NISM CERTIFICATION EXAMINATION WORK BOOK

XX

Taxation in Securities Markets

NISM
NATIONAL INSTITUTE OF SECURITIES MARKETS
An Educational Initiative of SEBI

Workbook for

NISM-Series-XX: Taxation in Securities Markets

Certification Examination

National Institute of Securities Markets

www.nism.ac.in

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Taxation in Securities Markets.

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Foreword

NISM is a leading provider of high-end professional education, certifications, training and research in financial markets. NISM engages in capacity building among stakeholders in the securities markets through professional education, financial literacy, enhancing governance standards and fostering policy research. NISM works closely with all financial sector regulators in the area of financial education.

NISM Certification programs aim to enhance the quality and standards of professionals employed in various segments of the financial services sector. NISM's School for Certification of Intermediaries (SCI) develops and conducts certification examinations and Continuing Professional Education (CPE) programs that aim to ensure that professionals meet the defined minimum common knowledge benchmark for various critical market functions.

NISM certification examinations and educational programs cater to different segments of intermediaries focusing on varied product lines and functional areas. NISM Certifications have established knowledge benchmarks for various market products and functions such as Equities, Mutual Funds, Derivatives, Compliance, Operations, Advisory and Research.

NISM certification examinations and training programs provide a structured learning plan and career path to students and job aspirants who wish to make a professional career in the Securities markets. Till March 2023, NISM has issued more than 17 lakh certificates through its Certification Examinations and CPE Programs.

NISM supports candidates by providing lucid and focused workbooks that assist them in understanding the subject and preparing for NISM Examinations. The book covers about basics of Indian Securities Markets-structure, participants, products, features. It also coves the basic concepts in Taxation, Capital Gains, Sources of Income etc. The books helps understand the different taxation aspects of products available in the market, viz., Equity, Debt, ESOPs, ETF, AIFs, Real Estate, Investment Trust, Infrastructure Investment Trust and Derivative Products. The book also covers the taxation in the hands of intermediaries, FPIs, IFSC etc.

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Director

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While the NISM Certification examination will be largely based on material in this workbook, NISM does not guarantee that all questions in the examination will be from material covered herein.

Acknowledgement

This workbook has been developed by NISM in consultation with the Examination Committee for NISM-Series-XX: Taxation in Securities Markets Certification Examination consisting of senior officials from Price Waterhouse Cooper, Ernst and Young and BSR Affiliates. NISM gratefully acknowledges the contribution of all the committee members.

About The Author

This workbook has been jointly developed by the certification team of NISM and Taxmann Publications Pvt Ltd. This version of the workbook have been reviewed by the team of Taxmann Publications.

About NISM Certifications

The School for Certification of Intermediaries (SCI) at NISM is engaged in developing and administering Certification Examinations and CPE Programs for professionals employed in various segments of the Indian securities markets. These Certifications and CPE Programs are being developed and administered by NISM as mandated under Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007.

The skills, expertise and ethics of professionals in the securities markets are crucial in providing effective intermediation to investors and in increasing the investor confidence in market systems and processes. The School for Certification of Intermediaries (SCI) seeks to ensure that market intermediaries meet defined minimum common benchmark of required functional knowledge through Certification Examinations and Continuing Professional Education Programmes on Mutual Funds, Equities, Derivatives Securities Operations, Compliance, Research Analysis, Investment Advice and many more.

Certification creates quality market professionals and catalyzes greater investor participation in the markets. Certification also provides structured career paths to students and job aspirants in the securities markets.

About the Examination:

The examination seeks to create knowledge amongst market participants about the different taxation aspects in the Securities Markets.

Examination Objectives

On successful completion of the examination, the candidate should:

- Know the basics of the Indian Securities Market-Structure, Participants, Products and Features.
- Know the basic concepts in Taxation, Capital Gains, Sources of Income etc.
- Understand the taxation of products available in the market viz., Equity, Debt, ESOPs, Exchange Traded Funds, Alternate Investment Funds, Real Estate Investment Trusts, Infrastructure Investment Trust and Derivative products.
- Taxation in the hands of the Intermediaries, Foreign Portfolio Investors, IFSC etc.

Assessment Structure

The examination consists of 75 questions, out of which 50 questions are of 1 mark each and 25 questions of 2 mark each. The exam should be completed in 2 hours. The passing score on the examination is 60 percent. There shall be negative marking of 25 percent of the marks assigned to a question.

How to register and take the examination

To find out more and register for the examination please visit *www.nism.ac.in*

Important

- Please note that the Test Centre workstations are equipped with either Microsoft Excel or OpenOffice Calc. Therefore, candidates are advised to be well versed with both of these softwares for computation of numericals.
- The sample questions and the examples discussed in the workbook are for reference purposes only. The level of difficulty may vary in the actual examination.

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CHAPTER 1: INTRODUCTION TO SECURITIES MARKETS AND SECURITIES

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Securities Market and Securities: Definitions and Features
- Securities Markets Structure and Participants
- Securities Markets: Products and Features
- Sources of Tax Regulations in Securities Markets

Modern day stock markets, trading and financial instruments have evolved over the last two centuries since loan securities of the East India Company were first traded in 1830s. Trading has been a vocation for centuries which initially started with goods, commodities, etc. and gradually moved to intangibles such as contracts. Trading was most prevalent closer to the ports in erstwhile British India lead by unorganized groups of people informally coming together and indulging in buying and selling. The American Civil War 1861, lead to the growth of cotton textile mills and other industries leading to capital being raised from traders and the wealthy in the form of shares. The unorganized nature led to many irregularities such as frauds, defaults etc. paving the way for a formalised market for trading. By then there were many stock exchanges across the country with no regulatory oversight and legislation until the 1950 when stock exchanges and forward markets come under the authority of Central Government. The Securities Contracts (Regulation) Act, 1956 bought all stock exchanges under its control to avert undesirable transactions in securities markets. Since then, the BSE (Bombay Stock Exchange) and NSE (National Stock Exchange) have been the premiere stock exchanges with state-of-the-art screen-based trading, clearing and settlement systems.

As the markets evolved so were the types of financial instruments and before we understand the tax implications it's imperative to understand the features of all types of securities available in the capital markets.

1.1 DEFINITIONS AND FEATURES

1.1-1 What is a Securities Market?

The securities market is a place where buyers and sellers of securities enter into transactions to purchase and sell various securities such as shares, bonds, debentures etc. The main instruments used in the securities market are stocks, shares, debentures, bonds, and government securities.

The various functions performed by securities markets are as follows:

a) *Continuous & ready market for securities:* Securities market provides a ready and continuous market for purchase and sale of securities. It provides a ready outlet for buying and selling securities.
b) *Evaluation of securities:* Securities market is useful for evaluation of securities. This enables investors to know the true worth of their holdings at any time. Comparison of companies in the same industry is possible through the securities market price list.
c) *Encourages capital formation*: Securities market accelerates the process of capital formation. It creates the habit of saving, investing and risk-taking among the investing class and converts their savings into a profitable investment. It acts as an instrument of capital formation.
d) *Safety in dealings:* Securities market provides safety in dealings as transactions are conducted as per well-defined rules and regulations. The managing body of the exchange keeps control of the members. Fraudulent practices are also checked effectively.
e) *Regulates company management*: Listed companies have to comply with rules and regulations of the concerned securities market and work under the vigilance of various authorities.
f) *Public borrowing:* Securities market serves as a platform for marketing Government securities. It enables the government to raise public debt easily and quickly.
g) *Clearing house facility*: Securities market provides a clearing house facility to members. It settles the transactions among the members quickly and with ease. The members have to pay or receive only the net dues because of the clearing house facility.
h) *Healthy speculation*: Normal speculation is not dangerous but provides more business to the exchange. However, excessive speculation is undesirable as it is dangerous to investors and the growth of corporate sector.
i) *Economic barometer:* Securities market indicates the state of health of companies and the national economy. It acts as a barometer of the economic conditions.
j) *Bank lending*: Banks easily know the prices of quoted securities. They offer loans to customers against corporate securities.

1.1-2 Statutes and authorities governing the securities market?

The following are the important statutes, which governs the Indian securities markets:

a) The Securities and Exchange Board of India Act, 1992 (SEBI)
b) The Securities Contracts (Regulation) Act, 1956 (SCRA)
c) The Depositories Act, 1996
d) The Companies Act, 2013
e) The Foreign Exchange Management Act, 1999 (FEMA)

The agencies involved in the relation of the securities market are:

a) Ministry of Finance (MoF)

b) Ministry of Corporate Affairs (MCA)
c) Department of Economic Affairs (DEA)
d) The Reserve Bank of India (RBI)
e) The Securities and Exchange Board of India (SEBI)
f) Stock Exchanges

1.1-3 Important definitions

1.1-3a Meaning of Derivatives

As per Section 2(ac) of Securities Contracts (Regulation) Act, 1956 (SCRA), 'derivative' includes:

a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
b) a contract which derives its value from the prices, or index of prices, of underlying securities;
c) commodity derivatives; and
d) such other instruments as may be declared by the Central Government to be derivatives.

1.1-3b Meaning of Government Securities

As per Section 2(b) of SCRA, 'Government Security' means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in section 2(2) of the Public Debt Act, 1944.

1.1-3c Meaning of Securities

As per Section 2(h) of SCRA, 'securities' include:

(a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or a pooled investment vehicle[1] or other body corporate;

(b) units or any other instrument issued by any pooled investment vehicle[2];

(c) derivative;

(d) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

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[1] 'A pooled investment vehicle' has been added in the definition of securities by the Finance Act, 2021 w.e.f. 01-04-2021.
[2] Inserted by the Finance Act, 2021 w.e.f. 01-04-2021.

(e) security receipt as defined in section 2(zg) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(f) units or any other such instrument issued to the investors under any mutual fund scheme;

(g) any certificate or instrument issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

(h) government securities;

(i) such other instruments as may be declared by the Central Government to be securities[3]; and

(j) rights or interest in securities.

'Securities' shall not include any unit-linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit-risk on the life of the persons and investment by such persons and issued by an insurer referred to in section 2(9) of the Insurance Act, 1938.

1.2 STRUCTURE AND PARTICIPANTS

1.2-1 Structure of the securities market

The securities market has two interdependent and inseparable segments.

1.2-1a Primary Market

The primary market is that part of the capital market that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of new shares or bond issue. The primary market is the market where the securities are sold for the first time. Therefore, it is also called as New Issue Market (NIM). The issue of securities by companies can take place in any of the following methods:

(a) Initial Public Offering (IPO)
(b) Further Public Offering (FPO)
(c) Rights Issue
(d) Firm Allotment

[3] "Onshore Rupee Bonds" issued by multilateral institutions like the Asian Development Bank and the International Finance Corporation declared as 'securities' vide Gazette Notification No. S. O. 1978(E) F. No. 1/45/EM/2013, dated 01.08.2014.

(e) Offer to Public
(f) Bonus issue
(g) Employee's Stock Option

1.2-1b Secondary Market

The secondary market, also known as the aftermarket, is the financial market where previously issued securities and financial instruments such as stock, bonds, options, and futures are bought and sold. The stock market or secondary market ensures free marketability, negotiability and price discharge. The secondary market has further two components:

a) Spot Market: Where securities are traded for immediate delivery and payment.
b) Futures Market: Where securities are traded for future delivery and payment.

1.2-2 **Participants of the securities market**

The participants of the securities market are as follows.

1.2-2a Merchant bankers

As per Regulation 2(cb) of SEBI (Merchant Bankers) Regulations, 1992. 'Merchant Banker' means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management. Merchant Bankers are required to register with SEBI in accordance with the SEBI (Merchant Bankers) Regulations, 1992.

1.2-2b Bankers to an issue

As per regulation 2(aa) of SEBI (Bankers to the Issue) Regulations, 1994

'Banker to an Issue' means a scheduled bank or such other banking company as may be specified by the board from time to time, carrying on any of the activities, including:

(a) acceptance of application and application monies;

(b) acceptance of allotment or call monies;

(c) refund of application monies;

(d) payment of dividend or interest warrants

The scheduled banks acting as bankers to an issue are required to be registered with SEBI in accordance with the SEBI (Bankers to the Issue) Rules and Regulations, 1994.

1.2-2c Portfolio managers

As per regulation 2(o) of SEBI (Portfolio Managers) Regulations, 2020 'Portfolio Managers' means a body corporate, which pursuant to a contract with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or goods or the funds of the client, as the case may be. The Portfolio Manager may also deal in goods received in delivery against the physical settlement of commodity derivatives. They are required to register with SEBI in accordance with the SEBI (Portfolio Managers) Regulations, 2020.

1.2-2d Debenture trustees

As per the SEBI (Debenture Trustees) Regulations, 1993 'Debenture Trustees' means a trustee appointed in respect of any issue of debenture of a body corporate. A debenture trustee is required to be registered with SEBI in accordance with the SEBI (Debenture Trustees) Regulations, 1993.

1.2-2e Registrars to an Issue

As per regulation 2(f) of SEBI (Registrar to the Issue and Share Transfer Agent) Regulations, 1993 'Registrar to an issue' means the person appointed by a body corporate or any person to carry on the following activities on behalf of the clients:

(a) Collecting applications from investors in respect of an issue;

(b) Keeping a proper record of applications and monies received from investors or paid to the seller of the securities; and

(c) Assisting body corporate or person or group of persons in:

- Determining the basis of allotment of securities in consultation with stock exchange;
- Finalising the list of persons entitled to allotment;
- Processing and dispatching allotment letters, refund orders or certificates and other related documents in respect of an issue

Registrars to an issue are registered with SEBI in accordance with the SEBI (Registrar to the Issue and Share Transfer Agent) Regulations, 1993.

1.2-2f Share Transfer Agents

As per Regulation (2g) of SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993. 'Share Transfer Agents' means:

(a) any person, who on behalf of a body corporate, maintains the records of holders of securities issued by such body corporate and deals with all matters connected with the transfer and redemption of its securities;

(b) a department or division, by whatever name called, of a body corporate performing the activities referred to in above point (a) if at any time the total number of the holders of its securities issued exceed one lakh.

Share Transfer Agents (STA) are registered with SEBI in accordance with the SEBI (Registrar to the Issue and Share Transfer Agent) Regulations, 1993.

1.2-2g Credit Rating Agency

As per Regulation 2(h) of SEBI (Credit Rating Agencies) Regulations, 1999 'Credit Rating Agency' means a body corporate which is engaged in or proposes to be engaged in the business of rating of securities that are listed or proposed to be listed on a stock exchange recognised by the Board. A credit rating agency is required to be registered with SEBI in accordance with SEBI (Credit Rating Agencies) Regulations, 1999.

1.2-2h Investment Advisor

As per clause 2(m) of SEBI (Investment Advisers), Regulations, 2013. 'Investment Advisers' means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called. An investment advisor is required to be registered with SEBI in accordance with SEBI (Investment Advisers) Regulations, 2013.

1.2-2i Research analyst

As per Regulation 2(u) of SEBI (Research Analysts) Regulations, 2014. 'Research Analysts' means a person who is primarily responsible for following activities with respect to securities that are listed or to be listed in a stock exchange whether or not any such person has the job title of 'research analyst' and includes any other entities engaged in the issuance of the research report or research analysis:

(a) preparation or publication of the content of the research report;

(b) providing research report;

(c) making 'buy/sell/hold' recommendation;

(d) giving price target;

(e) offering an opinion concerning the public offer.

The term also includes any associated person who reports directly or indirectly to such a research analyst in connection with the activities provided above. A research analyst is required to be registered with SEBI in accordance with SEBI (Research Analysts) Regulations, 2014.

1.2-2j Depository Participant

Depository Participants act as an agent of the depositories. They offer depository services to investors. According to SEBI guidelines, financial institutions, banks, custodians, stockbrokers, etc. are eligible to act as DPs. Depositories and Participants are required to be registered with SEBI in accordance with SEBI (Depositories and Participants) Regulations, 2018.

1.2-2k Stock Brokers

A stock broker is a person who has trading rights in any recognised stock exchange. It also includes a trading member. All stock-brokers dealing in securities are registered with SEBI in accordance with SEBI (Stock Brokers) Regulation 1992.

1.3 PRODUCTS AND FEATURES OF SECURITIES MARKETS

1.3-1 Securities market products

1.3-1a Equity Shares

Equity shares, commonly referred to as ordinary share, represents the ownership of a shareholder, as a fractional owner, in the company. The equity shareholders undertake the maximum entrepreneurial risk associated with a business venture. Equity share capital can be with voting rights or with differential rights as to dividend, voting or otherwise.

1.3-1b Shares with Differential Voting Rights

Section 43(a)(ii) of the Companies Act, 2013 authorizes a company to issue equity share capital with differential rights as to dividend, voting or otherwise in accordance with Rule 4 of Companies (Share Capital and Debentures) Rules, 2014. For taxation purpose, there is no difference in the treatment of income arising from such shares.

1.3-1c Preference Shares

Preference shares are those shares which get preference over equity shares in the case of distribution of dividend and distribution of surplus at the time of winding up. They generally carry a fixed rate of dividend and are redeemable after a specific period of time. According to Section 55 of the Companies Act, 2013, a company cannot issue irredeemable preference shares. The following types of preference shares are issued by the companies:

a) *Cumulative preference shares*: A preference share is said to be cumulative when the arrears of dividend are accumulated and such arrears are paid before paying any dividend to equity shareholders.
b) *Non-cumulative preference shares*: In the case of non-cumulative preference shares, the dividend does not accumulate. The dividend is only payable out of the net profits of each year. If there are no profits in any year, the arrears of dividend cannot be claimed in the subsequent years. If the dividend on the preference shares is not paid by the company during a particular year, it lapses.
c) *Convertible preference shares*: Convertible preference shares are those shares that can be converted into equity shares within a certain period. If the terms of issue of preference shares includes a right for converting them into equity shares at the end of a specified period they are called convertible preference shares. In the absence of such a condition or right, the preference shares are not converted into equity shares to become eligible for various rights such as voting, higher dividend, bonus issue etc. as in the case of equity shares.
d) *Redeemable preference shares*: A company limited by shares, may if so, authorized by its article, issue preference shares that are redeemable as per the provisions laid down in section 55 of Companies Act, 2013. Shares may be redeemed either after a fixed period or earlier at the option of the company.
e) *Participating preference share*: Normally preference shareholders are not entitled to dividend more than what has been indicated as part of the terms of issue, even in a year in which the company has made huge profits. However, in case of participating preference shares, holders are entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein. Subject to provisions in the terms of issue such preference shares can be entitled even to bonus shares.
f) *Non-participating preference shares*: Non-participating preference shares are entitled only to a fixed rate of dividend and do not share in the surplus profits. The preference shares are presumed to be non-participating unless expressly provided in the memorandum or the articles or the terms of issue.

1.3-1d Debentures

As per Section 2(30) of the Companies Act, 2013 'Debenture' includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

Further, the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934 and such other instruments as may be prescribed by the Central Government in consultation with the Reserve Bank of India shall not be treated as a debenture.

The following are the types of the debentures:

(a) Naked or unsecured debentures: Debentures of this kind do not carry any charge on the assets of the company.

(b) Secured debentures: Debentures that are secured by a mortgage of the whole or part of the assets of the company are called mortgage debentures or secured debentures.

(c) Redeemable debentures: Debentures that are redeemable on the expiry of a certain period are called redeemable debentures.

(d) Perpetual debentures: If debentures are issued subject to redemption on the happening of specified events that may not happen for an indefinite period, i.e., winding up, etc. they are called perpetual debentures.

(e) Registered debentures: Such debentures are payable to the registered holders whose name appears on the debenture certificate/letter of allotment and is registered on the companies register of debenture holders maintained as per Section 88(1)(b) of the Companies Act, 2013.

(f)Bearer debentures: Such debentures are payable to the bearer and are transferable by mere delivery.

1.3-1e Equity Derivatives

An equity derivative is a class of derivatives whose value is derived from one or more underlying equity securities. As per Section 2(ac) of the Securities Contracts (Regulation) Act, 1956, 'derivative' includes:

a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
b) a contract that derives its value from the prices, or index of prices, of underlying securities;
c) commodity derivatives; and
d) such other instruments as may be declared by the Central Government to be derivatives.

Options and futures are by far the most common equity derivatives. A 'future contract' is a standardized contract between two parties where one of the parties commits to sell, a specified quantity of a specified asset at an agreed price on a given date in the future. 'Option' is a contract that gives the holder the right to purchase or sell the underlying security at a specified price within a specified period of time. Option may be a 'Put Option' or 'Call Option'.

The commodity derivatives, currency derivatives and interest rate derivatives are similar to equity derivatives.

1.3-1f Sweat Equity Shares

'Sweat Equity Shares' means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

1.3-1g Employees Stock Option Plans ('ESOPs')

As per Section 2(37) of the Companies Act, 2013 "Employee Stock Option" means the option given to the following persons:

(*a*) Directors of the company;

(b) Officers of the company;

(c) Employees of a company;

(*d*) Employees of holding company/companies; and

(e) Employees of subsidiary company/companies;

Which gives such directors, officers or employees the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a predetermined price.

The ESOPs are given to retain brilliant employees and to acknowledge their proven contribution to the company. Whenever ESOPs are issued, employees get the right to purchase a certain number of securities of the employer company at a discounted price (i.e., less than the market price of such shares). It allows employees to have a stake in the company, which ensures higher loyalty and motivation for them to work. The option provided under this scheme confers a right but not an obligation on the employees. Such an option to purchase shares can be exercised only after the vesting period. Such vesting period is the time period an employee must wait to get the right to buy those specified number of shares. Upon vesting of options, employees can exercise the options to acquire shares by paying the predetermined exercise price.

A listed company can issue shares to its eligible employees under the following types of employee share-based schemes as prescribed under the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 (*a*) *Employee stock option scheme (ESOS)*

ESOS means a scheme under which a company grants stock options to the employees directly or through a trust.

(*b*) *Employee stock purchase scheme (ESPS)*

ESPS means a scheme under which a company offers shares to its employees, as a part of a public issue or otherwise, through a trust where the trust may undertake secondary acquisition for the purposes of the scheme.

(*c*) *Stock appreciation rights scheme (SARS)*

SARS means a scheme under which a company grants SARS to employees. Stock Appreciation Right (SAR) means a right given to a SAR grantee entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company.

(*d*) *General employee benefits scheme (GEBS)*

GEBS means any scheme of a company framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for the purpose of employee welfare, including healthcare benefits, hospital care, or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company.

(*e*) *Retirement benefit schemes (RBS)*

RBS means a scheme of a company, framed in accordance with these regulations, dealing in shares of the company or the shares of its listed holding company, for providing retirement benefits to the employees subject to compliance with existing rules and regulations as applicable under laws relevant to retirement benefits in India.

1.3-1h Secured Premium Notes

These instruments are issued with detachable warrants and are redeemable after a notified period, say 4 to 7 years. The warrants enable the holder to get equity shares allotted provided the secured premium notes are fully paid. It combines the feature of both debt and equity. During the lock-in period, no interest is paid. The holder has an option to sell back the SPN to the company at par value after the lock-in period. If the holder exercises this option, no interest/premium is paid on redemption. In case the holder keeps it further, he is repaid the principal amount along with the additional interest/premium on redemption in instalments as per the terms of issue. The conversion of detachable warrants into equity has to be done within the specified time.

1.3-1i Equity Shares with detachable warrants

The holder of the warrant is eligible to apply for the specified number of shares on the appointed date at the predetermined price. These warrants are separately registered with the stock exchanges and traded separately. The practice of issuing non-convertible debentures with detachable warrants also exists in the Indian market.

1.3-1j Dual Option Warrants

Dual option warrants are designed to provide the buyer with good potential of capital appreciation and limited downside risk. Dual option warrants may be used to sell equity shares in different markets. *For example*, equity shares or debentures may be issued with two warrants - one warrant giving a right to the purchaser to get one equity share at the end of a certain period and another warrant with a debt or preference share option.

1.3-1k Debt Instruments with Debt Warrants

Debt instruments may be issued with debt warrants which give the holder the option to invest in additional debt on the same terms within the period specified in the warrant. This instrument is beneficial to the investors in periods of falling interest rates when the holder can exercise the debt warrant option and hold additional debt at, interest rates above market rates.

1.3-1l Debt for Equity Swap

These instruments give an offer to the debt holders to exchange the debt for equity shares of the company. The issuers offering debt for equity swaps are interested in increasing equity capital by improving their debt-equity ratios and enhancing their debt issuing capacity. They reduce their interest burden and replace it with dividend burden which is payable at the discretion of the issuer. However, the issuer faces the risk of dilution of earnings per share by a sharp rise in the equity. In addition, dividends are not tax-deductible.

From the investors' point of view, there is a potential gain from the rise in the value of the equity shares. The potential rise in the price of equity shares may or may not materialize.

Variations of this instrument are mortgage-backed securities that split the monthly payment from underlying mortgages into two parts - each receiving a specified portion of the principal payments and a different specified portion of the interest payments.

1.3-1m Masala Bonds

Masala means spices and the term was used by International Finance Corporation (IFC) to popularize the culture and cuisine of India on foreign platforms. Masala Bonds are rupee-denominated borrowings issued by Indian entities in overseas markets. The objective of Masala Bonds is to fund infrastructure projects in India, fuel internal growth *via* borrowings and internationalize the Indian currency.

1.3-1n FCCBs

Foreign Currency Convertible Bond (FCCB) is a quasi-debt instrument which is issued by any corporate entity, international agency or sovereign state to investors all over the world. They are denominated in any freely convertible foreign currency. FCCBs can either be unsecured or secured, but in practice most of the FCCBs issued in India are unsecured. FCCBs are also freely tradeable and the issuer has no control over the transfer mechanism and cannot be even aware of the ultimate beneficiary.

FCCBs represent equity-linked debt security which can be converted into shares or into depository receipts. The investors of FCCBs have an option to convert it into equity in accordance with pre-determined formula and sometimes also at a pre-determined exchange rate. The investors also have an option to retain the bond. By issuing these bonds, a company can avoid any dilution in earnings per share that a further issue of equity might cause whereas such security still can be traded on the basis of underlying equity value.

1.3-1o ADRs, GDRs

An American Depository Receipt ('ADR') is a dollar-denominated form of equity ownership in the form of depository receipts in a non-US company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

Global Depository Receipt ('GDR') is a negotiable instrument denominated in US dollars. It is a form of depository receipt created by the Overseas Depository Bank outside India denominated in dollar and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company. GDRs have access usually to Euro market and US market. The US portion of GDRs to be listed on US exchanges to comply with SEC requirements and the European portion comply with EU directive. Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange, etc.

1.3-1p Zero-Coupon Bonds or Deep Discount Bonds

Zero-Coupon Bond is a type of bond which is issued at a deep discount to its face value. It is a type of debt security instrument that does not pay interest and is redeemed at face value at maturity.

1.3-1q Government Securities

A Government Security (G-Sec) is a tradeable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. Such securities are short-term (usually called treasury bills, with original maturities of less than one year) or long-term (usually called Government bonds or dated securities with an original maturity of one year or more). In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments.

1.3-1r Sovereign gold bonds

Sovereign Gold Bonds are government securities denominated in grams of gold. They are substitutes for holding physical gold. Investors have to pay the issue price in cash and the bonds will be redeemed in cash on maturity. The Bond is issued by Reserve Bank on behalf of the Government of India. The bonds are tradable on stock exchanges. The bonds can also be sold and transferred as per provisions of the Government Securities Act.

1.3-1s Equity Oriented Mutual Funds

An 'Equity Oriented Fund' is a mutual fund scheme where the investible funds are invested in equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund.

1.3-1t Exchange-Traded Funds (ETFs)

Exchange-Traded Funds (ETFs) are essentially Index Funds that are listed and traded on exchanges. An ETF is a basket of stocks, bonds or commodities that reflect the composition of an Index, like S&P, CNX, Nifty or Sensex. The current trading value of ETFs is derived from the net asset value of underlying stocks/commodities that it represents. ETFs are generally suitable for risk-averse traders who find it difficult to identify stocks for their portfolio. Various mutual funds provide ETF investment products that attempt to replicate the benchmark indices on the BSE & NSE.

1.4 VARIOUS INVESTMENT VEHICLES IN SECURITIES MARKETS

1.4-1a REITs

'Real Estate Investment Trust' (REIT) means a trust registered as such under the SEBI (Real Estate Investment Trusts) Regulations, 2014. In REIT, money is pooled together with other investors in a collective investment scheme that invests in a portfolio of income-generating real estate assets such as shopping malls, offices, hotels or serviced apartments with a view to generating income for unitholders. REITs are structured as trusts and thus the assets of a REIT are held by an independent trustee on behalf of unitholders.

1.4-1b InvITs

'Infrastructure Investment Trust' ('InvIT') means a trust registered as such under the SEBI (Infrastructure Investment Trusts) Regulations, 2014. Infrastructure Investment Trust is another form of mutual fund which enables small investors to invest in the infrastructure sector. As the name implies, infrastructure investment trust invests pooled money of investor in the sector and give returns in the form of dividend to their unitholders.

1.4-1c Alternative Investment Funds

As per Regulation 2(b) of SEBI (Alternative Investment Fund), Regulations, 2012. 'AIF' means any fund established incorporated in India in the form of a trust, company, LLP or a body corporate which:

(*a*) is a privately pooled investment vehicle that collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and

(*b*) is not covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of SEBI, which aims to regulate fund management activities.

Following entities or funds are not considered as Alternative Investment Fund:

(*a*) Family trusts set up for the benefit of 'relatives' as defined under Companies Act, 2013;

(*b*) ESOP Trusts set up under the SEBI (Share Based Employee Benefits) Regulations, 2014 or as permitted under Companies Act, 2013;

(*c*) Employee welfare trusts or gratuity trusts set up for the benefit of employees;

(*d*) 'Holding companies' as defined under Section 2(46) of Companies Act, 2013;

(*e*) Other special purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework;

(*f*) Funds managed by a securitisation company or reconstruction company which is registered with the RBI under Section 3 of the SARFAESI Act, 2002; and

(*g*) Any such pool of funds which is directly regulated by any other regulator in India.

1.4-1d Category-I Alternative Investment Fund

'Category-I Alternative Investment Funds' are those funds that invest in start-up or early-stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the Government or regulators consider as socially or economically desirable and shall include Venture Capital Funds, SME Funds, Social Impact Funds[4], Infrastructure Funds, Special Situation Funds and such other Alternative Investment Funds as may be specified.

This category of AIF shall include those funds which are generally perceived to have positive spill over effects on the economy and for which the Board or Government or other regulators in India might consider providing incentives or concessions. Where such funds are formed as companies or trusts, they shall be construed as 'Venture Capital Company (VCC)' or 'Venture Capital Fund' as specified under Section 10(23FB) of the Income-tax Act, 1961.

1.4-1e Category-II Alternative Investment Fund

'Category-II Alternative Investment Funds' are those funds that do not fall in Categories I and III and which do not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in these regulations.

This category of AIF shall include private equity funds or debt funds for which no specific incentives or concessions are given by the Government or any other Regulator.

1.4-1f Category-III Alternative Investment Fund

'Category-III Alternative Investment Funds' are those funds that employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives.

This category of AIF shall include hedge funds or funds that trade with a view to make short term returns or such other funds that are open-ended and for which no specific incentives or concessions are given by the Government or any other Regulator.

1.4-1g Specified Alternative Investment Fund

Specified Alternative Investment Fund are those funds which are specified under regulation 19 of the SEBI (Alternative Investment Fund), Regulations, 2012. SEBI has specified Corporate Debt Market Development Fund as a specified fund under regulation 19[5].

1.4-1h Foreign Portfolio Investors

As per Regulation 2(j) of the SEBI (Foreign Portfolio Investors) Regulations, 2019, 'Foreign Portfolio Investor' means a person who is registered under the regulations and shall be deemed to be an intermediary in terms of provisions of the Act. FPIs are those investors who hold a short-term view on investing in a company as compared to FDIs.

FPIs are categorized into two categories under which they can seek registration from SEBI:

(*a*) *Category I:* It includes Government and entities like Foreign Central banks,

[4] Substituted for "Social Venture Fund" by the SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2022 w.e.f. 25-07-2022

[5] Notified by SEBI vide notification no. No. SEBI/LAD-NRO/GN/2023/132 dated 15-06-2023.

Sovereign wealth Funds, Multilateral Organizations, Banks, Pension Funds and University Funds, Insurance or Reinsurance Companies, Investment Advisors, Asset Management Companies, Investment Managers, Portfolio Managers, Broker dealers and swap dealers, Entities from Financial Action Task Force (FATF) countries and an entity whose investment manager is from FATF member country, etc.

(*b*) *Category II:* It includes all the investors not eligible under the Category I foreign portfolio investors and shall include appropriately regulated funds not eligible as Category-I foreign portfolio investor, endowments and foundations, charitable organisations, corporate bodies, family offices, individuals, appropriately regulated entities (which shall include an applicant incorporated or established in an International Financial Services Centre) investing on behalf of their client, as per SEBI specified conditions and Unregulated funds in the form of limited partnership and trusts.

1.5 SOURCES OF TAX REGULATIONS IN SECURITIES MARKETS

Every person trading or investing in the securities market has to pay certain taxes on every transaction (refer *Annexure H* for taxes applicable on the sale/purchase of securities). Further, if he earns any income from the securities market during the financial year then he shall be liable to pay Income-tax thereon.

The regulations relating to Income-tax are provided under Income-tax Act, 1961. The Central Board of Direct Taxes (CBDT) is the statutory authority that deals with the matters relating to levy and collection of direct taxes (including Income-tax and STT).

The CBDT makes rules for carrying out the provisions of the Income-tax Act. The Rules relating to various provisions of the Income-tax Act, 1961 are provided under Income-tax Rules, 1962.

The rules so made by the CBDT are amended from time to time through notifications. Further, it also issues Circulars to clarify certain provisions of the Act or Rule which are binding on tax authorities but not on the taxpayers.

Review Questions:

1. **Which one of these is/are functions of the Securities Markets?**

   (a) Continuous & ready market for securities

   (b) Encourage capital formation

   (c) Economic barometer

   (d) All of these

2. **Which one of these is/are the regulator of the Securities Markets in India?**

   (a) The Reserve Bank of India (RBI)

   (b) Stock Exchanges

   (c) The Securities and Exchange Board of India (SEBI)

   (d) None of these

3. **Companies can issue securities by way of __________.**

   (a) Initial Public Offering (IPO)

   (b) Rights Issue

   (c) Bonus Issue

   (d) All of these

4. **Research analyst' is responsible for which of the following (with respect to securities)?**

   (a) Offer an opinion

   (b) Make 'buy/sell/hold' recommendations

   (c) Publish Research Reports

   (d) All of these

CHAPTER 2: CONCEPTS IN TAXATION

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Assessment Year, Previous Year, Person, Assessee, Residential Status
- Scope of Income, Different heads of Income, Deductions, Exemptions, Rebates
- Gross Taxable Income, Taxable Income, Tax Payable, Clubbing of Income
- Set off and Carry Forward of Loss under the Heads – Capital Gains and Income from Other Sources and Business Profession
- Difference between investing and dealing in shares and securities
- Alternate Minimum Tax (AMT) and Minimum Alternate Tax (MAT)
- Double Tax Avoidance Agreement (DTAA)
- General Anti-Avoidance Rules (GAAR)
- Exempt Exempt Tax (EET), Exempt Exempt Exempt (EEE), Exempt Taxable Taxable (ETT)
- Marginal Rate of Tax and Effective Rate of Tax
- Tax alpha

The provisions of Income-tax are contained in the Income-tax Act, 1961 which extends to the whole of India. The Income-tax Act comprises of various chapters which include provisions relating to the determination of the residential status of a person in India, exemptions, computation of total income, deductions, determination of tax liability, filing of income tax return, the procedure for assessments, etc. Before discussing the taxability of an investor, trader, or intermediaries dealing in the securities market, it is essential to learn about some of the basic concepts relating to the Indian Income-tax Act.

2.1 WHAT IS A 'PREVIOUS YEAR'?

Section 3 of the Income-tax Act defines 'Previous year' as the financial year immediately preceding the assessment year. In simple words, every financial year in which income is earned is termed as 'previous year'. Though a taxpayer pays tax in the previous year itself in which income is earned by way of Tax Deducted at Source (TDS) or Advance-tax, it is assessed to tax by the Income-tax Department in the assessment year which begins after the previous year ends.

2.2 WHAT IS 'ASSESSMENT YEAR'?

Section 2(9) of the Income-tax Act defines 'assessment year' as a period of 12 months commencing on the 1st day of April every year. Thus, an assessment year starts from 1st April every year and ends on 31st March of the next year. Income earned by a person in a previous year is taxed in the assessment year at the rates prescribed for such assessment year in the relevant Finance Act (***see Annexure E***).

For example, Income earned by a person during the financial year 2022-23 shall be assessed to tax in the financial year 2023-24. Thus, the assessment year, in this case, shall be financial year 2023-24 and the previous year shall be financial year 2022-23.

2.3 WHO IS A 'PERSON'?

Section 2(31) of the Income-tax Act provides an inclusive definition of a person. It provides that a person includes:

(a) Individual
(b) Hindu undivided family (HUF)
(c) Company
(d) Partnership Firm [including Limited Liability Partnership (LLP)]
(e) Association of Person (AOP) or Body of Individual (BOI), whether incorporated or not
(f) Local authority
(g) Artificial juridical person, not falling within any of the above categories.

Persons referred under clauses (e), (f), and (g) shall be deemed as a person even if it is not formed or established or incorporated with the object of deriving income, profits, or gains.

2.4 WHO IS AN 'ASSESSEE'?

Section 2(7) of the Income-tax Act defines the term assessee as the person who is liable for payment of taxes or any other sum of money under the Act. It also includes the person in respect of whom any proceeding has been initiated under this Act. Such proceedings may be in respect of income, loss, or refund. The term 'assessee' also includes 'deemed assessee' and 'assessee-in-default'.

2.4-1.*Deemed to be an assessee*

A deemed assessee is a person who is assessable in respect of income or loss or refund of any other person, such as representative assessee, legal representative, an agent of a non-resident, etc.

2.4-2.*Assessee-in-default*

Assessee in default is not specifically defined under the Income Tax Act, however in general sense, It includes a person who is deemed as an assessee-in-default under the provisions of the Income-tax Act. The Income-tax Act contains various provisions in which an assessee is deemed to be in default if he fails to discharge his prescribed obligations such as failure to furnish return of income, failure in payment or deposit of tax, etc.

2.5 WHAT IS 'RESIDENTIAL STATUS'?

The income-tax liability of an assessee is calculated on basis of his *'Total Income'*. What is to be included in the total income of an assessee is greatly influenced by his residential status in India. *For example*, a person resident in India is liable to pay tax in India on his total global income. On the other hand, a person, who is a citizen of India but non-resident in India during the year, is liable to pay tax only on his Indian income. The Total Income of an assessee cannot be computed unless his residential status is determined as per provisions of section 6 of the Income-tax Act.

Hitherto the residential status of an Individual was determined on the basis of his period of stay in India. However, with effect from Assessment Year 2021-22[6], the residential status of an Individual is determined on basis of his citizenship, period of stay in India, and total income from Indian sources.

An assessee can be categorized into the following residential status during the previous year:

(a) Resident in India
(b) Non-Resident in India

A resident individual and HUF are further sub-classified into the following status:

(a) Resident and Ordinarily Resident
(b) Resident but Not-ordinarily Resident

A new category of 'deemed resident' has been introduced in *clause (1A)* of Section 6 with effect from Assessment Year 2021-22. As per Section 6(1A)[7], an Indian citizen, who is not a resident under Section 6(1), shall be deemed to be resident in India (irrespective of his stay in India) if his total income, excluding income from foreign sources [hereinafter referred to as 'Indian Income'] exceeds Rs. 15 lakhs during the previous year and he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. Here, 'income from foreign sources' means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India) and which is not deemed to accrue or arise in India. A deemed resident is always treated as Not-Ordinarily Resident.

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[6] The Finance Act, 2020 substituted the provisions for determination of residential status with effect from Assessment Year 2021-22

[7] Inserted by the Finance Act, 2020

2.5-1.Residential status of an Individual

The residential status of an Individual is categorised into the following categories:

2.5-1a. Resident in India

An individual is treated as a resident in India if he stays in India for:

(a) 182 days or more during the relevant previous year; or
(b) 60 days or more (but less than 182 days) during the relevant previous year and for 365 days or more in 4 years preceding the previous year.

The condition *(b)* is not applicable in the case of an Indian citizen or a person of Indian Origin[8] in the following circumstances.

Exception 1: '60 days' to be replaced with '182 days'

The condition *(b)* is substituted with the condition of stay in India for 182 days during the relevant previous year and for 365 days or more in 4 years preceding the previous year if the individual falls in any of the following categories:

a) Indian citizen, being outside India, who comes on a visit to India during the previous year and his Indian income is up to Rs. 15 lakhs;
b) Person of Indian Origin, being outside India, who comes on a visit to India during the previous year and his Indian income is up to Rs. 15 lakhs;
c) An Indian citizen who leaves India during the previous year for the purpose of employment; or
d) An Indian citizen who leaves India during the previous year as a member of the crew of an Indian Ship.

Exception 2: '60 days' to be replaced with '120 days '

The condition *(b)* is substituted with the condition of stay in India for 120 days during the relevant previous year and for 365 days or more in 4 years preceding the previous year if the following conditions are satisfied:

a) The individual is an Indian Citizen or a Person of Indian Origin;
b) He comes on a visit to India; and
c) His Indian income during the previous year exceeds Rs. 15 lakhs.

[8] A person is said to be of Indian Origin if he, or either of his parents or any of his grandparents were born in undivided India, that is, before partition of India.

The individual, in this situation, is deemed as 'Not Ordinarily Resident in India'.

2.5-1b. Deemed Resident

In view of Section 6(1A)[9], an Indian Citizen, who is not a resident under Section 6(1), shall be deemed to be resident in India during the previous year if his Indian income during that year exceeds Rs. 15 lakhs and he is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature. Such an individual is deemed as 'Not Ordinarily Resident' in India. These provisions are applicable notwithstanding the number of days of stay in India during the previous year.

2.5-1c. Non-resident

An individual is treated as a non-resident in India if he does not satisfy any of the conditions required to be fulfilled to become a resident. In other words, he is treated as a non-resident if he does not satisfy the conditions of being a resident mentioned in para 2.5-1a and 2.5-1b.

2.5-1d. Not Ordinarily Resident

An individual will be treated as Not Ordinarily Resident (NOR) in India if he satisfies any one condition specified below:

a) He has been a non-resident in India for at least 9 out of 10 years immediately preceding the relevant previous year; or
b) He has been in India for 729 days or less during the period of 7 years immediately preceding the previous year.

If he does not satisfy any of the abovementioned conditions, he is treated as Ordinarily Resident (ROR) in India. However, the persons specified in the below categories are always considered as Not Ordinarily Resident.

a) Deemed Resident

An Indian Citizen who is deemed as a resident in India under Section 6(1A) is treated as Not Ordinarily Resident in India. In other words, an individual shall be deemed as Not Ordinarily Resident in India if the following conditions are satisfied:

(a) He is an Indian Citizen;
(b) His total income from Indian sources during that year exceeds Rs. 15 lakhs; and
(c) He is not liable to pay tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.

[9] Inserted by the Finance Act, 2020 with effect from Assessment year 2021-22

b) Specified Indian Citizens or Person of Indian Origin

An individual shall be deemed as Not Ordinarily Resident in India if the following conditions are satisfied:

(a) He is an Indian Citizen or a person of Indian origin;
(b) His Indian income during the previous year exceeds Rs. 15 lakhs; and
(c) His stay in India is for 120 days or more (but less than 182 days) during the relevant previous year and for a period of 365 days or more in 4 years preceding the previous year.

2.5-2.Residential Status of HUF

The residential status of an HUF depends upon its place of control and management and the residential status of its Karta.

2.5-2a. Resident in India

An HUF is said to be resident in India in any previous year in every case except where during the year the control and management of its affairs are situated wholly outside India. If principal decision-makers of the HUF take even a single decision in India, the HUF will be considered as a resident of India as 'part of its control and management' will be deemed to be situated in India.

2.5-2b. Non-Resident

An HUF is deemed as a non-resident in India if, during the previous year, the control and management of its affairs are situated wholly outside India.

2.5-2c. Resident and Not-Ordinarily Resident

A resident HUF is further categorised into Not-Ordinarily Resident in India if any one of the following conditions is satisfied:

1. Manager has been a non-resident in India for at least 9 years out of 10 years preceding the previous year; or
2. Manager has been in India for 729 days or less during the period of 7 years preceding the previous year.

2.5-3.Residential status of a company

2.5-3a. Indian Company

An Indian Company means a company formed and registered under the Companies Act, 2013. Indian companies are always treated as resident in India. Even if an Indian company is a subsidiary of a foreign company or it is controlled from a place located outside India, the Indian company is considered as resident in India. An Indian company can never be a non-resident person.

2.5-3b. Foreign Company

A foreign company[10] is treated as a resident in India if during the relevant previous year its Place of Effective Management (POEM) is in India.

For determination of Place of Effective Management, the CBDT has issued the guidelines in Circular No. 6/2017, dated January 24, 2017. These guidelines apply to a foreign company whose gross turnover or receipts during the year exceed Rs. 50 Crores[11].

2.5-4. Residential Status of Firm or AOP or BOI or Local Authority or Artificial Juridical Person

To determine the residential status of a partnership firm or Association Of Persons (AOP) or Body Of Individuals (BOI) or Local Authority or Artificial Juridical Person, the residential status of partner or member during the previous year is not relevant. A firm or AOP or BOI or Local Authority or Artificial Juridical Person cannot be "ordinarily resident" or "not ordinarily resident".

2.5-4a. Resident in India

A partnership firm or AOP or BOI or Local Authority or Artificial Juridical Person is said to be resident in India in a previous year if any part of the control and management of its affairs is situated in India during that year. If principal decision-makers take even a single decision in India, the firm or AOP or BOI or Local Authority or Artificial Juridical Person will be considered as resident of Indian as 'part of its control and management' will be deemed to be situated in India. In other words, it is not necessary that substantial control and management should be situated or exercised in India.

For example, if regular accounts and reports of the foreign AOP are forwarded to the members in India from time to time by the employees, instructions are sought from the members regarding the conduct of the foreign business, and such instructions are duly sent, these are substantial indications of the control and management situated in India.

[10] With effect from Assessment Year 2017-18 the residential status of a foreign company is determined as per POEM guidelines. Till Assessment Year 2016-17, a foreign company is said to be resident in India in any previous year, if during that year, the control and management of its affairs is situated wholly in India.
[11] Circular No. 8/2017, dated February 23, 2017

2.5-4b. Non-Resident in India

A partnership firm or AOP or BOI or Local Authority or Artificial Juridical Person is said to be non-resident in India in a previous year if the control and management of its affairs are situated wholly outside India during that year.

2.6 SCOPE OF INCOME

Scope of total income according to the residential status of an assessee shall be as under:

2.6-1.Resident and Ordinary Resident

A resident assessee (Individual and HUF) shall be liable to pay tax in India on the following incomes:

a) Income received or is deemed to be received in India in the previous year by or on behalf of such assessee;
b) Income accrues or arises or is deemed to accrue or arise to such assessee in India during such year; and
c) Income accrues or arises to him outside India during such year.

2.6-2.Resident and Not Ordinary Resident

A resident but not ordinarily resident assessee (Individual and HUF) shall be liable to pay tax in India on the following incomes:

a) Income received or is deemed to be received in India in the previous year by or on behalf of such assessee;
b) Income accrues or arises or is deemed to accrue or arise to such assessee in India during such year; and
c) Income accrues or arises to him outside India during such year if it is derived from a business controlled in India or from a profession set up in India.

2.6-3.Non-Resident

In case of a non-resident assessee, the following incomes shall be taxable in India:

a) Income received or is deemed to be received in India in the previous year by or on behalf of such person; and
b) Income accrues or arises or is deemed to accrue or arise to such person in India during such year.

2.6-4.Summary

Nature of income	*Resident and ordinarily resident*	*Resident but not ordinarily resident*	*Non-resident*
Income received or is deemed to be received in India	Taxable	Taxable	Taxable
Income accrues or arises or is deemed to accrue or arise in India	Taxable	Taxable	Taxable
Income accrues or arises outside India if it is derived from a business controlled in India or from a profession set up in India	Taxable	Taxable	Not-taxable
Income accrues or arises outside India from a business controlled outside India or a profession set up outside India	Taxable	Not-taxable	Not-taxable

2.7 HEADS OF INCOME

In the Income-tax Act, the income is computed under five heads of income, *namely,* salary, house property, business or profession, capital gain, and other sources. Total income is the aggregate of income computed under these heads.

2.7-1.Salary Income

'Salary' is the first head of income. Income-tax Act defines the term 'Salary' under section 17(1) which *inter alia* include wages, annuity, pension, gratuity, any fees, commissions, perquisites or profits in lieu of salary, salary advance, leave encashment, employers' contribution to provident fund in excess of 12% of salary, contribution to pension scheme under Section 80CCD, contribution to Agniveer corpus fund under Section 80CCH, etc. Taxability of an income under this head pre-requisites existence of an employer and employee relationship. In the absence of the employer-employee relationship, the income shall be assessable either as business income or income from other sources. It is pertinent to note that any benefit, whether monetary or otherwise derived by an employee in connection with his employment will be taxed under the head "Salary" only.

The income under this head shall be taxable on due basis or receipt basis, whichever is *earlier*. Salary due from an employer to an employee shall be chargeable to tax even if it is not paid during the year. However, taxation of Employee Stock Option Plans (ESOPs) is an exception to this principle. (for details see *Para 7.1* of Chapter 7 for Taxation of ESOPs).

2.7-1a. Computation of taxable income

Generally, the salary income shall be computed in the following manner:

Particulars	*Amount*
Basic Salary	xxx
Add: Additions	
a) Allowances (to the extent of taxable amount)	xxx
b) Perquisites	xxx
c) Profit in Lieu of Salary	xxx
d) Retirement benefits (to the extent of taxable amount)	xxx
e) Pension	xxx
Less: Deductions	
a) Entertainment Allowance	(xxx)
b) Employment Tax	(xxx)
c) Standard Deduction	(xxx)
Income chargeable under the head Salary	**Xxx**

2.7-2.House property income

Income is taxable under the head 'house property' if it arises from a property consisting of any building or lands appurtenant thereto. For the computation of income under this head, a house property is classified into three categories: (a) let-out; (b) self-occupied, and (c) deemed let-out house property.

The rental income from immovable property is taxable under the head 'Income from house property' if the following conditions are satisfied:

2.7-2a. Building and land appurtenant thereto

Income is taxable under this head if it arises from a property that consists of any building or lands appurtenant thereto. Though the word 'property' has a wide meaning, but for chargeability of income under this head, the property must consist of any building or land appurtenant thereto.

For example, if any income is derived from vacant land, then such income shall not be chargeable to tax under the head 'Income from house property' as the property does not consist of any building. Such rental income is chargeable to tax under the head 'profits and gains from business or profession' or 'Income from Other Sources'.

The land is called as 'land appurtenant to the building' if it is an indivisible part and parcel of a building for its use and enjoyment by the occupiers and it is not put to any other use and is not yielding any income assessable under this head. Generally, playgrounds, parking lots, garages, backyards, gardens, etc. are treated as land appurtenant to a building.

2.7-2b. Ownership of property

Income from a building and land appurtenant thereto are chargeable to tax under the head 'house property' only in the hands of an owner. If a person, deriving rental income from a property, is not the owner of such property, then the income so derived shall be chargeable to tax either as business income or income from other sources but not as income from house property.

To become an owner of a property, a person must hold the legal title of the property in his name. He should be able to exercise the rights of the owner, not on behalf of the owner but in his own right. However, in a certain situation, despite not holding the legal ownership of a property, a person is considered as deemed owner of the property, and income from such property is chargeable to tax in his hands.

2.7-2c. Use of property

The annual value of a house property is chargeable to tax under this head if the owner does not utilize the property to carry on his business or profession. Even if an assessee is engaged in the business of letting out of the property, the rental income earned from such business is taxable as income from house property. However, in certain situations, the rental income earned by a person is taxable as business income.

2.7-2d. Computation of income from house property

For the computation of income from house property, a house property has to be classified into the following categories:

(a) Let-out;
(b) Self-occupied; and
(c) Deemed let-out.

Broadly, the income from such house property is computed in the following manner:

Particulars	*Let-out*	*Self-occupied*	*Deemed Let-out*
Annual Value of the property (A)	xxx	-	Xxx
Less:			

(-) Municipal taxes (B)	(xxx)	-	(xxx)
Net Annual Value [C= A – B]	**xxx**	**-**	xxx
Share in Net Annual Value [D = C * share in property]	**xxx**	**-**	xxx
Less: Standard Deduction (E) {30% of D above}	(xxx)	-	(xxx)
Less: Interest on home loan (F)	(xxx)	(xxx)	(xxx)
Income from house property [G= D – E – F]	**xxx**	**xxx**	**xxx**
Add: Arrears of rent or unrealised rent * 70% [H]	xxx	-	**xxx**
Total Income from house property [I = G + H]	**xxx**	**xxx**	**xxx**

2.7-3.Profit and gains of business or profession

When an assessee carries on any business or profession, the income arising from such business or profession shall be calculated and taxed under the head 'Profit and Gains from Business or Profession'.

2.7-3a. Meaning of business

Section 2(13) of the Income-tax Act provides an inclusive definition of the term business: "Business includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."

However, the term business does not necessarily mean trade or manufacture only. The word 'business' has a comprehensive meaning and may be used in many different connotations. Business connotes some real, substantial, and systematic or organized course of activity or conduct with a set purpose[12]. It means an activity carried on continuously and systematically by a person by the application of his labour and skill to earn an income. In taxing statutes, it is used in the sense of an occupation or profession, which occupies time, attention, and labour of a person, generally with the object of making a profit. Though the element of profit is usually present in 'business' but the motive of making a profit or actual earning of profit is not a necessary ingredient of business.

2.7-3b. Computation of business income

As a general rule, all revenue receipts arising in the course of business shall be taxable under the head profits and gains from business or profession. Section 28 of the Income-tax Act provides an inclusive list of all income which are chargeable to tax under this head. The business profits shall be computed according to the method of accounting regularly employed by the assessee. Thus, if the assessee follows the cash system of accounting, profits shall be computed on a receipts basis, while in the mercantile system, it should be computed on an accrual basis.

[12] Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax - [1954] 26 ITR 765 (SC)

The Income-tax Act allows certain types of small and medium enterprises to compute income from business or profession on a presumptive basis. However, a person earning income in the nature of commission or brokerage cannot opt for such a presumptive taxation scheme.

The business income under the normal provision shall be computed in the following manner:

Particular	*Amount*
Revenue receipts	xxx
Capital receipts which are specifically covered	xxx
Less:	
1. Revenue Expenditures	(xxx)
2. Capital Expenditures which are specifically allowed as a deduction	(xxx)
3. Depreciation	(xxx)
4. Expenditures allowed on payment basis	(xxx)
5. Expenditures allowed on fulfilment of certain conditions	(xxx)
Taxable Income from business or profession	**Xxx**

The business income under the presumptive scheme shall be computed in the following manner:

Particulars	*Amount*
Total turnover or gross receipts of business or profession	Xxx
Presumptive income as a percentage of turnover or receipts or otherwise	xxx
Less:	
Expenditures which are specifically allowed as a deduction	(xxx)
Presumptive Income from business or profession	**Xxx**

2.7-3c. Speculative & Non-speculative business income

While computing the income under the head 'profits and gains from business or profession', a business transaction has to be classified into 'speculative' and 'non-speculative'. As per Section 43(5) of the Income-tax Act, a transaction of purchase or sale of any commodity (including stock and shares) is considered as a 'speculative transaction' if it is periodically or ultimately settled otherwise than through the actual delivery. However, where a transaction is entered into to safeguard against losses (i.e., hedging transaction) or a transaction in derivatives (including commodity derivatives) is not considered as a speculative transaction.

Where speculative transactions carried on by an assessee are of such a nature as to constitute a business, such business is treated as a speculative business. The provisions for computation of profit and tax rates are the same in case of a speculative and non-speculative business except treatment of losses. If any loss is suffered from speculative business, it cannot be set off or adjusted against any profit from the non-speculative business. Further, such losses can be carried forward for 4 years only in contrast to 8 years allowed for non-speculative business losses. (To know more about business income, please refer *Chapter 8*.)

2.7-4.Capital Gains

Any profit or gain arising from the transfer of a capital asset is taxable under the head 'capital gains' in the previous year in which such transfer takes place. However, every transfer of a capital asset does not give rise to taxable capital gain because some transactions are either not treated as 'transfer' under Section 47 or they are excluded from the meaning of a capital asset (such as rural agricultural land), or they enjoy exemption under Sections 54 to 54GB. Determination of income taxable under the head capital gains depends upon various factors such as period of holding, cost of acquisition, full value of consideration, etc. The nature of capital gain, *that is*, short-term or long-term, is determined on the basis of the period of holding of the capital asset (for detailed discussion refer *Chapter 3*).

The short-term and long-term capital gain arising from the transfer of a capital asset is computed in the following manner:

Computation of short-term capital gain	
Full value of consideration	xxx
Less:	
a) Expenditure incurred wholly and exclusively in connection with the	(xxx)
transfer	(xxx)
b) Cost of acquisition	(xxx)(xxx)
c) Cost of improvement	(xxx)
d) Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution	
e) Exemption under Sections 54B, 54D, 54G and 54GA	
Short-term capital gain or loss	**xxx**
Computation of long-term capital gain	
Full value of consideration	xxx
Less:	
a) Expenditure incurred wholly and exclusively in connection with	(xxx)
transfer	(xxx)
b) Indexed cost of acquisition	(xxx)
c) Indexed cost of improvement	(xxx)
d) Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution	(xxx)
e) Exemption under Sections 54 to 54GB	

Long-term capital gain or loss	**xxx**

2.7-5.Income from other sources

Any income, to be included in the total income, shall be chargeable to tax under the head ‘Income from other sources’, if it is not taxable under other four heads of income. However, certain incomes are always taxable under the head ‘Income from Other Sources’. Thus, income taxable under this head is an aggregate of certain incomes which are specifically taxed under this head and other incomes which are not chargeable under any other head, hence, chargeable under this head *(for detailed discussion refer Chapter 4).*

Income taxable under the head ‘income from other sources’ shall be broadly computed in the following manner:

Nature of Income	*Amount*
1. Dividend Income	xxx
2. Winning from lotteries, etc.	xxx
3. Winning from online games (in the nature of lotteries, etc.)	xxx
4. Employees’ contribution towards staff welfare scheme	xxx
5. Interest on securities	xxx
6. Rental income of machinery, plant, or furniture	xxx
7. Composite rental income from letting out of plant, machinery, furniture, and building	xxx xxx
8. Sum received under Keyman insurance policy	xxx
9. Deemed Income of a closely held company	xxx
10. Interest on compensation or enhanced compensation	xxx
11. Advance money received in the course of negotiations for the transfer of a capital asset	xxx
12. Gifts	xxx
13. Compensation on termination of employment or modification of terms of employment	
14. Any money, immovable property or movable property received without consideration or at a consideration less than the prescribed stamp duty value/fair market value.	xxx xxx (xxx)
15. Sum received under a life insurance policy (other than ULIP and keyman insurance policy) in excess of the aggregate premium paid during the policy term	
16. Specified sum received (other than interest/dividend from SPV and rental income from REITs) by a unitholder from a business trust	
17. Any other income not taxable under any other head	
Less: Attributable expenses (to the extent allowable)	

Income from other sources	**Xxx**

2.8 KNOW THE DEDUCTIONS

In computing the total income, certain deductions are allowed from the gross total income. These deductions are allowed to encourage saving habits in individuals and pursue institutions to take part in social activities. These deductions are prescribed in Chapter-VIA of the Income-tax Act. (Refer *Annexure F* for list of deductions available under Income-tax Act).

Deductions available to the assessee shall be deducted from his gross total income after setting off the unabsorbed losses. Total income shall be computed as follows:

Computation of Total Income	
Aggregate following incomes: 1. Income from salaries 2. Income from house property 3. Profits and gains from business and profession 4. Capital Gains 5. Income from other sources	 xxx xxx xxx xxx xxx
Total of head-wise income	*xxx*
Less: Set-off of current year and brought forward losses	xxx
Gross total income	*xxx*
Less: Deduction under chapter VI-A, i.e., Section 80C to 80U	*xxx*
Total income	***xxx***

2.9 KNOW ABOUT THE EXEMPTIONS

Any income which does not form part of 'total income' is called exempt income. Section 10 to 13B of the Income-tax Act provides exemptions for various types of incomes or income of certain types of institutes. (Refer *Annexure G* for exemptions available under Income-tax Act).

2.10 KNOW THE REBATES

Section 87A of the Income-tax Act provides a tax rebate of up to Rs. 12,500 to a resident individual whose total income during the previous year does not exceed Rs. 5,00,000. However, from assessment year 2024-25 onwards, if a resident individual opts for the new tax regime under Section 115BAC and his total income is up to Rs. 7,00,000, he can claim a higher amount of tax rebate of up to Rs. 25,000. If the total income exceeds Rs. 7,00,000, the tax rebate shall still be allowed with marginal relief.

However, the rebate under Section 87A is not available from tax payable as per section 112A in respect of long-term capital gains arising from the transfer of equity shares, units of equity-oriented mutual funds, certain ULIPs (*see details in Chapter 7*), or units of business trust which are chargeable to STT and tax on the accumulated balance of a recognised provident fund as referred under Section 111.

Normal tax liability	
Tax on income at normal rates Tax on income at special rates	xxx xxx
Tax on total Income *Less:* Rebate under section 87A	*xxx* (xxx)
Tax after rebate *Add:* Surcharge	*xxx* xxx
Tax after surcharge *Add:* Health and Education Cess	*xxx* xxx
Total Tax liability	xxx

2.11 KNOW THE GROSS TOTAL INCOME

Section 80B(5) of the Income-tax Act provides that 'Gross Total Income' means the total income computed in accordance with the provisions of the Income-tax Act before making any deduction under chapter VI-A. The Gross Total Income of an assessee is computed in the following steps:

Step 1: Calculate income under five heads of income

In the Income-tax Act, the income is computed in the following five heads of income:

a) Salary *(refer para 2.7-1.)*
b) House Property *(refer para 2.7-2.)*
c) Profits and gains from business or profession *(refer para 2.7-3.)*
d) Capital Gain *(refer para 2.7-4.)*
e) Income from Other Sources *(refer para 2.7-5.)*

Step 2: Club income of other persons

A taxpayer is generally taxed in respect of his own income. However, in respect of certain income, the Income-tax Act deviates from this general provision and clubs income of other persons in taxpayer's income. Hence, an assessee has to add the income of another person with his own income if clubbing provisions apply in his case (to know more about the clubbing of income, *see para 2.14*).

Step 3: Set-off the losses of the current year or earlier years

If the assessee has incurred losses under any head of income then he is allowed to make the following adjustments subject to relevant provisions relating to set-off and carry forward of losses:

a) Intra-head adjustment, i.e., set-off of losses from one source of income against income from another source taxable under the same head of income.
b) Inter-head adjustment, i.e., set-off of losses from one head of income against income taxable under another head of income.

If losses cannot be set-off in the same year due to inadequacy of eligible income, then such losses are carried forward to the next assessment year.

2.11-1. Overview

Computation of Gross Total Income (GTI)	
Aggregate the following incomes (Including income to be clubbed in the hands of the assessee):	
a) Income from salaries	xxx
b) Income from house property	xxx
c) Profits and gains of business or profession	xxx
d) Capital gains	xxx
e) Income from other sources	xxx
Total of head-wise income	xxx
Less: Set-off the current year and brought forward losses	(xxx)
Gross total income	**xxx**

2.12 KNOW THE TOTAL INCOME

An assessee is allowed to claim various deductions from the 'Gross Total Income' on account of investments and savings made by him. The balance income remaining after claiming the deductions is called 'Total Income', which shall be the base for calculation of tax liability.

