, debt, bonds, etc. Investments of a mutual fund are managed by the Asset Management Company through fund managers.

All the mutual funds are registered with the SEBI and they function within the provisions of strict regulation created to protect the interests of the investor.

Before understanding, taxation aspects of Mutual Funds, it is important to understand a few terms which are used in the Mutual Fund industry.

Equity Oriented Funds

'Equity Oriented Fund' means a fund set up under a scheme of a mutual fund specified under clause (23D) of section 10 or under a scheme of an insurance company comprising unit-linked insurance policies to which exemption under clause 10(10D) does not apply on account of the applicability of *fourth and fifth proviso* (i.e., high premium ULIP) and:

a) In a case where the fund invests in the units of another fund which is traded on a recognised stock exchange, at least 90% of the total proceeds of such fund is invested in the units of such other fund and such other fund also invests at least 90% of its total proceeds in equity shares of domestic companies listed on a recognised stock exchange; and
b) In any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange.

The percentage referred above shall be computed with reference to the annual average of the monthly averages of the opening and closing figures. Additionally, in case of high premium ULIPs, the requirement of investing in equity products needs to be fulfilled throughout the term of the policy.

Fund of Funds

Fund of Funds (FoF), as the name suggests, is a mutual fund scheme that invests in other schemes of mutual funds. These funds create a portfolio of other mutual funds. The portfolio is designed to suit investors across risk profiles and financial goals. The diversification of funds helps in reducing the risks to a certain extent.

Equity Linked Savings Scheme

Equity Linked Saving Scheme (ELSS) is a category of mutual funds that encourage long-term equity investments. Through the ELSS, the Government sought to improve equity participation by allowing tax-deductible investment in equity-based mutual funds. ELSS helps the investors to save Income-tax, that's why they are also known as tax-saving funds. The Income Tax Act allows a deduction under section 80C to the extent of Rs. 1.5 lakh in respect of investment made in ELSS, if the assesee opts for the old tax regime.

ELSS funds invest a large percentage of their portfolio in the equity shares. They have a compulsory lock-in period of 3 years, which is the shortest amongst all tax-saving instruments.

Systematic Investment Plan

Systematic Investment Plan (SIP) is a mutual fund tool and is one of the easiest ways through which any common man can enter the stock market. It is an investment strategy wherein an investor needs to invest some amount of money in a particular mutual fund at every stipulated time period, say, once a month or once a quarter. To understand the concept of SIP, one can compare it with recurring deposit with the bank where one puts in a small amount every month.

Systematic Withdrawal Plan

Systematic Withdrawal Plan (SWP) is used to redeem the investment from a mutual fund scheme in a phased manner. SWP is the opposite of SIP. SWP pays investors a specific amount of payout at a pre-determined time intervals, like monthly, quarterly, half-yearly or annually. Mutual Fund SWPs' provide the assurance of paying a fixed amount. Choosing the SWP helps investors customize their cash flow as per need. The capital gain arising on the withdrawals is taxable.

Systematic Transfer Plan

Systematic Transfer Plan (STP) allows the investor to transfer amount from one scheme to another scheme of the same mutual fund house. An STP transfers a fixed amount of money from one mutual fund to another. STPs can only transfer money between two mutual fund schemes of the same Asset Management Company (AMC).

11.6.1 Taxation of Mutual Funds

Mutual Funds offer investors two main sources of earnings: Capital Gains and Dividends. The taxation of dividend income from different types of mutual funds is governed by common provisions under the Income Tax Act. However, the taxation of capital gains resulting from the transfer or redemption of mutual fund units depends on the type of fund.

Until Financial Year 2023-24, mutual funds were categorized into two types, for taxation purposes: 1) Equity-oriented Mutual Funds and 2) Other Funds. However, with effect from Financial Year 2023-24 and amendments made thereafter, mutual funds are now classified into four types, for taxation purposes: 1) Equity-oriented Mutual Funds, 2) Specified Mutual Funds (Type 1) [schemes that invest 65% or greater directly or indirectly in money market or debt market products and which are bought on or after April 1, 2023] 3) Specified Mutual Funds (Type 2) [not being those referred to in (2) earlier; which invested less than 35% directly in domestic equity and were bought on or after April 1, 2023 but sold/redeemed before April 1, 2025] , and 4) Other Mutual Funds.

In this chapter, we will focus on explaining the taxation provisions related to Equity-oriented Mutual Funds only.

- ***Tax on dividend from equity-oriented mutual funds***

Dividends received by a resident unit-holder from a mutual fund shall be taxable in his hands as per applicable tax rates. An investor is allowed to claim a deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of the total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person to realise such dividend.

Where dividend is received by a non-resident person or foreign company, it shall be taxable in their hands at a special rate of 20% (10% if received from IFSC unit) *plus* surcharge & cess, subject to provisions of DTAA.

- ***Tax on long-term capital gains from equity-oriented mutual funds covered under section 112A***

Capital gain refers to the difference between the value at which an investor purchased the units of a mutual fund scheme and the value at which these units are sold or redeemed. Units of Equity Oriented Fund are treated as a long-term capital asset if they are held for more than 12 months immediately preceding the date of transfer.

Tax on long-term capital gain arising from the transfer of equity-oriented mutual funds depends on payment of securities transaction tax (STT) at the time of transfer. If STT is paid at the time of transfer then no tax shall be payable if the amount of capital gain earned during the year does not exceed Rs. 1,25,000. Where the amount of capital gain exceeds Rs. 1,25,000 then the excess amount shall be chargeable to tax at concessional rate of 12.50%. The condition of payment of STT at the time of transfer shall not be applicable if the transaction of sale of units is undertaken on a recognised stock exchange located in an International Financial Services Centre (IFSC) and the consideration for such transfer is received or receivable in foreign currency.

Cost of acquisition of units of equity oriented mutual funds acquired on or before 31-01-2018

The Finance Act 2018 grandfathered the investments made on or before 31-01-2018 as the long-term capital gains arising from the sale of units of listed equity oriented mutual funds were previously exempt from tax. The concept of grandfathering under this provision works as per the following mechanism.

If units of equity oriented mutual funds were acquired on or before 31-01-2018, the cost of acquisition of such units shall be higher of the following:

(a) The actual cost of acquisition of units of equity oriented mutual funds; or
(b) *Lower* of the fair market value of such asset as on 31-01-2018 or full value of the consideration received as a result of the transfer of units of equity oriented mutual funds.

The highest price of units quoted on a recognized stock exchange as on 31-01-2018 is taken as the fair market value. If there is no trading in such units on such exchange on 31-01-2018, the highest price of such units on a date immediately preceding 31-01-2018, when such units were traded, shall be its fair market value. In case such unit is not listed on a recognised stock exchange as on 31-01-2018, the net asset value of such unit as on the said date shall be treated as its fair market value.

Example 8: Mr. A (resident in India) acquired 5,000 listed units of an equity oriented mutual fund on 01-05-2017 for Rs. 200 per unit. He sold the units on 01-08-2024 for Rs. 300 per unit through the recognised exchange and paid STT on such transaction. The FMV of the units as on 31-01-2018 was Rs. 225 per unit. Compute the amount of income arising to Mr. A from transfer of units of equity oriented mutual funds and tax thereon.

Answer*:*

Particulars	*Amount*
Period of holding (from 01-05-2017 to 31-07-2024)	87 Months
Nature of capital gain (period of holding is more than 12 months)	Long term capital gain
Sale price (5,000 * Rs. 300 per unit)	Rs.15,00,000
Cost of acquisition [Note 1]	Rs. 11,25,000
Long term capital gain	Rs. 3,75,000
Tax rate†	12.50%
† The amount of capital gain in excess of Rs. 125,000 shall be chargeable to tax at concessional rate of 12.50% as per section 112A.	

Note 1: As the units were acquired by Mr. A on or before 31-01-2018, the cost of acquisition of such units shall be *higher* of the following:

(a) The actual cost of acquisition of units of equity oriented mutual funds, *that is*, Rs. 10,00,000 (5,000 units * Rs. 200); or
(b) *Lower* of the FMV of such asset as on 31-01-2018, *that is*, Rs. 11,25,000 (5,000 units * Rs. 225) or full value of the consideration received as a result of the transfer of units of equity oriented mutual funds, *that is*, Rs. 15,00,000 (5,000 units * Rs. 300)

Thus, the cost of units shall be Rs. 11,25,000.

Cost of acquisition of units of equity oriented mutual funds acquired on or after 01-02-2018

The cost of acquisition of units of equity oriented mutual funds, which are acquired on or after 01-02-2018, shall be computed as per general principles of Section 55, *that is*, the actual cost for which it is acquired by the assessee.

- ***Tax on long-term capital gains from equity-oriented mutual funds not covered under section 112A***

If STT is not paid at the time of transfer of equity-oriented mutual funds then tax shall also be charged at the rate of 12.50%. Further, capital gain shall be computed after taking the benefit of indexation.

- ***Tax on short-term capital gain from equity-oriented mutual fund***

Short-term capital gains arising from the sale of units of equity-oriented mutual funds are taxable at the rate of 20% if securities transaction tax is paid at the time of sale of such securities. However, the condition of payment of STT at the time of transfer shall not be applicable if the transfer is undertaken on a recognised stock exchange located in an International Financial Services Centre (IFSC) and the consideration for such transfer is received or receivable in foreign currency. Further, no deductions under chapter-VIA (i.e. deduction under Section 80C to 80U) shall be allowed from such income.

In case STT is not paid at the time transfer of equity-oriented mutual funds then short-term capital gain shall be chargeable to tax at normal rates as applicable in case of an assessee.

Example 9: Mr. X (resident in India) purchased 10,000 units of equity oriented mutual funds at the rate of Rs. 250 each per unit on 01-04-2021 through a recognised stock exchange. He had taken loan of Rs. 20,00,000 to purchase such units. He paid Rs. 1,60,000 as interest on such loan during the year. He received dividend of Rs. 50 per unit on 15-08-2024. Thereafter, he sold the units for Rs. 280 per unit on 01-09-2024 through a recognised stock exchange and paid STT on such transaction. Discuss the tax implications in the hands of Mr. X.

Answer:

Computation of dividend income	
Particulars	*Amount*
Number of units [A]	10,000
Dividend declared per unit [B]	Rs. 50
Total dividend received [C=A * B]	Rs. 500,000
Interest paid to earn dividend [D]	Rs. 160,000
Maximum deduction allowable [E = C * 20%]	Rs. 100,000
Income taxable as dividend income [C - E]	Rs. 400,000
Tax rate	Normal slab rate
Computation of capital gains	
Particulars	*Amount*
Period of holding (from 01-04-2021 to 31-08-2024)	41 Months
Nature of gains (period of holding is more than 12 months)	Long term capital gain
Sale price (10,000 units * Rs. 280)	Rs. 28,00,000
Less: Cost of acquisition (10,000 units * Rs. 250)	Rs. 25,00,000
Long term capital gain	Rs. 3,00,000
Tax rate on capital gain†	12.50%
†As STT has been paid at the time transfer of units, capital gain shall be chargeable to tax at the rate of 12.50% under section 112A of the Income Tax Act, 1961. The tax shall be charged on the amount of capital gain exceeding Rs. 125,000.	

11.7 Tax Treatment of Derivatives

Derivatives are the financial product whose value is derived from an underlying asset. The value of the derivative would replicate the value of the said asset. An equity derivative is a class of derivatives whose value is derived from one or more underlying equity securities. Trading in derivatives, popularly known as Future and Options (F&O), is quite popular among investors who invest in the stock market.

In the case of derivatives, the transactions are ultimately settled without the actual delivery of underlying security or index. These derivative transactions are not treated as speculative if transactions are carried in a recognised stock exchange through a stock-broker or such other intermediary registered with SEBI. Further, the contract note issued by such broker or intermediary to the client should indicate the unique client identity number and PAN of the client and should be time-stamped.

11.7.1 Types of Derivative Contracts

Commonly used derivatives are Futures, Options, Forwards and Swaps. These are briefly defined below:

Futures Contract

A 'futures contract' is a contract for buying or selling underlying security or index or commodity, on a future date, at a price specified today, and entered into through a formal mechanism on an exchange. The terms of the contract are specified by the exchange. Futures Contract or 'futures' are standardized and traded on a futures exchange thus counterparty risk if any is taken care of by the exchange mechanism. Underlying assets can be a commodity, stock, currencies, etc.

Options Contract

An 'option' is a contract that gives the right, but not an obligation, to buy or sell the underlying security or index on or before a specified date, at a stated price. An option contract gives the right, but not an obligation to do something in future. The buyer of the option contract is required to pay an upfront fee called option premium. There are two types of options:

(a) **Call option** which gives the right but not an obligation to buy an asset by a certain date for a certain price;
(b) **Put option** gives the right but not an obligation to sell an asset by a certain date for a certain price.

Forward Contracts

It is a contract between two parties, wherein settlement takes place on a specified date in future at an agreed price. Each contract is customized and unique in terms of contract size, expiry and asset type and quality. Thus, forward contracts are known as OTC (Over-the-counter) between parties without the exchange mechanism.

Swaps

These are private agreements between parties to exchange cash flows in the future according to a pre-arranged formula. They can be regarded as portfolios of forward contracts. The two commonly used swaps are:

a) ***Interest rate swaps*****:** It entails swapping only in the interest related cash flows between parties in the same currency like floating rate with a fixed rate of interest;
b) ***Currency swaps:*** These entail swapping both principal and interest between the parties, with the cash flow in two different currencies.

Currency Derivatives

Currency derivatives are exchange-based futures and options contracts that allow hedging against currency movements. Currency derivatives are a contract between the seller and buyer, whose value is to be derived from the underlying asset, *that is*, the currency value.

In India, one can use such derivative contracts to hedge against currencies like Dollar, Euro, U.K. Pound and Yen. Corporates, especially those with significant exposure to imports or exports, use these contracts to hedge against their exposure to a certain currency.

Interest Rate Derivative

Interest Rate Derivative is a financial derivative contract whose value is derived from one or more benchmark interest rates, price, interest rate instruments, or interest rate indexes.

Interest rate derivatives (IRDs) contracts can be traded either on:

a) Recognized Stock Exchanges; or
b) Over-the-Counter. It refers to all transactions done outside of recognized stock exchanges and shall include transactions on Electronic Trading Platforms (ETP).

Commodity Derivative

Commodity derivative is a contract to buy or sell a commodity at a preset price for delivery on a future date. Almost all commodity contracts, barring a few (like crude oil and natural gas), result in compulsory delivery.

The Finance Act, 2020 had amended the definition of “taxable commodities transaction” as a transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities traded in recognised stock exchanges. The intention behind introducing CTT was to bring parity between the derivative trading in the securities market and the commodity market.

Trading in derivatives including commodity derivatives is regulated by the Securities Contract (Regulation) Act, 1956 (SCRA). Apart from numerous regional exchanges, India has five national commodity exchanges namely, Multi Commodity Exchange (MCX), National Commodity and Derivatives Exchange (NCDEX), Indian Commodity Exchange (ICEX), National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).

11.7.2 Nature of Derivative Income

The gains or losses arising from trading in F&O are taxable under the head 'Profits and Gains from Business or Profession' (PGBP) or income from other sources depending upon the fact whether the assessee is into the business of derivative trading, frequency of the transactions etc. Where the activity is offered to tax as business income by the assessee, the following wjll be applicable:

The Income Tax Act classifies the business income into 'speculative' and 'non-speculative'. Though Income arising from speculative transactions are taxable under the head PGBP, yet they are treated differently and rigorously from non-speculative business income. Any loss arising from speculative transaction could be set-off only from speculative income.

A transaction is deemed as speculative if it is periodically or ultimately settled otherwise than through actual delivery or transfer. However, Section 43(5) has specifically excluded certain derivative transactions from the meaning of speculative transaction as these instruments are used for hedging of underlying assets. Thus, income or loss from dealing in F&O shall be deemed as normal business income (non-speculative business) even though delivery may not be effected in such transactions. Consequently, any loss arising from F&O can be set-off against any normal business income. The business income of an assessee is charged to tax at normal rates as applicable in case of an assessee.

11.7.3 Computation of Turnover

The Income Tax Act does not contain any provision or guidance for computation of turnover in F&O trading. However, the Guidance Note on Tax Audit issued by the ICAI prescribes the method of determining turnover which shall be as under:

a) The total of favourable and unfavourable differences is taken as turnover.
b) Premium received on sale of options is also to be included in turnover.
c) In respect of any reverse trades, the difference thereon should also form part of the turnover.

The computation of turnover is a very important factor as the applicability of tax audit is determined on the basis of turnover. Also, if the taxpayer is opting for the presumptive taxation scheme under section 44AD (subject to total turnover not exceeding Rs. 2 crores or 3 crores, as the case may be), he can declare the profit at the rate of 6% of such turnover in case of receipts in cheque or any digital modes or 8% of turnover in case of cash receipts.

11.7.4 Scheme of Taxation

The income from F&O trading can be offered to tax under the normal scheme of taxation or the presumptive scheme of taxation under Section 44AD (subject to total turnover not exceeding Rs. 2 crores or 3 crores, as the case may be). Under the presumptive scheme, the investor can choose to declare the profits at the rate of 6% of turnover as the payment is always received through banking channels. The presumptive income computed as per the prescribed rate is the final income and no further expenses will be allowed or disallowed. Also, the person opting for this scheme is not required to maintain the books of accounts prescribed under section 44AA and get them audited. Further, he can pay 100% of the advance tax in a single instalment up to 15th March of the relevant financial year.

11.7.5 Set-off and Carry Forward of Losses

The losses from the trading of F&O if treated as a normal business loss, it can be set-off against the income from the other heads. However, the business loss cannot be set-off against the income from salary.

The unabsorbed loss can be carried forward up to 8 Assessment years. It can be set-off only against the business income in the subsequent years. It is important to note that the assessee is entitled to carry forward the business loss provided the return of income is filed on or before the due date. If such return is not filed within the prescribed due date, the right to carry forward and set-off is lost.

