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Session 7-Investment Taxation

Objective

To understand the 10 most critical provisions of the Income Tax Act which may help an Individual in minimizing their tax liabilities for the year that arise out of the following 5 heads of Income:

1. Salary
2. House Property
3. Profits/Gains from Business/Profession
4. Capital Gains
5. Income from Other Source

Set Off & Carry Forward Losses

Section 70 - 74

Following are the key rules under the Income Tax Act regarding setting off loss from a head of Income in the same year:

Income	Salary	House Property	Business Income	Capital Gains Long Term	Capital Gains Short Term	Other Sources
Loss from House Property	✓	✓	✓	✓	✓	✓
Business Loss	×	✓	✓	✓	✓	✓
Long Term Capital Loss	×	×	×	✓	×	×
Short Term Capital Loss	×	×	×	✓	✓	×

Any loss that is not adjusted in the same year can be carried forward for next 8 years. However, once carried forward it can be adjusted against the same head of Income.

Exemption on Sale of Residential House

Section - 54

Any Long Term Capital Gains arising on sale of a residential house can be exempted from tax if an amount equivalent to Capital Gains is invested in ONE residential house.

In case of purchase of a house, within 2 years from the date of sale or within 1 year prior to the date of sale	In case of construction of a house, within 3 years from the date of sale

Note - Exemption can be claimed by investing in 2 residential houses provided LTCG is less than Rs. 2 crores. This is only available once in a lifetime.

Exemption on Sale of Other Assets

Section 54F

Any Long Term Capital Gains arising on sale of any Capital Asset (other than residential house) can be exempted from tax if an amount equivalent to sale value is invested in ONE residential house.

Time limits are as mentioned in Section 54. However, exemption is not available if a person owns 2 houses or more.

Assets where Section 54F exemption can be claimed include gold, shares, mutual funds, debentures, commercial property, etc

Exemption on Sale of Real Estate

Section 54F

1. Any Long Term Capital Gains arising on sale of any Real Estate can be exempted from tax by investing Capital Gains amount (up to Rs. 50 lakhs) in REC/NHAI Bonds.
2. Any Long Term Capital Gains arising on sale of any Real Estate can be exempted from tax by investing Capital Gains amount (up to Rs. 50 lakhs) in REC/NHAI Bonds.
3. Effective return of this bonds is ~9.75% p.a. after considering the tax benefit

Investment Amount	**50,00,000**	**39,60,00 0**
Interest - Year 1 (Net of tax) Reinvestment returns	**1,72,000** **49,272**	
	1,72,000 **35,767**	8.59% p.a
Interest - Year 2 (Net of tax) Reinvestment returns	**1,72,000** **23,087**	
Interest - Year 3 (Net of tax) Reinvestment returns	**1,72,000** **11,180**	
Interest - Year 4 (Net of tax) Reinvestment returns	**1,72,000**	
	59,79,306	**59,79,306**
Interest - Year 5 (Net of		

Tax implications on Gift

Section 54F

- Gift received, if in excess of Rs. 50,000 is fully taxable.. However, any gifts received from a "relative" will not be taxed at all.
- Definition of Relatives as per Income Tax Act is as follows:

- Spouse of the individual
- Brother or Sister of the Spouse
- All lineal ascendants / descendants of the spouse
- Spouse of all the persons mentioned above
- Brother or Sister of the individual
- All lineal ascendants / descendants of the individual
- Brother or Sister of either of the parents of the individual

Clubbing of Income

Section 64

- Any income generated on any asset/money gifted by an Individual will continue to be taxed in such Individual's name.

- However, provisions of this Section is only applicable on gifts made to:

1. Spouse
2. Minor children
3. Daughter in law
4. HUF

Indexation Benefit

Section 48

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1. Indexation means inflating the cost of an asset as per the current inflation levels.

2. Indexation is available for any Long Term Capital Asset except for Bonds/Debentures.

3. In 2018, an amendment was made to Section 48 where the base year for indexation was changed from 1981 to 2001.

4. Meaning for any asset acquired before 2001, guidance value* value as on April 1, 2001 will be considered as the cost of the asset and then indexation rules will apply.

*From 1st April, 2020.

Example:

1. If an investor bought unlisted equity shares worth Rs. 1 crore in 1981, its indexed cost as per the earlier rule would be Rs. 12.15 crore in FY 18-19.

