NOTE

1. The term ‘capital asset’ is defined under Section 2(14) of the IT Act to mean property of any kind held by a taxpayer whether or not connected with business or profession of the taxpayer but specifically excludes stock-in-trade and other specified assets from the definition. Shares qualify as capital asset under Section 2(14) of the IT Act and shares of an Indian company would be regarded as capital asset situated in India. Further, as per Section 45 of the IT Act, any gain arising on ‘transfer’ of a capital asset will be taxable as capital gains in the year of transfer.

2. <u>Mechanism for computation of capital gains</u>

   Section 48 of the IT Act provides for the mechanism for computation of capital gains and allows certain deductions that can be claimed viz. cost of acquisition of the capital asset and expenditure incurred wholly and exclusively in connection with transfer. As per the provisions of Section 48 of the IT Act, the capital gains shall be computed as under:

Sale consideration	XXX
Less: Cost of acquisition	XXX
Less: Expenditure incurred wholly and exclusively in connection with transfer	XXX
Capital Gains/ Loss	**XXX**

3. <u>Value of sale consideration</u>

   Unquoted shares –
   As per the provisions of Section 50CA of the IT Act, the fair market value (‘**FMV**’) of the unquoted shares shall be deemed to be the full value of consideration, for the purpose of computing capital gain, if the actual consideration paid for transfer of unquoted shares is less than the fair market value of such shares.

   Rule 11UA of the IT Rules prescribes the manner in which the FMV of unquoted shares is to be determined.

   Quoted shares –
   In case of transfer of quoted shares, the amount paid as consideration will be taken into consideration to compute the capital gains tax liability.

4. <u>Cost of Acquisition</u>

The cost of acquisition of shares held in E and M, will be computed as under -

- Pursuant to the demerger, the cost of acquisition of shares held in E by A has to be allocated to the shares held by A in E and shares allotted in M.
- As per Section 49(2C) of the IT Act, the cost of acquisition of shares allotted in M pursuant to demerger shall be the amount which bears to the cost of acquisition of shares held in E the same proportion as the net book value of assets transferred in a demerger bears to the net worth of E immediately before such demerger.

  Cost of acquisition of shares held in M =

  $$\text{Cost of acquisition of shares in E} \times \frac{\text{Net book value of assets transferred}}{\text{Net worth of E before the demerger}}$$

- As per Section 49(2D) of the IT Act, the cost of acquisition of the original shares held by the shareholders in E shall be reduced by the cost of acquisition of the shares in M computed as per Section 49(2C) of the IT Act.

  Cost of acquisition of the shares held in E =

  Cost of Acquisition of shares in E – Cost of Acquisition of shares of M arrived at above

- The cost of acquisition of shares held in E will be further reduced by $1/10^{th}$ value to account for capital reduction.

5. Applicable rate of tax

The capital gains are classified as long-term and short-term in accordance with the period of holding of the shares and the rate applicable on such gains depends on the type of gain, i.e., long term or short term.

As a general rule, a capital asset that is held for a period of more than 36 months before the date of transfer would qualify to be long term. However,

- in case of shares listed on stock exchange, to classify as long-term period of holding is more than 12 months;
- in case of unlisted shares, to classify as long-term period of holding is more than 24 months.