UNIT 7 : CAPITAL GAINS

Chargeability of Capital Gains:

Basically, capital receipts are not liable to tax; however, certain gains arising on transfer of capital assets, are taxable u/s 45.Any profits or gains arising from the transfer of capital assets effected during the previous year is chargeable to income-tax under the head 'Capital gains' and shall be deemed to be the income of that previous year in which the transfer takes place. Taxation of capital gains, thus, depends on two aspects, 'capital assets' and 'transfer'.

Any profits or gains arising from receipt of money or other assets under any insurance from an insurer on account of damage or destruction of any capital asset, as result of flood, typhoon, hurricane, cyclone, earthquake, riot, fire, explosion, war etc. shall be taxable as capital gains in the year such money or asset is received. (Sec. 45 (1A)).

Besides, capital gains shall also arise on transfer of a capital asset under certain specified circumstances, viz.- conversion of an asset into stock-in-trade, transfer of an asset by a person to a firm, AOP or BOI, in which he is or becomes a partner, distribution of assets on the dissolution of a firm AOP or BOI and transfer by way of compulsory acquisition of an asset. (**Sec.45 (2), (3), (4) & (5)**.)

Further, the profit (or loss) arising on repurchase of units (of UTI or specified mutual fund) issued under 'Equity Linked Savings Scheme, shall also be chargeable to tax as 'capital gains', in the year the units are so repurchased. The capital gain shall be equal to the difference between repurchase price and the original cost of the units. (**Sec.45 (6)**)

Definition of Capital Assets Sec 2(14)

Capital Asset means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include –

[i] Any stock- in- trade, consumable stores or raw materials held for the purposes of his business or profession:

[ii] personal effects, i.e. to say, movable property (including wearing apparel and furniture) but excluding Jewellery, Archaeological collections, drawings, Paintings, Sculptures or any work of art, held for personal use by the assessee or any member of his family dependent on him.

Explanation: -

For the purposes of this sub clause, "Jewellery" includes –

a. Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such semi-precious stone, and whether or not worked or sewn into any wearing apparel;
b. Precious or semi-precious stone, whether or not set in any furniture, utensil or other article or work or sewn into any wearing apparel;

[iii] agricultural land in India, not being land situated: -

a. In any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year :or

b. In any area within such distance, not being more than eight kilo meters, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may specify.

[iv] 6 ½ percent Gold Bonds, 1977, [or 7% Gold Bonds 1980,] or [National Defence Gold Bonds, 1980,] issued by the Central Government.

[v] Special Bearer Bonds, 1991 issued by the Central Government.

[vi] Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government;

Classification of Capital Gains:

1. **Short Term:** Gains on transfer of capital assets held by the assessee for not more than 36 months
   [(12months in case of a share held in a company or any other security listed in a recognised stock exchange in India, or a unit of the UTI or of a mutual fund specified u/s 10 (23D) immediately preceding the date of its transfer. (Sec.2 (42A)]
2. **Long Term:** The capital gains on transfer of capital assets held by the assessee for more than 36 months (12 months in case of shares held in a company or any other listed security or a unit of the UTI or of a specified mutual fund).

Capital Assets

Securities
(i.e. Shares, Debentures, Units of UTI etc.)

Remaining Capital Assets

Period of holding ≤1 year	Period of holding > 1 year	Period of holding ≤ 3 years	Period of holding >3 years
Short Term	Long Term	Short Term	Long Term

Transfers Resulting in Capital Gains:- Transfer basically means the act by which a person conveys property to one or more persons. As per Section 2(47), 'transfer' includes:

1. Sale or exchange of the asset;
2. Relinquishment of the asset;
3. Extinguishment of any rights in the asset;
4. Compulsory acquisition of the asset under any law;

5. Conversion of the asset into stock-in-trade of a business carried on by the owner of the asset;
6. Maturity or redemption of zero coupon bond
7. Handing over the possession of an immovable property in part performance of a contract for the transfer of that property;
8. Transactions involving transfer of membership of a group housing society, company, etc; which have the effect of transferring or enabling enjoyment of any immovable property or any rights therein;
9. Distribution of assets on the dissolution of a firm, body of individuals or association of persons.
10. Transfer of a capital asset by a partner or member to the firm or AOP, whether by way of capital contribution or otherwise; and
11. Transfer under a gift or an irrevocable trust of shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees stock option Plan or Scheme of the company as per Central Government guidelines. Sec. 47(iii) proviso.

