

## CHAPTER 8: TAXATION

### 8.1 Applicability of Taxes in Respect of Mutual Funds

Mutual funds in India are subject to various taxes that impact investors. Understanding these taxes is essential for making informed investment decisions.

**Direct Taxes:** These are levied on the income earned by investors from mutual funds, such as capital gains and dividend income.

**Indirect Taxes:** These include taxes like GST (Goods and Services Tax) applicable on mutual fund services.

**Fund Level Taxes:** Certain taxes are levied at the fund level, such as the Securities Transaction Tax (STT) on purchase and sale of units.

Quiz Questions:

What types of taxes are mutual funds in India subject to?

- A. Only direct taxes
- B. Only indirect taxes
- C. Both direct and indirect taxes

Answer: C

Which tax is levied at the fund level on the purchase and sale of units?

- A. Income Tax
- B. Securities Transaction Tax (STT)
- C. Capital Gains Tax

Answer: B

### 8.2 Capital Gains

Capital gains refer to the profit earned from the sale of mutual fund units. They are classified into short-term and long-term based on the holding period.

**Short-term Capital Gains (STCG):** Gains from units held for less than 36 months (for debt funds) or 12 months (for equity funds). These are taxed at 15% for equity funds and as per the investor's income slab for debt funds.

**Long-term Capital Gains (LTCG):** Gains from units held for more than 36 months (for debt funds) or 12 months (for equity funds). LTCG on equity funds up to ₹1 lakh is tax-free, and above ₹1 lakh is taxed at 10% without indexation. LTCG on debt funds is taxed at 20% with indexation.

Quiz Questions:

What is the holding period for short-term capital gains in equity mutual funds?

- A. Less than 36 months
- B. Less than 12 months
- C. Less than 24 months

Answer: B

What is the tax rate for long-term capital gains on equity mutual funds exceeding ₹1 lakh?

- A. 15%
- B. 20%
- C. 10%

Answer: C

### 8.3 Dividend Income (IDCW Option)

Dividend income from mutual funds, now referred to as Income Distribution cum Capital Withdrawal (IDCW), is taxable in the hands of the investor.

**Taxable Income:** Dividends received are added to the investor's income and taxed as per their income tax slab.

**TDS on Dividends:** A 10% Tax Deducted at Source (TDS) is applicable on dividends if the total amount exceeds ₹5,000 in a financial year.

Quiz Questions:

How is dividend income from mutual funds taxed?

- A. As capital gains
- B. As income in the hands of the investor
- C. It is tax-free

Answer: B

What is the TDS rate on mutual fund dividends exceeding ₹5,000 in a financial year?

- A. 5%
- B. 10%
- C. 15%

Answer: B

### 8.4 Stamp Duty on Mutual Fund Units

Stamp duty is levied on the purchase of mutual fund units, which affects the initial investment amount.

**Applicable Rate:** A stamp duty of 0.005% is charged on the purchase or switch-in of mutual fund units.

**Impact on Investment:** This duty is deducted from the invested amount, reducing the number of units allotted to the investor.

#### Quiz Questions:

What is the stamp duty rate on the purchase of mutual fund units?

- A. 0.01%
- B. 0.005%
- C. 0.1%

Answer: B

How does stamp duty affect mutual fund investments?

- A. It increases the number of units allotted
- B. It has no impact
- C. It reduces the number of units allotted

Answer: C

#### 8.5 Setting Off of Capital Gains and Losses under Income Tax Act

Investors can set off capital gains and losses to reduce their taxable income.

Short-term Losses: Can be set off against both short-term and long-term gains.

Long-term Losses: Can only be set off against long-term gains.

Carry Forward: Unutilized losses can be carried forward for up to 8 years to be set off against future gains.

#### Quiz Questions:

Against which type of gains can short-term capital losses be set off?

- A. Only short-term gains
- B. Only long-term gains
- C. Both short-term and long-term gains

Answer: C

For how many years can unutilized capital losses be carried forward?

- A. 5 years
- B. 8 years
- C. 10 years

Answer: B

#### 8.6 Securities Transaction Tax

Securities Transaction Tax (STT) is levied on the purchase and sale of equity mutual fund units.

STT Rate: STT of 0.001% is charged on the redemption of equity-oriented mutual fund units.

Impact on Transactions: This tax is directly deducted by the fund house at the time of redemption, impacting the net proceeds received by the investor.

Quiz Questions:

What is the STT rate on the redemption of equity-oriented mutual fund units?

- A. 0.1%
- B. 0.01%
- C. 0.001%

Answer: C

Who deducts the STT on mutual fund transactions?

- A. Investor
- B. Fund house
- C. SEBI

Answer: B

#### 8.7 Tax Benefit under Section 80C of the Income Tax Act

Investments in specific mutual funds, like Equity Linked Savings Schemes (ELSS), qualify for tax deductions under Section 80C.

ELSS Funds: Investments up to ₹1.5 lakh in ELSS funds are eligible for deduction from taxable income.

Lock-in Period: ELSS funds have a mandatory lock-in period of 3 years.

Quiz Questions:

Which type of mutual fund qualifies for tax deductions under Section 80C?

- A. Debt funds
- B. ELSS funds
- C. Balanced funds

Answer: B

What is the lock-in period for ELSS funds?

- A. 1 year
- B. 5 years
- C. 3 years

Answer: C

#### 8.8 Tax Deducted at Source

TDS is applicable on certain incomes earned from mutual fund investments.

Dividends: As mentioned earlier, a 10% TDS is applicable on dividends if they exceed ₹5,000 in a financial year.

Non-residents: TDS is also applicable on capital gains earned by non-resident investors, with rates varying based on the type of gain (short-term or long-term).

Quiz Questions:

When is TDS applicable on mutual fund dividends?

- A. Always
- B. When dividends exceed ₹5,000 in a financial year
- C. Never

Answer: B

Is TDS applicable on capital gains for non-resident investors?

- A. No
- B. Yes, with varying rates
- C. Only on short-term gains

Answer: B

#### 8.9 Applicability of GST

Goods and Services Tax (GST) is applicable on the services provided by mutual funds.

GST on Fund Management Fees: Fund management services attract an 18% GST, which is part of the Total Expense Ratio (TER) of the mutual fund.

Impact on TER: The inclusion of GST in the TER impacts the overall cost of the mutual fund to the investor.

Quiz Questions:

What is the GST rate on fund management fees for mutual funds?

- A. 10%
- B. 15%
- C. 18%

Answer: C

How does GST on fund management fees affect the mutual fund?

- A. It increases the Total Expense Ratio (TER)
- B. It decreases the Total Expense Ratio (TER)
- C. It has no impact on the Total Expense Ratio (TER)

Answer: A