Example 10: Mr. X, a resident investor, purchased 1 call option of X Ltd. at a premium of Rs. 35 per share on 01-08-2024. The details of the call option are as follows:

Lot size per option	1,000 shares
Exercise price	Rs. 450 per share
Date of expiry	24-08-2024

Determine the taxability in following situation:
Situation 1: It exercised the call option to buy shares of X Ltd. on 15-08-2024 and such shares were subsequently sold for Rs. 550 each on 30-11-2024.
Situation 2: It transferred such option for Rs. 30 per share on 10-08-2024.
Situation 3: It transferred such option for Rs. 37 per share on 10-08-2024
Situation 4: It does not transfer or exercise the call option and, therefore, contract was settled by stock exchange on expiry, *that is*, 24-08-2024 when premium for this option was prevailing at Rs. 10 per share.

Answer:
The taxability in aforesaid situations shall be as follows:

As Mr. X is trading in shares and derivatives, any income arising therefrom shall be taxable as normal business income. The computation of business income shall be follows:
Situation 1: Option exercised

Computation of business income on transfer of shares	
Particulars	*Amount*
Period of holding (from 15-08-2024 to 29-11-2024)	3.5 Months but does not matter as business income is being computed
Sale price [1,000 * Rs. 550] [A]	Rs. 550,000
Cost of Acquisition (Exercise price + Premium paid for call option) [1,000 * (450 + 35)] [B]	Rs. 485,000
Business Income [C = A - B]	Rs. 65,000
Tax rate on business income [D]	Applicable tax rate

Situation 2: Option transferred at loss

Computation of business income on transfer of option	
Particulars	*Amount*
Period of holding (from 01-08-2024 to 09-08-2024)	Less than 1 month but does not matter as business income is being calculated
Sale price (1,000 * Rs. 30) [A]	Rs. 30,000
Cost of Acquisition (1,000 * Rs. 35) [B]	Rs. 35,000
Business Income loss [C = A - B]	(Rs. 5,000)

Situation 3: Option transferred at gain

Computation of business income on transfer of option	
Particulars	*Amount*
Period of holding (from 01-08-2024 to 10-08-2024)	Less than 1 month but does not matter as business income is being calculated
Nature of capital asset	Short-term capital asset
Sale price (1,000 * Rs. 37) [A]	Rs. 37,000
Cost of Acquisition (1,000 * Rs. 35) [B]	Rs. 35,000
Business Gain [C = A - B]	Rs. 2,000
Tax rate [D]	Applicable rate

Situation 4: Option expired

Computation of business income on settlement of option on expiry	
Period of holding (from 01-08-2024 to 24-08-2024)	Less than 1 month but does not matter as business income is being calculated
Sale price (1,000 * Rs. 10) [A]	Rs. 10,000
Cost of Acquisition (1,000 * Rs. 35) [B]	Rs. 35,000
Business Income [C = A - B]	(Rs. 25,000)

Example 11*:* Mr. A (resident in India) is engaged in the trading of shares and derivatives. He purchased 5 call option of Z Ltd. at a premium of Rs. 22 per share on 01-08-2024. The details of the call option are as follows:

Lot size per option	1,000 shares
Exercise price	Rs. 200 per share
Date of expiry	27-08-2024

Determine the taxability in the hands of Mr. A if he exercised 2 call options on 14-08-2024 to buy 2,000 shares of Z Ltd. at exercise price. He subsequently sold such shares for Rs. 250 each on 30-10-2024. The remaining 3 call options were sold at a premium of Rs. 27 per share.

Answer*:*

As Mr. A is trading in shares and derivatives, any income arising therefrom shall be taxable as normal business income. The computation of business income shall be follows:

Computation of business income or loss	
Particulars	*Amount*
Sale price of shares (2,000 * Rs. 250) [A]	Rs. 500,000
Sale price of option (3,000 * Rs. 27) [B]	Rs. 81,000
Total Sale consideration [C = A + B]	**Rs. 581,000**
Cost of acquisition of shares (2,000 * Rs. 200) [D]	Rs. 400,000
Cost of acquisition of option (5,000 * Rs. 22) [E]	Rs. 1,10,000
Total purchase cost [F = D + E]	**Rs. 510,000**
Business Income [G = C - F]	**Rs. 71,000**

11.8 Bonus Stripping

Similar to dividend stripping, 'Bonus Stripping' is a practice where a person buys securities or units just before the record date to get bonus securities or units on basis of such holding and sells the original units after the record date at a price lower than the price at which securities or units were purchased and incurring a short-term capital loss.

To curb this practices, section 94(8) was inserted under Income Tax Act. The section provides that where any person acquires any securities or units within a period of 3 months, before the record date, and is allotted bonus securities or units on such date, then any loss arising on transfer of original securities or units shall be ignored to compute his income chargeable to tax, if he transfers such securities or units within a period of 9 months after the record date while continuing to hold all or any of the bonus securities or units.

Further, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of bonus securities or units held by him on the date of transfer of original units.

Example 12*:* Mr. Ravi purchased 1,000 units of an listed equity at Rs. 106 per unit as on 01-07-2023. Thereafter, the company declared allotment of bonus shares of 1:1 on 01-09-2023, *that is*, the person holding 1 share gets 1 bonus share. After getting the bonus share, Mr. Ravi sold the original 1,000 shares on 01-04-2024 at a price of Rs. 95 per share.

Answer*:*

In the given example, Mr. Ravi had acquired the shares of the company within 3 months before the record date of allotment of bonus shares and sold the same within 9 months after the record date while continuing to hold the bonus shares. Thus, any loss arising on transfer of original shares shall be ignored to compute his income chargeable to tax and the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of bonus shares held by him.

The loss arising on transfer of original shares shall be Rs. 11,000 [1,000 shares * (Rs. 106 – Rs. 95)] which shall be ignored. Consequently, the cost of acquisition of 1,000 bonus shares so allotted shall be deemed to be Rs. 11,000, and, accordingly, per share cost shall be Rs. 11.

11.9 Benefits not allowed from Capital Gains

Income Tax Act provides for concessional tax rates in respect of long-term capital gain and certain short-term capital gains. Long-term capital gain is generally chargeable to tax at concessional rate of 12.50%.

Short-term capital gain is generally chargeable to tax at normal rates. However, the short-term capital gain arising from the transfer of specified securities, being equity shares, units of equity-oriented mutual fund, high premium ULIPs and units of REITs or InvITs is chargeable to tax at concessional rate of 20% (subject to payment of securities transaction tax).

As Income Tax Act provides for concessional tax rates in respect of long-term capital gain as well as short-term capital gain from transfer of specified securities, certain benefits are not allowed while computing such capital gains.

11.9.1 Benefits not allowed from long-term capital gain chargeable to tax at the rate of 12.50%

No deduction shall be available under Sections 80C to 80U from the long-term capital gains taxable at the rate of 12.50% under Section 112.

Following benefits shall not be allowed from the long-term capital gains taxable at the rate of 12.50% under Section 112A, 115AC, 115ACA, 115AB, 115AD and 115E:

No computation in foreign currency

Mode of computation of capital gain in foreign currency as available in the case of a non-resident while computing capital gains arising from the transfer of a capital asset, being shares in, or debentures of, an Indian company, purchased in foreign currency shall not be allowed when the long-term capital gain is chargeable to tax at concessional rate of 12.50%.

No deduction under Section 80C to 80U

No deduction shall be available under Sections 80C to 80U from the long-term capital gains taxable at the rate of 12.50%.

No Section 87A rebate from long-term capital gain covered under section 112A

Rebate under Section 87A is not available from income-tax payable on long-term capital gain covered under 112A, i.e., the long-term capital gain arising from transfer of specified securities, being equity shares, units of equity-oriented mutual fund, high premium ULIPs and units of REITs or InvITs. However, the rebate shall be allowed from the tax payable on the total income as reduced by tax payable on such capital gains.

11.9.2 Benefits not allowed from short-term capital gain chargeable to tax at the rate of 20% under section 111A

No deduction shall be available under Sections 80C to 80U from the short-term capital gains chargeable to tax at concessional rate of 15%.

11.10 Adjustment of Exemption Limit from Capital Gains

Total income of a resident being inter-alia individual or a resident HUF is not chargeable to tax up to maximum exemption limit. Thus, if total income of a resident individual or HUF, as reduced by the amount of long-term capital gains referred to in Section 112 and 112A or short-term capital gains covered under section 111A, is less than maximum exemption limit, the amount of such capital gains shall be reduced by that amount that would enable the individual or HUF to fully claim the maximum exemption limit.

Example, if total income of a resident individual (excluding long-term capital gains) is Rs. 1,85,000 and long-term capital gain from the sale of unlisted shares is Rs. 2,50,000, the tax under this provision shall be computed on Rs. 1,85,000. Maximum exemption limit in case of a resident individual is Rs. 2,50,000 (under old tax regime) and total income falls short of this limit by Rs. 65,000. The amount of long-term capital gain shall be reduced by Rs. 65,000 and the remaining amount, i.e., Rs. 1,85,000 (Rs. 2,50,000 less Rs. 65,000) shall be charged to tax.

11.11 Summary of Taxation of Equity Products and Other Capital Assets

Sr. No	**For Resident in India Individual taxpayers**	**STCG On sale on or after 23 Jul 2024**	**Holding Period for classification as Long Term in respect of Sale on or after 23 Jul 2024**	**LTCG[Note1] on sale on or after 23 Jul 2024 but before 1 Apr 2025**	**LTCG[Note1] on sale on or after 1 Apr 2025**
	Listed Securities:		**In Months**		
1	Listed Equity Shares [Note2]	20%	> 12	12.50%	Same
2	Equity MF / ETF (> 65% investment in listed domestic equity) [Note2]	20%	> 12	12.50%	Same
3	Hybrid MF Schemes/ ETFs (< 65% but > 35% investment in listed domestic equity)	Slab rate	> 12	12.50%	Same
4	Other MF Schemes/ ETFs (< 35% investment in domestic equity) bought before 01-04-2023	Slab rate	> 12	12.50%	Same
5	Other MF Schemes/ ETFs/ Gold ETFs (< 35% investment in domestic equity) bough >= April 1, 2023:	Slab rate	Always Short Term if sold before 01-04-2025 else > 12 Months	Slab rate	12.50%
6	Debt Funds and ETF (invests > 65% directly or indirectly in debt or money market) bought >= April 1, 2023	Slab rate	Always short term	Not Applicable	Not Applicable
7	MF/ ETFs located overseas (Nasdaq ETF etc)	Slab rate	Always short term if bought >= 01-04-2023 & Sold before 01-04-2025 or else 24 Months	12.50%	Same
8	Listed Bonds / Debentures Including Sovereign Gold Bonds (SGBs) [Note3]	Slab rate	> 12	12.50%	Same
9	Listed Market Linked Debentures		Always to be taxed at Slab rates irrespective of period of holding		
10	Any other Listed Securities	Slab rate	> 12	12.50%	Same
11	Listed Zero coupon Bond	Slab rate	> 12	12.50%	Same

Sr. No	For Resident in India Individual taxpayers	STCG On sale on or after 23 Jul 2024	Holding Period for classification as Long Term in respect of Sale on or after 23 Jul 2024	LTCG[Note1] on sale on or after 23 Jul 2024 but before 1 Apr 2025	LTCG[Note1] on sale on or after 1 Apr 2025
12	Listed REITs/ Invits [Note2]	20%	> 12	12.50%	Same
	Mutual Funds (unlisted) & Other Unlisted Assets:				
1	Equity MF/ ULIP Fund investing > 65% directly in domestic equity [Note2]	20%	> 12	12.50%	Same
2	ULIP Funds investing > 90% in domestic equity through ETFs [Note2]	20%	> 12	12.50%	Same
3	Hybrid MF investing < 65% but > 35% directly in domestic equity	Slab rate	> 24	12.50%	Same
4	MF Schemes investing > 90% in domestic equity through ETFs [Note2]	20%	Always Short Term if purchased on >= 01-04-2023 and sold before 01-04-2025 or else > 12 Months	12.50%	Same
5	Other MF/ Gold MF bought before April 1, 2023	Slab rate	> 24	12.50%	Same
6	Other MF/Gold MF bought >= April 1, 2023	Slab rate	Always short term if sold before 01-04-2025 else > 24 Months	Slab rate	12.50%
7	Debt funds/ Money market funds bought >= April 1, 2023	Slab rate	Always short term	Slab rate	Same
8	Holding in Foreign MF including foreign index funds	Slab rate	Always taxed as short term If bought >= 01-04-2023 & Sold < 01-04-2025 or else > 24 Months	12.50%	Same
9	Shares not listed on Indian stock exchanges	Slab rate	> 24	12.50%	Same
10	Unlisted Bonds/ Debentures/ SGB (not incl. MLDs)	Slab rate	Always short term	Not Applicable	Not Applicable
11	REITs/ InvITs not listed on Indian stock exchanges [Note2]	Slab rate	> 24	12.50%	Same
12	Other unlisted securities/ Other ULIPs	Slab rate	> 24	12.50%	Same

Sr. No	For Resident in India Individual taxpayers	STCG On sale on or after 23 Jul 2024	Holding Period for classification as Long Term in respect of Sale on or after 23 Jul 2024	LTCG[Note1] on sale on or after 23 Jul 2024 but before 1 Apr 2025	LTCG[Note1] on sale on or after 1 Apr 2025
13	Immovable property (being land or building or both) bought after July 23, 2024	Slab rate	> 24	12.5% or 20% after indexation whichever is lower (the second option is availble only for property bought before July 23, 2024)	Same
14	Large Value ULIP bought after on or after February 1, 2021 (aggregate premium exceeding Rs. 2.50 lakhs) If investment in an "equity-oriented fund" [Note2]	20%	12	12.50%	Same
15	Large Value ULIP bought after on or after February 1, 2021 (aggregate premium exceeding Rs. 2.50 lakhs) If investment is not in a "equity oriented fund" (Note debt oriented fund in a ULIP are not covered by section 50AA) [Note2]	slab rates	24	12.50%	Same
16	Any Other capital assets (silver, art, etc.)	Slab rate	> 24	12.50%	Same

Note 1: In view of the amendment brought by the Finance Act, 2024, the benefit of indexation is now not available on any asset (except immovable property in certain cases).
Note 2: Tax on long-term capital gain arising from transfer of equity shares, units of equity oriented mutual fund, high premium ULIPs or units of REITs/ InvITs, chargeable to STT, shall not be levied if the aggregate amount of long-term capital gain earned during the year from transfer of said capital assets does not exceed Rs. 1,25,000.
Note 3: This does not apply to redemption of SGB with RBI as the redemption is not treated as a transfer under section 47 and hence no capital gains are required to be calculated in respect of such redemption.
Note 4: Income from derivatives is considered as business income or income from other sources.

CHAPTER 12: TAXATION OF OTHER PRODUCTS

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Tax aspects of:
  - Employee Stock Option Plans (ESOPs)
  - Sovereign Gold Bonds
  - Annuities (NPS Tier 1 & Tier 2) / ETFs
  - AIFs / REITs / InvITs
  - Life Insurance Products
  - Reverse Mortgage Loans

12.1 Taxation of Employees Stock Option Plan

Employee Stock Option Plans (ESOPs) are given to retain brilliant employees and to acknowledge their proven contribution to the company. Whenever ESOPs are issued, employees get the right to purchase a certain number of securities of the employer-company at a discounted price (i.e., less than the market price of such shares). It allows employees to have a stake in the company, which ensures higher loyalty and motivation for the employees to work. The option provided under this scheme confers a right but not an obligation on the employee.

Such an option to purchase shares can be exercised only after the vesting period. Such vesting period is the time period an employee must wait to get the right to buy those specified number of shares. Upon vesting of options, employees can exercise the options to acquire shares by paying the pre-determined exercise price.

Generally, employers offer ESOPs as an award to employees to retain top talent. Thus, it serves a twin-fold purpose both for the company and the employees. It acts as a motivation tool for the employees. After owning a stake in the company, they feel responsible for the performance of the company. It helps the employer to retain the top talent and assure the right level of performance in work.

ESOPs are quite popular amongst start-ups which cannot afford to pay huge salaries to employees in their initial phase and, accordingly, such start-ups offer ESOPs instead of monetary benefits to the top employees. ESOPs have been a significant component of the compensation for the employees of start-ups, as it allows the founders and start-ups to employ highly talented employees at a relatively low salary amount with the balance being made up *via* ESOPs.

12.1.1 Terms of ESOP

The employer-company does not charge anything at the time of offering ESOPs to employees. Such an option given to the employee can be exercised after a certain lock-in period, which is generally more than one year.

The right to exercise ESOP may get vested in the employee on the future date. The dates on which the employee becomes entitled to exercise the right to acquire the shares is called "vesting date".

Example 1, On April 1, Year 0, XYZ India Private Limited grants ESOP to its employee Mr. A to purchase 1,000 shares at a pre-determined price of Rs 100 per share. Date of vesting of ESOP is April 1, Year 4. Thus, Mr. A can exercise the right to exercise shares on or after April 1, Year 4. Incase of ESOPs, employees are given an option to exercise such option, and it is not compulsory for them to exercise such ESOP.

The employee is given a time period during which he has to exercise the option failing which the vested rights may lapse. The date on which the employees exercise this option to buy the shares is known as 'exercise date'.

12.1.2 Tax implications of ESOPs

The taxation of ESOPs is split into two components:

At the time of allotment of shares

The definition of salary also includes perquisites provided by the employer to employees. The value of any share allotted to an employee, either free of cost or at a concessional rate would be treated as perquisite.