2. If the current value is Rs. 30 crore, the LTCG would be Rs. 17.85 crore and the tax liability will be Rs. 4.27 crore. (Taxed @ 23.92%)

3. With the new rule, while calculating the long term capital gains, the value of the unlisted equity shares as on April 1, 2001, will have to be ascertained.

4. If this value were Rs. 10 crore, its indexed cost as per the new rule would be Rs. 28 crores for FY 18-19. Therefore the Capital Gains will be Rs. 2 crores and the tax liability will be Rs. 0.48 crore.

5. This new rule will help reduce the tax liability by Rs. 3.79 crores.

Abolishment of Dividend Distribution Tax

As per Finance Act, 2020 – Dividends from Companies as well as Mutual Funds will be taxed in the hands of the investor as per the slab rates.

Given that most HNIs fall in the highest tax bracket, opting for a growth plan for all types of Mutual Funds (Equity, Debt and Arbitrage), will be beneficial for two reasons:

1. Lower Tax Rates
2. Setting off Capital Losses

Surcharge Rates

Income Range	Surcharge	30%	20%	15%	10%
NIL to Rs. 50 lakhs	0%	31.20%	20.80%	15.60%	10.40%
Rs. 50 lakhs to Rs. 1 crore	10%	34.32%	22.88%	17.16%	11.44%
Rs. 1 crore to Rs. 2 crore	15%	35.88%	23.92%	17.94%	11.96%
Rs. 2 crore to Rs. 5 crore	25%	39.00%	26.00%	17.94%	13.00%
More than Rs. 5 crore	37%	42.74%	28.50%	17.94%	14.24%

Note: Surcharge on Listed Equity Shares, Equity Mutual Funds is restricted to 15% even if the income crosses Rs. 2 crores/Rs. 5 crores.

Taxation of Different Products

Product	Long Term if held for	Tax on STCG*	Tax on LTCG*
Equity Mutual Funds	> 12 months	15%	10% without Indexation
Listed Equity Shares	> 12 months	15%	10% without Indexation
Debt Mutual Funds	> 36 months	Slab Rates	20% with Indexation
Unlisted Debentures	> 36 months	Slab Rates	20% without Indexation
Unlisted Bonds	> 36 months	Slab Rates	20% without Indexation
Listed Debenture	> 12 months	Slab Rates	10% without Indexation
Listed Bonds	> 12 months	Slab Rates	10% without Indexation
Unlisted Shares	> 24 months	Slab Rates	20% with Indexation
Real Estate	> 24 months	Slab Rates	20% with Indexation
Jewelry/Gold Bars	> 36 months	Slab Rates	20% with Indexation

**Add Cess @4%*

Query resolution

- What if a client sells profit amount flat within a year

If a house is sold within five years of the end of the financial year in which it was purchased, the tax benefits claimed go out of the window. The tax deduction claimed for the principal repayment, stamp duty and registration under Sec 80C are reversed and the amount becomes taxable in the year of sale. Only the deduction of the interest payment under Section 24B is left untouched.

- NRI Taxation

When an NRI invests in certain Indian assets, he is taxed at 20%. If the special investment income is the only income the NRI has during the financial year, and TDS has been deducted on that, then such an NRI is not required to file an income tax return.

Query resolution (Cont.)

What are the Investments that Qualify for Special Treatment?
Income derived from the following Indian assets acquired in foreign currency:
Shares in a public or private Indian company
Debentures issued by a publicly-listed Indian company (not private)
Deposits with banks and public companies
Any security of the central government
Other assets of the central government as specified for this purpose in the official gazette No deduction under Section 80 is allowed while calculating investment income.
Special Provision Related to Long-Term Capital Gains
For long-term capital gains made from the sale of transfer of these foreign assets, there is no benefit of indexation and no deductions allowed under Section 80.
But you can avail an exemption on the profit under Section 115 F when the profit is reinvested back into:
Shares in an Indian company
Debentures of an Indian public company
Deposits with banks and Indian public companies
Central Government securities
NSC VI and VII issues
In this case, capital gains are exempt proportionately if the cost of the new asset is less than net consideration.

Remember, if the new asset purchased is transferred or sold back within 3 years, then the profit exempted will be added to the income in the year of sale/transfer.

The benefits above may be available to the NRI even when he/she becomes a resident – until such an asset is converted to money, and upon submission of a declaration for the application of the special provisions to the assessing officer by the NRI.

The NRI may choose to opt out of these special provisions and in that case the income (investment income and LTCG) will be charged to tax under the usual provisions of the Income Tax Act.

Thank You