Year of Taxability

Capital gains form part of the taxable income of the previous year in which the transfer giving rise to the gains takes place. Thus, the capital gain shall be chargeable in the year in which the sale, exchange, relinquishment, etc. takes place.

Computation of Capital Gains in case of non depreciable assets: -

1. Ascertain the **full value of consideration** received or acquired as a result of the transfer.
2. Deduct from the full value of consideration-
   (a) **Transfer expenditure** like brokerage, legal expenses, etc.
   (b) **Cost of acquisition** of the capital asset/indexed cost of acquisition in case of long-term capital asset; and
   (c) **Cost of improvement** to the capital asset/indexed cost of improvement in case of long-term capital asset. However cost of improvement is considered to be part of the cost of asset only if such cost is **incurred on or after 1^{st} April 1981** i.e. any cost of improvement incurred before 1^{st} April 1981 is not considered.
3. The balance left-over is the gross capital gain/loss.
4. Deduct the amount of permissible exemptions u/s 54. 54B, 54D, 54EC, 54F, 54G and 54H.
5. The balance is the net capital gain/loss, chargeable to tax.

Full value of Consideration

This is the amount for which a capital asset is transferred. It may be in money or money's worth or combination of both. For instance, in case of a sale, the full value of consideration is the full sale price actually paid by the transferee to transferor. Where the transfer is by way of exchange of one asset for another or when the consideration for transfer is partly in cash and partly in kind, the fair market value of the asset received as consideration, if any, together constitute full value of consideration.

In case of damage or destruction of an asset in fire, flood, riot etc. the amount of money or the fair market value of the asset received by way of insurance claim, shall be deemed as full value of consideration. (**Section 45 (1a)**).

From assessment year 2003-04, u/s 50 in case of transfer of land & building, sale consideration is taken as follows:
1) Actual sale value **OR**
2) Municipal valuation which is taken for payment of stamp duty.
whichever is **higher**.

When shares, debentures, warrants are allotted by a company under Employees' Stock Option Plan and such shares are transferred by the employee by way of gift, the market value on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as the result of such transfer.

Cost of Acquisition

The cost of acquisition in relation to a capital asset is the amount for which the asset was originally purchased by the assessee. (**Sec.55 (2) (b)**)

Any expenditure incurred in connection with such purchase, exchange or other transaction e.g. brokerage paid, registration charges and legal expenses, is added to price or value of consideration for the acquisition of the asset. Interest paid on money borrowed for purchasing the asset is also part of its cost of acquisition.

Where capital asset became the property of the assessee before 1.4.1981, he has an option to adopt the fair market value of the asset as on 1.4.1981, as its cost of acquisition.

Cost of Acquisition of Previous Owner u/s 49(1)

Where the asset was not originally purchased by the assessee but was transferred to him under any of the following circumstances, the cost of acquisition in the hands of the assessee shall be the cost for which the previous owner acquired it:-

1) On distribution of assets on the total or partial partition of a Hindu undivided Family;
2) Under gift or Will;
3) By succession, inheritance or devolution;
4) On distribution of assets on the liquidation of a company;
5) On distribution of asset on the dissolution of a firm, body of individuals or other association of persons where such dissolution had taken place before 1-4-1987;
6) Under a transfer to a revocable or an irrevocable trust.
7) By a wholly owned Indian subsidiary company from its holding company;
8) By an Indian holding company from its wholly owned subsidiary company;
9) In a scheme of amalgamation, by the amalgamated company from the amalgamating company which comes under section 47 (vi) /(via);

10) By a Hindu undivided family where one of its members has converted his self-acquired property into joint family property after 31-12-1969.

For computing period of holding in these cases the period for which the asset was held by the previous owner should be included. However, indexation is available from the year in which present owner held this asset for the first time. Indexation for the cost of improvement is available from the year in which cost was incurred by previous or present owner.

Cost of shares acquired by conversion of debentures : Section 49(2A)

On sale of shares which were acquired by conversion of debentures, cost will be taken as that part of the cost of debentures which has been appropriated towards shares.

Cost of ESOP or Sweat Equity Shares : Section 49(2AA)

It will be fair market value of shares on the date of allotment.

Cost of shares allotted in a scheme of demerger : Section 49(2C)

Cost in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before the demerger.

Indexed cost of Acquisition/ Improvement

For computing long term capital gains, 'Indexed Cost of Acquisition' and 'Indexed Cost of Improvement' are required to be deducted from the full value of consideration of a capital asset. Both these costs are thus required to be indexed with respect to the Cost Inflation Index.

