All you need to know about Capital Gains Tax

Why in news?

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The Prime Minister suggested that capital market participants should make a 'fair contribution' to nation building in the form of capital gains tax. This has had stock market investors in a state of jitters expecting capital gains tax to be slapped on their long-term gains from the market. The Finance Minister later played down these fears by saying that there was no plan to impose long term capital gain tax on equities.

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What is Capital Gains Tax?

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- Any profit from the sale of a capital asset is deemed as 'capital gains'.
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- A capital asset is officially defined as any kind of property held by an assesse, excluding goods held as stock-in-trade, agricultural land and personal effects.
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- Normally if an asset is held for less than 36 months, any gain arising from selling it is treated as a short-term capital gain (STCG) and taxed in your hands.
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- This becomes a 'long-term' capital gain (LTCG) if the asset is held for 36 months or more.
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- Shares and equity mutual funds alone enjoy a special dispensation on capital gains tax.
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- In their case, a holding period of 12 months or more qualifies as 'long-term'.
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- Current tax laws state LTCG arising on the sale of listed equity shares or equity oriented mutual funds are exempt from tax if you have paid Securities Transaction Tax (STT) on the sale transaction.
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- STCG from such shares and funds is also taxable at a flat 15 per cent (plus surcharge and cess).
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- The short-term capital loss from financial assets can be set off against any other capital gain.
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Why is it important?

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- The monthly cheque that you earn from your day job, profession or business is subject to income tax at hefty rates.
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- So is the dividend and interest that you earn from your investments.
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- But suppose the assets you own do not pay out any regular income by way of interest or dividend, but instead deliver returns by way of price appreciation on the asset, you stand to make a windfall profit when you sell them.
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- Capital gains tax is designed to ensure that such windfall profits do not escape the tax net, when you cash out.
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- While the capital gain arising from assets such as property or gold is taxed at your slab rate if held for less than 36 months, and at 20 per cent if held for more than 36 months, listed shares and equity funds alone enjoy concessions both on the holding period and rate of tax.
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- Long-term capital gains on equities is probably exempted, to encourage Indian households to park more of their savings in the stock market, so it can be put to productive use.
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Conclusion:

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If you’re a saver in India, shares and equity mutual funds are about the only investments where you can hope to make return without shelling out your pound of flesh to the taxman. Bank fixed deposits, bonds, gold, small savings schemes — the returns from all these avenues are taxable, most of it at your slab rate.

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Therefore, any decision to slap a LTCG on equity shares or funds will shut out your only avenue for tax-free returns. But on the flip side, only 0.7 per cent of the household disposable income in India goes into shares and mutual funds, according to RBI data. Also India is home to a mere three crore equity investors. So, it is quite legitimate to ask why shares should get a tax-free status, while small savings and bank FDs are taxed to the hilt.

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