2.12-1. Overview

Computation of Total Income	
Gross total income	*xxx*
Less: Deduction under Chapter VI-A, i.e., Section 80C to 80U	*(xxx)*
Total income	***xxx***

2.13 KNOW THE TAX PAYABLE

2.13-1. Corporate assessee

For the calculation of tax, the total income of a taxpayer is apportioned between normal income and special income. Normal income of a taxpayer is charged to tax as per applicable tax rates. Whereas, special income is charged to tax at special rates (Refer *Annexure E for tax rates*). The assessee has an option to compute tax at the concessional tax rates prescribed under Section 115BA, 115BAA, or 115BAB subject to fulfilment of certain conditions.

However, if the tax payable by a company is less than 15% of 'book profit', then it is liable to pay Minimum Alternate Tax (MAT) at the rate of 15% of the book profit. The MAT rate shall be 9% if the assessee is located in an International Financial Services Centre (IFSC) and derives income solely in convertible foreign exchange

The tax so computed on total income is further increased by surcharge (if applicable) and Health & Education Cess and reduced by the amount of MAT credit, foreign tax credit to arrive at net tax liability. Thereafter, the taxes already paid by the taxpayer in the form of Advance Tax, TDS, TCS, or Self-assessment tax shall be deducted from the aggregate tax liability to compute the amount of tax payable by or refundable to the taxpayer.

Particulars	**Amount**
MAT liability	
Tax payable on book profit computed as per MAT provisions	xxx
Add:	
Surcharge	xxx
MAT after surcharge	xxx
Add:	
Health and Education Cess	xxx
Total tax liability as per MAT provisions **(*A*)**	xxx
Normal tax liability	
Tax on income at normal rates	xxx
Tax on income at special rates	xxx
Tax on total income	*xxx*
Add:	
Surcharge	xxx
Tax after surcharge	*xxx*
Add:	
Health and Education Cess	xxx
Total tax liability as per normal provisions of the Income-tax Act **(*B*)**	xxx

Gross tax liability [Higher of MAT liability (A) or Normal tax liability (B)]	*xxx*
Less:	
- MAT Credit [If Normal tax liability (B) is higher than MAT liability (A)]	(*xxx*)
- Foreign tax credit under Section 90, 90A or 91[13]	(*xxx*)
Aggregate tax liability	*xxx*
Less: Prepaid taxes	
- TDS deducted	(*xxx*)
- TCS collected	(*xxx*)
- Advance tax paid	(*xxx*)
- Self-assessment tax paid	(*xxx*)
Particulars	**Amount**
Net tax liability	*xxx*
Add:	
- Interest under Sections 234A, 234B, 234C	xxx
- Fees for late filing of return under section 234F	xxx
Total tax payable/refundable	***xxx***

The provisions of MAT shall not be applicable to the following:

(a) The profits and gains arising to a company from the life insurance business and to a shipping company, the income of which is subject to tonnage taxation

(b) To the following foreign companies:
- Foreign companies which are taxable under presumptive taxation schemes of Section 44B, section 44BB, section 44BBA or section 44BBB.
- Foreign companies which do not have a Permanent Establishment (PE) in India under the provisions of the relevant DTAA.
- Foreign companies, which are residents of those countries with which India does not have a DTAA and which are not required to get registered in India under any law relating to companies.

(c) To the companies opting for payment of taxes at the concessional rates prescribed under section 115BAA or Section 115BAB.

2.13-2. Non-corporate assessee

[13] Where the amount available as a foreign tax credit against the tax payable as per the provisions of MAT exceeds the amount of MAT Credit, which is available against the normal provision, then such excess shall be ignored while computing the amount of credit available in respect of tax paid under the provisions of MAT.

Tax in respect of income of the non-corporate assessees shall be calculated as per the applicable tax rates and special tax rates (Refer *Annexure E for tax rates).* Assessee being an Individual, HUF, AOP, BOI, AJP, or a co-operative society has an option to compute tax at the concessional tax rates prescribed under Section 115BAC or 115BAD or 115BAE, as the case may be, subject to fulfilment of certain conditions.

However, if the tax payable by a non-corporate assessee on its total income (computed as per normal provisions of the Act) is less than 18.5% (or 9%[14] or 15%[15]) of 'adjusted total income' then it shall be liable to pay Alternate Minimum Tax (AMT) at the rate of 18.5% (or 9% or 15%) of the adjusted total income.

The tax so computed on total income is further increased by surcharge (if applicable) and Health & Education Cess and reduced by the amount of AMT credit, relief under section 89, or foreign tax credit to arrive at net tax liability. The net tax payable by the assessee shall be increased by the amount of interest and late filing fees (if any). Thereafter, the taxes already paid by the taxpayer in the form of Advance Tax, TDS, TCS, or Self-assessment tax shall be deducted from the aggregate tax liability to compute the amount of tax payable by or refundable to the taxpayer.

Particulars	**Amount**
AMT liability	
Tax payable on adjusted total income computed as per AMT provisions	xxx
Add:	
Surcharge	xxx
AMT after surcharge	xxx
Add:	
Health and Education Cess	xxx
***Total tax liability as per AMT provisions* (*A*)**	xxx
Normal tax liability	
Tax on income at normal rates	xxx
Tax on income at special rates	xxx
Tax on Total Income	*xxx*
Less:	
Rebate under section 87A	(*xxx*)
Tax after rebate	*xxx*

[14] The rate shall be 9% in case of a unit in an IFSC deriving income solely in convertible foreign exchange.
[15] With effect from Assessment Year 2023-24, the rate shall be 15% in case of co-operative society.

Add:	
Surcharge	xxx
Tax after surcharge	*xxx*
Add:	
Health and Education Cess	xxx
***Total tax liability as per normal provisions of the Income-tax Act* (*B*)**	xxx
Gross tax liability [Higher of AMT liability (*A*) *or Normal tax liability* (*B*)*]*	*xxx*
Particulars	**Amount**
Less:	
- AMT Credit [If Normal tax liability (B) is higher than AMT liability (A)]	(*xxx*)
Tax payable after AMT credit	*xxx*
Less:	
- Relief under Section 89[16]	(*xxx*)
- Foreign tax credit under Section 90, 90A or 91[17]	(*xxx*)
Aggregate tax liability	*xxx*
Less: Prepaid taxes	
- TDS deducted	(*xxx*)
- TCS collected	(*xxx*)
- Advance tax paid	(*xxx*)
- Self-assessment tax	(*xxx*)
Net tax liability	*xxx*
Add:	
- Interest under Sections 234A, 234B, 234C	xxx
- Fees for late filing of return under section 234F	xxx
Total tax payable/refundable	***xxx***

The provisions of AMT shall not be applicable:

(a) To an individual, HUF, AOP, or BOI (whether incorporated or not) or an artificial juridical person if the adjusted total income of such person does not exceed Rs. 20 lakhs;

[16] Allowed by the Finance Act (No. 2), 2019, with retrospective effect from Assessment year 2007-08.

[17] Where the amount available as a foreign tax credit against the tax payable as per the provisions of AMT exceeds the amount of AMT Credit, which is available against the normal provision, then such excess shall be ignored while computing the amount of credit available in respect of tax paid under the provisions of AMT.

(b) To the Individual, HUF, AOP (other than co-operative society), BOI or AJP opting for payment of taxes at the concessional rates prescribed under section 115BAC of the Act; and

(c) To the resident co-operative society opting for payment of taxes at the concessional rates prescribed under section 115BAD or section 115BAE of the Act.

(d) To a specified fund as defined under Section 10(4D).

2.14 CLUBBING OF INCOME

A taxpayer is generally taxed in respect of his own income. However, the Income-tax Act deviates from this general provision in some cases and clubs income of other persons in taxpayer's income. The clubbing provisions have been enacted to counteract a generally prevalent and growing tendency on the part of the taxpayers to dispose of their property or income in favour of other persons in such a manner that their tax liability may either be avoided or reduced.

The income will first be computed in the hands of the recipient under the relevant head after allowing all exemptions and deductions permissible under that head of income. Then the resultant income shall be clubbed in the hands of the transferor or beneficiary as per the provisions of sections 60 to 64. If the net result of the computation of income in the hands of the recipient is a loss, it shall be also be clubbed[18]. The income computed under the relevant head in the hands of the recipient will be included in the total income of the transferor or beneficiary under the same head of Income. Thus, the clubbed income shall be retained under the same head in which it is earned.

The provisions relating to clubbing of income are contained in Sections 60 to 65 of the Income-tax Act. These provisions are as follows:

a) Income from assets transferred to another person [Sections 60 to 63]
b) Income of another person to be included in the taxpayer's income [Section 64]

2.14-1. Income from assets transferred to another person

2.14-1a. Transfer of Income without transferring the Asset [Section 60]

If any person transfers the income from any asset without transferring the asset, such income is included in the total income of the transferor. In this situation, it is not material whether the agreement to transfer the income is revocable or irrevocable, and whether it was made before or after the commencement of this Act. Thus, even if an agreement to transfer the

[18] Circular No. 104, dated 19-02-1973

income was entered into before April 1, 1962, the clubbing provisions shall apply in respect of income earned in the current financial year.

For example, a security holder confers on his nephew the right to receive interest on securities, held by him. Such interest is included in the total income of the transferor.

Section 60 has no application where assets, producing income, are transferred along with the income.

For example, E holds 100, 10% redeemable debentures in Z Ltd. E assigns the right to receive interest from 50 debentures in favour of his nephew 'N' and gifts 50 Debentures to his son 'P'. Since E has transferred only the right to receive the income in favour of 'N' the income-producing asset remains his property. Therefore, interest income in respect of 50 Debentures shall be clubbed with the income of E as per provisions of Section 60. However, the interest earned from the remaining 50 Debentures shall not be clubbed with the income of E as he has transferred both—the asset as well as the income from the asset. Section 60 has no application in this case. If son is a minor child, such income shall be clubbed with the income of E as per provisions of Section 64.

2.14-1b. Revocable Transfer of Assets [Section 61]

All income arising to any person by virtue of a revocable transfer of assets is included in the total income of the transferor. If the transfer is revocable, the entire income of the transferred asset is included in the total income of the transferor, even if only part of the income of the transferred asset had been applied for the benefit of the transferor.

Any transfer of asset shall be deemed as 'Revocable', if:

a) It contains a provision for retransfer, directly or indirectly, of whole or any part of income or assets to the transferor; or
b) It gives the transferor a right to re-assume power, directly or indirectly, over whole or any part of income or assets.

Section 62 of the Income-tax Act contains an exception to the general rule prescribed in Section 61. If the transfer is not revocable during the lifetime of the beneficiary and the transferor derives no direct or indirect benefit from such income, the income shall be taxable in the hands of the beneficiary or transferee.

For example, Mr J settled certain properties on trust for the benefit of Mr C for his lifetime. He appoints Mr B as the trustee. In this case, if Mr J derives no benefit, either direct or indirect, from such transfer, either trustee (Mr B) or beneficiary (Mr C) shall be assessable on such income. However, if Mr J derives any benefit from such transfer, whole income from the settled properties is to be included in the total income of Mr J.

2.14-2. Income of another person to be included in taxpayer's income [Section 64]

Income-tax Act contains provisions for clubbing of income of another person with the income of the taxpayer. These situations arise when a minor child earns some income or when a taxpayer transfers his asset to his spouse, son's wife, etc.

The clubbing provisions have been introduced to stop taxpayers from diverting a part of their income to relatives in order to reduce the tax burden. To prevent such tax avoidance, clubbing provisions have been incorporated, subject to certain exceptions, in respect of the income of the following persons:

(a) Income of Spouse;
(b) Income of Son's Wife;
(c) Minor's Income;
(d) Income of any person or Association of persons;
(e) Income from property gifted to HUF.

2.15 SET-OFF AND CARRY FORWARD OF LOSS UNDER THE HEADS - CAPITAL GAINS, INCOME FROM OTHER SOURCES AND BUSINESS INCOME

2.15-1. Loss under the head Capital Gains

Capital losses can be of two types – Short-term Capital Loss and Long-term Capital Loss. Though both the losses are computed under the same head of income, yet distinct provisions have been prescribed for set-off of these losses. Both the losses are computed and disclosed separately in the Income-tax Returns.

2.15-1a. Intra-head Adjustment

As a general rule, if there are several sources of income, falling under any head of income, the loss from one source of income may be set-off against the income from another source, falling under the same head of income.

However, long-term capital loss can be set-off only against long-term capital gains. It cannot be set-off against short-term capital gains, though both of them fall under the same head 'Capital Gains'. Whereas, short-term capital loss can be set-off against any capital gain, whether short-term or long-term.

2.15-1b. Inter-head Adjustment

As a general rule, if after intra-head adjustment the net result under a head of income is a loss, the same can be set-off against the income from other heads in the same previous year. However, a capital loss, whether short-term or long-term, cannot be set-off against income taxable under any other head.

2.15-1c. Carry forward of losses

If capital loss could not be set-off against the eligible capital gains because of the inadequacy of income during the current year, it can be carried forward and set-off in the subsequent year. The short-term and long-term capital loss, which could not be set-off during the year, shall be carried forward separately. In subsequent years, the short-term capital loss can be set-off against the short-term or long-term capital gain but the brought forward long-term capital loss shall be set-off only against long-term capital gains.

The losses can be carried forward for 8 Assessment Years immediately following the year for which the loss was first computed.

The losses can be carried forward only if the return of income is filed on or before the due date. However, in case the tax return is filed after the due date, the assessee can apply to the CBDT for condonation of delay in filing of return of income.

2.15-1d. Summary

Type of Loss	***How to Set-off the loss?***	***Adjustment Against***	***Time Limit***
Long-term Capital Loss	Intra-head Adjustment of loss	Long-term Capital Gains	Same Year
Long-term Capital Loss	Inter-head Adjustment of loss	Not Allowed	-
Long-term Capital Loss	Carried Forward Losses	Long-term Capital Gains	Within 8 Years
Short-term Capital Loss	Intra-head Adjustment of loss	Any capital gains, whether short term or long term	Same Year
Short-term Capital Loss	Inter-head Adjustment of loss	Not Allowed	-
Short-term Capital Loss	Carried Forward Losses	Any capital gain, whether short term or long term	Within 8 Years

2.15-2. Loss under the head PGBP

Income-tax Act provides distinct provisions for set-off and carry forward of speculative loss and non-speculative loss. Loss from speculative transactions can be set-off only against profit from speculative transactions. Whereas, the normal business loss can be set-off against any income other than salary and from gambling activities.

If the loss couldn't be set-off in the current year due to inadequacy of profit under other heads of income, the same shall be carried forward for set-off in the subsequent year. Speculative loss and non-speculative loss can be carried forward for 4 years and 8 years respectively. In subsequent years, the speculative loss can be set-off only against speculative profit. Whereas, the normal business loss can be set-off against non-speculative as well as speculative income. (To know more about set-off and carry forward of business loss, refer *Chapter 8*).

Type of Loss	*How to Set-off the loss?*	*Adjustment Against*	*Time Limit*
Non-speculative Business Loss	Intra-head Adjustment of loss	Any Business Income, i.e., speculative or non-speculative business income	Same Year
Non-speculative Business Loss	Inter-head Adjustment of loss	Any Income except salary income and winning from lottery or gambling	Same Year
Non-speculative Business Loss	Carried Forward Losses	Any Business Income, i.e., speculative or non-speculative business income	Within 8 Years
Speculative Business Loss	Intra-head Adjustment of loss	Speculative Business Income	Same Year
Speculative Business Loss	Inter-head Adjustment of loss	Speculative Business Income	Same Year
Speculative Business Loss	Carried Forward Losses	Speculative Business Income	Within 4 Years

2.15-3. Loss under the head other sources

The loss under the head 'other sources' can be set-off against any income under any head. However, if loss under the head other sources cannot be set-off in the current year due to inadequacy of income under other heads then the same shall not be allowed to be carried forward to subsequent years.

2.15-4. Restriction on set-off of losses

An assessee is not allowed to claim set-off of any loss against the following incomes:

(a) Undisclosed income found during search/survey [Section 79A];

(b) Income from gambling activities or online gaming of gambling nature [Section 115BB and Section 115BBJ];

(c) Unexplained income [Section 115BBE];

(d) Income from transfer of virtual digital asset [Section 115BBH]; and

(e) Specified income of trust or institutions [Section 115BBI].

2.16 DIFFERENCE BETWEEN INVESTING AND DEALING IN SHARES AND SECURITIES

Shares and other securities can be held either as capital assets or as stock-in-trade/trading assets or both. Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has led to a lot of uncertainty and litigation in the past.

Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The CBDT has also, through Instruction No. 1827, dated 31-08-1989 and Circular No. 4 of 2007 dated 15-06-2007, summarized the principles for the guidance of the field formations.

Disputes, however, continue to exist on the application of these principles to the facts of an individual case since the taxpayers find it difficult to prove the intention in acquiring such shares/securities. In this background, while recognizing that no universal principle in absolute terms can be laid down to decide the character of income from the sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), the CBDT[19] realizing that significant part of shares/securities transactions takes place in respect of the listed ones and with a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, further instructs that the Assessing Officers in holding whether the surplus generated from the sale of listed shares or other securities would be treated as Capital Gain or Business Income, to take into account the following:

a) Where the assessee itself, irrespective of the period of holding of the listed shares and securities, opts to treat them as stock-in-trade, the income arising from the transfer of such shares/securities would be treated as its business income.
b) In respect of listed shares and securities held for more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the Assessing Officer. However, this stand, once taken by the assessee in a particular Assessment Year, shall remain applicable in subsequent Assessment Years also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in the subsequent years.

[19] Circular No.6/2016, dated 29-2-2016

c) In all other cases, the nature of a transaction (i.e., whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.

However, the above principles are not applicable in respect of such transactions in shares/securities where the genuineness of the transactions itself is questionable, such as bogus claims of long-term capital gain/short-term capital loss or any other sham transactions.

The CBDT has formulated the above principles with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from the transfer of shares and securities. All the relevant provisions of the Act shall continue to apply to the transactions involving the transfer of shares and securities.

Further, the CBDT *vide* Letter F.No.225/12/2016/ ITA.II, dated 02-05-2016 has clarified that the income arising from the transfer of unlisted shares would be considered under the head 'capital gains', irrespective of the period of holding, to avoid disputes/litigation and to maintain a uniform approach. However, this treatment would not be applicable in respect of the following situations where:

a) The genuineness of transactions in unlisted shares itself is questionable;
b) The transfer of unlisted shares is related to an issue pertaining to the lifting of the corporate veil; or
c) The transfer of unlisted shares is made along with the control and management of the underlying business and the Assessing Officer would take an appropriate view in such situations.

2.16-1. Overview

Security	*Held as*	*Period of holding*	*Chargeability under the head*	*Relevant Circular/Instruction*
Listed shares and securities	Stock-in-trade	Any	Business income	Circular No.6/2016, dated 29-2-2016
Listed shares and securities	Investment	More than 12 months	Capital gain	Circular No.6/2016, dated 29-2-2016
Listed shares and securities	Investment	12 months or less	Business income or capital gain, as the case may be.	Instruction No. 1827, dated 31-08-1989, and Circular No. 4 of 2007 dated 15-06-2007
Unlisted shares	Stock-in-trade	Any	Business income	Letter F.No.225/12/2016/ ITA.II, dated 02-05-2016

Unlisted shares	Investment	Any	Capital Gain	Letter F.No.225/12/2016/ ITA.II, dated 02-05-2016
Other Unlisted securities	Though the Instruction dated 02-05-2016 covers only unlisted shares, unlike Circular No. 6 of 2016 which covers listed shares as well as securities. But, to bring parity, the instruction should also be extended to other unlisted securities such as debentures and bonds.			

2.17 ALTERNATE MINIMUM TAX (AMT) AND MINIMUM ALTERNATE TAX (MAT)

2.17-1. Minimum Alternate Tax (MAT)

2.17-1a. Introduction

Minimum Alternate Tax (MAT) is payable by companies whose tax on total income is less than 15% of 'book profit'. 'Book profit' is computed by making specified additions and deletions to the profits determined as per the statement of profit and loss of the company. MAT is payable even if the total income of the company is *nil* or it has tax losses. The excess tax liability arising due to MAT can be claimed as a credit in subsequent years.

2.17-1b. Who is liable to pay MAT?

The provisions of MAT are applicable to all companies, whether foreign co. or domestic co. These include insurance companies, banking companies, companies in the business of generation or supply of electricity, or companies governed by the specific law, i.e., NBFC. However, there are a few exceptions.

a) Exception 1: Insurance & Shipping Cos.

The provisions of MAT shall not be applicable to the profits and gains arising to a company from the life insurance business and to a shipping company, income of which is subject to tonnage taxation.

b) Exception 2: Certain Foreign Companies

The provisions of MAT shall not be applicable to the following foreign companies:

- Foreign companies which are taxable under presumptive taxation schemes of Section 44B, section 44BB, section 44BBA or section 44BBB.
- Foreign companies which do not have a Permanent Establishment (PE) in India under the provisions of the relevant DTAA.
- Foreign companies, which are residents of those countries with which India does not have a DTAA and which are not required to get registered in India under any law relating to companies.

c) Exception 3: Companies opting for Section 115BAA or Section 115BAB

The provisions of MAT shall not be applicable to the companies opting for payment of taxes at the concessional rates prescribed under section 115BAA or Section 115BAB.

2.17-1c. When is MAT payable?

MAT is payable by a company if the tax payable by it on income computed as per normal provisions of the Income-tax Act is less than 15% of book profits. In such a case the book profit[20] is taken as the income of the company and tax is levied on the same at the rate of 15%.

2.17-1d. MAT credit

MAT is payable by the companies whose tax on total income is less than 15% of 'book profit'. If the tax payable as per provisions of MAT exceeds the tax calculated as per the normal provision, the excess amount of the tax paid is considered as MAT Credit. Such credit can be carried forward for 15 years to set-off against tax payable as per normal provision in future years.

However, the amount of MAT credit cannot be carried forward to the extent such credit relates to the difference between the following:

a) Amount of foreign tax credit allowed against MAT; and
b) Amount of foreign tax credit allowable against tax computed under regular provisions of Act.

Further, the companies which have opted for payment of the taxes at the concessional rates prescribed under Section 115BAA shall not be allowed to carry forward the MAT credit lying unutilized, consequent to exercise of such option.

2.17-2. Alternate Minimum Tax (AMT)

2.17-2a. Introduction

Alternate Minimum Tax (AMT) is payable by an assessee, other than a company, whose tax on total income is less than 18.5% (or 9% or 15%) of 'Adjusted Total Income[21]'. 'Adjusted Total

[20] The book profit shall be computed in accordance with *Explanation 1 and Explanation 2* to Section 115JB.
[21] Adjusted Total Income shall be computed in accordance with Section 115JC(2).

Income' is computed by adding back the specified deductions prescribed under section 115JC. AMT is payable even if the total income of the assessee is *nil* or it has tax losses. The excess tax liability arising due to AMT can be claimed as a credit in subsequent years.

2.17-2b. Who is liable to pay AMT?

The provisions relating to AMT shall apply in case of every person (other than a company) who has claimed any of the following deductions:

a) Deduction under heading '*C.—Deductions in respect of certain incomes*' of Chapter VI-A (not being the deduction claimed under Section 80P);
b) Deduction under Section 10AA in respect of the newly established units in Special Economic Zone;
c) Deduction under Section 35AD in respect of expenditure on specified business.

However, there are few exceptions:

a) Exception 1: Adjusted total income does not exceed Rs. 20 Lakh

An individual, HUF, AOP, or BOI (whether incorporated or not), or an artificial juridical person is not liable to pay AMT if the adjusted total income of such person does not exceed Rs. 20 lakhs.

b) Exception 2: Eligible assessee opting for Section 115BAC

The provisions of AMT shall not be applicable to the Individual, HUF, AOP, BOI, or AJP opting for payment of taxes at the concessional rates prescribed under section 115BAC.

c) Exception 3: Resident co-operative society opting for Section 115BAD or 115BAE

The provisions of AMT shall not be applicable to the resident co-operative society opting for payment of taxes at the concessional rates prescribed under Section 115BAD or Section 115BAE.

(d) Exception 4: Specified fund as defined under Section 10(4D)

The provisions of AMT shall not be applicable to a specified fund as defined under Section 10(4D) (*see Para 11.6-5*).

2.17-2c. When is AMT payable?

AMT is payable by an assessee if the tax payable by it on income computed as per normal provisions of the Income-tax Act is less than 18.5% (or 9%[22] or 15%[23]) of adjusted total income. In such a case the adjusted total income is taken as the income of the assessee and tax is levied on the same at the rate of 18.5% (or 9% or 15%).

2.17-2d. AMT credit

AMT is payable by the non-corporate assessees whose tax on total income is less than 18.5% (or 9% or 15%) of 'Adjusted Total Income'. If the tax payable as per provisions of AMT exceeds the tax calculated as per the normal provision, the excess amount of the tax paid is considered as AMT Credit. Such Credit can be carried forward for 15 years to set-off against tax payable as per normal provision in future years.

However, the amount of AMT credit cannot be carried forward to the extent such credit relates to the difference between the following:

a) Amount of foreign tax credit allowed against AMT; and
b) Amount of foreign tax credit allowable against tax computed under regular provisions of Act.

Further, an Individual, HUF, AOP, BOI, or AJP opting for Section 115BAC and a resident co-operative society opting for Section 115BAD or Section 115BAE shall not be allowed to carry forward the AMT credit lying unutilized, consequent to exercise of such option.

2.18 DOUBLE TAX AVOIDANCE AGREEMENT (DTAA) (CONCEPT OF MULTILATERAL INSTRUMENTS AND PERMANENT ESTABLISHMENT)

The mechanism for levy of tax on the income of a person differs from country to country. Generally, countries follow the principle of residence-based taxation or source-based taxation for levy of income tax. The principle of 'Residence Based Taxation' gives primary taxing rights to the country of residence of the assessee whereby the worldwide income of an assessee is taxed in the country in which he is a resident. The 'Source-Based Taxation' rule confers the right to tax a particular income to the country where the source of the said income is located. To elaborate, the source State seeks to tax the income within its territory even when such income belongs to a person who is not the resident of such State. India follows the dual approach whereby, on one hand, a person resident in India is liable to pay tax in India on his total global income. On the other hand, a person, who is non-resident in India during the year, is liable to pay tax only on his Indian income.

[22] The rate shall be 9% in case of a unit in an IFSC deriving income solely in convertible foreign exchange.
[23] With effect from Assessment Year 2023-24, the rate shall be 15% in case of co-operative society.

Because of these taxation principles, it might be possible that the same income of a person is charged to tax in two different countries, *that is*, residence country as well as source country which gives rise to double taxation of income.

For example, Mr A, a resident of India, has a house property in the USA which is being let-out for Rs. 1,00,000 per month. Mr A does not have any other income in India as well as in the USA.

In this case, as Mr A is a resident of India, he shall be liable to pay tax in India on his worldwide income. Thus, rental income shall be charged to tax in India even though the source of income, i.e., the property is located in the USA. Similarly, the USA may also impose a tax on such income if it applies the concept of source-based taxation. Thus, the same income may be taxed in both countries resulting in double taxation of income.

To avoid double taxation of income, countries enter into Double Taxation Avoidance Agreement (DTAA).

2.18-1. What is DTAA?

DTAA is an agreement entered into between two or more countries to avoid double taxation of income. With DTAA, countries can avoid double taxation by allocating the taxing rights or by giving credit for taxes paid in the source state by the residence state.

2.18-2. Types of DTAA

DTAAs are usually of the following types:

a) *Bilateral:* DTAAs which are entered into between two countries are called "Bilateral DTAA or Treaty". For example, DTAA between India and the USA.
b) *Multilateral:* Where DTAAs are entered into between more than two countries or groups of countries. Such DTAAs are called "Multilateral DTAA or Treaty". For example, DTAA among the Governments of SAARC member states, i.e., Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

2.18-3. Permanent Establishment

One of the essential terms that transpire in all the DTAAs is 'Permanent Establishment (PE)'. For taxability of business profits of a foreign enterprise in India, it must have a PE in India. Once it is established that a foreign enterprise has a PE in India then the source country is allowed to tax such foreign enterprise in respect of the amount of profit attributable to PE in India.

In DTAAs, PE is defined to mean a fixed place of business through which the business of the enterprise is wholly or partly carried on and it is broadly classified into the following categories:

a) Fixed Place PE

This refers to the place which is used by an enterprise for carrying out its business. The term "place of business" covers any premises, facilities, or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by the enterprise. Thus, the place of business must be at the disposal of the enterprise to constitute as Fixed Place PE. It may include "a place of management", "a branch", "an office", etc.

b) Construction PE

Construction PE arises when a building site or construction or installation project of an enterprise in the host country lasts for a specified period. The term "building site or construction or installation project" includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipelines and excavating and dredging. Additionally, the term "installation project" is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors.

c) Service PE

Service PE arises when an employee of a multinational enterprise renders services in the host country beyond a specified period and where such deputed employee continues to be on the payroll of the home country.

d) Agency PE

Agency PE arises when the agent is empowered to enter into or conclude the contracts and carry out jobs exclusively for its principal. The activities of a dependent agent may give rise to a PE for the principal. The dependency and obligation of the principal for all the acts of an agent shall determine the existence of an Agency PE based on the following facts:

- the agent has or habitually exercises an authority to conclude contracts on behalf of the principal; or
- the agent habitually secures orders in the host country, wholly or principally for the enterprise itself or for its associated enterprises.

Just because a company is a subsidiary in the host country of the holding company by reason of ownership, there will be no agency relationship. Any person who does activities independently shall not be considered as an agent of a principal. Hence, an independent contractor shall not form an agency PE.

2.19 GENERAL ANTI-AVOIDANCE RULES (GAAR)

2.19-1. What is GAAR?

GAAR is an anti-tax avoidance regulation codified in the Income-tax Act to counter aggressive tax planning arrangements which have an impact on eroding India's tax base. These provisions empower the Indian revenue authorities to declare an arrangement as an "impermissible avoidance arrangement" if the main purpose of the agreement is to obtain a 'tax benefit', and the arrangement lacks or is deemed to lack commercial substance.

2.19-2. What is Impermissible Avoidance Arrangement?

An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it:

a) creates rights or obligations, which are not ordinarily created between persons dealing at arm's length;
b) results in the misuse or abuse of provisions of Income-tax Act;
c) lacks commercial substance or deemed to lack commercial substance;
d) is entered into or carried out by means or in a manner which is not ordinarily employed for *bona fide* purposes.

2.19-3. Arrangements lacking commercial substance

An arrangement shall be deemed to lack commercial substance, if:

a) the substance or effect of the arrangement as a whole is inconsistent with, or differs significantly from, the form of its individual steps or a part; or
b) it involves or includes:
   - round trip financing;
   - an accommodating party;
   - elements that have an effect of offsetting or cancelling each other; or
   - a transaction which is conducted through one or more persons and disguises the value, location, source, ownership, or control of funds which is the subject matter of such transaction; or
c) it involves the location of an asset or a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit for a party; or

d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained.

2.19-4. What is round trip financing?

Round trip financing includes any arrangement in which, through a series of transactions:

a) funds are transferred among the parties to the arrangement; and
b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit without having any regard to:
   - whether or not the funds involved in the round-trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;
   - the time, or sequence, in which the funds involved in the round-trip financing are transferred or received; or
   - the means by, or manner in, or mode through, which funds involved in the round-trip financing are transferred or received.

2.19-5. Consequences of GAAR

If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences in relation to tax or benefit under a tax treaty can be determined by the assessing officer in such a manner as is deemed appropriate in the circumstances of the case. The consequences can be as follows:

a) disregarding or combining or re-characterising any step of the arrangement;
b) treating the impermissible avoidance arrangement as if it had not been entered into;
c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;
d) reallocating expenses and income between the parties to the arrangement;
e) relocating place of residence of a party, or location of a transaction or situs of an asset to place other than provided in the agreement;
f) considering or looking through any arrangement by disregarding any corporate structure;
g) re-characterising equity into debt or *vice versa*, capital receipt as revenue receipt or *vice versa*, and, any expenditure, deduction, or relief or rebate.

2.19-6. Non-applicability of GAAR provisions

The provisions relating to GAAR shall not apply to:

a) An arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed Rs. 3 crores;

b) A foreign institutional investor who has not taken benefit of the tax treaty and has invested in listed securities, or unlisted securities in accordance with SEBI guidelines;
c) A non-resident person who has made an investment by way of offshore derivative instruments or otherwise in a Foreign Institutional Investor; and
d) Any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received from the transfer of investments made before 01-04-2017.

2.20 KNOW ABOUT EEE, EET and ETE

EEE, EET and ETE are three basic terms which are commonly used in reference to tax-saving investments. Where 'E' denotes Exempt and 'T' denotes Taxable. Investment is generally made with an intention to grow the capital involving 3 stages:

Stage 1: When a person invests in any security.

Stage 2: When such investment yields interest or returns.

Stage 3: When a person transfers the security or withdraws the amount of principal *plus* interest.

So, if an investment provides tax benefit at all three stages, it will fall under the category of 'EEE' and here the exemption at the time of investment means such investments are eligible for deduction. The second exempt means that the return/interest on investment shall be exempt from tax. The third exempt means that no tax shall be levied at the time of transfer or at the time of withdrawal of principal or interest.

Similarly, if an investment provides tax benefit at the time of deposit and withdrawal but return on such investment is chargeable to tax then it will fall under the category of "ETE". Whereas, if an investment is chargeable to tax only at the time of transfer or withdrawal then it will fall under the category of "EET".

2.21 KNOW THE MAXIMUM MARGINAL RATE OF TAX (MMR)

Section 2(29C) of the Income-tax Act defines 'maximum marginal rate' as the rate of Income-tax (including surcharge and health & education cess) applicable in relation to the highest slab of income in the case of an individual, Association of Person or Body of Individual, as the case may be, as specified in the Finance Act of the relevant year. Thus, the Maximum Marginal Rate (MMR) shall be as under:

Particulars	*Rate (in %)*
Highest slab rate applicable in case of Individual	30
Add: Surcharge [(B) = (A) * 37%]	11.1

Add: Health & Education cess [(C) = {(A)+(B)} * 4%]	1.644
Maximum Marginal Rate (MMR)	**42.744**

2.22 EFFECTIVE RATE OF TAX

The term 'effective tax rate' is not defined under the Income-tax Act. In general, effective tax rate means a rate inclusive of surcharge and health and education cess which is leviable on the income of an assessee. The effective tax rate can be computed with the help of the following formulae:

Effective tax rate = Applicable tax rate × (1 + Rate of Surcharge) × (1 + Rate of health and education Cess)

Example: Effective tax rate in case of a partnership firm having income in excess of Rs. 1 crore would be 34.944% [30% x (1 + 12%) x (1 + 4%)]

In case of an individual, who is liable to pay tax as per slabs, the effective tax rate shall be total income-tax as a percentage of total taxable income.

Example: Effective tax rate in case of an individual having an income of Rs. 20 lakhs would be 21.45% [Rs. 4,29,000/Rs. 20,00,000]

2.23 KNOW ABOUT TAX ALPHA

Tax Alpha is a concept that adds value to a person's portfolio by implementing sound tax strategies. "Tax alpha" makes sure that taxes do not unnecessarily eat away the wealth of a person. The basic objective of Tax alpha is to maximize after-tax returns.

Review Questions:

1. According to the Income-tax act, 1961 'assessment Year' ________.

(a) Starts from April 1 every year & ends on March 31 next year

(b) Starts from January 1 and ends on December 31

(c) Starts from June 1 every year & ends on May 31 next year

(d) Starts from Sept. 1 every year & ends on Aug. 31 next year

2. Which one of these is a person as per Income-tax Act, 1961?

(a) Hindu undivided family (HUF)

(b) Company

(c) Local authority

(d) All of these

3. In case of a Non-resident which of these is NOT taxable?

(a) Income received or is deemed to be received in India

(b) Income accrues or arises or is deemed to accrue or arise in India

(c) Income accrues or arises outside India if it is derived from a business controlled in India or from a profession set up in India

(d) None of these

4. According to the Income-tax act, 1961 Salary includes which of the following?

(a) Wages

(b) Annuity

(c) Pension

(d) All of these

CHAPTER 3: CAPITAL GAINS

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Capital Assets
- Transfer of capital asset
- Transactions not regarded as transfer
- Tax aspects regarding Gifts and Inheritances (Cost of acquisition)
- Computation of Capital Gains

Any income arising from transfer of a capital asset is chargeable to tax under the head 'Capital Gains'. A capital asset is defined under Section 2(14) of the Income-tax Act. It includes every property held by the assessee, whether movable or immovable. It is bifurcated into short-term capital asset and long-term capital asset on the basis of the period of holding. This distinction is made because the incidence of tax is higher on short-term capital gains as compared to long-term capital gains.

3.1 WHAT ARE CAPITAL ASSETS?

3.1-1. Meaning of Capital Asset

As per Section 2(14) of the Income-tax Act, capital asset means:

a) Property of any kind, held by an assessee, whether or not connected with his business or profession;
b) Any securities held by a Foreign Institutional Investor (FII)[24] which has invested in such securities in accordance with the SEBI Regulations.
c) Any Unit Linked Insurance Policy ('ULIP') to which exemption under section 10(10D) does not apply on account of applicability of *fourth and fifth proviso* thereof[25] (hereinafter referred to as 'high premium ULIP').

3.1-2. Specific inclusions

All kind of properties, whether movable, immovable, tangible or intangible including rights of management or control of an Indian company is a capital asset. Thus, a capital asset includes business undertaking, partner's share in a firm, a route permit, a leasehold right, right to get conveyance executed, right to subscribe shares of a

[24] The concept of Foreign Institutional Investor (FII) has been substituted by Foreign Portfolio Investor (FPI) by SEBI (Foreign Portfolio Investors) Regulations, 2014 which has also been substituted by the SEBI (Foreign Portfolio Investors) Regulations, 2019.

[25] Inserted by the Finance Act 2021 with effect from Assessment year 2021-22

company, goodwill, license to manufacture, gold, Jewellery, securities, etc.

3.1-3. Exclusions

The following assets have been excluded from the definition of capital assets.

3.1-3a. Stock-in-trade

Any stock-in-trade, consumable stores or raw material held for the purpose of business or profession have been excluded from the purview of capital asset. Any surplus arising from the sale of stock-in-trade or raw material or consumables is chargeable to tax as business income under the head 'Profits and Gains from Business or Profession'. However, stock-in-trade does not include the securities held by FPI.

3.1-3b. Personal Effects

Movable property held for personal use of the assessee or any member of his family, dependent on him, is not treated as a capital asset. *For example*, wearing apparel, furniture, car, scooter, TV, refrigerator, musical instruments, gun, revolver, generator, etc., are personal effects, thus, they are not treated as capital assets.

An article is considered as personal effects if it is intended for personal or household use by the assessee and not merely because these articles are capable of being put to personal or household use. All personal effects need not be used daily. So long as they are meant for personal use, they are considered as personal effects.

However, the following assets, even if they are meant for personal use, shall not be considered as personal effects and any gain arising from their sale shall be charged to tax:

a) Jewellery (including ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals whether or not worked or sewn into any wearing apparel);
b) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;
c) Archaeological collections;
d) Drawings;
e) Paintings;
f) Sculptures;
g) Any work of art.

3.1-3c. Agricultural land in India

Any agricultural land situated in any rural area in India is not a capital asset. Thus, the following agricultural lands shall be considered as capital assets:

a) Agricultural land situated in an urban area in India or within the prescribed limits from municipalities;
b) Agricultural land situated in any foreign country.

3.1-3d. Bonds

Following Bonds have been excluded from the purview of capital asset:

a) 6.5% Gold Bonds, 1977
b) 7% Gold Bonds, 1980
c) National Defense Gold Bonds, 1980
d) Special Bearer Bonds, 1991
e) Gold Deposit Bonds issued under Gold Deposit Scheme, 1999.
f) Deposit certificates issued under the Gold Monetization Scheme, 2015

3.2 TYPES OF CAPITAL ASSET

To compute capital gain, capital assets are classified into short-term capital assets or long-term capital assets. This distinction is important as the incidence of tax is higher on short-term capital gains as compared to the long-term capital gains. The distinction between a long-term and short-term capital asset is based on the period for which an asset is held by the owner before transfer.

3.2-1. Short-term Capital Asset

In general, a capital asset is deemed as 'short-term' if it is held by an assessee for a period of not more than 36 months, immediately preceding the date of its transfer. The general rule has a few exceptions wherein an asset, held for not more than 12 months or 24 months, are treated as short-term capital asset. These exceptions are explained below.

3.2-1a. Exception 1: 24 months period

Following capital assets are treated as short-term capital asset if they are held for not more than 24 months immediately preceding the date of transfer:

a) Unlisted shares of a company (equity shares or preferences shares);
b) An immovable property, being land or building or both.

3.2-1b. *Exception 2: 12 months period*

Following capital assets are treated as short-term capital asset if they are held for not more than 12 months immediately preceding the date of transfer:

a) Listed Shares of a company (i.e., equity shares or preference shares);
b) Listed securities other than a unit (i.e., Debentures, Bonds, Derivatives, Government securities etc.);
c) Units of UTI (Listed or Unlisted);
d) Units of Equity Oriented Fund (Listed or Unlisted);
e) Zero-Coupon Bonds (Listed or Unlisted);
f) High Premium Equity Oriented ULIP[26].

3.2-1c. *Exception 3: No criteria of period of holding*

Irrespective of the period of holding, a depreciable asset is always treated as a short-term capital asset. The calculation of capital gains in case of depreciable asset shall be done in accordance with the provisions of Section 50 of the Income-tax Act.

Further, irrespective of the period of holding, the capital gains arising from the transfer, redemption or maturity of Market Linked Debentures (MLDs) or Specified Mutual Funds (SMFs) shall be taxable as short-term capital gains. Section 50AA[27] contains provisions for the computation of capital gains arising from the transfer, redemption or maturity of MLD or SMF (*Refer Para 5.8-4*).

3.2-2. Long Term Capital Asset

In general, a capital asset is considered as 'long-term' if it is held by an assessee for a period of more than 36 months, immediately preceding the date of its transfer. The general rule has a few exceptions wherein an asset, held for not more than 36 months but more than 12 or 24 months, are treated as long-term capital asset. These exceptions are explained below.

3.2-2a. *Exception 1: 24 months period*

Following capital assets are treated as long-term capital asset if they are held for more than 24 months immediately preceding the date of transfer:

a) Unlisted Shares of a company (equity shares or preferences shares);

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[26] ULIP to which exemption under section 10(10D) does not apply on account of applicability of *fourth and fifth proviso* thereof.

[27] Inserted by the Finance Act 2023 with effect from assessment year 2024-25.

b) An immovable property, being land or building or both.

3.2-2b. Exception 2: 12 months period

Following capital assets are treated as long-term capital asset if they are held for more than 12 months immediately preceding the date of transfer:

a) Listed Shares of a company (i.e., equity shares or preference shares);
b) Listed securities other than a unit (i.e., Debentures, Bonds, Derivatives, Government securities etc.);
c) Units of UTI (Listed or Unlisted);
d) Units of Equity Oriented Fund (Listed or Unlisted);
e) Zero-Coupon Bonds (Listed or Unlisted);
f) High premium Equity Oriented ULIP.

3.2-3. Overview

Nature of Security	*Holding should be more than the following period to be treated as a long-term capital asset*	
	Listed Securities	*Unlisted Securities*
Equity Shares	12 months	24 months
Units of Equity Oriented Funds	12 months	12 months
Units of UTI	12 months	12 months
Units of Business Trust	36 months	36 months
Other Units	36 months	36 months
Preference Shares	12 months	24 months
Debentures	12 months	36 months
Government Securities	12 months	36 months
Zero-coupon bonds	12 months	12 months
Other Bonds or securities	12 months	36 months
Immovable property (Land and building both)	24 months	
High Premium Equity Oriented ULIP[28]	12 months	
Any other asset	36 months	
Note: Market linked debentures (MLDs), specified mutual funds (SMFs) and depreciable assets are always treated as short-term capital assets irrespective of the period of holding.		

3.3 HOW TO CALCULATE THE PERIOD OF HOLDING?

The period of holding of a capital asset is calculated from the date of its purchase or acquisition till the date of its transfer. However, in certain cases, the period of holding

[28] ULIP to which exemption under section 10(10D) does not apply on account of applicability of *fourth and fifth proviso* thereof.

of a capital asset is determined in accordance with special provisions which are enumerated in the following table:

Type of Security	***Period of holding***	***For taxability, Refer***
Listed Shares sold through a broker	Date of broker's note to be considered as date of purchase and sale provided it is followed by delivery of shares and transfer of deed.	Para 6.2-4a
Listed shares transferred directly between parties (not through stock exchange)	Period of holding to be counted from date of purchase to date of contract of sale as declared by the parties provided it is followed by actual delivery of shares and transfer deed.	Para 6.2-4a
Securities held in Demat form	Period of holding is determined as per First-in-First-out (FIFO) method, i.e., the securities that first entered into the Demat account is deemed to be the first sold out.	Para 6.2-4b
Bonus shares	Period of holding is reckoned from the date of allotment of bonus shares.	Para 12.1-2a
Sweat Equity shares or ESOPs	Period of holding is reckoned from the date of allotment of Sweat equity shares or shares issued on exercise of ESOPs.	Para 7.1-4b
Conversion of preference shares into equity shares	The period for which the preference shares were held by the assessee is also included in the period of holding equity shares.	Para 12.9
Conversion of bonds/ debentures/ debenture-stock /deposit certificates into shares or debentures of that company	The period of holding of the original asset shall also be taken into consideration while determining the period of holding of converted assets.	Para 5.4
Right Shares	Period of holding is counted from the date of allotment of right shares.	Para 12.5
Renouncement of right to subscribe to shares or any other security of a company	Period of holding is reckoned from the date of offer made by the company to the date of renouncement.	Para 12.5
Shares of a company in liquidation	Period subsequent to the date on which the company goes into liquidation is excluded while computing the period of holding	Para 12.4

Shares of an amalgamated company	Period of holding of the original shares, held in the amalgamating company, is also included in computing the period of holding of the shares in the amalgamated company.	Para 12.6
Shares of a resulting company in case of demerger	Period of holding is counted from the date of holding of the shares in the demerged company and not from the date of allotment of the shares in the resulting company.	Para 12.6
Acquisition by operation of law in the circumstances specified in Section 49(1) *[See Note 1]*	Period of holding of the last previous owner who acquired the asset by way of purchase is also included to determine the period of holding by the assessee.	-
Conversion of stock into capital asset	Period of holding shall be reckoned from the date of conversion.	Para 12.10
Trading or clearing rights or equity shares acquired on demutualization or corporatization of recognised stock exchange in India	The period for which a person was a member of the recognised stock exchange, immediately prior to such demutualization or corporatization, is also included to determine the period of holding.	-
Units of business trust allotted on account of transfer of shares of special purpose vehicle (SPV).	The period for which the shares of SPV were held is also included in counting the period of holding of the units of business trust.	Para 7.4 and 7.5
Consolidation scheme of mutual fund	The period for which units were held under consolidating scheme shall also be included.	Para 12.8
Consolidation plan of mutual fund	The period for which units were held under consolidating plan shall also be included.	Para 12.11
Segregation of portfolio of mutual fund	The period for which original units were held in the main portfolio shall also be included.	Para 12.10
Shares of a company acquired by a non-resident on redemption of Global Depository Receipts (GDRs)	Period of holding of shares shall be counted from the date on which a request for redemption of GDRs was made.	Para 6.5-1e

Gold converted into an Electronic Gold Receipt (EGR) and vice-versa	The period for which the Gold was held before converting into EGR shall be included for computing the period of holding of the EGR and vice-versa	-

Note 1:

Circumstances specified in section 49(1) are as follows:

(a) Distribution of assets on total or partial partition of an HUF;
(b) Under a gift or will;
(c) By way of succession, inheritance or devolution;
(d) Distribution of assets on dissolution of a firm or BOI or AOP before April 1, 1987;
(e) Distribution of assets on liquidation of a company;
(f) Transfer to a revocable or irrevocable trust;
(g) Acquisition by Indian parent company from its wholly-owned subsidiary company;
(h) Acquisition by wholly-owned Indian subsidiary company from its parent company;
(i) Transfer of capital asset in a scheme of amalgamation, demerger or business reorganization if such transfer is in accordance with the prescribed conditions;
(j) Transfer of capital asset on conversion of firm or sole proprietorship into a company if such transfer is in accordance with the prescribed conditions;
(k) Any transfer of capital asset on demutualisation or corporatization of recognized stock exchange in India;
(l) Any transfer of capital asset by a company on its conversion into LLP, if such transfer is in accordance with the prescribed conditions;

3.4 TRANSFER OF CAPITAL ASSET

In general sense, the expression ‘transfer’ of property connotes the passing of a property or rights in a property from one person to another. The meaning of transfer has been defined under Section 2(47) of the Income-tax Act. It includes various means by which the property may be passed from one person to another which would get covered under the definition of ‘transfer’. Following are some of the examples of transfer of asset:

3.4-1. Sale of asset

The word ‘sale’ construes a transaction voluntarily entered into between two persons, commonly known as the buyer and seller, by which the buyer acquires property of the seller for an agreed consideration, commonly known as ‘price’.

3.4-2. Exchange of asset

Under Section 118 of the Transfer of Property Act, 1882, 'exchange' is defined to mean when two persons mutually transfer the ownership of one thing for the ownership of another thing, neither thing nor both things being money only.

Receipt of shares of a company in exchange of shares of another company at the time of business reconstruction which are not otherwise excluded from the definition of transfer will be covered in the definition of exchange of asset.

3.4-3. Relinquishment of asset

The word 'relinquishment' has not been defined in the Act. A relinquishment is said to have taken place when the owner withdraws himself from the property and abandons his/her rights thereto.

For example, Mr A and Mr B entered into a partnership and contributed some assets. After 2 years, Mr A retired from such a firm and relinquished his rights and interest in such property in favour of Mr B. In this case, such relinquishment of rights would amount to transfer and chargeable to tax under the head capital gains.

3.4-4. Extinguishment of rights

The word 'extinguishment' has also not been defined in the Act. It refers to the case where the rights of a person in a capital asset have been extinguished and not the extinguishment of the capital asset as such. If the asset has irretrievably lost, it cannot be said that the assessee suffered loss under the head 'capital gains'. The extinction or loss of the asset does not fall within the import of the expression 'extinguishment of the right'.

Reduction of share capital by a company amounts to extinguishment and constitutes transfer. After reduction of the share capital, though the shares remain the right of the shareholder to dividends or right to share in the distribution of the net assets upon liquidation of the company gets extinguished proportionately to the extent of reduction in the capital. If distribution in the event of reduction of share capital is over and above the accumulated profits of the company (whether capitalized or not), such excess would be considered a capital receipt in the hands of the shareholder, giving rise to capital gain. When the capital receipt is in excess of the original cost of acquisition of that interest which stands extinguished, there is a capital gain.

3.4-5. Conversion of asset into stock-in-trade

When a person converts or treats his capital asset as stock-in-trade of a business, such conversion is considered as a transfer of capital asset during the previous year in which such conversation took place.

For example, an investor introduces his personal investment in shares, securities and immovable property as stock-in-trade of his business, it will be deemed that he has transferred his capital asset even though the assets still belong to him.

Such conversion of capital asset would require computation of gains or loss in accordance with the provisions of Section 45 of the Act. The resultant gain or loss shall be taxable under the head capital gains. However, the liability to pay tax on such capital gain shall arise in the previous year in which stock-in-trade is sold or otherwise transferred. If stock-in-trade is sold in parts in different years, tax on capital gain computed at the time of conversion shall be deemed to arise in parts in different years and not in one year in which the first or last lot of stock-in-trade is sold. The Fair market value of such asset on the date of conversion shall be deemed to be its full value of consideration. In view of Section 2(22B), the fair market value of such capital asset means the price it would ordinarily fetch on sale in the open market on the date of conversion. Therefore, in the year of actual sale of stock in trade, the difference between the FMV on the date of conversion and original cost of acquisition of asset (subject to *second proviso* to Section 48, *that is*, indexation of cost of acquisition) shall be taxed as capital gain and the difference between actual sale proceeds and FMV on the date of conversion will be taxed as profits and gains of business and profession.

3.4-6. Maturity or redemption of zero-coupon bonds

Redemption or maturity of a zero-coupon bond, issued by, for example, any infrastructure capital company or infrastructure capital fund will be treated as transfer.

3.4-7. Indirect transfer

'Transfer' shall also include transfer of shares or interest in a foreign company or entity which derives its value substantially from the assets, located in India. Such transaction shall fall under the definition of transfer even if it takes place between non-resident persons or entity.

However, this provision does not apply where such asset or capital asset is held by a non-resident by way of investment, whether directly or indirectly, in Category-I FPI. As a result, no income shall be deemed to accrue or arise in India in the hands of a non-resident who transfers his investment in Category-I FPIs even if such investment derives its value from the assets located in India (i.e., shareholding of FPIs in Indian Companies). Here it is to be noted that the exemption has been provided to a non-resident who invests in FPIs and not to FPIs themselves. Hence, if FPIs transfer their shareholding in an Indian company to someone else then they shall be liable to pay capital gain tax in India.

Share or interest shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if the following two conditions are satisfied:

(a) The value of such assets exceeds the amount of ten crore rupees; and
(b) The value of such assets represents at least 50% of the value of all the assets owned by the company or entity, as the case may be.

Disposing off or parting with the shares of a company registered or incorporated outside India would be regarded as transfer if the above conditions are satisfied.

3.5 TRANSACTIONS NOT REGARDED AS TRANSFER

The Income-tax Act has listed certain transactions which are not regarded as transfers for the purpose of capital gains. Consequently, no capital gain may arise from such transfers. These transactions are listed in Section 46 and 47, enumerated below.

3.5-1. Lending of securities

Under the Securities Lending Scheme of SEBI, a person can lend his securities to a borrower through an approved intermediary for a specified period with the condition that the borrower would return equivalent securities of the same type or class at the end of the specified period along with interest. The CBDT has clarified[29] that any lending of scrips or security is not treated as a transfer even if the lender does not receive back the same distinctive numbers of scrip or security certificate. Hence, such transaction shall not be subject to capital gains tax.

3.5-2. Rollover of fixed maturity plans

Fixed Maturity Plans ('FMP') are closed-ended funds having a fixed maturity date wherein the duration of investment is decided upfront. The funds collected by FMPs are invested by the Asset Management Companies (AMCs) in securities having a similar maturity period. To enable the FMPs to qualify as a long-term capital asset, some AMCs administering mutual funds offer extension of the duration of the FMPs to a date beyond 36 months from the date of the original investment by providing to the investor an option of roll-over of FMPs. The CBDT has clarified[30] that the rollover of FMPs in accordance with the SEBI regulation will not amount to transfer as the scheme remains the same.

[29] Circular No. 751, dated February 10, 1997
[30] Circular No. 6/2015, dated April 9, 2015

3.5-3. Distribution in case of liquidation

Any distribution of assets in kind by a company to its shareholders at the time of liquidation is not treated as transfer of an asset by the Company. However, in this case, the shareholders are liable to pay tax on any capital gains arising therefrom in accordance with Section 46.

3.5-4. Gift, will or irrevocable trust

Any transfer of a capital asset under a gift or will or an irrevocable trust is excluded from the ambit of transfer, except shares, debentures or warrants allotted by a company directly or indirectly to its employees under any Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with prescribed guidelines.

3.5-5. Transfer between holding and subsidiary company

Any transfer of a capital asset by a holding company to its Indian subsidiary company or by a subsidiary company to its Indian holding company is not regarded as a transfer provided the specified conditions in respect of such transaction are satisfied.

3.5-6. Transfer in business restructuring

Any transfer of capital assets in a scheme of amalgamation/ demerger/ re-organization of co-operative banks to a successor co-operative bank or converted Banking company is not considered as transfer provided the specified conditions are satisfied.

In addition to this, any transfer of shares held as capital asset by the shareholder of a predecessor co-operative bank in consideration of the allotment of any shares in the successor co-operative bank or to the converted banking company will also not regarded as a transfer[31].

3.5-7. Transfer among non-residents

Transfer of the following securities by a non-resident to another non-resident is not charged to capital gains:

a) Transfer of bonds or GDR of an Indian company or public sector company as referred under Section 115AC by a non-resident to another non-resident outside India;
b) Transfer of Rupee Denominated Bond of an Indian company by one non-resident to another non-resident outside India;
c) Transfer of bonds, GDR, Rupee Denominated Bond, derivative, foreign currency-denominated bond, unit of a Mutual Fund, unit of a business trust, foreign currency-denominated equity shares of a company, unit of Alternative Investment Fund or

[31] Amended by Finance Act, 2021 with effect from Assessment year 2021-22

Bullion Depository Receipt with underlying bullion, by a non-resident on a recognised stock exchange located in any International Financial Services Centre provided the consideration is paid or payable in foreign currency; or

d) Transfer of Government Security, carrying periodic payment of interest, outside India through an intermediary dealing in settlement of securities by a non-resident to another non-resident.

3.5-8. Conversion of securities

The following conversion of securities shall not be deemed as transfer of securities:

a) Conversion of bonds, debentures, debenture-stock or deposit certificate of a company into shares or debentures of that company;
b) Conversion of Foreign Currency Exchange Bonds (FCEB), issued to non-residents by Indian companies, into shares of any company; and
c) Conversion of preferences shares into equity shares of that company.

3.5-9. Succession of entities

Transfer of securities in succession or conversion of entities in the following scenarios shall not be deemed as transfer, provided prescribed conditions are satisfied:

a) Succession of a partnership firm by a company;
b) Succession of a sole proprietary concern by a company;
c) Conversion of a private company or unlisted public company into a limited liability partnership ('LLP'); or
d) Where an AOP or BOI transfers any capital asset to a company in the course of demutualization or corporatization of a recognised stock exchange in India.

3.5-10. Redemption of sovereign gold bonds

Redemption of Sovereign Gold Bond, issued by the RBI under the Sovereign Gold Bond Scheme, by an individual will not be regarded as transfer.

3.5-11. Transfer of shares of Indian co. to business trust

Where shares of an Indian company, being Special Purpose Vehicle (SPV), is transferred to a business trust in exchange of units allotted by that trust to the transferor, it is not treated as transfer for the purposes of capital gains.

3.5-12. Transfer of interest in a Joint Venture by a public sector company

Transfer of interest in a joint venture by a public sector company in exchange for shares of a foreign company incorporated by the Government of a foreign state is not treated as transfer[32].

'Joint venture' shall mean a business entity, as may be notified by the Central Government.

3.5-13. Transfer of membership rights of stock exchange

Where a member of recognised stock exchange in India transfers membership right for acquisition of shares and trading or clearing rights in that stock exchange in accordance with a scheme for demutualisation or corporatisation, duly approved by the SEBI, such transaction is not treated as transfer.

3.5-14. Consolidation of mutual fund

To promote consolidation of different similar scheme of transfer of mutual fund, Income-tax Act provides that consolidation of units shall not be treated as transfer.

3.5-15. Relocation of offshore fund to IFSC

Transfer of capital asset by an original fund to resultant fund in pursuance of its relocation is not regarded as transfer for the purpose of computing capital gain. In addition to this, transfer of shares, unit or interest held by an investor in original fund in consideration of share, unit or interest in resultant fund is also not regarded as transfer (for the meaning of 'original fund', 'relocation' and 'resultant fund' see para 11.6-13) [33].

3.5-16. Conversion of Gold into Electronic Gold Receipt or vice versa

Conversion of Gold into Electronic Gold Receipt (EGR) issued by a vault manager, or conversion of EGR into Gold, is not treated as transfer for the purpose of computing capital gain[34].

"Electronic Gold Receipt (EGR)" is an electronic receipt which is issued based on the deposit of underlying physical gold in accordance with the regulations made by the Exchange. EGR is covered under the definition of securities[35].

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[32] Inserted by the Finance Act, 2023 with effect from assessment year 2023-24.
[33] Inserted by Finance Act, 2021 with effect from Assessment year 2022-23
[34] Inserted by the Finance Act, 2023 with effect from assessment year 2024-25.
[35] Regulation 2(1)(h) of the SEBI (Vault Managers) Regulations, 2021 read with Notification No. S.O. 5401(E), dated 24.12.2021 issued in exercise of the powers conferred by Section 2(h)(iia) of section 2 of the Securities Contracts (Regulation) Act, 1956.

"Vault Manager" means any person who stores and safe keeps gold deposited by the depositor, for the purpose of trading in Electronic Gold Receipt and providing services incidental thereto[36].

3.6 COMPUTATION OF CAPITAL GAINS

Any profit or gain arising from transfer of a capital asset is taxable on an accrual basis during the previous year in which such transfer takes place. The mechanism for computation of capital gain from transfer of a short-term capital asset is different from the one applicable in case of long-term capital asset. In case of a long-term capital asset, the indexation benefit is allowed except in a few cases.

3.6-1. In case of short-term capital gains

Particulars	*Rs.*
Full value of consideration	xxx
Less:	
a) Expenditure incurred wholly and exclusively in connection with transfer	(xxx)
b) Cost of acquisition	(xxx)
c) Cost of improvement	(xxx)
d) Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution[37]	(xxx)
e) Exemption under Sections 54B, 54D, 54G and 54GA	(xxx)
Short-term capital gain or loss	**xxx**

3.6-2. In case of long-term capital gains

Particulars	*Rs.*
Full value of consideration	xxx
Less:	
a) Expenditure incurred wholly and exclusively in connection with transfer	(xxx)
b) Indexed cost of acquisition	(xxx)
c) Indexed cost of improvement	(xxx)
d) Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution[38]	(xxx)
e) Exemption under Sections 54 to 54GB	(xxx)

[36] Regulation 2(1)(l) and 2(1)(m) of SEBI (Vault Managers) Regulations, 2021.
[37] Inserted by the Finance Act, 2021, with effect from Assessment Year 2021-2022
[38] Inserted by the Finance Act, 2021, with effect from Assessment Year 2021-2022

Long-term capital gain or loss	xxx

For the computation of capital gains, an assessee has to compute various figures which have been explained below.

3.6-3. Full value of consideration

The Act has not defined the term 'full value of consideration'. Therefore, it has to be understood in a commercial sense according to the prevalent usage. It is the amount of consideration received or receivable by the owner of asset in lieu of transfer of such assets. Such consideration may be received in cash or kind. If it is received in kind, then the fair market value of such assets received is taken as full value of consideration.

However, in the cases explained below, the full value of consideration shall be calculated in contrast to the general principle enumerated above.

Nature of security	***Full value of consideration***
Conversion of capital asset into stock-in-trade	Fair market value of capital asset on the date of conversion
Transfer of securities allotted under ESOPs as gift or under an irrevocable trust	Market value of such securities on the date of transfer
Redemption of rupee-denominated bonds by non-resident	An amount equal to the value of appreciation of rupee against a foreign currency from the date of issue to the date of redemption shall be excluded for the purpose of computing the full value of consideration.
Unquoted shares transferred for less than their fair market value	Fair market value of such shares on the date of transfer
Capital asset distributed on liquidation of company	Aggregate of money and market value of assets received by shareholder on liquidation *less* accumulated profits taxable as deemed dividend under section 2(22)(c)
Where the consideration for transfer is not ascertainable	Fair market value of asset on date of transfer
Receipt of capital asset by a partner or member in connection with reconstitution of Firm or other AOP or BOI (not being a company or a co-operative society)[39]	Fair market value of capital asset on the date of receipt
Transfer of capital asset by a Firm or other AOP or BOI (not being a company or a co-	Fair market value of capital asset on the date of receipt

[39] Inserted by the Finance Act, 2021 with effect from assessment Year 2021-22

operative society) to partner or member in connection with its dissolution or reconstitution[39]	

3.6-4. Expenditure incurred in connection with transfer

Any expenditure, incurred wholly and exclusively, in connection with transfer of a capital asset is allowed as a deduction in computing capital gain. Thus, the brokerage or commission, stamp duty, registration fee, travelling expenses and legal expenses, etc., incurred in connection with transfer are allowed to be deducted in computing capital gain. However, no deduction is allowed in respect of any sum paid on account of Securities Transaction Tax (STT), Commodities Transaction Tax (CTT) while calculating the capital gains from the sale of securities.

