Capital Gains Tax in India: A Perspective

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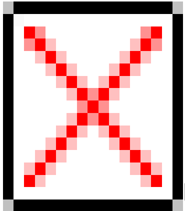**DESPITE** recurrent noises about anticipated changes to capital gains tax structure and imperatives for bringing about those changes, the system historically has remained relatively firm and consistent with no significant head turning alterations except the changes through (a) Finance Act 1987 defining the period of holding for a short term capital asset being shares held in a company to a period not exceeding 12 months and Finance Act 2017 defining the period of holding for a short term capital asset being unlisted shares or immovable property to a period not exceeding 24 months under section 2 (42A) (b) Finance Act 1992 laying down a flat special rate of taxation of long term capital gain (LTCG) under section 112 (c) Finance Act 2004 laying down a flat special rate of tax on short term capital gains in case of shares and units under section 111A (d) Finance No 2 Act of 2004 exempting income arising from transfer of long term capital asset being an equity share through section 10(38) and Finance Act 2018 withdrawing that exemption from 1-4-18 (e) Finance No 1 Act of 2019 laying down a lower rate for Securities Transaction Tax (STT) paid transaction of shares and units under section 112A. There have been though high pitched debates on the rationale behind the taxation structure for capital gains as existing in India qua other countries who in some instances have not distinguished between tax rate on capital gains vis a vis the corporate income tax rate, very unlike India , where tax rate on capital gains has varied between 10%, 15% and 20% based on the nature of assets and holding period contrasted with the highest marginal rate of 30% in case of individuals or HUF or partnership firms or companies etc.

More than the discussion on the lower rate of taxation on capital gains, a significant oddity in taxation of capital gains is the carte blanche available with the taxpayer to trigger a tax incidence at a time of his choosing unlike when he undertakes a business or profession or when he gets employed and earns an income from salary. Tax on income from business or profession is triggered if business or profession is carried on by the taxpayer at any time during the previous year. In respect of salary, section 15 for example which reads as below makes it clear that salaries due from an employer of ex- employer to a taxpayer even if unpaid is fully taxable:

> "15. ***The following income shall be chargeable to income-tax under the head "Salaries"-***
>
> ***(a)Â any salary due from an employer or a former employer to an assessee in the previous year,whether paid or not;***
>
> ***(b)Â any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;***
>
> ***(c)Â any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.***

Capital gains as per section 45 however connotes to a taxable event arising only from the transfer of a capital asset in the previous year. Transfer as defined in section 2(47) would mean and include among other variations those processes which signify (a) sale, exchange or relinquishment of the asset (b) extinguishment of any rights in the capital asset (c) compulsory acquisition under any law (d) conversion of a capital asset to a stock in trade (e) maturity or redemption of a zero coupon bond (f) allowing possession of an immovable property to be taken or retained in part performance of a contract (g) any transaction through an agreement or an arrangement which has the effect of transferring or enabling enjoyment of an immovable property. In effect only when an asset is effectively sold or transferred that tax incidence arises making

it fully permissible for a taxpayer to strategically plan for timing of such sale in order to coincide that event for harvesting any losses under any head of income or hold on to an asset if need be for life solely for a tax advantage. Appreciation in value of an asset unless sold and realised is never subject to a tax. Added to this is the long list of transactions (41 in all) details in section 47 including transfers following partition of a HUF or under a gift or will or an irrevocable trust , which are not to be regarded as transfer and hence outside the scope of any capital gains tax. All the 3 factors (reduced rate of taxation, choice with the taxpayer to determine the timing for a tax incidence in respect of capital gains, and multiple exceptions to the definition of transfer as legislatively provided) contribute to a growing perception of a tax preference for income from capital gains over income from business or profession or from employment.

In India context, the most revenue significant machinery provisions for invoking a capital gains tax are legislatively expressed through 3 sections/ sub sections : (a) section 112 prescribing rates for LTCG on listed securities/ units without indexation and LTCG on other classes of assets (b) section 112A prescribing LTCG tax on equity shares/ units of equity oriented funds/ units of business trusts on which STT is paid and (c) section 112(1)(c)(iii) prescribing LTCG rates for unlisted securities in case of non- residents. That apart, other eventualities giving rise to capital gains tax though of minor revenue implications expressed through legislative provisions are : (a) section 115AB (1)(b) in respect of LTCG arising from transfer of units purchased in foreign currency by an of shore fund (b) section 115AC (1)(c) in respect of LTCG arising from transfer of bonds or GDR purchased in foreign currency by a non-resident (c) section 115ACA (1)(b) in respect of LTCG arising from transfer of GDR purchased in foreign currency by a resident (d) section 115AD (1)(iii) in respect of LTCG by a FII (e) section 115E(a) in respect of LTCG on transfer any asset other than a specified asset of a non-resident (f) LTCG chargeable at special rates as per DTAA (h) pass through income in respect of LTCG chargeable at 10% or at 20%.