The first tax instance shall arise at the time of allotment of shares. When an employee exercises the option, the difference between the Fair Market Value (FMV) of the shares on the date the option is exercised and the amount paid by the employee for such share, is taxable as perquisite in the year of allotment. Here, it is to be noted that though the tax is levied at the time of allotment of shares, the FMV of the shares on the date of allotment of the shares is not relevant for the calculation of perquisite value. In other words, FMV of shares at the time of exercising of option is considered for calculation of perquisite and not the FMV of shares at the time of allotment of shares. We can consider the following step-by-step treatment to determine the value of perquisite arising from ESOP:

Step 1: Determine the Fair Market Value of shares on the date on which the employee exercises the option. FMV has to be determined as per Rule 3 of the Income tax Rules. It may be noted that the FMV of shares on the date of vesting shall not be considered.

Step 2: Determine the pre-determined value of shares paid or to be paid by the employee to the employer at the time of exercising of option.

Step 3: Value of perquisite = (Step 1 – Step 2) * Number of shares exercised by the employee

***Example 2**,* ABC India Private Limited has issued ESOP to Mr. B during the financial year 2024-25. Calculate the value of perquisite based on the following data:

Particulars	***Amount***
Date of granting of ESOP	01-04-2021
Vesting Period	01-04-2021 to 31-03-2024
Date of Exercise of ESOP	10-05-2024
Fair Market Value as on March 31, 2024	6,000
Fair Market Value as on May 10, 2024	6,500
Number of ESOP exercised	100
Pre-determined price to be paid by the employee to the employer	500
Value of perquisite [(Rs. 6,500 – Rs. 500) * 100]	**Rs 600,000**

At the time of sale of shares

The second tax implication shall arise when the employees sell shares allotted under ESOP. The resultant gains shall be taxable under the head capital gains. Taxability of capital gains shall depend on the type of share and the period of holding of such share.

The period of holding of shares shall be the period commencing from the date of allotment of shares, and not from the date of exercising of option, ending on the date employees sell the shares. Further, the fair market value of shares on the date of exercising the option shall be taken as the cost of acquisition of such shares to compute the capital gain.

***Example 4**,* Mr John exercised the ESOP on 01-04-2024, and the shares are allotted to him on 01-05-2024. He sold such shares on 01-08-2024. The period of holding of such shares shall be counted from 01-05-2024 (and not from 01-04-2024) till 31-07-2024. However, for computing the cost of acquisition, the fair market value of shares as on 01-04-2024, being the date of exercising of ESOP, shall be considered.

The capital gains from transfer of shares allotted under the ESOPs shall be computed as per normal capital gains provisions explained earlier. A summary of these provisions is given below:

a) *Equity shares chargeable to STT (long-term capital assets):* Where shares allotted under ESOPs are equity shares, and the employees sell them after holding for more than 12 months and paid STT on same, the resultant long-term capital gains shall be taxable under Section 112A. The period of holding of such shares shall be counted from the date of allotment of shares to employees under ESOP. The long-term capital gains, to the extent it exceeds Rs. 1,25,000 shall be taxable at the concessional rate of 12.50% plus surcharge and cess. If shares are listed on a recognized stock exchange but STT is not paid at the time of transfer of such share (i.e., Over-the-Counter sale) the resultant long-term capital gains shall be taxable Section 112(1), that is, at 12.50% but the initial exemption of Rs. 1,25,000 will not be available.

b) *Equity shares chargeable to STT (short-term capital assets):* Any short-term capital gains arising from the sale of equity shares allotted under ESOP on which STT has been paid shall be taxable at the rate of 20% *plus* surcharge and cess under Section 111A.

c) *Unlisted equity shares not chargeable to STT (long-term capital assets):* Where equity shares, which are not chargeable to STT, are sold by employees after holding it for a period of more than 24 months, the resultant long-term capital gains will be taxable at the rate of 12.50% *plus* surcharge and cess under Section 112. Period of holding of such shares shall be counted from the date of allotment of shares to employees under ESOP.

d) *Equity shares not chargeable to STT (short-term capital assets):* Any short-term capital gains arising from the sale of equity shares, which are not chargeable to STT, shall be taxable as per the Income-tax slab rate applicable to the taxpayer.

12.1.3 Deferment of tax on perquisite value of ESOPs in case of Start-ups

ESOPs are a significant component in the compensation of the employees of start-ups as it allows start-ups to employ highly talented employees at a relatively low salary amount with the balance being paid *via* ESOPs. The taxability of ESOPs arises in the hands of the employee at two stages. Firstly, when shares are allotted to employee on exercising his right to apply for the shares under ESOPs and, secondly, when such shares are sold by the employee.

At the time of allotment of shares, the difference between the fair market value of shares on the date of exercising the option and the amount actually paid by the employee for such shares is taxable as perquisite under section 17(2)(vi) of the Income Tax Act and chargeable to tax under the head 'Salary'. Consequently, the employer is required to include the amount of perquisite in the salary of the employee and deduct tax thereon under section 192 in the year in which shares are allotted.

As employees do not get any immediate benefit from the shares allotted under the ESOPs, the deduction of tax thereon in the year of allotment itself was very burdensome for them as it reduces the cash flow in their hand. To reduce the burden of taxes, the Finance Act, 2020 amended Section 192 (TDS on salary), Section 140A (self-assessment tax), Section 191 (direct payment of tax by the employee) and Section 156 (notice of demand) so to defer the deduction and payment of tax on income in the nature of perquisites arising from ESOPs for eligible start-ups as referred to in section 80-IAC.

Meaning of an eligible start-up

Only an eligible start-up as referred to in Section 80-IAC and its employees would get the benefit of deferment of TDS and tax payment on perquisite arising from ESOPs. As per section 80-IAC, an eligible start-up can only be a company or limited liability partnership (LLP) engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation. Further, it has to satisfy the following conditions:

1. It must be incorporated on or after 01-04-2016 but before 1-04-2024[33];
2. Total turnover shall not exceed Rs. 100 crores in the previous year for which deduction under section 80-IAC is claimed; [34] and
3. It must hold a certificate of eligible business from the Inter-Ministerial Board of Certification.

12.2 Sovereign Gold Bonds

Sovereign Gold Bonds (SGBs) are government securities, which are denominated in grams of gold. They are substitutes for holding physical gold. Investors have to pay the issue price in cash, and the bonds will be redeemed in cash on maturity. Reserve Bank of India issues the bond on behalf of the Government of India. The quantity of gold for which the investor pays is protected, as investor receives the market price of gold on redemption.

The SGB offers a superior alternative to holding gold in physical form. The risks and costs of storage are eliminated. Investors are assured of the market value of gold at the time of maturity and periodical interest. SGB is free from issues like making charges and purity in the case of gold in jewellery form. The bonds are held in the books of the RBI or in Demat form, eliminating the risk of loss of scrip, etc.

The Sovereign Gold Bonds may be held by a Trust, HUFs, Charitable Institution, University or by a person resident in India, being an individual, in his capacity as such individual, or on behalf of minor child, or jointly with any other individual.[35] An individual investor whose residential status subsequently changes from resident to non-resident may continue to hold SGB till the original term of redemption/maturity.

Rate of interest of SGBs

The bonds bear interest at the rate of 2.50 per cent (fixed rate) per annum on the nominal value of the bond. Interest will be credited half-yearly to the bank account of the investor, and the last interest will be payable on maturity along with the principal.

Limit of investment

The Bonds are issued in denominations of one gram of gold and multiples thereof. The minimum investment in the Bond shall be one gram with a maximum limit of subscription of 4 kg for individuals, 4 kg for Hindu Undivided Family (HUF) and 20 kg for trusts and similar entities notified by the government from time to time per fiscal year (April – March).

In case of joint holding, the limit applies to the first applicant only. The annual ceiling will include bonds subscribed under different tranches during initial issuance by Government

[33] The Finance Act, 2023 has extended the outer date from 01-04-2023 to 01-04-2024.
[34] The turnover limit has been increased from Rs. 25 crore to Rs. 100 crore by the Finance Act, 2020
[35] Sovereign Gold Bond Scheme 2023-24 notified *vide* Notification No. G.S.R. 438(E), dated 1-06-2023

and those purchased from the secondary market. The limit on investment will not include the holdings as collateral by banks and other Financial Institutions.

Maturity

The gold bonds will mature on the expiration of 8 years from the date of issue of the bonds. On maturity, the Gold Bonds shall be redeemed in Indian Rupees, and the redemption price shall be based on the simple average of the closing price of gold of 999 purity of previous three working days from the date of repayment, published by the India Bullion and Jewellers Association Limited. Both interest and redemption proceeds will be credited to the bank account furnished by the customer at the time of buying the bond. The RBI / depository shall inform the investor one month in advance, about the date of maturity of the Bond.

Premature redemption

Though the tenor of the bond is 8 years, early encashment/redemption of the Bond is allowed after the fifth year from the date of issue of bond. Such repayments will be made on next interest payment date. The bond will be tradable on Exchanges if held in Demat form. It can also be transferred to any other eligible investor.

Collateral for loans

These securities are eligible to be used as collateral for loans from banks, financial Institutions and Non-Banking Financial Companies (NBFC). The Loan to Value ratio will be the same as applicable to conventional gold loan prescribed by the RBI from time to time. Granting loan against SGBs would be subject to the decision of the bank/financing agency, and cannot be inferred as a matter of right.

12.2.1 Tax implications on SGBs

Interest income

The interest received on the sovereign gold bond shall be chargeable to tax under the head 'Income from other sources' and taxed as per the tax rates applicable in case of an assessee.

However, any payment of interest on SGBs would not attract any TDS as they are Government Securities. Thus, investors would receive the full amount of interest on SGBs in their bank accounts. Currently, SGBs pay an interest of 2.5% per annum on the nominal value of the bond and interest is credited half-yearly to the bank account of the investor.

Capital gain on redemption

SGBs have a tenor of 8 years. The redemption of the SGBs would normally be treated as transfer, thus, be charged to capital gains tax. However, Section 47 of the Income Tax Act provides that redemption by an individual does not amount to 'transfer' and thus no capital gains arise on such redemption by an individual investor.

However, investors can go for pre-mature redemption of SGBs after the fifth year from the date of issue. Any capital gains arising to an investor other than Individual on redemption of SGBs (whether on maturity or pre-mature redemption) shall be taxable as a long-term capital gain if held for more than 12 months. As SGBs are listed on stock exchanges in India, the investor has to pay tax at the rate of 12.50%. If the non-individual has held the SGB for less than 12 months on the date of redemption then they will need to pay tax at normal slab rates.

For SGB sold or transferred other than through redemption, capital gains will be taxed at the rate of 12.50% (if held for more than 12 months) and at slab rates if held for less.

Example 6*,* Mr X purchased SGBs for Rs 5 lakhs. He received Rs. 6 lakhs on their redemption. The capital gain arising on such redemption shall not be charged to tax in the hands of Mr X as he is an Individual and redemption is not treated as transfer. However, if the capital gain is arising to a trust then it shall be charged to tax at the rate of 12.50% if the trust has held it for more than 12 months on the date of such redemption else on slab rates.

It is to be noted that if a person buys SGBs from the secondary market and not from the primary issue, the taxability on redemption would remain the same.

Capital gain on transfer

Sovereign Gold Bonds are listed on stock exchanges in India. Thus, a person can transfer the SGBs in the secondary market. The profit or loss arising on transfer of SGBs shall be chargeable to tax under the head capital gain. If the SGBs are transferred after holding for more than 12 months, the resultant gains shall be taxable as a long-term capital gain; whereas, if the SGBs are transferred within 12 months then the gains shall be treated as a short-term capital gain.

Short-term capital gain arising on transfer of SGBs is charged to tax at normal tax rates as applicable in case of an assessee. Long-term capital gain is charged to tax at the rate of 12.50% plus surcharge and cess.

The taxability shall remain same in case of off-market transactions. Further, it is to be noted that even an individual shall be liable to pay tax on capital gains arising on transfer of SGBs as exemption has been provided only in case of redemption and not on transfer of SGBs.

Example 7*:* Mr. X purchased 100 SGBs at its nominal value of Rs. 425,000 on 28-04-2019. The SGBs carry interest rate of 2.5% per annum on the nominal value of bond. The interest is payable at half yearly intervals on 28th October and 28th April every year. The bonds are redeemable on 28-04-2027 with the option for early redemption after 5th year from the date of issue of bonds.

What shall be the tax implications in the hands of Mr. X in following scenarios?

1. He holds SGBs till maturity;
2. He transfers SGBs in the secondary market on 01-08-2024for Rs. 7,50,000;
3. He transfers SGBs in the secondary market on 29-10-2024 for Rs. 7,92,000.

Answer:

Situation 1: SGBs held till maturity

As per section 47 of the Income Tax Act, the redemption of SGBs by an Individual is not treated as transfer. Thus, no capital gain shall arise in such a case. However, the interest received or receivable on SGBs is chargeable to tax in the hands of the investor at the applicable rates. Thus, Mr. X shall be liable to pay tax on the interest amount. For instance, for the financial year 2020-21, the interest amount taxable in the hands of Mr. X shall be Rs. 10,625 (425,000 * 2.5%).

Situation 2: SGBs transferred in the secondary market on 01-08-2024

Mr. X transferred SGBs for Rs. 750,000 on 01-08-2024 before the due date of payment of half yearly interest on 28-10-2024. The sales consideration shall include the amount of interest accrued to him from the last coupon date to the date of transfer of SGBs, *that is*, from 29-04-2024 to 01-08-2024. As interest is taxable under the head "Income from other sources', the amount of interest accrued shall be reduced from the amount of consideration to compute the capital gain arising on transfer of SGBs.

The amount of interest accrued to Mr. X before the date of transfer of SGBs shall be Rs. 2,765 (Rs. 425,000 * 2.5% * 95/365 days). The resultant value shall be the sale price of SGBs, *that is*, Rs. 7,47,235 (Rs. 7,50,000 – Rs. 2,765). The capital gain shall be computed as follows:

Computation of capital gain on transfer of SGBs	
Period of holding (from 28-04-2019 to 01-08-2024)	More than 12 months
Nature of capital gain	Long-term capital gain
Sale price	Rs. 7,47,235
Less: Cost of acquisition	Rs. 4,25,000
Long term capital gain	Rs. 3,22,235
Tax on capital gain	Tax @12.50%

Situation 3: SGBs transferred in the secondary market on 29-10-2024

The amount of interest taxable in hands of Mr. X in the financial year 2024-25 shall be Rs. 6,142 (Rs. 425,000 * 2.5% * 211/365 days).

A) As SGBs were transferred next day after the due date of payment of half yearly interest, no interest shall accrue to Mr. X from last coupon date to date of transfer of SGBs. Thus, interest amount shall not be reduced from consideration received on transfer of SGBs. Further, as Mr. X has transferred SGBs after holding for a period of more than 12 months, the nature of capital gain shall be long-term capital gain.

Computation of capital gain	
Particulars	*Amount*
Sale price [A]	7,92,000

Cost of Acquisition [B]	425,000
Long term capital gain [D = A - C]	3,67,000
Tax rate on capital gain [E]	12.50%

12.3 National Pension System

As discussed in earlier module, Retirement planning requires disciplined saving, vigilant investment to build a sufficient retirement corpus and its judicious drawdown in the post-retirement phase. This can be achieved by joining a pension/retirement plan at an early stage so that when a person retires from active work life, he gets a regular stream of income in the form of pension or annuity for his life.

National Pension System (NPS) is a defined contribution retirement savings scheme designed to enable the subscribers to make optimum decisions regarding their future through systematic savings during their working life. It is administered and regulated by Pension Fund Regulatory and Development Authority (PFRDA). NPS seeks to inculcate the habit of savings for retirement amongst the citizens. It is an attempt towards finding a sustainable solution to the problem of providing adequate retirement income to every citizen of India.

Under the NPS, individual savings are pooled into a pension fund which is invested by PFRDA regulated professional fund managers as per the approved investment guidelines into the diversified portfolios comprising of government bonds, bills, corporate debentures and shares. These contributions would grow and accumulate over the years, depending on the returns earned on the investment made.

At the time of normal exit from NPS, the subscribers may use the accumulated pension wealth under the scheme to purchase a life annuity from a PFRDA empanelled life insurance company apart from withdrawing a part of the accumulated pension wealth as lump-sum, if they choose so.

Features of NPS

NPS offers a range of investment options and choice of Pension Fund Manager (PFMs) for planning the growth of investments in a reasonable manner. Individuals can switch from one investment option to another or from one fund manager to another subject to certain regulatory restrictions.

When anyone opens an account with NPS, he gets Permanent Retirement Account Number (PRAN), which is a unique number and it remains with the subscriber throughout his lifetime.

NPS provides two types of accounts to the subscribers - Tier I and Tier II. Tier I is a mandatory retirement account, whereas Tier II is a voluntary saving account associated with PRAN of the subscriber. Tier II offers greater flexibility in terms of withdrawal, unlike Tier I account, the subscriber can withdraw from Tier II account at any point of time.

12.3.1 Tax treatment of contribution to NPS

Employee's contribution to NPS

When contribution to NPS is made by the employee himself, the deduction shall be allowed under Section 80CCD(1) which shall be lower of the amount contributed by the employee to NPS or 10% of salary. This deduction is subject to the overall limit of Rs. 1,50,000 available for other modes of investments such as Life Insurance premium, ELSS, Employee contribution to EPF, Public Provident Fund etc. An additional deduction of Rs. 50,000 over and above this limit is allowed under Section 80CCD(1B) to an employee for the amount deposited by him to his NPS account. Both these deductions are available only if the assessee has chosen the Old tax regime.

For this purpose, 'salary' includes dearness allowance (if terms of employment so provide) but excludes all other allowances and perquisites.

Employer contribution to NPS

When contribution to the NPS is made by the employer, such contribution is taxable in the hands of the employee and included in his salary income. However, deduction shall be allowed under Section 80CCD(2) to the employee for such contribution which shall be lower of the amount contributed by the employer to NPS, or 14% of salary in case of Central or State Government employee or 10% (for old tax regime) or 14% (in case of New tax regime) of salary in case of any other employee.