3.6-5. Cost of acquisition

As a general principle, the cost of acquisition of an asset is the value for which it was acquired by the assessee. It includes all expenses which are incurred by the assessee in acquiring the capital asset. However, in the following circumstances, the cost of acquisition of a capital asset shall be different from its actual cost.

Situation	***Cost of Acquisition***
Shares acquired by way of purchase on or after 01-04-2001	Price actually paid for acquisition (subject to certain exceptions, i.e., Section 112A, etc.)
Shares acquired on or before 31-03-2001	Price actually paid for the acquisition or Fair Market Value as on 01-04-2001, whichever is *higher*
Equity shares, units of equity oriented mutual fund or units of business trust (being long-term capital asset) chargeable to Securities Transaction Tax acquired on or before 31-01-2018 and sold after 01-04-2018	Higher of following: a) Actual cost of acquisition b) Fair Market value as on 31-01-2018 or full value of consideration, whichever is *lower*
Right Shares	Price actually paid for acquisition
Renouncement of right	*Nil*
Bonus share	If bonus shares issued on or before 31-03-2001: Fair Market value of the share as on 01-04-2001 If bonus shares issued on or after 01-04-2001: *Nil*
Sweat Equity Shares or shares allotted under ESOP	Fair Market Value of shares on the date of exercise of option

Units of business trust allotted in consideration of transfer of shares of special purpose vehicle (SPV)	Cost of acquisition of shares of SPV
Securities held in Demat Form	Security that first entered into the Demat account is deemed to be the first sold out, and, accordingly, cost of acquisition is computed.
Conversion of bonds/ debentures/ debenture-stock /deposit certificates into shares or debentures of that company	Cost of converted shares or debentures is taken at the price paid for the acquisition of original bonds, debentures or debenture certificate
Shares of a company acquired on redemption of Global Depository Receipts (GDRs) by non-resident	Price of such share prevailing on any recognized stock exchange on the date on which a request for redemption of GDRs was made
Conversion of preference shares to equity shares	Cost of acquisition of preference shares shall be deemed to be the cost of acquisition of equity shares.
Stock or share becoming property of the assessee on consolidation, conversion etc.	Cost of acquisition of the shares or stock from which such asset is derived
Consolidation of mutual fund scheme or plan	Cost of acquisition of units held in consolidating scheme or plan
Conversion of Gold into Electronic Gold Receipt (EGR)	Cost of acquisition of gold shall be considered as the cost of acquisition of such EGR
Conversion of EGR into Gold	Cost of acquisition of EGR shall be considered as the cost of acquisition of such gold
Segregation of portfolio of mutual fund	Amount which bears, to the cost of acquisition of a unit held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios. Further, the cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the cost of acquisition of units in the segregated portfolio
Allotment of shares of the amalgamated company in lieu of shares held in amalgamating company	Price paid for acquisition of shares in amalgamating company
Shares acquired in the resulting company in case of demerger	The cost of acquisition of shares held by the assessee in the demerged company in

	proportion to the net book value of assets transferred in demerger bear to the net worth of the demerged company, immediately before the specified date of demerger.
Shares remained in demerged company after demerger	Cost of acquisition of the shares held by the shareholders in the demerged company is reduced by the cost of acquisition of shares, acquired from resulting company
Shares transferred by holding company to a wholly-owned subsidiary or *vice-versa*	Cost of acquisition of such shares to subsidiary shall be the cost for which such shares was acquired by the holding company or *vice-versa*
Right of partner to share the profit and loss of LLP which become the property of assessee on conversion of Company into LLP	Cost of acquisition of such right is deemed to be the cost of acquisition of such share in the company immediately before its conversion.
Cost of acquisition by operation of law i.e. on Partition of HUF, under a gift or will, by succession, inheritance or devolution, Transfer of property by a member to HUF	Cost of acquisition of the previous owner. However, if such cost cannot be determined, cost of acquisition will be the fair market value of such asset on the date on which such asset was acquired by the previous owner.
Allotment of equity shares and right to trade in stock exchange, allotted to members of stock exchange under a scheme of demutualization or corporatization of stock exchanges in India as approved by SEBI	Cost of acquisition of shares: Cost of acquisition of original membership of stock exchange Cost of acquisition of trading or clearing rights of stock exchange: *Nil*
Stock-in-trade converted into capital asset	Fair market value of stock on the date of conversion
Shares of a company in Liquidation	Cost of acquisition shall be computed as per general provisions contained in Section 48. However, if such shares were subscribed by a non-resident in foreign currency, the cost of acquisition shall be converted into Indian rupees in accordance with the provisions of *First Proviso* to Section 48 or Rule 115A, as the case may be.
Receipt of capital asset or money or both by a partner or member in connection with reconstitution of Firm	Balance in the capital account of partner or member (represented in any manner) in the books of account of the firm or AOP or BOI at the time of its reconstitution. However, the increase in the capital account due to revaluation of any

or other AOP or BOI (not being a company or a co-operative society)[40]	asset or due to self-generated goodwill or any other self-generated asset shall be ignored.

3.6-6. Indexed cost of acquisition

The Indexed Cost of acquisition shall be calculated in a two-step process. The first step is to calculate the cost of acquisition of capital asset. In the second step, such cost of acquisition is multiplied by the CII of the year in which capital asset is transferred and divided by CII of the year in which asset is first held by the assessee or CII of 2001-02, whichever is later (Refer *Annexure-I* for Notified CII).

$$\textit{Indexed Cost of Acquisition} = \textit{Cost of Acquisition} \times \frac{\textit{CII of the year in which asset is transferred}}{\textit{CII of the year in which asset is first held by assessee or CII of 2001-02, whichever is later}}$$

3.6-6a. When Indexation benefit is not available?

The benefit of indexation shall not be available in the respect of the following long-term capital assets:

a) Equity shares, units of equity oriented mutual funds, high premium ULIPs or units of business trust chargeable to Securities Transaction Tax, if the resultant capital gain is taxable under Section 112A;
b) Bond or debenture, except Capital Indexed Bonds issued by the Government and Sovereign Gold Bond issued by RBI;
c) Investment in Securities by Non-resident in Foreign Currency;
d) Depreciable assets;
e) Slump sale;
f) Units purchased in foreign currency by offshore funds;
g) Securities referred to in Section 115AD purchased by FPIs, Specified Category-III AIFs or Investment division of an offshore banking unit;
h) Foreign Currency Convertible bonds or GDRs, as referred under section 115AC, purchased in foreign currency;
i) Unlisted securities purchased by a non-resident; and
j) Global Depository Receipts issued to a resident employee as referred under Section 115ACA.
k) Specified Mutual Fund acquired on or after 01-04-2023[41];

[40] Inserted by the Finance Act, 2021 with effect from assessment Year 2021-22
[41] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25.

l) Market Linked Debenture[42]

3.6-7. Cost of improvement

'Cost of Improvement' means all expenditure of a capital nature incurred on or after 01-04-2001 in making any addition or alterations to the capital asset either by the assessee or the previous owner. Therefore, all capital expenditure incurred on or after 01-04-2001 shall be deducted while calculating the capital gains. In case capital asset is acquired by the assessee before 01-04-2001, any cost of improvement incurred prior to 01-04-2001, shall be ignored.

However, the cost of improvement in relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing or right to carry on any business or profession shall be taken to be nil. Further, in relation to the Market Linked Debentures (MLDs) or Specified Mutual Funds (SMFs), the cost of improvement is not allowed to be deducted, notwithstanding whether it has been incurred by the assessee himself or by the previous owner.

Further, cost of improvement shall not include such expenditure which is deductible in computing the income chargeable under the head 'Income from House Property', 'Profits and Gains of Business or Profession', or 'Income from Other Sources'.

3.6-8. Indexed cost of improvement

The Indexed Cost of improvement shall be calculated in the same manner in which indexed cost of acquisition is computed.

3.6-9. Conversion of capital gain earned in foreign currency into Indian rupees

If any income accrues or arises to a resident or non-resident person in foreign currency, it shall be translated into Indian Rupees. The translation shall be done as per the conversion rate prevalent on the relevant dates, as prescribed.

3.6-9a. In case of capital gains earned by the Non-resident Investors from shares or debentures of an Indian company

Where a non-resident assessee (except FII) acquires shares or debentures of an Indian company in foreign currency, the capital gain arising from the transfer of such shares or debentures shall be first computed in the foreign currency in which such security is purchased, then it shall be converted into Indian currency. This provision of computation of capital gain shall be applicable in respect of capital gain accruing or arising from sale of every re-investment thereafter in shares or debentures of an Indian company. However, this provision

[42] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25.

shall not apply for the computation of capital gain arising from the transfer of Market Linked Debentures (MLDs).

Different provisions have been prescribed by Rule 115A for conversion of cost of acquisition, expenditure in connection with transfer and the capital gains. These provisions shall apply to every re-investment of sale consideration into shares or debenture of an Indian company. These provisions have been explained below.

1. Sales Consideration

The sales consideration shall be converted at the average rate of foreign currency as on the date of transfer. Average rate is computed by dividing the aggregate of Telegraphic Transfer (TT) buying and selling rate as adopted by the State Bank of India (SBI).

2. Cost of Acquisition

The cost of acquisition shall be converted into foreign currency at the average rate of foreign currency as on the date of acquisition of share or debenture. Average rate is computed by dividing the aggregate of TT buying and selling rate as adopted by the SBI. In this case, the benefit of indexation shall not be available.

3. Expenditure in connection with transfer

The expenditure incurred wholly and exclusively in connection with transfer of the capital asset shall be converted at the average rate of foreign currency as on the date of transfer. Average rate is computed by dividing the aggregate of Telegraphic Transfer (TT) buying and selling rate as adopted by the State Bank of India (SBI).

4. Capital Gains

The resultant capital gains computed in foreign currency shall be converted into INR at TT buying rate of such currency on the date of transfer of the capital asset.

3.6-9b. In case of other Capital Gains

The capital gains arising to a resident or non-resident person in foreign currency, in any other case, shall be converted into Indian Rupees at the telegraphic transfer buying rate of such currency as it existed on the last day of the month immediately preceding the month in which the capital asset is transferred.

For example, if on May 15, 2022 an Indian resident transfers a plot of land situated in Dubai, the capital gains arising therefrom shall be converted into Indian Rupee at the rate of exchange as it existed on April 30, 2022.

3.6-10. Exemption for capital gains

The Income-tax Act allows exemption from capital gains tax if the amount of capital gains or consideration, as the case may be, is further invested in specified new assets. These exemptions are subject to various prescribed conditions, which are briefly captured in the below table.

Section	*Eligible Assessee*	*Nature of Capital Asset*	*Nature of original asset*	*Nature of new asset*	*Time-limit allowed for investment*	*Capital gain account scheme applicability*	*Amount of exemption*
Section 54	Individual and HUF	Long-term Capital Asset	Residential House Property	Residential House Property	*To Buy:* 1 Year before and 2 Years after the date of transfer *To Construct:* 3 Years after the date of transfer	Applicable	Lower of the following: - Rs. 10 crores - Aggregate of amount invested in new house property and deposited in capital gain account scheme

Section 54B	Individual and HUF	Short-term or Long-term	Agriculture land	Agriculture land	2 years after the date of transfer	Applicable	Aggregate of amount invested in new agricultural land and deposited in capital gain account scheme
Section 54D	Any Assessee	Short-term or Long-term	Land or Building forming part of Industrial Undertaking transferred by way of compulsory acquisition	Land or Building to shift, re-establish or set up a new Industrial Undertaking	*To Buy or construct:* 3 Years after the date of compulsory acquisition	Applicable	Aggregate of amount invested in new land or building and deposited in capital gain account scheme
Section 54EC	Any Assessee	Long-term Capital Asset	Immovable Property	Bonds of NHAI or REC or other notified bonds	6 months after the date of transfer	Not Applicable	Lower of the following: - Rs. 50,00,000 - Amount invested in specified bonds

Section 54EE	Any Assessee	Long-term Capital Asset	Any Capital Asset	Units of Notified Fund	6 months after the date of transfer	Not Applicable	Lower of the following: - Rs. 50,00,000 - Amount invested in notified funds
Section 54F	Individual and HUF	Long-term Capital Asset	Any capital asset other than residential house property	Residential House Property	*To Buy:* 1 Year before and 2 Years after the date of transfer *To Construct:* 3 Years after the date of transfer	Applicable	Exemption is computed as per following formula: Eligible Investment * Long-term capital gain/Net sale consideration Note: The amount of eligible investment cannot exceed Rs. 10 crores.

Section 54G	Any Assessee	Short-term or Long-term	Specified Assets of Industrial Undertaking in urban area	Assets of Industrial Undertaking in non-urban area	1 Year before and 3 Years after the date of transfer	Applicable	Aggregate of amount invested in new asset or transfer of establishment and deposited in capital gain account scheme
Section 54GA	Any Assessee	Short-term or Long-term	Specified Assets of Industrial Undertaking in urban area	Specified Assets of Industrial Undertaking in SEZ	1 Year before and 3 Years after the date of transfer	Applicable	Aggregate of amount invested in new asset or transfer of establishment and deposited in capital gain account scheme
Section 54GB	Individual and HUF	Long-term Capital Asset	Residential Property, i.e., house or plot of land	Equity shares of eligible company or eligible start-up	*To Buy shares:* On or before the due date for furnishing of return *To Buy new assets by the company:* Within 1 year after the date of subscription of shares	Applicable	Exemption is computed as per following formula: Investment in new asset by eligible company * Capital gain/Net sale consideration

Section 115F	Non-Resident Indian	Long-term Capital Asset	Shares of an Indian company, Debentures, Deposits of Indian Public Company or Government Securities purchased in foreign currency	Shares of an Indian company, Debentures, Deposits of Indian Public Company or Government Securities	6 months from the date of transfer	Not Applicable	Exemption is computed as per following formula: Investment in new asset * Capital gain/Net sale consideration

Note: As per Section 54H, if the transfer of original asset with respect to Section 54, 54B, 54D, 54EC and 54F occurs by way of compulsory acquisition and the consideration is not received on date of transfer, the timelines provided above shall be considered from the date of receipt of the consideration.

3.6-11. Tax rates on capital gains

3.6-11a. Short-term Capital Gains

Short-term capital gain is chargeable to tax at the rate of 15% *plus* surcharge and cess if such capital gain arises from transfer of securities, being equity shares, units of an equity-oriented fund, high premium ULIPs[43] or units of business trust, and such transaction is chargeable to Securities Transaction Tax (STT). If STT is not applicable, the short-term capital gain shall be taxable at the applicable rate (*see Annexure E for the relevant rates*).

3.6-11b. Long-term Capital Gains

Long-term capital gain in excess of Rs. 1 lakh shall be chargeable to tax at the rate of 10% *plus* surcharge and cess if such capital gain arises from transfer of securities, being equity shares, units of the equity-oriented fund, high premium ULIPs or units of business trust, and such transaction is chargeable to STT. If STT is not applicable, the long-term capital gain shall be taxable at the rate of 20% *plus* surcharge and cess (*please refer Annexure E for relevant rates*). However, for the specified securities the assessee shall have an option to pay tax at the rate

[43] ULIP to which exemption under section 10(10D) does not apply on account of applicability of *fourth and fifth proviso* thereof.

of 10% without claiming the benefit of Indexation or Indexation and foreign fluctuations, as the case may be.

This option to pay tax at the rate of 20% (with indexation) and 10% (without indexation) is available only in respect of the following securities:

a) Listed Securities other than units (i.e., equity shares, debentures, govt. securities, etc.); and
b) Zero-Coupon Bonds.

Further, benefit of indexation is also not available in respect of transfer of unlisted Securities by non-resident assessee, and tax on capital gains shall be computed without considering the benefit of currency translation.

3.6-11c. Summary

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 111A	Any Person	Short-term capital gains arising from transfer of equity shares or units of equity oriented mutual fund or high premium ULIPs[44] or units of business trust if transfer of such capital asset is chargeable to Securities Transaction Tax (STT)	15%
Section 112	Any person	Long-term capital gains arising from transfer of listed securities (other than a unit) or zero-coupon bonds without giving effect to benefit of indexation.	10%
	Non-resident (not being a company) or a foreign company	Long-term capital gains arising from transfer of unlisted securities or shares of closely held companies without giving effect to benefit of indexation and currency translation.	10%
	Any Person	Any other long-term capital gains	20%
Section 112A	Any Person	Long-term capital gains, in excess of Rs. 1 lakh, arising from transfer of equity shares, units of equity oriented mutual fund, high premium ULIPs or units of business trust if transfer of such capital	10%

[44] ULIP to which exemption under section 10(10D) does not apply on account of applicability of *fourth and fifth proviso* thereof.

		asset is chargeable to Securities Transaction Tax (STT) (without giving effect to benefit of indexation and currency translation)	
Section 115AB	Overseas financial organization or offshore funds	Long-term capital gain arising from transfer of units of specified Mutual Funds or of UTI purchased in foreign currency without giving effect to benefit of indexation	10%
Section 115AC	Non-resident	Long-term capital gains arising from transfer of specified Bonds or GDRs of an Indian Company or Public sector company (PSU) purchased in foreign currency without giving effect to benefit of indexation and currency translation	10%
Section 115ACA	Resident Individual	Long-term capital gains arising from transfer of GDRs issued by an Indian company or its subsidiary, engaged in specified knowledge-based industry or service, to its employees if such GDRs are purchased in foreign currency and capital gain is computed without taking benefit of foreign exchange fluctuation and indexation (*see para 11.6-15*)	10%
Section 115AD, read with section 111A and 112A	Foreign Institutional Investors[45] or Specified fund (see *para 11.6-5*)	Short-term capital gains arising from transfer of equity shares or units of equity oriented mutual fund or units of business trust as covered under Section 111A	15%
		Short-term capital gains arising from transfer of any other securities, not being the units referred under Section 115AB	30%
		Long-term capital gains in excess of Rs. 1 lakh arising from transfer of equity shares or units of equity oriented mutual fund or units of business trust as covered under Section 112A	10%

[45] The concept of Foreign Institutional Investor (FII) has been substituted by Foreign Portfolio Investor (FPI) by SEBI (Foreign Portfolio Investors) Regulations, 2014 which has also been substituted by the SEBI (Foreign Portfolio Investors) Regulations, 2019.

		Long-term capital gains arising from transfer of other securities, not being the units referred under Section 115AB, provided capital gain is computed without taking benefit of foreign exchange fluctuation and indexation.	10%
Section 115E	Non-resident Indian	Long-term capital gains from transfer of foreign exchange asset without giving effect to benefit of indexation.	10%

Review Questions:

1. **Which one of these is included in 'Capital asset'?**

   (a) Movable Property

   (b) Immovable Property

   (c) Leasehold Right

   (d) All of these

2. **Capital asset does not include which of the following?**

   (a) Raw Materials for Business or Profession

   (b) Immovable Property

   (c) Leasehold Right

   (d) None of these

3. **Gains from the sale of which of the following shall be chargeable to tax?**

   (a) Sculptures

   (b) Paintings

   (c) Jewellery

   (d) All of these

4. **A depreciable asset will always be treated as:**

   (a) Short-term capital asset

   (b) Long-term capital asset

   (c) Both short & long-term depending on holding period

   (d) None of these

CHAPTER 4: INCOME FROM OTHER SOURCES

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Deemed Gift Tax
- Interest and Dividend
- Income Computation and Disclosure Standards (ICDS)

4.1 INTRODUCTION

Any income, which is not exempt from tax and has to be included in the total income, shall be chargeable to tax under the head ‘Income from other sources’, if it is not chargeable to income-tax under other four heads of income, - Salaries, Income from House Property, Profits and Gains from business or profession and, Capital gains. However, there are certain incomes which are always taxable under the head ‘income from other sources’.

Income taxable under the head ‘income from other sources’ shall be computed in the following manner:

Nature of Income	*Amount*
1. Dividend Income	xxx
2. Winning from lotteries, etc.	xxx
3. Winning from online games (in the nature of lotteries, etc.)	xxx
4. Employees’ contribution towards staff welfare scheme**	xxx
5. Interest on securities**	xxx
6. Rental income of machinery, plant or furniture**	xxx
7. Composite rental income from letting out of plant, machinery, furniture and building**	xxx xxx
8. Sum received under Keyman insurance policy++	xxx
9. Deemed Income of a closely held company	xxx
10. Interest on compensation or enhanced compensation	xxx
11. Advance money received in the course of negotiations for transfer of a capital asset which has been forfeited and negotiation do not result in transfer of such capital asset	xxx
12. Deemed Income in certain cases	xxx
13. Compensation on termination of employment or modification of terms of employment	xxx
14. Sum received under a life insurance policy (other than ULIP and keyman insurance policy) in excess of the aggregate premium paid during the policy term	xxx xxx

15. Specified sum received (other than interest/dividend from SPV and rental income from REITs) by a unitholder from a business trust 16. Any other income not taxable under any other head *Less:* Attributable expenses	(xxx)
Income from other sources	**Xxx**

** If such income is not chargeable to income-tax under the head "Profits and gains of business or profession"

++ If such income is not chargeable to income-tax under the head "Profits and gains of business or profession" or under the head "Salaries".

Income arising from securities which are always chargeable to tax under the head other sources are as follows:

a) Dividend income from securities;
b) Interest income from securities held as an investment;
c) Advance money received in the course of negotiations for transfer of a capital asset which has been forfeited and negotiation do not result in transfer of such capital asset;
d) Deemed Income in certain cases specified under section 56(2);
e) Shares issued at premium by a closely-held company; and
f) Specified sum received by a unitholder from a business trust.

4.2 DIVIDEND INCOME

4.2-1. ***Meaning of Dividend***

'Dividend' usually refers to the distribution of profits by a company to its shareholders. However, certain receipts also deemed as a dividend. The deemed dividend, as defined in Section 2(22) of the Income-tax Act, includes the following:

a) Distribution of accumulated profits to shareholders entailing release of the company's assets;
b) Distribution of debentures, debenture stock, or deposit certificates to shareholders out of the accumulated profits of the company and issue of bonus shares to preference shareholders out of accumulated profits;
c) Distribution to shareholders of the company on its liquidation out of accumulated profits;
d) Distribution to shareholders out of accumulated profits on the reduction of capital by the company; and
e) Loan or advance by a closely-held company to its shareholder out of accumulated profits.

4.2-2. ***Scheme of Taxation***

Up to Assessment Year 2020-21, domestic companies and mutual funds were liable to pay Dividend Distribution Tax (DDT) on dividend. Therefore, shareholders or unit-holders were exempt from paying tax on the dividend income (subject to certain conditions). After the abolition of DDT by the Finance Act, 2020 with effect from Assessment Year 2021-22, if a company, mutual fund, business trust or any other fund distributes dividend to its shareholders or unit-holders then such dividend income is taxable in the hands of such shareholder or unit-holders. The taxability of dividend and tax rate thereon shall depend upon the residential status of the shareholders and quantum of income. In case of a non-resident shareholder, the provisions of Double Taxation Avoidance Agreements (DTAAs) and Multilateral Instrument (MLI) shall also come into play (*see Chapter 6* and *Chapter 7* to know more about the taxation of dividend).

*4.2-3. **Applicability of TDS provision***

The tax is required to be deducted from dividend in accordance with Section 194 or Section 194K of the Act, as the case may be.

4.3 INTEREST ON SECURITIES

The income in the nature of interest on securities is taxable in the hands of the assessee under the head 'income from other sources'. This income is taxable as other sources if it is not in the nature of business income.

*4.3-1. **Meaning of 'interest on securities'***

As per Section 2(28B) of the Income-tax Act, 'interest on securities' means:

a) Interest on any security of the Central Government or a State Government;
b) Interest on debentures/other securities for money issued by or on the benefit of a local authority or a company or a corporation established by a Central or State or provincial Act.

*4.3-2. **Meaning of 'securities'***

As the word 'security' is not defined under the Income-tax Act, the reference can be taken from Section 2(h) of the Securities Contracts (Regulation) Act, 1956. Thus, the interest on securities can arise from the following securities:

a) Bonds;
b) Debentures or debenture stock;
c) Security receipt;
d) Government securities.
e) Pooled Investment Vehicle

4.3-3. ***Basis of charge***

In view of Section 145 of the Income-tax Act, income in the nature of interest on securities shall be computed in accordance with the method of accounting regularly employed by the assessee. Two methods of accounting are allowed under the Income-tax Act, *namely*, the mercantile system and cash system. If the assessee follows mercantile system of accounting, interest on securities is taxable on accrual basis. If he follows the cash system of accounting, it is taxable on receipt basis.

Where the assessee follows the mercantile system of accounting, the interest on securities shall be recognized in accordance with ICDS-IV (Revenue Recognition) on time basis determined by the amount outstanding and the rate applicable. The interest income so computed on a time basis shall be recognized on accrual basis even if it does not fall due. However, if due to any reason interest received by the assessee is less than the interest computed on a day-to-day basis, then the interest income for the period during which the securities were held by the owner would be deemed as income of such the assessee if following conditions are satisfied:

a) The assessee has a beneficial interest in such security at any time during any previous year; and
b) The result of any transaction relating to such securities (or income thereof) is that either no income is received by him or the income received by him is less than the sum he would have received if interest had accrued from day-to-day.

Similarly, where an assessee enters into a sale and buy-back transaction and as a result of such transaction interest payable in respect of such transaction is receivable by any other person, such interest shall be deemed to be the income of assessee.

These provisions shall not apply if the assessee proves to the satisfaction of the Assessing Officer that there has been no avoidance of tax, or avoidance of tax was exceptional and not systematic and in any of the 3 preceding years there was no avoidance of tax by any transaction of such nature.

4.3-4. ***Interest exempt from tax***

Section 10 of the Income-tax Act provides exemption for certain interest income (*see Annexure G* for exemptions relating to interest income).

4.3-5. ***Computation of taxable income***

The taxable income in the nature of interest on securities shall be computed in the following manner:

Particulars	*Amount*
Gross interest from securities	xxx
Less: Permissible deductions	
a) Collection charges	(xxx)
b) Interest on borrowings obtained to purchase securities	(xxx)
c) Any other revenue expenditure laid out or expended wholly and exclusively for the purpose of earning such income	(xxx)
Taxable income from securities	**xxx**

4.3-6. ***Applicability of TDS provision***

The tax is required to be deducted from interest on securities in accordance with Section 193 of the Act. Where interest is paid after deduction of tax at source, it is to be grossed up because the amount of tax deducted at source is a part of the income of the assessee.

The grossing up is to be done in the following manner:

$$\text{Taxable interest} = \text{Net amount of interest received} \times \frac{100}{(100 - \text{Rate of TDS})}$$

The rate of grossing up of interest depends on the rate at which tax was deducted at source. The interest from tax-free government securities need not be grossed up since no tax is leviable on such securities.

4.3-7. ***Taxability of income***

If securities are held as stock-in-trade, any profit arising from the sale of securities is chargeable to tax under the head profits and gains of business or profession. If securities are held as an investment, any profit arising from the sale of such securities is chargeable to tax under the head capital gains.

4.3-8. ***Conversion of income from securities earned in foreign currency into Indian rupees***

If any income from securities, earned in foreign currency, is taxable in India it shall be converted into Indian Rupees at the SBI telegraphic transfer buying rate that existed on the last day of the month immediately preceding the month in which income is due. In case the income payable in foreign currency is subject to TDS as per the provision of the Income-tax Act, the date of conversion will be the date on which tax is required to be deducted.

4.3-9. ***Rate of tax***

The interest shall be chargeable as per tax rates applicable to the assessee. However, in case of non-residents, certain interest incomes are taxable at concessional rates, which are enumerated below.

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or Foreign Co.	Interest received from Government or an Indian concern on monies borrowed or debt incurred by such Government or Indian concern in foreign currency.	20%
	Non-resident or Foreign Co.	Interest received from notified Infrastructure Debt Fund as referred to in Section 10(47)	5%
	Non-resident or Foreign Co.	Interest received from an Indian Co. or business trust as specified in Section 194LC, i.e., interest in respect of monies borrowed by them in foreign currency or long-term infrastructure bonds or rupee-denominated bonds.	• Interest payable in respect of long-term bond or rupee-denominated bonds listed on a recognised stock exchange in IFSC- 4% if bonds are issued before 01-07-2023 and 9% if bonds are issued on or after 01-07-2023[46] • In any other case- 5%
	Non-resident or Foreign Co.	Interest on rupee-denominated bonds of an Indian Co. or Government Securities or	5%

[46] Amendment made by the Finance Act, 2023 with effect from 01-07-2023.

		municipal debt securities as referred to in Section 194LD	
	Non-resident or Foreign Co.	Interest income distributed by business trust to its unitholders as referred to in Section 194LBA.	5%
Section 115AC	Non-resident	Interest on bonds of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10%
Section 115AD	Foreign Institutional Investor	Interest on rupee-denominated bonds of an Indian Company or Government Securities or municipal debt securities	5%
Section 115AD	Foreign Institutional Investors	Interest on securities other than securities referred under Section 115AB	20%
Section 115AD	Specified fund (See *Para 11.6-5a*)	Interest on securities other than securities referred under Section 115AB	10%

4.4 GIFT OF SECURITIES

Where any person receives a movable property from any person without consideration or for inadequate consideration than the tax shall be chargeable in the hands of the recipient as income from other sources. However, no tax shall be charged if the aggregate amount of difference between the fair market value of properties received during the year and the amount of consideration paid in respect thereof, if any, does not exceed Rs. 50,000. The movable property, for this provision, shall include shares and securities.

*4.4-1. **Computation of income***

Where shares and securities are received from any person without consideration, the whole of the aggregate fair market value of such properties received during the year shall be chargeable to tax if the aggregate fair market value thereof exceeds Rs. 50,000

Where shares and securities are received for inadequate consideration, the difference between the fair market value and consideration shall be chargeable to tax if the aggregate amount of difference between the fair market value of properties received during the year and consideration paid in respect thereof exceeds Rs. 50,000.

4.4-2. ***Computation of fair market value***

The fair market value of share and securities is computed as per Rule 11UA of the Income-tax Rules, 1962. Rule 11UA prescribes the different method for computing the fair market value of quoted and unquoted shares and securities.

4.4-2a. Quoted shares and securities

If quoted shares and securities are received by way of any transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange.

If quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date.

Where on the valuation date there is no trading in such shares and securities on any recognized stock exchange, the fair market value shall be the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange.

4.4-2b. Unquoted shares and securities

The fair market value of unquoted equity shares shall be determined as per the following formula.

$$\left(\textit{Book Value of Assets}\ \textit{(less)}\ \textit{Book Value of Liabilities}\right) \times \frac{\textit{Paid-up value of such equity shares}}{\textit{Total amount of paid-up equity share capital as shown in the balance-sheet}}$$

Calculation of book value of assets

The value of certain assets to be included in the book value of assets shall be determined as per the following provisions:

a) Value of Jewellery and artistic work shall be the price it would fetch if sold in the open market on the basis of valuation report obtained from a registered valuer;
b) Value of shares and securities shall be the fair market value determined in the manner provided in Rule 11UA; and
c) Value of immovable property shall be the value adopted/assessed/assessable by the authorities for payment of stamp duty in respect of such property.

The book value of assets shall not include the following:

a) Amount of pre-paid taxes (i.e., TDS, TCS, Advance tax) as reduced by the amount of Income-tax refund claimed;
a) Any amount shown in the balance sheet as an asset that does not represent the value of any asset (i.e., unamortized amount of deferred expenditure, deferred tax asset, etc.)

Calculation of book value of liabilities

The book value of liabilities shall not include the following:

a) Paid-up capital in respect of equity shares;
b) Amount set aside for payment of dividend on preference shares and equity shares if such dividends have not been declared (before the date of transfer) at a general body meeting of the company;
c) Reserves and surplus (even if the resulting figure is negative) other than those set apart towards depreciation;
d) Excess provision for tax (including deferred tax liability)
e) Provisions for unascertained liabilities;
f) Contingent Liabilities other than arrears of dividends payable in respect of cumulative preference shares.

For example, in the year 00, XYZ Pvt. Ltd. issued 10,000 shares having a face value of Rs. 10 each to Mr A at Rs. 120 per share. Book value of the assets and liabilities were as follows:

Particulars	*Amount (Rs.)*
Share Capital	1,00,00,000
General Reserves	10,00,000
Creditors	10,00,000
Long-term loans	10,00,000
Provision for tax (Including Rs. 5,00,000, being excess provision for tax)	10,00,000
Contingent liabilities	7,50,000
Total Liabilities and Capital	***1,47,50,000***
Land and building (Stamp Duty Value Rs. 75,00,000)	60,00,000
Jewellery (Fair Market value Rs. 17,00,000)	15,00,000
Plant and machinery	50,00,000

Furniture	4,00,000
Computer and other equipment	2,50,000
Paintings (Fair Market Value Rs. 90,000)	1,00,000
Other assets	9,50,000
Unamortized expenditure	5,50,000
Total Assets	***1,47,50,000***

The Fair market value of the shares shall be calculated as follows:

Amount received by the company	*Amount*
Total value of assets	1,47,50,000
Add/(Less): Adjustment of difference between book value and Fair Market Value	
- Land and building	15,00,000
- Jewellery	2,00,000
- Paintings	(10,000)
Less: Unamortized expenditure	(5,50,000)
Book value of asset (A)	*1,58,90,000*
Total value of capital and liabilities	1,47,50,000
Less:	
a) Share Capital	(1,00,00,000)
b) Reserves	(10,00,000)
c) Provision for tax	(5,00,000)
d) Contingent liabilities	(7,50,000)
Book value of liabilities (B)	*25,00,000*
Amount received by the company for issue of shares [C= A - B]	**1,33,90,000**
Paid up value of equity shares held by Mr. A [D = 10,000 * 10]	1,00,000
Total amount of paid-up equity share capital [E]	1,00,00,000

Fair market value of shares held by Mr. A [E= C * D / E]	**1,33,900**
Fair market value per share [F = E / 10,000]	**13.39**

4.4-2c. Valuation of other unquoted securities

The fair market value of unquoted shares and securities (other than equity shares) in a company shall be estimated to be the price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.

4.4-3. ***Cases when income is not chargeable to tax***

Where shares and securities are received without consideration or for inadequate consideration, no tax shall be charged in the following cases:

4.4-3a. Due to specified event

Income shall not arise under this provision if any sum of money or any property is received:

a) on the occasion of the marriage of the individual;
b) under a will or by way of inheritance;
c) in contemplation of death of the payer or donor;

4.4-3b. Due to the status of donor/payer

Income shall not arise under this provision if any sum of money or any property is received:

a) from any specified relative;
b) from any local authority;
c) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C);
d) from any trust or institution registered under section 12A/12AA/12AB;
e) from an individual by a trust created or established solely for the benefit of relative of such individual.

In case of HUF, every member of HUF will be treated as a relative. However, in case of an individual, the following persons are treated as a relative for the purpose of this provision:

▪ Husband/Wife	
▪ Son/Daughter (Including Stepchild and Adopted child)	▪ Daughter-in-Law/Son-in-Law
▪ Father/Mother	▪ Mother-In-Law

▪ Step-father/mother	▪ Father-In-Law
▪ Brother (and his wife)/Sister (and her husband) ▪ Half-brother/Sister	▪ Brother-in-Law (and his wife) ▪ Sister-in-law (and her husband)
▪ Grandfather ▪ Grandmother	▪ Spouse's Grandfather ▪ Spouse's Grandmother
▪ Grandson (and his wife) ▪ Granddaughter (and her husband)	▪ Great Grandson (and his wife) ▪ Great Granddaughter (and her husband)
▪ Great Grandfather ▪ Great Grandmother	▪ Spouse's Great Grandfather ▪ Spouse's Great Grandmother
▪ Father's Brother (and his wife) ▪ Father's Sister (and her husband)	▪ Mother's Brother (and his wife) ▪ Mother's Sister (and her husband)
The following persons are not deemed as 'relatives' for this provision: a) Step-brother/sister b) Nephew/Niece c) Cousins	

4.4-3c. Due to the status of the donee/payee

Income shall not arise under this provision if any sum of money or any property is received:

a) by any trust or institution registered under section 12A/12AA/12AB;
b) by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in Section 10(23C)(iv)/(v)/(vi)/(via);

4.4-3d. Due to transactions not regarded as transfer

Income shall not arise under this provision if any sum of money or any property is received under the following transactions not regarded as transfer under Section 47:

a) Any distribution of capital assets on total or partial partition of a HUF [Section 47(i)];
b) Transfer of a capital asset by a holding company to its Indian wholly owned subsidiary company or by the wholly subsidiary to its Indian holding company provided the conditions specified in Section 47(iv)/(v) are satisfied;
c) Transfer of a capital asset in a scheme of amalgamation, demerger or business reorganization specified in clause (vi) or clause (via) or clause (viaa) or clause (vib) or clause (vic) or clause (vica) or clause (vicb) or clause (vid) or clause (vii) or (viiac) or (viiad) or (viiae) or (viiaf) of section 47.

4.4-3e. Due to Covid-19

Income shall not arise under this provision if any sum of money or property is received:

(a) in respect of any expenditure actually incurred by a person on his medical treatment or treatment of any member of his family, for any illness related to COVID-19. This benefit shall be allowed subject to such conditions as notified by the Central Government[47];

(b) by a family member of a person who died due to Covid-19. If the sum is received from the employer of the deceased, no tax shall be charged irrespective of the amount received. However, where the sum is received from any other person, sum received upto Rs. 10 lakhs shall be tax-free. This benefit shall be allowed only if the payment is received within 12 months from the date of death of the person and subject to such other conditions as notified by the Central Government[48].

4.4-3f. Due to notified class

These provisions will not apply to any sum of money or any property received from such class of persons and subject to such conditions, as may be prescribed.

The CBDT has notified[49] that the provisions of Section 56(2)(x) shall not be applicable to the following:

a) Any immovable property, being land or building or both, received by a resident of an unauthorized colony in the NCT of Delhi. This exemption is subject to the condition that such transaction must be regularized by the Central Government on the basis of the latest power of attorney, agreement to sale, will, possession letter and other documents, including documents evidencing payment of consideration for conferring or recognising the right of ownership or transfer or mortgage in regard to such immovable property in favour of such resident. Therefore, on the execution of conveyance deed, no income shall be chargeable to tax in hands of resident of unauthorized colonies as per the provisions of section 56(2)(x);
b) Any unquoted shares of a company and its subsidiary and the subsidiary of such subsidiary received by a shareholder where:
    - The Tribunal, on an application moved by Central Government under Section 241 of the Companies Act, 2013, has suspended the board of directors of such company and has appointed new directors as nominated by the Central Government; and
    - The share of the company and its subsidiary and the subsidiary of such subsidiary has been received pursuant to a resolution plan approved by the Tribunal, after affording a reasonable opportunity of being heard to the Jurisdictional Principal Commissioner or Commissioner.
c) Any equity shares of the reconstructed bank received by the investor or the investor bank under Yes Bank Limited Reconstruction Scheme, 2020, at the price specified therein.

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[47] Notification No. 91/2022, dated 05-08-2022.
[48] Notification No. 92/2022, dated 05-08-2022.
[49] Rule 11UAC Substituted *vide* Notification No. 40/2020 dated 29-06-2020

d) Any movable property, being equity shares of the public sector company, received by a person from the Central Government or any State Government under strategic disinvestment. Strategic disinvestment means the sale of shareholding by the Central Government or any State Government in a public sector company which results in the reduction of its shareholding to below 51% along with a transfer of control to the buyer.
e) Where the investment manager entity[50] of the original fund[51] is relocated to the IFSC, and a new fund management entity[52] is established there. In this case, shares, interests, or units received by the new fund management entity in the resultant fund in lieu of shares, interests or units held by the investment manager entity in the original fund, shall not be taxable.

   To qualify for the tax exemption, the new fund management entity in the IFSC must maintain a similar ownership structure as the investment manager entity of the original fund maintained. At least 90% of the shares, units, or interests in both entities should be held by the same entity(s) or person(s) in the same proportion.

4.5 SHARES ISSUED AT PREMIUM BY CLOSELY HELD COMPANY

4.5-1. ***Taxability of excess premium***

Any excess premium received by a company from the issue of shares is chargeable to tax under the head income from other sources if the following conditions are satisfied:

a) Shares (equity or preference shares) are issued by a closely held company;
b) The consideration for the issue of shares is received from any person[53];
c) The consideration received exceeds the face value and fair market value of shares.

If the above conditions are satisfied, the consideration exceeding the fair market value of the share shall be taxable in the hands of the issuer company. The fair market value of shares shall be determined as per Rule 11UA.

However, in the following cases, this provision shall not apply to any consideration received for the issue of shares:

a) Where consideration is received by a Venture Capital Undertaking from a Venture Capital Company or Venture Capital Fund or Category-I or Category-II Alternative Investment Fund (AIF)

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[50] "investment manager entity" means the fund manager of the original fund regulated by the respective regulation of the jurisdiction in which the original fund is located.
[51] Defined under Explanation to clauses (viiac) and (viiad) of Section 47 of the Income-tax Act, 1961
[52] "fund management entity" shall have the same meaning as provided in the sub-clause (p) of regulation 2 of the International Financial Services Centres Authority (Fund Management) Regulations, 2022
[53] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25. Earlier, this provision was applicable only when consideration for issue of shares is received from a resident person.

b) Where consideration is received by a company from the following class or classes of persons:
   i. Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled by the Government or where direct or indirect ownership of the Government is 75% or more;
   ii. Banks or Entities involved in Insurance Business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident;
   iii. Any of the following entities, which is a resident of any country or specified territory (listed in the Annexure of Notification No. 29/2023, dated 24-05-2023), and such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident:
      - entities registered with the Securities and Exchange Board of India as Category-I Foreign Portfolio Investors;
      - endowment funds associated with a university, hospitals, or charities;
      - pension funds created or established under the law of the foreign country or specified territory;
      - Broad Based Pooled Investment Vehicle or fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

c) Where the company is an eligible start-up fulfilling conditions as prescribed in the Notification issued by the DPIIT.

Issuing Company	*Shares issued to*	*Whether Section 56(2)(viib) is applicable?*
Venture Capital Undertaking	Venture Capital Company	No
	Venture Capital Fund	No
	Category-I or Category-II AIF	No
Eligible Start-up	Any person (in compliance with DPIIT Notification)	No
	Any person (In any other case)	Yes
Closely held company not being an eligible start-up	Non-resident person	Yes (If issue price is more than FMV)
	Resident person	Yes (If issue price is more than FMV)
	Notified class of persons (Notification No. 29/2023, dated 24-05-2023)	No

4.5-2. ***Valuation of unquoted equity shares***

For the purpose of calculation of deemed income under Section 56(2)(viib), which may arise in the hands of a closely held company when shares are issued at a premium, the fair market value of unquoted shares shall be determined as per any of the following method (at the option of the closely held company):

a) Book Value Method
b) Discounted Cash Flow Method determined by a Merchant Banker

4.5-2a. Book Value Method

Fair Market Value of unquote shares shall be determined as per the following formula

$$\textit{Book Value of Assets} \;(\textit{less})\; \textit{Book Value of Liabilities} \times \frac{\textit{Paid-up value of such equity shares}}{\textit{Total amount of paid-up equity share capital as shown in the balance-sheet}}$$

Calculation of book value of assets

The book value of assets shall not include the following:

a) Amount of pre-paid taxes (i.e., TDS, TCS, Advance tax) as reduced by the amount of Income-tax refund claimed;
b) Any amount shown in the balance sheet as an asset that does not represent the value of any asset (i.e., unamortized amount of deferred expenditure, deferred tax asset, etc.)

Calculation of book value of liabilities

The book value of liabilities shall not include the following:

a) Paid-up capital in respect of equity shares;
b) Amount set aside for payment of dividend on preference shares and equity shares if such dividends have not been declared (before the date of transfer) at a general body meeting of the company;
c) Reserves and surplus (even if the resulting figure is negative) other than those set apart towards depreciation;
d) Excess provision for tax (including deferred tax liability)
e) Provisions for unascertained liabilities;
f) Contingent Liabilities other than arrears of dividends payable in respect of cumulative preference shares.

For example, in year 00, XYZ Pvt. Ltd. issued 1,000 shares of face value of Rs. 1,000 each to

Mr A at Rs. 2,000 per share. Book value of the assets and liabilities are as follows:

Particulars	*Amount (Rs.)*
Share Capital	1,00,00,000
General Reserves	10,00,000
Creditors	10,00,000
Long-term loans	10,00,000
Provision for tax (Including Rs. 5,00,000, being excess provision for tax)	10,00,000
Contingent liabilities	7,50,000
Total Liabilities and Capital	***1,47,50,000***
Land and building	73,00,000
Plant and machinery	50,00,000
Furniture	4,00,000
Computer and other equipments	2,50,000
Advance tax	5,00,000
Tax Deducted at source	3,00,000
Other assets	4,50,000
Unamortized expenditure	5,50,000
Total Assets	***1,47,50,000***

The Fair market value of the shares shall be calculated as follows:

Amount received by the company	*Amount*
Total value of assets	1,47,50,000
Less: Unamortized expenditure	(5,50,000)
Less: Prepaid taxes as reduced by Income-tax refund claimed [Rs. 5,00,000 + Rs. 3,00,000 – (Rs. 10,00,000 – Rs. 5,00,000)]	(3,00,000)
Book value of asset (A)	*1,39,00,000*
Total value of capital and liabilities	1,47,50,000
Less:	

e) Share Capital f) Reserves g) Provision for tax h) Contingent liabilities	(1,00,00,000) (10,00,000) (-) (7,50,000)
Book value of liabilities (B)	*30,00,000*
Amount received by the company for issue of shares [C= A - B]	**1,09,00,000**
Paid up value of equity shares held by Mr. A [D = Rs. 1,000 * 1,000]	10,00,000
Total amount of paid up equity share capital [E]	1,00,00,000
Fair market value of shares held by Mr. A [E= C * D / E]	**10,90,000**
Fair market value per share [F = E / 1,000]	**1,090**

4.5-2b. *Discounted Cash Flow Method*

The Discounted Cash Flow (DCF) methodology expresses the present value of a business as a function of its future cash earnings capacity. In this method, future cash flows of a business are discounted at an appropriate discount rate on a going concern assumption. In this method, the net present value of cash flow is determined for a selected period which is called 'explicit forecast period'. The value is placed both on the explicit cash flows, and the ongoing cash flows a company will generate after the explicit forecast period which is known as the terminal value.

The discount rate is applied to estimate the present value of the explicit forecast period's free cash flows as well as the continuing value. The resultant figure is taken at the Cost of Equity (COE) or the Weighted Average Cost of Capital (WACC). While COE is used for the Free Cash Flow to Equity (FCFE) variant of DCF, WACC is the discount rate used in Free Cash Flow to the Firm (FCFF). One of the advantages of the DCF approach is that it permits the various elements that make up the discount factor to be considered separately, and thus, the effect of the variations in the assumptions can be modelled more easily. The principal elements of WACC are COE (which is the desired rate of return for an equity investor given the risk profile of the company and associated cash flows), the post-tax cost of debt, and the target capital structure of the company (a function of debt-to-equity ratio). COE is derived on the basis of the capital asset pricing model (CAPM), as a function of the risk-free rate, Beta (an estimate of the risk profile of the company relative to equity market) and equity risk premium assigned to the subject equity market.

The cumulative DCF is adjusted for items whose value cannot be ascribed to the equity capital to arrive at the equity value.

4.6 APPLICABILITY OF INCOME COMPUTATION AND DISCLOSURE STANDARD (ICDS)

The income taxable under the head of Income from other sources shall be computed in accordance with provisions of Section 56 to Section 59 and Income Computation and Disclosure Standards. The Central Government has notified 10 ICDS which are applicable with effect from 01-04-2016 for computation of income taxable under the head 'Profit and gains from business and profession' and 'Income from other sources'. Following ICDSs have been notified by the Govt.:

1. ICDS I: Accounting Policies
2. ICDS II: Valuation of inventories
3. ICDS III: Construction contracts
4. ICDS IV: Revenue Recognition
5. ICDS V: Tangible fixed assets
6. ICDS VI: Effects of change in Foreign exchange rates
7. ICDS VII: Government Grants
8. ICDS VIII: Securities
9. ICDS IX: Borrowing costs
10. ICDS X: Provisions, Contingent liabilities and Contingent Assets.

Review Questions:

1. **When the assessee is a non-resident or a foreign company, interest received from a notified Infrastructure Debt Fund is chargeable to tax at the rate of _____________.**

   (a) 5 percent

   (b) 10 percent

   (c) 15 percent

   (d) 20 percent

2. **When the assessee is a Foreign Portfolio Investor (FPI) interest on rupee denominated bonds of an Indian Company is chargeable to tax at the rate of _____.**

   (a) 10 percent

   (b) 15 percent

   (c) 5 percent

   (d) 20 percent

3. **For calculating book value of liabilities in case of unquoted shares which of the following shall NOT be included?**

   (a) Paid-up capital of equity shares

   (b) Reserves and surplus

   (c) Provisions for unascertained liabilities

   (d) All of these

4. **'Income from other sources' will includes which of the following?**

   (a) Dividend Income

   (b) Employees' contribution towards staff welfare scheme

   (c) Deemed Income of a closely held company

   (d) All of these

CHAPTER 5: TAXATION OF DEBT PRODUCTS[54]

LEARNING OBJECTIVES:
After studying this chapter, you should know about: • Source of Income • Types of Debt Products

Debt instruments are used by many entities to raise funds from the market. Debt instruments are similar to giving a loan to the issuing entity by the investor. The person holding the debt instrument of an entity would not hold any voting power or dividend claim. However, he is entitled to receive interest and redemption value at the time of maturity from the entity.

5.1 SOURCES OF INCOME FROM DEBT PRODUCTS

Periodic income earned from debt instruments is classified as interest income. Whereas, the gain or loss arising from transfer or redemption of debt instruments is classified as capital gains and taxed as such.

5.1-1. Interest income

The income in the nature of interest on securities is taxable in the hands of the assessee under the head 'income from other sources' if the same is not taxable under the head business income.

As per Section 145 of the Income-tax Act, income chargeable to tax under the head 'Income from Other Sources' or Business Income shall be computed in accordance with the method of accounting regularly employed by the assessee. Two methods of accounting are allowed under the Income-tax Act, *namely*, the mercantile system and cash system, whichever is regularly employed by the assessee. If the assessee regularly follows mercantile system of accounting, interest on securities is taxable on an accrual basis. If he regularly follows the cash system of accounting, it is taxable on a receipt basis.

The income taxable under the head 'Business or Profession' and 'Income from Other Sources' is computed as per the provisions of the Income-tax Act and Income Computation and Disclosure Standards (ICDS). To date, the Central Government has notified 10 ICDS. ICDS-IV deals with revenue recognition. It provides that interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.

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[54] In case of FPIs and Specified funds, tax shall be charged at the concessional rate specified under Section 115AD. For taxability of these FPIs and Funds refer chapter 10 and Chapter 11.

The taxable income in the nature of interest on securities shall be computed in the following manner:

Particulars	*Amount*
Gross interest from securities	xxx
Less: Permissible deductions	
a) Collection charges	(xxx)
b) Interest on borrowings obtained to purchase securities	(xxx)
c) Any other revenue expenditure laid out or expended wholly and exclusively for the purpose of earning such income	(xxx)
Taxable income from securities	**xxx**

Section 10 of the Income-tax Act provides exemption from certain interest income and, accordingly, no tax is charged thereon (*see Annexure G* for exemptions relating to interest income).

5.1-2. Capital gains

Gain or loss arising from transfer or redemption of any security including debt securities is chargeable to tax under the head capital gain if same is held by the assessee as a capital asset, *that is*, as an investment. Securities held by foreign portfolio investors (FPIs) are always treated as capital asset. Therefore, income arising from the transfer or redemption of securities by FPIs shall always be taxed under the head capital gain. Tax on capital gain depends upon many factors such as nature of security, the period of holding, residential status of the assessee, etc. Section 47 of the Income-tax Act has specifically excluded certain types of transfer from the scope and meaning of the word 'transfer' in relation to a capital asset. Consequently, no capital gain may arise from such a transfer (see *Chapter 3* to know more about the Capital Gains).

5.2 COUPON BONDS

Bonds are generally issued and redeemed at face value and carry interest which is paid to the investor over the tenure of the Bond. The principal features of a bond are maturity (i.e., tenure), coupon (i.e., interest), and principal (i.e., face value). In many cases, the name of the bond itself conveys the key features of a bond. *For example*, 7.4% CG Bond 2018 refers to a Central Government Bond maturing in the year 2018 and paying a coupon of 7.40%.

Coupon Bonds are the bonds which carry coupon rate and the lender is entitled to periodic interest payments on such bonds.

The market value of a bond is determined by computing the present value of all future cash flows. The interest rate at which the present value of future cash flows is determined is known as 'Yield-To-Maturity'. Where a seller transfers bond, a portion of the sales consideration payable to him shall be towards the interest accrued from the last coupon date till the date preceding the date of transfer. As interest arising from bonds is chargeable to tax under the head 'income from other sources', it shall be excluded from the sale consideration while computing capital gain.

5.2-1. Tax on interest arising from bonds

Interest arising from bonds is taxable under the head 'Income from other sources' and generally taxable at a normal rate as applicable in case of an assessee (*see Annexure E* for the tax rates). The assessee is allowed to deduct all expenditures laid out or expended wholly and exclusively to earn such interest income and the amount of commission or remuneration paid to a banker or any other person to realise such interest.

However, there are some cases where interest arising from bonds is chargeable to tax at a concessional rate and no deduction (including deduction under sections 80C to 80U) is allowed from such interest income. Such provisions are as follows:

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or Foreign Co.	Interest received from Government or an Indian concern on monies borrowed or debt incurred by such Government or Indian concern in foreign currency	20%
	Non-resident or Foreign Co.	Interest received from notified Infrastructure Debt Fund as referred to in Section 10(47)	5%
	Non-resident or Foreign Co.	Interest on money borrowed by an Indian company or REITs/InVITs in foreign currency under a loan agreement or through the issuance of long-term bonds including (long-term infrastructure bonds) or through rupee-denominated bonds	• Interest payable in respect of long-term bond or rupee denominated bonds listed on a recognized stock exchange in IFSC- 4% if bonds are issued before 01-07-2023 and 9% if bonds are issued on or after 01-07-2023 • In any other case- 5%

	Non-resident or Foreign Co.	Interest on rupee-denominated bonds of an Indian company or Government security or Municipal debt securities	5%
Section 115AC	Non-resident	Interest on foreign currency convertible bonds (FCCBs) of an Indian Company or Public Sector Company (PSU)	10%
Section 115AD	Foreign Institutional Investor	Interest on rupee-denominated bonds of an Indian company or Government security or Municipal debt securities	5%
Section 115AD	Foreign Institutional investor	Income from any other securities	20%
Section 115AD	Specified funds (*refer para 11.6-5a)*	Income from securities	10%
Section 115E	Non-resident Indian	Income from specified assets purchased in foreign currency being debentures issued by an Indian Public Company or deposits with such company or securities of Central Government.	20%

Example 1: Mr A, a person resident in India, purchased 1,000 bonds of an Indian Company at Rs. 100 each on 01-01-2022. The face value, coupon rate and date of maturity of such bonds are as follows:

Face Value	Rs. 100 each
Coupon Rate	7.50% per annum
Date of Maturity	31-12-2027

The interest on bonds is paid half-yearly on June 30 and December 31 every year. Compute the amount of interest income chargeable to tax in the hands of Mr A for the previous year 2022-23 (Assessment Year 2023-24).

Answer:

As per Section 145 of the Income-tax Act, income in the nature of interest on securities shall be computed in accordance with the method of accounting regularly employed by the assessee. Two methods of accounting are allowed under the Income-tax Act, *namely*, the mercantile system and cash system. If the assessee follows mercantile system of accounting, interest on securities is taxable on an accrual basis. If he follows the cash system of accounting, it is taxable on a receipt basis.

Further, ICDS-IV which deals with revenue recognition provides that interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.

The amount of interest on bonds chargeable to tax in the hands of Mr A for the Previous Year 2022-23 (Assessment Year 2023-24) shall be as follows:

Particulars	*Interest received*	*Interest chargeable to tax if Mr A follows*		*Taxability arises in the previous year*
		Mercantile System	*Cash System*	
Interest for the period Jan 2022 to March 2022 (received on June 30, 2022)	-	1,875	-	2021-22
Interest for the period April, 2022 to June, 2022 (received on June 30, 2022)	3,750	1,875	3,750	2022-23
Interest for the period July, 2022 to December, 2022 (received on December 31, 2022)	3,750	3,750	3,750	2022-23
Interest for the period Jan 2023 to March 2023 (received on June 30, 2023)	-	1,875	-	2022-23
Interest for the period April, 2023 to June, 2023 (received on June 30, 2023)	3,750	1,875	3,750	2023-24

5.2-2. Tax on long-term capital gain arising to a resident person from transfer or redemption of bonds

Where a person earns any profit or gains from transfer or redemption of bonds held as capital assets, it shall be chargeable to tax under the head capital gain. Taxability of capital gain arising from the transfer of bonds depends upon the nature of the bond, period of holding thereof and the status of the assessee.

The period of holding in case of coupon bonds can be explained with the help of the following table:

Bonds	*Period of holding to qualify as a long-term capital asset should be more than*
Coupon Bonds listed on a recognized stock exchange in India	12 months
Coupon Bonds not listed on a recognized stock exchange in India	36 months

Long-term capital gain arising from the transfer of any capital asset is generally chargeable to tax at the rate of 20% (*plus* applicable surcharge and Health and Education cess) and the assessee is allowed the benefit of indexation while computing the long-term capital gain. However, in the case of bonds (other than capital indexed bonds issued by the Government and sovereign gold bonds issued by the Reserve Bank of India), the benefit of indexation is not allowed while computing the capital gain. Thus, the long-term capital gain arising from the transfer of bonds (other than capital indexed bonds and sovereign gold bonds) is chargeable to tax at the rate of 20% without providing the benefit of indexation.

As per section 112 of the Income-tax Act, an assessee has the option to pay tax at the rate of 10% on long-term capital gain arising from listed securities provided the benefit of indexation is not taken while computing the amount of capital gain. As in the case of bonds, the benefit of indexation is by default restricted, the long-term capital gain arising from the transfer of listed coupon bonds shall be taxable at the rate of 10%. As far as taxability of capital indexed bonds and sovereign gold bond is concerned, if such bonds are listed on any recognized stock exchange in India then the assessee has the option to pay tax either at the rate of 20% with indexation or 10% without indexation, as the case may be. Whereas, if such bonds are not listed then tax shall be payable at the rate of 20% and benefit of indexation shall be allowed while computing capital gain.

Thus, the tax rates in case of long-term capital gain arising to a resident person from the transfer of coupon bonds can be explained with the help of the following table:

Bond	*Tax Rate*	
	Listed	*Unlisted*
Capital Indexed Bonds or Inflation-Indexed Bonds	20% with indexation or 10% without indexation	20% with indexation
Sovereign Gold Bonds	20% with indexation or 10% without indexation	20% with indexation
Any other Bond	10% without indexation	20% without indexation

The long-term capital gain in case of transfer of bonds shall be computed as under:

Particulars	Rs.
Full value of the consideration (in case of transfer) or Redeemable Value (in case of redemption) *Less:* *a)* Cost of acquisition* *b)* Expenditure incurred wholly and exclusively in connection with transfer *c)* Exemption under Sections 54 to 54GB	xxx (xxx) (xxx) (xxx)
Long-term capital gain or loss	**Xxx**
** Cost of acquisition shall be taken as indexed cost of acquisition in case of Capital Indexed Bonds or Sovereign Gold Bonds if the long-term capital gain is chargeable to tax at the rate of 20%.*	

Example 2: Mr A purchased 400 listed bonds of ABC Ltd. at Rs. 1,200 each on 01-01-2016. The face value of the bond is Rs. 1,000. It carries a coupon rate of 7% per annum. The interest on bonds is paid half-yearly on June 30 and December 31 every year. The bonds are redeemable on 31-12-2026. However, Mr A sold such bonds on 01-07-2022 at Rs. 2,000 each. Compute the amount of interest and capital gain chargeable to tax in the hands of Mr X for the financial year 2022-23. Assume that Mr A follows the mercantile system of accounting.

Answer:

1. Computation of interest on bonds chargeable to tax for the financial year 2022-23.

Particulars	*Amount*
Half yearly interest received on June 30, 2022 (400 * Rs. 1,000 * 7% * 6/12)	14,000
Interest accrued for the month of April 2022 to June 2022	7,000
Interest chargeable to tax for the financial year 2022-23	**7,000**

2. Computation of capital gain chargeable to tax for the financial year 2022-23

Computation of capital gain	
Period of holding (from 01-01-2016 to 30-06-2022)	5.5 years
Nature of capital gain (held for more than 12 months)	Long-term capital gain
Full value of consideration (400 bonds * Rs. 2,000)	800,000
Less: Cost of acquisition (400 Bonds * Rs. 1,200)	(480,000)
Long-term capital gain	3,20,000
Tax rate on capital gain	10%†
† Long-term capital gain arising from the transfer of bonds is chargeable to tax at the rate of 10% as bonds are listed on a recognized stock exchange in India. The capital gain shall be	

computed without allowing the benefit of indexation as it is not available in case of bonds (other than capital indexed bonds and sovereign gold bonds).

Example 3: Suppose in the above Example 2, the bonds are unlisted.

Answer:

As unlisted bonds are transferred after holding for a period of more than 36 months, they shall be treated as long-term capital assets. As per section 112 of the Income-tax Act, an assessee has the option to pay tax at the rate of 10% on long-term capital gain arising from listed securities provided the benefit of indexation is not taken while computing the amount of capital gain. As in case of bonds, the benefit of indexation is by default restricted, the long-term capital gain arising from the transfer of listed bonds shall be taxable at the rate of 10%.

Whereas, if such bonds are not listed then tax shall be payable at the rate of 20% and benefit of indexation shall not be allowed while computing capital gain. Thus, the amount of capital gain shall be the same. However, the tax rate shall be 20% instead of 10%.

5.2-3. Tax on long-term capital gain arising to a non-resident person from transfer or redemption of bonds

Tax on long-term capital gain arising to a non-resident person from transfer or redemption of bonds is always taxable at the rate of 10% and no benefit of indexation and foreign currency fluctuation is allowed in certain cases while computing the capital gain. However, in case of listed capital gain indexed bonds or sovereign gold bonds, a non-resident person has the option to pay tax either at the rate of 20% with indexation or 10% without indexation, whichever is more beneficial for him.

The relevant provisions of the Income-tax Act for taxability of long-term capital gain arising to a non-resident (including foreign portfolio investors) or foreign company from the transfer of bonds are summarized in the following table:

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115AC	Non-resident	Long-term capital gain from transfer of foreign currency bonds of an Indian Company or Public Sector Company (PSU)	10% (without indexation and foreign exchange fluctuation benefit)
Section 115AD	Foreign Portfolio Investors	Long-term capital gains arising from the transfer of any debt security including rupee-denominated bonds* of an Indian	10% (without indexation and foreign exchange

	(FPIs) or Specified fund (*see para 11.6-5a)*	company or Government security or Municipal debt securities	fluctuation benefit)
Section 115E	Non-resident Indian	Long-term capital gains arising from the transfer of Government securities or debentures of an Indian Public Company purchased in foreign currency	10% (without indexation and foreign exchange fluctuation benefit)
Section 112(1)(c)	Non-resident or foreign company	Long-term capital gain arising from any unlisted security	10% (without indexation and foreign exchange fluctuation benefit)
Proviso to Section 112	Any person	Long-term capital gain from bonds that are listed on a recognized stock exchange in India	10% (without indexation benefit)
Proviso to section 112 *read with fourth proviso* to section 48	Any person	Long-term capital gain arising from the transfer of listed Capital Gain Indexed Bonds or Sovereign Gold Bond	20% with indexation or 10% without indexation
** As per the fifth proviso to Section 48, in case of an assessee being a non-resident, any gain arising on account of appreciation of rupee against a foreign currency, at the time of redemption of the rupee-denominated bond of an Indian company, shall be ignored for computation of full value of consideration.*			

5.2-4. Tax on short-term capital gain from bonds

Short-term capital gain arising from the transfer of bonds is generally taxable at normal rates as applicable in case of an assessee.

