

BONUS STRIPPING

SECTION 94(8): MEASURES TO CURB BONUS STRIPPING

♦ ANALYSIS OF SECTION 94(8) ♦

Bonus stripping in units curtailed (Section 94)

Prior to Finance Act, 2022, Bonus Stripping was possible in case of stocks i.e., shares. Section 94(8) has been amended by Finance Act, 2022 to curb the practice of creation of losses *via* bonus stripping in case of stocks i.e., shares. Briefly, it provides that the loss, if any, arising to a person on account of purchase and sale of original securities or units shall be ignored for the purposes of computing his income chargeable to tax if the following conditions are satisfied:

- (a) The person has bought or acquired the securities or units within a period of 3 months prior to the record date.
- (b) He is allotted additional securities or units without any payment on the basis of holding of such securities or units on such date (bonus securities or units).
- (c) He has sold or transferred all or any of the securities or units referred to in (a) within a period of 9 months after the record date.
- (d) On the date of sale or transfer referred to in (c) above, he held at least one of the additional bonus securities or units allotted to him.

However, the loss will be considered to be the cost of acquisition of the bonus securities or units held on the date of sale.

The provision:

- applies to all securities or units whether bought or ‘acquired’
- **is applicable even in case where securities or units are held as stock in trade**
- **is applicable in respect of securities or units**
- **does not apply if all additional securities or units are transferred before the original securities or units are sold**

As mentioned above, all the conditions have to* be cumulatively satisfied in order to attract section 94(8). Hence, in the following situations, section 94(8) will not apply.

SITUATION 1

- Securities or Units bought or acquired *before* a period of three months prior to the record date;
- Bonus securities or units on such units obtained during the intervening period; and
- Original securities or units sold or transferred within a period of nine months after the record date.

SITUATION 2

- Securities or Units bought or acquired within a period of three months prior to the record date;
- Bonus securities or units on such units obtained during the intervening period; and
- Original securities or units sold or transferred *after* a period of nine months from the record date.

SITUATION 3

- Securities or Units bought or acquired within a period of three months prior to the record date;
- No bonus securities or units are allotted during the intervening period; and
- Original securities or units are sold or transferred within a period of nine months after the record date.

Indexed cost of acquisition – Since the loss is considered to be the cost of acquisition of the bonus securities or units held on the date of sale, the benefit of indexation should be **available** on such deemed cost of acquisition.

Illustration 1:

A company Ipcat Lab Limited declared 1:1 bonus shares on its equity shares on 30.6.2022. The company fixed the record date for bonus entitlement to be 31.8.2022. Mr. X purchases 1,000 shares of Ipcat Lab Limited on 20.7.2022 for ₹ 900 each and is allotted 1,000 bonus shares on 31.8.2022. Mr. X sells 1000 original shares on 10.10.2022 for ₹ 460 per share. Discuss the tax implications.

Answer:

CAPITAL GAIN ON SALE OF ORIGINAL SHARES TAXABLE IN ASSESSMENT YEAR 2022-23

Period of Holding:	20.7.2022 to 9.10.2022		Short Term
Sales Price:	₹ 460 × 1,000 Original shares	=	4,60,000
Cost Price:	₹ 900 × 1,000 Original shares	=	9,00,000
Short Term Capital Loss			(-) 4,40,000

Short term capital loss of ₹ 4,40,000 can't be set-off against any long-term capital gain or short-term capital gain, and can't be carried forward.

The cost of 1,000 bonus shares shall be taken to be 4,40,000 as per section 94(8).

Illustration 2:

Morgan Stanley Mutual Fund declares 1 : 1 bonus units on its units on 30.4.2022. The Fund fixed the record date for bonus entitlement to be 31.5.2022. Mr. A purchases 1,000 units of Morgan Stanley Mutual Fund on 20.5.2022 @ ₹ 20 per unit. Mr. A sells 1,000 original units on 11.11.2022 for ₹ 9 per unit. Discuss the tax implications.

Answer:

Section 94(8) is applicable here since

- units are purchased with a period of three months prior to record date.
- bonus units are allotted on record date
- original units are sold within a period of 9 months after the record date while continuing to hold the bonus units.