'Salary' for the purpose of contribution by the employer and employee shall mean basic salary and dearness allowance (if terms of employment so provide). All other allowance or perquisites will not be part of salary for the purpose of calculation.

Contribution to Tier II account by Central Govt. employees

Any contribution made by Central Govt. employees to the tier II NPS shall be allowed as tax deduction under Section 80C. However, such contribution to NPS shall be made for a fixed period of at least 3 years. The maximum amount of deduction allowed under this section shall be Rs 1,50,000.

Contribution to NPS by a self-employed person

When contribution to the NPS is made by a self-employed individual, the deduction shall be allowed under Section 80CCD which shall be *lower* of the amount contributed by him to NPS or 20% of his gross income. This is within the overall limit of Rs. 1,50,000 permissible for various investments such as PPF, ELSS or expenses such as Life Insurance premium, that is allowed under the old tax regime. An additional deduction of Rs. 50,000 over and above this limit is allowed under Section 80CCD(1B) to such individual for the amount deposited by him to his NPS account under the old tax regime.

Threshold limit for deduction in respect of contribution to NPS

The total deduction under Section 80C, 80CCC and 80CCD(1) shall be limited to Rs. 1,50,000. This limit of Rs. 1,50,000 is not applicable in respect of:

1. The contribution made by the employer to NPS account of the employee; and
2. Additional deduction of Rs. 50,000 for the contribution made by an individual (employee or self-employed) to his NPS account.

Thus, the total deduction to be allowed to an individual in respect of contribution to NPS can go up to Rs. 2,00,000. The additional deduction of Rs. 50,000 is above this limit of Rs. 1,50,000. In other words, an assessee can choose to take a tax deduction in respect of contribution to NPS within the limit of Rs. 1,50,000 or as an additional deduction.

Example 8, An employee repays a housing loan of Rs. 170,000 during the year and contributes Rs. 65,000 in his NPS account. Repayment of housing loan to a bank or housing finance company is eligible for deduction under Section 80C. Since the limit of Rs. 150,000 is exhausted by such repayment, the employee can choose to take the benefit of the additional deduction for the contribution to NPS. Thus, the total deduction shall be Rs. 2,00,000 (Rs. 1,50,000 under Section 80C for housing loan repayment and Rs. 50,000 for contribution to NPS under Section 80CCD(1B)).

Example 9, Basic salary of Mr. Gopal is Rs 50,000 per month. He is entitled to dearness allowance of 40% of basic salary (Rs. 20,000 per month) and 50% thereof forms part of retirement benefits. He and his employer (non-govt.) both contribute 15% of basic salary as a contribution to NPS. Mr. Gopal is already claiming a deduction of Rs 150,000 under Section 80C.

The contribution made by the employer to NPS would be treated as part of the salary of Mr. Gopal. Thus, employer's contribution of Rs. 90,000 (Rs. 600,000 * 15%) would be included in the salary of Mr. Gopal. The deduction available under Section 80CCD shall be computed in following two steps:

Step 1: Computation of salary

Particulars	*Amount*
Basic Salary [Rs. 50,000 * 12 months]	600,000
Dearness allowance [Rs. 20,000 * 12 months * 50% (forming part of retirement benefits]	120,000
Salary for computation of deduction under Section 80CCD	**720,000**

Step 2 Computation of deduction under new tax regime

Particulars	*Amount*
Deduction for employee's contribution [Note 1] [A]	Not available under new tax regime
Deduction for the employer's Contribution *(a)* Contribution by employer *(b)* Deduction allowable under Section 80CCD(2) [Note 2][B]	 90,000 90,000
Deduction under Section 80CCD [A + B]	**90,000**

Note 1: No deduction is available for this under the new tax regime *Note 2:* Deduction for the employer's contribution to the NPS shall be limited to 14% of the salary, that is, Rs. 7,20,000 * 14%. = Rs. 1,00,800, subject to a maximum of actual contribution which is Rs. 90,000.

Step 2: Computation of deduction under old tax regime

Particulars	*Amount*
Deduction for employee's contribution *(a)* Contribution by employee *(b)* Deduction allowable under Section 80CCD(1B) [Note 1] [A]	 90,000 50,000
Deduction for the employer's Contribution *(c)* Contribution by employer *(d)* Deduction allowable under Section 80CCD(2) [Note 2][B]	 90,000 72,000
Deduction under Section 80CCD [A + B]	**1,22,000**
Note 1: Maximum deduction of Rs. 150,000 is allowed under Section 80C, 80CCC and 80CCD(1), which has already been exhausted for deduction under Section 80C. Thus, no deduction can be claimed under Section 80CCD(1). However, deduction of up to Rs. 50,000 can be claimed under Section 80CCD(1B). *Note 2:* Deduction for the employer's contribution to the NPS shall be limited to 10% of the salary, that is, Rs. 7,20,000 * 10%. The deduction for employer's contribution would be in addition to deduction available for Rs. 150,000.	

Step 3 – Calculating Taxable Income

Sr No	Description	Calculation	Old Tax regime (Rs.)	New Tax regime (Rs.)
1	Basic (A)	6,00,000		
2	Dearness Allowance – (part of retirement calculation) (B)	1,20,000		
3	Dearness Allowance – not part of retirement calculation (C)	1,20,000		
4	Employer's Contribution to NPS (D)	90,000		
5	12.3.2 Gross Salary Less: Standard deduction **Net Salary (E)**	12.3.3 9,30,000	12.3.4 9,30,000 (50,000) **8,80,000**	12.3.5 9,30,000 (75,000) **8,55,000**
6	12.3.6 **Deduction under section 80C (F)**	12.3.7	12.3.8 **1,50,000**	12.3.9 **Nil**
7	12.3.10 **Employee contribution to NPS – deduction under 80CCD (1) (G)**	12.3.11	12.3.12 **Nil as limit already consumed by section 80C**	12.3.13 **Nil**
8	12.3.14 **Employee contribution to NPS – deduction under 80CCD (1B) (H)**	12.3.15	12.3.16 **50,000**	12.3.17 **Nil**

9	12.3.18 **Employer Contribution under section 80CCD (2) (I)**	12.3.19	12.3.20 **72,000**	12.3.21 **90,000**
10	12.3.22 Total deductions [(F+G+H+I) = J]	12.3.23	12.3.24 2,72,000	12.3.25 90,000
11	12.3.26 Taxable Income [E minus J = K]	12.3.27	12.3.28 6,08,000	12.3.29 7,65,000

The Finance Act, 2020 introduced a cap on maximum contribution an employer can make towards recognized provident fund (PF), National pension scheme (NPS) and Superannuation fund (hereinafter collectively referred to as 'employee welfare schemes'). The contribution to employee welfare schemes in excess of Rs. 750,000 shall be taxed as perquisite in the hands of the employees.

Employers' contribution to NPS is taxed as salary in any case. Thus, there is a double add back of employers' contribution to NPS (in excess of Rs. 7.50 lakhs) with only a single deduction.

An example is given below to understand this better:

Example 10:

Mr X has a basic salary of Rs. 50,00,000

His employer contributes 12% of his basic (Rs. 6 lakhs) to Mr X's EPF account. Mr X also contributes Rs. 6 lakhs as his contribution to EPF. Additionally, the employer contributes 14% of his Basic (Rs. 7,00,000) to his NPS account. Mr X contributes Rs. 50,000 to his NPS account.

Here is his calculation of Taxable Income under both the taxation regimes:

Sr No	Description	Calculation	Old Tax regime (Rs.)	New Tax regime (Rs.)
1	Basic (A)	50,00,000		
2	12% employers' contribution (6,00,000) to EPF is exempt (B)	Nil		
3	14% employers' contribution to NPS is added back as salary (C)	7,00,000		
4	Employers' contribution to EPF and NPS in excess of 7,50,000 is added as a perk (6,00,000+C)- 7,50,000	5,50,000		
5	**Gross Salary** Less: Standard deduction **Net Salary (E)**	62,50,000	**62,50,000** (50,000) **62,00,000**	**62,50,000** (75,000) **61,75,000**

6	Deduction under section 80C – employee EPF contribution (F) maximum of Rs. 1,50,000		1,50,000	Nil
7	Employee contribution to NPS – deduction under 80CCD (1) (G)		Nil, as limit already consumed by section 80C	Nil
8	Employee contribution to NPS – deduction under 80CCD (1B) (H) additional Rs. 50,000		50,000	Nil
9	Employer Contribution under section 80CCD (2) (I)		5,00,000 (max 10% of Basic)	7,00,000 (Max 14% of Basic)
10	Total deductions [(F+G+H+I) = J]		7,00,000	7,00,000
11	Taxable Income [E minus J]		**55,00,000**	**54,75,000**

Effectively the employers' contribution to NPS has been fully taxed since it has been added back 2 times while calculating salary (once as salary and another time as perk) and deduction has been allowed only once.

12.3.2 Tax treatment of sum received from NPS

In case of withdrawal on closure of account or opting out of NPS

Any payment from the National Pension System Trust to an assessee on closure of his account or on his opting out of the pension scheme is exempt from tax to the extent of 60% of the total corpus. As per the NPS scheme, a person can withdraw up to 60% of the total corpus. The exemption limit under the Income Tax Act has been set in symmetry with the NPS. Thus, the total amount withdrawn by an assessee at the time of closure of NPS account or opting out of the scheme shall be completely tax-free.

In case of partial withdrawal from NPS

Any amount withdrawn from NPS before the closure of account or opting out of the scheme shall be exempt only in case of employees to the extent of 25% of employee's contribution to NPS. Further, the amount should be withdrawn in accordance with the terms and conditions specified under the Pension Fund Regulatory and Development Authority (PFRDA) Act, 2013.

As per PFRDA (Exits and Withdrawals under the National Pension System) (First Amendment) Regulations 2017, the subscribers can withdraw after 3 years from the date of joining the system and a maximum of three times during the entire tenure of subscription under NPS.

In case amount is received by the nominee on death of subscriber

Where the amount standing to the credit of an assessee in NPS is received by his nominee on the death of the subscriber, it shall be fully exempt from tax.

In case pension received out of NPS

When a pension is received out of fund contributed to NPS, it will be chargeable to tax in the hands of the recipient.

In case amount withdrawn from NPS utilized for purchasing an annuity plan

Where the amount withdrawn or received out of NPS is utilized for purchasing an annuity plan of LIC or some other insurer in the same previous year then the annuity income received shall be taxable in the hands of the recipient.

In case of withdrawal from Tier II account

The investment made in Tier II Account is considered just like as an investment in an open-ended mutual fund. Thus, any profit or loss arising on account of withdrawal of amount from Tier II Account shall be taxable under the head of capital gain.

Summary of Taxability of NPS

Particulars	***Taxability***
Contribution to NPS	
Employees' contribution to NPS	The deduction is allowed up to 10% of salary *plus* additional deduction of Rs. 50,000.
Employers' contribution to NPS*	The deduction is allowed up to: ▪ 14% of salary in case of Central or State Government employees; ▪ 10% of salary in case of other employees (under old tax regime) and 14% of salary (under new tax regime)
Any other person not being an employee	The deduction is allowed up to 20% of gross total income *plus* additional deduction of Rs. 50,000.
Accumulation	Tax Free
Withdrawal	
Partial withdrawal	If subscriber is an employee, exempt to the extent of 25% of the contribution made by the employee to the NPS.
Final withdrawal at the time of closure of account or opting out of the scheme	Exempt up to 60% of the total corpus available in the NPS account of the subscriber.
Amount received by a nominee on death of the subscriber	The whole of the amount received by the nominee shall be exempt in the hands of the receiver.
In case of withdrawal from Tier II account	Profit or loss from investment in Tier II account shall be taxable under the head "Capital Gains".
In case the amount withdrawn from NPS utilised for purchasing an annuity plan	No tax shall be charged on such amount withdrawn if it is utilized for purchasing the annuity plan of LIC or some other insurer.

Pension Income	
Pension received out of fund contributed to NPS	Pension received from the fund will be taxable in the hands of the receiver

12.4 Real Estate Investment Trust

Real Estate Investment Trusts (REITs) were first introduced in the United States in 1960-61 through the Cigar Excise Tax Extension Act. It gave an opportunity to the investors to invest in large-scale, diversified portfolios of income-producing real estate. Since then, more than 30 countries have introduced REIT regimes. The concept of REIT was introduced in India in 2014 by SEBI. REITs are registered with the SEBI under SEBI (REITs) Regulations, 2014.

REITs invest in the majority of real estate property types, which includes offices, apartment buildings, warehouses, retail centres, medical facilities, data centres, cell towers, infrastructure and hotels. Most REITs focus on a particular property type, but some hold multiple types of properties in their portfolios. For example, Office REITs are those that own and manage office real estate and rent the space in those properties and Industrial REITs own and manage industrial facilities and rent space in those properties. Similarly, Retail REITs include REITs that focus on large malls, outlet centres, grocery anchored shopping centres etc. Residential REITs include REITs that specialize in apartment buildings, student housing, manufactured homes and single-family homes. Timberland REITs own and manage various types of timberland real estate. Timberland REITs specialize in harvesting and selling timber.

REITs allow investors to invest in portfolios of real estate assets the same way they invest in shares or a mutual fund or exchange-traded fund (ETF).

Structure of REITs

The structure of REITs is similar to that of a mutual fund wherein sponsor (generally real estate developers) sets up the REITs to collect money from the general public for investing on their behalf in income-generating real estate properties. The investment is made in real estate properties either by REITs directly or through Special Purpose Vehicle (SPV) in which it holds the controlling interest. SPVs is a separate entity which can be a company which is floated to hold and develop real estate properties.

Unit-holder

Unit-holder means any person who owns units of the REIT.

However, assets falling under the preview of “Infrastructure” shall not be considered as Real Estate property except following:

a) hotels, hospitals and convention centres forming part of composite real estate projects, whether rent generating or income-generating;
b) common infrastructure for composite real estate projects, industrial parks and SEZ.

12.4.1 Taxation of REITs

REITs are structured as a hybrid pass-through entity. Thus, certain types of income are exempt at REITs level and taxable at the level of unit-holders.

REITs may have the following types of income:

a) Rental income from real estate property;
b) Capital gains from the transfer of real estate property;
c) Dividend received from SPV;
d) Interest received from SPV; and
e) Any other income

The pass-through status is provided only in respect of income covered under point (a), (c) and (d) above. Thus, if REIT distributes any rental, dividend or interest income to its unit-holder then tax shall be charged at the level of unit-holder and not in the hands of the REIT. Further, any income distributed by REIT to its unit-holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit-holder had it been received by, or accrued to, the REIT. Taxability of various income earned by REITs are explained as under:

Rental Income

Rental income earned by the REITs from the investment made in properties shall be tax-free by virtue of Section 10(23FCA) of the Income Tax Act. Thus, such rental income shall be exempt at the REITs level. Rental income distributed by REITs to its unit-holders shall be taxed in the hands of unit holders.

Interest Income

REITs may also invest in real estate *via* Special Purpose Vehicle (SPV). Any interest income that REITs earned from SPV is exempt in the hands of REITs under Section 10(23FC). However, when such interest income is further distributed to the unit-holders, it is taxable in the hands of the unit-holders.

Any other interest income earned by REITs (other than from SPV) is not exempt at the level of REITs. Consequently, such interest income is taxable in the hands of REITs and when such income is further distributed, it is exempt from tax under Section 10(23FD) in the hands of unit-holders. However, if such interest income is not chargeable to tax in the hands of the REIT, it shall be taxable in the hands of the unit holder under the head “other sources” as per Section 56(2)(xii).[36]

[36] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25. Earlier, sum received from business trust (other than interest/dividend from SPV or rental income from REIT) was exempt in the hands of unit holder even if the sum so distributed is not chargeable to tax in hands of business trust.

Dividend Income

Dividend received by REITs from SPV is exempt from tax under Section 10(23FC). If dividend received from SPV is further distributed by REITs to the unit-holders, it shall be taxable in the hands of the unit-holders, being a pass-through income. However, if the dividend is received from SPV who has not opted for concessional tax regime of section 115BAA then such dividend shall be exempt in the hands of the unit holders as well under section 10(23FD).

Any other dividend income earned by REITs (other than from SPV) is not exempt at the level of REITs. Consequently, such dividend income is taxable in the hands of REITs and when such income is further distributed, it is exempt from tax under Section 10(23FD) in the hands of unit-holders. But, if such dividend income is not chargeable to tax in the hands of the REITs, it shall be taxable in the hands of the unit holder under the head "other sources" as per Section 56(2)(xii).

Capital Gains

Income Tax Act provides pass-through status to REITs only for rental income and interest/dividend received from SPV whereby tax is charged at the level of unit-holders. All other incomes are chargeable to tax at the level of REIT itself. Thus, any capital gain arising on transfer of real estate properties (including securities) by REIT shall be charged to tax in its own hands and not in the hands of the unit-holders.

Other income

All other incomes of REITs are chargeable to tax in the hands of REITs itself at a maximum marginal rate under Section 115UA. However, if the income is not chargeable to tax in the hands of the REIT and it is subsequently distributed to the unit holders, it shall be taxable in the hands of the unit holder under the head "other sources" as per Section 56(2)(xii).

12.4.2 Taxation of unit-holder of REITs

The income of a unit-holder in a REIT can be categorized into the following three categories:

(a) Pass-through Income: This includes sums distributed by the REIT to unit-holders for which pass-through status is accorded. In this case, the tax liability on the income is directly passed on to the unit-holders, and the REIT itself is not taxed on such distributed sums.

(b) Non-Pass-through Income: This category covers sums distributed by the REIT to unit-holders, but in this case, no pass-through status is accorded. As a result, the REIT is subject to taxation on such distributed sums at its own applicable tax rate, and the unit-holders are exempt from paying tax on this income. It is essential to note that if the sum distributed by the REIT to its unit-holder is not chargeable to tax at the level of the REIT itself, it becomes taxable in the hands of the unit-holder as per Section 56(2)(xii).[37]

(c) Capital Gains from Unit Redemption or Transfer: The third category pertains to any income arising from the redemption or transfer of units of the REIT.