Example 4: Mr A acquired 9% Listed Bond having face value of Rs. 10,000 on April 1, 2022, for Rs. 10,500. Such a bond provides for quarterly payment of interest. After receiving interest for the first 2 quarters, that is, the quarter ending on June 30, 2022, and September 30, 2022, he transferred such bond on November 1, 2022, for Rs. 13,000 inclusive of interest accrued till the date of transfer.

Compute the amount of interest and capital gain chargeable to tax in hands of Mr A

Answer:

Computation of interest income	
Particulars	*Amount*
Interest received for the quarter ending on 30-06-2022 (Rs. 10,000 * 9% * 1/4) [A]	225
Interest received for the quarter ending on 30-09-2022 (Rs. 10,000 * 9% * 1/4) [B]	225
Interest accrued till 31-10-2022 (Rs. 10,000 * 9% * 1/12) [C]	75
Total taxable interest income	**525**

Computation of capital gains	
Period of holding (from 01-04-2022 to 31-10-2022)	7 Months
Nature of capital gain (period of holding of less than 12 months)	Short term capital gain
Sales consideration [D]	13,000
Interest accrued but not received before the date of sale [E = C]	75
Adjusted sales consideration [F = D – C]	12,925
Less: Cost of Acquisition [G]	10,500
Short term capital gain [H = F - G]	2,425
Tax rate on capital gain	Applicable tax rate

5.3 ZERO COUPON BONDS AND DEEP DISCOUNT BONDS

Zero-Coupon Bonds (ZCBs) are also known as Zero Interest Debentures. As the name suggests, ZCBs do not carry any coupon. Thus, no interest is paid on such bonds. A zero-coupon bond is issued at a discount to the investors and redeemed at face value at the time of maturity. Therefore, the difference between the face value of the bond and the issue price is in the nature of the capital gains.

A Deep Discount Bond (DDB) is a form of ZCB. It is issued at a deep/ steep discount over its face value. DDBs are being issued by the public financial institutions in India like SIDBI, IDBI, ICICI and so on.

5.3-1. Tax on long-term capital gain arising on redemption of bonds

Where a person earns any profit or gains on redemption of bonds, it shall be chargeable to tax under the head capital gains. Profit or gain arising from the transfer of ZCB or DDB is treated as long-term capital gain if bonds are transferred after holding for a period of more than 12 months.

As per Section 112 of the Income-tax Act, an assessee has the option to pay tax at the rate of 10% on long-term capital gain arising from zero-coupon bonds or deep discount bonds provided the benefit of indexation is not taken while computing the amount of capital gain. As in case of bonds, the benefit of indexation is by default restricted, the long-term capital gain arising from the transfer of zero-coupon bonds or deep discount bonds shall be taxable at the rate of 10%.

Thus, the tax rates in case of long-term capital gain arising from the transfer of Zero bonds or deep discount bonds shall be 10% without indexation, whether these bonds are listed or unlisted.

Example 5: ABC Ltd. allotted 400 Zero Coupon Bonds of face value of Rs. 1,000 each to Mr X on 01-01-2010. The Bonds were issued to Mr A at a discounted price of Rs. 400 per bond. Compute the capital gain chargeable in the hands of Mr X if bonds are redeemed on 25-03-2023.

Answer:

Computation of capital gain	
Period of holding (from 01-01-2010 to 24-03-2023)	13+ Years
Nature of capital gain (period of holding is more than 12 months)	Long-term capital gain
Full value of consideration (400 bonds * Rs. 1,000)	400,000
Less: Cost of Acquisition (400 Bonds * Rs. 400)	160,000
Long-term capital gain	240,000
Tax rate on capital gain	10%†
† Long-term capital gain arising from the transfer of Zero-Coupon Bonds is chargeable to tax at 10% whether the bonds are listed or unlisted. Further, the benefit of indexation is not available while computing the capital gain.	

5.3-2. Tax on short-term capital gain from bonds

Short-term capital gain arising from the transfer or redemption of a zero-coupon bond is generally taxable at normal rates as applicable in case of an assessee.

Example 6: ABC Ltd. allotted 400 Zero Coupon Bonds of face value of Rs. 1,000 each to Mr X on 01-04-2022. The Bonds were issued to Mr A at a discounted price of Rs. 400 per bond. The bonds are redeemable in March 2030. However, Mr X transfers such bonds to Mr Y on 25-03-2023 for Rs. 500 each. Compute the capital gain chargeable in the hands of Mr X.

Answer:

Computation of capital gain

Period of holding (from 01-04-2022 to 24-03-2023)	Less than 12 months
Nature of capital gain	Short-term capital gain
Full Value of Consideration (400 bonds * Rs. 500)	200,000
Less: Cost of acquisition (400 Bonds * Rs. 400)	160,000
Short-term capital gain	40,000
Tax rate on capital gain	Applicable rates†
† Short-term capital gains arising from the transfer of Zero-Coupon Bonds are chargeable to tax at normal rates as applicable in case of assessee (*See Annexure E* for the tax rates).	

5.4 CONVERTIBLE BONDS

This type of bond allows the bond-holder to convert their bonds into equity shares of the issuing corporation, on pre-specified terms. At the time of issue of the bond, the indenture specifies the conversion ratio and the conversion price. The conversion ratio refers to the number of equity shares, which will be issued in exchange for the bond that is being converted. The conversion price is the resulting price when the conversion ratio is applied to the value of the bond, at the time of conversion. Bonds can be fully converted, such that they are fully redeemed on the date of conversion. Bonds can also be issued as partially convertible where a part of the bond is redeemed and equity shares are issued in the pre-specified conversion ratio, and the non-convertible portion continues to remain as a bond.

5.4-1. Taxability

As per Section 2(47) of the Act, 'transfer' includes the exchange of assets. When two persons mutually transfer the ownership of one thing for the ownership of another, but none of the things is money, the transaction is called an 'exchange'. Any conversion of Bonds into shares or any other asset is an "exchange" and should fall within the definition of transfer, and, consequently, the capital gain tax shall be charged on such transfer.

However, the Income-tax Act has specifically excluded certain types of transfer from the scope and meaning of the word 'transfer' in relation to a capital asset. Consequently, no capital gain shall arise from such a transfer. These transactions are specified in Section 47 of the Act and one such transaction is the conversion of bonds into shares or debentures of the company.

As per Section 47, the following transactions relating to the conversion of securities are not treated as a transfer:

(a) Conversion of bonds into shares

Where bonds, debentures, debenture-stock or deposit certificate of a company is converted into shares or debentures of that company in any form, such conversion is not treated as a transfer.

(b) Conversion of foreign currency exchange bonds

Where Foreign Currency Exchange Bonds (FCEB), issued to non-residents by Indian companies, are converted into shares of any company, such conversion is not treated as a transfer. Accordingly, no capital gain shall arise on the conversion of FCEB into shares.

Though conversion of bonds into shares or debentures of the company is not treated as transfer under Section 47, but when a person subsequently sells such shares or debentures, the cost of acquisition thereof shall be the same as that of the bonds. Further, the period of holding of shares or debentures shall be reckoned from the date of acquisition of the bonds.

Example 7: Mr X purchased 400 listed convertible bonds of ABC Ltd. on 01-01-2010 for Rs. 500 each. The bonds are converted into equity share on 01-01-2023 at a conversion ratio of 1:1. As a result, Mr X is allotted 400 shares of ABC Ltd. The fair market value of the share on the date of conversion is Rs. 850 per share. Mr X sold the shares on 25-03-2023 for Rs. 1,000 per share. Securities Transaction Tax (STT) was paid at the time of transfer of shares. What shall be the tax implications in the hands of Mr X in this case?

Answer:

The tax implications in the hands of Mr X shall be as follows:

1. *Tax implication in case of conversion of bonds into shares of the company on 01-01-2023*

As per Section 47 of the Income-tax Act where bonds of a company are converted into shares of that company, such conversion is not treated as a transfer. Thus, no capital gain shall arise on the conversion of bonds into shares.

2. *Tax implication on the transfer of shares on 25-03-2023*

As Mr X got shares of ABC Ltd. in lieu of its bonds, the cost of acquisition of shares shall be the same as that of the bonds. Further, the period of holding of shares shall be reckoned from the date of acquisition of the bonds.

Mr X has sold the shares on 25-03-2023. Therefore, the capital gain or loss arising on such transfer shall be computed in the financial year 2022-23. The computation of capital gain shall be as follows:

Computation of capital gain on transfer of shares	
Period of holding (from 01-01-2010 to 24-03-2023)	13+ Years
Nature of capital gain (period of holding more than 12 months)	Long-term capital gain
Full value of consideration (400 * Rs. 1,000)	400,000
Less: Cost of acquisition (400 * Rs. 500)	(200,000)

Long-term capital gain	2,00,000
Tax rate on capital gain in excess of Rs. 1,00,000	10%†
†As Mr X has paid STT at the time transfer of shares and acquisition is made by mode of transfer referred to in Section 47, long-term capital gain in excess of Rs. 100,000 shall be chargeable to tax at the rate of 10% under Section 112A of the Income-tax Act[55].	

5.5 TAXATION OF COMMERCIAL PAPERS

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP, as a privately placed instrument, was introduced in India in 1990 to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Subsequently, financial institutions were also permitted to issue CP to enable them to meet their short-term funding requirements for their operations. Guidelines for the issue of CP are presently governed by various directives issued by the Reserve Bank of India (RBI), as amended from time to time.

CP may be issued to and held by individuals, banking companies, corporates, non-corporates, Non-Resident Indians (NRIs) and Foreign Portfolio Investors (FPIs). However, investment by FPIs should be within the limits set for their investments by the Securities and Exchange Board of India (SEBI).

CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. Thus, the maturity period of CP cannot exceed 1 year. CPs are issued at a discount and are actively traded in the OTC market. Therefore, the difference between the face value and issue price shall be the gain for an investor if CPs are held till maturity. Whereas, if CPs are transferred before maturity, then the difference between the consideration received on transfer and acquisition cost of CP shall be the gain or loss.

As far as taxability of commercial paper is concerned, the CBDT has clarified *vide Circular No. 647, dated 22-03-1993* that the difference between the issue price and the face value of the CP is treated as 'discount allowed' and not as 'interest paid'. Thus, the same shall not be taxable as interest income in the hands of the investor. Hence, the provisions of the Income-tax Act relating to deduction of tax at source are not applicable in the case of transactions in CPs.

However, where the income from the commercial paper is arising to a non-resident then tax shall be deducted as per the provisions of section 195 of the income-tax Act. Section 195 requires every person to deduct tax if any sum paid or payable to a non-resident person is chargeable to tax in India. The tax in respect of income arising from commercial papers shall

[55] The concessional tax rate under Section 112A is available in case of transfer of equity shares, if STT is chargeable both at the time of transfer and at the time of acquisition of shares. However, the CBDT has relaxed this condition of payment of STT at the time of acquisition in case of acquisition by mode of transfer referred to in Section 47 - Notification No. SO 5054(E) [F.NO. 60/2018 (F.No.370142/9/2017-TPL)], dated 1-10-2018

be deducted at the rate of 30% if the payee is a non-resident not being a foreign company and at 40% if the payee is a foreign company.

The difference between the face value and the issue price of a commercial paper shall be taxable under the head capital gains. As commercial papers are always issued with a maturity period of 1 year or less, any gain arising on transfer/redemption of commercial papers shall always give rise to short-term capital gain. The capital gain shall be taxable as per applicable tax rates in case of a resident person, non-resident person and a foreign company. However, in case of an FPI and Specified fund (*see para 11.6-5a)*, the short-term capital gains will be taxable at the flat rate of 30% under Section 115AD.

Example 8: XYZ Ltd. issued commercial papers having face value of Rs. 50 lakhs to Mr A for Rs. 47 lakhs on 01-07-2022. The commercial papers are redeemable at face value on 31-03-2023. Discuss the tax implication in hands of Mr A if he holds such commercial papers till maturity.

Answer:

CPs are issued at a discount. Therefore, the difference between the face value and issue price shall be the gain for an investor if CPs are held till maturity.

In the given example, commercial papers of face value of Rs. 50 lakhs are issued to Mr A for Rs. 47 lakhs. Therefore, the difference between the face value and issue price (i.e., Rs. 3,00,000) shall be taxable in the hands of Mr A as short-term capital gain.

5.6 TAXATION OF GOVERNMENT SECURITIES

A Government Security (G-Sec) is a tradable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. Securities that are issued for short term (i.e., with a maturity of less than 1 year) are usually called as treasury bills or cash management bills. Whereas, long term securities (i.e., Government securities with a maturity of 1 year or more) are called as Government bonds or dated securities. In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called as State Development Loans (SDLs).

G-Secs are considered as the safest investment instrument as they carry Sovereign's commitment for payment of interest and repayment of principal. They carry practically no risk of default and, therefore, they are also called as risk-free gilt-edged securities. Investors have the option to hold G-Secs in a dematerialized account with a depository (NSDL/CDSL, etc.). This facilitates the trading of G-Secs on the stock exchanges. Thus, G-Secs can be sold easily in the secondary market to meet cash requirements.

5.6-1. Types of government securities

G-Secs are available in a wide range of maturities ranging from less than 91 days to as long as 40 years to suit the duration of varied liability structure of various institutions. Depending upon the maturity period, G-Secs are classified into the following types:

a) Cash Management Bills

Cash Management Bills ('CMBs') are issued for a very short period usually less than 91 days. These are highly flexible bills and are issued as per the cash requirements of the Government. CMBs are issued at a discounted price to their investors and are redeemed at the face value.

b) Treasury Bills

Treasury Bills (T-Bills) are the short-term debt instruments that are issued at a discounted price by the Government of India. These bills are issued in 3 tenors, *namely*, 91 days or 182 days or 364 days. The maturity period of T-Bills does not exceed 1 year.

These bills do not offer any interest to its investors. The return on a T-Bill is the difference between the issue price and the redemption value being the face value.

c) Dated Government Securities (Dated G-Secs)

Dated G-Secs are the type of bonds issued by the RBI on behalf of the government which carry a fixed or floating coupon (interest rate) which is paid on the face value, on a half-yearly basis. Generally, the tenor of dated securities ranges from 5 years to 40 years.

d) State Development Loans

State Governments also raise loans from the market which are called as State Development Loans (SDLs). Like Dated G-secs, interest on SDLs is serviced at half-yearly intervals and the principal is repaid on the maturity date.

5.6-2. Taxability of Cash Management Bills and T-bills

Cash Management Bills and Treasury Bills (T-Bills) are issued for a maturity period of less than 1 year, and they do not offer any interest to the investor. The income of a person investing in such instruments is the difference between the issue price and the face value. Profit arising on redemption or transfer of these bills shall be considered as a short-term capital gain which shall be chargeable to tax at the rates applicable in case of an assessee.

5.6-3. Taxability of Dated G-Secs and SDLs

Dated Government securities (Dated G-Secs) and State Development Loans (SDLs) are issued in the form of bonds by Central Government and State Governments, respectively. The taxability of these securities shall be the same as in case of bonds (*see Para 5.2* for taxation in case of bonds).

No tax is required to be deducted under section 193 from the payment of interest to a resident person in respect of securities of Central Government or State Government except in case of 8% Savings (Taxable) Bonds, 2003 and 7.75% Savings (Taxable) Bonds, 2018. Further, tax on interest paid in respect of 8% Savings (Taxable) Bonds, 2003 and 7.75% Savings (Taxable) Bonds, 2018 is required to be deducted by the payer only when the amount of interest paid during the year exceeds Rs. 10,000.

Example 9: XYZ Bank invested Rs. 50 lakhs in Dated G-Secs on 01-01-2015. The bonds are not listed on any recognized stock exchange in India. The details regarding face value, issue price, coupon rate, date of maturity and number of bonds issued are as follows:

Face Value	Rs. 100 each
Issue price	Rs. 125 each
No. of Bonds issued	40,000
Coupon Rate	7.50% per annum
Date of Maturity	31-12-2025

The interest on bonds is paid half-yearly on June 30 and December 31 every year. The Bank transferred such bonds on 01-01-2023 at Rs. 150 each. Compute the amount of interest income and capital gain chargeable to tax in the hands of XYZ Bank for the financial year 2022-23.

Answer:

1. Computation of interest on Dated G-Secs chargeable to tax for the financial year 2022-23.

Particulars	*Amount*
Interest accrued for the month of April, 2022 to Dec, 2022 (40,000 * Rs. 100 * 7.50%* 9/12)	225,000
Interest chargeable to tax for the financial year 2022-23	**225,000**

2. Computation of capital gain chargeable to tax for the financial year 2022-23.

Computation of capital gain	
Period of holding (from 01-01-2015 to 31-12-2022)	8 Years
Nature of capital gain (holding period is more than 36 months)	Long-term capital gain
Full Value of Consideration (40,000 bonds * Rs. 150 each)	60,00,000
Less: Cost of Acquisition (40,000 Bonds * Rs. 125)	50,00,000
Long-term capital gain	10,00,000

Tax rate on capital gain	20%†
† Long-term capital gain arising from the transfer of bonds is chargeable to tax at 20% if the bonds are not listed on a recognized stock exchange in India. Further, benefit of indexation is not allowed while computing capital gain.	

5.7 TAX FREE BONDS

As the name suggests, tax-free bonds are the bonds that provide tax-free income. The interest paid on these bonds is tax-free in the hand of the investor. Section 10 of the Income-tax Act provides various exemptions for the income earned from bonds issued by various organizations (*see Para 4.3-4.* for list of tax-free bonds).

However, the capital gains arising on transfer or redemption of tax-free bonds shall be chargeable to tax. The taxability of such capital gains is the same as in the case of Coupon Bonds (*See para 5.2-2 to 5.2-4).*

Example 10: Mr X is issued 5,000 tax-free bonds of NABARD at the rate of Rs. 120 each in year 00. The bonds are listed on a recognized stock exchange in India and carrying an interest rate of 5% per annum. The bonds are redeemable in Year 02 at the rate of Rs. 150 each. Discuss the tax implications.

Answer

The tax implications in the hands of Mr X shall be as follows:

1. *Interest on bonds*

Interest on tax-free bonds is exempt under section 10 of the Income-tax Act. Thus, no tax shall be payable by Mr X on interest income.

2. *Capital gain arising on redemption of bonds*

Capital gain arising on redemption of bonds shall be computed as follows:

Particulars	*Rs.*
Full value of consideration (Rs. 150 * 5000) *Less:* Cost of acquisition (Rs. 120 * 5000)	750,000 (600,000)
Long-term capital gain	**1,50,000**
Tax rate	**10%***

Note: *As bonds are listed on a stock exchange and the period of holding is more than 12 months, the resultant long term capital gain shall be chargeable to tax at the rate of 10% without providing the benefit of indexation.*

5.8 TAXATION OF MUTUAL FUNDS

Mutual Funds are the funds which collect money from the investor and invest the same in the capital market. Mutual Funds invest in a variety of instruments such as equity, debt, bonds, etc.

5.8-1. Types of Mutual Funds

Mutual funds are classified into the following categories based on their investment portfolios:

a) Equity Oriented Funds

These funds invest majorly in shares of companies. They allow investors to participate in the equity market. Though categorised as high risk, these schemes also have a high return potential in the long run (*see Para 6.7-2* for Taxation of Mutual Funds)

b) Debt Oriented Funds

These funds invest in debt securities, or interest-bearing instruments like government securities, bonds, debentures, etc. These funds provide low return but are considered as safe for investment as compared to equity funds.

c) Money Market Funds or Liquid Funds

These funds invest in liquid instruments such as Treasury Bills and Commercial Papers, etc. having high liquidity. These funds are suitable for conservative investors who want to invest their surplus funds over a short-term for a reasonable return.

d) Balanced or Hybrid Funds

These funds invest in all kinds of assets, *that is*, equity, debt and money market instruments. Some funds invest their major portion into the equity and the lesser in the debts whereas some opt for the other way around based on their needs for return and risk appetite

5.8-2. Tax on income from mutual funds

Mutual Funds offer investors two main sources of earnings: Capital Gains and Dividends. The taxation of dividend income from different types of mutual funds is governed by common provisions under the Income-tax Act. However, the taxation of capital gains resulting from the transfer or redemption of mutual fund units depends on the type of fund.

Until Assessment Year 2023-24, mutual funds were categorized into two types for taxation purposes: 1) Equity-oriented Mutual Funds and 2) Other Funds. However, with effect from Assessment Year 2024-25, mutual funds are now classified into three types for taxation purposes: 1) Equity-oriented Mutual Funds, 2) Specified Funds, and 3) Other Funds.

In this chapter, we will focus on explaining the taxation provisions related to Specified and Other Mutual Funds (for details on Taxation of Equity-Oriented Mutual Funds, please refer to Para 6.7-2).

5.8-3. Tax on dividend from Mutual Funds

Dividend received by a resident unit-holder from a mutual fund shall be taxable in his hands as per applicable tax rates (*see Annexure E* for the Tax Rates). An investor is allowed to claim a deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of the total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person to realise such dividend.

Where the dividend is received by a non-resident person, foreign company, FPI, Offshore fund or specified fund, the dividend shall taxable at concessional rates. However, in such cases, the assessee shall not be allowed to deduct any expenditure from such income. Further, deduction under Chapter VIA (i.e., section 80C to 80U) shall not be allowed from such income. The relevant provisions of the Act which provides for the concessional tax rate are as follows:

Section	*Assessee*	*Income*	*Tax Rate*
115A	Non-resident or Foreign Company	Dividend	10% if received from IFSC unit[56] otherwise 20%
115AB	Offshore fund	Dividend from units of a mutual fund purchased in foreign currency	10%
115AD	FPIs	Dividend income from any security (other than units referred to in Section 115AB)	20%
115AD	Specified Fund	Dividend income from any security (other than units referred to in Section 115AB)	10%

[56] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25.

Example 11: Mr A (resident in India) invested Rs. 50 lakhs in debt-oriented mutual funds. He received a dividend of Rs. 500,000 in respect of such units. He paid an interest of Rs. 150,000 on the amount borrowed for investing in mutual funds. Determine the taxability of dividend in the hands of Mr A. Whether taxability will remain the same if Mr A is a non-resident in India.

Answer:

The amount of dividend income taxable in the hands of Mr A shall be as follows:

Particulars	*Amount (in Rs.)*
Amount received as dividend [A]	500,000
Expenses incurred for realising dividend [B]	150,000
Maximum amount which can be claimed as expenses [C = A * 20%]	100,000
Taxable dividend income [D = A - C]	400,000

Since Mr A is resident in India, dividend income will be taxable in his hands at the normal tax rates. However, if he is non-resident in India then he would not be allowed to claim a deduction for expenses and entire dividend income of Rs. 500,000 shall be taxable at the rate of 20% (subject to the provisions of DTAA).

5.8-4. Tax on capital gain from specified Mutual Funds

The specified mutual fund (SMF) is a mutual fund where not more than 35% of its total proceeds are invested in the equity shares of domestic companies. The taxation of capital gain from SMF is governed by the provision of Section 50AA[57].

Section 50AA applies prospectively to the SMFs acquired on or after 01-04-2023. This means the SMFs acquired on or before 31-03-2023 will be subject to taxation as per the normal provisions as applicable in the case of any other mutual fund. Section 50AA will not apply to the specified mutual funds acquired on or before 31-03-2023 but redeemed or transferred on or after 01-04-2023.

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute the capital arising from its transfer or redemption. However, as per Section 50AA, the capital gains arising from the transfer, redemption or maturity of SMFs shall be taxable as short-term capital gains irrespective of the period of holding.

The short-term capital gains from SMFs shall be computed in the following manner:

Particulars	*Rs.*

[57] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25.

Full value of consideration *Less:* *(a)* Cost of acquisition of units *(b)* Expenditure incurred wholly and exclusively in connection with the transfer or redemption or maturity of SMFs	xxx (xxx) (xxx)
Short-term capital gain or loss	**xxx**

The short-term capital gain so computed shall be taxable at normal tax rates as applicable in the case of the assessee.

5.8-5. Tax on capital gain from other Mutual Funds

5.8-5a Long-term capital gain from other mutual fund

The difference, between the value at which an investor purchased the units of a mutual fund scheme and the value at which these units are sold or redeemed, shall be taxable under the head capital gains. Units of a Debt Oriented Mutual Fund (whether listed or unlisted) are treated as long-term capital asset if they are held for more than 36 months immediately preceding the date of transfer.

Long-term capital gain arising from the transfer of debt-oriented mutual funds is chargeable to tax at the rate of 20%. Further, capital gain shall be computed after taking the benefit of indexation. However, in the following cases, the tax shall be charged at the rate of 10% without providing the benefit of indexation:

Section	*Assessee*	*Circumstances*
112(1)(c)	Non-resident or foreign company	If units are not listed on a recognised stock exchange in India
115AB	Offshore fund	If units are purchased in foreign currency
115AD	FPIs or Specified Funds	If units are purchased in Indian currency

5.8-5b Short-term capital gain from other mutual fund

Short-term capital gains arising from the sale of units of debt-oriented mutual funds is chargeable to tax as per the rate applicable in case of an assessee.

Example 12: Mr A acquired 1,000 units of a debt-oriented mutual fund at Rs. 150 per unit on 01-01-2017. He sold such units on 15-03-2023 at Rs. 300 per unit. Compute the amount of capital gain chargeable to tax in hands of Mr A.

Answer:

Computation of capital gain	
Period of holding (from 01-01-2017 to 14-03-2022)	6+ Years
Nature of capital gain (period of holding is more than 36 months)	Long-term capital gain
Full Value of Consideration (1,000 units * Rs. 300)	300,000
Less: Indexed Cost of Acquisition [Note]	(188,068)
Long-term capital gain	**111,932**
Tax rate on capital gain	**20%**

Note: The Indexed cost of acquisition is calculated in two steps. The first step is to calculate the cost of acquisition of capital asset. In the second step, such cost of acquisition is multiplied by the CII of the year in which capital asset is transferred and divided by CII of the year in which asset is acquired.

$$\text{Indexed Cost of Acquisition} = \text{Cost of Acquisition} \times \frac{\text{CII of the year in which asset is transferred}}{\text{CII of the year in which asset is first held by assessee or CII of 2001-02, whichever is } \textit{later}}$$

The indexed cost of acquisition shall be Rs. 188,068 [150,000 * 331/264].

5.9 MASALA BONDS

Rupee Denominated Bonds or Masala Bonds are an innovative type of bonds, which are linked to Rupee but issued to overseas investors. Masala Bonds were first issued by the International Finance Corporation (IFC) in London to increase foreign investment in India. IFC is a member of the World Bank which invests in sustainable private enterprises in developing countries. IFC named the Bond as ‘Masala’ to reflect the spiciness and culture of India.

As Masala bond is issued and denominated in Indian currency, it protects Indian Company from currency risk and instead transfers the risk of currency fluctuation to investors buying these bonds. The detailed guidelines for issuance of Rupee Denominated Bonds overseas are set out in the RBI’s Circular No. 17, Dated 29-09-2015 as amended from time to time. As per RBI Guidelines, any corporate or body corporate is eligible to issue Rupee Denominated Bonds overseas. Real Estate Investment Trusts (REITs), Infrastructure Investment Trusts (InvITs) and Banks are also eligible to issue RDBs.

The RDBs borrowing procedure pursues the same guidelines as the corporate follows to issue External Commercial Borrowings (ECBs). The corporate needs RBI permission to avail masala bonds if they issue ECBs under the approval route, whereas under the automatic route of ECBs issue, RBI approval is not needed. The payments of coupon and redemptions are settled in foreign currency. The amount to be issued, the average maturity period and end-use of the proceeds from the Masala Bond are made as per RBI's guidelines on ECBs.

5.9-1. Tax on interest arising from Masala Bonds

In general, taxability of interest on Masala bonds is the same as in case of coupon bonds (*Refer para 5.2-1.)*

However, there are some cases where interest arising from bonds is chargeable to tax at a concessional rate and the assessee is not allowed to deduct any expenditure incurred to earn such interest income. Further, no deduction under sections 80C to 80U is allowed from such interest income. Such provisions are as follows:

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or Foreign Co.	Interest payable in respect of rupee-denominated bonds issued by an Indian company or REITs/InVITs. However, if interest is payable in respect of bonds issued during the period beginning from the 17th day of September 2018 and ending on the 31st day of March 2019, same shall be exempt from tax as per section 10(4C) of the Income-tax Act.	5%
Section 115A	Non-resident or Foreign Co.	Interest payable in respect of rupee-denominated bonds listed only on a recognised stock exchange located in any International Financial Services Centre, issued during the specified period by an Indian company or REITs/InVITs	4% if bonds are issued before 01-07-2023 and 9% if bonds are issued on or after 01-07-2023[58]
Section 115AD	Foreign Portfolio Investor (FPI)	Interest payable in respect of rupee-denominated bonds issued by an Indian company	5%
Section 115AD	Specified funds (*see para 11.6-5a)* (FPI)	Interest payable in respect of rupee-denominated bonds issued by an Indian company	10%

[58] Amendment made by the Finance Act, 2023 with effect from 01-07-2023.

5.9-2. Tax on long-term capital gain arising from transfer or redemption of masala bonds

In general taxability of long-term capital gains arising from the transfer of Masala bonds is the same as coupon bonds *(refer para 5.2-2)*

However, *fifth proviso* to Section 48 provides that any gain arising to a non-resident, on account of appreciation of rupee against a foreign currency at the time of redemption of the rupee-denominated bond of an Indian company, it shall be ignored while making computation of full value of consideration.

5.9-3. Tax on short-term capital gain from masala bonds

Short-term capital gain arising from the transfer of bonds is generally taxable at normal rates as applicable in case of an assessee.

5.9-4. Transactions not regarded as transfer

5.9-4a Transfer of Rupee Denominated Bond

Any transfer of Rupee-Denominated Bond of an Indian company by a non-resident to another non-resident outside India is not treated as a transfer.

5.9-4b Transfer through Stock Exchange located in IFSC

Any transfer of Rupee Denominated Bond of an Indian company by a non-resident on a recognised stock exchange located in any International Financial Services Centre is not treated as transfer provided the consideration is paid or payable in foreign currency. It is to be noted that this provision shall apply even if the transfer is not amongst non-residents.

Where a non-resident instead of investing directly, invest in aforesaid securities through Category-III Alternative Investment Fund (AIF), no tax benefit was available under the Income-tax Act. To make this investment tax-neutral for non-residents even when they invest indirectly through AIF, a new section 10(4D) has been inserted under the Income-tax Act by Finance (No. 2) Act, 2019 to provide tax exemption to Category-III AIFs in respect of capital gain arising from the transfer of such securities to the extent gains arise in respect of units in the fund held by a non-resident. However, the exemption under section 10(4D) is provided only when Category-III AIFs is located in IFSC and all the units of the fund are held by non-residents (except units held by sponsor or manager). This condition is relaxed from Assessment Year 2023-24 to provide that if the non-resident unitholder(s) becomes resident or deemed to be resident in India in any previous year subsequent to the year in which units were issued to him, the exemption shall continue to be available to specified fund provided such unitholders do not hold more than 5% of the total units issued by the specified fund. Further, this benefit shall be available subject to the fulfilment of other conditions as prescribed under section 10(4D) [see Chapter 11 for detailed discussion]. The transfer of securities should be done through stock exchange located in IFSC and consideration for such transfer should be paid or payable in convertible foreign currency.

From Assessment Year 2022-23, the exemption under Section 10(4D) is available to the investment division of offshore banking unit as well (*see Chapter 11* for detailed discussion).

5.10 FOREIGN CURRENCY CONVERTIBLE BONDS

A Foreign Currency Convertible Bond (FCCB) is a quasi-debt instrument which is issued by any corporate entity, international agency or sovereign state to investors all over the world. They are denominated in any freely convertible foreign currency.

FCCBs represent equity-linked debt security which can be converted into shares or depository receipts. The investors of FCCBs have an option to convert it into equity normally in accordance with pre-determined formula and sometimes also at a pre-determined exchange rate. The investor also has the option to retain the bond. The FCCBs, due to their convertibility nature, offers a privilege to the issuer of lower interest cost than that of the similar non-convertible debt instrument. Like GDRs, FCCBs are also freely tradable and the issuer has no control over the transfer mechanism and cannot be even aware of the ultimate beneficiary.

FCCBs are considered as an approved instrument of accessing external commercial borrowings (ECBs). Thus, the terms and conditions normally applicable to ECBs are also applicable to convertible bonds.

5.10-1. Tax on interest arising from FCCBs

Taxability of interest on Foreign currency convertible bonds is the same as in case of coupon bonds (*See para 5.2-1.).*

However, interest arising to a non-resident on foreign currency convertible bonds issued by an Indian Company or Public sector company (PSU) shall be taxable at a concessional rate of 10% as per section 115AC of the Income-tax Act. In such a case, the assessee is not allowed to deduct any expenditure incurred to earn such interest income. Further, no deduction (including deduction under sections 80C to 80U) is allowed from such interest income.

5.10-2. Taxability on conversion of bonds into shares or debentures of the company

Where the investor converts FCCBs into shares of the company, the taxability shall be the same as in case of conversion of convertible bonds *(refer para 5.4-1.).*

5.10-3. Tax on Capital gains arising from transfer of FCCBs

Taxability of capital gains arising from the transfer of Foreign currency convertible bonds is the same as in case of coupon bonds *(see para 5.2-2 to 5.2-4).*

However, the long-term capital gain arising to a non-resident on transfer of foreign currency convertible bonds issued by an Indian Company or Public sector company (PSU) shall be taxable at the rate of 10% as per section 115AC of the Income-tax Act.

5.10-4. Transactions not regarded as transfer

5.10-4a Transfer of foreign currency convertible bonds (FCCBs)

Any transfer of foreign currency convertible bonds (FCCBs) of an Indian company or Public sector company (PSU) by a non-resident to another non-resident outside India is not treated as transfer, provided the Bonds were purchased in foreign currency under a scheme approved by the Central Government.

5.10-4b Transfer through Stock Exchange located in IFSC

Any transfer of foreign currency convertible bonds (FCCBs) by a non-resident on a recognised stock exchange located in any International Financial Services Centre is not treated as a transfer provided the consideration is paid or payable in foreign currency. It is to be noted that this provision shall apply even if the transfer is not amongst non-residents.

Where a non-resident instead of investing directly, invest in aforesaid securities through Category-III Alternative Investment Fund (AIF), no tax benefit was available under the Income-tax Act. To make this investment tax-neutral for non-residents even when they invest indirectly through AIF, a new section 10(4D) has been inserted under the Income-tax Act by Finance (No. 2) Act, 2019 to provide tax exemption to Category-III AIFs in respect of capital gain arising from the transfer of such securities to the extent gains arise in respect of units in the fund held by a non-resident. However, the exemption under section 10(4D) is provided only when Category-III AIFs is located in IFSC and all the units of the fund are held by non-residents (except units held by sponsor or manager). This condition is relaxed from Assessment Year 2023-24 to provide that if the non-resident unitholder(s) becomes resident or deemed to be resident in India in any previous year subsequent to the year in which units were issued to him, the exemption shall continue to be available to specified fund provided such unitholders do not hold more than 5% of the total units issued by the specified fund. Further, this benefit shall be available subject to the fulfilment of other conditions as prescribed under section 10(4D) [see Chapter 11 for detailed discussion]. The transfer of securities should be done through stock exchange located in IFSC and consideration for such transfer should be paid or payable in convertible foreign currency.

From Assessment Year 2022-23, exemption under section 10(4D) is available to the investment division of offshore banking unit as well (please refer chapter 11 for detailed discussion)

Example 13: Mr A (a non-resident) acquired 5,000 foreign currency convertible bonds (FCCBs) of ABC Ltd. at the rate of Rs. 1,000 each on 01-01-2015. The bonds are listed on IFSC stock exchange and are convertible into shares of ABC Ltd. at a conversion ratio of 50:1 (50 shares in lieu of 1 Bond) on 01-01-2023. Mr X exercised the option to convert 1,000 FCCBs into shares. The market value of shares on the date of conversion is Rs. 25 per share. Determine the taxability if Mr A did the following transactions:

a) 50,000 shares received in exchange for bonds were transferred on 15-02-2023 for Rs. 30 each. The shares were listed on a recognized stock exchange in India and STT was paid at the time of transfer.
b) 2,000 bonds were transferred at Rs. 1,200 each through IFSC stock exchange on 31-07-2022.
c) 1,000 bonds were transferred to another non-resident outside India on 01-02-2023.
d) 1,000 bonds were transferred to Mr B, a person resident in India, on 31-03-2023 for Rs. 1,500 each. This transaction was not made through the stock exchange.

Answer:

The tax implications of various transactions made by Mr A shall be as follows:

1. *Conversion of FCCBs into shares on 01-01-2023*

When Foreign Currency Exchange Bonds (FCEB), issued to non-residents by established Indian companies, are converted into shares of any company, such conversion is not treated as a transfer. Accordingly, no capital gain shall arise on the conversion of FCEB into shares.

2. *Sale of shares allotted in lieu of bonds*

As Mr A got shares of ABC Ltd. in lieu of FCCBs, the cost of acquisition of shares shall be the same as that of the bonds. Further, the period of holding of shares shall be reckoned from the date of acquisition of the bonds.

The computation of capital gain shall be as follows:

Computation of capital gain on transfer of shares	
Period of holding (from 01-01-2015 to 14-02-2023)	8+ Years
Nature of capital gain (period of holding is more than 12 months)	Long-term capital gain

Sale Price (50,000 shares * Rs. 30)	15,00,000
Less: Cost of acquisition (1,000 Bonds * Rs. 1,000)	(10,00,000)
Long-term capital gain	**5,00,000**
Tax rate on capital gain in excess of Rs. 1,00,000	10%†
† As per Section 112A of the Income-tax Act, the long-term capital gain in excess of Rs. 100,000 shall be chargeable to tax at the rate of 10%.	

3. *Transfer of bonds through IFSC stock exchange*

Any transfer of foreign currency convertible bonds (FCCBs) by a non-resident on a recognised stock exchange located in any International Financial Services Centre is not treated as transfer provided the consideration is paid or payable in foreign currency. Thus, no capital gain shall arise in this case.

4. *Transfer of bonds to a non-resident outside India*

Any transfer of foreign currency convertible bonds (FCCBs) of an Indian company by a non-resident to another non-resident outside India is not treated as transfer, provided the Bonds were purchased in foreign currency under a scheme approved by the Central Government. Thus, no capital gain shall arise in this case also.

5. *Over-the-counter transfer of bonds to Mr B*

As the bonds were transferred to Mr B, a person resident in India, and transaction was not made through stock exchange located in IFSC. The capital gain arising on the transfer of bonds shall be chargeable to tax in the hands of Mr A.

The computation of capital gain shall be as follows:

Computation of capital gain on transfer of bonds	
Period of holding (from 01-01-2015 to 30-03-2023)	8+ Years
Nature of capital gain (Period of holding is more than 12 months)	Long-term capital gain
Sale Price (1,000 Bonds * Rs. 1,500)	15,00,000
Less: Cost of Acquisition (1,000 Bonds * Rs. 1,000)	10,00,000
Long-term capital gain	500,000
Tax rate on capital gain	10%†
†Long-term capital gain shall be chargeable to tax at the rate of 10% as per section 115AC of the Income-tax Act, 1961.	

5.11 TAXATION OF MARKET LINKED DEBENTURES

Market Linked Debentures (MLDs) are financial instruments regulated in India by various laws and regulations[59]. These debentures differ from traditional fixed-income investments because their returns are not fixed but instead linked to the performance of an underlying market index or security. The movement of the underlying asset determines the returns on MLDs. MLDs can be of two types; 1) Principal Protected MLDs and 2) Principal Non-Protected MLDs.

Principal Protected MLDs guarantee the return of the investor's principal amount at maturity, regardless of the underlying asset's performance. Whereas Principal Non-Protected MLDs do not guarantee the return of the principal amount at maturity. The coupon rates vary based on the performance of the underlying asset.

The key features of MLDs are as follows:

(a) Computation of Coupon Rate: The returns on MLDs are variable and depend on the performance of the underlying index or security. If the underlying asset performs well, the MLDs will provide a higher return at maturity, but if it performs poorly, the returns may be lower or result in a loss of principal.

(b) Issuers and Investors: MLDs can be issued by companies with a minimum net worth of Rs. 100 crores. Investors, typically high-net-worth individuals (HNIs) or ultra HNIs, can invest in MLDs.

(c) Tenure and Repayment: The maximum tenure for MLDs is generally between 12 to 36 months. Unlike traditional debentures that provide periodic interest payments, MLDs offer returns only upon maturity, comprising the principal sum plus earned interest.

5.11-1. Tax on income from MLDs

Up to Assessment Year 2023-24, income from market-linked debentures was taxable similarly to regular debentures or coupon bonds. However, with effect from the assessment year 2024-25, a new section 50AA is inserted under the Income-tax Act, which governs the taxability of income arising from MLDs held as capital assets.

Section 50AA defines MLDs as security which has an underlying principle component in the form of debt security and where the returns are linked to the market returns on other underlying securities or indices and includes any security classified or regulated as an MLD by the SEBI.

MLDs transferred, redeemed or matured on or after 01-04-2023 shall be subject to taxation under Section 50AA even if such MLDs were issued or acquired before that date. However, if the investor chooses to redeem or transfer the MLDs prematurely on or before 31-03-2023, the income and tax on the MLDs shall be calculated according to the normal provisions.

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[59] SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021, SEBI Circular No. SEBI/HO/DDHS/P/CIR/2021/613, dated 10-08-2021, Section 71 of the Companies Act, 2013 and Income-tax Act, 1961

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute the capital gain arising from its transfer or redemption. However, as per Section 50AA, the capital gains arising from the transfer, redemption or maturity of MLDs shall be taxable as short-term capital gains irrespective of the period of holding.

The short-term capital gains from MLDs shall be computed in the following manner:

Particulars	*Rs.*
Full value of consideration *Less:* *(c)* Cost of acquisition of MLDs *(d)* Expenditure incurred wholly and exclusively in connection with the transfer, redemption, or maturity of MLDs	xxx (xxx) (xxx)
Short-term capital gain or loss	xxx

The short-term capital gain so computed shall be taxable at normal tax rates as applicable in the case of the assessee.

5.12 TAXATION OF FINANCIAL SECURITIES

5.12-1. Pass-Through Certificates or Securitised Debt Instruments

Pass-Through Certificates (also known as 'Securitised Debt Instruments') are debt securities which are created from a select pool of assets, mainly, debt or receivables of an enterprise. It includes a complex process where a large number of loans given by an enterprise is pooled together and proceeds arising therefrom are transferred to the holder of securitized debt instruments.

The process begins with the entity that holds the assets, i.e., the originator. It sells its assets being debt or receivables to a legal entity called 'Special Purpose Vehicle (SPV)'. After acquiring the debt or receivables of the originator, SPV issues securities that are backed by such debt or receivables. The proceeds from the underlying debt or receivables are transferred by SPV to the security holder. SPV works as a pass-through entity which transfers the income from debt or receivable of the originator to its security holders, the securities issued by the SPV is called Pass-Through Certificates. Where debt or receivables acquired by the SPV from the originator are secured by the mortgage, securities issued by SPV are called 'Mortgage-Backed Securities' or 'Asset-Backed Securities'.

For example, housing loans of a loan originator (*say*, a housing finance company) can be pooled, and securities can be created, which represent a claim of the security holder on the repayments made by home loan borrowers.

Securitised Debt Instruments are included in the definition of 'Securities' as defined under section 2(h) of the Securities Contracts (Regulation) Act, 1956. The public offer and listing of these instruments are regulated by SEBI through the SEBI (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008. Various terms which are important to understand the process of issuance of Securitised Debt Instruments are defined in the said regulations as follows:

a) Originator

'Originator' means the assignor of debt or receivables to a special purpose distinct entity for the purpose of securitization.

b) Asset pool

'Asset Pool', in relation to a scheme of a special purpose distinct entity, means the total debt or receivables, assigned to such entity and in which investors of such scheme have a beneficial interest.

c) Securitisation

'Securitisation' means the acquisition of debt or receivables by any special purpose distinct entity from any originator or originators for issuance of securitised debt instruments to investors based on such debt or receivables and such issuance.

d) Special Purpose Distinct Entity (SPV)

'Special Purpose Distinct Entity' means a trust which acquires debt or receivables out of funds mobilized by it by the issuance of securitised debt instruments through one or more schemes, and includes any trust set up by the National Housing Bank under the National Housing Bank Act, 1987 or by the National Bank for Agriculture and Rural Development (NABARD) under the National Bank for Agriculture and Rural Development Act, 1981.

e) Investor

Investor shall mean:

(a) With respect to "securities debt instrument" means any person holding any securitised debt instrument which acknowledges the interest of such person in the debt or receivables assigned to the special purpose distinct entity; and

(b) With respect to "security receipts" means a qualified buyer holding security receipts that acknowledge the interest in the financial asset assigned to the issuer.

5.12-2. Security Receipts

'Security Receipt' is defined under clause (zg) of section 2 Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). It means a receipt or other security issued by Asset Reconstruction Company to any Qualified Buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitization.

Before understanding the security receipt, it is important to understand the Asset Reconstruction Companies (ARCs) and the concept of securitization.

ARCs are created to manage and recover Non-performing Assets (NPAs) of Banks and Financial Institutions. Essentially, ARC functions as a specialized financial entity that isolates NPAs from the balance sheets of Bank/financial institutions and facilitates the latter to concentrate on normal banking activities. Banks and financial institutions sell a large proportion of their bad loans or NPAs to ARCs. Then ARCs recover NPAs or bad loans through attachment, liquidation, etc. ARCs are expected to make profits by buying NPAs at a lower price. ARC can acquire the NPAs or bad loans of financial institutions or banks on their own account or through the issuance of Security Receipts (SRs) to Qualified Institutional Buyers. This whole process is called 'securitisation' whereby loans of banks and financial institutions are converted into marketable securities through the issuance of security receipts.

SARFAESI Act provides a legal framework for the securitization of financial assets and asset reconstruction. The Asset Reconstruction Companies are regulated by the RBI. The security receipts issued by ARCs are included in the definition of 'securities' as defined under section 2(h) of the Securities Contracts (Regulation) Act, 1956. Further, the public offer and listing of security receipts are regulated by SEBI through the SEBI (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008.

Various terms which are important to understand in the context of security receipt are defined in the SARFAESI Act as follows:

a) Asset Reconstruction

'Asset Reconstruction' means the acquisition by any asset reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the realisation of such financial assistance.

b) Originator

'Originator' means the owner of a financial asset which is acquired by an asset reconstruction company for securitisation or asset reconstruction.

c) Asset Reconstruction Company

'Asset Reconstruction Company' means a company registered with Reserve Bank under section 3 of the SARFAESI Act to carry the business of asset reconstruction or securitisation or both

d) Securitisation

'Securitisation' means the acquisition of financial assets by any asset reconstruction company from any originator, whether by raising funds by such asset reconstruction company from qualified buyers by the issue of security receipts representing an undivided interest in such financial assets or otherwise.

e) Qualified Buyer

'Qualified Buyer' means a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or asset reconstruction company which has been granted a certificate of registration under section 3(4) or any asset management company investing on behalf of a mutual fund or a foreign institutional investor registered with SEBI or any category of non-institutional investors as may be specified by RBI or any other body corporate as may be specified by the SEBI.

5.12-3. Taxation of Financial Securities

Taxability of Securitized Debt Instruments and Security Receipts is governed by Section 115TCA read *with* Section 10(23DA) of the Income-tax Act whereby pass-through status has been provided to securitization trusts, *that is*, SPVs or trusts set up by ARCs. Thus, income arising from securitization trust is exempt from tax under Section 10(23DA). Whereas, income accrued or received from the securitisation trust from the activity of securitization shall be taxable in the hands of the investor under section 115TCA in the same manner and to the same extent as if the investment in underlying assets (i.e., debts or receivables of the originator entity) been made directly by him and not through the securitization trust.

The income accruing or arising to, or received by, the securitisation trust, during a previous year, if not paid or credited to the investor thereof, shall be deemed to have been credited to the account of the investors on the last day of the previous year in the same proportion in which investors would have been entitled to receive the income had it been paid in the previous year. Thus, in simple words, the securitization trust is deemed to have distributed the entire income earned during a previous year to its investors.

CBDT *vide* Notification no. 46/2016, dated 17-06-2016 notified that no deduction of tax shall be made on payments to a securitisation trust, which are in nature as specified under section 10(23DA) of the Income-tax Act, i.e., income from the activity of securitisation.

Further, it is the liability of the securitisation trust to deduct tax while distributing the income to its investors. The tax is required to be deducted under section 194LBC of the Income-tax Act at the following rates:

a) where an investor is a resident in India

The tax shall be deducted at the rate of 25% from the income distributed to an individual or HUF. If the recipient is any other person, the tax shall be deducted at the rate of 30%. These rates shall not be further increased by Surcharge and Health & Education Cess.

b) where an investor is a non-resident or a foreign company

The tax shall be deductible at the rate provided under Part II of First Schedule of Finance Act of the relevant year if the recipient is a foreign company or non-resident. The rate of tax shall be increased by the applicable surcharge and health & education cess.

Furthermore, when securitization trust distributes any income to its investors, it shall be required to furnish a statement to the investors as well as to the Income-tax department giving the details of the nature of the income paid during the previous year to investors.

The statement shall be required to be furnished to the investors in Form No. 64F by the 30th June of the financial year following the previous year during which the income is distributed.

The statement shall be required to be furnished to the Income-tax department in Form No. 64E by the 30th November of the financial year following the previous year during which the income is distributed.

Example 14: A securitisation trust has derived the following income from securitisation activity during the year:

Nature of income	*Amount (in lakhs)*
Income under the head profit and gains from business and profession	50
Income under the head capital gains	25
Income from other sources	10

One of its investors A Ltd. holds 40% share in it. During the year, such securitisation has credited the entire income to the accounts of its investors except for income in the nature of other sources worth Rs. 5 lakhs. Determine the taxable income both in the hands of securitisation trust and A Ltd.

Answer:

Taxability in the hands of Securitisation Trust

No taxability will arise in the hands of securitisation trust as it enjoys pass-through status by virtue of section 115TCA and its income is exempt under section 10(23DA). However, it is required to deduct tax at source in accordance with the provision of Section 194LBC.

Taxability in the hands of A Ltd

Nature of income	*Amount (in lakhs)*
Income credited by the securitisation trust: Income under the head profit and gains from business and profession Income under the head capital gains Income from other sources	 20 10 2
Total income credited [A]	32
Income deemed to be credited [B = 5 * 40%]	2
Total Income [C = A + B]	**34**

Review Questions:

1. Which methods of accounting are allowed in the Income-tax Act?

(*a*) Mercantile system

(*b*) Cash system

(*c*) Either mercantile or cash system whichever is followed regularly

2. Which of the following are the key features of a bond?

(*a*) Maturity (Tenure)

(*b*) Interest (Coupon)

(*c*) Principal (Face Value)

(*d*) All of these

3. For coupon bonds listed on a recognised stock exchange period of holding to qualify as a long-term capital asset is _________.

(*a*) greater than 12 months

(*b*) greater than 3 months

(*c*) less than 12 months

(*d*) One month

4. Tax rate for listed Sovereign Gold Bonds (SGBs) without indexation is _____.

(*a*) 15 percent

(*b*) 20 percent

(*c*) 10 percent

(*d*) 30 percent

CHAPTER 6: TAXATION OF EQUITY PRODUCTS[60]

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Source of Income
- Tax treatment of listed equity shares
- Tax treatment of unlisted equity shares
- Taxation of Preference shares
- Taxation of GDR/ADR
- Taxation of Warrants
- Taxation in Equity Oriented Mutual Funds
- Equity Derivatives
- Dividend and Bonus Stripping

The equity market, often called a stock market or share market, is a place where shares of companies or entities are traded. The market allows sellers and buyers to deal with equity shares and other securities on the same platform. Equity share represents the ownership of a person in the company. Equity investments are generally considered as risky as compared to debt instruments. There are many types of equity-related products available in the market, but they are not the same. Tax rules applicable to these products also differ. Taxes can reduce the overall returns that an investor gets from a product. Thus, it is important to understand the taxability of equity products before investing therein.

6.1 SOURCES OF INCOME

An equity investment generally refers to the buying and holding of shares by an investor in anticipation of the return of income. Two types of income are earned from investment in equity products - Capital gains and Dividend Income. Capital Gains arise when a capital asset is sold at a price higher than its cost of acquisition. The dividend is the sum paid by the company out of its profits to shareholders which, in turn, reduce the retained profits of the company.

The taxability of both types of incomes has been discussed in detail in the forthcoming paragraphs of this chapter.

[60] In case of FPIs and Specified funds, tax shall be charged at the concessional rate specified under Section 115AD. For taxability of these FPIs and Specified Funds refer chapter 10 and Chapter 11.

6.1-1. Dividend Income

Dividend usually refers to the distribution of profits by a company to its shareholders. The dividend is paid by a company out of its profits. Thus, a share of profit received by a shareholder out of the profits of the company, proportionate to his shareholding, is termed as 'Dividend'.

Dividend declared at an annual general meeting is deemed to be the income of the previous year of the shareholder in which it is declared. The date of receipt by the assessee is not material. The interim dividend is deemed to be the income of the previous year in which the amount of such dividend is unconditionally made available by the company to the shareholder. In other words, it is chargeable to tax on receipt basis.

The tax treatment of the dividend in the hands of shareholders depends on whether the dividend is received from a foreign company or a domestic company.

6.1-1a. Place of accrual of dividend

The dividend payable by an Indian company is always deemed to accrue or arise in India whether it is paid in India or Outside India. Thus, every person (whether resident or non-resident) is liable to pay tax in India on dividend distributed or paid by an Indian company.

Dividend paid by a foreign company outside India is not deemed to accrue or arise in India. It means a non-resident is not liable to pay tax on dividend received outside India from a foreign company. Dividend from foreign companies, even if it is operating in India, is taxable only if it is paid in India.

6.1-1b. Tax on dividend

Up to Assessment Year 2020-21, domestic companies and mutual funds were liable to pay Dividend Distribution Tax (DDT) on the dividend. Therefore, shareholders or unit-holders were exempt from paying tax on the dividend income. After the abolition of dividend distribution tax by the Finance Act, 2020 with effect from Assessment Year 2021-22, if a company, mutual fund, business trust or any other fund distributes dividend to its shareholders or unit-holders then such dividend income is taxable in the hands of such shareholder or unit-holders. The taxability of dividend and tax rate thereon shall depend upon the residential status of the shareholders and quantum of income. In case of a non-resident shareholder, the provisions of Double Taxation Avoidance Agreements (DTAAs) and Multilateral Instrument (MLI) shall also come into play (*See Para 6.2-2 and 6.2-3* for taxability of dividend).

6.1-2. Capital Gains

Any profit or gain arising from the sale of a 'capital asset'[61] is chargeable to tax as a capital gain. Income from Capital Gains is computed as under:

Particulars	*Amount*
Full Value of Consideration	Xxx
Less:	
a) Expenses incurred wholly and exclusively in connection with transfer	(xxx)
b) Cost of Acquisition/Indexed Cost of Acquisition	(xxx)
c) Cost of Improvement/Indexed Cost of Improvement	(xxx)
d) Capital gain taxable under Section 45(4) which is attributable to capital asset remaining with the firm, AOP or BOI after reconstitution	(xxx)
Less: Exemption under Sections 54 to 54GB to the extent of the net result of above calculation	
Short-term or Long-term Capital Gains	**xxx**

The capital gains from the sale of equity shares can be either long-term capital gains or short-term capital gains depending upon the period of holding of capital assets. The period of holding a capital asset is determined to classify it into a short-term capital asset or long-term capital asset. This distinction is important as the incidence of tax is higher on short-term capital gains as compared to the long-term capital gains. Generally, the period of holding of a capital asset is calculated from the date of its purchase or acquisition till the date of its transfer.

The rate of tax on capital gains differs according to the nature of capital gain. Long-term capital gains are taxable at concessional rates of 20% or 10%, as the case may be. Short-term capital gains are generally added to total taxable income and are chargeable to tax as per the tax rate applicable according to the status of the assessee. However, in a few cases, short-term capital gains are also taxable at concessional rates.

In this chapter, we will discuss the tax treatment of capital gains arising from the following equity products:

a) Listed Equity Shares;
b) Unlisted Equity Shares;
c) Preference shares;
d) GDR/ADR;
e) Warrants;

[61] Refer Chapter 3 for meaning of 'Capital Asset'.

f) Equity Oriented Mutual Funds; and
g) Equity Derivatives.

6.2 LISTED EQUITY SHARES

Equity shares represent ownership of a person in a company. Any company offering its shares to the public for subscription is required to be listed on the stock exchange and has to comply with the conditions as provided in the SEBI (Issue of capital and disclosure requirements) Regulations, 2018 [commonly known as SEBI (ICDR), Regulations].

Listing of securities with stock exchange is a matter of great importance for companies and investors because this provides liquidity to the securities in the market. The two major stock exchanges of India in which shares of a company can be listed are the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

All vital concepts of the securities markets, whether relating to investment in listed shares or calculation of gains or calculation of tax from such gains have been discussed in the forthcoming paragraphs.

6.2-1. Charges & Taxes

Various taxes and charges are payable to purchase and sell equity shares through stock exchanges, which have been explained below.

6.2-1a. Brokerage

Brokerage is charged by the share broker who maintains the share trading account of the investor. The amount of brokerage depends upon the broker and the nature of the order placed.

6.2-1b. Security Transaction Tax

The securities transaction tax is a tax levied on sale/purchase of securities (other than debt securities or debt mutual fund). Every recognised stock exchange or trustee of a mutual fund or lead merchant banker (in case of IPO) is required to collect the STT from purchaser or seller of the securities, as the case may be, and, subsequently, remit the same to the Central Government. STT collected during a calendar month is required to be paid to the Central Government by 7^{th} day of the month immediately following the said calendar month (Refer *Annexure H* for the rates of STT).

6.2-1c. Stamp Duty

Stamp duty is levied for transferring shares and securities from one person to another. Stamp duty is levied by States, thus, the rate of duty varies from state to state. However, with effect from April 1, 2020, stamp duty shall be levied at unified rates across India in respect of listed securities. The same rate shall apply even in case of off-market transactions (Refer Annexure H for the rates of stamp duty).

6.2-1d. Exchange Charges

This charge is levied by the stock exchanges of India. Transaction charges are levied on both sides of the trading and are same for both intraday and delivery. NSE and BSE charge a transaction fee of 0.00325% of the aggregate amount of purchase and sale, respectively.

6.2-1e. SEBI Turnover Charges

Securities Exchange Board of India (SEBI) is the security market regulator, which forms rules and regulations for the stock exchanges. A turnover charge of Rs. 10 per crore is levied by SEBI for regulating the markets. This charge is levied on both sides of the transaction, i.e., while buying and selling. A turnover charge of Rs. 2.5 per crore is levied on all purchase and sale transaction in debt securities.

6.2-1f. Depository Participant (DP) Charges

NSDL (National Securities Depository Limited) and CDSL (Central Depository Services Limited) are two stock depositories in India. The depositories hold shares and securities in electronic form on behalf of the shareholder and facilitate the exchange thereof between buyer and seller. When a person buys shares, such shares are credited in DEMAT account of that person and when he sells such shares, they are debited from his DEMAT account. Depositories charge Rs. 13.5 plus GST (irrespective of quantity) for this facility on the day the securities are debited from DEMAT Account.

The depository participants (i.e., broker) form the bridge between the investors and the depository as investors cannot directly approach the depository. Therefore, the depository charges a fee from the depository participant and who in turn, charge the investors.

6.2-1g. GST

It is levied on the amount of brokerage, exchange transaction charges and clearing charges. At present, the GST is charged at the rate of 18% on the amount of brokerage, transaction and clearing charges.

6.2-2. Tax on dividend

6.2-2a. *As per domestic laws*

Dividend received by a resident shareholder is taxable in his hands at the applicable rates (for normal tax rates applicable in case of various persons, *see Annexure E*). A resident shareholder is allowed a deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend.

Where the dividend is received by a non-resident person or foreign company (including foreign portfolio investors (FPIs) and Non-resident Indian Citizens), the dividend shall taxable in their hands at special rates, subject to provisions of DTAA. In case of a specified fund, as referred to in section 10(4D), dividend income is chargeable to tax at a concessional rate of 10%. However, no expenditure shall be allowed to be deducted from such income. Further, deduction under Chapter-VIA, *that is*, Sections 80C to 80U, shall not be allowed from such income. The tax rates on dividend income shall be as follows:

Section	*Assessee*	*Income*	*Tax Rate*
56	Resident	Dividend	Applicable Rate
115A	Non-resident or Foreign Company	Dividend	10% if received from IFSC unit[62] otherwise 20%
115AB	Offshore fund	Dividend from units of mutual fund purchased in foreign currency	10%
115AD	FPIs	Dividend income from any security (other than units referred to in Section 115AB)	20%
115AD	Specified Fund	Dividend income from any security (other than units referred to in Section 115AB)	10%

6.2-2b. As per DTAA

As per DTAA, dividend income is generally chargeable to tax in the source country as well as the country of residence of the assessee and, consequently, the country of residence provides a credit of taxes paid by the assessee in the source country. Thus, the dividend income shall

[62] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25.

be taxable in India as per provisions of the Act or as per relevant DTAA, whichever is more beneficial.

As per most of the DTAAs India has entered into with foreign countries, the dividend is taxable in the source country in the hands of the beneficial owner of shares at the rate ranging from 5% to 15% of the gross amount of the dividends.

In DTAA with countries like Canada, Denmark, Singapore, the dividend tax rate is further reduced where the dividend is payable to a company that holds a specific percentage (generally 25%) of shares of the company paying the dividend. However, no minimum time limit has been prescribed in these DTAAs for which such shareholding should be maintained by the recipient company. Therefore, MNCs were often found misusing the provisions by increasing their shareholding in the company immediately before the declaration of the dividend and offloading the same after getting the dividend. India did not face this situation as dividend income was exempt from tax in the hands of the shareholders till Assessment Year 2020-21. However, after the abolition of dividend distribution tax, India will face the risk of tax avoidance by the foreign company by artificially increasing the holding in the dividend declarant domestic company.

India is a signatory to the Multilateral Convention (MLI) which shall implement the measures recommended by the OECD to prevent Base Erosion and Profit Shifting. MLI is a binding international legal instrument that is envisaged with a view to swiftly implement the measures recommended by OECD to prevent Base Erosion and Profit Shifting in existing bilateral tax treaties in force. With respect to dividend income, Article 8 (Dividend Transfer Transactions) of MLI provides for a minimum period of 365 days for which a shareholder, receiving dividend income, has to maintain its shareholding in the company paying the dividend to get the benefit of the reduced tax rate on the dividend. However, this condition is applicable only if India and partner county have notified this clause. As of now 4 countries i.e., Canada, Montenegro, Slovak Republic and Slovenia have notified this clause.

6.2-3. Tax on inter-corporate dividend

The taxability of dividend has been shifted from companies to shareholders with effect from Assessment Year 2021-22. Therefore, in order to remove the cascading effect where a domestic company receives dividend from other domestic company, foreign company or business trust, a new section 80M has been introduced under the Income-tax Act to provide that inter-corporate dividend shall be reduced from total income of the company (computed under normal provision or alternative tax regime of Section 115BAA or Section 115BAB) if the same is further distributed to shareholders on or before the due date (i.e., one month prior to the due date of filing of return).

Example 1: XYZ Ltd. borrowed Rs. 50 lakhs carrying interest rate of 7% per annum for the purpose of business. Out of the borrowed funds, Rs. 10 lakhs was lying unutilised, therefore, same was invested in equity shares of a company ABC Ltd.

During the financial year 2022-23, XYZ Ltd. received dividend of Rs. 3 lakhs in respect of investment made in ABC Ltd. It incurred an expenditure of Rs. 50,000 towards commission paid to banker for realising the dividend. The due date of filing of return for the financial year 2022-23 by XYZ Ltd. is 31-10-2023.

Compute the amount of dividend taxable in the hands of XYZ Ltd. and the deduction available under Section 80M in respect of inter-corporate dividend in the following scenarios:

(a) XYZ Ltd. distributed Rs. 2,00,000 as dividend to its shareholders in the month of August 2023.

