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LTCG tax: how will the new provisions really work?

There is a doubt whether the definitions in the normal capital gain computation sections would continue to apply for assets such as bonus shares, right shares, shares received on inheritance or as gift, and others

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In the recent Union Budget, the one significant change that has impacted a large number of taxpayers is the one relating to reintroduction of long-term capital gains (LTCG) tax on sale of listed equity shares and units of equity-oriented mutual funds from April 2018 onwards. The impact of the 10% tax on the gains, computed without cost indexation, has been softened by providing for taking the cost at the fair market value as of 31 January 2018, thus ensuring that gains up to that date continue to enjoy the benefit of exemption. While there clearly seem to be two views as to whether the removal of such exemption was desirable or not, and much discussion has centred around this, not much has been discussed about how the new provisions would really work.

Unfortunately, the manner of drafting of the amendments leaves much to be desired. The amendments have been introduced in the section dealing with determination of tax, and should therefore have focused mainly on the tax rate. Unfortunately, the provisions also talk about the manner of computation of capital gains, without specifically excluding the normal provisions for computation of capital gains. The Central Board of Direct Taxes (CBDT) has issued some clarifications on the manner of computation of the tax on such capital gains. However, these clarifications only cover some of the issues, and do not clarify all the issues.

The CBDT has clarified that the capital gains on such assets are to be computed without cost indexation, and the 10% rate is to be applied on the total of such gains which are in excess of Rs1 lakh. The cost is to be taken at the higher of the actual cost or the fair market value as on 31 January 2018; however, the substitution of the 31 January 2018 valuation cannot result in a loss. The substitution of cost is also permissible for bonus shares and right shares acquired before 1 February 2018. Further, the holding perioc is to be considered from the original date of acquisition, and not 31 January 2018. Computation under four scenarios has been provided for understanding how these provisions would operate. It has also been clarified that if the computation results in a long-

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term capital loss, such loss can be set off against other LTCG or carried forward for a period of up to 8 years for set-off against future LTCG.

One issue that remains unanswered is as to whether other long-term capital losses, either current or brought forward, can be set off against such capital gains from listed equity shares or equity-oriented funds. Logically, this type of set-off of such losses should be permitted before determining the capital gains subject to the 10% tax. However, the language of the amendment is ambiguous on the issue of such set-off.

The new section provides for the cost of acquisition of equity shares or units acquired on or before 31 January 2018. There is no definition of cost of acquisition for such assets acquired after that date. Since the computation provisions are contained in this new section, there is a doubt as to whether the definitions in the normal capital gain computation sections would continue to apply, in particular, for assets such as bonus shares, right shares, and shares received on inheritance or as gift.

Another issue that affects a large number of taxpayers is whether the benefit of exemption under section 54F, in relation to reinvestment of the sale consideration of the shares or units in a residential house, would still be available after the amendments come into force. Many individuals invest in shares or mutual funds with a view to accumulate sufficient money to purchase a house. So far, any capital gains reinvested in a residential house is exempt from tax, so long as the conditions are fulfilled. The language and placement of the amendment does raise doubts as to whether this exemption would still be available in respect of sale of listed equity shares and equity-oriented mutual funds or whether tax will have to be paid irrespective of reinvestment in a residential house. The language seems to suggest that this exemption may still be available, and tax would have to be paid only on the capital gains remaining after computing such exemption.

Given the large number of investors whose taxation is likely to be affected, it is essential that the draft provisions are amended before becoming law, so that the computation provisions find a place among the other computation provisions, with only the rate of tax continuing in the proposed new section. Alternatively, the CBDT needs to come out with many more clarifications, clarifying the manner of computation of the capital gains which would be subject to the 10% tax rate. It is only then that avoidable uncertainty in interpretation, and the consequent litigation can be avoided.

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