12.4.3 Taxation of capital gain from redemption or transfer of units of REITs

Redemption of units of REIT

Sum received on redemption of units of REIT shall be taxable under the head other sources in accordance with the provision of Section 56(2)(xii).

Transfer of units of REIT

Income arising from the transfer of units of REIT shall be taxable in the hands of the unit-holder under the head capital gain. Where units of listed REITs are held for 12 months or less or 24 months or less in the case of unlisted REITs short-term capital gains will arise. However, if the holding period is more than 12 or 24 months for listed REITs and Unlisted REITs respectively, the gains arising from the transfer of such units shall be in the nature of long-term capital gains.

The tax on short-term or long-term capital gain shall depend upon the payment of security transaction tax (STT) at the time of transfer of units of business trust.

If STT has been paid on the transfer of units of REIT, short-term capital gains shall be taxable at the rate of 20% *plus* surcharge and cess under Section 111A

Whereas long-term capital gains in excess of Rs 1,25,000 would be taxable at the rate of 12.50% *plus* surcharge and cess under Section 112A.

The investments made on or before 31-01-2018 were grandfathered as the long-term capital gains arising from the sale of units of business trust were previously exempt from tax. The grandfathering works as per the following mechanism.

If units of business trust were acquired on or before 31-01-2018, the cost of acquisition of such units shall be higher of the following:

a) The actual cost of acquisition of units of business trust; or
b) *Lower* of the fair market value of such asset as on 31-01-2018 or full value of the consideration received as a result of the transfer of units of business trust.

[37] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25. Earlier, sum distributed by the business trust (other than sum distributed under pass through status) was exempt in the hands of unit holder even if the sum so distributed is not chargeable to tax in the hands of business trust.

The highest price of units quoted on a recognized stock exchange as on 31-01-2018 is taken as the fair market value. If there is no trading in such units on such exchange on 31-01-2018, the highest price of such units on a date immediately preceding 31-01-2018 when such units were traded shall be the fair market value.

If units of business trust are not listed on a recognised stock exchange as on the 31-01-2018, the net asset value of such unit as on the said date is considered as cost of acquisition.

If STT has not been paid on the transfer of units of REIT, Short-term capital gains shall be taxable as per the tax rates applicable in case of unit-holder. Long-term capital gains shall be taxable at the rate of 12.50% under Section 112 of the Act in case of a resident.

12.4.4 Applicability of TDS

REIT to unit-holder

When REIT distributes the rental income or interest/dividend received from SPV to its unit-holders, the income so distributed is chargeable to tax in the hands of the unit-holders. Thus, to collect taxes from unit-holders at the time of distribution of such income by REITs, the Govt. has introduced TDS provisions. The REITs are required to deduct tax under section 194LBA while distributing the said incomes to the unit-holders. The tax shall be deducted at the following rates:

Nature of distributed income	***Residential status of the unit-holder***	
	Resident	*Non-resident**
Rental income	10%	Foreign company: 35% Any other non-resident person: 30%
Dividend income received from SPV[38]	10%	10%
Interest income received from SPV	10%	5%
**If the provisions of DTAA are more beneficial the tax shall be deducted as per DTAA.*		

12.4.5 Reporting of income by REITs to its unit-holders

When REITs distributes any income to its unit-holders, including the income taxable under Section 56(2)(xii), it shall be required to furnish a statement to the unit-holders (Form No. 64B) as well as to the income-tax department (Form No. 64A) giving the details of the nature of the income paid during the previous year to unit-holders.

12.5 Infrastructure Investment Trust

Infrastructure Investment Trusts (InvITs) invest in infrastructure projects that include roads, bridges, ports, airports, metros, electricity generation, transmission or distribution, telecommunication services, telecommunication towers, special economic zones, etc.

[38] No tax shall be deducted if the dividend is received from SPV which has not opted for concessional tax regime of section 115BAA.

InvITs are registered with SEBI under SEBI (InvITs) Regulations, 2014. The structure of InvITs is very much similar to that of a REITs. Further, the tax implications are also same for both InvITs and REITs, except pass-through status relating to rental income.

The rental income of REITs is chargeable to tax in the hands of the unit-holders as pass-through status has been provided to REITs in respect of such income. But, in case of InvITs, rental income is chargeable to tax in its own hands and not in the hands of its unit-holders.

Summary of Taxability of REITs and InvITs

Nature of sum received	**Taxability in the hands of**		
	REIT	**InvIT**	**Unit holders**
Interest from SPV	Exempt [Section 10(23FC)(a)]	Exempt [Section 10(23FC)(a)]	Taxable
Dividend from SPV (SPV has exercised option under Section 115BAA)	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FC)(b)]	Taxable [Income from business/other sources]
Dividend from SPV (SPV has not exercised option under Section 115BAA)	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FD)]
Rental income from property owned by trust	Exempt [Section 10(23FCA)]	Taxable [Income from business]	Taxable (if received from REIT)
Other sum or income (if taxable in hands of business trust)	Taxable [Income from business/capital gain/ other sources]	Taxable [Income from business/capital gain/ other sources]	Exempt [Section 10(23FD)]
Other sum or income (if not taxable in the hands of business trust)	Not taxable	Not taxable	Taxable [Income from other sources under section 56(2)(xii)]

Tax on capital gain arising to unit holder from redemption or transfer of units of REITs/InVITs		
Nature of Income	*Tax Rates*	
	Resident	*Non-Resident*
Redemption of units of business trust	Normal tax rate [Income from other sources under Section 56(2)(xii)]	
Short-term capital gains from transfer of units of business trust (other than redemption)	*(a)* 20% under Section 111A (in the case of listed units) *(b)* Applicable rate (in case of unlisted units)	
Long-term capital gains from the transfer of units of business trust (other than redemption)	*(a)* 12.50% under Section 112A above Rs. 1,25,000 (listed units) *(b)* 12.50% under Section 112 (unlisted units)	*(a)* 12.50% under Section 112A above Rs. 1,25,000 (listed units) *(b)* 12.50% under Section 112 (unlisted units)

12.6 Alternative Investment Funds

Alternative Investment Fund (AIF) means any fund established or incorporated in India, as a privately pooled investment vehicle, to collect funds from sophisticated investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of its investors. However, it does not include mutual funds, collective investment fund or any other fund for which there are separate regulations of SEBI.

AIF can be set up as a trust, company, limited liability partnership and any other body corporate and it is mandatory to obtain registration from SEBI as per SEBI (Alternative Investment Funds) Regulations, 2012 or under the International Financial Services Centres Authority Act, 2019.[39] SEBI grants registration to AIFs on the basis of their operational strategies, objectives and fund structure and, for this purpose, they are categorized into various categories. The AIF categories have already been discussed in Investment Adviser Level 1 workbook.

12.6.1 Taxation of Category-I and Category-II AIFs

Taxation of Category-I and Category-II AIFs is governed by Section 115UB of the Income Tax Act which provides pass-through status to such funds wherein income arising to such funds is exempted from tax, while investors are liable to pay tax on such income as if the investors have directly made the investments. However, this pass-through status is not given in respect of 'business income' of the AIF. Thus, business income is chargeable to tax in the hands of AIF itself.

Any income arising in the hands of the Investment fund shall be bifurcated into the following two categories:

a) Business income; and
b) Any other income.

Taxability of Business Income

Income in the nature of business income shall be taxed in the hands of the Investment Fund under the head 'Profits and gains from business or profession' and it shall be exempt in the hands of the unit-holders under Section 10(23FBB).

If Investment fund is a company or a firm, such business income will be taxable at the rates applicable to the company or firm. However, in any other case, where AIF is registered as a trust or any other body corporate, such income shall be taxed at maximum marginal rates.

Taxability of Other Income

Any other income shall be taxable in the hands of the unit-holder and it shall be exempt in the hands of the Investment Fund under Section 10(23FBA).

[39] Amended by the Finance Act 2021, with effect from assessment year 2022-2023

The income arising to the unit-holder, out of the investment made in the Investment Fund, shall be chargeable to tax in the same manner as if it were the income accruing or arising to them, had the investments (made by the Investment Fund) been made by them directly.

The income paid or credited by the investment fund to the unit-holder shall be deemed to be of the same nature and in the same proportion in the hands of the unit-holder as if it had been received by, or had accrued or arisen to, the investment fund.

Further, the income accruing or arising to, or received by, the AIF, during a previous year, if not paid or credited to the investor thereof, shall be deemed to have been credited to the account of the investors on the last day of the previous year in the same proportion in which investors would have been entitled to receive the income had it been paid in the previous year.

Set-off and carry forward of losses

Any losses arising in the hands of the investment fund under the head 'Profits and gains arising from business or profession' shall be allowed to carry forward and not to be passed to its unit-holders.

Up to Assessment Year 2019-20, AIFs were allowed to pass the income to the unit-holders but not losses. Thus, if the net result of the computation of total income of the AIF is a loss then the same was not allocated amongst the unit-holders. Thus, they were deprived of setting off such loss against their income. The Finance (No. 2) Act, 2019 amended the provisions of section 115UB to allow pass-through of losses as well. Thus, from Assessment Year 2020-21, non-business losses of AIF is allowed to be allocated amongst unit holders except where such loss is in respect of a unit, which has not been held by the unit-holder for a period of at least 12 months.

Any losses, other than the business losses, accumulated at the level of investment fund as on 31-03-2019, shall be deemed to be the loss of the unit-holder who held the units as on that date. In other words, the accumulated losses shall be deemed to be the losses of the unit-holders who held the units as on 31-03-2019 even if the period of holding of such unit is less than 12 months.

Such losses shall be allowed to be carried forward by such unit-holders for the remaining period calculated from the year in which the loss had occurred for the first time taking that year as the first year. He shall be allowed to set off and carry forward the losses in accordance with the provisions of Chapter-VI. Such losses which are passed to the unit-holders shall not be allowed to the investment fund for set off and carry forward.

Applicability of TDS Provisions

As other income (not being a business income) is taxable in the hands of the unit-holder, the CBDT has notified that no tax shall be deducted from the payment of such income to the investment fund.[40]

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[40]Notification No. 51/2015/SO 1703(E), dated 25-6-2015

For example, if an investment fund receives any rental income or interest income from a bank, the payer shall not deduct tax from such payment.

In case the income arising in the hands of investment fund is taxable in the hands of the unit-holder, the investment fund shall deduct tax under Section 194LBB from the payment at the rate of 10% in case of resident unitholders and at rates in force in case of foreign unitholders. If the unit-holder is a non-resident (not being a company) or a foreign company, no tax shall be deductible in respect of any income which is not chargeable to tax.

Reporting of income by AIF

When AIF distributes any income to its unit-holders, it shall be required to furnish a statement to the unit-holders as well as to the income-tax department giving the details of the nature of the income paid during the previous year to unit-holders.

The statement shall be required to be furnished to the unit-holders in Form No. 64C by the 30^{th} June of the financial year following the previous year during which the income is paid or credited.

The statement shall be required to be furnished to the Income-tax department in Form No. 64D by the 30^{th} November of the financial year following the previous year during which the income is distributed.

Example 14: Category-I AIF, registered as a trust, has derived following income during the year:

Nature of income	*Amount (in lakhs)*
Income under the head profit and gains from business and profession	20
Income under the head capital gains	15
Income from other sources	5

Mr. X holds 30% units of the AIF. During the year, the AIF has credited the entire income to the accounts of its investors except for income in the nature of other sources. Determine the taxability both in the hands of AIF and Mr. X.

Taxability in the hands of AIF

Income Tax Act provides the pass-through status to the Category-I AIF. The income arising to the AIF is exempt from tax as investors are liable to pay tax on such income as if they have directly made the investments. However, this pass-through status is not given in respect of 'business income' of the AIF. Thus, business income of Rs. 20 lakh shall be chargeable to tax in the hands of AIF itself. As the AIF is registered as a trust, the business income shall be chargeable to tax at maximum marginal rate (MMR).

Taxability in the hands of Mr. X

Nature of income	*Amount (in lakhs)*
Income credited by the AIF:	

- Income under the head PGBP[†]	-
- Income under the head capital gains	4.5
Income deemed to be credited:	
- Income from other sources	1.5
Total income	**6**
[†] *Income received by unit holder from AIF in the nature of income from business or profession shall be exempt under section 10(23FBB).*	

12.6.2 Taxation of Category-III AIFs

Pass-through status has been accorded only to Category-I and Category-II AIF and not Category-III AIF. Thus, as AIFs can be formed as a trust, company, limited liability partnership and any other body corporate, the taxation system in the case of Category-III AIF shall be the same as in case of a normal trust, company, LLP or any other body corporate.

In case such Category III AIF fulfils the conditions for being a specified fund as referred under Section 10(4D), it shall be entitled to various exemptions, concessions and allowances.

12.7 Exchange Traded Funds (ETFs)

Exchange-Traded Funds (ETFs) are like Mutual Funds that track an index (i.e., NIFTY/SENSEX), or a commodity (Gold/Silver) or a basket of assets like an index fund. However, unlike regular Mutual Funds, ETFs are listed on exchange and trade like a stock, thus experiencing price changes throughout the day as it is bought and sold.

12.7.1 Gold ETFs

Gold exchange-traded fund scheme (Gold ETF) is defined under SEBI (Mutual Funds) Regulations, 1996 to mean mutual fund scheme that invests primarily in gold or gold related instruments. The taxation and exemption rules for them are the same as for physical gold or other than equity oriented mutual funds.

Any profit arising from the sale of Gold ETFs, after holding it for a period of more than 12months, is considered as long-term capital gain. Such capital gains are taxable at the rate of 12.50% *plus* surcharge and cess after taking benefit of Indexation. Further, where Gold ETFs are held for 12 months or less, any profit on sale of such ETFs is taxable at normal rate as applicable in case of the investor.

For Gold ETFs that were bought after April 1, 2023 and sold before April 1, 2025 the capital gains will always be treated as short term capital gains and will be taxed at Slab rates. This rule does not apply if the Gold ETF has been bought before April 1, 2023 or is sold on or after April1, 2025.

Example 15, Mr. A (resident in India) acquired 10,000 units of Gold ETF at Rs. 30 per unit on 01-03-2018. He sold such units on 25-03-2025 at Rs. 50 per unit. Compute the amount of capital gain chargeable to tax in hands of Mr. A.

Answer:

Computation of capital gain	
Particulars	*Amount*
Period of holding (from 01-03-2018 to 24-03-2025)	84+ Months
Nature of capital gain (held for more than 36 months)	Long term capital gain
Full Value of Consideration (10,000 units * Rs. 50)	500,000
Less: Cost of Acquisition	(-) 3,00,000
Long-term capital gain	**2,00,000**
Tax rate on capital gain	**12.50%**

12.7.2 Equity Index ETFs

Index fund scheme (Index ETF) is defined under Regulation 2(mn) of SEBI (Mutual Funds) Regulations, 1996 to mean a mutual fund scheme that invests in securities in the same proportion as an index of securities. Tax treatment of index ETFs that track equity indexes would be same as in the case of listed equity oriented mutual funds. Any profit arising from index ETF would be long-term if it is held for more than 12 months. Such long-term capital gains above Rs 1.25 lakh would be taxable at the rate of 12.50% *plus* surcharge and cess under Section 112A. However, short-term capital gains on index ETFs would be taxable at the rate of 15% under Section 111A.

Example 16, Mr. A (resident in India) acquired 5,000 units of an Nifty 50 Equity Index ETF on 01-05-2019 at Rs. 200 per unit. He sold the units on 01-08-2024 at Rs. 300 per unit through the recognised exchange and paid STT on such transaction. Compute the amount of capital gain chargeable to tax in hands of Mr. A.

Answer:

Particulars	*Amount*
Period of holding (from 01-05-2019 to 31-07-2024)	12+ Months
Nature of capital gain (holding period is more than 12 months)	Long term capital gain
Sale price (5,000 units * Rs. 300)	Rs. 15,00,000
Cost of acquisition (5,000 units * Rs. 200)	Rs. 10,00,000
Long term capital gain	Rs. 5,00,000
Tax rate of capital gain†	12.50%
† As the amount of capital gain exceeds Rs. 125,000, the excess amount shall be chargeable to tax at concessional rate of 12.50% as per section 112A.	

12.8 Tax aspects of Life Insurance Products

Any sum received from life insurance policy including bonus is exempt from tax.

However, it may be taxed if any of the following situations exist:

a) any sum received under a Keyman insurance policy

b) any sum received under sub-section (3) of section 80DD (i.e. where any amount is paid under the scheme of Life Insurance Corporation for maintenance of dependent and the dependent predeceases the assessee, the amount received by the assessee on death of dependent).

c) Where the insurance policy is issued on or after the 1st day of April, 2003 but on or before the 31st day of March, 2012 if the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured; or

d) Where the insurance policy is issued on or after the 1st day of April, 2012 if the premium payable for any of the years during the term of the policy exceeds ten per cent of the actual capital sum assured.

Any amount received on death of the person is not taxable and the conditions mentioned under point (c) and (d) above are not applicable.

The above tax treatment is applicable to all types of life insurance policies – be it traditional insurance policies, or unit linked insurance policy or pension plan.

Premiums payable are also allowed as deduction under section 80C. The total deduction allowed under section 80C (along with section 80CCC and 80CCD) is Rs. 150,000.

Certain important points to remember in this regard are:

i). In case of an individual, deduction is available for policy issued in the name of individual himself or spouse or children.

ii). In case of a HUF, deduction is available for policy issued in the name of any of the member thereof.

iii). Deduction is restricted to 20% of sum assured for policies issued on or before 31.03.2012 and 10% for policies issued on or after 01.04.2012. In case of policy taken on or after 1-4-2013 in the name of any person suffering from disability or severe disability referred to in section 80U or suffering from disease or ailment as given in section 80DDB, the limit will be 15% of capital sum assured

iv). The various policies need to be held for a minimum period as follows. Where the policies are terminated before this minimum period, any deduction allowed in earlier years will be taxed as income of the year in which such policy got terminated.