(b) XYZ Ltd. distributed Rs. 1,00,000 as dividend to its shareholders in the month of August 2023 and Rs. 1,00,000 in the month of December 2023.

Answer

The dividend taxable in the hands of XYZ Ltd. and the deduction available under Section 80M in respect of inter-corporate dividend shall be computed as follows:

Scenario 1: XYZ Ltd. distributed dividend of Rs. 2,00,000 in the month of August 2023

Particulars	*Amount*
Dividend received from ABC Ltd. [A]	3,00,000
Interest incurred [B = 10,00,000 * 7%]	70,000
20% of dividend [C = 3,00,000 * 20%]	60,000
Interest allowable as deduction under section 57 [D = lower of B or C][‡]	60,000
Dividend taxable under the head other sources [E = A - D]	2,40,000
Deduction under Section 80M[†] [F]	2,00,000
Taxable income [G = E - F]	40,000
[†] *As dividend has been further distributed before the due date (one month prior to due date of furnishing return of income) deduction under Section 80M shall be allowed.* [‡] *As per proviso to section 57(i), expenses incurred as commission for realizing dividend is not allowed as deduction.*	

Scenario 2: XYZ Ltd. distributed dividend of Rs. 1,00,000 during the month of August 2023 and Rs. 1,00,000 during the month December 2023.

Particulars	*Amount*
Dividend received [A]	3,00,000
Interest incurred [B = 10,00,000 * 7%]	70,000
20% of dividend [C = 3,00,000 * 20%]	60,000

Interest allowable as deduction under section 57 [D = lower of B or C] ‡	60,000
Dividend taxable under the head other sources [E = A - D]	2,40,000
Deduction under section 80M† [F]	1,00,000
Taxable income [G = E - F]	1,40,000
† *As dividend has been further distributed on or before the due date (one month prior to due date of furnishing return of income) deduction under Section 80M shall be allowed. Dividend of Rs. 100,000 distributed in the month of December 2023 can be claimed as deduction in the subsequent year provided the company has earned dividend income in that year.* ‡ *As per proviso to section 57(i), expenses incurred as commission for realizing dividend shall not be allowable as deduction.*	

6.2-4. Period of holding

The tax treatment of gains or losses arising from the sale of listed equity shares depends upon whether the gains are long-term or short-term. Shares which are listed on the stock exchange in India are treated as a short-term capital asset if they are held for not more than 12 months immediately preceding the date of transfer. In other cases, they are treated as long term capital assets.

6.2-4a. Securities held in Physical Form

If listed shares or securities are sold through brokers, the date of the broker's note is treated as the date of transfer, provided the contract is followed by delivery. Thus, the period of holding should be counted from the date of purchase to the date of the broker's note.

In case the transaction takes place directly between the parties and not through the stock exchange, the date of the contract of sale as declared by the parties is treated as the date of transfer, provided it is followed by the actual delivery of shares and the transfer deeds[63].

6.2-4b. Securities held in Demat Form

As per Section 45(2A)[64] the period of holding of securities held in Demat Form shall be determined as per First-In-First-Out (FIFO) Method. It implies that the securities that first entered into the Demat account are deemed to be the first to be sold out. In other words, the securities acquired last will be taken to be remaining with the assessee while securities acquired first will be treated as sold. For determining the period of holding, the contract note or Broker's note shall be considered provided such transactions are followed by delivery of shares and transfer deeds.

[63] Circular No. 704, dated 28.04.1995
[64] Also see the Circular No. 768, Dated June 24, 1998

In the depository system, the investor can open and hold multiple accounts. In such a case, where an investor has more than one security account, the FIFO method will be applied account-wise. This is because where a particular account of an investor is debited for the sale of securities, the securities lying in his other account cannot be construed to have been sold as they continue to remain in that account.

If in an existing account of Demat stock, the old physical stock is dematerialized and entered at a later date, under the FIFO method, the basis for determining the movement out of the account is the date of entry into the account.

Example 2,

Date of credit in Demat account	*Date of purchase*	*Particulars*	*Quantity*
1-6-2020	25-05-2020	Purchased directly in Demat Form	2,000
5-6-2020	01-11-2005	Shares certificates Dematerialized	5,000
10-6-2020	10-6-2020	Purchased directly in Demat form on 10-6-2019	4,000
15-6-2020	01-05-2001	Shares certificates Dematerialized	3,000

If 2,500 shares are sold from this account, then the cost of acquisition of first 2,000 shares shall be calculated from 25-5-2020, whereas the balance 500 shares will be treated as having been acquired on November 1, 2005, at the relevant cost. This is the effect of the FIFO method.

6.2-5. Tax on long-term capital gains as per section 112A

Earlier the long-term capital gains arising from the sale of listed equity shares were exempt under section 10(38) of the Income-tax Act. In Finance Act, 2018, the long-term capital gains arising from the sale of listed equity shares were made taxable. Such long-term capital gain is chargeable to tax at different rates depending upon the year of acquisition and the payment of STT.

6.2-5a. Rate of tax

Where the total income of an assessee includes long-term capital gain arising from the transfer of listed equity shares, no tax shall be charged on such long-term capital gain if the aggregate amount of such gain during the year is up to Rs. 1,00,000. Where the amount of capital gain exceeds Rs. 1,00,000, the excess amount is chargeable to tax at a concessional rate of 10% under section 112A of the Income-tax Act. However, this section applies only when securities transaction tax is paid at the time of acquisition and at the time of transfer of equity shares, except in the following cases:

Exception 1: Transaction undertaken on a stock exchange located in IFSC

The condition of payment of STT shall not be applicable if the transaction is undertaken on a recognised stock exchange located in an International Financial Services Centre. This concession is available only when the consideration for such a transaction is received or receivable in foreign currency.

Exception 2: If STT is not paid at the time of acquisition

The benefit of the concessional tax rate is available in case of transfer of equity shares if STT is chargeable both at the time of transfer and at the time of acquisition of shares. The CBDT[65] has relaxed this condition of payment of STT at the time of acquisition in the following scenarios:

a) Shares are acquired before 1-10-2004;
b) The acquisition has been approved by the Supreme Court, High Court, NCLT, SEBI or RBI;
c) The acquisition by any non-resident is in accordance with FDI guidelines issued by the Government of India;
d) The acquisition is done by an Investment Fund or Venture Capital Fund or a Qualified Institutional Buyer;
e) The acquisition is done through a preferential issue to which SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply;
f) The acquisition is done through an issue of share by a company;
g) The acquisition of shares is made by the scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;
h) The acquisition is done under the ESOP or ESPS scheme framed under SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;
i) The acquisition of shares is made as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;
j) The acquisition is made from the Government; and
k) The acquisition is made by mode of transfer referred to in Section 47 or Section 50B or Section 45(3) or Section 45(4) of the Income-tax Act, if the previous owner or transferor of such shares has acquired shares by any of the modes given in this list.

[65]Notification No. 60/2018, dated 01-10-2018

6.2-5b. Cost of acquisition of shares acquired on or before 31-012018

The Finance Act 2018 grandfathered the investments made on or before 31-01-2018 as the long-term capital gains arising from the sale of equity shares chargeable to STT were previously exempt from tax. The concept of grandfathering under this provision works as per the following mechanism.

If equity shares were acquired on or before 31-01-2018, the cost of acquisition of such shares or units shall be higher of the following:

a) The actual cost of acquisition of equity shares; or
b) *Lower* of the fair market value of such asset as on 31-01-2018 or full value of the consideration received as a result of the transfer of equity shares.

In case of listed equity shares, the highest price of share quoted on a recognized stock exchange as on 31-01-2018 is taken as the fair market value. If there is no trading in such share on such exchange on 31-01-2018, the highest price of such share on a date immediately preceding 31-01-2018 when such share was traded shall be the fair market value.

However, the fair market value of the following equity shares shall be an amount which bears to its cost of acquisition the same proportion as the Cost Inflation Index for the financial year 2017-18 bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 01-04-2001, whichever is *later*:

(a) Shares are not listed on recognised stock exchange on 31-01-2018 but listed on such exchange on the date of transfer; or
(b) Shares listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31-01-2018 by way of transaction not regarded as transfer under Section 47.

In general cost of acquisition of the bonus shares are taken to be *nil*, however, if bonus shares are complying with the conditions prescribed in section 112A, the cost of acquisition shall be computed in the manner described above.

*L*et's understand how to compute long-term capital gains with the help of the following examples.

Scenario 1: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 200 on 31-01-2018 and it is sold on 01-01-2023 at Rs. 250.

As the actual cost of acquisition is less than the fair market value as on 31-01-2018, the fair market value of Rs. 200 will be taken as the cost of acquisition and the long-term capital gain will be Rs. 50 (Rs. 250 - Rs. 200).

Scenario 2: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 200 on 31-01-2018 and it is sold on 01-01-2023 at Rs. 150.

In this case, the actual cost of acquisition is less than the fair market value as on 31-01-2018. However, the sale value is also less than the fair market value as on 31-01-2018. Accordingly, the sale value of Rs. 150 will be taken as the cost of acquisition and the long-term capital gain will be *nil* (Rs. 150 - Rs. 150).

Scenario 3: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 50 on 31-01-2018 and it is sold on 01-01-2023 at Rs. 150.

In this case, the fair market value as on 31-01-2018 is less than the actual cost of acquisition, and therefore, the actual cost of Rs. 100 will be taken as the actual cost of acquisition and the long-term capital gain will be Rs. 50 (Rs. 150 - Rs. 100).

Scenario 4: An equity share is acquired on 01-01-2017 at Rs. 100, its fair market value is Rs. 200 on 31-01-2018 and it is sold on 01-01-2023 at Rs. 50.

In this case, the actual cost of acquisition is less than the fair market value as on 31-01--2018. The sale value is less than the fair market value as on 31-01-2018 and also the actual cost of acquisition. Therefore, the actual cost of Rs. 100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be Rs. 50 (Rs. 50 - Rs. 100) in this case.

6.2-5c. *Cost of acquisition of shares acquired on or after 01-02-2018*

The cost of acquisition of equity shares, which are acquired on or after 01-02-2018, shall be computed as per general principles of Section 55, i.e., the actual cost for which it is acquired by the assessee.

6.2-6. Tax on long-term capital gain as per section 112

Long-term capital gains arising from the sale of equity shares are taxable at the rate of 20% under section 112 if they are not taxable at the concessional rate of 10% under section 112A. Tax is charged at a flat rate of 20% *plus* surcharge and health & education cess (*see Annexure E for the applicable rates of surcharge and cess*). However, the long-term capital gains shall be taxable at the rate of 10% if the benefit of indexation is not taken.

6.2-7. Tax on short-term capital gains as per Section 111A

Short-term capital gains arising from the sale of listed equity shares is chargeable to tax at a concessional rate of 15% *plus* surcharge and cess (*see Annexure E for relevant rates*) if the transaction is chargeable to Securities transaction tax or transaction is undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre.

However, no deduction under Sections 80C to 80U shall be allowed from short-term capital gains covered under section 111A.

6.2-8. Tax on normal short-term capital gain

Short-term capital gain arising from the sale of equity shares is chargeable to tax at normal rates as applicable in case of an assessee if it is not taxable at the concessional rate of 15% under Section 111A. This case arises if conditions specified under Section 111A are not satisfied.

Tax treatment of Listed Equity Shares is enumerated in the below table:

Nature	*Rate of Tax (If STT is paid)*	*Rate of Tax (If STT is not paid)*	
		With Indexation	*Without Indexation*
Long Term	10%	20%	10%
Short Term	15%	-	As per applicable rate of tax

The rate of surcharge on the capital gains arising from the transfer of listed equity shares by an Individual, HUF, AOP*, BOI or AJP is enumerated in the below table.

Total Income	*Capital gains covered under Section 112A, 112 and 111A*	*Other Income*
Up to Rs 50 lakhs	Nil	Nil
Rs 50 lakhs – Rs 1 crore	10%	10%
Rs 1 crore – Rs 2 crore	15%	15%
Rs 2 crore – Rs 5 crore	15%	25%
Above Rs 5 crore	15%	25% if opts for new tax regime of Section 115BAC otherwise 37%

*The Finance Act, 2022 has put a cap on the rate of surcharge to 15% in case of an AOP consisting of only companies as its members. The rate of surcharge in case of such AOP shall be as follows:

- 10% where total income exceeds Rs. 50 lakh but does not exceed Rs. 1 crore;
- 15% where total income exceeds Rs. 1 crore.

Example 3: Mr X (resident in India) invested in equity shares of the following listed companies:

Company	*No. of shares*	*Date of Purchase*	*Purchase cost (Per share)*
ABC Ltd.	1,000	01-04-2021	Rs. 105

XYZ Ltd.	1,500	01-10-2021	Rs. 120

During the Financial Year 2022-23, he sold the shares as follows:

Company	*No. of shares*	*Date of sale*	*Selling price (Per share)*
ABC Ltd.	1,000	04-05-2022	Rs. 107
XYZ Ltd.	1,000	01-08-2022	Rs. 135

Answer:

The computation of capital gain from the sale of shares by Mr X during the financial year 2022-23 shall be as follows:

Particulars	*ABC Ltd.*	*XYZ Ltd.*
Date of Purchase	01-04-2021	01-10-2021
Date of sale	04-05-2022	01-08-2022
Period of holding	13+ Months	10 Months
Nature of Capital Gain	Long term capital gains	Short term capital gains
Full Value of Consideration [A]	Rs. 107,000 (1,000 shares * Rs. 107)	Rs. 135,000 (1,000 shares * Rs. 135)
Cost of Acquisition [B]	Rs. 105,000 (1,000 shares * Rs. 105)	Rs. 120,000 (1,000 shares * Rs. 120)
Amount of capital gain [A-B]	Rs. 2,000	Rs. 15,000
Tax rate	10% under Section 112A (on capital gains in excess of Rs. 1 lakhs).	15% under Section 111A

6.3 TAX TREATMENT OF UNLISTED EQUITY SHARES

Unlisted shares or unquoted shares are the shares that are not listed on any Stock Exchange. The tax treatment of gains or losses arising from the sale of unlisted equity shares depends upon whether the gains are long term or short term. Unlisted shares of a company are treated as short-term capital asset if they are held for not more than 24 months immediately preceding the date of transfer. Whereas, if the shares are held for more than 24 months then long-term capital gain arises.

6.3-1. Tax on dividend from unlisted shares

The taxability of dividend income arising from unlisted equity shares shall be the same as in case of listed equity shares *[See para 6.2-2. and 6.2.-3]*.

6.3-2. Tax on long-term capital gains from unlisted shares

Long-term capital gains arising from the sale of unlisted equity shares shall be taxable at the rate of 20 per cent *plus* surcharge and health & education cess. In that case, the benefit of Indexation would be available to resident taxpayers.

Where unlisted equity shares are offered for sale under an initial public offer (IPO), gain arising therefrom shall be chargeable to tax in accordance with the provisions contained under Section 112A as referred under *para 6.2-5*.

6.3-3. Tax on short-term capital gains from unlisted shares

Short-term capital gain arising from the transfer of unlisted shares shall be taxable at the normal rate as applicable in case of an assessee.

Example 4: If in Example 3, shares of ABC Ltd. and XYZ Ltd. are not listed on a stock exchange. Will there be any difference in tax implications in the hands of Mr X?

Answer:

Unlisted shares are treated as a long-term capital asset if they are sold after holding for a period of more than 24 months. Whereas, capital gain arising from transfer of listed shares is treated as long-term capital gain if they are sold after holding for more than 12 months.

As shares of ABC Ltd. and XYZ Ltd. were sold within 24 months, the resultant capital gain shall be taxable as short-term capital gains. Further, as the shares are not listed on a stock exchange, the short-term capital gain shall be taxable at normal slab rate.

6.4 TAX TREATMENT OF PREFERENCE SHARES

Preference shares are those shares that carry certain special or priority rights. The preference share-holders get a right of fixed dividend, whose payment takes priority over ordinary dividends. Capital raised by the issue of preference shares is called preference share capital.

Preference share capital, with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right to:

a) Payment of dividend, either as a fixed amount or at a fixed rate; and
b) Repayment in the case of a winding-up or repayment of capital specified in the memorandum or articles of the company.

6.4-1. Tax on dividend from preference share

The taxability of dividend income arising from preference shares shall be same as in case of equity shares [*See para 6.2-2. and 6.2.-3]*.

6.4-2. Conversion of preference share into equity share

Where preferences shares in a company are converted into equity shares of that company, it is not treated as transfer as defined under Section 47 of the Income-tax Act. Hence no income would arise at the time of conversion of preference shares into equity shares. Capital gains would arise at the time of sale of such equity share. The cost of such converted equity shares would be taken at the price for which the original preference shares were acquired. Additionally, period of holding of equity shares would be counted from the date of holding of the preference shares.

6.4-3. Tax on long-term capital gain from preference share

The gain resulting from the redemption of preference shares is computed by reducing the indexed cost of acquisition from the redemption value and is taxable as long-term capital gains. Unlisted preference shares are treated as long-term capital asset if they are held for more than 24 months immediately preceding the date of transfer. However, in the case of listed preference shares, the period of holding is 12 months instead of 24 months.

Long-term capital gains are generally taxable at a flat rate of 20% *plus* surcharge and health & education cess (*see Annexure E for relevant rates*). However, in the case of listed securities, the assessee has the option to pay tax at the rate of 10% if he does not take the benefit of indexation while computing the amount of capital gain.

In case of unlisted securities or shares of a closely held company, a non-resident assessee or a foreign company has to pay tax at the rate of 10% without claiming the benefit of indexation and foreign currency fluctuation.

6.4-4. Tax on short-term capital gain from preference share

Where listed preference shares are redeemed or sold within 12 months then it shall be treated as a short-term capital asset and, accordingly, short-term capital gain shall arise. In case of unlisted preference shares, short-term capital gain shall arise when they are transferred or redeemed within 24 months.

Short-term capital gain arising from transfer or redemption of preference share is chargeable to tax at a normal rate as applicable in case of an assessee.

Example 5:

Mr X (resident in India) acquired 1,000 preference shares of ABC Ltd. at Rs. 105 each on 01-

07-2018. The shares are listed on a stock exchange. He transferred such shares on 04-05-2022 at Rs. 120 per share. Compute the amount of capital gain chargeable to tax in hands of Mr X.

Answer:

As the preference shares are listed on a stock exchange and transferred by Mr X after holding for more than 12 months, the gain arising from transfer shall be treated as a long-term capital gain.

Long-term capital gains are generally taxable at a flat rate of 20% *plus* surcharge and health & education cess. However, in the case of listed securities, the assessee has an option to pay tax at the rate of 10% if he does not take the benefit of indexation while computing the amount of capital gain.

Thus. Mr X has two options - avail benefit of indexation while computing capital gain and pay tax at the rate of 20% or pay tax at the rate of 10% without claiming the benefit of indexation.

The computation of capital gain under both the option shall be as follows:

Particulars	*Option 1*	*Option 2*
	(With Indexation)	*(Without Indexation)*
Full Value of Consideration [A]	Rs. 1,20,000 (1,000 shares * Rs. 120)	Rs. 1,20,000 (1,000 shares * Rs. 120)
Cost of Acquisition [B]	-	Rs. 1,05,000 (1,000 shares * Rs. 105)
Indexed Cost of Acquisition [B]	Rs. 1,24,125 (Rs. 105,000 * 331/280)	-
Capital gain/loss [A-B]	(Rs. 4,125)	Rs. 15,000
Tax rate	20%	10%
Tax	Nil	Rs. 1,500
Tax saving if Mr X opts for option 1	**Rs. 1,500**	

6.5 TAX TREATMENT OF GDR OR ADR

Global Depository Receipt (GDR) means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India or in an IFSC and issued to investors against the issue of:

(a) Ordinary shares of issuing company, being a company listed on a recognised stock exchange in India;

(b) Foreign currency convertible bonds of issuing company; or

(c) Ordinary shares of issuing company, being a company incorporated outside India, if such depository receipt or certificate is listed and traded on any IFSC[66].

Issuing company means an Indian Company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts. The GDRs are listed on stock exchanges outside India and are tradable and transferable in accordance with the laws relating to the country in which the GDRs are listed.

After getting approval from the Ministry of Finance and completing other formalities, a company issues rupee-denominated shares in the name of the depository which delivers these shares to its local custodian bank ('overseas depository'). The depository then issues dollar-denominated depository receipts (or GDR) against the shares registered with it. Generally, one GDR is equivalent to one or more (rupee-denominated) shares. It is traded like any other dollar-denominated security in foreign markets.

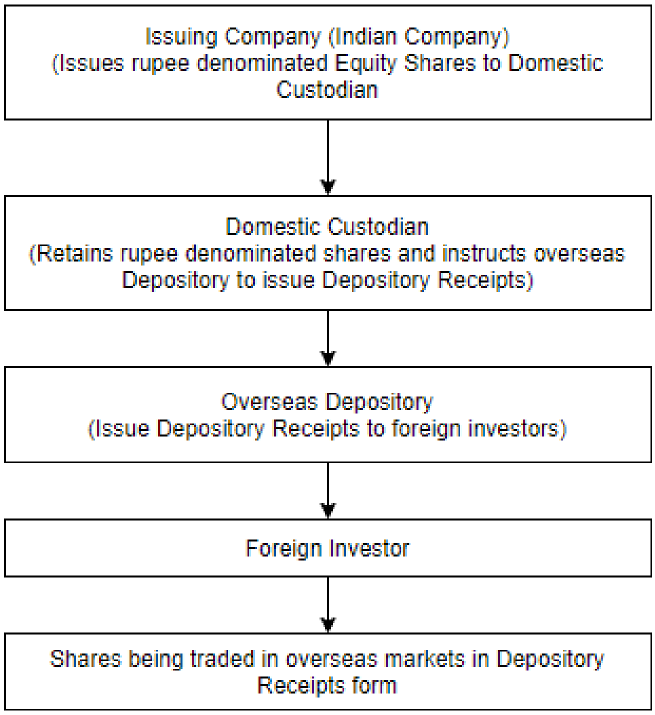
These Depository Receipts (DR) were brought out as an option for Indian companies to get access to overseas capital markets. Depository Receipts issued in American stock exchanges are termed as American Depository receipts ('ADRs').

An American depositary receipt (ADR) is a US dollar-denominated stock that trades in the United States and represents equity ownership in a non-US company. Shares of many Non-US companies trade on US stock exchanges through ADRs, which are denominated and pay dividends in US dollars and may be traded like regular shares of stock.

GDRs have access usually to Euro and US market. The US portion of GDRs to be listed on US exchanges have to comply with SEC requirements and the European portion have to comply with EU directive. Listing of GDR may take place in international stock exchanges such as London Stock Exchange, New York Stock Exchange, American Stock Exchange, NASDAQ, Luxemburg Stock Exchange, etc.

The process involved in the issue of depository receipts can be explained with the help of the following diagram:

[66] Amended by the Finance Act, 2021 with effect from assessment year 2022-2023



6.5-1. Tax implications of GDR/ADR in case of non-resident

6.5-1a. Dividend income

Dividend distributed by an Indian company in respect of GDRs, purchased in foreign currency by a non-resident or a foreign company, shall be taxable in the hands of such non-resident person or foreign company at a concessional rate of 10% under section 115AC of the Income-tax Act.

As dividend received in respect of GDRs is chargeable to tax at a concessional tax rate of 10%, no expenditure shall be allowed to be deducted from such income. Further, deduction under Chapter-VIA (i.e., Section 80C to 80U) shall not be allowed from such income.

6.5-1b. Long-term capital gain from transfer of GDR

GDRs are securities that are listed on foreign stock exchanges and not on any Indian stock exchange. Thus, the long-term capital gain from the transfer of GDRs shall arise when they are transferred after holding it for a period of more than 36 months.

Section 47 of the Act specifically provides that transfer of GDRs, being capital assets, made outside India between two non-resident persons is not treated as a transfer. Thus, no capital gain shall arise on the transfer of GDRs from one non-resident person to another non-resident person. Further, in view of Section 47(viiab) any transfer of Global Depository Receipts, referred under Section 115AC, by a non-resident on recognised stock exchange located in any

International Financial Services Centre is also outside the purview of transfer provided consideration for same is received is foreign currency.

Section 115AC of the Act provides that the capital gain arising from the transfer of GDRs, by a non-resident, would be liable to tax at the rate of 10 per cent if such gains are in the nature of long-term capital gains. In other words, as transfer between two non-resident persons and transfer by a non-resident on stock exchange located in IFSC is exempt from tax under Section 47, the provisions of section 115AC would cover transactions of sale of GDRs by a non-resident assessee to a resident assessee which is undertaken on a stock exchange which is not located on an IFSC. The concessional tax rate of 10% shall apply only when GDRs are purchased in foreign currency and capital gain is computed without taking the benefit of indexation and foreign currency fluctuation.

In other cases, where GDRs are not purchased in the foreign currency, the long-term capital gain arising from the transfer of GDRs shall be chargeable to tax at the rate of 20% *plus* surcharge & cess (*see Annexure E* for relevant rates) and capital gain shall be computed after claiming the benefit of indexation.

6.5-1c. Short-term capital gain from transfer of GDR

Short-term capital gain from the transfer of GDRs, which are not excluded from the transfer as referred in *para 6.5-1b*, shall arise when they are transferred within a period of 36 months from the date of acquisition. It shall be chargeable to tax at the normal rates as applicable in case of an assessee.

6.5-1d. Capital gain on conversion of GDRs into shares

Where GDRs are converted into shares of the issuing company then it shall attract capital gain tax in the hands of the holder of GDRs. For this purpose, the price of the shares prevailing on any recognised stock exchange on the date on which a request for such redemption/conversion is made shall be considered as the full value of consideration. Accordingly, capital gain shall be computed by reducing the cost of acquisition/indexed cost of acquisition of GDRs from the value of shares.

6.5-1e. Capital gain on subsequent transfer of share

Where shares so received on conversion/redemption of GDRs are subsequently sold by the assessee, it shall give rise to capital gain. The cost of acquisition of the shares so acquired on the conversion of GDRs shall be the price of the shares prevailing on any recognised stock exchange on the date on which a request for such redemption/conversion is made. Further, the period of holding shall be reckoned from the date on which the request for redemption/conversion of GDRs was made.

6.5-1f. Conversion of income earned in foreign currency into Indian rupees

Where dividend income from GDRs is earned in foreign currency, it shall be converted into Indian Rupees at telegraphic transfer buying rate of such currency as existed on the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company (*see para 4.3-8*).

Further, the capital gain arising to a resident or non-resident person in foreign currency shall be converted into Indian Rupees at the telegraphic transfer buying rate of such currency as existed on the last day of the month immediately preceding the month in which the capital asset is transferred (*see para 3.6-9*).

Example 6, Mr Adam, a person non-resident in India, invested in GDRs of an Indian company on 01-04-2021. He purchased 1,000 GDRs at the rate of USD 148 each. On 31-03-2022, he received dividend of USD 5 per GDR. He paid USD 1,000 to his portfolio manager. On 07-06-2022, he sold the GDRs to a person resident in India at the rate of USD 193 per GDR. Compute the income taxable in his hands and tax thereon.

Following is the list of the exchange rates on various dates.

Date	*TT Buying Rate*	*TT Selling Rate*
01-04-2021	65	68
28-02-2022	68	71
31-03-2022	67	70
31-05-2022	69	72
07-06-2022	66	68

Answer:

Taxability of Dividend Income	
No. of GDRs [A]	1,000
Dividend received [B]	$ 5 per GDR
Total Dividend income [C=A* B]	$ 5,000
Allowable deduction [D]	*Nil*
Taxable income [E= C-D]	$ 5,000
Exchange rate (TT Buying rate as on 28-02-2022) [F]	Rs. 68
Taxable dividend income [G= E*F]	Rs. 3,40,000
Tax rate on dividend income	10%

Computation and taxability of the gains on transfer of the GDR

Computation of capital gains

Period of holding (from 01-04-2021 to 06-06-2022)	14+ Months
Nature of gain (less than 36 months)	Short term capital gains
Sale price (1,000 * $ 193) [A]	$ 193,000
Less: Purchase cost (1,000 * $ 148) [B]	$ 148,000
Short term capital gain in USD [C = A – B]	$ 45,000
Exchange rate (TT Buying Rate as on 31-05-2022) [D]	Rs. 69
Short term capital gain in INR [E = C * D]	Rs. 31,05,000
Tax rate on capital gain	Normal slab rate

6.5-2. Tax implications of GDR/ADR in case of resident

6.5-2a. Dividend income

Where an Indian company or its subsidiary, engaged in Information technology, entertainment, pharmaceutical or biotechnology industry, distributes dividend in respect of GDRs issued to its employees under an Employees' Stock Option Scheme, the dividend shall be taxable at a concessional tax rate of 10% under Section 115ACA in the hands of the employee provided the recipient is a resident in India and he purchased such GDRs in foreign currency.

As dividend received in respect of GDRs is chargeable to tax at a concessional tax rate of 10%, no expenditure shall be allowed to be deducted from such income. Further, deduction under Chapter-VIA (i.e., section 80C to 80U) shall not be allowed from such income.

In other cases, the dividend received in respect of GDRs shall be chargeable to tax at normal rates. Further, an assessee shall be entitled to claim the deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of the total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person to realise such dividend.

6.5-2b. Long-term capital gains from transfer of the GDRs

Long term capital gains arising from the transfer of GDRs (covered under section 115ACA) shall be taxed in the hands of the assessee at the rate of 10% *plus* surcharge and cess (*see Annexure E for relevant rates*) without providing the benefit of indexation and foreign exchange fluctuation. While calculating total taxable income, no deduction under Chapter-VI A shall be available against such capital gains.

In other cases, long-term capital gain shall be taxable at the rate of 20% *plus* surcharge and cess (*refer Annexure E for relevant rates*) and capital gain shall be computed after providing for the benefit of indexation.

6.5-2c. Short-term capital gains from transfer of the GDRs

Short-term capital gain arising from the transfer of GDRs shall be taxable at normal rates as applicable in case of the assessee.

6.6 TAX TREATMENT OF SHARE WARRANTS

Share warrant is an option issued by the company which gives the warrant holder a right to subscribe to equity shares at a pre-determined price on or after a pre-determined time period.

Stock warrant is issued with a "strike price" and an expiration date. The strike price is the price at which the warrant becomes exercisable, *that is*, the price at which the warrant holder is entitled to subscribe for equity shares of the company. As per Regulation 13 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ('ICDR'), the warrant holder is required to pay at least 25% of the strike price upfront. The tenure of share warrants shall not exceed 18 months from the date of their allotment in the IPO or Right Issue or FPO, as the case may be.

In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within 3 months from the date of payment of full consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

In the case of share warrants, the following transactions are possible:

a) Conversion of share warrants into shares;
b) Transfer of share warrants to another person;
c) Forfeiture of the share warrant.

6.6-1. Tax on conversion of share warrants into shares

The conversion of share warrants into shares shall be treated as a transfer of share warrants. The resultant capital gains arising from such transfer will always be deemed as short-term capital gains as a share warrant can have a maximum period of 18 months. The short-term capital gains shall be excess of the full value of consideration arising from such conversion over the strike price of the share warrant. In view of Section 50D of the Income-tax Act, the full value of consideration is the fair market value of shares on the date of conversion of warrants into shares.

The short-term capital gains shall be taxable as per applicable tax rates.

6.6-2. Tax on transfer of share warrants

The transfer of share warrants to another person shall be treated as a transfer of a capital asset. The resultant capital gains arising from such transfer will always be deemed as short-term capital gains as a share warrant can have a maximum period of 18 months. The short-term capital gains shall be excess of the full value of consideration arising from such transfer over the upfront payment or price paid for share warrant. The full value of consideration is the sum received from the buyer of the warrant.

The short-term capital gains shall be taxable as per applicable tax rates.

6.6-3. Forfeiture of premium paid for share warrants

In case a warrant holder does not exercise the option to take equity shares against any of the warrants held by him, within 3 months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer. The loss arising from such forfeiture of the premium will have no tax treatment and will be ignored for the calculation of taxable income.

Example 7: ABC Ltd. issued 1,00,000 warrants of Rs. 200 each aggregating to Rs. 2 crores to Mr X on 29-12-2021. Share warrants are exercisable into an equal number of equity shares of face value of Rs. 10 each. The company received a sum of Rs. 50 lakh from Mr X towards 25% subscription against the said warrants on the same date.

What shall be the tax implications in the hands of Mr X in the following scenarios?

(1) Mr X exercised warrants and paid the entire consideration of Rs. 2 crores to ABC Ltd. on 29-03-2023. On the same day, the company allotted 1,00,000 equity shares of face value of Rs. 10 each to Mr X at a premium of Rs. 190 per share. The fair market value of the share on the date of allotment was Rs. 250 share.
(2) Mr X transferred share warrants to Mr Y on 15-06-2022 for Rs. 75 per warrant.

Answer:

The tax implications in the hands of Mr X shall be as follows:

Scenario 1: Tax on conversion of share warrants into shares

The conversion of share warrants into shares shall be treated as a transfer of share warrants. The resultant capital gains arising from such transfer will always be deemed as short-term capital gains as a share warrant can have a maximum tenure of 18 months. The computation of short-term capital gain arising on conversion of share warrants into shares shall be as follows:

Particulars	*Amount*

Full value of consideration (FMV of shares on the date of allotment)	Rs. 2,50,00,000 (100,000 shares* Rs. 250)
Less: Cost of Acquisition (strike price of share warrants)	Rs. 2,00,00,000 (100,000 warrants * Rs. 200)
Short-term capital gain	**50,00,000**
Tax rate	Normal Slab Rate

Scenario 2: Tax on transfer of share warrants

The transfer of share warrants to another person shall be treated as a transfer of a capital asset. The resultant capital gains arising from such transfer will always be deemed as short-term capital gains as a share warrant can have a maximum period of 18 months. The computation of short-term capital gain arising on transfer of share warrants shall be computed as follows:

Particulars	*Amount*
Full Value of Consideration (sale price of share warrants)	Rs. 75,00,000 (100,000 warrants * Rs. 75)
Less: Cost of Acquisition (i.e., upfront payment made for share warrants)	50,00,000
Short-term capital gain	**25,00,000**
Tax rate	Normal Slab Rate

6.7 TAX TREATMENT OF MUTUAL FUNDS

Mutual funds are the funds which collect money from the investor and invest the same in the capital market for their benefit. Mutual funds invest in a variety of instruments such as equity, debt, bonds, etc. Investments of a mutual fund are managed by the Asset Management Company through fund managers.

All the mutual funds are registered with the SEBI and they function within the provisions of strict regulation created to protect the interests of the investor.

6.7-1. Important Terms

Before understanding, taxation aspects of Mutual Funds, it is important to understand a few terms which are used in the Mutual Fund industry.

6.7-1a. Meaning of Equity Oriented Funds

“Equity Oriented Fund” means a fund set up under a scheme of a mutual fund specified under clause (23D) of section 10 or under a scheme of an insurance company comprising unit-linked insurance policies to which exemption under clause 10(10D) does not apply on account of the applicability of *fourth and fifth proviso* (i.e., high premium ULIP) and:

(a) In a case where the fund invests in the units of another fund which is traded on a recognised stock exchange, at least 90% of the total proceeds of such fund is invested in the units of such other fund and such other fund also invests at least 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and
(b) In any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange.

The percentage referred above shall be computed with reference to the annual average of the monthly averages of the opening and closing figures. Additionally, in case of high premium ULIPs, the requirement of investing in equity products needs to be fulfilled throughout the term of the policy [*see para 7.8* for detailed discussion on taxability of such policies].

6.7-1b. Fund of Funds

Fund of Funds (FoF), as the name suggests, is a mutual fund scheme that invests in other schemes of mutual funds. These funds create a portfolio of other mutual funds. The portfolio is designed to suit investors across risk profiles and financial goals. The diversification of funds helps with reducing the risks to a certain extent.

6.7-1c. ELSS Funds

Equity Linked Saving Scheme (ELSS) is a category of mutual funds that encourage long-term equity investments. Through the ELSS scheme, the Government sought to improve equity participation by allowing tax-deductible investment in equity-based mutual funds. ELSS investment schemes help the investors to save Income-tax that's why they are also known as tax-saving funds. The Income-tax Act allows a deduction under Section 80C to the extent of Rs. 1.5 lakh in respect of investment made in ELSS.

ELSS funds invest a large percentage of their portfolio in the equity shares. They have a compulsory lock-in period of 3 years, which is the shortest amongst all tax-saving instruments.

6.7-1d. Systematic Investment Plan ('SIP')

SIP (Systematic Investment Plan) is a mutual fund tool and is one of the easiest ways through which any common man can enter the stock market. It is an investment strategy wherein an investor needs to invest some amount of money in a particular mutual fund at every stipulated time period, say, once a month or once a quarter. To understand the concept of SIP, one can compare it with a recurring deposit with the bank where one puts in a small amount every month.

6.7-1e. Systematic Withdrawal Plan ('SWP')

Systematic Withdrawal Plan (SWP) is used to redeem the investment from a mutual fund scheme in a phased manner. SWP is the opposite of SIP. SWP pays investors a specific amount of payout at pre-determined time intervals, like monthly, quarterly, half-yearly or annually. Mutual Fund SWPs' provide the assurance of paying a fixed amount. Choosing the SWP helps investors customize their cash flow as per need. The capital gain arising from the withdrawals is taxable.

6.7-1f. Systematic Transfer Plan ('STP')

Systematic Transfer Plan (STP) allows the investor to transfer the amount from one scheme to another scheme of the same mutual fund house. An STP transfers a fixed amount of money from one mutual fund to another. STPs can only transfer money between two mutual fund schemes of the same Asset Management Company (AMC).

6.7-2. Taxation of Mutual Funds

Mutual Funds offer investors two main sources of earnings: Capital Gains and Dividends. The taxation of dividend income from different types of mutual funds is governed by common provisions under the Income-tax Act. However, the taxation of capital gains resulting from the transfer or redemption of mutual fund units depends on the type of fund.

Until Assessment Year 2023-24, mutual funds were categorized into two types for taxation purposes: 1) Equity-oriented Mutual Funds and 2) Other Funds. However, with effect from Assessment Year 2024-25, mutual funds are now classified into three types for taxation purposes: 1) Equity-oriented Mutual Funds, 2) Specified Funds, and 3) Other Funds.

In this chapter, we will focus on explaining the taxation provisions related to Equity-oriented Mutual Funds (for details on the Taxation of Specified and Other Mutual Funds, please refer to *Para 5.8*).

6.7-3. Tax on dividend from equity-oriented mutual funds

Dividend received by a resident unit-holder from a mutual fund shall be taxable in his hands as per applicable tax rates (for normal tax rates, *see Annexure E*). An investor is allowed to claim a deduction of interest expenditure incurred to earn that dividend income to the extent of 20% of the total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person to realise such dividend.

Where the dividend is received by a non-resident person or foreign company, the dividend shall taxable in their hands at a special rate of 20% (10% if received from IFSC unit) *plus* surcharge & cess (*refer Annexure E for relevant rates*), subject to provisions of DTAA. Where the dividend is received by an FPI in respect of units purchased in foreign currency or where the dividend is received by a specified fund, the tax rate shall be 10%. The non-resident person or foreign company or FPI or specified fund, as the case may be, shall not be allowed to deduct any expenditure from such income. Further, deduction under Chapter VIA (i.e., section 80C to 80U) shall not be allowed from such income.

Section	*Assessee*	*Income*	*Tax Rate*
115A	Non-resident or Foreign Company	Dividend	10% if received from IFSC unit otherwise 20%[67]
115AB	Offshore fund	Dividend from units of mutual fund purchased in foreign currency	10%
115AD	FPIs	Dividend income from any security (other than units referred to in Section 115AB)	20%
115AD	Specified Fund	Dividend income from any security (other than units referred to in Section 115AB)	10%

6.7-4. Tax on long-term capital gains from equity-oriented mutual funds covered under Section 112A

Capital gain refers to the difference between the value at which an investor purchased the units of a mutual fund scheme and the value at which these units are sold or redeemed. Units of Equity Oriented Fund are treated as long-term capital asset if they are held for more than 12 months immediately preceding the date of transfer.

Tax on long-term capital gain arising from the transfer of equity-oriented mutual funds depends on payment of securities transaction tax (STT) at the time of transfer. If STT is paid at the time of transfer then no tax shall be payable if the amount of capital gain earned during the year does not exceed Rs. 1,00,000. Where the amount of capital gain exceeds Rs. 1,00,000 then the excess amount shall be chargeable to tax at concessional rate of 10% *plus* surcharge & cess (*see Annexure E* for relevant rates). The condition of payment of STT at the time of transfer shall not be applicable if the transaction of sale of units is undertaken on a recognised stock exchange located in an International Financial Services Centre (IFSC) and the consideration for such transfer is received or receivable in foreign currency.

6.7-4a. Cost of acquisition of units of equity oriented mutual funds acquired on or before 31-

[67] Amendment made by the Finance Act, 2023, with effect from Assessment Year 2024-25.

01-2018

The Finance Act 2018 grandfathered the investments made on or before 31-01-2018 as the long-term capital gains arising from the sale of units of listed equity oriented mutual funds were previously exempt from tax. The concept of grandfathering under this provision works as per the following mechanism.

If units of equity oriented mutual funds were acquired on or before 31-01-2018, the cost of acquisition of such units shall be higher of the following:

(a) The actual cost of acquisition of units of equity oriented mutual funds; or
(b) *Lower* of the fair market value of such asset as on 31-01-2018 or full value of the consideration received as a result of the transfer of units of equity oriented mutual funds.

The highest price of units quoted on a recognized stock exchange as on 31-01-2018 is taken as the fair market value. If there is no trading in such units on such exchange on 31-01-2018, the highest price of such units on a date immediately preceding 31-01-2018, when such units were traded, shall be its fair market value. In case such unit is not listed on a recognised stock exchange as on 31-01-2018, the net asset value of such unit as on the said date shall be treated as its fair market value.

Example 8: Mr A (resident in India) acquired 5,000 listed units of an equity oriented mutual fund on 01-05-2017 for Rs. 200 per unit. He sold the units on 01-06-2022 for Rs. 300 per unit through the recognised exchange and paid STT on such transaction. The FMV of the units as on 31-01-2018 was Rs. 225 per unit. Compute the amount of income arising to Mr A from the transfer of units of equity oriented mutual funds and tax thereon.

Answer:

Particulars	*Amount*
Period of holding (from 01-05-2017 to 31-05-2022)	60+ Months
Nature of capital gain (period of holding is more than 12 months)	Long term capital gain
Sale price (5,000 * Rs. 300 per unit)	Rs.15,00,000
Cost of acquisition [Note 1]	Rs. 11,25,000
Long term capital gain	Rs. 3,75,000
Tax rate†	10%
† The amount of capital gain in excess of Rs. 100,000 shall be chargeable to tax at a concessional rate of 10% as per section 112A.	

Note 1: As the units were acquired by Mr A on or before 31-01-2018, the cost of acquisition of such units shall be *higher* of the following:

(a) The actual cost of acquisition of units of equity oriented mutual funds, *that is*, Rs. 10,00,000 (5,000 units * Rs. 200); or

(b) *Lower* of the FMV of such asset as on 31-01-2018, *that is*, Rs. 11,25,000 (5,000 units * Rs. 225) or full value of the consideration received as a result of the transfer of units of equity oriented mutual funds, *that is*, Rs. 15,00,000 (5,000 units * Rs. 300)

Thus, the cost of units shall be Rs. 11,25,000.

6.7-4b. *Cost of acquisition of units of equity oriented mutual funds acquired on or after 01-02-2018*

The cost of acquisition of units of equity oriented mutual funds, which are acquired on or after 01-02-2018, shall be computed as per general principles of Section 55, *that is*, the actual cost for which it is acquired by the assessee.

6.7-5. Tax on long-term capital gains from equity-oriented mutual funds not covered under section 112A

If STT is not paid at the time of transfer of equity-oriented mutual funds then tax shall be charged at the rate of 20% *plus* surcharge & cess (*see Annexure E* for relevant rates). Further, capital gain shall be computed after taking the benefit of indexation.

6.7-6. Tax on short-term capital gain from equity-oriented mutual fund

Short-term capital gains arising from the sale of units of equity-oriented mutual funds are taxable at the rate of 15% *plus* surcharge & cess (*see Annexure E* for relevant rates) if securities transaction tax is paid at the time of sale of such securities. However, the condition of payment of STT at the time of transfer shall not be applicable if the transfer is undertaken on a recognised stock exchange located in an International Financial Services Centre (IFSC) and the consideration for such transfer is received or receivable in foreign currency. Further, no deductions under Chapter-VIA (i.e., deduction under Section 80C to 80U) shall be allowed from such income.

In case STT is not paid at the time transfer of equity-oriented mutual funds then short-term capital gain shall be chargeable to tax at normal rates as applicable in case of an assessee.

Example 9: Mr X purchased 10,000 units of equity oriented mutual funds at the rate of Rs. 250 each per unit on 01-04-2021 through a recognised stock exchange. He had taken a loan of Rs. 20,00,000 to purchase such units. He paid Rs. 1,60,000 as interest on such a loan during the year. He received dividend of Rs. 50 per unit on 15-03-2022. Thereafter, he sold the units for Rs. 280 per unit on 01-06-2022 through a recognised stock exchange and paid STT on such transaction. Discuss the tax implications in the hands of Mr X.

Answer:

Computation of dividend income	
Particulars	*Amount*
Number of units [A]	10,000
Dividend declared per unit [B]	Rs. 50
Total dividend received [C=A * B]	Rs. 500,000
Interest paid to earn dividend [D]	Rs. 160,000
Maximum deduction allowable [E = C * 20%]	Rs. 100,000
Income taxable as dividend income [C - E]	Rs. 400,000
Tax rate	Normal slab rate
Computation of capital gains	
Particulars	*Amount*
Period of holding (from 01-04-2021 to 31-05-2022)	14 Months
Nature of gains (period of holding is more than 12 months)	Long term capital gain
Sale price (10,000 units * Rs. 280)	Rs. 28,00,000
Less: Cost of acquisition (10,000 units * Rs. 250)	Rs. 25,00,000
Long term capital gain	Rs. 3,00,000
Tax rate on capital gain†	10%
†As STT has been paid at the time transfer of units, capital gain shall be chargeable to tax at the rate of 10% under section 112A of the Income-tax Act, 1961. The tax shall be charged on the amount of capital gain exceeding Rs. 100,000.	

6.8 TAX TREATMENT OF DERIVATIVES

Derivatives are financial products whose value is derived from the real asset. The value of the derivative would replicate the value of the real asset. An equity derivative is a class of derivatives whose value is derived from one or more underlying equity securities. Trading in derivatives, popularly known as Future and Options (F&O), is quite popular among investors who invest in the stock market.

A ‘future’ is a contract for buying or selling underlying security, commodity or index, on a future date, at a price specified today, and entered into through a formal mechanism on an exchange. The terms of the contract are specified by the exchange.

An ‘option’ is a contract that gives the right, but not an obligation, to buy or sell the underlying security or index on or before a specified date, at a stated price. Options are categorized into 2 categories - Call Options and Put Options. Option, which gives the buyer a right to buy the underlying asset, is called ‘Call option’ and the option which gives the buyer a right to sell the underlying asset, is called ‘Put option’.

In the case of derivatives, the transactions are ultimately settled without the actual delivery of underlying security or index. These derivative transactions are not treated as speculative if transactions are carried in a recognised stock exchange through a stock-broker or sub-broker or such other intermediary registered with SEBI. Further, the contract note issued by such a broker or intermediary to the client should indicate the unique client identity number and PAN of the client and should be time-stamped.

6.8-1. Types of Derivative Contracts

Commonly used derivatives are Futures, Options, Forwards and Swaps. These are briefly defined below:

6.8-1a. Futures Contract

A futures contract is an agreement between parties to buy or sell an underlying asset in future at a fixed price. Such underlying asset can be a commodity, stock, currencies, etc. Futures Contract or 'futures' are standardized and traded on a futures exchange thus counterparty risk if any is taken care of by the exchange mechanism.

6.8-1b. *Options Contract*

An option contract gives the right, but not an obligation to do something in future. The buyer of the option contract is required to pay an upfront fee called option premium. There are two types of options:

(a) Call option which gives the right but not an obligation to buy an asset by a certain date for a certain price;

(b) Put option gives the right but not an obligation to sell an asset by a certain date for a certain price.

6.8-1c. Forward Contracts

It is a contract between two parties, wherein settlement takes place on a specified date in future at an agreed price. Each contract is customized and unique in terms of contract size, expiry and asset type and quality. Thus forward contracts are known as OTC (Over-the-counter) between parties without the exchange mechanism.

6.8-1d. Swaps

These are private agreements between parties to exchange cash flows in the future according to a pre-arranged formula. They can be regarded as portfolios of forward contracts. The two commonly used swaps are:

a) *Interest rate swaps*: It entails swapping only in the interest related cash flows between parties in the same currency like floating rate with a fixed rate of interest;
b) *Currency swap:* This entails swapping both principal and interest between the parties, with the cash flow in two different currencies.

6.8-1e. Currency Derivatives

Currency derivatives are exchange-based futures and options contracts that allow hedging against currency movements. Currency derivatives are a contract between the seller and buyer, whose value is to be derived from the underlying asset, *that is*, the currency value.

In India, one can use such derivative contracts to hedge against currencies like the Dollar, Euro, U.K. Pound and Yen. Corporates, especially those with significant exposure to imports or exports, use these contracts to hedge against their exposure to a certain currency.

6.8-1f. Interest Rate Derivative

Interest Rate Derivative is a financial derivative contract whose value is derived from one or more benchmark interest rates, price, interest rate instruments, or interest rate indexes.

Interest rate derivatives (IRDs) contracts can be traded either on:

a) Recognized Stock Exchanges; or
b) Over-the-Counter. It refers to all transactions done outside of recognized stock exchanges and shall include transactions on Electronic Trading Platforms (ETP).

6.8-1g. Commodity derivative

Commodity derivative is a contract to buy or sell a commodity at a pre-set price for delivery on a future date. Unlike equity futures, almost all commodity contracts, barring a few (like crude oil and natural gas) result in compulsory delivery.

The Finance Act, 2020 had amended the definition of "taxable commodities transaction" as a transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities, traded in recognised stock exchange. The intention behind introducing CTT was to bring parity between the derivative trading in the securities market and the commodity market.

Trading in derivatives including commodity derivatives is regulated by the Securities Contract (Regulation) Act, 1956 (SCRA). Apart from numerous regional exchanges, India has five national commodity exchanges namely, Multi Commodity Exchange (MCX), National

Commodity and Derivatives Exchange (NCDEX), Indian Commodity Exchange (ICEX), National Stock Exchange (NSE) and Bombay Stock Exchange (BSE).

6.8-2. Nature of Derivative Income

The gains or losses arising from trading in F&O are always taxable under the head 'Profits and Gains from Business or Profession'. The Income-tax Act classifies the business income into 'speculative' and 'non-speculative'. Though Income arising from speculative transactions are taxable under the head PGBP, yet they are treated differently and rigorously from non-speculative business income. Any loss arising from speculative transaction could be set off only from speculative income.

A transaction is deemed as speculative if it is periodically or ultimately settled otherwise than through actual delivery or transfer. However, Section 43(5) has specifically excluded certain derivative transactions from the meaning of speculative transaction as these instruments are used for hedging underlying assets. Thus, income or loss from dealing in F&O shall be deemed as normal business income (non-speculative business) even though delivery is not effected in such transactions. Consequently, any loss arising from F&O can be set off against any normal business income. The business income of an assessee is charged to tax at normal rates as applicable in case of an assessee.

However, securities held by FPIs are always treated as capital asset. Therefore, any profit and gains arising to FPI from derivative transactions shall always be taxable under the head capital gain. Generally, the derivatives can be held for a maximum period of 3 months. Therefore, any gain or loss arising to an FPI from dealing in derivatives shall be chargeable to tax as short-term capital gain or loss. The tax rate on short-term capital gain shall be 30% *plus* surcharge & cess (*see Annexure E* for relevant rates) as per section 115AD of the Income-tax Act. No deduction under Chapter VI-A (i.e., deduction under section 80C to 80U) shall be allowed to the FPIs from such income.

6.8-3. Computation of Turnover

The Income-tax Act does not contain any provision or guidance for computation of turnover in F&O trading. However, the Guidance Note on Tax Audit issued by the ICAI prescribes the method of determining turnover which shall be as under:

a) The total of favourable and unfavourable differences is taken as turnover.
b) Premium received on sale of options is also to be included in turnover.
c) In respect of any reverse trades, the difference thereon should also form part of the turnover.

The computation of turnover is a very important factor as the applicability of tax audit is determined on the basis of turnover. Also, if the taxpayer is opting for the presumptive taxation scheme under section 44AD (subject to total turnover not exceeding Rs. 2 crores or 3 crores, as the case may be), he can declare the profit at the rate of 6% of such turnover in case of receipts in cheque or any digital modes or 8% of turnover in case of cash receipts.

6.8-4. Scheme of Taxation

The income from F&O trading can be offered to tax under the normal scheme of taxation or the presumptive scheme of taxation under Section 44AD (subject to total turnover not exceeding Rs. 2 crores or 3 crores, as the case may be). Under the presumptive scheme, the investor can choose to declare the profits at the rate of 6% of turnover as the payment is always received through banking channels. The presumptive income computed as per the prescribed rate is the final income and no further expenses will be allowed or disallowed. Also, the person opting for this scheme is not required to maintain the books of accounts prescribed under section 44AA and get them audited. Further, he can pay 100% of the advance tax in a single instalment up to 15th March of the relevant financial year.

6.8-5. Set-off and Carry Forward of Losses

The losses from the trading of F&O, if treated as a normal business loss, can be set off against the income from the other heads. However, the business loss cannot be set off against the income from salary.

The unabsorbed loss can be carried forward up to 8 Assessment years. It can be set off only against the business income in the subsequent years. It is important to note that the assessee is entitled to carry forward the business loss provided the return of income is filed on or before the due date. If such return is not filed within the prescribed due date, the right to carry forward and set-off is lost.

Example 10: X Fund, a foreign portfolio investor (FPI), purchased 1 call option of X Ltd. at a premium of Rs. 35 per share on 01-06-2022. The details of the call option are as follows:

Lot size per option	1,000 shares
Exercise price	Rs. 450 per share
Date of expiry	24-06-2022

Determine the taxability in the following situation:

Situation 1: It exercised the call option to buy shares of X Ltd. on 15-06-2022 and such shares were subsequently sold for Rs. 550 each on 30-11-2022.

Situation 2: It transferred such an option for Rs. 30 per share on 10-06-2022.

Situation 3: It transferred such option for Rs. 37 per share on 10-06-2022

Situation 4: It does not transfer or exercise the call option and, therefore, contract was settled by the stock exchange on expiry, *that is*, 24-06-2022 when premium for this option was prevailing at Rs. 10 per share.

Answer:

The taxability in aforesaid situations shall be as follows:

Situation 1: Option exercised

Computation of capital gains on transfer of shares	
Particulars	*Amount*
Period of holding (from 15-06-2022 to 29-11-2022)	5.5 Months
Nature of capital gain (period of holding is less than 12 months)	Short term capital gain
Sale price [1,000 * Rs. 550]	Rs. 550,000
Cost of Acquisition (Exercise price + Premium paid for call option) [1,000 * (450 + 35)] [B]	Rs. 485,000
Short term capital gain [C = A - B]	Rs. 65,000
Tax rate on capital gain [D]	30%

Situation 2: Option transferred at a loss

Computation of capital loss on transfer of option	
Particulars	*Amount*
Period of holding (from 01-06-2022 to 09-06-2022)	Less than 1 month
Nature of capital asset	Short-term capital asset
Sale price (1,000 * Rs. 30) [A]	Rs. 30,000
Cost of Acquisition (1,000 * Rs. 35) [B]	Rs. 35,000
Short-term capital loss [C = A - B]	(Rs. 5,000)

Situation 3: Option transferred at gain

Computation of capital gain on transfer of option	
Particulars	*Amount*
Period of holding (from 01-06-2022 to 09-06-2022)	Less than 1 month
Nature of capital asset	Short-term capital asset
Sale price (1,000 * Rs. 37) [A]	Rs. 37,000
Cost of Acquisition (1,000 * Rs. 35) [B]	Rs. 35,000
Short-term capital gain [C = A - B]	Rs. 2,000

Tax rate [D]	30%

Situation 4: Option expired

Computation of capital loss on settlement of option on expiry	
Period of holding (from 01-06-2022 to 24-06-2022)	Less than 1 month
Nature of capital asset (period of holding is less than 12 months)	Short term capital asset
Sale price (1,000 * Rs. 10) [A]	Rs. 10,000
Cost of Acquisition (1,000 * Rs. 35) [B]	Rs. 35,000
Short term capital loss [C = A - B]	(Rs. 25,000)

Example 11: Mr A (resident in India) is engaged in the trading of shares and derivatives. He purchased 5 call option of Z Ltd. at a premium of Rs. 22 per share on 01-05-2022. The details of the call option are as follows:

Lot size per option	1,000 shares
Exercise price	Rs. 200 per share
Date of expiry	27-05-2022

Determine the taxability in the hands of Mr A if he exercised 2 call options on 14-05-2022 to buy 2,000 shares of Z Ltd. at the exercise price. He subsequently sold such shares for Rs. 250 each on 30-07-2022. The remaining 3 call options were sold at a premium of Rs. 27 per share.

Answer:

As Mr A is trading in shares and derivatives, any income arising from shall be taxable as normal business income. The computation of business income shall be as follows:

Computation of business income or loss	
Particulars	*Amount*
Sale price of shares (2,000 * Rs. 250) [A]	Rs. 500,000
Sale price of option (3,000 * Rs. 27) [B]	Rs. 81,000
Total Sale consideration [C = A + B]	**Rs. 581,000**
Cost of acquisition of shares (2,000 * Rs. 200) [D]	Rs. 400,000
Cost of acquisition of option (5,000 * Rs. 22) [E]	Rs. 1,10,000
Total purchase cost [F = D + E]	**Rs. 510,000**
Business Income [G = C - F]	**Rs. 71,000**

6.9 DIVIDEND STRIPPING

Dividend stripping is an attempt to reduce the tax liability by an investor who invests in securities (i.e., shares, stock or debentures, etc.) and units shortly before the record date and getting a dividend/income, and exiting after the record date at a price lower than the price at which such securities/units were purchased and incurring a short-term capital loss. The strategy behind dividend stripping is a two-way strategy wherein the investor gets tax free dividend/income on one hand and on the other hand he incurs a short-term capital loss on sale which is allowed to be set off and carry forward against any other capital gain.

To curb the aforesaid malpractice, provisions of Section 94(7) had been inserted under Income-tax Act to provide that where any person buys or acquires any securities or unit within a period of 3 months before the record date and subsequently sells or transfers such securities within a period of 3 months or units within a period of 9 months, after such date then, the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored to compute his income chargeable to tax.

6.10 BONUS STRIPPING

Similar to dividend stripping, 'Bonus Stripping' is a practice where a person buys securities or units just before the record date to get bonus securities or units on basis of such holding and sold the original units after the record date at a price lower than the price at which securities or units were purchased and incurring a short-term capital loss.

To curb this practices, section 94(8) was inserted under Income-tax Act to provide that where any person acquires any securities or unit of within a period of 3 months before the record date and is allotted bonus securities or units on such date then any loss arising on transfer of original securities or units shall be ignored to compute his income chargeable to tax if he transfers such securities or units within a period of 9 months after the record date while continuing to hold all or any of the bonus securities or units.

Further, the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of bonus securities or units held by him on the date of transfer of original units.

Example 12: Mr Ravi purchased 1,000 units of an equity oriented mutual fund at Rs. 106 per unit as on 01-07-2021. Thereafter, the mutual fund declared allotment of bonus units of 1:1 on 01-09-2021, *that is*, the person holding 1 unit gets 1 bonus unit. After getting the bonus units, Mr Ravi sold the original 1,000 units on 01-04-2022 at a price of Rs. 95 per unit.

Answer:

In the given example, Mr Ravi had acquired the units of a mutual fund within 3 months before the record date of allotment of bonus units and sold the same within 9 months after the record date while continuing to hold the bonus units. Thus, any loss arising on transfer of original units shall be ignored to compute his income chargeable to tax and the amount of loss so ignored shall be deemed to be the cost of purchase or acquisition of bonus units held by him.

The loss arising on transfer of original units shall be Rs. 11,000 [1,000 units * (Rs. 106 – Rs. 95)] shall be ignored. Consequently, the cost of acquisition of 1,000 bonus units so allotted shall be deemed to be Rs. 11,000, and, accordingly, per unit cost shall be Rs. 11.

6.11 MEANING OF SECURITIES, UNIT, AND RECORD DATE FOR DIVIDEND/BONUS STRIPPING

The terms ‘securities’, ‘unit’, and ‘record date’ are defined for the purpose of Dividend and Bonus stripping as under:

6.11-1 Meaning of Securities

“Securities” is defined to include includes stocks and shares. Further, it is provided that securities shall be deemed to be similar if they entitle their holders to the same rights against the same persons as to capital and interest and the same remedies for the enforcement of those rights, notwithstanding any difference in the total nominal amounts of the respective securities or in the form in which they are held or in the manner in which they can be transferred.

6.11-2 Meaning of Unit

‘Unit’ is defined to mean:

(a) Unit of a Business Trust; or

(b) Unit of a Mutual Fund or UTI; or

(c) Beneficial interest (including shares or partnership interest) of an investor in an Alternative Investment Fund.

6.11-3 Meaning of Record Date

‘Record date’ means a date fixed by—

(a) a Company; or

(b) a Mutual Fund; or

(c) a Business Trust; or

(d) an Alternative Investment Fund

for the purposes of entitlement of the holder of the securities or units to receive dividends or income, or additional securities or units without any consideration.

6.12 BENEFITS NOT ALLOWED FROM CAPITAL GAINS

Income-tax Act provides for concessional tax rates in respect of long-term capital gain and certain short-term capital gains. Long-term capital gain is generally chargeable to tax at a concessional rate of 20%. However, under certain circumstances, the tax on long-term capital gain is further reduced to 10%.

Short-term capital gain is generally chargeable to tax at normal rates. However, the short-term capital gain arising from the transfer of specified securities, being equity shares, units of an equity-oriented mutual fund, high premium ULIPs and units of REITs or InVITs is chargeable to tax at a concessional rate of 15% (subject to payment of securities transaction tax).

As Income-tax Act provides for concessional tax rates in respect of long-term capital gain as well as short-term capital gain from transfer of specified securities, certain benefits are not allowed while computing such capital gains.

6.12-1. Benefits not allowed from long-term capital gain chargeable to tax at the rate of 20%

No deduction shall be available under Sections 80C to 80U from the long-term capital gains taxable at the rate of 20% under Section 112.

6.12-2. Benefits not allowed from long-term capital chargeable to tax at the rate of 10%

Following benefits shall not be allowed from the long-term capital gains taxable at the rate of 10% under Section 112A, 115AC, 115ACA, 115AB, 115AD and 115E.

6.12-2a. No benefit of indexation

Usually for computation of cost of acquisition, in case of long-term capital assets, the indexation benefit is available. However, in this case, the indexation benefit shall not be available.

6.12-2b. No computation in foreign currency

Mode of computation of capital gain in foreign currency as available in the case of a non-resident while computing capital gains arising from the transfer of a capital asset, being shares in, or debentures of, an Indian company, purchased in foreign currency shall not be allowed when the long-term capital gain is chargeable to tax at concessional rate of 10%.

6.12-2c. No deduction under Section 80C to 80U

No deduction shall be available under Sections 80C to 80U from the long-term capital gains taxable at the rate of 10%.

6.12-2d. No Section 87A rebate from long-term capital gain covered under section 112A

Rebate under Section 87A is not available from income-tax payable on long-term capital gain covered under Section 112A, i.e., the long-term capital gain arising from transfer of specified securities, being equity shares, units of an equity-oriented mutual fund, high premium ULIPs and units of REITs or InVITs chargeable to Securities Transaction Tax. However, the rebate shall be allowed from the tax payable on the total income as reduced by tax payable on such capital gains.

