

Opinion | Capital loss on investments due to debt crisis begs for better tax clarity

3 min read. Updated: 12 Jun 2019, 01:33 PM IST [Gautam Nayak](#)

Government can clarify that losses would be allowable as capital loss for investors

Topics

[NBFC Crisis](#) | [NBFC](#) | [Debt Crisis](#) | [LTCG](#)

With the recent NBFC (non-banking financial company) and HFC (housing finance company) crisis, investors have been staring at losses on various types of investments—equity shares, preference shares, units of mutual funds, company debentures and company fixed deposits. In some cases, the entire value of the investment may be wiped out. The natural questions that spring to the mind of an investor are: are my losses deductible for income tax purposes? Can I claim a capital loss in respect of such investments?

For a capital gain or a capital loss to be considered for taxation purposes, there has to be a transfer of the capital asset (in this case, the investment) and the transfer has to be for a consideration (price). There is a legal debate on whether a situation where there is nil consideration should be considered as a case of existence of a consideration and, therefore, should it result in a taxable capital loss, as opposed to a situation where a consideration cannot be envisaged and, therefore, capital gain or loss cannot be computed.

As far as equity shares and mutual funds are concerned, if the shares are sold on the stock market or the units are redeemed, there is certainly a transfer. There is also a sale price or redemption proceeds, which would be regarded as the consideration. Now that long-term capital gains (LTCG) on sale of equity shares or equity-oriented mutual fund units is no longer exempt, the capital loss would also no longer be exempt and would, therefore, be allowable. It can be set off against other capital gains (though long-term capital loss can only be set off against LTCG).

Company deposits are at the other end of the taxation spectrum. In most cases, the depositor does not get back anything at all in cases of default, given the unsecured nature of such investment. Further, company deposits cannot be transferred for a price, unlike securities. Therefore, in the event of loss suffered on a company deposit, the investor cannot claim any capital loss at all for tax purposes, though he has lost a part of his capital.

Preference shares and debentures can also theoretically be sold, and if so, the capital loss would certainly be allowable. Practically, however, there may be no buyers for such instruments in cases where the company is likely to default on these instruments. In such situations, there could be various alternative situations. Firstly, the company may go into liquidation, with nothing being received by the investors. In rare cases, the debenture-holders may get back a part of their investments, either on such liquidation of the company, or on the security trustee stepping in and encashing the security.

In a situation where a debenture-holder or preference shareholder gets back a part of his investment and the instruments are cancelled, there would be both a transfer and a consideration, since maturity or redemption is regarded as a transfer. Therefore, the capital loss would be allowable.

Where the company goes into liquidation, the liquidation results in extinguishment of the debenture, regarded as a transfer. However, if no amount is paid to the debenture-holder, the question is whether there is a consideration in such a case, which is nil, and, therefore, whether capital gains can be computed, and the capital loss can be allowed. The fact that there is a consideration, which is nil, does seem to be the better and fairer interpretation in this case and, therefore, capital loss should be allowable.

As far as preference shares are concerned, there is a specific provision of the tax laws which provides that any receipt by a shareholder on liquidation of a company shall be chargeable to capital gains tax and regarded as consideration for the purpose of

computation of capital gains. Therefore, here also, based on the logic discussed above, the capital loss on account of the preference shares should be an allowable capital loss.

Given the current investment scenario, where investors have lost significant amounts of money in companies whose instruments or deposits were hitherto regarded as investment grade, where the feeling that prevails among investors is of being let down by the system, perhaps the government can take steps to assuage these feelings by clarifying that such losses of investments (including company deposits) would be allowable as capital losses for investors, which can be adjusted against other capital gains. This will also bring in much-needed clarity in the tax laws pertaining to losses in such cases, and would be fair to such investors.

Gautam Nayak is a chartered accountant