If the returns of income for FY 19-20 which show an incidence of LTCG are mapped LTCG slab-wise, the picture for the 3 most significant LTCG provisions would appear as follows:

37,633 returns declaring a sum of LTCG of Rs 7,413 Cr in respect of listed securities and units without indexation under section 112:

LTCG Income Range in Cr	**Number of returns**	**Sum of LTCG Income in CR**	**% of out of total LTCG in Cr**
Less than Rs 1 Lakh	28,036	63	0.8
1 to 5 Lakhs	6,328	139	1.9
5 to 10 Lakhs	1,294	92	1.2
10 to 25 Lakhs	1,068	165	2.2
25 to 50 Lakhs	407	142	1.9
50 Lakhs to 1 Cr	232	162	2.2
In excess of Rs 1 Cr	**268**	**6,651**	**90**

4,46,634 returns declaring a sum of LTCG of Rs 1,00,758 Cr in respect of others under section 112

LTCG Income Range in Cr	Number of returns	Sum of LTCG Income in CR	% of out of total LTCG in Cr
Less than Rs 1 Lakh	1,41,251	545	0.5
1 to 5 Lakhs	1,60,734	4,066	4
5 to 10 Lakhs	49,911	3,560	3.5
10 to 25 Lakhs	47,866	7,570	7.5
25 to 50 Lakhs	23,063	8,102	8
50 Lakhs to 1 Cr	11,937	8,387	8.3
In excess of Rs 1 Cr	**11,872**	**68,527**	**68**

4,37,053 returns declaring a sum of LTCG of Rs 31,588 Cr in respect of equity shares/units of equity oriented funds/ units of business trusts on which STT has been paid under section 112A

LTCG Income Range in Cr	Number of returns	Sum of LTCG Income in CR	% of out of total LTCG in Cr
Less than Rs 1 Lakh	3,53,372	800	2.5
1 to 5 Lakhs	63,384	1,342	4.3
5 to 10 Lakhs	9,826	684	2.2
10 to 25 Lakhs	6,324	967	3

25 to 50 Lakhs	2,086	719	2.3
50 Lakhs to 1 Cr	1,002	696	2.2
In excess of Rs 1 Cr	**1,059**	**26,380**	**83.5**

While it is not difficult to decipher from the above data that capital gains accrue overwhelmingly to the well-heeled and those in the top most income bracket having the wherewithal to own property, this is true of all economies, whether developed or developing. One more symptomatic conclusion on the character of our economy seen through the lens of declared capital gains as per returns submitted (preponderance of LTCG on transfer of assets not being shares or securities)generally should testify another truism about the character of all economies- that capital gains in developing economies would be primarily from sale of physical assets or real estate unlike in developed economies where it would be from sale of securities.

While India's capital gains tax structure is neither overly complex nor too difficult to administer despite the multiple parameters regarding nature of assets subject of transfer and their holding period, the most germane of the issues with regard to rate disparity qua income from business or from employment , and the number of exceptions under section 47 are hard to ignore, keeping in view that capital gains tax has been intended to introduce an element of progressivity to the overall taxation system and help reduce concentration of wealth in few hands. Calibrating the rate for capital gains at par with other income however must come after evaluating the repercussions on the supply of savings and the probable areas where the current investments would migrate to, and after fully understanding the various sub components within the current capital gains. A long shot exercise should be towards innovating a mark-to-market capital gains tax strategy as was proposed in 2019 by US senator Ron Wyden to help capture and tax the element of unearned increment in respect of the overwhelmingly wealthy. Finally how far the equity element in the current flat rate design of tax under section 111A, 112 and 112A cutting across all income slabs has been sub-served and whether a progressive tax structure even for capital gains would be more equitable should be a relevant question for the policy makers.