Impact of Taxation on Mutual Funds

Synopsis:

- Mutual funds are taxed based on capital gains and dividends.
- Dividends are taxed as per the investor's income tax slab and subject to TDS.
- Capital gains taxation varies between equity and debt funds.
- Equity funds have different tax rates for short-term and long-term gains.
- Debt funds no longer qualify for indexation benefits and are taxed as per income slabs.

Overview

Over the years, Mutual Funds have gained the reputation of being profitable investments that help you reach your financial objectives. Also, Mutual Funds are known for their tax efficiency and ability to

What is the Impact of Tax on Mutual Fund Investments?

Much like the returns from any other investment vehicle, returns on Mutual Funds are subject to taxation. The following variables will help you understand how Mutual Funds are taxed.

Type of Fund

How your Mutual Fund investment will be taxed depends on whether you've invested in equity-based or debt-oriented schemes.

- Capital Gains: The tax you pay on your Mutual Funds also depends on the capital gains, which is the profit earned by selling an asset at a higher rate than the buying price.
- Dividends: Dividends are portions of the accumulated profits the Mutual Fund house distributes to investors.
- Holding Period: The holding period refers to the duration between the buying and selling of Mutual Fund units. Usually, you have to pay less tax if the holding period is longer, encouraging investors to retain their investments for extended periods.

Investors earn profits from Mutual Funds through capital gains and dividends. Capital gains are taxed only upon redeeming Mutual Fund units, while dividends are taxed immediately.

Taxation on Dividends Earned on Mutual Funds

TDS. When filing your taxes, you can claim this TDS amount and pay only the balance due.

Taxation on Capital Gains on Mutual Funds

The tax treatment of capital gains earned from Mutual Funds depends largely on the type of scheme and the holding period.

Equity Funds

An Equity Fund is a Mutual Funds scheme that pools investments into shares of companies. Typically, these funds have an equity exposure of 65%. If you have invested in equity funds, any short-term capital gains earned on the same will be taxed at a rate of 20% if you sell units within a holding period of a year.

Alternatively, you earn long-term gains if you sell such units after a year. Such gains are tax-free up to ₹1.25 lakh p.a. Exceeding this threshold, long-term capital gains are subject to a tax of 12.5% without any indexation benefit. A 4% cess and a surcharge apply in both short-term and long-term capital gains.

Debt Funds

As of 1 April 2023, debt funds are not eligible for indexation benefits and will be treated as short-term capital gains. The returns from the debt fund will be combined with your taxable income and subject to taxation at your applicable income tax slab rate.

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