6.12-3. Benefits not allowed from short-term capital gain chargeable to tax at the rate of 15% under section 111A and 115AD

6.12-3a. No computation in foreign currency in case of FPIs

Mode of computation of capital gain in foreign currency as available in the case of a non-resident while computing capital gains arising from the transfer of a capital asset, being shares in, or debentures of, an Indian company shall not be allowed in case of FPIs.

6.12-3b. No deduction under Section 80C to 80U

No deduction shall be available under Sections 80C to 80U from the short-term capital gains chargeable to tax at a concessional rate of 15%.

6.12-4. Benefits not allowed from capital gain arising from market linked debentures or specified mutual funds under Section 50AA

6.12-4a. No benefit of period of holding

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute capital gain. However, irrespective of the period of holding, the capital gains arising from the transfer, redemption or maturity of MLDs or SMFs shall be taxable as short-term capital gains.

6.12-4b. No benefit of indexation

As capital gain arising from the transfer, redemption or maturity of market linked debentures (MLDs) or specified mutual fund (SMFs) is deemed to be short-term capital gain irrespective of the period of holding, the indexation of the cost of acquisition of the MLDs or SMFs shall not be allowed.

6.12-4c. No foreign exchange fluctuation

The option available under the first proviso to Section 48 to compute capital gains in the foreign currency utilised to purchase the MLDs, then convert it into Indian currency shall not be available. Thus, where a non-resident assessee acquires MLDs in foreign currency, the capital gain arising from the transfer of such market linked debentures shall be computed in Indian currency directly.

6.12-4d. No deduction for the cost of improvement

In relation to the MLDs or SMFs, the cost of improvement shall be taken to be nil, notwithstanding whether it has been incurred by the assessee himself or by the previous owner.

6.12-4e. No adjustment under Section 45(4)

Where an amount is charged to tax as income of the partnership firm under Section 45(4), the firm can attribute such amount to the capital asset remaining with it. At the time of computation of capital gains from the sale of such capital asset remaining with the partnership firm, such attribution is allowed by way of deduction under Section 48(iii). No such adjustment shall be allowed while computing the capital gains from the transfer of MLDs or SMFs.

6.13 ADJUSTMENT OF EXEMPTION LIMIT FROM CAPITAL GAIN

The total income of a resident being an individual or a resident HUF is not chargeable to tax up to the maximum exemption limit. Thus, if the total income of a resident individual or HUF, as reduced by the amount of long-term capital gains referred to in Section 112 and 112A or short-term capital gains covered under section 111A, is less than maximum exemption limit, the amount of such capital gains shall be reduced by that amount that would enable the individual or HUF to fully claim the maximum exemption limit.

For example, if the total income of a resident individual (excluding long-term capital gains) is Rs. 1,85,000 and long-term capital gain from the sale of unlisted shares is Rs. 2,50,000, the tax under this provision shall be computed on Rs. 1,85,000. The maximum exemption limit in case of a resident individual is Rs. 2,50,000 and total income falls short of this limit by Rs. 65,000. The amount of long-term capital gain shall be reduced by Rs. 65,000 and the remaining amount, i.e., Rs. 1,85,000 (Rs. 2,50,000 *less* Rs. 65,000) shall be charged to tax.

6.14 OVERVIEW OF TAXATION OF EQUITY PRODUCTS

Product	***Period of holding to qualify for long-term capital asset (in months)***	***Tax on short-term capital gain***			***Tax on long-term capital gain*** [Note 1]		
		In case of resident	*In case of non-resident*	*In case of FPIs or Specified fund* Note 6	*In case of resident*	*In case of non-resident*	*In case of FPIs or Specified fund* Note 6
Listed equity shares (STT Paid)	12	15%	15%	15%	10% [Note 2]	10% [Note 2]	10% [Note 2]
Listed equity shares (STT not paid)	12	Normal tax rate	Normal tax rate	30%	20% with indexation or 10% without indexation	20% with indexation or 10% without indexation	10%
Unlisted shares	24	Normal tax rate	Normal tax rate	30%	20% with indexation	10%without indexation and forex fluctuation	10%
Listed Preference shares	12	Normal tax rate	Normal tax rate	30%	20% with indexation or 10% without indexation	20% with indexation or 10% without indexation	10%
Unlisted Preference shares	24	Normal tax rate	Normal tax rate	30%	20% with indexation	10% without indexation and forex fluctuation	10%
GDRs [Note 3]	36	Normal tax rate	Normal tax rate	30%	10% under section 115ACA and 20% with indexation	10% under section 115AC and 20% with indexation	10%

					in other cases	in other cases	
Share warrants [Note 4]	-	Normal tax rate	Normal tax rate	30%	-	-	-
Equity Oriented Mutual Funds (if STT Paid)	12	15%	15%	15%	10% [Note 2]	10% [Note 2]	10% [Note 2]
Equity Oriented Mutual Funds (if STT not Paid)	12	Normal tax rate	Normal tax rate	30%	20% with indexation	20% with Indexation	10%
Derivatives [Note 5]	-	-	-	30%	-	-	-

Note 1: Where the long-term capital gain is charged to tax at the rate of 20%, the benefit of indexation shall be allowed at the time of computing capital gain to assessees. Further, a non-resident assessee, who has acquired shares or debentures in foreign currency, shall be allowed to compute capital gain in foreign currency in case of transfer of shares or debentures of an Indian company. However, if the long-term capital gain is charged to tax at the rate of 10% then no benefit of indexation and foreign currency fluctuation shall be allowed while computing capital gain.

Note 2: Tax on long-term capital gain arising from transfer of equity shares, units of equity oriented mutual fund, high premium ULIPs or units of REITs/ InVITs, chargeable to STT, shall not be levied if the aggregate amount of long-term capital gain earned during the year from transfer of said capital assets does not exceed Rs. 1,00,000.

Note 3: Tax rate in case of conversion of GDR into other security would be same as applicable at the time of transfer of GDRs.

Note 4: Tenure of share warrants shall not exceed 18 months from the date of their allotment in the IPO or Right Issue or FPO, as the case may be. Thus, short-term capital gain shall arise in every situation on transfer of share warrants or conversion thereof into shares.

Note 5: Income from derivatives is considered as business income in case of every person other than FPIs and tax is charged as applicable tax rates. Transfer of derivatives would not lead to arise of long term capital gains as the maximum holding period of derivatives is 3 months. However, in case of FPIs, the resultant gains from derivatives shall always be short-term capital gains.

Note 6: Specified funds mean Category III Alternative Investment Fund located in IFSC, entire units of which are held by non-residents (other than units held by sponsors or managers) or investment division of banking unit granted a certificate of registration as Category – I FPI as located in IFSC.

6.15 OVERVIEW OF BENEFITS NOT AVAILABLE FROM CAPITAL GAINS

Capital Gain	***Indexation***	***Foreign Currency Fluctuation***	***Deduction under Chapter VI-A***	***Rebate under Section 87A****
Long-term capital gain chargeable to tax at the rate of 10% under section 112A	No	No	No	No
Long-term capital gain chargeable to tax at the rate of 10% under any other provision	No	No	No	Yes
Long-term capital gain chargeable to tax at the rate of 20% under Section 112	Yes	Yes	No	Yes
Short-term capital gain chargeable to tax at the rate of 15% under section 111A	No	Yes	No	Yes
Short-term capital gain chargeable to tax at the rate of 30% in case of FPIs or specified fund under section 115AD	No	No	No	No
Short-term capital gain chargeable to tax as per applicable rates	No	Yes (except MLDs and SMFs)	Yes	Yes

* Rebate under Section 87A shall be allowed to an assessee being a resident Individual Only.

Review Questions:

1. Investment is equity products may generate.

(*a*) Dividend Income

(*b*) Capital Gains

(*c*) Both dividend & capital gains

(*d*) Neither dividend & capital gains

2. In case of a Non-resident or Foreign Company dividend income received from IFSC Unit is charged to tax at _______.

(*a*) **10 percent**

(*b*) 20 percent

(*c*) 30 percent

(*d*) Not Taxable

3. Which of the following are key features of a Global Depository Receipt (GDR)?

(*a*) Issuing company is an Indian Co.

(*b*) GDRs are listed on stock exchanges outside India

(*c*) GDRs are tradeable & transferable

(*d*) All of these

4. The buyer of an option Contract is required to pay an upfront fee which is known as _____.

(*a*) Premium

(*b*) Face Value

(*c*) Surcharge

(*d*) Cess

CHAPTER 7: TAXATION OF OTHER PRODUCTS[68]

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Tax aspects of Employee Stock Ownership (ESOPs)
- Tax aspects Sovereign gold bonds
- Tax aspects Annuities (NPS Tier 1 & Tier 2)
- Exchange Traded Funds (ETFs)
- Alternate Investment Funds (AIF)
- Real Estate Investment Trusts (REITs)
- Infrastructure Investment Trust (InvITs)
- Other Derivative Products

7.1 TAXATION OF EMPLOYEES STOCK OPTION PLAN ("ESOP")

7.1-1. Introduction to ESOP

Employee Stock Option Plans ("ESOPs") are given to retain brilliant employees and to acknowledge their proven contribution to the company. Whenever ESOPs are issued, employees get the right to purchase a certain number of securities of the employer company at a discounted price (i.e., less than the market price of such shares). It allows employees to have a stake in the company, which ensures higher loyalty and motivation for the employees to work. The option provided under this scheme confers a right but not an obligation on the employee.

Such an option to purchase shares can be exercised only after the vesting period. Such vesting period is the time period an employee must wait to get the right to buy those specified number of shares. Upon vesting of options, employees can exercise the options to acquire shares by paying the pre-determined exercise price.

7.1-2. Why are ESOPs given?

Generally, employers offer ESOPs as an award to employees to retain top talent. Thus, it serves a twin-fold purpose both for the company and the employees. It acts as a motivation tool for the employees. After owning a stake in the company, they feel responsible for the performance of the company. It helps the employer to retain the top talent and assure the right level of performance in work.

[68] In case of FPIs and Specified funds, tax shall be charged at the concessional rate specified under Section 115AD. For taxability of these FPIs and Funds refer chapter 10 and Chapter 11.

ESOPs are quite popular amongst start-ups that cannot afford to pay huge salaries to employees in their initial phase and, accordingly, such start-ups offer ESOPs instead of monetary benefits to the top employees. ESOPs have been a significant component of the compensation for the employees of start-ups, as it allows the founders and start-ups to employ highly talented employees at a relatively low salary amount with the balance being made up *via* ESOPs.

7.1-3. Terms of ESOP

The employer-company does not charge anything at the time of offering ESOPs to employees. Such an option given to the employee can be exercised after a certain lock-in period, which is generally more than one year.

The right to exercise ESOP may get vested in the employee on future dates. The date on which the employee becomes entitled to exercise the right to acquire the shares is called “vesting date”.

Example 1, On April 1, Year 00, XYZ India Private Limited grants ESOP to its employee Mr A to purchase 1,000 shares at a pre-determined price of Rs 100 per share. The date of vesting of ESOP is April 1, Year 04. Thus, Mr A can exercise the right to exercise shares on or after April 1, Year 04.

In the case of ESOPs, employees are given an option to exercise such option, and it is not compulsory for them to exercise such ESOP.

The employee is given a time period during which he has to exercise the option failing which the vested rights may lapse. The date on which the employees exercise their option to buy the shares is known as ‘exercise date’.

7.1-4. Tax implications of ESOPs

The taxation of ESOPs is split into two components:

7.1-4a. At the time of allotment of shares

Any company responsible for paying salaries to employees shall deduct tax at the time of payment of such salary at the average rate of tax. The definition of salary also includes perquisites provided by the employer to employees. The value of any share allotted to an employee either free of cost or at a concessional rate would be treated as perquisite.

The first tax instance shall arise at the time of allotment of shares. When an employee exercises the option, the difference between the Fair Market Value (“FMV”) of the shares on the date the option is exercised and the amount paid by the employee for such share, is taxable as perquisite in the year of allotment. Here, it is be noted that though the tax is levied at the time of allotment of shares the FMV of the shares on the date of allotment of the shares is not relevant for the calculation of perquisite value. In other words, the FMV of shares at the time of exercising of option is considered for calculation of perquisite and not the FMV of shares at the time of allotment of shares. We can consider the following step-by-step treatment to determine the value of perquisite arising from ESOP:

Step 1: Determine the Fair Market Value of shares on the date on which the employee exercises the option. It may be noted that the Fair Market Value of shares on the date of vesting shall not be considered.

- *Where the securities offered under ESOP are 'equity shares'*

The Fair Market Value of Equity Shares on the date of exercise of ESOP shall be computed in accordance with the following:

Scenarios	*Fair Market Value*
Where shares are listed on one stock exchange on the date of exercising of ESOP	Average of the opening price and closing price of the share on that date on the stock exchange
Where shares are listed on more than one stock exchange on the date of exercising of ESOP	Average of opening price and closing price of the share on that stock exchange which records the highest volume of trading in the share on that date
Where on the date of exercising of ESOP there is no trading in shares in the stock exchange	• The closing price of the share on the stock exchange on a date closest to the date of exercising of ESOP and immediately preceding such date; or • In case the closing price of the share is recorded on more than one recognized stock exchange, the closing price on the stock exchange records the highest volume of trading in such share as on the date closest to the date of exercising of the option and immediately preceding such date.
Where shares are not listed on a stock exchange	Value of share as determined by a merchant banker on: • The date of exercising of ESOP; or • Any date earlier than the date of the exercising of the option, not being a

	date, which is more than 180 days earlier than the date of the exercising of option.

- *Where the securities allotted under ESOP are 'other than equity shares'*

The fair market value of any specified security, not being an equity share in a company, on the date on which the option is exercised by the employee, shall be such value as determined by a merchant banker on:

- The date of exercising of the option; or
- Any date earlier than the date of exercise of option, not being a date which is more than 180 days earlier than the date of the exercising of option.

Step 2: Determine the pre-determined value of shares paid or to be paid by the employee to the employer at the time of exercising of option.

Step 3: Value of perquisite = (Step 1 – Step 2) * Number of shares exercised by the employee

Example 2, ABC India Private Limited has issued ESOP to Mr B during the financial year 2022-23. Calculate the value of perquisite based on the following data:

Particulars	***Amount***
Date of granting of ESOP	01-04-2019
Vesting Period	01-04-2019 to 31-03-2022
Date of Exercise of ESOP	10-05-2022
Fair Market Value as on March 31, 2022	6,000
Fair Market Value as on May 10, 2022	6,500
Number of ESOP exercised	100
Pre-determined price to be paid by the employee to the employer	500
Value of perquisite [(Rs. 6,500 – Rs. 500) * 100]	Rs 600,000

Example 3, Mr Rahul is working with MNO Private Limited. He was given ESOP on 01-06-2019 to purchase 1,000 shares at a discounted price of Rs. 500 per share. The vesting period was from 01-06-2019 to 31-03-2022. He exercised the option on 31-03-2022. The Fair Market Value of such shares on the said date was Rs. 7,000 on NSE and Rs 7,500 on BSE. The BSE has recorded the highest volume of trading in such shares. The Company allotted him 1,000 shares on 30-04-2022. The fair market value of the share on the date of allotment was Rs 6,000 on NSE and Rs 6,500 on BSE. The NSE has recorded the highest volume of transactions on that date. Calculate the value of perquisite.

Answer: The fair market value of shares on the date of exercising of option is considered for valuation of perquisite, but the perquisite value is taxable in the financial year in which shares are allotted. Thus, the perquisite value shall be considered on basis of FMV existing on 31-03-2022 but it will be taxable in the financial year 2022-23, being the year in which shares are allotted to Mr Rahul. Since shares are listed on more than one stock exchange, their fair market value shall be the price of shares on the stock exchange, which records the highest volume of transaction. The value of perquisite shall be Rs. 70,00,000 [(Rs. 7,500 – Rs. 500) * 1,000].

7.1-4b. At the time of sale of shares

The second tax implication shall arise when the employees sell shares allotted under ESOP. The resultant gains shall be taxable under the head capital gains. The taxability of capital gains shall depend on the type of share and the period of holding of such share.

The period of holding of shares shall be the period commencing from the date of allotment of shares, and not from the date of exercising of option, ending on the date employees sell the shares. Further, the fair market value of shares on the date of exercising the option shall be taken as the cost of acquisition of such shares to compute the capital gain.

Example 4, Mr John exercised the ESOP on 01-04-2019, and the shares are allotted to him on 01-05-2019. He sold such shares on 01-04-2022. The period of holding of such shares shall be counted from 01-05-2019 (and not from 01-04-2019) till 31-03-2022. However, for computing the cost of acquisition, the fair market value of shares as on 01-04-2019, being the date of exercising of ESOP, shall be considered.

The capital gains from the transfer of shares allotted under the ESOPs shall be computed as per the following provisions:

a) Equity shares chargeable to STT (long-term capital assets): Where shares allotted under ESOPs are equity shares, and the employees sell them after holding them for more than 12 months and paid STT on same, the resultant long-term capital gains shall be taxable under Section 112A. The period of holding of such shares shall be counted from the date of allotment of shares to employees under ESOP. The long-term capital gains, to the extent it exceeds Rs. 1,00,000 shall be taxable at the concessional rate of 10% *plus* surcharge and cess (*see Annexure E for relevant rates*). If shares are listed on a recognized stock exchange but STT is not paid at the time of transfer of such share (i.e., Over-the-Counter sale) the resultant long-term capital gains shall be taxable as per *first proviso* to Section 112(1), *that is*, at 20% with indexation or 10% without indexation. To know more about Section 112A and Section 112, *see Para 6.2.*

b) *Equity shares chargeable to STT (short-term capital assets):* Any short-term capital gains arising from the sale of equity shares allotted under ESOP on which STT has been paid shall be taxable at the rate of 15% *plus* surcharge and cess (*see Annexure E for relevant rates*) under Section 111A. To know more about Section 111A, *see Para 6.2.*

c) *Unlisted equity shares not chargeable to STT (long-term capital assets):* Where equity shares, which are not chargeable to STT, are sold by employees after holding it for a period of more than 24 months, the resultant long-term capital gains will be taxable at the rate of 20% *plus* surcharge and cess (*see Annexure E for relevant rates*) under Section 112 after providing the benefit of indexation. Period of holding of such shares shall be counted from the date of allotment of shares to employees under ESOP. In case of unlisted shares of a closely held company, a non-resident assessee has to pay tax at the rate of 10% without claiming the benefit of indexation and foreign currency fluctuation. To know more about Section 112, *see Para 6.3.*

d) *Equity shares not chargeable to STT (short-term capital assets):* Any short-term capital gains arising from the sale of equity shares, which are not chargeable to STT, shall be taxable as per the Income-tax slab rate applicable to the taxpayer. To know more, *see Para 6.3.*

e) *Other securities:* In case of any other security issued by the employer, taxability would depend on the nature of security issued (already discussed in previous chapters). In case of debt securities such as bonds and debentures, *see Chapter 5*, in case of other securities, *see Chapter 6*.

7.1-5. Deferment of tax on perquisite value of ESOPs in case of Start-ups

ESOPs are a significant component in the compensation of the employees of start-ups as it allows start-ups to employ highly talented employees at a relatively low salary amount with the balance being paid *via* ESOPs. The taxability of ESOPs arises in the hands of the employee at two stages. Firstly, when shares are allotted to the employee on exercising his right to apply for the shares under ESOPs and, secondly, when such shares are sold by the employee.

At the time of allotment of shares, the difference between the fair market value of shares on the date of exercising the option and the amount paid by the employee for such shares is taxable as perquisite under Section 17(2)(vi) of the Income-tax Act and chargeable to tax under the head salary. Consequently, the employer is required to include the amount of perquisite in the salary of the employee and deduct tax thereon under Section 192 in the year in which shares are allotted.

As employees do not get any immediate benefit from the shares allotted under the ESOPs, the deduction of tax thereon in the year of allotment itself was very burdensome for them as it reduces the cash flow in their hand. To reduce the burden of taxes, the Finance Act, 2020 amended Section 192 (TDS on salary), Section 140A (self-assessment tax), Section 191 (direct payment of tax by the employee) and Section 156 (notice of demand) so to defer the deduction and payment of tax on income in the nature of perquisites arising from ESOPs for eligible start-ups as referred to in Section 80-IAC.

Section 192, contains provisions for deduction of tax by the employer from salary of the employee, provides that an eligible start-up as referred to in Section 80-IAC shall deduct tax from income arising in the nature of perquisites from ESOPs within 14 days from the happening of any the following events (whichever is earlier):

a) after the expiry of 48 months from the end of the Assessment year relevant to the previous year in which shares are allotted under ESOPs;
b) From the date the assessee ceases to be the employee of the organization; or
c) From the date of sale of shares allotted under ESOP.

For this purpose, the tax shall be deducted on the basis of rates in force for the financial year in which shares are allotted or transferred under ESOPs.

A similar amendment has been made to section 191 and section 156 to provide that if an employer does not deduct tax on perquisite arising from ESOPs, then tax shall be payable by the employee directly within the period mentioned above either voluntarily or in response to a notice of demand. Consequent amendments have also been made to Section 140A to provide that tax on perquisite arising from ESOPs shall be appropriately taken into account while computing the self-assessment tax at the time of filing of return.

7.1-5a. Meaning of an eligible start-up

Only an eligible start-up as referred to in Section 80-IAC and its employees would get the benefit of deferment of TDS and tax payment on perquisite arising from ESOPs. As per Section 80-IAC, an eligible start-up can only be a company or limited liability partnership (LLP) engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation. Further, it has to satisfy the following conditions:

1. It must be incorporated on or after 01-04-2016 but before 01-04-2024[69];
2. Total turnover shall not exceed Rs. 100 crores[70] in the previous year for which deduction under Section 80-IAC is claimed; and
3. It must hold a certificate of eligible business from the Inter-Ministerial Board of

[69] The Finance Act, 2023 has extended the outer date from 01-04-2023 to 01-04-2024.
[70]The turnover limit has been increased from Rs. 25 crores to Rs. 100 crores by the Finance Act, 2020

Certification.

The meaning of an eligible start-up is defined differently in the notification issued by DPIIT and in Section 80-IAC, which has been explained in the below table.

Particulars	*Definition as per DPIIT*	*Definition as per section 80-IAC*
Incorporation	The start-up should be incorporated as a: • Company • LLP • Partnership Firm	The start-up should be incorporated as a: • Company • LLP
Date of Incorporation	No condition as to the date of incorporation	Should be incorporated between 01-04-2016 and 31-03-2024
Eligible Business	The entity should be working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.	Same
Tenure	An entity is considered as an eligible start-up up to 10 years from the date of incorporation/registration.	An entity is considered as an eligible start-up for the deduction up to 10 years from the beginning of the year in which it is incorporated or registered.
Total Turnover	Turnover of entity for any of the financial years since incorporation/registration should not exceed Rs. 100 crores.	Turnover of entity for any of the financial years in which deduction is claimed should not exceed Rs. 100 crores.
Reorganization	The entity should not be formed by splitting up or reconstruction of an existing business.	The entity should not be formed by splitting up or reconstruction of an existing business except in a situation specified in section 33B.

Second-hand plant or machinery	No condition as to the status of plant or machinery purchased for the business	Value of second-hand plant and machinery should not exceed 20% of the total value of plant and machinery used in the business
Benefit of deferment of TDS on perquisites arising from ESOPs	Not allowed	Allowed

7.1-5b. Mechanism for deferment of tax on perquisite arising from ESOPs

Though the Government has provided for deferment of tax and TDS on perquisite arising from ESOPs. But no amendment has been made to Section 17(2)(vi) which provides for chargeability of perquisite arising from ESOPs under the head "salary". Thus, perquisite arising from ESOPs shall be treated as income of an employee of the year in which shares are allotted but no tax would be required to be deducted or paid in that respect by the employer and employee, respectively.

Due to deferment of tax, employee shall not be required to pay tax in the year of allotment of securities under ESOP. However, the tax so deferred shall be required to be disclosed in the ITR. The tax to be payable on the salary income, excluding the perquisite value of ESOPs, should be computed as per following formula.

$$\textit{Tax payable on salary income excluding ESOPs perquisite} = \textit{Tax on total income including ESOPs perquisites} \; X \; \frac{\textit{Total income excluding ESOPs perquisites}}{\textit{Total income including ESOPs perquisites}}$$

Example 5, Mr A, working in an eligible start-up company, has been allotted 100,000 shares at the rate of Rs. 10 per share under the ESOP scheme in the Financial Year 2021-22. The fair market value of shares at the time of exercising of option by Mr A is Rs. 100. The perquisite value of ESOPs taxable in the hands of Mr A shall be Rs. 90 Lakhs [100,000 shares* (Rs. 100 – Rs. 10)]. The annual salary of Mr A (excluding perquisite value of ESOPs) in that year is Rs. 40 Lakhs. He continues with the company even after the expiry of 48 months from the end of the assessment year in which shares are allotted and he does not sell the shares even after the expiry of said period. What shall be the mechanism for deferment of TDS and tax on perquisite value of ESOPs in such a case?

a) Assessment Year 2022-23

Mr A shall not be liable to pay any tax on the perquisite value of ESOPs, i.e., Rs. 90 lakhs in the year of allotment of shares. However, the tax so deferred shall be required to be disclosed in the Return of Income. The tax to be payable on the salary income, excluding the perquisite value of ESOPs, shall be computed in the following manner:

Particulars	**Amount (in Rs.)**
Total Income before including perquisite value of ESOPs (A)	40,00,000
Add: Perquisite Value of ESOPs (B)	90,00,000
Total Income after including perquisite value of ESOPs (C)	**1,30,00,000**
Tax on Rs. 1.30 crores as per slab rates applicable for Assessment Year 2022-23 as per old taxation regime (D)	37,12,500
Add: Surcharge [E = D * 15%]	5,56,875
Add: Education Cess [F = (D + E) * 4%]	1,70,775
Total tax liability for Assessment Year 2022-23 after considering perquisite value of ESOPs [G = D + E + F]	44,40,150
Tax liability attributable to salary income (excluding the perquisite of ESOPs) [G * A / C]	**13,66,200**

b) Assessment Year 2027-28

As Mr A continues with the company after the expiry of 48 months from the end of the Assessment Year in which shares are allotted and he does not sell the shares even after expiry of said period, the liability to deduct tax or make payment of tax on perquisite value of ESOP will arise in the Assessment Year 2027-28, i.e., after the expiry of 48 months from the end of the Assessment year (2022-23) in which shares are allotted. TDS shall be deducted within 14 days from the end of the assessment year 2026-27. The tax liability for the Assessment Year 2027-28 shall be computed as under:

Particulars	*Amount (in Rs.)*
Total tax liability for Assessment Year 2022-23 after considering perquisite value of ESOPs	**44,40,150**
Less: Tax already paid at the time of filing of return for the Assessment Year 2022-23 excluding the tax liability attributable to ESOPs	13,66,200

Differential amount to be deducted or paid by the employer or employee in the Assessment Year 2027-28 towards the tax liability attributable to ESOPs	**30,73,950**

In this regard, the Government has amended the Income-tax return forms. Part B of Schedule TTI (Computation of tax liability on total income) seeks the disclosure of the tax amount which has been deferred in this respect.

7.1-5c. Consequences in case of failure to deduct or pay tax on perquisite value of ESOPs

Section 191 of the Act provides that where a person who was liable for deduction of tax at source fails to deduct or after deduction fails to pay such tax to the credit of the central government, he shall be deemed as assessee-in-default. In such a case, the assessee shall be liable for payment of taxes directly. If he fails to make direct payment of such tax, he shall also be deemed as assessee-in-default.

Consequently, they could be liable for the following consequences:

Particulars	***Employer***	***Employee***
Interest	1% per month for failure to deduct tax or 1.5% per month for failure to pay tax [Section 201(1A)]	1% per month [Section 220(2)]
Penalty	Amount of tax which he fails to deduct or pay (Section 271C) and the amount as Assessing Officer may direct (Section 221)	Up to the amount of tax in arrears (Section 221)
Prosecution	For a period not less than 3 months but which may extend to 7 years and with a fine (Section 276B)	-

However, the employer will not be treated as an assessee-in-default if the employee:

(a) Has furnished his return of income under Section 139;

(b) Has taken into account such sum for computing income in such return of income; and

(c) Has paid the tax due on the income declared by him in such return of income, and furnishes a certificate to this effect from an accountant in Form 26A.

In such a case, the employer shall be liable to pay interest as stated in the table above only from the date on which such tax was deductible to the date of furnishing of return of income by the employee.

7.2 SOVEREIGN GOLD BOND SCHEME

7.2-1. Introduction

Sovereign Gold Bonds (SGBs) are government securities, which are denominated in grams of gold. They are substitutes for holding physical gold. Investors have to pay the issue price in cash, and the bonds will be redeemed in cash on maturity. Reserve Bank of India issues the bond on behalf of the Government of India. The quantity of gold for which the investor pays is protected, as the investor receives the market price of gold on redemption.

The SGB offers a superior alternative to holding gold in physical form. The risks and costs of storage are eliminated. Investors are assured of the market value of gold at the time of maturity and periodical interest. SGB is free from issues like making charges and purity. The bonds are held in the books of the RBI or Demat form eliminating the risk of loss of scrip, etc.

7.2-2. Who can invest in the SGBs?

The Sovereign Gold Bonds[71] may be held by a Trust, HUFs, Charitable Institution, University or by a person resident in India, being an individual, in his capacity as such individual, or on behalf of a minor child, or jointly with any other individual. An individual investor whose residential status subsequently changes from resident to non-resident may continue to hold SGB till the original term of redemption/maturity.

7.2-2a. Meaning of 'Person resident in India'

The expression 'person resident in India' shall have the same meaning as defined in Section 2(v) of the Foreign Exchange Management Act, 1999.

7.2-2b. Meaning of 'Trust'

'Trust' means a trust constituted or formed as per the Indian Trusts Act, 1882, or a public or private trust constituted or recognized under the provisions of any Central or State law for the time being in force and also an express or constructive trust constituted for either a public religious or charitable purpose or both which includes a temple, math, a wakf, a church, a synagogue, agiary or any other place of public religious worship, or a dharmada or any other religious or charitable endowment and also society, formed either for a religious or charitable purpose or for both, registered under the Societies Registration Act, 1860 or under any other law for the time being in force in India.

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[71] Sovereign Gold Bond Scheme 2023-24 notified *vide* Notification G.S.R. 438(E), dated 14-06-2023.

7.2-2c. Meaning of 'Charitable Institution'

'Charitable Institution' means a Company registered under Section 25 of the Indian Companies Act, 1956 or under Section 8 of the Companies Act, 2013; or an institution, which has obtained a Certificate of Registration as a charitable institution in accordance with a law in force; or Any institution which has obtained a certificate from an Income Tax Authority under Section 80G of the Income Tax Act, 1961.

7.2-2d. Meaning of University

University means a university established or incorporated by a Central, State or Provincial Act, and includes an institution declared under Section 3 of the University Grants Commission Act, 1956, to be a university for the purposes of the Act.

7.2-3. Rate of interest of SGBs

The bonds bear interest at the rate of 2.50 per cent (fixed rate) per annum on the nominal value of the bond. Interest will be credited -half-yearly to the bank account of the investor, and the last interest will be payable on maturity along with the principal.

7.2-4. Limit of investment

The Bonds are issued in denominations of one gram of gold and multiples thereof. The minimum investment in the Bond shall be one gram with a maximum limit of subscription of 4 kg for individuals, 4 kg for Hindu Undivided Family (HUF) and 20 kg for trusts and similar entities notified by the government from time to time per fiscal year (April – March).

In case of joint holding, the limit applies to the first applicant only. The annual ceiling will include bonds subscribed under different tranches during initial issuance by Government and those purchased from the secondary market. The investment limit will not include the holdings as collateral by banks and other Financial Institutions.

7.2-5. Maturity

The gold bonds will mature on the expiration of 8 years from the date of issue of the bonds. On maturity, the Gold Bonds shall be redeemed in Indian Rupees, and the redemption price shall be based on the simple average of the closing price of gold of 999 purity of previous three working days from the date of repayment, published by the India Bullion and Jewellers Association Limited. Both interest and redemption proceeds will be credited to the bank account furnished by the customer at the time of buying the bond. The RBI/depository shall inform the investor one month in advance, about the date of maturity of the Bond.

7.2-6. Premature redemption

Though the tenor of the bond is 8 years, early encashment/redemption of the Bond is allowed after the fifth year from the date of issue of bond. Such repayments will be made on the next interest payment date. The bond will be tradable on Exchanges if held in Demat form. It can also be transferred to any other eligible investor.

7.2-7. Collateral for loans

These securities are eligible to be used as collateral for loans from banks, financial Institutions and Non-Banking Financial Companies (NBFC). The Loan to Value ratio will be the same as applicable to conventional gold loan prescribed by the RBI from time to time. Granting a loan against SGBs would be subject to the decision of the bank/financing agency, and cannot be inferred as a matter of right.

7.2-8. Tax implications on SGBs

7.2-8a. Interest income

The interest received on the sovereign gold bond shall be chargeable to tax under the head 'Income from other sources' and taxed as per the tax rates applicable in case of an assessee. (For tax rates applicable in case of various persons, *see Annexure* E).

However, any payment of interest on SGBs would not attract any TDS as they are Government Securities. Thus, investors would receive the full amount of interest on SGBs in their bank accounts. Currently, SGBs pay an interest of 2.5% per annum on the nominal value of the bond and interest is credited half-yearly to the bank account of the investor.

7.2-8b. Capital gain on redemption

SGBs have a tenor of 8 years. The redemption of the SGBs is treated as transfer, thus, charged to capital gains tax. However, Section 47 of the Income-tax Act provides an exemption for such capital gain arising from the redemption of SGBs to an individual investor.

However, investors can go for pre-mature redemption of SGBs after the fifth year from the date of issue. Any capital gains arising to an investor other than an individual on redemption of SGBs (whether on maturity or pre-mature redemption) shall be taxable as a long-term capital gain. As SGBs are listed on stock exchanges in India, the investor has an option to compute the capital gain with or without taking the benefit of indexation. If the benefit of indexation is taken, then tax shall be charged at the rate of 20% otherwise at the rate of 10%.

Example 6, Mr X purchased SGBs for Rs 5 lakhs. He received Rs. 6 lakhs on their redemption. The capital gain arising on such redemption shall not be charged to tax in the hands of Mr X as he is an Individual. However, if the capital gain is arising to trust, then it shall be charged to tax at the rate of 20% if the assessee takes the benefit of indexation while computing the capital gain. Otherwise, the tax shall be charged at the rate of 10%.

It is to be noted that if a person buys SGBs from the secondary market and not from the primary issue, the taxability on redemption would remain the same.

7.2-8c. Capital gain on transfer

Sovereign Gold Bonds are listed on stock exchanges in India. Thus, a person can transfer the SGBs in the secondary market. The profit or loss arising on the transfer of SGBs shall be chargeable to tax under the head capital gain. If the SGBs are transferred after holding for more than 12 months, the resultant gains shall be taxable as a long-term capital gain. Whereas, if the SGBs are transferred within 12 months then the gains shall be treated as a short-term capital gain.

Short-term capital gain arising on the transfer of SGBs is charged to tax at normal tax rates as applicable in case of an assessee. Long-term capital gain is charged to tax at the rate of 20% if the benefit of indexation is taken while computing capital gain otherwise tax is charged at the rate of 10%. In addition to the basic tax rate, surcharge and cess would be levied (*see Annexure E for relevant rates*).

The taxability shall remain same in case of off-market transactions. Further, it is to be noted that even an individual shall be liable to pay tax on capital gains arising on the transfer of SGBs as exemption has been provided only in case of redemption and not on transfer of SGBs.

7.2-8d. Indexation of cost of acquisition of SGBs

In the case of the transfer of a long-term capital asset, the cost of acquisition of the capital asset is adjusted to reduce the impact of indexation. Such adjustment in the cost is called the indexed cost of acquisition which is calculated in a two-step process. The first step is to calculate the cost of acquisition of capital asset. In the second step, such cost of acquisition is multiplied with the CII of the year in which capital asset is transferred and divided by CII of the year in which asset is first held by the assessee or CII of 2001-02, whichever is later.

The scheme of indexation does not apply to any transfer of a bond or debenture. Thus, even if the bond or debenture is a long-term capital asset, the deduction is allowed only for the simple cost of such bonds or debenture. However, Capital Indexed Bonds issued by the Government and Sovereign Gold Bond issued by RBI under the Sovereign Gold Bond Scheme are exceptions for this. Indexation scheme remains applicable to such bonds.

The notified Cost Inflation Index ("CII") for different years are given in Annexure I.

Example 7: Mr X purchased 100 SGBs at its nominal value of Rs. 425,000 on 28-04-2019. The SGBs carry an interest rate of 2.5% per annum on the nominal value of bond. The interest is payable at half-yearly intervals on 28th October and 28th April every year. The bonds are redeemable on 28-04-2027 with the option for early redemption after the 5th year from the date of issue of bonds.

What shall be the tax implications in the hands of Mr X in the following scenarios?

1. He holds SGBs till maturity;
2. He transfers SGBs in the secondary market on 01-04-2020 for Rs. 450,000; or
3. He transfers SGBs in the secondary market on 29-10-2020 for Rs. 5,00,000.

Answer

Situation 1: SGBs held till maturity

As per Section 47 of the Income-tax Act, the redemption of SGBs by an Individual is not treated as a transfer. Thus, no capital gain shall arise in such a case. However, the interest received or receivable on SGBs is chargeable to tax in the hands of the investor at the applicable rates. Thus, Mr X shall be liable to pay tax on the interest amount. For instance, for the financial year 2020-21, the interest amount taxable in the hands of Mr X shall be Rs. 10,625 (425,000 * 2.5%).

Situation 2: SGBs transferred in the secondary market on 01-04-2020

Mr X transferred SGBs for Rs. 450,000 on 01-04-2020 before the due date of payment of half-yearly interest on 28-04-2020. The sales consideration shall include the amount of interest accrued to him from the last coupon date to the date of transfer of SGBs, *that is*, from 29-10-2019 to 31-03-2020. As interest is taxable under the head 'Income from other sources', the amount of interest accrued shall be reduced from the amount of consideration to compute the capital gain arising on the transfer of SGBs.

The amount of interest accrued to Mr X before the date of transfer of SGBs shall be Rs. 4,512 (Rs. 425,000 * 2.5% * 155/365 days). The resultant value shall be the sale price of SGBs, *that is*, Rs. 445,488 (Rs. 4,50,000 – Rs. 4,512). The capital gain shall be computed as follows:

Computation of capital gain on transfer of SGBs	
Period of holding (from 28-04-2019 to 31-03-2020)	Less than 12 months
Nature of capital gain	Short term capital gain
Sale price	Rs. 4,45,488
Less: Cost of acquisition	Rs. 4,25,000
Short term capital gain	Rs. 20,488

Tax on capital gain	Normal slab rate

Situation 3: SGBs transferred in the secondary market on 29-10-2020

The amount of interest taxable in hands of Mr X in the financial year 2020-21 shall be Rs. 6,142 (Rs. 425,000 * 2.5% * 211/365 days).

As SGBs were transferred the next day after the due date of payment of half-yearly interest, no interest shall accrue to Mr X from the last coupon date to the date of transfer of SGBs. Thus, the interest amount shall not be reduced from the consideration received on transfer of SGBs. Further, as Mr X has transferred SGBs after holding for more than 12 months, the nature of capital gain shall be long-term capital gain. The tax on long-term capital gain arising from SGBs depends on whether the assessee takes the benefit of indexation or not while computing the capital gain. Thus, Mr X has the following two options:

A) Option 1: Benefit of Indexation is claimed

Computation of capital gain	
Particulars	*Amount*
Sale price [A]	500,000
Cost of Acquisition [B]	425,000
Indexed cost of acquisition [C = B * 301/289]	442,647
Long term capital gain [D = A - C]	57,353
Tax rate on capital gain [E]	20%†
Tax on capital gain [F = D * E]	11,470
†As benefit of indexation has been claimed, capital gains shall be chargeable to tax at the rate of 20% as per Section 112 of the Income-tax Act, 1961.	

B) Option 2: Benefit of Indexation is not claimed

Computation of capital gain	
Particulars	*Amount*
Sale price [A]	500,000
Cost of Acquisition [B]	425,000
Long term capital gain [D = A - C]	75,000
Tax rate on capital gain [E]	10%†
Tax on capital gain [F = D * E]	7,500
† As the benefit of indexation has not been claimed, capital gains shall be chargeable to tax at the rate of 10% as per section 112 of the Income-tax Act, 1961.	

Since tax liability is lower when Mr X does not take benefit of indexation, it is advisable that he pays tax at the rate of 10% without claiming the benefit of indexation.

7.3 NATIONAL PENSION SYSTEM

7.3-1. Introduction

Retirement planning requires disciplined saving, vigilant investment to build a sufficient retirement corpus and its judicious drawdown in the post-retirement phase. This can be achieved by joining a pension/retirement plan at an early stage so that when a person retires from active work life, he gets a regular stream of income in the form of pension or annuity for his life.

National Pension System (NPS) is a voluntary, defined contribution retirement savings scheme designed to enable the subscribers to make optimum decisions regarding their future through systematic savings during their working life. It is administered and regulated by Pension Fund Regulatory and Development Authority (PFRDA). NPS seeks to inculcate the habit of saving for retirement amongst the citizens. It is an attempt towards finding a sustainable solution to the problem of providing adequate retirement income to every citizen of India.

Under the NPS, individual savings are pooled into a pension fund which is invested by PFRDA regulated professional fund managers as per the approved investment guidelines into the diversified portfolios comprising of government bonds, bills, corporate debentures and shares. These contributions would grow and accumulate over the years, depending on the returns earned on the investment made.

At the time of normal exit from NPS, the subscribers may use the accumulated pension wealth under the scheme to purchase a life annuity from a PFRDA empanelled life insurance company apart from withdrawing a part of the accumulated pension wealth as lump-sum, if they choose so.

7.3-2. Features of NPS

NPS offers a range of investment options and a choice of Pension Fund Manager (PFMs) for planning the growth of investments in a reasonable manner. Individuals can switch over from one investment option to another or from one fund manager to another subject to certain regulatory restrictions.

When anyone opens an account with NPS, he gets a Permanent Retirement Account Number (PRAN), which is a unique number and it remains with the subscriber throughout his lifetime.

NPS provides two types of accounts to the subscribers - Tier I and Tier II. Tier I is a mandatory retirement account, whereas Tier II is a voluntary saving account associated with PRAN of the subscriber. Tier II offers greater flexibility in terms of withdrawal, unlike the Tier I account, the subscriber can withdraw from the Tier II account at any point of time.

7.3-3. Eligibility of NPS

Any citizen of India, whether resident or non-resident can join NPS whose age is between 18 – 70 years as on the date of submission of his/her application. The citizens can join NPS either as an individual or as an employee-employer group(s) (corporates) subject to the submission of all required information and KYC documents.

A Non-Resident Indian can also open an NPS account. A contribution made by an NRI is subject to regulatory requirements as prescribed by the RBI and FEMA from time to time. However, OCI (Overseas Citizens of India), PIO (Person of Indian Origin) cardholders and HUFs are not eligible to open an NPS account. If the subscriber's citizenship status changes, his/her NPS account would be closed.

7.3-4. How to open an NPS account?

An individual citizen or an employee of corporates (providing NPS to their employees) can open an NPS account either online or by visiting Points of Presence - Service Providers (POP-SP) registered with PFRDA.

7.3-4a. Online (eNPS)

To open an NPS account online through eNPS platform, an eligible person must have a PAN card. Further, he must have either a savings/current bank account or any other account such as Demat/Mutual Fund/Insurance etc. (in case of non-Bank POPs). If any bank is selected as POP then the internet banking facility must be enabled for the account of the person with such bank.

7.3-4b. Offline through POP-SP

An eligible person who wants to open an NPS account can go to his nearest POP-SP and submit the PRAN application along with the KYC documents. Currently, almost all banks (both private and public sector) are registered to act as POP-SP apart from several other financial institutions.

7.3-5. Features of Tier I and Tier II NPS Account

Under the NPS account, two types of accounts – Tier I & II are provided (NRI's can open only Tier-I Account). It is mandatory for a subscriber of NPS to open a Tier I account and contribute therein every financial year. However, the opening of a Tier II account and contributing therein is at the option of the subscriber. The salient features of the Tier-I and Tier-II account can be explained with the help of the following table:

Particulars	*Tier I Account*	*Tier II Account*
Eligibility	Any citizen of India (whether resident or non-resident) can open a Tier I Account.	A subscriber who has an active Tier I account can activate a Tier II account. However, Non-resident Indians (NRIs) cannot activate Tier II account.
Contribution	A minimum contribution of Rs. 1,000 is required every year.	No minimum contribution is required every year. However, initially, a subscriber has to contribute a minimum of Rs. 1,000 to activate Tier II account.
Withdrawal	Withdrawal is allowed after a certain lock-in-period and that too subject to certain conditions	Amount can be freely withdrawn from the Tier II account.
Tax Benefits	Subscribers shall be entitled to deduction under section 80CCD at the time of contributing to NPS. Further, no tax shall be levied at the time of withdrawal of lump-sum amount from NPS.	There is no tax benefit for the investment made in Tier II NPS Account except Government employees who are entitled to deduction under section 80C in respect of contribution made by them in Tier II account. However, deduction shall be allowed subject to conditions specified under the scheme notified in this behalf.

7.3-6. Tax treatment of contribution to NPS

7.3-6a. Employee's contribution to NPS

When contribution to NPS is made by the employee himself, the deduction shall be allowed under Section 80CCD(1) which shall be lower of the amount contributed by the employee to NPS or 10% of salary. An additional deduction of Rs. 50,000 over and above this limit is allowed under Section 80CCD(1B) to an employee for the amount deposited by him to his NPS account.

* For this purpose, 'salary' includes dearness allowance (if terms of employment so provide) but excludes all other allowances and perquisites.

7.3-6b. Employer contribution to NPS

When contribution to the NPS is made by the employer, such contribution is taxable in the hands of the employee and included in his salary income. However, deduction shall be allowed under Section 80CCD(2) to the employee for such contribution which shall be lower of the amount contributed by the employer to NPS, or 14% of salary in case of Central or State Government employee or 10% of salary in case of any other employee.

* 'Salary' for the purpose of contribution by the employer and employee shall mean basic salary, dearness allowance (if terms of employment so provide). All other allowance or perquisites will not be part of salary for calculation.

The Finance Act, 2020 introduced a cap on the maximum contribution an employer can make towards recognized provident fund (PF), National pension scheme (NPS) and Superannuation fund (hereinafter collectively referred to as 'employee welfare schemes'). With effect from Assessment Year 2021-22, the contribution to employee welfare schemes in excess of Rs. 750,000 shall be taxed as a perquisite in the hands of the employees. Further, the annual accretion by way of interest, dividend or any other amount of similar nature in respect of such excess shall also be taxable as perquisite. The annual accretion shall be computed as per Rule 3B.

Rule 3B provides that the annual accretion related to the excess contribution made by the employer to welfare funds shall be computed by using the following formula:

$TP = (PC/2) \times R + (PC1 + TP1) \times R$

Where,

(a) TP = Taxable perquisite under section 17(2)(viia) for the current previous year;

(b) TP1 = Aggregate of taxable perquisite under section 17(2)(viia) for the previous year(s) commencing on or after 01-04-2020 other than the current previous year.

(c) PC = Aggregate of the principal contribution made by the employer in excess of Rs. 7.50 lakh to the employee's welfare funds during the previous year;

(d) PC1 = Aggregate of the principal contribution made by the employer in excess of Rs. 7.50 lakh to the employee's welfare funds for the previous year(s) commencing on or after 01-04-2020 other than the current previous year;

(e) R = I/ Favg;

(f) I = Aggregate of income accrued during the current previous year in the employee's welfare funds;

(g) Favg = (Aggregate of balance to the credit of the employee's welfare funds on the first day of the current previous Year + Aggregate of balance to the credit of the employee's welfare funds on the last day of the current previous year)/2

Where the aggregate of TP1 and PC1 exceeds the aggregate of balance to the credit of the specified fund or scheme on the first day of the current previous year, then the amount in excess of the aggregate of amounts of the said balance shall be ignored to compute the aggregate of amounts of TP1 and PC1.

In simple words, the perquisites arising from the annual accretion on the employer's contribution to welfare funds shall be the average return (I/Favg) on the sum of:

(a) ½ of the current year's contribution in excess of Rs. 750,000;

(b) Contribution in excess of Rs. 750,000 up to last year; and

(c) Accretion taxable as perquisite up to last year.

If the sum of (b) and (c) exceeds the opening balance of the fund, it shall be restricted to such opening balance.

Let us understand this with the help of an example:

Particulars	**Recognized provident fund**	**National pension scheme**	**Superannuation fund**	**Total**
2020-2021				
Opening Balance	5,00,000	4,50,000	8,50,000	18,00,000
Employer's contribution	2,50,000	3,00,000	2,50,000	8,00,000
Income Accrued	60,000	60,000	88,000	2,08,000
Closing Balance	8,10,000	8,10,000	11,88,000	28,08,000

2021-2022				
Opening Balance	8,10,000	8,10,000	11,88,000	28,08,000
Employer's contribution	3,00,000	3,50,000	2,75,000	9,25,000
Income Accrued	88,800	92,800	1,17,040	2,98,640
Closing Balance	11,98,800	12,52,800	15,80,040	40,31,640
2022-2023				
Opening Balance	11,98,800	12,52,800	15,80,040	40,31,640
Employer's contribution	3,50,000	4,00,000	3,00,000	10,50,000
Particulars	**Recognized provident fund**	**National pension scheme**	**Superannuation fund**	**Total**
Income Accrued	1,23,904	1,32,224	1,50,403	4,06,531
Closing Balance	16,72,704	17,85,024	20,30,443	54,88,171
Particulars	Reference	2020-2021	2021-2022	2022-2023
Opening Balance (A)	-	18,00,000	28,08,000	40,31,640
Employer's contribution (B)	-	8,00,000	9,25,000	10,50,000
Excess contribution [C = B – 7,50,000]	PC	50,000	1,75,000	3,00,000
Income accrued during the year (D)	I	2,08,000	2,98,640	4,06,531
Closing Balance (E = A + B + D)	Favg	28,08,000	40,31,640	54,88,171
Average of opening and closing balance [F = (A + E)/2]	-	23,04,000	34,19,820	47,59,906

Perquisites (accretion income) up to last year (G)	TP1	-	2,257	14,461
Perquisites (excess contribution) up to last year (H)	PC1	-	50,000	2,25,000
Aggregate of perquisites [I = G + H]	-	-	52,257	2,39,461
Annual accretion of current year [J = (C/2+I)*(D/F)]	TP	2,257	12,204	33,263

7.3-6c. Contribution to Tier II account by Central Govt. employees

Any contribution made by Central Govt. employees to the Tier II NPS shall be allowed as tax deduction under Section 80C. However, such contribution to NPS shall be made for a fixed period of at least 3 years. The maximum amount of deduction allowed under this section shall be Rs. 1,50,000.

7.3-6d. Contribution to NPS by a self-employed person

When contribution to the NPS is made by a self-employed individual, the deduction shall be allowed under Section 80CCD which shall be *lower* of the amount contributed by him to NPS or 20% of his gross income. An additional deduction of Rs. 50,000 over and above this limit is allowed under Section 80CCD(1B) to such an individual for the amount deposited by him to his NPS account.

7.3-6e. Threshold limit for deduction in respect of contribution to NPS

The total deduction under Section 80C, 80CCC and 80CCD(1) shall be limited to Rs. 1,50,000. This limit of Rs. 1,50,000 is not applicable in respect of:

1. The contribution made by the employer to NPS account of the employee; and
2. Additional deduction of Rs. 50,000 for the contribution made by an individual (employee or self-employed) to his NPS account.

Thus, the total deduction to be allowed to an individual in respect of contribution to NPS can go up to Rs. 2,00,000. The additional deduction of Rs. 50,000 is above this limit of Rs. 1,50,000. In other words, an assessee can choose to take a tax deduction in respect of contribution to NPS within the limit of Rs. 1,50,000 or as an additional deduction.

Example 8, An employee repays a housing loan of Rs. 170,000 during the year and contributes Rs. 65,000 in his NPS account. Repayment of housing loan to a bank or housing finance company is eligible for deduction under Section 80C. Since the limit of Rs. 150,000 is exhausted by such repayment, the employee can choose to take the benefit of the additional deduction for the contribution to NPS. Thus, the total deduction shall be Rs. 2,00,000 (Rs. 1,50,000 under Section 80C for housing loan repayment and Rs. 50,000 for contribution to NPS under Section 80CCD(1B)).

Example 9, Basic salary of Mr Gopal is Rs 50,000 per month. He is entitled to a dearness allowance of 40% of basic salary (Rs. 20,000 per month) and 50% thereof forms part of retirement benefits. He and his employer (non-govt.) both contribute 15% of basic salary as a contribution to NPS. Mr Gopal is already claiming a deduction of Rs 150,000 under Section 80C.

The contribution made by the employer to NPS would be treated as part of the salary of Mr Gopal. Thus, the employer's contribution of Rs. 90,000 (Rs. 600,000 * 15%) would be included in the salary of Mr Gopal. The deduction available under Section 80CCD shall be computed in the following two steps:

Step 1: Computation of salary

Particulars	*Amount*
Basic Salary [Rs. 50,000 * 12 months]	600,000
Dearness allowance [Rs. 20,000 * 12 months * 50% (forming part of retirement benefits]	120,000
Salary for computation of deduction under Section 80CCD	**720,000**

Step 2: Computation of deduction

Particulars	*Amount*
Deduction for employee's contribution *(a)* Contribution by employee *(b)* Deduction allowable under Section 80CCD(1B) [Note 1] [A]	 90,000 50,000
Deduction for the employer's Contribution *(a)* Contribution by employer *(b)* Deduction allowable under Section 80CCD(2) [Note 2] [B]	 90,000 72,000
Deduction under Section 80CCD [A + B]	**1,22,000**
Note 1: Maximum deduction of Rs. 150,000 is allowed under Section 80C, 80CCC and 80CCD(1), which has already been exhausted for deduction under Section 80C. Thus, no deduction can be claimed under Section 80CCD(1). However, a deduction of up to Rs. 50,000 can be claimed under Section 80CCD(1B).	

Note 2: Deduction for the employer's contribution to the NPS shall be limited to 10% of the salary, that is, Rs. 7,20,000 * 10%. The deduction for the employer's contribution would be in addition to the deduction available for Rs. 150,000.

7.3-7. Tax treatment of sum received from NPS

7.3-7a. In case of withdrawal on the closure of account or opting out of NPS

Any payment from the National Pension System Trust to an assessee on the closure of his account or on his opting out of the pension scheme is exempt from tax to the extent of 60% of the total corpus. As per the NPS scheme, a person can withdraw up to 60% of the total corpus. The exemption limit under the Income-tax Act has been set in symmetry with the NPS scheme. Thus, the total amount withdrawn by an assessee at the time of closure of the NPS account or opting out of the scheme shall be completely tax-free.

7.3-7b. In case of partial withdrawal from NPS

Any amount withdrawn from NPS before the closure of the account or opting out of the scheme shall be exempt only in the case of employees to the extent of 25% of the employee's contribution to NPS. Further, the amount should be withdrawn in accordance with the terms and conditions specified under the Pension Fund Regulatory and Development Authority (PFRDA) Act, 2013 and regulations made under this Act.

As per PFRDA (Exits and Withdrawals under the National Pension System) (First Amendment) Regulations 2017, the subscribers can withdraw after 3 years from the date of joining the system and a maximum of three times during the entire tenure of subscription under NPS.

7.3-7c. In case the amount is received by the nominee on the death of the subscriber

Where the amount standing to the credit of an assessee in NPS is received by his nominee on the death of the subscriber, it shall be fully exempt from tax.

7.3-7d. In case pension received out of NPS

When a pension is received out of fund contributed to NPS, it will be chargeable to tax in the hands of the recipient.

7.3-7e. In case the amount withdrawn from NPS utilized for purchasing an annuity plan

Where the amount withdrawn or received out of NPS is utilized for purchasing an annuity plan of LIC or some other insurer in the same previous year then the annuity income received shall be taxable in the hands of the recipient.

7.3-7f. In case of withdrawal from Tier II account

The investment made in a Tier II Account is considered just like an investment in an open-ended mutual fund. Thus, any profit or loss arising on account of withdrawal of amount from Tier II Account shall be taxable under the head Capital Gain (see *Chapter 6* for taxability in case of investment in mutual funds).

7.3-8. Summary of taxability of NPS

Particulars	*Taxability*
Contribution to NPS	
a) Employees' contribution to NPS	The deduction is allowed up to 10% of salary *plus* an additional deduction of Rs. 50,000.
b) Employers' contribution to NPS*	The deduction is allowed up to: ▪ 14% of salary in case of Central or State Government employees; ▪ 10% of salary in case of other employees.
c) Any other person not being an employee	The deduction is allowed up to 20% of gross total income *plus* an additional deduction of Rs. 50,000.
Accumulation	Tax-free
Yearly return on the corpus amount	
Withdrawal	
a) Partial withdrawal	If subscriber is an employee, exempt to the extent of 25% of the contribution made by the employee to the NPS.
b) Final withdrawal at the time of closure of account or opting out of the scheme	Exempt up to 60% of the total corpus available in the NPS account of the subscriber.
c) Amount received by a nominee on death of the subscriber	The whole of the amount received by the nominee shall be exempt in the hands of the receiver

d) In case of withdrawal from Tier II account	Profit or loss from investment in Tier II account shall be taxable under the head "Capital Gains"
e) In case the amount withdrawn from NPS utilised for purchasing an annuity plan	No tax shall be charged on such amount withdrawn if it is utilized for purchasing the annuity plan of LIC or some other insurer.
Pension Income	
Pension received out of fund contributed to NPS	Pension received from the fund will be taxable in the hands of the receiver

7.4 REAL ESTATE INVESTMENT TRUST

Real Estate Investment Trusts (REITs) were first introduced in the United States in 1960-61 through the Cigar Excise Tax Extension Act. It allowed the investors to invest in large-scale, diversified portfolios of income-producing real estate. Since then, more than 30 countries have introduced REIT regimes. The concept of REIT was introduced in India in 2014 by the SEBI. REITs are registered with the Securities and Exchange Board of India (SEBI) under SEBI (REITs) Regulations, 2014.

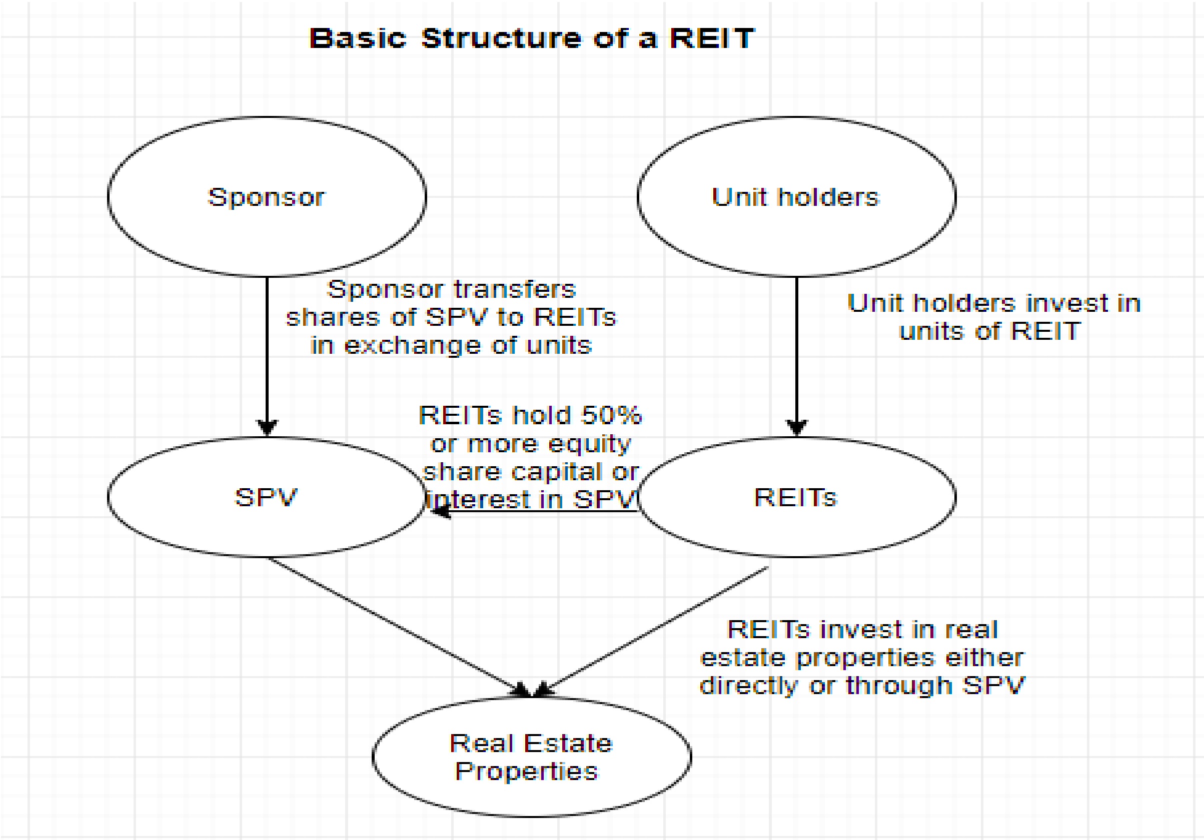
REITs invest in the majority of real estate property types, which includes offices, apartment buildings, warehouses, retail centres, medical facilities, data centres, cell towers, infrastructure and hotels. Most REITs focus on a particular property type, but some hold multiple types of properties in their portfolios. For example, Office REITs are those that own and manage office real estate and rent the space in those properties and Industrial REITs own and manage industrial facilities and rent space in those properties. Similarly, Retail REITs include REITs that focus on large malls, outlet centres, grocery-anchored shopping centres, etc. Residential REITs include REITs that specialize in apartment buildings, student housing, manufactured homes and single-family homes. Timberland REITs own and manage various types of timberland real estate. Timberland REITs specialize in harvesting and selling timber.

REITs allow investors to invest in portfolios of real estate assets the same way they invest in shares or a mutual fund or exchange-traded fund (ETF).

7.4-1. Structure of REITs

The structure of REITs is similar to that of a mutual fund wherein sponsor (generally real estate developers) sets up the REITs to collect money from the general public for investing on their behalf in income-generating real estate properties. The investment is made in real estate properties either by REITs directly or through Special Purpose Vehicle (SPV) in which it holds the controlling interest.

The basic structure of a REIT can be explained with the help of the following diagram:



7.4-1a. Sponsor

Sponsor means any person who set up the REIT and is designated as such at the time of application made to the SEBI and shall include an inducted sponsor[72]. The collective holding of the sponsor(s) should be 15% in REIT for at least 3 years from the date of listing of units of REITs.[73]

7.4-1b. Special Purpose Vehicle

Special Purpose Vehicle (SPV) means any company or LLP:

(a) In which either the REIT or the Holdco holds or proposes to hold 50% or more of the equity share capital or interest;

[72] Regulation 2(zt) of SEBI (Real Estate Investment Trusts) Regulations, 2014

[73] Earlier, the sponsors had to maintain a collective holding of 15% after the initial 3 years. Now there is no requirement for the sponsors to maintain a minimum holding. The amendment has been made vide the SEBI (Real Estate Investment Trusts) (Second Amendment) Regulations, 2020, w.e.f. 16-06-2020.

(b) Which holds 90% or more of its assets directly in properties and does not invest in other SPV; and

(c) Which is not engaged in any activity other than holding and developing property and any other activity incidental to such holding or development[74].

Meaning of the term "Holdco"

The Holdco or "Holding Company" shall mean a company or LLP:

(a) In which REIT holds or proposes to hold minimum 50% of the equity share capital or interest and which it in turn has made investments in other SPV(s), which ultimately hold the property(ies); and

(b) Which is not engaged in any other activity other than holding of the underlying SPV(s), holding of real estate/properties and any other activities pertaining to and incidental to such holding[75].

7.4-1c. Real Estate Investment Trust (REIT)

REIT means a trust which is registered under SEBI (Real Estate Investment Trusts) Regulations, 2014. REIT works just like a mutual fund whereby funds collected from investors are invested in real estate properties. REITs invest in real estate properties either directly or through SPV.