Nature of policy	Minimum Holding Period
ULIP of UTI or LIC	5 years
Life Insurance Policy	2 years

Following are salient features in respect of High value ULIPs vide amendments made by Finance Act:

1) Applies only in respect of ULIP policies issued on or after 1 February 2021 (affected policies) and does not impact earlier policies
2) Determination of High Value premium only for affected policies
3) Premiums of all affected policies to be added up together
4) To the extent the premium of the affected policies does not exceed Rs. 2,50,000 – old provisions will continue to apply
5) Long term period for equity-oriented funds from high premium ULIPs (defined in the same manner as an equity oriented mutual fund but with a requirement to maintain the 65% or 90% character of listed domestic equity throughout the tenure of the policy) will be 1 year.
6) Equity oriented funds within high premium ULIPs will be taxed at concessional rate of 12.50% for long term capital gains.
7) Short term capital gains (if any) on equity-oriented fund in a high premium ULIP will be taxed at the special rate of 20%.
8) Any gains on non-equity-oriented fund in a high premium ULIP would be taxed in accordance with normal capital gains taxation – normal rates for short term and 12.50% for long term.

However, where any sum is received on death of a person, the same will not be taxed and will remain exempt under section 10(10D).

Consequential amendment made in Finance (No 2) Act, 2004 to make security transaction tax applicable on maturity or partial withdrawal with respect to unit linked insurance policy issued by insurance company on or after the 1st February, 2021 [to which exemption under clause (10D) of section 10 of the Act does not apply on account of the applicability of the fourth and fifth proviso]. This amendment is effective from 1st February, 2021.

With the insertion of above amendments, it is quite clear that policies covered by virtue of above amendments will be treated as capital asset. However, for other policies where the conditions of section 10(10D) (i.e. 20% / 10% of sum assured, as the case may be) are not satisfied, it remains an open issue still as to whether maturity proceeds of such policies will be treated as capital gains or income from other sources.

Taxation of Endowment Policies:

Endowment policies are the type of life insurance policies for a particular term. Where the policy holder survives the term, he is paid lumpsum (sum assured plus bonus, as may be applicable) on the maturity of the policy. In the event of his death, his nominee receives death benefit.

Maturity proceeds received on endowment policies taken after 1st April, 2012 will be exempt under section 10(10D) of the premium payable for any of the year does not exceed 10% of the sum assured.

For policies taken on or after 1st April, 2023, if the premium or the aggregate of the premium payable during the term of the policy exceeds Rs. 500,000, then the maturity proceeds are taxable as income from other sources even if the sum assured is 10 times or more of the premium amount.

Example, Mr. X has taken an endowment policy of say Rs. 60 lakhs on 1st April 2024. The premium payable on the same is Rs. 6 lakhs every year. Here the condition of premium not exceeding 10% is being satisfied. However, since premium payable is more than Rs. 5 lakhs, the maturity proceeds including any bonus received will be taxable under income from other sources after deducting the aggregate amounts of premium paid (which has not been claimed as deduction in any preceding years).

12.9 Tax aspects of Reverse Mortgage

Reverse mortgage is a facility given to senior citizens whereby they can mortgage their house property and borrow funds. They can continue to stay and occupy the said property. This helps them to unlock the value of their immovable property.

These schemes had certain tax issues around it. It was highly debatable as to whether mortgaging a property will amount to 'transfer' under the Income Tax Act. Hence, clause (xvi) was inserted in section 47 of the Income Tax Act so as to specifically exclude a reverse mortgage transaction from the ambit of the term 'transfer' if such transaction is under a scheme made and notified by the Central Government. Also, section 10(43) exempts from tax any amount received as loan either in lumpsum or in instalment under reverse mortgage transaction scheme referred to in section 47(xvi).

12.10 Taxation of other Derivative Products

The taxation aspects of all derivative products have been discussed in detail in Section 11.7 under Chapter 11.

CHAPTER 13: TAX PROVISIONS FOR SPECIAL CASES

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Tax applicability on:
  - Bonus issues / Rights issues / Buyback of shares
  - Split / Consolidation / Mergers / Acquisitions of securities
  - Stock Lending and Borrowing
  - Conversion of Bonds or Preference shares in equity shares
  - Segregated portfolios in mutual funds
  - Winding up of mutual fund schemes

13.1 Taxation of Bonus Shares

Meaning of Bonus shares

Bonus shares are the additional shares issued by a company to the existing shareholders on the basis of shares already owned by them. Bonus shares are issued to the shareholders without any additional cost. These shares are issued so as to give the shareholders an incentive and increase the equity base of the company.

The tax treatment of bonus issue depends upon whether the shares are held as stock-in-trade or as a capital asset. If they are held as capital assets, any profit or gain arising from the transfer of such shares are taxable as capital gains. If shares are held as stock-in-trade, the gain or loss arising therefrom is taxable under the head profits and gains from business and profession.

13.1.1 Taxation under the head capital gains

No tax implication arises either in the hands of the company or in the hands of the shareholders at the time of allotment of bonus shares. Gains will be calculated only at the time of transfer of shares by the shareholder. If the bonus shares are held as a capital asset, the profit arising from its transfer shall be taxable under the head capital gains. To calculate the capital gains, one should consider the following provisions.

Period of holding

The bonus shares may be classified either as long-term capital asset or short-term capital asset on the basis of the period of holding of such shares. The period of holding of bonus shares shall be reckoned from the date of allotment of such shares. If the bonus share is listed on the stock exchange in India, it will be treated as a short-term capital asset if it is held for not more than 12 months immediately preceding the date of transfer, otherwise, they are treated as long-term capital assets. However, in case these shares are not listed on a recognised stock exchange, such a period of 12 months shall be increased to 24 months.

Cost of acquisition

If bonus shares are allotted to shareholder without any payment on the basis of holding of original shares, the cost of such bonus shares will be ***nil*** in the hand of the original shareholder. However, if bonus shares are issued to the assessee prior to 01-04-2001, the cost of acquisition is taken at fair market value as on 01-04-2001, at the option of the assessee, is considered as cost of acquisition.

Where bonus shares are long-term capital assets and they fulfil the conditions prescribed under section 112A, then the cost of acquisition shall be higher of the following:

a) The actual cost of acquisition of bonus shares (which is *nil*); or
b) *Lower* of the fair market value of such shares as on 31-01-2018 or full value of the consideration received as a result of the transfer of such shares.

As the actual cost of acquisition of a bonus share is *nil*, the deemed cost of acquisition of such share shall be lower of its FMV as on 31-01-2018 and full value of the consideration received as a result of the transfer of such shares.

Sale consideration

The sale consideration arising from the transfer of bonus shares shall be the amount received or receivable by the person transferring the shares. However, where bonus shares are unquoted shares and the consideration received by the shareholder from the transfer of such shares is less than the fair market value, such FMV shall be treated as sale consideration.

Computation of capital gains

The capital gains shall be computed in the following manner:

Particulars	*Amount*
Sale Consideration	xxx
Less:	
- Cost of acquisition of shares	(xxx)
- Cost of improvement	(xxx)
- Expenditure in connection with the transfer	(xxx)
- Exemption under Sections 54 to 54GB, if any	(xxx)
Short-term Capital Gains/Long-term Capital Gains	**xxx**

Applicable tax rates

a) *Tax on short term capital gains:* Short-term capital gains arising from the transfer of equity shares (if STT is paid at the time of transfer) are taxable under Section 111A at the rate of 20%. In other cases, gains are added to the total taxable income and are chargeable to tax as per the tax rate applicable according to the status of the assessee.

b) *Tax on long term capital gains:* Long-term capital gains, arising from the transfer of equity shares (if STT is paid at the time of transfer), is chargeable to tax under Section 112A at the rate of 12.50% for capital gains exceeding Rs. 1,25,000. If STT is not paid at the time of transfer of listed equity shares, the long-term capital gains shall be taxable at the rate of 12.50% as the case may be under section 112.

13.1.2 Taxable under the head profits and gains from business or profession (PGBP)

If the bonus shares are held as stock in trade, gains arising at the time of transfer of such bonus shares shall be taxable under the head PGBP. As per ICDS-VIII, the shares held as stock-in-trade shall be initially recorded in the books at their cost of acquisition. As the cost of acquisition of bonus shares is *nil*, the value of shares held as stock-in-trade shall not be enhanced.

Gains or loss from the sale of bonus shares held as stock in trade shall be calculated as follows:

Particulars	*Amount*
Sale consideration	xxx
Less:	
- Cost of acquisition	(xxx)
- Expenditure relating to such sale	(xxx)
Business Income or loss	**xxx**

The gains arising in the manner explained above shall be assessable under head 'Profits and gains from business or profession' at the rates of tax as applicable in case of the assessee.

Example 1, Mr. A purchased 10,000 shares of X ltd (a listed co.) at Rs. 105 per share on 01-04-2020. Thereafter, the company announced bonus shares in the ratio of 1:2, *that is*, one bonus share for every two shares. The bonus shares were issued on 01-09-2023. Mr. A sold all 15,000 shares at Rs. 120 each on 01-08-2024. Compute the tax liability in his hands.

The capital gains shall be computed for the original shares (10,000 shares) and bonus shares (5,000) separately.

(a) Computation of capital gains from transfer of 10,000 original shares

No. of shares [A]	10,000
Cost per share [B]	Rs. 105
Total purchase value [C= A*B]	Rs. 10,50,000
Date of purchase	01-04-2020
Date of transfer	01-08-2024
Period of holding	52 months
Selling price per share [D]	Rs. 120
Total sale consideration [E=A*D]	Rs. 12,00,000
Long-term capital gains from sale of shares	Rs. 150,000

Tax Rate	12.50% on capital gain exceeding Rs. 125,000 under Section 112A

(b) Computation of capital gains from transfer of 5,000 bonus shares

No. of shares [A]	5,000
Total purchase value [B]	*Nil*
Date of purchase	01-09-2023
Date of transfer	01-08-2024
Holding period	11 months
Selling price per share [C]	Rs. 120
Total sale consideration [D = A * C]	Rs. 600,000
Short-term capital gains [E = D – B]	Rs. 6,00,000
Tax rate	20% under Section 111A

13.2 Taxation on Share Split or Consolidation of Shares

Meaning of Stock split

The process of dividing the outstanding shares into further smaller shares is known as a stock split. A stock split or stock divide increases the number of shares in a company. If a company declares a stock split, the number of shares of that company increases, but the market cap remains the same.

Meaning of Consolidation of shares

The share consolidation is a process conducted by the company with the intention to reduce its number of shares without reducing the share capital. The shares of the company are merged to reduce the number of shares and thereby increasing the market value of the shares. Consolidation of shares would lead to a decrease in the number of shares whilst an increase in the market price per share.

13.2.1 Taxation under the head capital gains

Section 45 provides that any profit or gain arising from transfer of a capital asset is taxable during the previous year in which such transfer takes place. Section 2(47) provides an inclusive definition of the term “Transfer”. However, splitting or consolidation of shares is not covered within the definition of transfer. Further, Section 55 provides that the cost of acquisition of such shares shall be determined with reference to the cost of acquisition of the shares or stock from which such asset is derived. Thus, it can be interpreted that no tax will be levied at the time of splitting or consolidation of shares though there is no specific exemption provided for this purpose under section 47. Tax implications will arise only at the time of sale of such converted shares. In such cases, the tax shall be computed as follows:

Cost of acquisition of shares after consolidation

In the case of consolidation of shares, the cost of acquisition shall be the total amount paid to acquire the original shares apportioned between the consolidated shares. Let’s understand this with the help of an example.

***Example 2**,* Mr A acquired 2,000 shares of XYZ Ltd. at its face value of Rs. 100 per share. Subsequently, the company announces to consolidate 2 shares of face value Rs. 100 per share into one share having face value of Rs. 200. After the consolidation, Mr A will hold 1,000 shares of XYZ Ltd. of the face value of Rs. 200 each. Cost of acquisition of such consolidated shares shall be Rs. 200 per share (Rs. 200,000/1,000).

Cost of acquisition of shares after the split

Amount paid originally by the investor for acquiring the shares shall be divided proportionately to the split shares for the purpose of determining the cost of acquisition of the shares.

***Example 3**,* Mr A purchased 1,000 shares of XYZ Ltd. having face value Rs. 100 for Rs. 150 per share. Subsequently, the company announces to split its one share of Rs. 100 into two shares of face value of Rs. 50 each. Now, after splitting up Mr A will hold 2,000 shares having face value Rs. 50 each. Cost of acquisition of such shares shall be Rs. 75 per share (Rs. 150,000/2000 shares).

Period of holding

Consolidation or splitting of shares does not amount to transfer and its cost is to be computed with reference to the cost of acquisition of the shares or stock from which such asset is derived, based on said principle it can be interpreted that the period of holding with respect to the split/consolidated shares shall be calculated from the date of acquisition of the original shares though no specific provision has been made in this regard.

13.2.2 Taxation under the head PGBP

If the shares are held as stock in trade, gains will be calculated only at the time of sale /transfer of such split up or consolidated shares. As per ICDS-VIII (Securities), the shares held as stock-in-trade shall be recorded in the books at their cost of acquisition.

***Example 4**,* Mr. Rishabh purchased 10,000 shares of a company at Rs. 400 per share. These shares were held by him as stock-in-trade. Subsequently, the company announces to split the shares from one share having face value of Rs. 100 each into two shares of Rs. 50 each. He sold all shares (20,000 shares) at Rs. 207 each. Compute his business income.

Answer:
After splitting, the cost of acquisition of a share shall be the amount originally paid by the investor for acquiring the shares as divided by the number of shares in hand after split-up. Thus, the cost of acquisition shall be Rs. 200 per share (Rs. 40 lakh/20,000 shares).

As the shares are held as stock-in-trade and sold for Rs. 207 per share, the amount of business income chargeable to tax in the hands of Mr. Rishabh shall be Rs. 140,000 [20,000 shares * (Rs. 207 – Rs. 200)].

13.3 Taxation of Buyback of Shares

Meaning of buy-back of shares

'Buy-back' of shares mean the purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies.

With effect from 1st October 2024, buyback proceeds received by shareholder shall be taxed as dividend under the head 'income from other sources'. No deduction for expenses or the cost of acquisition of such shares shall be available from such dividend while determining the income from other sources. The cost of acquisition of shares which are brought back by the company will be treated as capital loss (long-term or short-term, depending upon the period of holding of the shares bought back) in the hands of the shareholder and will be eligible for set off as per the applicable provisions.

Domestic company liable to pay tax[41]

As per section 115QA, if a domestic company purchases its own shares under a buyback scheme, such company shall be liable to pay tax on such distributed income. On the other hand, the consideration so received by the shareholders under the scheme shall be exempt from tax under Section 10(34A).

"Distributed income" means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares.

Only domestic company shall be liable to pay tax on the amount of distributed income paid to the shareholders at the time of buy-back of shares (listed or unlisted). However, if a foreign company pays consideration to buy-back shares from its Indian shareholders, the shareholders shall be liable to pay tax on the amount of capital gains arising from such transfer. The capital gains, in such a case, shall be computed in accordance with Section 46A.

The domestic company shall be liable to pay tax at the rate of 20% (*plus* 12% surcharge and 4% cess) of the distributed profit. The effective tax rate shall be 23.296%. The tax payable by the domestic company under this provision is an additional tax liability which shall be payable irrespective of the fact that the regular income-tax is payable or not payable by the company on its total income.

Payment of Tax

[41] SEBI (Buy-Back of Securities) Regulations 2018 and Section 68 of the Companies Act, 2013.

The tax on the distributed income shall be paid by the company to the credit of the central government through challan No. ITNS 280 within 14 days from the date of payment of such consideration.

The above tax shall be the final payment of tax in respect of the income on buy-back of shares and no credit thereof can be claimed either by the company or by any other person in respect of the tax paid. Further, no deduction under any other provision of the Act is allowed to the company or shareholder in respect of income distributed or the tax paid thereon.

13.3.1 Consequences of Default

If the tax on distributed income is not paid within the specified time-limit, the company shall be liable to pay interest at the rate of 1% per month (or part of the month) for the period beginning immediately after the last date on which tax was payable and ending with the date of actual payment. Also, the principal officer of the company and the company shall be deemed to be an assessee-in-default for the amount of tax payable.

Example 5, Mr. X subscribed 10,000 shares of ABC Ltd. (a domestic company) at the rate of Rs. 100 per share. The issuer co. announced to buy-back the shares at Rs. 125 per share. Discuss the liability in the hands of the company and Mr. X.

Answer:

(a) Taxability in the hands of Mr. X

No income shall be assessable in the hands of Mr. X as income arising in the hands of the shareholder due to buy-back of shares is exempt under section 10(34A).

(b) Taxability in the hands of the company

If a domestic company purchases its own shares under a buy-back scheme, such company shall be liable to pay tax on distributed income. The computation of tax shall be as follows:

Particulars	*Amount*
Number of shares bought back [A]	10,000
Issue price [B]	Rs. 100 per share
Buy-back price [C]	Rs. 125 per share
Distributed Income [D=C-B]	Rs. 25 per share
Total amount assessable as distributed income [E = D * A]	Rs. 250,000
Tax payable by the company [E * 23.296%]	Rs. 58,240

13.4 Taxation of Rights Issues

Meaning of Right Issue

A rights issue is a way of raising additional capital, wherein, instead of going to the public, the company gives its existing shareholders the right to subscribe to newly issued shares in proportion to their existing holdings.

13.4.1 Taxability at the time of renunciation of right

In general, the existing shareholders are given a right to acquire shares of the company at a price, which in most practical instances, is lower than the actual market price. There is an option with the shareholder either to purchase the shares at a given price or renounce his right in favor of some other investor and collect a fee from him for this purpose.