Cases where indexation is not applicable

Indexation is not applicable in case of:

[1] shares and debentures of an Indian Company transferred by a non resident assessee in case of all the assesses.

[2] transfer of bond and debenture except capital index bonds issued by the Govt.

[3] on short term capital gain.

Accordingly, indexed cost of Acquisition & Indexed Cost of Improvement shall be computed as under: **(sec.48)**

$$\text{Indexed Cost of Acquisition} = \frac{\text{Cost of Acquisition x Cost Inflation Index for the year of transfer}}{\text{Cost Inflation Index for the year of acquisition or 1981-82, whichever is later}}$$

$$\text{Indexed Cost of Improvement} = \frac{\text{Cost of Improvement x Cost Inflation Index for the year of transfer}}{\text{Cost Inflation Index for the year of improvement}}$$

Cost Inflation Index:

S. No.	Financial Year	Cost Inflation Index	S. No.	Financial Year	Cost Inflation Index
(1)	(2)	(3)	(1)	(2)	(3)
1	1981-82	100	19	1999-2000	389
2	1982-83	109	20	2000-01	406
3	1983-84	116	21	2001-02	426
4	1984-85	125	22	2002-03	447
5	1985-86	133	23	2003-04	463
6	1986-87	140	24	2004-05	480
7	1987-88	150	25	2005-06	497
8	1988-89	161	26	2006-07	519
9	1989-90	172	27	2007-08	551
10	1990-91	182	28	2008-09	582
11	1991-92	199	29	2009-10	632
12	1992-93	223	30	2010-11	711
13	1993-94	244	31	2011-12	785
14	1994-95	259	32	2012-13	852
15	1995-96	281	33	2013-14	939
16	1996-97	305	34	2014-15	1025
17	1997-98	331	35	2015-16	1081
18	1998-99	351			

SPECIAL CASES

I. Depreciable Assets: -

1. **Applicable to Depreciable assets: -** These special rules are applicable only to capital assets belonging to any block of depreciable assets (Plant, Machinery, Buildings, etc). There are two cases in which capital gains arises- (a) when, out of a block of assets, only some assets are transferred or (b) when all assets are transferred.
2. **Case A – Transfer of Some Assets in a Block [S.50(1)] :-**
   a. Transfer of Some Assets: In this case assets belonging to a block are transferred, [but the block of assets does not cease to exist as in the case B].
   b. Computation of Capital Gains: Capital gains are computed as follows:

Opening WDV of the block	xxx
Add: Cost of additions during the year	xxx
	xxx
Less: Net value of consideration	xxx
Balance	xxx

If this balance is **positive figure** then **depreciation** is allowed u/s 32 (Refer Chapter 7)

If balance is **negative figure** then it treated as **short term capital gain**.

3. Case B – Transfer of All Assets in a Block: [S.50 (2)]

a. Transfer of all assets: In this case a block of assets ceases to exist because all assets in that block are transferred during the previous year
b. Computation of Capital Gain: Capital Gain/Loss is calculated as follows:

Opening WDV of the block	xxx
Add: Cost of additions during the year	xxx
Less: Net value of consideration	xxx
Balance	xxx

If balance is **positive figure** then it is treated as **short term capital loss**.
If balance is the **negative figure** then it is treated as **short term capital gain**.

II. Introduction of Capital Asset as Capital

On transfer of a capital asset by a partner to a firm as capital contribution-

(a) Capital gain accrues to the partner who transfers the asset;
(b) Such gains are taxed as his income in the year of such transfer;
(c) The full value of the consideration for transfer is taken to be the amount recorded in the books of accounts of the firm as the value capital asset.

III . Distribution of Capital Asset on Dissolution

In case of transfer by way of distribution of capital assets by a firm, on dissolutions-

(a) capital gains are taxed in the hands of such firm;
(b) gains are taxed in the previous year when such transfer takes place.
(a) The fair market value of the assets on the date of transfer is deemed to be the full value of consideration.

IV. Conversion of Capital Asset into stock

1] Conversion of investment into stock-in-trade will be treated as transfer under section 2(47). It will be treated as transfer in the year in which capital asset is converted into stock-in-trade. [Normally, such conversion would not be treated as transfer, as transfer arises only between two different persons.]
2] The notional capital gain arising from transfer by way of conversion of a capital asset in to stock-in trade will be chargeable to tax in the year in which the stock-in-trade is sold. [Normally, capital gain would have been taxed in the year of transfer i.e. such conversion]
3] For the purpose of computing the capital gain in such cases, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset. [Normally, consideration would be Nil, as no consideration is received /receivable.]
4] Period of holding of the asset runs from the date of acquisition of the asset to the date of such conversion.
5] In case of short term asset, cost is computed without indexation.

