Income from Capital Gains

What is capital gain?

Capital gain means any profit or gain arising from the transfer of capital assets in the previous year.

Transfer: Sec 2(47): Transfer means change in ownership. Transfer of capital assets includes sale, exchange or relinquishment of the asset or extinguishment of any rights therein or compulsory acquisition under any law.

Capital Asset: Section 2(14): Capital asset means property of any kind held by an assessee, whether or not connected with his business or profession. All the movable and immovable properties including lease hold rights, goodwill, license, jewellery etc are treated as capital assets.

Assets which are not treated as capital assets:

1. Stock in trade, raw-materials and consumable stores
2. Personal effects of movable nature such as vehicles, furniture, utensils etc held for personal use by the assessee or any dependent member of his family. Note: However personal effects do not include jewellery, painting, drawings, art working etc.
3. Agriculture land in India not being situated in an urban area.
4. Gold bonds, gold deposit schemes notified by government of India.
5. Special bearer bonds 1991 issued by the central government of India.

Types of Capital Assets:

A) On the bases of nature, capital assets may be classified in to:

1. Financial capital assets
2. Non financial capital assets

1. Financial capital assets: Financial capital assets refers to equity shares, preference shares, securities like debentures, government securities listed on a recognized stock exchange in India, units of UTI and zero coupon bonds.

2. Non financial capital assets: Non financial capital assets refer to those capital assets which are not financial capital assets.
Example: Building, plant and machinery, jewellery etc.

B. On the basis of period of holding, capital assets may be classified in to:

1. Short -term capital assets
2. Long-term capital assets

1. Short-term capital assets: Sec. 2(42A): Financial assets held by an assessee for 12 months or less than 12 months and non-financial assets held by an assessee for 36 months or less than 36 months are called short-term capital assets.

2. Long- term capital assets: Sec. 2(29A): Financial assets held by an assessee for more than 12 months and non-financial assets held by an assessee for more than 36 months are called long-term capital assets.

Assets	Short term capital asset	Long term capital asset
1. Listed securities 2. Units of UTI 3. Unit of Equity Oriented funds(Mutual Funds) Zero Coupon Bonds	Period of holding is not more than 12 months	Period of holding is more than 12 months
1. Unlisted Shares	Period of holding is not more than 24 months	Period of holding is more than 24 months
1. Immovable Property being Land or Building or Both	Period of holding is not more than 24 months	Period of holding is more than 24 months
1. Any other assets	Period of holding is not more than 36 months	Period of holding is more than 36 months

Types of capital gains:

There are two types of capital gains. They are:

1. Short – term capital gains
2. Long – term capital gains

Short –term capital gains: Any profits or gains arising from the transfer of short-term capital assets, are called short-term capital gains (STCG). If any losses arise from the transfer of short-term capital assets, then they are called short-term capital loss.

Long-term capital gains: Any profits or gains arising from the transfer of long-term capital assets, are called long-term capital gains (LTCG). If any losses arise from the transfer of long-term capital assets, then they are called long-term capital loss

Differences between short term capital gain and long term capital gain:

Short-term capital gain	Long-term capital gain
1.It is a profit or gain arising from the transfer of short-term capital asset	1.It is a profit or gain arising from the transfer of long-term capital asset
2.No indexation is applicable	2.It should be indexed except in case of bonds & debentures
3.It is taxable at progressive rate of income-tax	3.It is taxable at a flat rate of 20% (10% in case of listed securities)
4.Exemptions u/s 54B,54D &54G are available	4. Exemptions u/s 54 to 54H are available

Specimen for Computation of short-term capital gain:

Particulars	Amount	Amount
Full value of consideration (sale value)	XXX	
Less: Expenses incurred at the time of sale	XXX	
Net-consideration		XXX
Less: Cost of acquisition	XXX	
Cost of improvement	XXX	
Advance received & return	XXX	
Gross STCG		XXX
Less: Exemption u/s 54B, 54D, &54G	XXX	
Net STCG		**XXX**

Cost of acquisition: Cost of acquisition of an asset is the value for which the asset was acquired by the assessee. It means the prices paid for the purchase of an asset and expenses incurred at the time of purchase of an asset is called cost of acquisition. Cost of acquisition is the value for which it is acquired or purchased by assessee.

