# How to gain from grandfathering provision on LTCG


Istock

3 min read . Updated: 29 Dec 2021, 06:22 AM IST**Gautam Nayak**

The FM had announced that gains up to 31 January 2018 would be grandfathered

When the exemption for long-term capital gains (LTCG) on the sale of listed shares was done away with by the 2018 Budget, along with the introduction of a 10% tax on such gains, the then finance minister Arun Jaitley announced that gains up to 31 January 2018 would be grandfathered. This meant that the extent of such gains up to that date would not be taxed. An example of how this would work was also given by the finance minister in his budget speech.

Such benefits to gains accrued up to 31 January 2018 was achieved by providing that if a taxpayer had acquired the shares before 31 January 2018, he/she could substitute the fair market value (FMV) of the shares as of 31 January 2018 for his/her actual cost, while computing the gains. As illustrated by the finance minister, if an equity share is purchased six months before 31 January 2018 at ₹100 and the highest price quoted on 31 January 2018 in respect of this share is ₹120, there will be no tax on the gain of ₹20 if this share is sold after one year from the date of purchase. However, any gain in excess of ₹20 earned after 31 January 2018 will be taxed at 10%, if this share is sold after 31 July 2018.

Unfortunately, however, many investors may not get the full benefit of this grandfathering, if there are corporate actions by the company after 31 January 2018. Taking the above example, with the difference that there was a bonus issue in the ratio of 1:1 by the company in June 2018, and both the original and the bonus shares are sold for ₹75 each. If the bonus issue had not taken place, the sale price would have been ₹150, and since the market value as on 31 January 2018 was ₹120, the taxable capital gains would have been ₹30.

However, after the bonus issue post January 2018, only the original share was held as on 31 January 2018, and therefore only that qualifies for substitution of the cost of ₹120. Moreover, the provision states that you cannot have a loss arising due to such substitution of cost. So, the taxpayer can opt out of such cost substitution, and from the sale price of ₹75, deduct the actual cost of ₹100, to arrive at a capital loss of ₹25. Since the cost of the bonus share is to be taken as nil, and as the bonus share was issued after 31 January 2018, one cannot substitute the fair market value as on 31 January 2018. Therefore, the entire sale proceeds of ₹75 of the bonus share would be taxed as capital gain, the total capital gain, therefore, being ₹50. Thus, the issue of bonus shares post 31 January 2018 has worked to the detriment of the shareholder, as he/she is taxed on a gain of ₹50 (effectively without the benefit of grandfathering), as against the intended taxation of gain of only ₹30 as intended by the grandfathering provisions.

A similar issue arises in case of other corporate actions such as receipt of shares on demerger or merger of companies after 31 January 2018, where the benefits of grandfathering are effectively denied to the new shares, though one adopts the cost of the old shares, if one goes by the strict language of the provisions. It would be possible for a taxpayer, at least in cases of merger or demerger, to contend that since the cost being adopted is that of the earlier shares which were held on 31 January 2018, the benefit of 31 January 2018 cost substitution should be available in such cases. In case of share split (sub-division into lesser face value) also, it should be possible for a taxpayer to claim that the benefit of substitution of 31 January 2018 FMV should be available. The matter may, however, be disputed by the tax authorities, leading to possible litigation.

To avoid unnecessary litigation, in all fairness, it is necessary that the Central Board of Direct Taxes (CBDT) should come out with a clarification that the benefit of grandfathering of capital gains would also be available in cases of such corporate actions of bonus, split, mergers and demergers which have or will take place after 31 January 2018. This alone will ensure that taxpayers get the full benefit of the grandfathering of the capital gains as promised by the finance minister in his Budget speech, without having to struggle to get this promised benefit.

*Gautam Nayak is partner, CNK & Associates LLP.*