6] In case of long term asset, indexed cost is computed. For the purpose of indexation, year of conversion is taken as the year of transfer.

7] Business income from such converted stock-in-trade arises in the year such stock is sold. Business income is equal to Sale value of stock Less Fair market value of the asset on the date of conversion.

V. In case of compulsory acquisition of assets: -

a) For initial compensation capital gain is taxable in the year in the year in which compensation is received & not in the year in which assets was acquired. However, for indexed cost, index of the year of compulsory acquisition is considered.

b) For enhanced compensation capital gain is taxable in the year in which such compensation is received & cost of acquisition is taken to be NIL.

EXEMPTION FROM CAPITAL GAIN U/S 10

1. Capital gain on transfer of US64 [u/s 10 (33)] provided transfer taken place on or after 1.4.2002. This exemption is applicable for both short term as well as long term gain.

2. Long Term Capital Gain on transfer of BSE-500 Equity shares [u/s 10(36)] if eligible equity share were acquired between 1.3.2003 & 29.2.2004.

Eligible shares for this purpose are equity shares being constituent of BSE-500 index Mumbai Stock Exchange as on 1.3.2003 & also equity shares allotted through public issue on or after 1.3.2003 & listed in a recognised stock of exchange in India before 1.3.2004.

3. Capital Gain on compulsory acquisition of Urban Agricultural Land, long term or short term [section 10(37)] provided such land was used for agricultural purpose during 2 years immediately prior to the date of transfer.

4. Long Term Capital Gain on transfer of securities (equity shares or units of equity oriented mutual fund) which are subject to Securities Transaction Tax (STT) [Section 10(38)] provided such a transaction takes place on or after 1.10.2004.

PROBLEMS

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1. Mr. X purchased a House Property on 15th April 1994 for ₹ 4 lacs. He constructed additional floor in July 2006 by spending ₹ 1,50,000. He sold the same asset on 1st Jan 2016 for ₹ 20,00,000. Find out capital gains if brokerage paid is 2%.

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2. Mr. X purchased House Property in 1965 for ₹ 10,000. He constructed 1st floor in Jan 1973 by paying ₹ 5,000. During Jan 1999 he constructed 2nd floor by paying ₹ 1,00,000. He sold entire property in Jan. 2014 for ₹ 20,00,000. Fair market value of the property on 1st April 1982 was ₹ 3,00,000. Brokerage 2%. Calculate Capital Gain.

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3. Mrs. Sachin purchased a house property for ₹ 2,00,000 in the year 1974-75. Following expenses were incurred for the house property.

(a) Cost of additions in the year 1981-82 ₹ 1,50,000.

(b) Cost of Construction of 1st floor in 1992-93 ₹ 3,50,000
(c) Alteration to house property in 2001-2002 ₹ 3,00,000
(d) Fair Market Value of the property on 1st April 1981 was ₹ 5,00,000. The house property is sold to Mr. Ashok in the previous year 2015-2016 for ₹ 80,00,000.
(e) Expenses incurred on transfer during the previous year is ₹ 5,000.
Compute the Capital Gain for A.Y. 2016-2017.

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4. Mr. A purchased House property on 7th Feb. 2009 for ₹ 2,00,000. On 1st Jan 2012 he gifted the same asset to Mr. B. Market value of the asset on the same date was ₹ 5,00,000. Mr. B sold the same asset in April 2014 for ₹ 10,00,000. Expenses on brokerage 2%. Calculate Capital Gain.

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5. Mr. A purchased House Property in Jan 1965 for ₹ 5,000. He constructed 1st floor in 1976 for ₹ 1,00,000. He constructed 2nd floor in March 1994 for ₹ 2,00,000. He died on 9th Oct 2011. & House Property was transferred to his son Mr. B on the same date. Mr. B constructed 3rd floor in Dec. 2012 for ₹ 2,00,000. He sold entire property in April 2015 for ₹ 40,00,000. Fair market value on 1st April 1981 was ₹ 2,00,000. Brokerage paid is 2%. Calculate Capital Gain.