Note: If any asset purchased before 1-4-2001 then cost of acquisition or fair market value on 1-4-2001, whichever is higher is taken as cost of acquisition.

Cost of acquisition being nil for the following capital assets:

1. Self generated goodwill
2. Tenancy rights
3. Patent rights, trade mark or brand name self generated.

Cost of improvement: Any capital expenditure incurred towards the improvement of a capital asset is called cost of improvement. Any expenditure incurred to increase the value of capital asset is called cost of improvement.

Note: The cost of improvement incurred prior to 1-4-2001 is not taken in to account (not considered). It means it is ignored.

Specimen for computation of long-term capital gain:

Particular	**Amount**	**Amount**
Full value of consideration (sale value)	XXX	
Less: Expenses incurred at the time of sale	XXX	
Net-consideration		XXX
Less: Index cost of acquisition	XXX	
Index cost of improvement	XXX	
Gross LTCG		XXX
Less: Exemption u/s 54 to 54H	XXX	
Net LTCG		**XXX**

Indexation: Indexation means converting purchase cost of the asset in to its present cost by using index number for inflation.

Note: Index is not applicable for debentures, bonds and depreciable assets, whose written down value is given in the problem.

Indexed cost of acquisition: Indexed cost of acquisition means the cost of acquisition which bears to CII for the year of sale, which bears to CII for the year of purchase.

$$\text{Indexed cost of acquisition} = \frac{\text{Cost of acquisition X CII for the year of sale}}{\text{CII for the year of Purchase or CII for 2001-02}}$$

Index cost of improvement: Index cost of improvement means an amount or cost of improvement bears to CII for the year sale which bears to CII for year of Improvement.

$$\text{Index cost of Improvement} = \frac{\text{cost of improvement X CII for the year of sale}}{\text{CII for the year of Improvement}}$$

Note: CII= cost Inflation Index

1. If any assets before 1-4-2001, the cost of acquisition or fair market value whichever is higher is taken as cost of acquisition.
2. Improvement cost before 1-4-2001 is ignored.

3. Cost Inflation Index is not applicable for debenture, bonds and depreciable assets whose written down value is given in the problem.
4. Index is not applicable to short-term capital gains.

Conversion of capital asset in to stock in trade: Sec. 45(2)
Calculation of business income and capital gain:

Particulars	Amount
Sale proceeds of converted capital asset	XXX
Less: Fair market value of converted capital asset on the date of conversion	XXX
Business Income	XXX
Fair market value of converted capital asset	XXX
Less: Cost of acquisition for STCG	XXX
Or	XXX
Index cost of acquisition for LTCG	XXX
CAPITAL GAINS	XXX

Exemptions:

1. **Long-term capital gains on residential house invested in the residential house u/s 54:** Any long term capital gain arising from the transfer of a residential house and invested in another residential house is exempt from tax subject to the following conditions:

- The income from such house property is taxable under the head income from house property.
- The house property should be held for at least three years before its transfer
- If the amount of capital does not exceed Rs. 2 Crores: The assessee should purchase two new residential house within a period of one year before or two years after the date of transfer or construct two new residential house within a period of three years after the date of transfer.
- If the amount of capital exceeds Rs. 2 Crores. The assessee should purchase one new residential house within a period of one year before or two years after the date of transfer or construct one new residential house within a period of three years after the date of transfer.
- If the assessee has not purchased or constructed a new residential house, he must deposit the amount of capital gain in a specified scheme called "Capital Gain Account Scheme" (CGAS)

<u>Amount of exemption u/s 54:</u>

Cost of new residential house:	xxx
Amount deposited in CGAS:	xxx
	xxx
OR	
Long term capital gain	xxx
Whichever is less	**xxx**

2. **Capital gain on agricultural land invested in other agricultural land: sec 54B:** Any capital gain arising from the transfer of agricultural land is exempt from tax subject to the following conditions:

- The land must have been used for agricultural purpose for at least two years before the date of transfer either by assessee or his parents.
- Assessee must purchase a new agricultural land within two years from the date of transfer.