ASSESSMENT YEAR 2023-24
SHORT TERM CAPITAL GAINS ON SALE OF ORIGINAL UNITS

Period of Holding:	20.5.2022 to 10.11.2022	Short Term
Sales Price:	₹ 9 × 1,000	= 9,000
Cost of Acquisition :	₹ 20 × 1,000	= 20,000
Short Term Capital Loss		(-) 11,000

However, as per section 94(8), the short term capital loss of ₹ 11,000 shall be ignored for the purposes of computing the total income and such STCL of ₹11,000 shall neither be set off nor be carried forward.

The cost of acquisition of 1,000 bonus units shall be taken to be ₹ 11,000.

Illustration 3:

Suppose in Illustration 2, Mr. A sells 1,000 original units and 800 bonus units on 11.11.2022 for ₹ 9 per unit. Discuss the tax implications.

Answer:

ASSESSMENT YEAR 2023-24

Capital Gains on Original Units

Period of Holding:	20.5.2022 to 10.11.2022	Short Term
Sales Price:	₹ 9 × 1,000	= 9,000
Cost of Acquisition :	₹ 20 × 1,000	= 20,000
Short Term Capital Loss		(-) 11,000

Capital Gains on Bonus Units

Period of Holding:	31.5.2022 to 10.11.2022	Short Term
Sales Price:	₹ 9 × 800	= 7,200
Cost of Acquisition :	Nil as per section 55	= NIL
Short Term Capital Gains		(+) 7,200

As per section 94(8), STCL of ₹ 11,000 shall be ignored and shall not be set off or carried forward. The short-term capital gains of ₹ 7,200 shall be taxable.

The cost of acquisition of 200 bonus units shall be ₹ 11,000.

Illustration 4:

Suppose in Illustration 2, Mr. A sells 1,000 original units on 11.11.2022 @ ₹ 9 per unit and 800 bonus units on 15.11.2022 @ ₹ 9 per unit.

Answer:

ASSESSMENT YEAR 2023-24

Capital Gains on Original Units

Period of Holding:	20.5.2022 to 10.11.2022	Short Term
Sales Price:	₹ 9 × 1,000	= 9,000
Cost of Acquisition :	₹ 20 × 1,000	= 20,000
Short Term Capital Loss		(-) 11,000

Now as per section 94(8), STCL of ₹ 11,000 shall be ignored and shall not be set off or carried forward.

Number of bonus units held on the date of transfer of original units is 1,000 and as per section 94(8), the cost of acquisition of these 1,000 bonus units shall be taken to be ₹11,000.

Capital Gains on Bonus Units

Period of Holding:	31.5.2022 to 14.11.2022	Short Term
Sales Price:	₹ 9 × 800	= 7,200
Cost of Acquisition :	₹ 11,000 × 800 / 1,000	= 8,800
Short Term Capital Gains		(-) 1,600

The short-term capital loss of ₹ 1,600 shall be allowed to be set off and carried forward. The cost of acquisition of 200 bonus units shall be ₹ 2,200.

Illustration 5:

Suppose in Illustration No. 2, Mr. A sells 1,000 original units on 11.11.2022 @ ₹ 9 per unit and 800 bonus shares on 15.10.2022 @ ₹ 9 per unit.

Answer:

Answer will be the same as Illustration No. 3 except that the period of holding of bonus shares shall be from 31.5.2022 to 14.10.2022

Illustration 6:

Suppose in Illustration No. 2 Mr. A sells 1,000 bonus units on 15.10.2022 @ ₹ 9 per unit and 1,000 original units on 11.11.2022.

Answer:

Capital Gains on sale of Bonus Units

Period of Holding:	31.5.2022 to 14.10.2022	Short Term
Sales Price:		9,000
Cost of Acquisition :		NIL
Short Term Capital Gains		(+) 9,000

Capital Gains on sale of Original Units

Period of Holding:	20.5.2022 to 10.11.2022	Short Term
Sales Price:		9,000
Cost of Acquisition :		20,000
Short Term Capital Loss		(-) 11,000

Section 94(8) is not applicable since on the date of sale of original units, the assessee does not hold any bonus units. Therefore, STCL of ₹ 11,000 shall be allowed to be set-off or carried forward.