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6. Mr. X acquired a house on 10th April 1971 for ₹ 50,000. He carried out improvement worth ₹ 1,00,000 in Jan 1977. He gifted the same asset to Mr. Y on 6th Oct 2007. Mr. Y carried out improvements in August 2011 worth ₹ 2,00,000. He sold the same for ₹ 30,00,000 in May 2015. Fair market value on 1st April 1981 was ₹ 31,00,000.

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7. Calculate Capital Gain in each of the following cases:-

Assets	Acquisition Cost (₹)	Acquisition Date	Sale Consideration (₹)	Transfer Date
1. Residential Property	2,00,000	09-08-09	10,00,000	11-12-15
2. Residential Property	3,00,000	10-08-13	6,00,000	11-12-15
3. Personal Scooter	50,000	01-04-11	40,000	02-04-15
4. Gold	1,00,000	01-09-93	9,00,000	01-01-16
5. Urban Agricultural Land Compulsory acquisition	2,00,000	10-12-95	20,00,000	01-04-15
6. Building	4,00,000	10-09-2007	10,00,000	11-09-15
7. House Property	2,50,000	05-04-2007	6,00,000	15-04-15
8. Agricultural land in village	3,00,000	01-04-2003	50,00,000	10-01-16
9. Ornaments	1,00,000	21-04-12	3,00,000	10-01-16

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8. Opening Balance on 1st April 2015
Machinery A 2,00,000
Purchases:
Machinery B 3,00,000
Machinery C 1,00,000

Sales during the year:	Case I	Case II
A	1,00,000	2,00,000
B	50,000	1,50,000
C	2,00,000	5,00,000

Expenses on transfer ₹25,000. Depreciation 10%.
Calculate the depreciation or Capital Gain/Loss for the assessment year 2016-2017.

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9. Opening Balance

Machinery A	2,00,000
Purchases:	
B	3,00,000
C	1,00,000
Sales:	
Machinery A	10,00,000
Expenses on transfer	25,000

Calculate the amount of depreciation or Capital Gain for the assessment year 2016-2017. Rate of depreciation is 20%.

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10. Mr. Acharekar runs his own business of manufacturing and selling switches. He owns a block of assets being plant and machinery which falls in the general category. On 1-4-2014 the written down value of the block was ₹ 6,00,000. During the financial year 2014-2015 the company sells some items of plant and machinery for ₹ 1,50,000. Thereafter, during the financial year 2015-2016 the company purchases plant and machinery for ₹ 50,000 & sells certain items for ₹ 4,00,000, expenditure incurred for effecting the sale being ₹ 10,000. Determine the amount of depreciation and Capital Gain/Loss for the assessment year 2015-2016 & 2016-2017. Rate of depreciation is 25%.

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11. Mr. Palekar has his own business of buying and selling chemicals. Among the other Assets the written down value of a block of assets comprising furniture is ₹ 5,00,000 on 1-4-2014 He purchases some more furniture in July 2014 for ₹ 50,000 and thereafter sells all the furniture for ₹ 3,20,000 during the financial year 2015-2016. Determine the amount of depreciation & Capital Gain/Loss for the assessment year 2016-17. Rate of depreciation is 15%.

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12. Mr. X purchased a machine for ₹ 1,00,000 (Brokerage paid 5%) in 1994-1995. During June 2015 he was admitted as partner in XYZ firm. He introduced this machine into business as his capital contribution. Market value on the date of transfer was ₹ 10,00,000. But entry passed in the books is as follows:-

Machinery A/c Dr.	6,00,000	
To X's Capital a/c		6,00,000

Find out Capital Gains for X for A.Y. 2016-17.

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13. XYZ firm purchased house property for ₹ 2,00,000 in 1994-1995. During 2015-2016 firm was dissolved and X took over House property. Value recorded in the books was ₹ 5,00,000. Market value of the asset on the same day was ₹ 10,00,000. Find out capital gains for XYZ firm for A.Y. 2016-17.

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14. Mr. X purchased gold for ₹ 2,00,000 in May 1994. In June 2007 he started a jewellery shop and introduced the same gold in the business. Market value of gold in June 2007 was ₹ 8,00,000. In June 2015 he sold entire gold for ₹ 12,00,000. Discuss taxability in these cases.

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15. On 10th May 1993 Mr. X acquired House Property for ₹ 2,00,000. On 15th August 2011 government compulsorily acquired this property. Compensation ₹ 10,00,000 was paid on 25th Jan 2015. Mr. X did not agree with the amount of compensation and filed a suit in court. On 5th April 2015, Court awarded additional compensation of ₹ 3,00,000. Find out capital gains for P.Y. 2014-15 & 2015-16.

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