<u>Amount of exemption u/s 54B:</u> Cost of new agricultural land (CGAS) or capital gain whichever is less.

3. **Capital gains on compulsory acquisition of land and building invested in other land and building: sec 54D**

   Any capital gain arising from the compulsory acquisition land and building exempt from tax subject to the following conditions:

- The property acquired is land and building forming part of industrial undertaking.
- The asset must have been used for the purpose of business for at least two years immediately preceding the date of transfer.
- Assessee should purchase new land and building for establishing another industrial undertaking, shifting or re-establishing the existing undertaking within a period of three years from the date of transfer.

<u>Amount of exemption u/s 54D:</u> Cost of new land and building (CGAS) or capital gain whichever is less.

4. **Long-term capital gains invested in certain bonds: sec 54EC:**

   Any long –term capital gain is exempt from tax subject to the following conditions.

- The amount should be invested in long-term specified bonds within 6 months from the date of transfer.
- Specified bonds redeemable after three years issued by: a) National Highways Authority of India (NHAI) b) Rural Electrification Corporation Ltd (REC)

<u>Amount of exemption u/s 54EC:</u> Amount invested in bonds (CGAS) or capital gain or maximum Rs.50,00,000 whichever is less.

5. **Long-term capital gains other than residential house invested in residential house: sec 54F:**

   Any long-term capital gain other than residential house being invested in residential house is exempt from tax subject to the following conditions:

- The long-term capital gain should be the gain other than residential house.
- Assessee should purchased a new residential house within a period of one year before or two year after the date of transfer or construct a new residential house within a period of three years after the date of transfer
- The assessee should not own more than one residential house property on the date of transfer.
- The assessee should not purchase within a period of one year or construct within a period of three years any residential house other than the new house.
- The new residential house should not be sold within a period of three years from date of acquisition.

Amount of exemption: Sec. 54F: Long term capital gain X <u>cost of new house (CGAS</u>)
Net consideration

6. **Capital gains on shifting of industrial undertaking invested in new industrial undertaking in other than urban area: sec 54G:**

   Any capital gain arising from the transfer of machinery, plant, land and building is exempt from tax subject to the following conditions:

- Transfer of industrial undertaking should be any area other than an urban area.
- The assessee within a period of one year before or three yearly after the date of transfer should purchase plant and machinery, land and building or construct a building and complete shifting to the new area.

Amount of exemption u/s 54G: Cost of new plant, machinery, land and building (CGAS) or capital gain whichever is less.

7. **Capital gain on shifting of industrial undertaking invested in new industrial undertaking in Special Economic Zone (SEZ) Sec: 54GA:**
   Any capital gain arising from the transfer or shifting to SEZ is exempt from tax subject to the following conditions:

- The transfer of industrial undertaking should be to any SEZ
- The assessee within a period of one year before or three years after the date of transfer should purchase plant and machinery and building or construct a building in SEZ

Amount of exemption u/s 54GA: Cost of new asset (CGAS) or capital gain whichever is less.

8. **Extension of time limit for acquiring new asset: sec 54H:**
   In case of compulsory acquisition of any asset under any law, the date of transfer is not considered for calculation of capital gain. The date of transfer is the date on which the assessee receives the compensation. In the view of this provision the period of making investment or acquiring the asset commences only from the date of compensation and not from the date of transfer of original asset.

Retention money: How do you treat advance money received and retained by the assessee?
If advance money received is forfeited on or after 01-04-2014 it will be taxable as " Income from other sources". But for advance money received is forfeited before 01-04-2014, it shall be deducted from cost of acquisition.