7.4-1d. Unit-holder

Unit-holder means any person who owns units of the REIT[76].

7.4-1e. Real Estate Property

"Real estate" or "property" means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include a mortgage.

However, assets falling under the preview of "Infrastructure" shall not be considered as Real Estate property except following:

a) hotels, hospitals and convention centres forming part of composite real estate projects, whether rent generating or income-generating;

[74] Regulation 2(zs) of SEBI (Real Estate Investment Trusts) Regulations, 2014
[75] Regulation 2(qa) of SEBI (Real Estate Investment Trusts) Regulations, 2014
[76] Regulation 2(zy) of SEBI (Real Estate Investment Trusts) Regulations, 2014

b) common infrastructure for composite real estate projects, industrial parks and SEZ[77].

7.4-2. Taxation of REITs

REITs are structured as a hybrid pass-through entity. Thus, certain types of income are exempt at REITs level and taxable at the level of unit-holders.

REITs may have the following types of income:

a) Rental income from real estate property;
b) Capital gains from the transfer of real estate property;
c) Dividend received from SPV;
d) Interest received from SPV; and
e) Any other income

The pass-through status is provided only in respect of income covered under point (a), (c) and (d) above. Thus, if REIT distributes any rental, dividend or interest income to its unit-holder then tax shall be charged at the level of unit-holder and not in the hands of the REIT. Further, any income distributed by REIT to its unit-holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit-holder had it been received by, or accrued to, the REIT. The taxability of various income earned by REITs are explained as under:

7.4-2a. Rental Income

Rental income earned by the REITs from the investment made in properties shall be tax-free by virtue of Section 10(23FCA) of the Income-tax Act. Thus, such rental income shall be exempt at the REITs level. However, if such rental income is distributed by REITs to its unit-holders then unit-holders shall be liable to pay tax thereon.

7.4-2b. Interest Income

REITs may also invest in real estate *via* Special Purpose Vehicle (SPV). Any interest income that REITs earned from SPV is exempt in the hands of REITs under Section 10(23FC). When such interest income is further distributed to the unit-holders, it is taxable in the hands of the unit-holders.

Any other interest income earned by REITs (other than from SPV) is not exempt at the level of REITs. Consequently, such interest income is taxable in the hand of REITs and when such income is further distributed, it is exempt from tax under Section 10(23FD) in the hands of unit-holders. However, if such interest income is not chargeable to tax in the hands of the

[77] Regulation 2(zi) of SEBI (Real Estate Investment Trusts) Regulations, 2014

REIT, it shall be taxable in the hands of the unit holder under the head “other sources” as per Section 56(2)(xii)[78].

7.4-2c. Dividend Income

Dividend received by REITs from SPV is exempt from tax under Section 10(23FC). If dividend received from SPV is further distributed by REITs to the unit-holders, it shall be taxable in the hands of the unit-holders being a pass-through income. However, if the dividend is received from SPV who has not opted for the concessional tax regime of section 115BAA then such dividend shall be exempt in the hands of the unit-holders as well under Section 10(23FD). Any other dividend income earned by REITs (other than from SPV) is not exempt at the level of REITs. Consequently, such dividend income is taxable in the hands of REITs and when such income is further distributed, it is exempt from tax under Section 10(23FD) in the hands of unit-holders. But, if such dividend income is not chargeable to tax in the hands of the REIT, it shall be taxable in the hands of the unit holder under the head "other sources" as per Section 56(2)(xii).

7.4-2d. Capital Gains

Income-tax Act provides pass-through status to REITs only for rental income and interest/dividend received from SPV whereby tax is charged at the level of unit-holders. All other incomes are chargeable to tax at the level of REIT itself. Thus, any capital gain arising on the transfer of real estate properties (including securities) by REIT shall be charged to tax in its own hands and not in the hands of the unit-holders.

The capital gain tax rate in the case of REITs shall be as follows:

Capital Asset	*Nature of capital gain*	*Tax Rate*	*Relevant Section*
Equity Shares or Units of equity oriented mutual funds or Units of business trust	Short-term	*Chargeable to STT* - 15%	111A
		Not chargeable to STT – Maximum Marginal Rate	115UA
Equity Shares or Units of equity oriented mutual funds or Units of business trust	Long-term	*Chargeable to STT* - 10% on the amount of capital gain in excess of Rs. 1,00,000	112A**
		Not chargeable to STT- 20%	112

[78] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25. Earlier, sum received from business trust (other than interest/dividend from SPV or rental income from REIT) was exempt in the hands of unit holder even if the sum so distributed is not chargeable to tax in hands of business trust.

<table>
<tr><td>Other capital assets (including securities)</td><td>Short-term</td><td>Maximum Marginal Rate</td><td>115UA</td></tr>
<tr><td>Other capital assets (including securities)</td><td>Long-term</td><td>20% with indexation benefit*</td><td>112</td></tr>
<tr><td colspan="4">* No benefit of indexation shall be allowed in the case of bonds and debentures except sovereign gold bonds or capital indexed bonds. Further, in the case of listed securities (other than units) and zero-coupon bonds, resident assessees have the option to pay tax at the rate of 10% if it does not take the benefit of indexation.</td></tr>
<tr><td colspan="4">** Section 115UA of the Income-tax Act provides that subject to section 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate. Section 111A provides for a concessional tax rate of 15% in respect of short-term capital gain arising from the transfer of equity shares, equity-oriented mutual funds and units of business trust chargeable to STT. Whereas, section 112 provides for a concessional tax rate of 20% in case of long-term capital gain. Section 112A provides for the taxability of income arising from the transfer of a long-term capital asset, being an equity share or a unit of an equity-oriented fund or a unit of a business trust chargeable to STT at the rate of 10% on the amount of capital gain in excess of Rs. 1,00,000. However, no consequential amendment was made to Section 115UA to insert a reference of Section 112A which seems to be unintentional.</td></tr>
</table>

7.4-2e. Other income

All other incomes of REITs are chargeable to tax in the hands of REITs itself at a maximum marginal rate under Section 115UA. However, if the income is not chargeable to tax in the hands of the REIT and it is subsequently distributed to the unit holders, it shall be taxable in the hands of the unit holder under the head "other sources" as per Section 56(2)(xii).

7.4-3. *Taxation of unit-holder of REITs*

The income of a unit-holder in a REIT can be categorized into the following three categories:

(a) Pass-through Income: This includes sums distributed by the REIT to unit-holders for which pass-through status is accorded. In this case, the tax liability on the income is directly passed on to the unit-holders, and the REIT itself is not taxed on such distributed sums.
(b) Non-Pass-through Income: This category covers sums distributed by the REIT to unit-holders, but in this case, no pass-through status is accorded. As a result, the REIT is subject to taxation on such distributed sums at its own applicable tax rate, and the unit-holders are exempt from paying tax on this income. It is essential to note that if the sum

distributed by the REIT to its unit-holder is not chargeable to tax at the level of the REIT itself, it becomes taxable in the hands of the unit-holder as per Section 56(2)(xii)[79].

(c) Capital Gains from Unit Redemption or Transfer: The third category pertains to any income arising from the redemption or transfer of units of the REIT.

7.4-4. *Taxation of pass-through income in hands of unit-holder of REITs*

A REIT is accorded a pass-through status in respect of the following incomes:

(a) Income by way of interest from SPV;
(b) Dividend from SPV; and
(c) Rental income from real estate assets directly owned by Real Estate Investment Trust (REIT).

The aforesaid incomes are exempt in the hands of REIT and are taxable in the hands of the unit holders. The income shall be deemed to be of the same nature and in the same proportion in the hands of the unit-holder had it been received by, or accrued to, the REIT. The taxability of various pass-through income from REITs in the hands of the unit holders shall be as follows:

7.4-4a. Interest from SPV

Interest from SPV will be included in the income of the unit holders under the head 'Business or Profession. If a unitholder is a person resident in India, then tax is charged at normal rates as applicable in his case. Further, he shall be allowed to claim a deduction of expenses incurred to earn such interest income and deduction under Chapter VI-A (i.e., deductions under sections 80C to 80U) from such income.

Whereas, if the unit-holder is a non-resident or a foreign company, then tax is charged under Section 115A read with Section 194LBA at the rate of 5% without providing for any deduction in respect of such income. Further, deductions under Section 80C to 80U are also not allowed from such income. However, the Unit of an International Financial Service Centre (IFSC) shall be entitled to claim a deduction under section 80LA. It is to be noted that if the interest income is not chargeable to tax or chargeable to tax at lower rates as per provisions of DTAA then provisions of DTAA shall apply and tax shall be charged accordingly.

[79] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25. Earlier, sum distributed by the business trust (other than sum distributed under pass through status) was exempt in the hands of unit holder even if the sum so distributed is not chargeable to tax in the hands of business trust.

7.4-4b. Dividend from SPV

If the dividend received from SPV is further distributed by REITs to the unit-holders, it shall be taxable in the hands of the unit-holders, being a pass-through income. However, if the dividend is received from SPV who has not opted for the concessional tax regime of section 115BAA then such dividend shall be exempt in the hands of the unit-holders as well under Section10(23FD).

If a unit-holder is a person resident in India, then tax is charged at normal rates as applicable in his case. Further, the unit-holder shall be entitled to claim a deduction of only interest expenditure which has been incurred to earn that dividend income to the extent of 20% of total dividend income. No deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend. However, deductions under Chapter VIA (i.e., deductions under sections 80C to 80U) can be claimed from such income.

Whereas, if the unit-holder is a non-resident or a foreign company, then tax shall be charged under Section 115A at the rate of 20% (10% if received from IFSC unit[80]) without providing for any deduction in respect of such income. Further, deductions under sections 80C to 80U are also not allowed from such income. However, the Unit of an International Financial Service Centre (IFSC) shall be entitled to claim a deduction under Section 80LA. It is to be noted that if the dividend income is not chargeable to tax or chargeable to tax at lower rates as per provisions of DTAA, then provisions of DTAA shall apply and tax shall be charged accordingly.

7.4-4c. Rental Income

If rental income is distributed by REITs to its unit-holders, then unit-holders shall be liable to pay tax thereon. The tax shall be charged in the hands of the unit-holder at the applicable tax rate.

7.4-5. *Taxation of non-pass-through income in hands of unit-holder of REITs*

REIT is accorded a pass-through status in respect of the following incomes:

(a) Income by way of interest from SPV;
(b) Dividend from SPV; and
(c) Rental income from real estate assets directly owned by Real Estate Investment Trust (REIT).

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[80] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25.

The aforesaid incomes are exempt in the hands of REIT and are taxable in the hands of the unit holders. In contrast, other income of the REIT is chargeable to tax in its own hands and exempt in the hands of the unit holder.

However, the Finance Act, 2023 has addressed a situation where the sum distributed by the business trust to its unit holder goes untaxed in the hands of both the business trust and the unit holder. *For example*, if a business trust gets repayment of a loan provided to SPV, it will not be taxable in the hands of the business trust. However, if the business trust distributes this sum to its unit holders as "repayment of debt", it will not be considered as income and hence, not taxable in the hands of the unit holders.

This issue of dual non-taxation is addressed by providing that any specified sum received by a unit holder from a business trust will be taxable under the head "Income from other sources" as per Section 56(2)(xii) if such sum is neither chargeable to tax in the hands of the unit holder nor the hands of the business trust[81].

7.4-5a. Taxability of specified sum

The specified sum subject to taxation under Section 56(2)(xii) is expressly included in the definition of income. Thus, even if the sum received by a unit holder from a business trust does not fit in the general and natural meaning of the term "income", it shall still be considered income. The specified sum shall be taxable at normal tax rates as applicable in the case of the unit holder.

The *Explanation* to Section 56(2)(xii) provides a formula for the computation of specified sum. The following amount is included or excluded in the specified sum as per the given formula:

Particulars	***Amount***
Sum distributed by the business trust with respect to the units to the unit holder who holds such unit on the date of distribution of sum [See Note 1] - During the previous year - During any earlier previous years	 **** ****
Sum distributed by the business trust with respect to the units to the unit holder who held such unit at any time prior to the date of such distribution of sum [See Note 1] - During the previous year - During any earlier previous years	 **** ****

[81] Amendment made with effect from Assessment Year 2024-25. Earlier, sum received from business trust (other than interest/dividend from SPV or rental income from REIT) was exempt in the hands of unit holder even if the sum so distributed is not chargeable to tax in hands of business trust.

Aggregate of sum distributed by the business trust with respect to the units	****
Less: Amount at which the business trust issued such units	(****)
Less: Amount charged to tax under Section 56(2)(xii) in any earlier previous year	(****)
Specified sum [See Note 2]	****
Note 1: If the sum distributed is in the nature of interest or dividend from special purpose vehicle as referred to in clause (23FC) of Section 10 or is in the nature of rental income from real estate asset directly owned by REIT as referred to in clause (23FCA) of Section 10 or it is chargeable to tax in the hands of business trust under Section 115UA(2), then same shall not be included in the aggregate amount of sum so distributed.	
Note 2: If the net figure after including and excluding the aforesaid amounts results in a negative value, the specified sum shall be deemed to be zero.	

Example 10, Mr. A bought 1,000 units of a REIT at a price of Rs. 100 each as on 01-4-2022. REIT distributes the following sum to its unit holders in different previous years:

Previous Year	*Interest from SPV (A)*	*Rental income from property directly owned by REIT (B)*	*Return of capital (C)*	*Total sum received (D = A + B+ C)*
2023-24	Rs. 5 per unit	Rs. 15 per unit	Rs. 50 per unit	Rs. 70 per unit
2024-25	Rs. 10 per unit	Rs. 10 per unit	Rs. 40 per unit	Rs. 60 per unit
2025-26	Rs. 15 per unit	Rs. 5 per unit	Rs. 30 per unit	Rs. 50 per unit

In the given example, the specified sum for different years and its taxability under Section 56(2)(xii) shall be as follows:

Particulars	*2023-24*	*2024-25*	*2025-26*
Sum distributed by the business trust during the previous year (other than interest from SPV or rental income) [E = C * No. of Units]	50,000	40,000	30,000
Sum distributed by business trust in earlier previous years (other than interest from SPV or rental income) [F] - Previous year 2022-23 - Previous year 2023-24 - Previous year 2024-25	 - - -	 - 50,000 -	 - 50,000 40,000
Issue price of units (G)	1,00,000	1,00,000	1,00,000
Amount charged to tax under Section 56(2)(xii) in earlier	-	-	-

previous year (H)			
Specified sum (I = E + F – G – H)	(50,000)	(10,000)	20,000
Specified sum chargeable to tax under Section 56(2)(xii) [Zero, if [I] is negative]	**-**	**-**	**20,000**

Example 11, suppose in example 10, Mr. A transfers 200 units to Mr. B in the previous year 2025-26, and he receives the sum in the previous year 2025-26 with respect to 800 units, and Mr. B receives the sum in the previous year 2025-26 in respect to 200 units.

Taxability in the hands of Mr. A

Mr. A held and received a sum with respect to 1,000 units of REIT in the previous year 2023-24 and 2024-25. Thus, the specified sum for the previous year 2023-24 and 2024-25 shall be computed with respect to 1,000 units. For the previous year 2025-26, the specified sum shall be computed in respect to 800 units. The amount of the specified sum for different years and its taxability under Section 56(2)(xii) in the hands of Mr. A shall be as follows:

Particulars	*2023-24*	*2024-25*	*2025-26*
Sum distributed by business trust during the previous year (other than interest from SPV or rental income) [per unit] [E]	50	40	30
No. of units [F]	1,000	1,000	800
Sum distributed by business trust during the previous year (other than interest from SPV or rental income) [G = E * F]	50,000	40,000	24,000
Sum distributed by business trust in earlier previous years (other than interest from SPV or rental income) [F] - Previous year 2022-23 - Previous year 2023-24 - Previous year 2024-25	- - -	- 50,000 -	- 40,000† 32,000†
Issue price of units (H)	1,00,000	1,00,000	80,000†
Amount charged to tax under Section 56(2)(xii) in earlier previous year (I)	-	-	-
Specified sum (J = G + F – H – I)	(50,000)	(10,000)	16,000
Specified sum chargeable to tax under Section 56(2)(xii) [Zero, if [J] is negative]	**-**	**-**	**16,000**

† Mr. A held and received sum in respect to 800 units of REIT in the previous year 2025-26. Thus, the calculation is made in respect to 800 units.

Taxability in the hands of Mr. B

As Mr. B held and received a sum in respect to 200 units of REIT in the previous year 2025-26, the specified sum shall be computed with respect to 200 units. The amount of the specified sum taxable in the hands of Mr. B shall be as follows:

Particulars	*2025-26*
Sum distributed by the business trust during the previous year (other than interest from SPV or rental income) [per unit] [E]	30
No. of units [F]	200
Sum distributed by the business trust during the previous year (other than interest from SPV or rental income) [G = E * F]	6,000
Sum distributed by business trust to Mr. A in respect of such 200 units in the earlier previous years (other than interest from SPV or rental income) [H] - Previous Year 2023-24 - Previous Year 2024-25 - Previous Year 2025-26	 10,000 8,000 -
Issue price of units (I)	20,000
Amount charged to tax under Section 56(2)(xii) in earlier previous year (J)	Nil
Specified sum (K = G + H - I - J)	**4,000**
Specified sum chargeable to tax under Section 56(2)(xii) [Zero, if [K] is negative]	**4,000**

7.4-5b. Adjustment to cost of acquisition of unit of business trust

The Finance Act, 2023 has inserted *Explanation 1* and *Explanation 2* in clause (ii) of Section 48 with effect from Assessment Year 2024-25.

Explanation 1 provides that the cost of acquisition of a unit of a business trust shall be reduced and shall be deemed to have always been reduced by any sum received by a unit holder from the business trust with respect to such unit if such sum:

(a) is not in the nature of interest/dividend from SPV or rental income from the property directly owned by REIT; and
(b) is not chargeable to tax in the hands of the unit holder under Section 56(2)(xii); and
(c) is not chargeable to tax in the hands of the business trust under Section 115UA(2).

In simple words, if any sum received by a unit holder from a business trust in respect to a unit is neither chargeable to tax in the hands of the unit holder nor in the hands of the business trust then such sum shall be reduced from the cost of acquisition of such unit.

Explanation 2 covers the situation where the transaction of transfer of a unit is not considered as transfer under Section 47, and the cost of acquisition of such unit is determined under Section 49. It provides that sum received with respect to such unit before such transaction and after such transaction shall be reduced from the cost of acquisition. Thus, if an assessee has received a unit of business trust under a transaction which is not regarded as a "transfer", the cost of acquisition of such unit shall be reduced by the sum received from the business trust by the assessee and the previous unit holder provided such sum was not charged to tax either in the hands of the assessee, the previous unit holder and the business trust.

Though *Explanation 1* and *Explanation 2* to clause (ii) of Section 48 have been inserted with effect from Assessment 2024-25, they will have a retroactive effect. It means if a person holds the unit of a business trust as on 01-04-2023, any sum received from a business trust in respect of such unit on or before 31-03-2023 shall be reduced from the cost of acquisition of such unit if such sum was not charged to tax in the hands of the unit holder or the business trust.

Any sum received (other than dividend/interest from SPV and rental income from REIT) on or after 01-04-2023 in respect of the units shall be reduced from the cost of acquisition even if no taxable income arises in the year of distribution due to the mechanism provided for the computation of the specified sum. However, if the income distributed to a unitholder is not taxable due an exemption provision, it will not be reduced from the cost of acquisition. *For instance*, the sum referred to in Section 56(2)(xii) distributed by a business trust to the Abu Dhabi Investment Authority shall be exempt from tax under Section 10(4E). Such a sum shall not be reduced from the cost of acquisition even if it is not taxable.

Example 12, ABC REIT issued 1,000 units to Mr. A for Rs. 100 each on 01-4-2022. Mr. A sold 200 units to Mr. B for Rs. 120 per unit on 31-12-2025. REIT distributes the following sum to its unit holders in the different previous years:

Previous Year	*Interest from SPV (A)*	*Rental income from property directly owned by REIT (B)*	*Return of capital (C)*	*Total sum received* *(D = A + B+ C)*
2022-23	Rs. 2 per unit	Rs. 8 per unit	Rs. 20 per unit	Rs. 30 per unit
2023-24	Rs. 5 per unit	Rs. 15 per unit	Rs. 50 per unit	Rs. 70 per unit
2024-25	Rs. 10 per unit	Rs. 10 per unit	Rs. 40 per unit	Rs. 60 per unit
2025-26	Rs. 15 per unit	Rs. 5 per unit	Rs. 30 per unit	Rs. 50 per unit

In the given example, the tax implications in the hands of Mr. A and Mr. B shall be as follows:

Tax treatment of sum (other than interest and rental income) received by Mr. A from REIT

Particulars	*2022-23*	*2023-24*	*2024-25*	*2025-26*
Sum distributed by business trust during the previous year (other than interest and rental income) [E = C * No. of Units]	20,000	50,000	40,000	24,000†
Sum distributed by business trust in earlier previous years (other than interest from SPV or rental income) [F] - Previous year 2022-23 - Previous year 2023-24 - Previous year 2024-25	- - -	20,000 - -	20,000 50,000 -	16,000† 40,000† 32,000†
Issue price of units (G)	-	1,00,000	1,00,000	80,000
Amount charged to tax under Section 56(2)(xii) in earlier previous year (H)	-	-	-	10,000
Specified sum (I = E + F – G – H)	20,000	(30,000)	10,000	22,000
Specified sum chargeable to tax under Section 56(2)(xii) [J = I, Zero, if [I] is negative]	**-**	**-**	**10,000**	**22,000**
Cost of acquisition of unit (K)	1,00,000	1,00,000	80,000	30,000
Adjustment to cost of acquisition as per *Explanation 1* to Section 48(ii) (L)	-	20,000	50,000	30,000
Adjusted cost of acquisition (M = K – L, nil if negative)	**1,00,000**	**80,000**	**30,000**	**Nil**

Adjusted cost of acquisition (per unit)	**100**	**80**	**30**	**Nil**
† Mr. A held and received sum in respect to 800 units of REIT in the previous year 2025-26. Thus, the calculation is made in respect of 800 units.				

Capital gain on transfer of units by Mr. A to Mr. B

Particulars	*Amount*
Full value of consideration (200 units * 120 per unit)	24,000
Less: Adjusted cost of acquisition	Nil
Long-term capital gain	**24,000**
Note: Long-term capital gain shall be taxable under Section 112A. As the amount of capital gain does not exceed Rs. 1,00,000, no tax shall be payable under Section 112A.	

Tax treatment of sum (other than interest or Rental income) received by Mr. B from REIT

Particulars	*2025-26*
Sum distributed by business trust during the previous year (other than interest from SPV or rental income) [per unit] [E]	30
No. of units [F]	200
Sum distributed by business trust during the previous year (other than interest from SPV or rental income) [G = E * F]	6,000
Sum distributed by business trust to Mr. A in respect of such 200 units in the earlier previous years (other than interest from SPV or rental income) [H] - Previous Year 2022-23 - Previous Year 2023-24 - Previous Year 2024-25 - Previous Year 2025-26	 4,000 10,000 8,000 -
Issue price of units (I)	20,000
Amount charged to tax under Section 56(2)(xii) in earlier previous year (J)	-
Specified sum (K = G + H - I - J)	**8,000**
Specified sum chargeable to tax under Section 56(2)(xii) [Zero, if [K] is negative]	**8,000**
Cost of acquisition of unit (K)	**24,000**
Adjustment to cost of acquisition as per *Explanation 1* to Section 48(ii) (L)	Nil

Adjusted cost of acquisition (M = K – L)	**24,000**

7.4-6. Taxation of capital gain from redemption or transfer of units of REITs

7.4-6a. Redemption of units of REIT

Sum received on redemption of units of REIT shall be taxable under the head other sources in accordance with the provision of Section 56(2)(xii).

7.4-6b. Transfer of units of REIT

Income arising from the transfer of units of REIT shall be taxable in the hands of the unit-holder under the head capital gain. Where units of REITs are held for 36 months or less, short-term capital gains will arise. However, if the holding period is more than 36 months, the gains arising from the transfer of such units shall be in the nature of long-term capital gains.

The tax on short-term or long-term capital gain shall depend upon the payment of security transaction tax (STT) at the time of transfer of units of business trust.

If STT has been paid on the transfer of units of REIT, short-term capital gains shall be taxable at the rate of 15% *plus* surcharge and cess under Section 111A.

Whereas long-term capital gains in excess of Rs 1 lakh would be taxable at the rate of 10% *plus* surcharge and cess under Section 112A. The investments made on or before 31-01-2018 were grandfathered as the long-term capital gains arising from the sale of units of business trust were previously exempt from tax. The grandfathering works as per the following mechanism.

If units of business trust were acquired on or before 31-01-2018, the cost of acquisition of such units shall be higher of the following:

a) The actual cost of acquisition of units of business trust; or
b) *Lower* of the fair market value of such asset as on 31-01-2018 or full value of the consideration received as a result of the transfer of units of business trust.

The highest price of units quoted on a recognized stock exchange as on 31-01-2018 is taken as the fair market value. If there is no trading in such units on such exchange on 31-01-2018, the highest price of such units on a date immediately preceding 31-01-2018 when such units were traded shall be the fair market value.

If units of a business trust are not listed on a recognised stock exchange as on 31-01-2018, the net asset value of such unit as on the said date is considered as cost of acquisition.

If STT has not been paid on the transfer of units of REIT, Short-term capital gains shall be taxable as per the tax rates applicable in case of unit-holder. Whereas long-term capital gains shall be taxable at the rate of 20% *plus* surcharge and cess under Section 112 of the Act in case of a resident. In case the unitholder is a non-resident or a foreign company then tax shall be levied at the rate of 10% *plus* surcharge and cess without providing for the benefit of indexation and foreign currency fluctuation if such units are unlisted. (*see Annexure E for relevant rates*)

7.4-7. Taxability in the hands of the sponsor

Section 47(xvii) of the Income-tax Act, provides that where a sponsor transfers his shares in SPV to a business trust in exchange for units of such business trust, such exchange would not amount to transfer. Thus, no taxability will arise on the transfer of such shares. If any notional gain or loss arises on such transfer of shares in exchange of units and it is credited or debited to the profit and loss account, then same shall be reduced or added back, respectively, while computing the book profit for purpose of levy of MAT. Such adjustment shall be made if SPV has not opted for a concessional tax regime prescribed under Section 115BAA or Section 115BAB.

(*Income arising in respect of units of business trust shall be taxable in the same manner as referred to in Para 7.4-3 to 7.4-6*).

Example 13, Mr X is holding 30% of the shares of an SPV. He transferred such shares to a REIT in exchange for an allotment of 25% units of such REIT. Such exchange would not be regarded as transfer by virtue of section 47(xvii).

7.4-8. Summary of taxability of REITs

7.4-8a. Taxation of sum distributed to unit holders

Nature of sum received	*Taxability in the hands of*		
	REIT	*InVIT*	*Unit holders*
Interest from SPV	Exempt [Section 10(23FC)(a)]	Exempt [Section 10(23FC)(a)]	Taxable [Income from business]
Dividend from SPV (SPV has exercised option under Section 115BAA)	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FC)(b)]	Taxable [Income from business/other sources]
Dividend from SPV (SPV has not exercised option	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FD)]

under Section 115BAA)			
Rental income from property owned by trust	Exempt [Section 10(23FCA)]	Taxable [Income from business]	Taxable (if received from REIT) [Income from business]
Other sum or income (if taxable in hands of business trust)	Taxable [Income from business/capital gain/ other sources]	Taxable [Income from business/capital gain/ other sources]	Exempt [Section 10(23FD)]
Other sum or income (if not taxable in the hands of business trust)	Not taxable	Not taxable	Taxable [Income from other sources under section 56(2)(xii)]

7.4-8b. Tax on redemption or transfer of units of REIT

Nature of Income	*Tax Rates*	
	Resident	*Non-Resident and foreign company*
Redemption of units of business trust	Normal tax rate [Income from other sources under Section 56(2)(xii)]	
Short-term capital gains from transfer of units of business trust (other than redemption)	*(a)* 15% under Section 111A (in the case of listed units) *(b)* Applicable rate (in case of unlisted units)	
Long-term capital gains from the transfer of units of business trust (other than redemption)	*(a)* 10% under Section 112A (listed units) *(b)* 20% under Section 112 (unlisted units)	*(a)* 10% under Section 112A (listed units) *(b)* 10% under Section 112 (unlisted units)
* No benefit of indexation and foreign exchange fluctuation shall be allowed where the long-term capital gain is taxable at the rate of 10%.		

7.4-9. Applicability of TDS

7.4-9a. SPV to REIT

TDS is not applicable when REIT is receiving interest or dividend income from SPV in respect of securities or income by way of renting or leasing or letting out any real estate asset owned directly by the REIT.

7.4-9b. REIT to unit-holder

When REIT distributes the rental income or interest/dividend received from SPV to its unit-holders, the income so distributed is chargeable to tax in the hands of the unit-holders. Thus, to collect taxes from unit-holders at the time of distribution of such income by REITs, the Govt. has introduced TDS provisions. The REITs are required to deduct tax under Section 194LBA while distributing the said incomes to the unit-holders. The tax shall be deducted at the following rates:

Nature of distributed income	***Residential status of the unit-holder***	
	Resident	*Non-resident**
Rental income	10%	a) Foreign company: 40% b) Any other non-resident person: 30%
Dividend income received from SPV[82]	10%	10%
Interest income received from SPV	10%	5%
**If the provisions of DTAA are more beneficial the tax shall be deducted as per DTAA.*		

7.4-10. Reporting of income by REITs to its unit-holders

When REITs distributes any income to its unit-holders, including the income taxable under Section 56(2)(xii), it shall be required to furnish a statement to the unit-holders as well as to the income-tax department giving the details of the nature of the income paid during the previous year to unit-holders.

The statement shall be required to be furnished to the unit-holders in Form No. 64B by the 30th June of the financial year following the previous year during which the income is distributed. The statement shall be required to be furnished to the Income-tax department in Form No. 64A by the 30th November of the financial year following the previous year during which the income is distributed.

7.5 INFRASTRUCTURE INVESTMENT TRUST (InVITs)

Real Estate and Infrastructure are two important sectors that have critical importance for India's growth both on economic and social parameters. The concept of REITs and InVITs were introduced in India to boost financing and investment in these sectors. REITs invest in income-generating real estate properties. Whereas, InVITs invest in infrastructure projects which include roads, bridges, ports, airports, metros, electricity generation, transmission or distribution, telecommunication services, telecommunication towers, special economic zones, etc.

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[82] No tax shall deducted if the dividend is received from SPV which has not opted for concessional tax regime of section 115BAA.

InVITs are registered with SEBI under SEBI (Infrastructure Investment Trusts) Regulations, 2014. The structure of InVITs is very much similar to that of a REIT. Further, the tax implications are also the same both in case of InVITs and REITs except pass-through status relating to rental income.

The rental income of REITs is chargeable to tax in the hands of the unit-holders as pass-through status has been provided to REITs in respect of such income. But, in case of InVITs, rental income is chargeable to tax in its own hands and not in the hands of unit-holders.

Further, any sum received by a wholly-owned subsidiary of ADIA, Sovereign wealth fund or pension fund with respect to the units held in InVIT shall be exempt from tax under Section 10(23FE), if investment is made between 01-04-2020 and 31-03-2024 and it is held for at least for 3 years.

7.6 ALTERNATIVE INVESTMENT FUNDS

Alternative Investment Fund (AIF) means any fund established or incorporated in India, as a privately pooled investment vehicle, to collect funds from sophisticated investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of its investors. However, it does not include mutual funds, collective investment fund or any other fund for which there are separate regulations of SEBI.

AIF can be set up as a trust, company, limited liability partnership and any other body corporate and it is mandatory to obtain registration from SEBI as per SEBI (Alternative Investment Funds) Regulations, 2012 or under the International Financial Services Centres Authority Act, 2019[83]. SEBI grants registration to AIFs based on their operational strategies, objectives and fund structure and, for this purpose, they are categorized into various categories. The AIF categories have already been discussed in section 1.3.

7.6-1. Taxation of Category-I and Category-II AIFs

Taxation of Category-I and Category-II AIFs is governed by Section 115UB of the Income-tax Act which provides pass-through status to such funds wherein income arising to such funds is exempted from tax, while investors are liable to pay tax on such income as if the investors have directly made the investments. However, this pass-through status is not given in respect of 'business income' of the AIF. Thus, business income is chargeable to tax in the hands of AIF itself.

Any income arising in the hands of the Investment fund shall be bifurcated into the following two categories:

a) Business income; and

[83] Amended by the Finance Act 2021, with effect from assessment year 2022-2023

b) Any other income.

7.6-1a. Taxability of Business Income

Income in the nature of business income shall be taxed in the hands of the Investment Fund under the head 'Profits and gains from business or profession' and it shall be exempt in the hands of the unit-holders under Section 10(23FBB).

If an investment fund is a company or a firm, such business income will be taxable at the rates applicable to the company or firm. However, in any other case, where AIF is registered as a trust or any other body corporate, such income shall be taxed at a maximum marginal rate.

7.6-1b. Taxability of Other Income

Any other income shall be taxable in the hands of the unit-holder and it shall be exempt in the hands of the Investment Fund under Section 10(23FBA).

The income arising to the unit-holder, out of the investment made in the Investment Fund, shall be chargeable to tax in the same manner as if it were the income accruing or arising to them, had the investments (made by the Investment Fund) been made by them directly.

The income paid or credited by the investment fund to the unit-holder shall be deemed to be of the same nature and in the same proportion in the hands of the unit-holder as if it had been received by, or had accrued or arisen to, the investment fund.

Further, the income accruing or arising to, or received by, the AIF, during a previous year, if not paid or credited to the investor thereof, shall be deemed to have been credited to the account of the investors on the last day of the previous year in the same proportion in which investors would have been entitled to receive the income had it been paid in the previous year.

7.6-1c. Set-off and carry forward of losses

Any losses arising in the hands of the investment fund under the head 'Profits and gains arising from business or profession' shall be allowed to carry forward and not to be passed to its unit-holders.

Up to Assessment Year 2019-20, AIFs were allowed to pass the income to the unit-holders but not losses. Thus, if the net result of the computation of total income of the AIF is a loss then the same was not allocated amongst the unit-holders. Thus, they were deprived of setting off such loss against their income. The Finance (No. 2) Act, 2019 amended the provisions of Section 115UB to allow a pass-through of losses as well. Thus, from Assessment Year 2020-21, non-business losses of AIF are allowed to be allocated amongst unit holders except where such loss is in respect of a unit, which has not been held by the unit-holder for at least 12 months.

Any losses, other than the business losses, accumulated at the level of investment fund as on 31-03-2019, shall be deemed to be the loss of the unit-holder who held the units as on that date. In other words, the accumulated losses shall be deemed to be the losses of the unit-holders who held the units as on 31-03-2019 even if the period of holding of such unit is less than 12 months.

Such losses shall be allowed to be carried forward by such unit-holders for the remaining period calculated from the year in which the loss had occurred for the first time by taking that year as the first year. He shall be allowed to set off and carry forward the losses in accordance with the provisions of Chapter-VI. Such losses which are passed to the unit-holders shall not be allowed to the investment fund for set off and carry forward.

Example 14: As on 31-03-2019, an AIF had accumulated losses as follows:

Nature of loss	*Amount (in lakhs)*
Loss under the head house property	5
Loss under the head capital gains (long-term)	20
Loss under the head capital gains (short-term)	10

It has incurred a loss of Rs. 15 lakhs under the head "Profits and gains from business and profession" and a loss of Rs. 5 lakhs under the head house property during the financial year 2019-20. Details of unitholders are as follows:

Unitholder	*Percentage of units*	
	As on 31-03-2019	*As on 31-03-2020*
A	25%	20%
B	25%	20%
C	25%	20%
D	25%	20%
E	-	20% (acquired on 01-05-2019)

Attribution of losses to unit-holders shall be as follows:

Unitholder	*Loss accumulated till 31-03-2019*	*Loss incurred during the year 2019-2020*[†]
A	8.75	1
B	8.75	1
C	8.75	1

D	8.75	1
E	-	-‡

† Only non-business losses are allowed to be passed on to the unitholders.

‡ As E held the units for less than 12 months, the loss attributable to such units shall not be passed on to the unitholders and it shall lapse.

7.6-1d. Applicability of TDS Provisions

As other income (not being a business income) is taxable in the hands of the unit-holder, the CBDT has notified[84] that no tax shall be deducted from the payment of such income to the investment fund. *For example*, if an investment fund receives any rental income or interest income from a bank, the payer shall not deduct tax from such payment.

In case the income arising in the hands of the investment fund is taxable in the hands of the unit-holder, the investment fund shall deduct tax under Section 194LBB from the payment at the rate of 10% in case of resident unitholders and rates in force in case of foreign unitholders. If the unit-holder is a non-resident (not being a company) or a foreign company, no tax shall be deductible in respect of any income which is not chargeable to tax.

7.6-1e. Reporting of income by AIF

When AIF distributes any income to its unit-holders, it shall be required to furnish a statement to the unit-holders as well as to the income-tax department giving the details of the nature of the income paid during the previous year to unit-holders.

The statement shall be required to be furnished to the unit-holders in Form No. 64C by the 30th June of the financial year following the previous year during which the income is paid or credited.

The statement shall be required to be furnished to the Income-tax department in Form No. 64D by the 15th June of the financial year following the previous year during which the income is paid or credited.

7.6-1f. Relaxation from angel tax [Section 56(2)(viib)]

Any excess premium received by a company from the issue of shares is chargeable to tax in its hand under the head income from other sources if the following conditions are satisfied:

(a) Shares (equity or preference shares) are issued by a closely held company;
(b) The consideration for the issue of shares is received from any person[85];

[84] Notification No. 51/2015/SO 1703(E), dated 25-6-2015
[85] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25. Earlier, this provision was applicable only when consideration for issue of shares is received from a resident person.

(c) The consideration received for the issue of shares exceeds the face value and fair market value of shares.

If the above conditions are satisfied, the consideration received exceeding the fair market value of the share shall be taxable in the hands of the issuer company. The fair market value of shares shall be determined as per Rule 11UA.

However, in the following cases, this provision shall not apply to tax any consideration received for the issue of shares:

(a) Where consideration is received by a Venture Capital Undertaking from a Venture Capital Company or Venture Capital Fund or Category-I or Category-II Alternative Investment Fund (AIF);

(b) Where the company is an eligible start-up fulfilling conditions as prescribed in the Notification issued by the DPIIT.

(c) Where consideration is received by a company from the following class or classes of persons[86]:

i. Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled by the Government or where direct or indirect ownership of the Government is 75% or more;

ii. Banks or Entities involved in Insurance Business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident;

iii. Any of the following entities, which is a resident of any country or specified territory (listed in the Annexure of Notification No. 29/2023, dated 24-05-2023), and such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident:

- entities registered with the SEBI as Category-I Foreign Portfolio Investors;
- endowment funds associated with a university, hospitals, or charities;
- pension funds created or established under the law of the foreign country or specified territory;
- Broad Based Pooled Investment Vehicle or fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

[86] Notification No. 29/2023, dated 24-05-2023 effective from 01.04.2023

7.6-1g. Relaxation from the filing of return of income

The CBDT[87] has exempted a non-resident or a foreign company from the requirement of filing a return of income if it has any income from any investment in Category-I and Category-II Alternative Investment Fund (AIF) set up in an IFSC located in India. This exemption can be claimed subject to certain conditions. (Refer *Para 11.6-9*)

7.6-1h. Exemption to ADIA's subsidiary or Sovereign wealth fund or pension fund

Any income arising to a wholly-owned subsidiary of ADIA, Sovereign wealth fund or pension fund in the nature of dividend, interest or long-term capital gains arising from an investment made in Category-I or Category-II AIF shall be exempt from tax under section 10(23FE), subject to fulfilment of certain conditions, *namely*:

(a) Investment is made between 01-04-2020 and 31-03-2024;
(b) Investment is held for at least for 3 years;
(c) Investment is made in Category-I or Category-II AIF having more than 50% investment in any of the following entities:
  - An InVIT; or
  - Enterprise carrying on the business of developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility as defined under Section 80-IA(4)(i) or other notified business;
  - A domestic company registered on or after 1st April, 2021 having a minimum of 75% investments in one or more of the company or enterprise as referred in point (b); or
  - An NBFC registered as an infrastructure finance company[88] having a minimum of 90% of its lending to one or more of the companies or enterprises or entities referred in point (b) above; or
  - An Infrastructure debt fund[89] having a minimum of 90% lending to one or more of the companies or enterprises or entities referred in point (b) above.

Here "Investment" shall mean movable and immovable assets including current and non-current investments, loans and advances, and cash and cash equivalents[90].

The amount of exemption will be computed proportionately based on the investment in various entities. The Central Government has notified Rule 2DCA[91] for computation of minimum investment and exempt income for the purpose of section 10(23FE).

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[87] Notification No. S.O. 2672(e), dated 26-7-2019
[88] Infrastructure finance company shall be as referred to in Notification No. RBI/2009-10/316 issued by the RBI.
[89] A NBFC, as referred to in the Infrastructure Debt Fund-Non-Banking Financial Companies (Reserve Bank) Directions, 2011, issued by the RBI.
[90] Defined under Rule 2DCA as inserted by the Income-tax Amendment (Thirteenth Amendment) Rules, 2022 *vide* Notification No. 50/2022, dated 06-05-2022
[91] Inserted by the Income-tax Amendment (Thirteenth Amendment) Rules, 2022 *vide* Notification No. 50/2022, dated 06-05-2022

7.6-1i. Relaxation from obtaining or Quoting PAN

Deductee, being a non-resident (not being a company) or a foreign company, is not required to obtain or quote PAN if he receives income in respect of investment in Category-I or Category-II AIFs and fulfils certain specified conditions (*see Para 11.6-18*)

Example 15: Category-I AIF, registered as a trust, has derived the following income during the year:

Nature of income	**Amount *(in lakhs)***
Income under the head profit and gains from business and profession	20
Income under the head capital gains	15
Income from other sources	5

Mr. X holds 30% units of the AIF. During the year, the AIF has credited the entire income to the accounts of its investors except for income in the nature of other sources. Determine the taxability both in the hands of AIF and Mr. X.

Taxability in the hands of AIF

Income-tax Act provides the pass-through status to the Category-I AIF. The income arising to the AIF is exempt from tax as investors are liable to pay tax on such income as if they have directly made the investments. However, this pass-through status is not given in respect of 'business income' of the AIF. Thus, a business income of Rs. 20 lakhs shall be chargeable to tax in the hands of AIF itself. As the AIF is registered as a trust, the business income shall be chargeable to tax at the maximum marginal rate (MMR).

Taxability in the hands of Mr. X

Nature of income	**Amount *(in lakhs)***
Income credited by the AIF:	
- Income under the head PGBP†	-
- Income under the head capital gains	4.5
Income deemed to be credited:	
- Income from other sources	1.5
Total income	**6**
† Income received by unit holder from AIF in the nature of income from business or profession shall be exempt under section 10(23FBB).	

7.6-2. Taxation of Category-III AIFs

Pass-through status has been accorded only to Category-I and Category-II AIF and not Category-III AIF. Thus, as AIFs can be formed as a trust, company, limited liability partnership and any other body corporate, the taxation system in the case of Category-III AIF shall be the same as in case of a normal trust, company, LLP or any other body corporate.

In case such Category III AIF fulfils the conditions for being a specified fund as referred under Section 10(4D), it shall be entitled to various exemptions, concessions and allowances *(see Para 11.6-5 to 11.6-7 and Para 11.6-13d*).

7.7 EXCHANGE-TRADED FUNDS

Exchange-Traded Funds (ETFs) are like Mutual Funds that track an index (i.e., NIFTY/SENSEX), or a commodity (Gold) or a basket of assets like an index fund. However, unlike regular Mutual Funds, ETFs are listed on exchange and trade like a stock, thus experiencing price changes throughout the day as it is bought and sold.

7.7-1. Gold ETFs

Gold exchange-traded fund scheme (Gold ETF) is defined under SEBI ('Mutual Funds) Regulations, 1996 to mean mutual fund scheme that invests primarily in gold or gold-related instruments. The taxation and exemption rules for them are the same as for physical gold or other than equity oriented mutual funds.

Any profit arising from the sale of Gold ETFs, after holding it for more than 36 months, is considered as long-term capital gain. Such capital gains are taxable at the rate of 20% *plus* surcharge and cess (*please refer Annexure E for relevant rates*) after taking benefit of Indexation. Further, where Gold ETFs are held for 36 months or less, any profit on the sale of such ETFs is taxable at a normal rate as applicable in the case of the investor.

Example 16, Mr A (resident in India) acquired 10,000 units of Gold ETF at Rs. 30 per unit on 01-03-2018. He sold such units on 25-03-2021 at Rs. 50 per unit. Compute the amount of capital gain chargeable to tax in hands of Mr A.

Answer

Computation of capital gain	
Particulars	*Amount*
Period of holding (from 01-03-2018 to 24-03-2021)	36+ Months
Nature of capital gain (held for more than 36 months)	Long term capital gain
Full Value of Consideration (10,000 units * Rs. 50)	500,000
Less: Indexed Cost of Acquisition [Note]	3,31,985
Long-term capital gain	**1,68,015**

Tax rate on capital gain	**20%**

Note: The Indexed cost of acquisition is calculated in two steps. The first step is to calculate the cost of acquisition of capital asset. In the second step, such cost of acquisition is multiplied by the CII of the year in which capital asset is transferred and divided by CII of the year in which asset is acquired.

$$\text{Indexed Cost of Acquisition} = \text{Cost of Acquisition} \times \frac{\text{CII of the year in which asset is transferred}}{\text{CII of the year in which asset is first held by assessee or CII of 2001-02, whichever is } \textit{later}}$$

The indexed cost of acquisition shall be Rs. 3,31,985 [3,00,000 * 301/272].

7.7-2. Index ETFs

Index fund scheme (Index ETF) is defined under Regulation 2(mn) of SEBI (Mutual Funds) Regulations, 1996 to mean a mutual fund scheme that invests in securities in the same proportion as an index of securities. Tax treatment of index ETFs would be the same as in the case of listed equity oriented mutual funds. Any profit arising from index ETF would be long-term if it is held for more than 12 months. Such long-term capital gains above Rs 1 lakh would be taxable at the rate of 10% *plus* surcharge and cess (*see Annexure E for relevant rates*) under Section 112A. However, short-term capital gains on index ETFs would be taxable at the rate of 15% under Section 111A.

Example 17, Mr A (resident in India) acquired 5,000 units of an Index ETF on 01-05-2019 at Rs. 200 per unit. He sold the units on 01-06-2021 at Rs. 300 per unit through the recognised exchange and paid STT on such transaction. Compute the amount of capital gain chargeable to tax in hands of Mr A.

Answer

Particulars	*Amount*
Period of holding (from 01-05-2019 to 31-05-2021)	12+ Months
Nature of capital gain (holding period is more than 12 months)	Long term capital gain
Sale price (5,000 units * Rs. 300)	Rs. 15,00,000
Cost of acquisition (5,000 units * Rs. 200)	Rs. 10,00,000
Long term capital gain	Rs. 5,00,000
Tax rate of capital gain†	10%
† As the amount of capital gain exceeds Rs. 100,000, the excess amount shall be chargeable to tax at a concessional rate of 10% as per section 112A.	

7.8 UNIT LINKED INSURANCE POLICIES

Unit Linked Insurance Plan is a hybrid investment option which consists of a mix of insurance and investment to serve the needs of the respective investors. The amount of premium of a ULIP scheme is partly towards the insurance of the policyholder and partly towards the investment. The investable portion of the premium is invested in equity, debt, money market or a mix of all based on the goals and risk appetite of the investor.

7.8-1. Types of ULIPs?

An investor can invest in the ULIPs for his retirement planning, wealth-creation, child education, family security, so on and so forth. ULIPs, by and large, allow options of payment of single-premium or regular premium. ULIPs based on the types of portfolios the money of insurer is invested in can be categorized into the following:

(a) Equity-Based Funds;
(b) Debt-Based Funds;
(c) Money Market Based Funds; and
(d) Balanced Funds.

7.8-2. Exemptions under Income Tax Act

Section 10(10D) provides for exemption with respect to any sum received under ULIP, including the sum allocated by way of bonus on such policy. However, if the premium is paid in excess of the limits prescribed, no exemption will be provided under this section.

In the event of the death of the policy-holder, the exemption shall not be denied under Section 10(10D) from either of the policy, that is, excess premium policy (more than 10% of sum assured) or higher premium policy (more than Rs. 2,50,000).

7.8-2a. Excess premium ULIPs

If the premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured, then no exemption under this section would be allowed with respect to the sum received under the policy. Such a situation is hereinafter referred to as ‘excess premium’.

7.8-2b. High premium ULIPs[92]

Besides restricting the exemption under Section 10(10D) for payment of excess premium, the Finance Act, 2021 has inserted *Fourth and Fifth Proviso* to Section 10(10D) that no exemption shall be available under this provision in respect of ULIPs issued on or after the 01-02-2021, if

[92] Inserted by the Finance Act, 2021 with effect from assessment year 2021-22

the amount of premium payable for any of the previous years during the term of the policy exceeds Rs. 2,50,000 (i.e., 'high premium' ULIPs).

The *Fourth Proviso* provides that no exemption shall be available for a policy, acquired on or after 01-02-2021 if the premium paid in any year during the tenure of the ULIP exceeds Rs. 2,50,000 (single policy). So, where the premium payable for a policy exceeds Rs. 2.5 lakhs in any year during its tenure, no exemption under section 10(10D) will be allowed with respect to such policy.

The *Fifth Proviso* provides the exemption for all those policies whose aggregate premium in any year during the tenure of the policies is less than Rs. 2,50,000 (Multiple Policies). This would imply that in case the person has more than one policy acquired on or after 01-02-2021, and the premium payable for each of such policy during any year does not exceed Rs. 2.5 lakhs but the aggregate of premium payable for all such policies exceeds Rs. 2.5 lakhs in a year, the exemption under this section would be allowed only in respect of those policies whose aggregate premium is within such prescribed limit.

Thus, in other words, the exemption shall be allowed only with respect to low premium ULIPs the aggregate of which is under the threshold limit of Rs. 2.5 Lakh.

Example 1: Determine whether the exemption is available under Section 10(10D) for a single policy purchased by four different persons in the following scenarios.

Particulars	*Person A*	*Person B*	*Person C*	*Person D*
Date of investment in ULIP	31-12-2020	15-01-2021	15-02-2021	28-02-2021
Premium payable every year (In lakhs)	2.60	2.00	2.30	2.55
Sum assured (In lakhs)	50.00	18.00	20.00	35.00
Whether the amount of premium exceeds 10% of the capital sum assured?	No	Yes	Yes	No
Whether the amount of premium during the year exceeds Rs. 2.5 lakhs?	Not applicable	Not applicable	No	Yes
Whether exemption	Yes	No	No	No

available under Section 10(10D)?				

Example 2: Determine whether the exemption is available under Section 10(10D) for multiple policies purchased by one person on or after 01-02-2021 in the following scenarios.

Particulars	*Premium payable every year*	*Capital sum assured*	*Whether premium exceeds 10% of capital sum assured?*	*Whether premium exceeds Rs. 2,50,000*	*Whether eligible for exemption under Sec. 10(10D)?*
	(In lakhs)	*(In lakhs)*			
Policy A	2.60	26.00	No	Yes	No
Policy B	2.00	15.00	Yes	No	No
Policy C	1.25	10.00	Yes	No	No
Policy D	0.60	5.00	Yes	No	No
Policy E	1.00	80.00	No	No	Yes*
Policy F	0.60	60.00	No	No	Yes*
Policy G	0.90	10.00	No	No	Yes*
Policy H	0.85	9.00	No	No	Yes*

* Though the last four policies are eligible for exemption under Section 10(10D) the exemption can be claimed in respect of only those policies whose aggregate premium during the year does not exceed Rs. 2,50,000 (i.e., low premium policies). Further, the threshold limit of Rs. 2,50,000 should be exhausted for those low premium policies first which have a higher yield. Low-yield ULIPs should be avoided from exhausting the limit of Rs. 2,50,000. It will, in turn, reduce the ultimate taxable capital gains. If the yield from such eligible policies is the same, the investor should consider Policy E, F and G as the aggregate premium of such policies equal to Rs. 2,50,000. If policy H is included, the limit of Rs. 2,50,000 cannot be exhausted fully.

7.8-3. CBDT's guidelines on the applicability of the fourth and fifth proviso to section 10(10D)

To determine the exemption under Section 10(10D) for the current previous year, the CBDT has issued clarifications on the following two situations:

- Assessee receives no sum from ULIPs in the past years, or sum is received, but assessee chose not to claim an exemption under section 10(10D);

- The sum is received, and the assessee has claimed exemption under Section 10(10D).

7.8-3a Where no consideration is received, or the assessee claims no exemption on the sum received

An assessee has not received any sum from eligible ULIPs or if the sum is received, but the assessee did not claim exemption on such sum. In such cases, the exemption under Section 10(10D) for the current previous year shall be determined in the following manner:

(a) Sum is received from one ULIP only

The assessee shall be eligible to claim exemption only if the annual premium payable does not exceed Rs. 2.5 lakh in any year during the term of such one ULIP. If the premium payable exceeds Rs. 2.5 lakh in any year, the fourth proviso is attracted, and the sum received from ULIP shall not be eligible for exemption under Section 10(10D).

Example 3, Mr. Raj has ULIP A satisfying all the conditions of Section 10(10D), except the conditions provided by Fourth and Fifth Proviso. Determine the exemption on maturity in the previous year 2031-32, assuming he did not receive any consideration under any other ULIPs in previous years.

ULIP	***A***
Date of policy	01-04-2021
Annual premium	Rs. 2,00,000
Sum assured	Rs. 20,00,000
Consideration received on 01-04-2031 on maturity	Rs. 22,00,000

As the annual premium does not exceed the prescribed limit of Rs. 2.5 lakh, the consideration received on maturity will be exempt under Section 10(10D).

Example 4, Mr. Raj has ULIP A satisfying all the conditions of Section 10(10D), except the conditions provided by Fourth and Fifth Proviso. Determine the exemption on maturity in the previous year 2031-32, assuming he did not receive any consideration under any other ULIPs in any previous years.

ULIP	***A***
Date of policy	01-04-2021

Quarterly premium paid during 2021-22	Rs. 65,000
Annual premium paid from 2022-23 and onwards	Rs. 2,00,000
Sum assured	Rs. 20,00,000
Consideration received on 01-11-2031 on maturity	Rs. 22,00,000

Though the annual premium does not exceed the prescribed limit of Rs. 2.5 lakh, but the aggregate of quarterly payment premium during the first year exceeded Rs. 2.50 lakhs. Thus, the fourth proviso is attracted, and no exemption would be available as the premium payable exceeded Rs. 2.50 lakhs in any year during the policy term. Thus, the consideration received on maturity will not be exempt under section 10(10D).

(b) Sum is received from more than one ULIPs

The assessee shall be eligible to claim the exemption for all ULIPs if the aggregate of premium payable on all such ULIPs does not exceed Rs. 2.5 lakh in any year during their policy term. If the aggregate of premium payable on all ULIPs exceeds Rs. 2.5 lakh in any of the years, the consideration received from only those ULIPs shall be exempt whose aggregate premium payable does not exceed Rs. 2,50,000.

Example 5, Mr. Raj has multiple ULIPs satisfying all the conditions of Section 10(10D), except the conditions provided by Fourth and Fifth Proviso. Determine the exemption on maturity in the previous year 2031-32, assuming he did not receive any consideration under any other ULIPs in previous years.

ULIP	**A**	**B**	**C**	**D**
Date of policy	01-04-2021	01-04-2021	01-04-2021	01-04-2021
Annual premium (X)	Rs. 1,00,000	Rs. 1,50,000	Rs. 2,00,000	Rs. 3,00,000
Tenure of policy (Y)	10 years	10 years	10 years	10 years
Sum assured	Rs. 20,00,000	Rs. 20,00,000	Rs. 30,00,000	Rs. 30,00,000
Consideration received on 01-04-2031 on maturity (Z)	Rs. 22,00,000	Rs. 30,00,000	Rs. 34,00,000	Rs. 40,00,000

Yield (Z-X*Y)	12,00,000	15,00,000	14,00,000	10,00,000
Eligible for exemption	Yes	Yes	Yes	No
Exemption to be claimed	Yes	Yes	No	-

Since Mr. Raj has invested in multiple policies issued on or after 01-04-2021, and the aggregate of premiums payable in any year during such policies term exceeds Rs. 2,50,000 the fifth proviso will apply. Accordingly, the exemption shall be allowed only for those low premium ULIPs, whose aggregate premium does not exceed the threshold limit of Rs. 2.5 lakh.

ULIP D is not eligible for exemption since its annual premium exceeds the threshold limit of Rs. 2.5 lakh.

Out of the remaining ULIPs A, B and C, the exemption can be claimed only for those ULIPs whose aggregate premium during any year does not exceed Rs. 2,50,000. He should choose those policies for the exemption that gives him maximum benefit. In this exercise, two factors should be considered: the yield of the policy and the policies that can exhaust the full limit of Rs. 2,50,000.

• As the yield of ULIP B is maximum (Rs. 15 lakhs), this should be considered for exemption.

• The annual premium of ULIP B is Rs. 1,50,000, so the next policy should be one having maximum yield but the premium of that should not exceed Rs. 1,00,000.

• The next high yield policy is ULIP C (Rs. 14 lakhs) but it cannot be considered as its annual premium is Rs. 2,00,000. So he will have to choose ULIP A for the exemption.

Accordingly, the consideration received on maturity of ULIP A and B shall be eligible for exemption under section 10(10D).

Example 6, Suppose in Example 3, Mr Raj has paid a quarterly premium of Rs. 65,000 towards ULIP A in its first year and thereafter an annual premium of Rs. 1,00,000. What would be the implication?

As he pays an annual premium of Rs. 2.6 lakhs on ULIP A, he cannot claim an exemption for such ULIP. Though the annual premium of ULIP B and ULIP C is within the prescribed limit, i.e., 1.5 lakh and Rs. 2 lakh, respectively but the aggregate annual premium of both policies is Rs. 3.5 lakhs. Thus, he can claim the exemption either for ULIP B or for ULIP C. It is advisable that he should claim the exemption for ULIP B having maximum yield.

(c) Summary

The situations discussed above have been summarised in the following table:

Number of ULIPs	*Premium for individual policy exceeds Rs. 2,50,000 (fourth proviso)*	*Aggregate payment of premium in any year during the term of any policy/policies exceeds Rs. 2,50,000 (fifth proviso)*	*Is exemption under section 10(10D) available?*
One	No	-	Yes
One	Yes	-	No
Multiple	No	No	Yes, for all policies
Multiple	No	Yes	Yes, for those ULIPs, the aggregate annual premium of which is under the threshold limit of Rs. 2,50,000
Multiple	Yes	Yes	No

7.8-3b Where an exemption is claimed for consideration received from ULIP in any previous year

The assessee has received any sum from eligible ULIPs during the preceding year and claimed the exemption for the same ('old ULIPs'). In such a case, the exemption under Section 10(10D) during the current previous year shall be determined in the following manner:

(a) Sum is received from one ULIP only

The assessee can claim exemption only if the premium payable on such ULIP and old ULIPs does not exceed Rs. 2.5 lakh in any year during the term of such ULIP. If the premium payable exceeds Rs. 2.5 lakh in any year, the sum received from such ULIP shall not be eligible for exemption under Section 10(10D).

Example 7, Mr. Raj has the following ULIPs satisfying all the conditions of Section 10(10D), except the conditions provided in Fourth and Fifth Proviso. Determine the exemption on maturity in the previous year 2032-33, assuming he received consideration on the maturity of ULIP A in the previous year 2031-32.

ULIP	*A*	*B*
Date of policy	01-04-2021	01-04-2022
Annual premium	Rs. 1,00,000	Rs. 1,50,000
Sum assured	Rs. 20,00,000	Rs. 20,00,000
Consideration received on 01-04-2031 on maturity	Rs. 28,00,000	-
Consideration received on 01-04-2032 on maturity	-	Rs. 30,00,000

The sum received on ULIP A would be eligible for exemption as the annual premium of ULIP A does not exceed Rs. 2.5. lakh. As aggregate premium payable for ULIPs A and B does not exceed Rs. 2.5 lakh in any term of the policy, ULIP B shall also be eligible for exemption under Section 10(10D).

Suppose in the above example, the annual premium for ULIP B is Rs. 2,00,000. In that case, the sum received from ULIP B shall not be eligible for exemption as the amount of premium payable on ULIP B and ULIP A exceeded the threshold limit of Rs. 2.5 lakhs.

(b) Sum is received from more than one ULIPs

The assessee can claim exemption only if the premium payable on more than one ULIPs and old ULIPs on which exemption was claimed in the prior year does not exceed Rs. 2.5 lakh in any year during their term. If the premium payable exceeds Rs. 2.5 lakh in any year, the sum received from ULIP shall not be eligible for exemption under section 10(10D).

Example 8, Mr. Raj has the following ULIPs satisfying all the conditions of Section 10(10D), except the conditions provided in Fourth and Fifth Proviso. Determine the exemption on maturity in the previous year 2032-33, assuming he claimed exemption on consideration received on the maturity of ULIP A in the previous year 2031-32.

ULIP	**A**	**B**	**C**	**D**
Date of policy	01-04-2021	01-04-2022	01-04-2023	01-04-2023
Annual premium (X)	Rs. 1,00,000	Rs. 50,000	Rs. 1,00,000	Rs. 2,00,000
Tenure of policy (Y)	10 years	10 years	10 years	10 years

Sum assured	Rs. 20,00,000	Rs. 10,00,000	Rs. 15,00,000	Rs. 20,00,000
Consideration received on 01-04-2031 on maturity (Z1)	Rs. 22,00,000	-	-	-
Consideration received on 01-04-2032 on maturity (Z2)	-	Rs. 20,00,000	Rs. 15,00,000	Rs. 30,00,000
Yield (Z2+Z2-X*Y)	Rs. 12,00,000	Rs. 15,00,000	Rs. 5,00,000	Rs. 10,00,000

All the policies shall be eligible for the exemption because the annual premium for each policy does not exceed Rs. 2.5 lakhs in any year. However, as the aggregate premium of all policies exceeds Rs. 2.5 lakhs in any year (in this case, it exceeded in the previous year 2023-24 and onwards) the exemption shall be allowed only with respect to those ULIPs, whose aggregate premium does not exceed the threshold limit of Rs. 2.5 lakhs. Since he has already claimed exemption for ULIP A, its annual premium shall also be considered while computing the limit of Rs. 2.5 lakhs.

Out of the remaining ULIPs B, C and D, the exemption can be claimed only for those ULIPs whose aggregate premium, including premium payable on old ULIPs (ULIP A) during any year, does not exceed Rs. 2,50,000.

The annual premium of the old ULIP was Rs. 1,00,000. Thus, he should choose those policies whose aggregate annual premium is Rs. 1,50,000 and give him maximum benefit. In this exercise, two factors should be considered: the yield of the policy and the policies that can exhaust the full limit of Rs. 2,50,000.

- As the yield of ULIP B is maximum (Rs. 15 lakhs), this should be considered for exemption.

- The annual premium of ULIP B is Rs. 50,000, so the next policy should be one whose premium does not exceed Rs. 1,00,000.

- He cannot choose ULIP D because its annual premium is Rs. 2,00,000. So he will have to choose ULIP C.

Accordingly, the consideration received on maturity of ULIP B and C shall be eligible for exemption under section 10(10D).

Example 9, Suppose in Example 7, the annual premium for ULIP A is Rs. 2,00,000. In that case, the exemption will be available only for ULIP B as the aggregate annual premium of ULIP B

(Rs. 50,000), and ULIP A (Rs. 2,00,000) does not exceed Rs. 2.50 lakh. In all other combinations, the aggregate premium would exceed Rs. 2,50,000. Thus, the sum received from ULIP C and ULIP D shall not be exempt under Section 10(10D).