Any right available to a shareholder to subscribe to shares or any other security of a company is treated as 'capital asset' under Income Tax Act. Capital gains will arise in the hands of the shareholder who renounces his right in favour of any other person. Gains and tax thereon shall be calculated in accordance with the following provisions.

Cost of acquisition

The cost of acquisition of the rights so renounced shall be *nil*.

Period of holding

If such capital asset is renounced in favor of any other person, the period of holding of such capital asset shall be reckoned from the date of offer made by the company to the date of renouncement. Such right is deemed as 'short-term' if it is held by an assessee for a period of not more than 12 months (if the rights are listed) and 24 months (if the rights are not listed), immediately preceding the date of its transfer. In all practical aspect, the rights will be held for a short period which is likely to be less than even 12 months and hence always likely to be a short-term capital asset.

Sale consideration

The sale consideration shall be the amount received or receivable by the person renouncing the right.

Computation of capital gains

Particulars	*Amount*
Sale Consideration	xxx
Less:	
- Cost of acquisition	(xxx)
- Expenditure in connection with transfer	(xxx)
Short-term capital gains	**xxx**

Applicable tax rates

Such gains are generally in the nature of short-term capital gains, which shall be added to total taxable income and are chargeable to tax as per tax rate applicable according to the status of the assessee. Even if the rights are listed, it is not a listed equity share and hence not covered by section 111A.

13.4.2 Taxability at the time of sale of shares

Shares held as capital assets

Capital gains shall arise in the hands of the shareholder at the time of sale of such shares. Such gains shall be computed as under:

Particulars	*Amount*
Sale Consideration	xxx
Less:	
- Cost of acquisition of shares	(xxx)
- Cost of improvement of shares	(xxx)
- Expenditure in connection with the transfer	(xxx)
Short-term Capital Gains/Long-term Capital Gains	**xxx**

Cost of acquisition of the right shares is the price paid by the shareholder for their acquisition. If assessee buys shares on basis of rights entitlements of an original shareholder, the cost of acquisition of the rights shares so acquired shall be aggregate of the amount paid by him to renouncer (original shareholder) and the amount paid by him to the company for acquiring such rights shares.

The period of holding is reckoned from the date of allotment of such right share or security. Following periods shall be considered while determining whether the same shall be regarded as long term or short-term capital asset.

Type of shares and period of holding	*Nature of asset*
Unquoted shares held for not more than 24 months	Short term capital asset
Unquoted shares held for more than 24 months	Long term capital asset
Quoted shares held for not more than 12 months	Short term capital asset
Quoted shares held for more than 12 months	Long term capital asset

Sale of shares held as stock in trade

The profits arising from the transfer of right shares held as stock-in-trade, or from the renunciation of the right (obtained on basis of original shares held as stock-in-trade), shall be taxable as business income. Such business income shall be computed as per general provisions. The cost of acquisition of the rights so renounced shall be deemed to be *nil*.

Example 7, Mr. Paul purchased 1,000 shares of ABC Ltd. on 01-04-2024 at Rs. 500 each. On 01-08-2024 the company announced the right issue in the ratio of 2:1 giving the existing shareholders a right to purchase the shares at Rs. 250 each. Ascertain the taxability in the following cases:

(a) Mr. Paul renounced his right in favour of Mr. X for Rs. 200 per share on 01-09-2024.
(b) Mr. Paul exercised his right and the company allotted him 500 right shares as on 01-12-2024. On the date of allotment of right shares, the fair market value of the shares was Rs. 510. He thereafter sold the shares at Rs. 520 on 25-01-2025. The shares of the company are listed on stock exchange. Thus, STT was charged at the time of transfer.

(a) Computation of income and tax thereon in case rights are renounced

If Mr. Paul has renounced his right to subscribe for shares in favour of any other person. The capital gain arising from transfer of such right will be computed as follows:

Computation of capital gain on renouncement of right	
Particulars	*Amount*
Period of holding (from 01-08-2024 to 31-08-2024)	1 month
Nature of capital gain	Short-term capital gain
Full value of consideration (500 shares * Rs. 200)	Rs. 100,000
Less: Cost of acquisition	*Nil*
Short-term capital gain	Rs. 1,00,000
Tax rate on capital gain	Normal tax rates applicable to Mr. Paul

(b) Computation of income and tax thereon in case rights are exercised and shares are subsequently transferred

Computation of capital gain on transfer of right shares	
Particulars	*Amount*
Period of holding (from 01-12-2024 to 24-01-2025)	Less than 2 months
Nature of capital gain (held for less than 12 months)	Short-term capital gain
Sale Price (500 shares * Rs. 520 each)	Rs. 2,60,000
Less: Cost of Acquisition (500 shares * Rs. 250)	Rs. 1,25,000
Short-term capital gain	Rs. 1,35,000
Tax rate on capital gain	20%†
†As Mr. Paul has paid STT at the time of transfer of shares, capital gain shall be chargeable to tax at the rate of 20% under Section 111A of the Income Tax Act.	

13.5 Taxation in case of Mergers & Acquisitions

Meaning of Merger

The term merger and acquisition is not specifically defined under the Income Tax Act. In general sense, merger is the voluntary fusion of two companies either by closing the existing companies and making a new one or by one company absorbing the other company. Quite often term amalgamation is interchangeably used with mergers.

Under the Income Tax Act, amalgamation is defined as the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that:

a) All the property of the amalgamating co(s).(transferor co.) immediately before the amalgamation becomes the property of the amalgamated co.(transferee co.) by virtue of the amalgamation;
b) All the liabilities of the amalgamating co. immediately before the amalgamation become the liabilities of the amalgamated co. by virtue of the amalgamation;
c) Shareholders holding not less than 75% in value of the shares in the amalgamating co. (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated co. or its subsidiary) become shareholders of the amalgamated co. by virtue of the amalgamation.

The amalgamation should be otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

13.5.1 Taxability at the time of allocation of shares

In case such shares are held as capital asset, there will be no tax implication in the hands of the shareholder at the time of allotment of shares of the amalgamated company in lieu of shares held as capital asset in the amalgamating company, as such transactions are not regarded as 'transfer' as per section 47(vii).

However, where such shares are held as stock-in-trade, income arising at the time of such exchange shall be taxable under the head profit and gains from business or profession.

13.5.2 Taxability at the time of transfer of shares

If the shares acquired in the amalgamated company are held as capital asset, the profits from its transfer shall be taxable under the head capital gains. On the other hands, if such shares are held as stock-in-trade, the profit or losses arising from the transfer shall be taxable under the head profits and gains from business or profession.

Shares held as capital assets

The capital gains from transfer of shares acquired in the amalgamated company shall be computed as per general provisions. The cost of acquisition of the shares acquired in the amalgamated company shall be the amount paid by the shareholder at the time of acquisition of original shares of the amalgamating company. The period of holding is reckoned from the date of acquisition of original shares in the amalgamating company

For other provisions relating to computation of sale consideration and the rate of tax, refer relevant paragraphs of the chapter - Taxation of equity products.

Shares held as stock-in-trade

The gains or loss from transfer of shares acquired in the amalgamated company shall be computed as per general provisions. Fair value of securities acquired under the scheme of amalgamation, i.e., shares of amalgamated company, shall be treated as actual cost of such securities while determining such income.

Example 8, Mr. X purchased 10,000 shares of A Ltd. on 01-04-2023 for Rs. 58 each for investment purpose. With effect from on 01-08-2024, A Ltd. amalgamated with B Ltd. to form a new company AB Ltd. Mr. X was allotted 8,000 shares in the new amalgamated company. He sold the shares of the amalgamated company for Rs. 100 per share on 01-09-2024. The shares of AB Ltd. are listed on recognized stock exchange and STT was charged at the time of transfer. Compute his income and tax thereon.

Computation of capital gain on transfer of shares	
Particulars	*Amount*
Period of holding (from 01-04-2023 to 31-08-2024)	17 Months
Nature of capital gain (held for more than 12 months)	Long term capital gain
Sale Price (8,000 shares * Rs. 100 each)	Rs. 800,000
Less: Cost of acquisition of shares in the amalgamating co. (10,000 shares * Rs. 58)	Rs. 580,000
Long-term capital gain	Rs. 220,000
Tax rate on capital gain	12.50%
†As Mr. X has paid STT at the time of transfer of units, capital gain shall be chargeable to tax at the rate of 12.50% under section 112A of the Income Tax Act on the gains that exceed Rs. 1,25,000. It is irrespective of the fact that STT is paid at the time of acquisition or not as CBDT vide Notification No. SO 5054(E), dated 1-10-2018, has exempted the condition of payment of STT at the time of acquisition in respect of listed shares acquired by any mode of transfer referred under Section 47.	

13.6 Taxation in case of Stock Lending and Borrowing

Meaning of Stock Lending and Borrowing

Stock Lending and Borrowing (SLB) is a system wherein a person can lend his securities to a borrower through approved intermediary for a specified period with the condition that the borrower would return equivalent securities of the same type or class at the end of the specified period along with all the corporate benefits which have accrued on securities (e.g. dividend) during the period of borrowing. It is a temporary lending of securities executed by a lender to a borrower, for a stipulated duration, for a certain fee. The lending and borrowing of securities is regulated by the SEBI through Securities Lending Scheme, 1997.

The framework for Securities Lending and Borrowing (SLB) was specified by SEBI.[42] As per the circular, all market participants (including retail or institutional) in the Indian securities market are permitted to lend and borrow securities through an Authorized Intermediary (AI). Clearing Corporation of NSE and BSE are approved as an Intermediary for this purpose.

The SLB takes place on an automated, screen based, order-matching platform provided by the AIs which shall be independent of the other trading platforms. Further, only the securities traded in F&O segment and liquid index ETFs are eligible for lending & borrowing

[42]SEBI Circular No.: MRD/DoP/SE/Dep/Cir-14/2007 dated December 20, 2007 as amended from time to time.

under the scheme.[43] The SLB contracts can be of different tenures ranging from 1 day to 12 months. But, usually they are entered for 1 month and lender or borrower is allowed to rollover the contract but total duration of the contract after taking into account rollovers shall not exceed 12 months from the date of the original contract.

The process of lending and borrowing of securities is as follows:

1) Lender and borrowers place an order with intermediary mentioning the stock, quantity to lend or borrow, time period, and lending fees. Thereafter, order matching takes place similar to trading on an exchange.
2) The lender is required to deposit 25% of the lending price (i.e., total value of stock) as margin. If the lender lends securities on the date of transaction itself, no margin is required to be deposited.
3) Borrower is required to deposit 100% of the lending price, lending fee, value at risk margins and extreme loss margins on an upfront basis and, thereafter, daily mark to market margin (MTM) is collected.
4) At the end of contract, lender gets back the stock and borrower margin is released. If borrower fails to return the securities, the AIs shall have the right to liquidate the collateral deposited with it, in order to purchase from the market, the equivalent securities of the same class and type for the purpose of returning the equivalent securities to the lender.

Benefit of SLB to borrower and lender

The benefit of SLB for lender is that it provides incremental return on an idle portfolio. A person holding shares of a company with an intent to hold them for long-term may earn additional return in form of lending fees by lending such shares to borrower for short-term. This can be a meaningful income enhancer for mutual fund holdings that are meant to be held for the long-term.

Whereas, a borrower can borrow securities to cover his short-positions, avoid settlement failure or for arbitrage or hedging strategies.

Example, if futures of a stock is trading at a discount, then a borrower can take advantage of SLB by selling borrowed stock at spot price and buying stock futures.

13.6.1 Taxability in hands of lenders

Lenders can earn additional income from the idle portfolio held as they receive a certain fee to lend the stock, depending upon the demand and time value.

Any lending of scrips or security is not treated as exchange even if lender does not receive back same distinctive numbers of scrip or security certificate. The transaction of lending of shares or any other security under the securities lending scheme would not result in 'transfer' for the purpose of invoking the provisions relating to capital gains under the

[43]SEBI Circular CIR/MR/DP/30/2012dated November22, 2012.

Income Tax Act pursuant to section 47(xv) of the Act. The department has also clarified that transactions done in the SLB segment will not be treated as transfer.[44]

However, the fee earned from lending business shall be taxable under the head 'profits and gains from business or profession' or 'Income from other sources'.

13.6.2 Taxability in hands of borrowers

The borrower purchases the stocks with the objective of selling them. Hence, any gains or losses arising to the borrower from the sale of such shares shall be taxable under the head capital gains or PGBP, as the case may be. The fee paid by the borrowers may be claimed as deduction while computing the income under capital gains or PGBP.

Example 9, In December 2024, Mr. A lends 10,000 shares of XYZ Ltd. for one month. He receives the lending fee of Rs. 200,000 (Rs. 20/share * 10,000 shares). As per terms of the contract, Mr. A gets back his shares on first Thursday of the month of Jan 2025. He paid transaction charges of Rs. 2,000 for lending of securities. Compute the amount of income chargeable to tax in hands of Mr. A.

Answer: The fee earned from lending of securities shall be taxable under the head 'profits and gains from business or profession' if the assessee is in the business thereof otherwise income shall be taxable under the head other sources. The assessee can claim the deduction of the expenses incurred to earn such income.

Thus, in the given example, the amount of income taxable in the hands of Mr. A shall be Rs. 1,98,000 (Rs. 2,00,000 – Rs. 2,000).

Example 10, Mr. B borrowed 10,000 shares of Reliance Ltd. on 01-08-2024 at a lending fee of Rs. 5 per share. On the said date, the share of Reliance Ltd. was trading at stock market at Rs. 1,600 per share. Mr. B short-sells 1 lot of 10,000 shares at Rs. 1,600 in anticipation of decrease in the share price. In order to hedge his position and avoid settlement risk, he bought call option of Reliance Ltd. (1 lot of 10,000 shares) with an exercise price of Rs. 1,600 at a premium of Rs. 30 per share.

The expiry of the derivatives contracts (i.e., futures and options) of the month of August 2024 was 30-08-2024 and Mr. B has to return the shares to the lender on the first Thursday of the September, 2024, i.e., 05-09-2024.

Compute the amount of income or loss arising to Mr. B in following situations:

(a) If on the date of expiry (30-08-2024) the share price of Reliance Ltd. came down to Rs. 1,500 as anticipated by Mr. B. He squared off his short position at Rs. 1,500. Further, the call option that he purchased for the purpose of hedging was transferred at Rs. 10 per share.
(b) If on the date of expiry (30-08-2024) the share price of Reliance Ltd. increased to Rs. 1,700. As Mr. B did not anticipate the increase in share price, he exercised the call

[44] Circular No. 2/2008, dated 22-02-2008

option to take delivery of 10,000 shares to return them to the lender. The shares so borrowed by him were used to settle the short-position he made in Reliance Futures.

Answer:

(a) Situation 1: Share price of Reliance Ltd. reduced to Rs. 1,500

The income or loss arising to Mr. B shall be computed as follows:

Particulars	*Amount*
Futures	
- Profit of Rs. 100 per share arising after squaring off the short-position made at Rs. 1,600 per share [10,000 shares * (Rs. 1600 – Rs. 1500)]	10,00,000
Call Option	
- Loss of Rs. 20 per share arising on transfer of call option at Rs. 10 per share [10,000 shares * (Rs. 30 – Rs. 10)]	(-) 200,000
Lending Fees of Rs. 5 per share paid to borrow 10,000 shares	(-) 50,000
Net Profit	**7,50,000**
Tax rate	**Normal slab rate**

(b) Situation 2: Share price of Reliance Ltd. increased to Rs. 1,700

The income or loss arising to Mr. B shall be computed as follows:

Particulars	*Amount*
Call option premium (10,000 shares * Rs. 30 per share)	300,000
Lending Fees (10,000 shares * Rs. 5 per share)	50,000
Total Loss	**3,50,000**

13.7 Taxation in case of conversion of Preference Shares into Equity Shares

As per Section 2(47) of the Income Tax Act, 'transfer' includes exchange of assets. When two persons mutually transfer the ownership of one thing for the ownership of another, and none of them is a money, this transaction is treated as 'exchange'. Any conversion of an asset into other asset is an 'exchange'. It falls within the definition of transfer, and, consequently, the capital gain tax shall be charged on such transfer.

However, the Income Tax Act has specifically excluded certain types of transactions from the scope and meaning of the word 'transfer' in relation to a capital asset. Consequently, no capital gain shall arise on such transactions. These transactions are specified in Section 47 of the Act. The transaction of conversion of preference shares into equity shares has been excluded from the scope of transfer.

Section 47(xb) provides that any conversion of preference shares of a company into equity shares of that company would not amount to 'transfer'. However, when a person subsequently sells equity shares, the cost of acquisition thereof shall be same as that of the preference share. Further, the period of holding of equity shares shall be reckoned from the date of acquisition of the preference shares.

Example 11, Mr. X acquired 20,000 preference shares of ABC Ltd. on 01-01-2010 at Rs. 10 each. The preference shares are converted into equity share on 01-01-2023 at a convertible ratio of 2:1 (1 equity share for every 2 preference shares). As a result, Mr. X is allotted 10,000 equity shares of ABC Ltd. The fair market value of the equity share on the date of conversion is Rs. 25 per share. Mr. X sold the shares on 25-08-2024 for Rs. 35 per share. Securities Transaction Tax (STT) was paid at the time of transfer of shares. What shall be the tax implications in the hands of Mr. X in this case?

Answer: The tax implications in the hands of Mr. X shall be as follows:

(a) Tax implication in case of conversion of preference shares into equity shares of the company on 01-01-2023

As per Section 47(xb) of the Income Tax Act, conversion of preference shares of a company into equity shares of that company is not treated as transfer. Thus, no capital gain shall arise on conversion of preference shares into equity shares.

(b) Tax implication on transfer of equity shares on 25-08-2024

The cost of acquisition of the equity shares of ABC Ltd., acquired on conversion of the preference shares, shall be the same as that of those preference shares. Further, the period of holding of equity shares shall be reckoned from the date of acquisition of the preference shares.

The capital gain arising on transfer of equity shares shall be computed in the financial year 2024-25 in the following manner:

Computation of capital gain on transfer of equity shares	
Particulars	*Amount*
Period of holding (from 01-01-2010 to 24-08-2024)	14+ Years
Nature of capital gain (Period of holding is more than 12 months)	Long-term capital gain
Full value of consideration (10,000 equity shares * Rs. 35) [A]	350,000
Less: Cost of acquisition (20,000 preference shares * Rs. 10) [B]	200,000
Long-term capital gain [C = A - B]	150,000
Tax rate on capital gain in excess of Rs. 125,000	12.50%†
†As STT has been paid at the time transfer of shares and acquisition is made by mode of transfer referred to in Section 47, long-term capital gain in excess of Rs. 125,000 shall be chargeable to tax at the rate of 12.50% under Section 112A of the Income Tax Act.	

13.8 Taxation in case of Segregated Portfolios of Mutual Funds

The SEBI has permitted creation of segregated portfolio of debt and money market instruments by Mutual Fund schemes.[45] As per the SEBI circular, all the existing unit holders in the affected scheme as on the day of the credit event shall be allotted equal number of units in the segregated portfolio as held in the main portfolio. However, the SEBI has permitted the creation of a segregated portfolio of unrated debt or money market instruments by mutual fund schemes of an issuer that does not have any outstanding rated

[45]Circular SEBI/HO/IMD/DF2/CIR/P/2018/160, dated 28-12-2018

debt or money market instruments, subject to the conditions specified in the circular.[46] On segregation, the unit holders come to hold the same number of units in two schemes - the main scheme and the segregated scheme.

Taxability of income arising from transfer of units of segregated portfolio shall be similar as in case of normal mutual funds. However, period of holding and cost of acquisition of these units shall be computed as follows.

Period of holding

In the case of a capital asset, being units in a segregated portfolio, the period for which the original units were held in the main portfolio is also included in the period of holding of the units acquired in the segregated portfolio.

Example 14, Mr. X acquired units in the main portfolio on 01-06-2021. He was allotted units in the segregated portfolio on 01-04-2022. The period of holding of the units in the segregated portfolio shall be reckoned from 01-06-2021.

Cost of acquisition

Where a mutual fund segregates the portfolios, the cost of acquisition of units in the segregated portfolio shall be computed as follows:

Cost of acquisition of units in segregated portfolio	=	*Cost of acquisition of units in the total portfolio*	X	*Net asset value of the asset transferred to the segregated portfolio*
				Net asset value of the total portfolio immediately before the segregation of portfolios

Further, cost of acquisition of these units shall be reduced from the cost of acquisition of units held in main portfolio.

Example 15, Mr. X acquired 1,000 units of a mutual fund on 01-04-2021 at Rs. 15 per unit. The mutual fund segregated the portfolio on 01-06-2022 and allotted 1,000 units of segregated portfolio to Mr. X whose net asset value (NAV) is Rs. 2 per unit. The NAV of the total portfolio on 31-05-2022 was Rs. 12 per unit. Compute the cost of acquisition of units of main portfolio and segregated portfolio after segregation of the portfolios.

Answer: The cost of acquisition of units in the segregated portfolio shall be computed as follows:

Cost of acquisition of units in segregated portfolio	=	*Cost of acquisition of units in the total portfolio*	X	*NAV of the asset transferred to the segregated portfolio [Rs. 2 per unit]*

[46] Circular SEBI/HO/IMD/DF2/CIR/P/2019/127, dated 07-11-2019

	*[1,000 units * Rs. 15 per units]*	*NAV of the total portfolio immediately before segregation of portfolios [Rs. 12 per unit]*

Thus, the cost of acquisition of units in segregated portfolio shall be Rs. 2,500 and cost per unit shall be Rs. 2.5 per unit (Rs. 2,500/1000 units).

The cost of acquisition of units in main portfolio shall be Rs. 12,500 [i.e., Original cost of acquisition (Rs. 15,000) *minus* Cost of acquisition of units in segregated portfolio (Rs. 2,500)].

13.9 Taxation in case of Consolidation of Mutual Fund schemes or plans

Any transfer of units held by a unit-holder in the consolidating scheme of a mutual fund in consideration of allotment of units in the consolidated scheme of the mutual fund shall not be treated as transfer. The exemption is available provided the consolidation is of two or more schemes of equity-oriented fund or two or more schemes of a fund other than equity-oriented fund.

Similarly, any transfer of units held by a unit holder in the consolidating plan of a mutual fund scheme in consideration of allotment of units in the consolidated plan of that scheme shall not be treated as transfer.

Where such units are further transferred, the taxability will be similar as in case of normal mutual funds. However, period of holding and cost of acquisition of these units shall be computed as follows.

Period of holding

Where units of a mutual fund become the property of the assessee in the consolidation scheme of a mutual fund, the period for which the units were held under consolidating scheme is also included in the period of holding of units acquired.
Where units of consolidated plan become the property of the assessee in consolidation of the plans within the scheme of a mutual fund, the period for which the unit or units were held under consolidating plan within the scheme is also included in the period of holding of units acquired.

Cost of acquisition

Where units in a consolidated scheme of mutual fund became the property of the assessee in consideration of transfer of units, held by him in the consolidating scheme of a mutual fund, the cost of acquisition of such units is deemed to be the cost of acquisition of the units held by him in consolidating scheme of the mutual fund.

Similarly, where units in a consolidated plan of mutual fund became the property of the assessee in consideration of any transfer of units, held by him in the consolidating plan of the same mutual fund, the cost of acquisition of such units is deemed to be the cost of acquisition of the units held by him in consolidating plan of the mutual fund.

13.10 Taxation in case of winding up of Mutual Funds

As per SEBI (Mutual Funds) Regulations, 1996, a close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled over for a further period.

In any other case, a scheme of a mutual fund may be wound up, after repaying the amount due to the unit holders:

(a) on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or

(b) if seventy-five per cent of the unit holders of a scheme pass a resolution that the scheme be wound up; or

(c) if the Board so directs in the interest of the unitholders.

Where a scheme is to be wound up as above, the trustees shall give notice disclosing the circumstances leading to the winding up of the scheme: (a) to the Board; and (b) in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed.

On and from the date of the publication of, the trustee or the asset management company as the case may be, shall—

(a) cease to carry on any business activities in respect of the scheme so wound up;

(b) cease to create or cancel units in the scheme;

(c) cease to issue or redeem units in the scheme.

Procedure and manner of winding up

(1) The trustee shall call a meeting of the unitholders to approve by simple majority and authorize the trustees or any other person to take steps for winding up of the scheme

(2)(a) The trustee or the person authorised shall dispose of the assets of the scheme concerned in the best interest of the unitholders of that scheme.

(2)(b) The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unitholders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken.

(3) On the completion of the winding up, the trustee shall forward to the SEBI and the unitholders a report on the winding up.

Winding up of the scheme

After the receipt of the report, if the SEBI is satisfied that all measures for winding up of the scheme have been complied with, the scheme shall cease to exist.

Delisting of units

The units of a mutual fund scheme shall be delisted from a recognised stock exchange in accordance with the guidelines as may be specified by the SEBI.

Hence, generally, the mutual fund schemes are first 'shut' (term used in common parlance) by giving notice in the newspapers. Once this notice is given, the trustees / AMC cannot carry on any business or create or redeem any units.

Thereafter, pursuant to voting done by the unit holders, the decision on winding up is finalized. Subsequently, the trustees would dispose of all the assets and pay off all liabilities. The balance amount is used to pay to unit holders in proportion of their units held.

When the amount received on winding of the mutual funds, it will be treated like normal redemption amount.

Annexure 1: Tax Rates for Financial Year 2024-25

1. Individual or HUF

1.1. Normal tax rates as applicable in case of Individual/ HUF

Net income range	***Resident Super Senior Citizen***	***Resident Senior Citizen***	***Any other Individual/HUF***
Up to Rs. 2,50,000	*Nil*	*Nil*	*Nil*
Rs. 2,50,001- Rs. 3,00,000	*Nil*	*Nil*	*5%*
Rs. 3,00,001- Rs. 5,00,000	*Nil*	*5%*	*5%*
Rs. 5,00,001- Rs. 10,00,000	20%	20%	20%
Above Rs. 10,00,000	30%	30%	30%

1.2. Alternative tax rates applicable to Individual/HUF under section 115BAC (New Tax regime)

Net Income Range	***Financial Year 2024-25***
Upto Rs. 3,00,000	-
Rs. 3,00,001 to Rs. 7,00,000	5%
Rs. 7,00,001 to Rs. 10,00,000	10%
Rs. 10,00,001 to Rs. 12,00,000	15%
Rs. 12,00,001 to Rs. 15,00,000	20%
Above Rs. 15,00,000	30%

1.3. Surcharge on tax whether computed as per the normal tax rates or new tax regime under section 115BAC

Nature of Income	***Range of Total Income***				
	Up to Rs. 50 lakh	***More than Rs. 50 lakh but up to Rs. 1 crore***	***More than Rs. 1 crore but up to Rs. 2 crore***	***More than Rs. 2 crore but up to Rs. 5 crore***	***More than Rs. 5 crore***
Short-term capital gain covered under Section 111A or under Section 115AD	*Nil*	10%	15%	15%	15%
Long-term capital gain covered under Sections 112, 112A and 115AD	*Nil*	10%	15%	15%	15%
Dividend income (not being dividend income chargeable to tax at a special rate under sections	*Nil*	10%	15%	15%	15%

115A, 115AB, 115AC, 115ACA)					
Unexplained income chargeable to tax under Section 115BBE	25%	25%	25%	25%	25%
Any other income	*Nil*	10%	15%	25%	37%*

* From the financial year 2023-24, the surcharge rates on other income for assessee opting to pay tax under the new tax regime of Section 115BAC shall not exceed 25%. Thus, the income exceeding Rs. 5 crores shall be subject to the surcharge rate of 25% if the assessee opts for the new tax regime of Section 115BAC.

1.4. Health and education cess

The amount of income tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge.

2. Special tax rates

Income-tax Act prescribes the following special tax rates in respect of certain income:

2.1. In case of capital gains

Section	***Assessee***	***Particulars***	***Tax Rate***
Section 111A	Any Person	Short-term capital gains arising from transfer of equity shares or units of equity-oriented mutual fund or units of business trust if the transfer of such capital asset is chargeable to Securities Transaction Tax (STT)	20%
Section 112	Any person	Long-term capital gains arising from transfer of listed securities (other than a unit) or zero-coupon bonds	12.50%
	Non-resident.	Long-term capital gains arising from the transfer of unlisted shares or shares of closely held companies without giving effect to benefit of indexation and currency translation.	12.50%
	Any Person	Any other long-term capital gains	12.50%
Section 112A	Any Person	Long-term capital gains, in excess of Rs. 1.25 lakhs, arising from transfer of equity shares, units of equity-oriented mutual fund or units of business	12.50%

		trust if the transfer of such capital asset is chargeable to Securities Transaction Tax (STT)	
Section 115E	Non-Resident Indian	Long-term capital gains arising from transfer of specified asset purchased in foreign currency	12.5%
Section 115BBH	Any Person	Income from transfer of any Virtual Digital Asset (VDA)	30%

2.2. In case of interest income

Section	***Assessee***	***Particulars***	***Tax Rate***
Section 115A	Non-resident or Foreign Co.	Interest received from Government or an Indian concern on monies borrowed or debt incurred by such Government or Indian concern in foreign currency	20%
	Non-resident or Foreign Co.	Interest on rupee-denominated bonds of an Indian Co. or Government Securities or municipal debt securities as referred to in Section 194LD	5%
	Non-resident or Foreign Co.	Interest income distributed by business trust to its unitholders as referred to in Section 194LBA.	5%
Section 115AC	Non-resident	Interest on bonds of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10%

2.3. In case of dividend income

Section	***Assessee***	***Particulars***	***Tax Rate***
Section 115A	Non-resident or foreign co.	Dividend income	10% if dividend is received from a unit in an IFSC otherwise 20%

In case of other income from securities

Section	***Assessee***	***Particulars***	***Tax Rate***
Section 115A	Non-resident or Foreign Co.	Income received in respect of units of specified Mutual Funds or UTI purchased in foreign currency	20%
Section 115E	Non-resident Indian	Income from the specified asset purchased in foreign currency	20%

2.4. In case of other incomes

Section	***Assessee***	***Particulars***	***Tax Rate***
Section 115BBE	Any person	Undisclosed income as referred to in Sections 68, 69, 69A, 69B, 69C and 69D	60%
Section 115BBH	Any Person	Income from transfer of any Virtual Digital Asset (VDA)	30%
Section 115BBJ	Any Person	Income by way of winning from Online Games	30%

Annexure 2: Exemptions under Income Tax Act

(A) Income exempts under the head 'Salary'

Section	*Nature of Income*	*Whether available in New Tax regime*
Section 10(5)	Leave Travel Concession	No
Section 10(7)	Allowance/perquisites to Government employee for rendering service outside India	Yes
Section 10(10)	Gratuity	Yes
Section 10(10A)	Pension	Yes
Section 10(10AA)	Leave Salary	Yes
Section 10(10B)	Retrenchment Compensation	Yes
Section 10(10C)	Voluntary Retirement Compensation	Yes
Section 10(10CC)	Tax on non-monetary perquisites paid by the employer	Yes
Section 10(12)	Amount received from recognized Provident Fund subject to prescribed limit	Yes
Section 10(12C)[47]	Amount received from Agniveer Corpus Fund	Yes
Section 10(13)	Payment from an approved superannuation fund	Yes
Section 10(13A)	House Rent Allowance	No
Section 10(14)	Office Duty Allowances and Personal Allowances	Not allowed except as prescribed
Section 10(18)	Pension to gallantry award winner	Yes
Section 10(19)	Family pension received by the family members of armed forces	Yes

[47] Inserted by the Finance Act, 2023 with effect from Assessment Year 2023-24

(B) Income exempt under the head 'Capital Gains'

Section	*Nature of Income*
Section 10(10D)	Any sum received under a life insurance policy except certain excessive and high premium life insurance policies (including ULIPs) or high premium endowment policies
Section 10(37)	Capital gains on compulsory acquisition of urban agricultural land

(C) Income exempt under the head 'Income from other sources'

Section	*Nature of Income*
Section 10(4)(i)	Interest on notified securities and bonds
Section 10(4)(ii)	Interest on NRE account
Section 10(11)	Amount received from public provident fund subject to prescribed limit
Section 10(11A)	Amount received from Sukanya Samriddhi Account
Section 10(12A)	Payment from the National Pension Scheme
Section 10(12B)	Partial withdrawal from NPS
Section 10(15)	Interest on specified securities as prescribed

(D) Income exempt of certain specified assessees

Section	*Nature of Income*
Section 10(2)	Amount received by member of HUF
Section 10(4G)[48]	Income of a non-resident arising from portfolio of securities or financial products or funds, managed through IFSC or from the specified activity carried out by the specified person[49]
Section 10(23FC)]	Income of a Business Trust
Section 10(23FCA)	Certain income of a business trust, being a real estate investment trust

(E) Income exempt in the nature of distributed Income

Section	*Nature of Income*
Section 10(4E)	Income distributed by an IFSC banking unit to a non-resident in respect of offshore derivative instruments[50].
Section 10(23FBB)	Income referred to in section 115UB of a unit holder of an investment fund
Section 10(23FBC)	Income received by a unit holder of Category III AIF
Section 10(23FD)	Certain distributed Income of a Unit Holder from the Business Trust
Section 10(35A)	Income of an investor received from a securitisation trust

[48] Inserted by the Finance Act, 2022 with effect from Assessment Year 2023-24

[49] Amendment made by the Finance Act, 2023 with effect from assessment year 2024-25.

[50] Amendment made by the Finance Act, 2023 with effect from assessment year 2024-25.

After the abolition of dividend distribution tax, no exemption is available under Section 10(34) and Section 10(35) for the dividend distributed by a company or a mutual fund, as the case may be.

(F) Others

Section	*Nature of Income*
Section 10(1)	Agriculture Income
Section 10(16)	Educational scholarship
Section 10(17)	Daily allowance to a Member of Parliament or State Legislature
Section 10(17A)	Awards and Rewards
Section 10(43)	Loan in the case of reverse mortgage

Annexure 3: Cost Inflation Index

Cost Inflation Index (CII) is the inflation rate used to bring the cost of goods in line with the increased prices in the market. Under Income-tax Act, it is used to compute the indexed cost of acquisition and indexed cost of improvement of a long-term capital asset. CII for every year is notified through an official gazette each year.

Financial Year	***CII***
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254
2016-17	264
2017-18	272
2018-19	280
2019-20	289
2020-21	301
2021-22	317
2022-23	331
2023-24	348

Module 9: Taxation I Module-end Questions

1. Short term capital loss can be set off against which income?
    a. **Long-term or Short-term capital gains**
    b. Short term capital gains
    c. Long term capital gains
    d. Any Income

2. Who cannot invest in Sovereign Gold Bonds?
    a. **A Company**
    b. An individual on behalf of a minor individual
    c. A Charitable Institute
    d. A Private Trust

3. Maximum deduction available to a self-employed person for the investment made in NPS is ________.
    a. **Rs. 2,00,000**
    b. Rs. 1,50,000
    c. Rs. 50,000
    d. No limit

4. Which of the following statements is False?
    a. **Gains arising from currency derivatives is always regarded as capital gains**
    b. Derivative transactions will always lead to non-speculative business transaction
    c. Transaction in securities with actual delivery always deemed as non-speculative transaction

5. Which income is exempt in the hands of REIT?
    a. **Rental income from investment made by REIT in properties**
    b. Interest income from loan given to employees
    c. Dividend income from investment made in companies other than SPV
    d. Capital gains from transfer of shares in SPV