Example 10, Suppose in Example 7, Mr Raj did not claim an exemption in respect of the sum received from ULIP A. In that case, out of the remaining ULIPs B, C and D, the exemption can be claimed only for those ULIPs whose aggregate premium during any year does not exceed Rs. 2,50,000. He should choose those policies for the exemption that gives him maximum benefit. In this exercise, two factors should be considered: the yield of the policy and the policies that can exhaust the full limit of Rs. 2,50,000.

- As the yield of ULIP B is maximum (Rs. 15 lakhs), this should be considered for exemption.

- The annual premium of ULIP B is Rs. 50,000, so the next policy should be one whose premium should be Rs. 2,00,000.

- He should not choose ULIP C because he will not exhaust the entire limit of Rs. 2,50,000. So he should choose ULIP D for exemption.

Accordingly, the consideration received on maturity of ULIP B and D shall be eligible for exemption under section 10(10D), and consideration from ULIP C shall be taxable.

(c) Summary

The situations discussed above have been summarised in the following table:

Number of remaining ULIPs	*Premium for remaining individual policy exceeds Rs. 2,50,000*	*Aggregate payment of premium in any year during the term of old and remaining policies exceeds Rs. 2,50,000*	*Is exemption under section 10(10D) available for remaining low premium ULIP?*
One	No	No	Yes
One	No	Yes	No
One	Yes	Yes	No
Multiple	No	No	Yes, for all policies
Multiple	No	Yes	Yes, for those ULIPs, whose aggregate annual premium

			along with the aggregate annual premium of old ULIPs does not exceed Rs 2,50,000.
Multiple	Yes	Yes	No

7.8-4. Taxability on ULIP

Where any person receives at any time during any previous year any amount under a ULIP, to which exemption under Section 10(10D) does not apply on account of the *fourth and fifth proviso* thereof, including the amount allocated by way of bonus on such policy, then, any profits or gains arising from receipt of such amount by such person shall be chargeable to tax under the head "Capital gains" in the previous year in which such amount was received.

7.8-4a. Capital gains from ULIPs

Computation of capital gains if the sum received from ULIPs is not exempt

The Central Board of Direct Taxes (CBDT) has notified Rule 8AD[93] prescribing manner to compute capital gain if the sum received from ULIPs is not exempt in hands of the receiver. Such computation shall be made in the following manner:

(a) Sum received from high premium ULIPs for the first time

If the assessee has received the sum from high premium ULIPs for the first time, then the capital gains shall be calculated in the following manner:

Particulars	*Amount*
Amount received for the first time from ULIP	xxx
Add: Amount allocated by way of bonus on such policy	xxx
Less: Aggregate of premium paid during the term of the policy till the date of receipt of the amount	(xxx)
Capital Gains	**xxx**

(b) Sum received from high premium ULIPs for the second time and subsequently

[93] Notification No. 8/2022, dated 18-01-2022.

If the sum received from high premium ULIPs isn't the sum received for the first time, then the capital gains shall be calculated in the following manner:

Particulars	*Amount*
Amount received from such ULIP	xxx
Add: Amount allocated by way of bonus on such policy	xxx
Less: Amount received from the same policy and considered while computing capital gains in earlier previous years	(xxx)
Less: Aggregate of premium paid during the term of the policy till the date of receipt of the amount	(xxx)
Less: Premium already considered for calculation of the taxable amount in the earlier previous year	(xxx)
Capital Gains	**xxx**

Example 11, Mr. Raj has the following ULIPs satisfying all the conditions of Section 10(10D), except the conditions provided in Fourth and Fifth Proviso. Determine the exemption and capital gains (if any), assuming he did not receive any consideration under any other ULIPs in earlier previous years.

ULIP	***A***	***B***
Date of policy	01-04-2021	01-04-2022
Annual premium	Rs. 1,00,000	Rs. 3,00,000
Sum assured	Rs. 10,00,000	Rs. 20,00,000
Consideration received on 31-03-2024 on maturity	Rs. 20,00,000	-
Consideration received on 31-03-2027 on partial maturity	-	Rs. 16,00,000
Bonus received on 31-03-2027 on partial maturity	-	Rs. 3,00,000
Consideration received on 31-03-2032 on full maturity	-	Rs. 40,00,000
Bonus received on 31-03-2032 on full maturity	-	Rs. 4,00,000

The sum received from ULIP A shall be eligible for exemption as the annual premium does not exceed Rs. 2.5 lakh. However, the sum received from ULIP B isn't eligible for exemption as the premium payable exceeds Rs. 2.5 lakh.

Since the exemption under Section 10(10D) is not applicable on ULIP B, the sum received from such ULIP shall be chargeable to capital gains. The computation of capital gains on such receipt shall be made in the following manner:

Computation of capital gains for the previous year 2026-27:

Particulars	***Amount (in Rs.)***
Sum received for the first time from ULIP B	16,00,000
Add: Sum allocated by way of bonus	3,00,000
Less: Sum already considered for computing capital gains in earlier years	-
Less: Aggregate of premium paid till receipt of maturity sum from ULIP B - 3,00,000 x 5 (from 01-04-22 till 01-04-26)	(15,00,000)
Long-term capital gains for the previous year 2026-27	**4,00,000**

Computation of capital gains for the previous year 2031-32:

Particulars	**Amount (in Rs.)**
Sum received for the second time from ULIP B	40,00,000
Add: Sum allocated by way of bonus	4,00,000
Less: Sum already considered for computing capital gains in earlier years (including sum allotted by bonus)	(19,00,000)
Less: Aggregate of premium paid till receipt of maturity sum from ULIP B - 3,00,000 x 10 (from 01-04-22 till 01-04-31) *minus* 15,00,000 *(amount of premium considered while computing capital gain in prior year)*	(15,00,000)
Long-term capital gains for the previous year 2031-32	**10,00,000**

7.8-4b. Period of holding

ULIP	*Period of holding to qualify as long-term capital asset*
Equity Oriented	
- High premium policies	More than 12 months
- Other policies	More than 36 months
Other than equity oriented	
- High premium	More than 36 months
- Other policies	More than 36 months

7.8-4c. Types of ULIPs for the purpose of taxation

Equity oriented high premium ULIP

Equity oriented high premium ULIPs are the policies that have invested their funds in either of the following and have kept them invested throughout the term of the policy:

- 65% of its funds in equity shares of domestic companies listed on a recognised stock exchange; or
- 90% of its funds in units of another fund that is registered on a recognised stock exchange and invest in its proceeds in equity shares of a domestic company or equity-oriented fund.

Other ULIP

Any other kind of ULIP whether high premium or excess premium or debt-oriented or hybrid ULIPs shall have the same tax treatment.

7.8-5. Tax on ULIPs

7.8-5a. Long term capital gains

long term capital gains arising from transfer of High premium equity-oriented ULIPs on which STT is paid shall be charged to tax at the rates of 10% on capital gains in excess of Rs. 1,00,000. In any other case, long term capital gains arising from ULIPs would be charged to tax at 20% under section 112.

7.8-5b. Short term capital gains

Short term capital gains arising from transfer of high premium equity-oriented ULIPs on which STT is paid shall be charged to tax at the rate of 15% under section 111A. In any other case, short term capital gains arising from ULIPs would be charged at normal tax rates as in the case of the assessee.

7.9 ELECTRONIC GOLD RECEIPTS (EGR)

As per Regulation 2(1)(h) of the SEBI (Vault Managers) Regulations, 2021, "Electronic Gold Receipt" shall have the meaning assigned to it under the Securities Contracts (Regulation) Act, 1956 (SCRA).

The SCRA defines "Electronic Gold Receipt" as an electronic receipt issued based on the deposit of underlying physical gold in accordance with the regulations made by the Exchange Board. Further, in exercising the powers conferred by sub-clause (iia) of clause (h) of Section 2 of the SCRA, the Central Govt. declared[94] the term 'Electronic Gold Receipt' under the definition of Securities.

In simple words, EGR is an electronic receipt issued by the Vault Manager against the gold deposited with them. EGR is a security and is traded on the stock exchange like any other security.

7.9-1. Who is authorised to issue EGRs?

A Vault Manager is authorised[95] by the Govt. to issue EGR. The Vault Manager is a person who carries on or intends to carry on the business of providing vaulting services.

Vaulting service[96] in relation to gold means the storage and safekeeping of gold deposited with the Vault Manager, by the depositor, for the purpose of trading in Electronic Gold Receipts and providing services incidental thereto, and includes—

(a) Utilising the services of assayers empanelled with the Stock Exchanges for testing as per the gold standard, wherever required;
(b) Coordination with depositories for creation, transfer, and extinguishment of Electronic Gold Receipts; and
(c) Providing deposit, storage, and withdrawal services to the beneficial owners.

7.9-2. Trading of EGRs

The EGRs are held in Demat accounts. Investors can buy and sell EGRs on the stock exchange just like any other security, and the value of the EGR is linked to the price of physical gold.

The EGRs can be traded on the stock exchange[97]. The settlement of EGR will be done on a T+1 rolling basis. The trades on the stock exchange will be settled by way of transferring funds to the seller and EGR to the buyer. The EGR will be transferred to the Demat account of the buyer.

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[94] Notification No. S.O. 5401(E)., Dated 24.12.2021
[95] Regulation 2(k) of SEBI (Vault Managers) Regulations, 2021.
[96] Regulation 2(m) of SEBI (Vault Managers) Regulations, 2021.
[97] Para 5 of Circular No. SEBI/HO/CDMRD/DMP/CIR/P/2022/07, Dated 10-01-2022

The buyer can continue to hold the EGR in the Demat account for further trading or take the physical delivery of gold from the Vault Manager. The Vault Manager will extinguish the EGR upon delivery of the gold to the investor.

7.9-3. Tax on income from EGR

From assessment year 2024-25, a new sub-section (viid) has been inserted under section 47 of the Income-tax Act, which provides that where an assessee exchange gold for an EGR from a Vault Manager or exchange an EGR for gold, it will not be considered a transfer. Accordingly, the assessee is not liable to pay tax on such conversion.

It is important to understand that only the conversion of gold into an EGR and vice-versa will be eligible for exemption from capital gains tax. The transfer of EGR after conversion from gold will be subject to capital gains tax liability. The computation of capital gain in such cases would be governed as per the normal provisions.

In general, a capital asset is bifurcated into a short-term and a long-term capital asset based on the period of holding to compute the capital gain arising from its transfer or redemption. As EGRs are listed securities, they shall be considered long-term capital assets if held for more than 12 months, while physical gold needs to be held for more than 36 months to qualify as long-term.

It is to be noted that if a person converts gold into EGR and then transfers it, the period during which he holds the gold before conversion into EGR would be included in the holding period of EGR and *vice-versa*. Further, when a person receives an EGR from a Vault Manager after exchanging gold, the cost of gold shall be considered as the cost of such EGR. Similarly, receiving gold by transferring an EGR to Vault Manager, the cost of EGR shall be considered as the cost of acquiring such gold.

The short-term and long-term capital gain arising from the transfer of EGR is computed in the following manner:

Particulars	
Full Value of Consideration *Less:* a) Cost of Acquisition/Indexed Cost of Acquisition b) Expenses incurred wholly and exclusively in connection with transfer *Less:* Exemption under Sections 54 to 54GB to the extent of the net result of above calculation	xxx (xxx) (xxx) (xxx)
Short-term or Long-term Capital Gains	**xxx**

The short-term capital gain so computed shall be taxable at normal tax rates as applicable in the case of the assessee. In contrast, the long-term capital gains shall be taxable at 10% without indexation or 20% with indexation [*first proviso* to Section 112].

Review Questions:

1. **Under Employee Stock option Plans ("ESoPs") employees get a right to purchase a certain number of securities at a _______________ price**

   (*a*) Discounted price

   (*b*) Premium price

   (*c*) Face value

   (*d*) Less than face value

2. **Which of the following is/are key features of Sovereign Gold Bonds (SGBs)**

   (*a*) denominated in grams of gold

   (*b*) issued by RBI on behalf of Government of India (GoI)

   (*c*) redeemed at the market price

   (*d*) All of these

3. **Which of the following is/are true of National Pension System (NPS)**

   (*a*) Voluntary

   (*b*) defined contribution retirement savings scheme

   (*c*) regulated by Pension Fund Regulatory and Development Authority (PFRDA)

   (*d*) All of these

4. **Real Estate Investment Trust (REIT) may have following types of income**

   (*a*) Rental income from real estate property

   (*b*) Capital gains from the transfer of real estate property

   (*c*) Dividend and Interest received from SPV

   (*d*) All of these

CHAPTER 8: BUSINESS INCOME

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Speculative/Non Speculative Business Income
- Method of accounting
- Valuation of stock-in-trade
- Valuation of stock in special cases
- Actual cost of assets
- Computation of Business Income
- Set off and carry forward of Business loss
- Relevance of ICDS

As per Section 14 of the Income-tax Act, all income taxable during the relevant Assessment Year is computed under five heads of income and 'profit and gains from business or profession' is one of such heads. The profit and gain from business or profession arises when a person carries on business, commerce or adventure in the nature of trade. A person is said to be carrying on a business if he carries on some activities continuously and systematically by the application of his labour and skill with a view to earn an income. As computation provisions and tax rates are different for capital gains and business income, a proper distinction must be made between these two incomes. A person can be a trader as well as an investor. The income earned by him from the trading activities is taxable under the head business income, and the income earned from the personal investment is taxable under the head capital gains. To know more about the calculation of business income, *see Para 2.7-3*. In this chapter, various essential concepts have been discussed. These concepts are relevant for a trader whose income from the securities market is taxable under the head business income.

8.1 SPECULATIVE & NON-SPECULATIVE BUSINESS INCOME

8.1-1. Meaning of Speculative Transaction

While computing the income under the head 'profits and gains from business or profession', a business transaction has to be classified into 'speculative' and 'non-speculative'. A speculative business is deemed to be distinct and separate from any other business. Though the provisions for computation of profit and tax rates are the same in the case of a speculative and non-speculative business such distinction has been made due to restricted treatment of losses arising from a speculative transaction. If any loss is suffered from speculative business, it cannot be set off or adjusted against any profit from a non-speculative business. Further, such losses can be carried forward for 4 years only in contrast to 8 years allowed for non-speculative business losses.

As per Section 43(5) of the Income-tax Act, 'speculative transaction' means a transaction in which a contract for purchase or sale of any commodity including stock and shares is periodically or ultimately settled otherwise than through the actual delivery or transfer of the commodity or scrips. Thus, in a speculative transaction, the contract is settled otherwise by giving or receiving the delivery and squared up by paying out the difference which may be positive or negative.

Where a transaction of purchase or sale of any security is settled by actual delivery then such transaction is not treated as a speculative transaction and any income or loss arising therefrom is treated as a non-speculative business income or loss.

While classifying a transaction into speculative or non-speculative, the intention of the parties is immaterial. At the outset of the contract, the parties might have decided to settle the contract by taking actual delivery but if ultimately the contract is settled by accepting the difference in prices it becomes a speculative transaction.

Example 1**,** Intra-day trading of shares is considered a speculative transaction as delivery of shares is not made in such transactions and traders have to square up their position on the same day. Whereas, if a trader takes the delivery of shares and subsequently sells the same, any income or loss arising therefrom is treated as non-speculative business income or loss.

8.1-2. Exceptions

There are some transactions which are completed without delivery and look like a speculative transaction but are not regarded as speculative. Such transactions are mentioned below:

8.1-2a. Hedging Contracts

Any hedging contract in respect of stocks and shares is not treated as speculative transaction. This hedging contract is entered into by a dealer or investor to safeguard against loss that may arise due to price fluctuations in his holdings of stocks and shares.

Further, a contract entered into by a member of a forward market or a stock exchange, in the course of any transaction in the nature of jobbing or arbitrage, is not deemed as a speculative transaction. This contract is entered into to guard against the loss which may arise in the ordinary course of business of such member.

8.1-2b. Transaction in share derivatives

A derivative is a security or contract which derives its value from the prices, or index of prices, of another underlying asset. The underlying asset can be anything - a share, bond, commodity, currency, etc. The commonly used derivatives are 'Futures' and 'Options'.

A ‘future’ is a contract for buying or selling underlying security or index, on a future date, at a price specified today, and entered into through a formal mechanism on an exchange. The terms of the contract are specified by the exchange.

An ‘option’ is a contract that gives the right, but not an obligation, to buy or sell the underlying security or index on or before a specified date, at a stated price. Options are categorized into 2 categories - Call Options and Put Options. Option, which gives the buyer a right to buy the underlying asset, is called ‘Call option’ and the option which gives the buyer a right to sell the underlying asset, is called ‘Put option’.

In case of derivatives, the transactions are ultimately settled without actual delivery of underlying security or index. These derivative transactions are not treated as speculative if transactions are carried in a recognised stock exchange through a stockbroker or sub-broker or such other intermediary registered with SEBI. Further, the contract note issued by such broker or intermediary to the client should indicate the unique client identity number and PAN of the client and it should be time-stamped.

8.1-2c. Transaction in Commodity Derivatives

As discussed earlier, a derivative is a security or contract which derives its value from the prices, or index of prices, of other underlying securities. When the underlying asset is a commodity, e.g., Oil or Metal, the contract is termed as a ‘commodity derivative’. Sale of option in goods is also considered a commodity derivative. In commodities derivatives, the transactions are ultimately settled without the actual delivery of underlying assets. These derivative transactions are not treated as speculative if transactions are carried in a recognised stock exchange and it is charged to the commodity transaction tax. The condition of payment of commodity transaction tax does not apply in the case of a transaction in agriculture commodity derivatives (*see Annexure H* for rates of Commodities Transaction Tax (CTT)).

The relaxation from treating a commodity derivative as a speculative transaction is given if the transaction is carried out electronically through a member or an intermediary registered with the recognized stock exchange. Further, the contract note issued by such a member or intermediary to the client should indicate the unique client identity number, unique trade number and PAN of the client and should be time-stamped.

8.2 METHOD OF ACCOUNTING

As per Section 145 of the Income-tax Act, Income under the heads ‘Profits and gains of business or profession’ and ‘Income from other sources’ shall be computed in accordance with the method of accounting regularly employed by the assessee. The provisions of this section have no application to income taxable under the head ‘Salaries’, ‘Income from House Property’, and ‘Capital Gains’.

8.2-1. Types of method of accounting

An assessee may employ different methods of accounting for different sources of income. If such different methods are employed regularly and consistently the profits have to be computed in accordance with the respective methods, provided it results in a proper determination of true profits. Two methods of accounting are allowed to be followed under the Income-tax Act, which are as follows:

8.2-1a. Mercantile System

Under this system, the net profit or loss is calculated after taking into account all income and the expenditure relating to the period whether such income has been received or not and whether such expenditure has been paid or not. Thus, the profit computed under the system is the profit earned, though not necessarily realised in cash, or the loss computed under this system is the loss sustained, though not necessarily paid in cash. Under this system, the deduction for expenditure is allowed on an accrual basis although the liability may pertain to an earlier year, or may have to be discharged at a future date. However, there are certain categories of expenses specified in the Income-tax Act, which are allowed only on payment basis. Similarly, certain incomes are taxable on receipt basis only.

8.2-1b. Cash System

According to the cash basis of accounting, a record is kept of actual receipts and actual payments, entries are made only when money is collected or disbursed. If the profits of a business or profession are accounted for in this way, the tax is payable on the difference between the receipts and the disbursements for the period in question.

Income, when received, may attract tax even if the source of income has ceased to exist at the time of receipt, and all admissible expenditure must be allowed in the year in which it is disbursed, irrespective of the question when the liability to pay the same arose.

8.2-2. Income not taxable as per method of accounting

Exception 1: Dividend income

Section 8 *read with* ICDS-IV provides that irrespective of the method of accounting followed by the assessee, any dividend (including deemed dividend) declared, distributed or paid by a company is chargeable to tax as income of the previous year in which it is so declared, distributed or paid. However, interim dividend is chargeable to tax as the income of the previous year in which it is unconditionally made available by the company to the member who is entitled to it. Thus, the requirement of method of accounting does not apply to dividend income.

Exception 2: Interest income

Where no regular method of accounting is employed by the assessee, interest on securities is chargeable to tax as the income of the previous year in which it becomes due.

Exception 3: Interest on Income-tax refund

As per ICDS-IV (Revenue Recognition), Interest on refund of tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received.

Exception 4: Interest on Compensation

Interest received on any compensation or enhanced compensation shall be deemed to be the income of the previous year in which it is received.

Exception 5: Claim for escalation of price

Any claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realization is achieved.

Exception 6: Government grant or Subsidy

Income referred in Section 2(24)(xviii), i.e., certain subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement received or receivable from the Central Government or a State Government or any authority or body or agency in cash or kind, shall be deemed to be the income of the previous year in which it is received provided it is not charged to Income-tax in any earlier previous year.

8.2-3. When maintenance of books of account is mandatory?

As per Section 44AA of the Income-tax Act, an assessee shall maintain books of accounts to enable the Assessing Officer (AO) to compute his total income. Such books of accounts are required to be maintained if their income or gross turnover/receipts during the specified period exceeds the prescribed threshold limit. If the threshold limit, as specified in the below table, is not crossed, the assessee shall not be required to maintain books of accounts in accordance with this provision.

The table below demonstrates the requirement for maintaining books of accounts by a taxpayer engaged in any business. If a taxpayer exceeds either of the thresholds of income or gross turnover, he shall be required to maintain the books of account.

Nature of Business	*Category of Taxpayer*	*Threshold Limits*	
		For Income	*For Gross Turnover or Receipts*
Business	Individual or HUF	More than Rs. 2,50,000 in any of the 3 years immediately	More than Rs. 25 lakhs in any of the 3 years immediately preceding the previous year*

		preceding the previous year*	
Business	Others	More than Rs. 1,20,000 in any of the 3 years immediately preceding the previous year*	More than Rs. 10 lakhs in any of the 3 years immediately preceding the previous year*
Business eligible for Presumptive Tax Scheme under Section 44AD	Resident Individual or HUF	If the income of assessee exceeds the maximum exemption limit and the person has opted for the presumptive scheme in any of the last 5 previous years but does not opt for the same in the current year.	
Business eligible for Presumptive Tax Scheme under Section 44AD	Resident Partnership Firm	The taxpayer has opted for the scheme in any of the last 5 previous years but it does not opt for the same in the current year.	

* Where business or profession has been set up during the previous year, the threshold limit of income or gross receipts of the current year shall be checked. In other words, in case of new business or profession, if income or turnover or receipt of the current year, as the case may be, are not likely to exceed the threshold limit, the assessee shall not be required to maintain the books of account.

8.2-4. ***Which books of accounts have to be maintained?***

The following documents should be maintained by the taxpayers to comply with the requirement of maintenance of books of accounts:

S. No.	*Nature of Business*	*Threshold Limits*	*Books of Accounts to be maintained*
1.	Business	Income and turnover do not exceed the threshold limit as specified above	Not required to maintain books of accounts
2.	Business	Income and turnover exceed the threshold limit as specified above	Such books of accounts may enable the Assessing Officer to compute the taxable income.

* Where the business has been set up during the previous year, the threshold limit of income or gross receipts of the current year shall be checked.

"Books or books of account" is defined under section 2(12A) of the Income-tax Act to include ledgers, day-books, cash books, account-books and other books, whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form or in a floppy, disc, tape or any other form of electro-magnetic data storage device.

8.2-5. How to compute turnover?

Income-tax Act contains various provisions which have a reference to the sales turnover of an assessee. The quantum of sales turnover from a business is pertinent to determine the eligibility of an assessee for a presumptive tax scheme or to determine the obligation of the assessee to maintain books of accounts under Section 44AA or to get them audited under Section 44AB, etc. Despite the immense significance of these terms, the Income-tax Act does not define it. However, the Guidance Note on Tax Audit issued by the ICAI prescribes the method of determining turnover.

8.2-5a. In case of speculative transaction

A speculative transaction means a transaction in which a contract for purchase or sale of any commodity or securities, is periodically or ultimately settled otherwise than by the actual delivery or transfer of commodity or scrips. Thus, in speculative transactions, there can be both positive and negative differences arising from the settlement of contracts. Each transaction resulting in whether a positive or negative difference is an independent transaction. In such transactions, though the contract notes are issued for the full value of the purchased or sold asset, the entries in the books of account are made only for the differences. Accordingly, the aggregate of both positive and negative differences is to be considered as the turnover.

Example 2, Mr X does the following intra-day trading of shares during the year:

Securities	*Purchase Value*	*Sale value*	*Amount of gain or (loss)*
A	1,00,000	1,15,000	15,000
B	95,000	71,000	(24,000)
C	250,000	2,35,800	(14,200)
D	3,04,000	3,20,000	16,000

Compute his turnover from intra-day trading of shares, that is, speculative transactions.

Answer

In speculative transactions, the aggregate of both positive and negative differences (income and loss) is considered as the turnover. Thus, the turnover of Mr X shall be computed as follows:

Securities	Amount of gain or (loss)
A	15,000
B	(24,000)
C	(14,200)
D	16,000
Total	**69,200**

8.2-5b. In case of derivatives

Derivative transactions which are completed without delivery of shares or securities and squared up by the payment of differences contain all feature which a speculative transaction has, but same are not considered as speculative.

The turnover in such types of transactions is determined as follows:

a) Total of favourable and unfavourable differences shall be taken as turnover;
b) Premium received on sale of options is also to be included in turnover. However, where the premium received is included for determining net profit for transactions, the same should not be separately included; and
c) In respect of any reverse trades entered, the difference thereon should also form part of the turnover.

Example 3, Mr A enters into the following transaction during the financial year:

Security Name	*Type*	*Premium received*	*Buy Amount*	*Sell Amount*	*Profit/(Loss)*
Cipla	Futures	-	7,47,500	8,05,000	57,500
Nifty	Call	-	3,375	6,000	2,625
BHEL	Call	-	41,600	20,800	(20,800)
ONGC	Futures	-	3,48,500	3,28,000	(20,500)
IOC	Put (Sell)	500	-	-	500

ITC	Put (Sell)	1,000	4,000 (Square Off Price)	-	(3,000)
Reliance Ltd.	Put	-	4,500	2,500	(2,000)

Compute his turnover from the aforesaid transactions.

Answer

In case of derivative transactions, the aggregate of both favourable and unfavourable differences (i.e., income and loss) is considered as the turnover. Further, the premium received on the sale of options is also included in turnover if the same is not included while determining the net profit or loss from the transaction. Thus, the turnover of Mr A shall be as follows:

Security Name	*Profit/(Loss)*
Cipla	57,500
Nifty	2,625
BHEL	(20,800)
ONGC	(20,500)
IOC	500
ITC*	(3,000)
Reliance Ltd.	(2,000)
Total Turnover	**1,06,925**
* As the amount of premium received is already considered for computing the profit or loss from the transaction, it is not included again while computing the turnover.	

8.2-5c. In case of delivery-based transaction

Delivery based transactions are those transactions under which transactions are completed with the actual delivery of stocks and shares, whether intended originally or happened eventually. While determining the turnover in the case of delivery-based transactions, the total value of sale shall be considered as the turnover of the assessee.

In *Example 3*, If Mr X bought 100 shares of Reliance Ltd at Rs 1,600 per share and sold them at Rs 1,720, the selling value of Rs. 172,000 (100 shares x Rs. 1,720) shall be considered as turnover.

8.2-5d. In case of investment

Where transactions of sale or purchase of securities are for the purposes of investment and income arising therefrom is computed under the head 'Capital Gains', then the value of such transaction is not to be included in sales or turnover. However, in case such transactions are in the course of business, then the total of such sales are to be included in the sale turnover or gross receipts, as the case may be.

8.3 VALUATION OF SECURITIES HELD AS STOCK-IN-TRADE

Section 145A of the Income-tax Act provides that for the purpose of determining the income chargeable under the head 'Profits and gains of business or profession', the value of securities held as stock-in-trade should be calculated in accordance with Income Computation and Disclosure Standards (ICDS). Thus, the valuation of securities held as stock-in-trade shall be made in accordance with ICDS-VIII.

8.3-1. Valuation at the time of acquisition

Where any security is acquired by way of purchase, it shall be recognised at an actual cost in the books of account. The actual cost shall be aggregate of the purchase price and other directly attributable acquisition charges such as brokerage, fees, taxes, duty or cess.

ICDS-VIII does not provide any guidance on how the indirect cost should be attributed and added to the actual cost of the securities held as stock-in-trade. Thus, the general accounting principles can be referred to for such attribution. As per the principles mentioned in Accounting Standard-2 (*Inventories)*, the indirect cost shall be bifurcated on some appropriate basis. Thus, indirect costs, which are not directly attributable to any particular security, can be allocated on an appropriate basis such as the value of securities, number of securities, time period, etc.

8.3-2. Valuation at the end of the previous year

At the end of any previous year, the listed securities, which have been held as stock-in-trade, shall be valued at actual cost initially recognised or net realisable value at the end of that previous year, whichever is *lower*. Such comparison of actual cost and net realisable value shall be done category-wise and not for each security. For this purpose, securities shall be classified into the following categories:

a) Shares
b) Debt Securities
c) Convertible Securities
d) Any other securities not covered above

8.3-2a. Determination of actual cost

The actual cost of securities shall be determined as per the specific identification method. Under this method, specific costs are attributed to the identified items of securities. If the application of this method is not practically possible, then the First-In-First-Out method or Weighted Average method can be applied.

8.3-2b. Determination of net realisable value

The net realisable value of listed securities, for this purpose, shall be the price at which it is quoted at the stock exchange *less* the estimated cost to be incurred on its sale.

8.3-3. Treatment of income or loss on account of valuation of stock

Marked-to-market loss, computed as per this ICDS, arising on the subsequent valuation of listed securities held as stock-in-trade shall be allowed as deduction under Section 36(1)(xviii). Recognizing unrealized loss in respect of securities held as stock-in-trade at the end of the previous years is commonly known as 'marked-to-market loss'. If the notional loss is not computed in accordance with this ICDS, it shall be disallowed under Section 40A(13). Whereas, any gain arising due to such valuation shall be taxable as business income under Section 28. All these adjustments shall be made in the taxable business profits and will be reflected separately in the Income-tax return and tax audit report.

Example 4, Mr X acquired the following securities from the stock market:

Equity shares	*Date of purchase*	*No. of shares*	*Cost per share* (In Rs.)*	*Total Value (In Rs.)*
Wipro	May 1, Year 00	150	100	15,000
Infosys	June 10, Year 00	200	150	30,000
Wipro	July 31, Year 00	50	110	5,500
Tata Steel	October 08, Year 00	100	250	25,000
Infosys	November 15, Year 00	75	140	10,500
Tata Steel	November 30, Year 00	100	240	24,000
Total		**675**		**1,10,000**

* Cost shall include purchase price and other directly attributable acquisition charges such as brokerage, fees, taxes, duty or cess.

During the relevant year, he transfers the following shares:

Equity shares	*No. of shares*	*Sale price per share (In Rs.)*	*Total Value (In Rs.)*
Wipro	60	120	7,200
Infosys	100	200	20,000

Tata Steel	75	300	22,500
Total	**235**		**49,700**

The NRV of the shares at the end of the previous year is as follows:

Equity shares	*NRV per share (In Rs.)*
Wipro	125
Infosys	160
Tata Steel	200

As in the case of listed shares (held in Demat form), it is impossible to follow the specific identification method, the value of equity shares at the year-end can be determined either as per the FIFO Method or Weighted Average Method.

1. *Value of closing stock as per FIFO method*

Equity shares	*Date of purchase*	*No. of shares remaining*	*Cost per share*	*NRV*	*Total Cost*	*Total NRV*
Wipro	May 1, Year 00	*90*	*100*	*125*	*9,000*	*11,250*
Infosys	June 10, Year 00	*100*	*150*	*160*	*15,000*	*16,000*
Wipro	July 31, Year 00	*50*	*110*	*125*	*5,500*	*6,250*
Tata Steel	October 08, Year 00	*25*	*250*	*200*	*6,250*	*5,000*
Infosys	November 15, Year 00	*75*	*140*	*160*	*10,500*	*12,000*
Tata Steel	November 30, Year 00	*100*	*240*	*200*	*24,000*	*20,000*
Total		***440***			***70,250***	***70,500***

As the aggregate of cost of securities, held as stock-in-trade at the end of the year, is less than the aggregate of NRV of securities, no adjustment is required under this ICDS and stock shall be recognized at cost.

2. *Value of closing stock as per weighted average*

Equity shares	*No. of shares remaining*	*Cost per share (In Rs.)**	*Net Realisable Value (NRV)*	*Total Cost*	*Total NRV*
Wipro	140	102.50	125	14,350	17,500
Tata Steel	125	245	200	30,625	25,000
Infosys	175	147.27	160	25,772	28,000
Total	**440**			**70,747**	**70,500**

* The cost per share as per weighted average shall be calculated as per the following formula:

Weighted Avg. cost per share	=	Total cost incurred in 1st acquisition + Total cost incurred in 2nd acquisition + …….. and so on / Total no. of shares acquired

As the aggregate of NRV of securities, held as stock-in-trade at the end of the year, is less than the aggregate of the actual cost of acquisition. The stock shall be recognized at NRV, and the difference shall be allowed to be deducted as a marked-to-market loss while computing business income.

8.4 VALUATION OF STOCK IN SPECIAL CASES

8.4-1. Securities not acquired from market

A trader or broker may consider his investment as stock-in-trade or a partner may introduce his investment as capital contribution in a share broking firm. As such securities have not been acquired from the market, on the date such securities are added in the ledger of stock-in-trade, the valuation of such securities shall be computed as per specific provisions of the Income-tax Act.

8.4-1a. Conversion into stock-in-trade

Where a capital asset is converted or treated by the owner as stock-in-trade of the business carried on by him, such conversion is treated as a transfer of a capital asset in the year of conversion itself. However, the capital gain arising therefrom is charged to tax in the previous year in which such stock-in-trade is sold. In view of Section 45(2) of the Income-tax Act, to calculate the capital gains on such conversion, the fair market value of such asset on the date of conversion is deemed as sales consideration arising from the transfer of such asset. The same fair market value is considered as the actual cost of the stock-in-trade arising from the conversion of a capital asset.

8.4-1b. Introduction of investment as a capital contribution

When a new partner (or member) is introduced in a partnership firm (or AOP or BOI) and he introduces a capital asset in the firm as his capital contribution, he is deemed to have transferred the ownership of such capital asset to the firm. In view of Section 45(3) of the Income-tax Act, to calculate the capital gains in such case, the amount recorded in the books of accounts of the firm, in respect of such contribution is deemed as the full value of the consideration received by the partner as a result of a transfer of the capital asset. If the firm treats such capital contribution as stock-in-trade, the value of such stock shall be the amount so recorded by the firm in its books of account.

8.4-2. Opening Stock of Securities

The closing stock of a year is the opening stock of next year. Thus, the value placed by the assessee on the closing stock of a year should be adopted by him as the value of the opening stock of next year. Thus, where an assessee values his closing stock in a year at cost or NRV, whichever is *less*, he cannot be permitted to value his opening stock next year at cost price.

8.4-3. In case of dissolution of a firm

As per ICDS-II (Valuation of Inventories), in case of dissolution of a partnership firm or AOP or BOI, the inventories shall be valued at the net realisable value on the date of dissolution, irrespective of the fact the business is discontinued or not. Thus, where the business of the firm is taken over by a partner without discontinuance, the value of the closing stock, for the purpose of determining the income of the firm up to the date of dissolution, shall be deemed to be its market value.

8.5 DETERMINATION OF ACTUAL COST OF SECURITIES

8.5-1. Actual cost of securities purchased

As per Section 145A of the Income-tax Act, where securities are held as inventories, the value thereof shall be calculated in accordance with the following:

a) Securities not listed on a recognised stock exchange, or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised in accordance with ICDS-VIII;
b) Other securities shall be valued at lower of actual cost or net realisable value in accordance with ICDS-VIII.

As per ICDS-VIII, where any security is acquired by way of purchase, the actual cost shall be aggregate of the purchase price and other directly attributable acquisition charges such as brokerage, fees, taxes, duty or cess. If security is acquired in exchange of any other security or asset, the actual cost shall be the fair value of the security which has been acquired. Fair value of security refers to the amount for which the asset could be exchanged between knowledgeable parties at an arm's length transaction.

ICDS-VIII does not provide any guidance on how the indirect cost should be attributed and added to the actual cost of the securities held as stock-in-trade. Thus, the general accounting principles can be referred to for such attribution. As per the principles mentioned in Accounting Standard-2 (*Inventories)*, the indirect cost shall be bifurcated on some appropriate basis. Thus, indirect costs, which are not directly attributable to any particular security, can be allocated on an appropriate basis such as the value of securities, number of securities, time period, etc.

***Example 5*,** Mr A acquired the following securities:

Equity Shares	*No. of shares*	*Rate per share (In Rs.)*	*Total Value (in Rs.)*
A Ltd.	100	100	10,000
B Ltd.	250	50	12,500
C Ltd.	150	15	2,250

D Ltd.	500	20	10,000
X Ltd.	50	150	7,500
Y Ltd.	100	25	2,500
Total			**44,750**

In respect of these acquisitions, the taxpayer has taken the advice from a consultant and paid consultancy fees at the rate of 10% of the total value of the portfolio i.e. Rs. 4,475. He also pays the security transaction tax at the rate of 0.1% on the value of each transaction.

For calculation of the actual cost of the securities, the directly attributable cost shall be taken on an actual basis and the indirect expenses shall be allocated on some reasonable basis (i.e., the value of securities acquired). Thus, the actual cost of these securities shall be determined in the following manner:

Equity Shares	*Cost of Acquisition*	*STT at the rate of 0.1%*	*Advisory fee at the rate of 10%*	*Actual cost of shares*
A Ltd.	10,000	10	1,000	11,010
B Ltd.	12,500	12.50	1,250	13,762.50
C Ltd.	2,250	2.25	225	2477.25
D Ltd.	10,000	10	1,000	11,010
X Ltd.	7,500	7.50	750	8,257.50
Y Ltd.	2,500	2.50	250	2752.50

8.5-2. Securities acquired on partition of HUF or by gift or inheritance

As per Section 43C(2) of the Income-tax Act, where securities are acquired by the assessee on the total or partial partition of a HUF or under a gift or will or an irrevocable trust, and it is sold by the assessee as stock-in-trade, the cost of acquisition of such securities in the hands of the assessee shall be the cost of acquisition of the said securities to the transferor or the donor, as the case may be. This actual cost shall be increased by the cost of any improvement made thereto. Further, the expenditure, if any, incurred, wholly and exclusively in connection with such transfer shall also be added to the cost of acquisition.

8.5-3. Securities acquired in a scheme of amalgamation

As per Section 43C(1) of the Income-tax Act, where securities are acquired by the assessee, an amalgamated co., under a scheme of amalgamation, and it is sold by the assessee as stock-in-trade, the cost of acquisition of such securities in the hands of the assessee shall be the cost of acquisition of the said securities to the amalgamating co. (transferor). This actual cost shall be increased by the cost of any improvement made thereto. Further, the expenditure, if any, incurred, wholly and exclusively in connection with such transfer shall also be added to the cost of acquisition.

8.5-4. Securities acquired in cash

As per Section 40A(3) of the Income-tax Act, no deduction is allowed for an expenditure, even if it is deductible under any other provision if payment (or aggregate of payments) for such expenditure to a person in a day exceeds Rs. 10,000 and it is made by any mode other than account payee cheque or bank draft or electronic clearing system through a bank account or prescribed electronic modes. Thus, if consideration for the purchase of securities (held as stock-in-trade) are not made through the prescribed mode of payment, the amount so paid in contravention shall be disallowed while computing the business income.

8.6 COMPUTATION OF BUSINESS INCOME

An assessee has two options to pay tax on business income. Under the first option, he can compute taxable income based on books of account. The second option is a presumptive tax scheme wherein the income will be estimated at a prescribed percentage or amount based on total turnover or gross receipts. The computation of income under normal provisions of the Income-tax Act and on a presumptive basis have been explained below.

8.6-1. Computation as per normal provisions

The business income under the normal provision shall be computed in the following manner:

Particulars	*Amount*
Aggregate of:	
1. Revenue receipts	xxx
2. Capital receipts which are specifically covered	xxx
Less:	
1. Revenue Expenditures	xxx
2. Capital Expenditures which are specifically allowed as deduction	xxx
3. Depreciation	xxx
4. Expenditures allowed on payment basis	xxx
5. Expenditures allowed on fulfilment of certain conditions	xxx
Taxable Income from business or profession	**xxx**

The advantage of not computing income on a presumptive scheme is that a person can claim a deduction of all the expenses incurred in connection with the sale or purchase of securities. Following are some of the expenses that can be claimed when real income is computed on basis of books of account:

a) Brokerage, exchange charges, stamp duty, security transaction tax and all other taxes;
b) Internet or telephone charges;
c) Depreciation on computer/other electronics;
d) Office rent;

e) Staff salary;
f) Advisory fee, etc.

These expenditures shall not be allowed to be deducted while computing the income on a presumptive basis.

Example 6, Mr A is engaged in the trading of shares and derivatives. He entered into the following transactions during the financial year:

Security	*Type of Transaction*	*Qty.*	*Buy Value*	*Sell Value*	*Buy Average*	*Sell Average*	*Realized P&L*
Tata Motors	Intra-day	10,000	862,000	926,000	86.2	92.6	64,000
IOC	Futures	12,000	16,27,200	15,00,000	135.6	125	(-) 127,200
ONGC	Call	99,000	12,87,000	13,86,000	13	14	99,000
BHEL	Put	300,000	11,70,000	11,16,000	3.9	3.72	(-) 54,000
Tata Steel	Intra-day	1,500	840,000	720,000	560	480	(-) 120,000
SAIL	Futures	25,000	10,85,000	11,00,000	43.4	44	15,000
Reliance	Futures	5,000	49,00,000	57,50,000	980	1150	850,000
					Realized Profit		**726,800**

He paid the following charges in respect of intra-day and derivative transactions:

Transaction charges	*Intra-day*	*Derivative*
Brokerage	184	1,656
Exchange Transaction Charges	174	1,564
Integrated GST	70	630
SEBI Turnover Fees	12	108
Securities Transaction Tax	3,570	32,130
Stamp Duty	377	3,398

Total	**4,387**	**39,486**

Compute the amount of income chargeable to tax in the hands of Mr A.

Answer

The profit and loss arising to Mr A from trading in shares and derivatives shall be computed as follows:

Particulars	*Intra-day*	*Derivative*
Turnover [Aggregate of income and loss]	184,000	11,45,200
Gross Profit [Sale – Purchase]	(-) 56,000	782,800
Less:		
Expenses	4,387	39,486
Net Profit/(Loss)	**(-) 60,387**	**743,314**

As intra-day trading is treated as a speculative transaction, loss of Rs. 60,387 arising from such transaction shall not be allowed to be set-off from the income of Rs. 743,314 arising from derivative transactions being normal business income. Thus, the amount of income chargeable to tax in the hands of Mr X for the relevant financial year shall be Rs. 743,314. Further, the speculative loss of Rs. 60,387 shall be carried forward up to a period of four assessment years for set-off against income from speculative transactions.

8.6-2.Computation under presumptive scheme

Section 44AD of the Income-tax Act allows small businessmen to offer their income to tax on a presumptive basis. A person opting for a presumptive taxation scheme is not required to maintain the books of accounts and get them audited. However, he shall not be allowed to claim a deduction of any expenses, whether revenue or capital expenditure, while computing his income. The business income under the presumptive scheme is computed in the following manner:

Particulars	*Amount*
Total turnover or gross receipts of business or profession (A) Percentage at which presumptive income shall be computed (B)	xxx xxx
Presumptive Income from business or profession [C = A * B]	**xxx**

The presumptive taxation scheme of Section 44AD can be opted by an eligible person (a resident Individual, HUF and partnership firm) if the turnover from the business during the relevant previous year does not exceed Rs. 2 crores. However, the limit of Rs. 2 crores shall be increased to Rs. 3 crores[98] if the amount or aggregate of the amount of cash received during the previous year does not exceed 5% of the total turnover or gross receipts of such year. It is also expressly provided that receipts through the mode of cheque or a bank draft which is not an account payee shall be considered a receipt in cash.

As per this scheme, 8% of total turnover from business is deemed as presumptive income. However, where the payment is received by an account payee cheque or bank draft or ECS or through other prescribed electronic modes during the previous year or before the due date of furnishing return of income, the presumptive income on that portion shall be 6%. As in case of the securities market, all transactions are made through a bank account, the presumptive income shall be 6% of the turnover.

As per section 44AD of the Income-tax Act, an eligible person can opt for a presumptive taxation scheme in respect of any business except where the person is engaged in any agency business or earning income in the nature of commission or brokerage. Section 44AD does not exclude speculative business from its scope. However, a person opting for a presumptive taxation scheme is required to file his return of income under ITR-4 and in the instruction relating to filing of such return, it has been specifically mentioned that income from speculative business shall not be computed under section 44AD. Hence, even though section 44AD does not specifically exclude speculative business from its scope but the department does not provide the benefit of a presumptive taxation scheme in case of speculative business.

8.7 SET OFF AND CARRY FORWARD OF BUSINESS LOSS

Income-tax Act provides distinct provisions for set-off and carry forward of speculative loss and non-speculative loss which are as follows:

8.7-1. Intra-head Adjustment

If there are several sources of income, falling under the same head of income, the loss from one source of income may be set-off against the income from another source, falling under the same head of income.

For example, loss from one business can be set off against the income from another business.

However, losses from speculative business (i.e., loss from intra-day trading) can be set-off only against speculative profits (i.e., profit from intra-day trading). These losses cannot be set off against normal business profits, though both of them fall under the same head 'profits and gains of business or profession'. However, losses from a normal business can be adjusted against the profits of a speculative business.

[98] Amendment made by the Finance Act, 2023 with effect from assessment year 2024-25.

8.7-2.Inter-head Adjustment

Where after intra-head adjustment the net result under a head of income is a loss, the same can be set-off against the income from other heads in the same previous year.

For example, business losses can be set off against income taxable under the head Income from house property. However, there are some exceptions to the rule of inter-head adjustment.

8.7-2a. Exception 1: No Set-off against Salary Income

Business loss cannot be set off against the income assessable under the head salaries.

8.7-2b. Exception 2: Speculation Loss

Speculative losses cannot be set off against income taxable under any other head, i.e., salaries, house property, capital gains and other sources. These losses can be set off only against income from speculative business.

8.7-2c. Exception 3: Loss from specified business

Losses from specified business as referred to in Section 35AD cannot be set off against income taxable under any other head. These losses shall be set off against income from the specified business only.

8.7-2d. Exception 4: No set-off of losses against certain incomes

Business loss (whether speculative or non-speculative) or unabsorbed depreciation cannot be set-off against the following incomes:

(a) Undisclosed income found during search/survey [Section 79A];

(b) Income from gambling activities [Section 115BB]

(c) Unexplained income [Section 115BBE];

(d) Income from transfer of virtual digital asset [Section 115BBH]; and

(e) Specified income of trust or institutions [Section 115BBI]

(f) Winnings from online games (if such winnings are from the lottery, crossword puzzle, race, horse race, card game, other game of any sort, gambling or betting) [Section 115BBJ]

8.7-3. ***Carry Forward of Losses***

8.7-3a. Non-speculative Losses

If the loss from non-speculative business cannot be set-off against income taxable under the same head and income taxable under another head within the same previous year, such unabsorbed loss shall be allowed to be carried forward to set-off against any business income (i.e., income from speculative, non-speculative or specified business) of subsequent years. The losses can be carried forward for 8 Assessment Years immediately following the year for which the loss was first computed. Carried forward a loss from non-speculative business can be set off against any business income of subsequent years. However, it cannot be set-off against income taxable under any other head in subsequent years.

For example, if business loss relates to the Assessment Year 2019–20, it can be carried forward for 8 Assessment Years, that is, up to Assessment Year 2027–28.

8.7-3b. Speculative Loss

Income-tax Act has applied different yardsticks for speculation losses and business losses, though both of them fall under the same head of income. If losses from a speculative business could not be set off from the similar income of the same assessment year, it can be carried forward to be set-off against speculative income of the future years. Such losses can be carried forward for 4 Assessment Years immediately following the year for which the loss was first computed.

8.7-4. Summary

Type of Loss	*How to Set-off the loss?*	*Adjustment Against*	*Time Limit*
Non-speculative Business Loss	Intra-head Adjustment of loss	Any Business Income, i.e., speculative or non-speculative business income	Same Year
Non-speculative Business Loss	Inter-head Adjustment of loss	Any Income except salary income and other specified incomes	Same Year
Non-speculative Business Loss	Carried Forward Losses	Any Business Income, i.e., speculative or non-speculative business income	Within 8 Years
Speculative Business Loss	Intra-head Adjustment of loss	Speculative Business Income	Same Year
Speculative Business Loss	Inter-head Adjustment of loss	Not Allowed	-
Speculative Business Loss	Carried Forward Losses	Speculative Business Income	Within 4 Years

8.7-5. Condition to carry forward the loss

The assessee is entitled to carry forward the business loss provided the return of income is filed on or before the due date. If such return is not filed within the prescribed due date, the right to carry forward and set off such loss is lost. However, Intra-head adjustment of losses, Inter-head adjustment of losses and unabsorbed depreciation during the current year shall not be impacted even if the return is not filed on or before the due date. If assessee failed to file the return on time, he can apply to the Assessing Officer (AO) or the CBDT for condonation of delay in filing of return of income.

8.8 INCOME COMPUTATION AND DISCLOSURE STANDARDS

The CBDT has notified Income Computation and Disclosures Standards or ICDS for computation of taxable income. To date, 10 ICDS have been notified which are applicable from Assessment Year 2017-18. ICDS are applicable only for computation of taxable income and not for maintenance of books of account.

8.8-1. About ICDS

In exercise of the powers conferred by Section 145(2) of the Income-tax Act, 1961, the Central Government has notified the Income Computation and Disclosure Standards (also referred to as ICDS). ICDSs have been issued to bring uniformity in the accounting policies governing computation of income for taxability under the Income-tax Act and to reduce the litigations.

8.8-2. Applicability

Every assessee earning income taxable under the head 'Profit and gains from business or profession' or 'Income from other sources' or both is required to compute taxable income in accordance with notified ICDS. However, the ICDS shall be followed only if the assessee is maintaining accounts as per the 'Mercantile system' of accounting.

There is no threshold limit on the amount of turnover or taxable income for the applicability of ICDS. Thus, every assessee earning business income or residuary income shall be required to follow ICDS for computation of income. The applicability of ICDS shall be subject to certain exceptions.

The CBDT has clarified that the general provisions of ICDS shall apply to all persons including banks, NBFCs, insurance companies, etc. unless there are sector-specific provisions contained in the ICDS or the Act. For example, ICDS-VIII (Securities) contains specific provisions for banks and certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business.

Exception 1: Exemption to certain assessees

Following assessees are not required to comply with the requirements of ICDS:

(a) An individual or HUF who is not required to get his books of account, of the previous year, audited under section 44AB; and
(b) Any assessee who has opted for a presumptive taxation scheme.

However, the CBDT has clarified that the relevant provisions of ICDS shall also apply to the persons computing income under the presumptive taxation scheme. *For instance*, for computing the presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.

Exception 2: Exemption for MAT Computation

The CBDT has clarified that the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, thus, the provisions of ICDS shall not apply for computation of MAT. However, where the assessee is liable to pay AMT under the provisions of Section 115JC, the provisions of ICDS shall be applicable for computation of AMT.

8.8-3. ICDS & Income-tax Act

ICDSs have to be applied for the purpose of computation of business income only and an assessee is not required to maintain books of accounts as per these standards. In the event of a conflict between the provisions of the Act or Rules and ICDS, the provisions of the Act or Rule, as the case may be, shall prevail over ICDS.

8.8-4. Notified ICDS

The CBDT has notified the following 10 Income Computation and Disclosure Standards:

2. ICDS 1: Accounting Policies
3. ICDS II: Valuation of inventories
4. ICDS III: Construction contracts
5. ICDS IV: Revenue Recognition
6. ICDS V: Tangible fixed assets
7. ICDS VI: The effects of change in Foreign exchange rates
8. ICDS VII: Government Grants
9. ICDS VIII: Securities
10. ICDS IX: Borrowing costs
11. ICDS X: Provisions, Contingent liabilities and Contingent Assets

These ICDS are applicable with effect from April 1, 2016. Thus, income taxable for the Assessment Year 2017-18 onwards shall be computed in accordance with these ICDS.

Review Questions

1. **Which of these are Income are NOT taxable as per method of accounting?**

   (*a*) Dividend Income

   (*b*) Interest Income

   (*c*) Interest on Income-tax refund

   (*d*) All of these

2. **Which of the following expenses can be claimed when real income is computed on basis of books of account?**

   (*a*) Brokerage, exchange charges, stamp duty, security transaction tax & other taxes

   (*b*) Office rent

   (*c*) Depreciation on computer/other electronics

   (*d*) All of these

3. **Non-speculative business losses can be carried forward and set-off against business income within**

   (*a*) Within 8 years

   (*b*) the same year only

   (*c*) Within 10 years

   (*d*) Within 5 years

4. **Payment of commodity transaction tax (CTT) does not apply in case of**

   (*a*) Agricultural commodity derivatives

   (*b*) Oil derivatives

   (*c*) Metal derivatives

   (*d*) Index Derivatives

CHAPTER 9: TAXATION IN THE HANDS OF INTERMEDIARIES

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Taxes paid by the different Securities Market Intermediaries

Intermediaries occupy an essential space in today's capital market. Market intermediaries operate as a bridge between capital providers and capital seekers. Any person operating in the capital market other than investor & issuer is an intermediary.

9.1 WHO IS AN INTERMEDIARY?

The intermediary has been defined in the SEBI (Intermediaries) Regulations, 2008. This definition covers the following persons:

a) Stock-brokers and sub-brokers
b) Share transfer agents
c) Bankers to an issue
d) Trustees of trust deeds
e) Registrars to an issue
f) Merchant bankers
g) Underwriters
h) Portfolio managers
i) Investment advisers
j) Depositories and depository participants
k) Custodians of securities
l) Foreign Institutional Investor
m) Credit rating agencies and such other intermediaries as notified by the Board
n) Asset management companies
o) Clearing members of clearing corporation or clearing house
p) Foreign Portfolio Investors
q) Trading member of derivative segment or currency derivative segment
r) Any other intermediary who may be associated with securities markets in any manner

The intermediary regulation excludes explicitly the following persons from the definition of intermediary:

a) Foreign Venture Capital Investors
b) Mutual Funds
c) Collective Investment Scheme
d) Venture Capital Funds

For the meaning of persons covered in the definition of intermediaries *see Para 1.2-2* of Chapter-1.

9.2 TAXATION OF MARKET INTERMEDIARIES

There are no separate provisions for taxation of income of intermediaries except in the case of FPIs (*see Chapter 10 for taxability of FPIs*). Thus, the income of an intermediary shall be taxed as per the general provisions of the Income-tax Act. The income earned by the market intermediaries, which is generally in the nature of commission income, fees or brokerage, is treated as the business income and taxable under the head 'Profit and gains from business or profession'. However, if intermediaries hold some securities as an investment, the gain or loss arising therefrom shall be taxable under the head capital gains *(see Chapter 3 to know more about Capital Gains)*.

Various provisions of the Income-tax Act which are relevant for the Intermediaries have been discussed below.

9.2-1. Determination of business income

The business income shall be computed in accordance with the method of accounting regularly followed by the intermediary. For the computation of business income, a taxpayer can follow either the mercantile system of accounting or cash basis of accounting.

Income-tax Act allows small and medium enterprises to compute income from business or profession on a presumptive basis. Thus, a person earning business income has an option to declare his income in accordance with the presumptive taxation scheme or to declare his income in accordance with normal provisions prescribed under Section 28 to Section 44DB. However, Section 44AD specifically prohibits an assessee from opting presumptive taxation scheme in respect of commission or brokerage income.

Where an assessee is carrying on the following professions, he can opt for the presumptive taxation scheme of Section 44ADA:

a) Legal
b) Medical
c) Engineering
d) Architectural
e) Technical Consultancy
f) Interior decoration
g) Film artist
h) Authorized Representative
i) Accountancy Profession
j) Company secretary
k) Information Technology

Security market intermediaries do not have an option to declare their income as per the presumptive taxation scheme if their income is in the nature of commission income or brokerage income. They have to compute the income in accordance with the general provisions prescribed under section 28 to section 44DB. The method for computation of business has been enumerated below.

Particulars	*Amount*
Aggregate of:	
1. Revenue receipts	xxx
2. Capital receipts which are specifically covered	xxx
Less:	
6. Revenue Expenditures	xxx
7. Capital Expenditures which are specifically allowed as deduction	xxx
8. Depreciation	xxx
9. Expenditures allowed on payment basis	xxx
10. Expenditures allowed on fulfilment of certain conditions	xxx
Taxable Income from business or profession	**xxx**

9.2-2 Payment of advance tax

Section 208 of the Income-tax Act provides that if the estimated tax liability of an assessee during a financial year is Rs. 10,000 or more, he is liable to make payment of advance tax. To determine the tax payable by way of advance tax, the assessee is required to compute his estimated income for the financial year and the tax liability thereon.

Step 1: *Calculate the estimated total income of the previous year*

Estimated Income and Deductions	*Amount*
Normal income taxable as per applicable tax rate	xxx
Special income taxable as per special tax rate	xxx
Estimated Gross Total Income	***xxx***
Less:	
Deductions under Chapter VI-A	(xxx)
Estimated Net Taxable Income	***xxx***

Step 2: Calculate tax on the estimated total income of the previous year.

Particulars	*Amount*
Tax on income at normal rates	xxx
Tax on income at special rates	xxx

Tax on Total Income *Less:* Rebate under section 87A	*xxx* (xxx)
Tax after rebate *Add:* Surcharge	*xxx* xxx
Tax after surcharge *Add:* Health and Education Cess	*xxx* xxx
Gross tax liability *Less:* - MAT Credit or AMT Credit - Tax relief under Section 89 - Foreign tax credit under Section 90, 90A or 91	*xxx* (xxx) (xxx) (xxx)
Net tax liability *Less: Prepaid taxes* - TDS deducted - TCS collected	*xxx* (xxx) (xxx)
Total advance tax liability	***xxx***

The amount payable by way of advance tax is rounded off to the nearest multiple of Rs. 10. For this purpose, any part of the rupee, consisting of paisa, is ignored. Thereafter, where such amount is not a multiple of ten, and the last figure in that amount is five or more, such amount is increased to the next higher amount which is a multiple of ten. If the last figure of such amount is less than five, the amount is reduced to the next lower amount which is a multiple of ten.

For example, the tax payable of Rs. 15,493 shall round down to Rs. 15,490 and tax of Rs. 15,495.01 shall be round up to Rs. 15,500.

Advance tax is required to be paid in four instalments as follows:

Due date for payment of advance tax	*Advance tax to be payable*
On or before June 15 of the previous year	Not less than 15% of advance tax
On or before September 15 of the previous year	Not less than 45% of advance tax
On or before December 15 of the previous year	Not less than 75% of advance tax
On or before March 15 of the previous year	100% of advance tax

Any tax paid, on or before 31st March, shall also be treated as advance tax paid during the financial year.

Where an assessee declares his business or professional income in accordance with the presumptive tax scheme of Section 44AD or Section 44ADA, he is not liable to discharge his advance tax liability in accordance with aforesaid instalments. He can discharge the whole amount of his advance tax liability on or before March 15th of the previous year. Thus, he can pay 100% of advance tax in a single instalment on or before March 15 of the previous year.

9.2-3 Deduction of tax at source

The concept of Tax Deducted at Source, commonly known as TDS or withholding tax, has been introduced to ensure regular flow of revenue to the Government. The payer of income is required to deduct tax from certain payments at the prescribed rates and deposit it to the credit of the Central Government within the prescribed time. The provisions of TDS have been summarized in the below table.

Overview of TDS							
Section	*Nature of Income*	*Payer*	*Payee*	*Rate of TDS*			*Time of Deduction*
				If PAN is furnished	*If PAN is not furnished*	*If return is not furnished*	
(a)	*(b)*	*(c)*	*(d)*	*(e)*	*(f)*	*(g)*	*(h)*
193	Interest on Securities	Every Payer	Resident Person	10%	20%	20%	At the time of credit or payment, whichever is earlier
194	Dividend	Indian Company or specified non-Indian company	Resident Person	10%	20%	20%	At the time of payment or distribution, whichever is earlier
194A	Interest other than interest on	Any person *(Refer note 3)*	Resident Person	10%	20%	20%	At the time of credit or payment,

	Securities						whichever is earlier
194D	Insurance Commission	Every Payer	Resident Person	▪ 10% - If deductee is a domestic company ▪ 5% - In other cases	20%	-20% - If deductee is a domestic company -10%-In other cases	At the time of credit or payment, whichever is earlier
194EE	Payment in respect of deposits under National Saving Scheme	Every Payer	Any Person	10%	20%	20% [Note 1]	At the time of payment
194F	Repurchase of Units by Mutual Fund or UTI	Every Payer	Any Individual or HUF	20%	20%	40% [Note 1]	At the time of payment
194H	Commission and Brokerage	Any person *(Refer note 3)*	Resident Person	5%	20%	10%	At the time of credit or payment, whichever is earlier
194J	Royalty and Fees for Professio	Any person *(Refer note 3)*	Resident Person	▪ 2%: If the sum is payable towards	20%	▪ 5%: If the sum is payable towards	At the time of credit or

	nal or Technical Services			royalty income arising to a person by way of sale, distribution or exhibition of cinematographic films ▪ 2%: If the recipient is engaged in business of operation of call Centre ▪ 2%: If the sum is payable towards fees for technical services (other than professional services) ▪ 10%: In all other cases		royalty income arising to a person by way of sale, distribution or exhibition of cinematographic films ▪ 5%: If the recipient is engaged in business of operation of call Centre ▪ 5%: If the sum is payable towards fees for technical services (other than professional services) 20%: In all other cases	payment, whichever is earlier
194K	Income in respect of units	Any person	Resident person	▪ 10%	20%	20%	At the time of credit or

	of mutual fund						payment, whichever is earlier
194LB	Interest from Infrastructure Debt Fund	Any Person	Non-resident Person	5%	20%	10% [Note 1]	At the time of credit or payment, whichever is earlier
194LBA	Income distributed by a Business Trust	Real Estate Investment Trust (REIT) or Infrastructure Investment Trust (InVITs)	Any person who is a unit holder	▪ 10%: If the recipient is resident in India ▪ 5%: If the recipient is non-resident and payment is in nature of interest ▪ 10%: If the recipient is non-resident and payment is in nature of dividend ▪ Rates in force[99]: If the	▪ 20%: If the recipient is resident in India ▪ 20%: If the recipient is non-resident and Payment is in nature of interest and dividend ▪ Rates in force: If	▪ 20%: If the recipient is resident in India ▪ 10%: If the recipient is non-resident and payment is in nature of interest ▪ 20%: If the recipient is non-resident and payment is in nature of dividend ▪ Twice of rate in force: If	At the time of credit or payment, whichever is earlier

99 'Rate or rates in force' means the rate or rates of income-tax as specified for deduction of tax in this behalf in the Finance Act of the relevant year or the rate or rates of income-tax specified in DTAA, whichever is *lower*.

				recipient is non-resident and payment is in nature of rent	the recipient is non-resident and payment is in nature of rent	the recipient is non-resident and payment is in nature of rent *[Refer Note 1]*	
194LBB	Income in respect of units of Category I or Category II Alternative Investment Fund (AIFs)	Any Person	Any person who is a unit holder	▪ 10%: If the recipient is resident in India ▪ Rates in force: If the recipient is a non-resident	▪ 20%: If the recipient is resident in India ▪ Rates in force or 20%, whichever is higher: If the recipient is a non-resident	▪ 20%: If the recipient is resident in India ▪ Twice of rates in force: If the recipient is a non-resident *[Refer Note 1]*	At the time of credit or payment, whichever is earlier
194LBC	Income in respect of investment in Securitization Trust	Any Person	Any person who is a unit holder	▪ 25%: If the recipient is a resident individual or HUF ▪ 30%: If the recipient is any other	▪ 25%: If the recipient is a resident individual or HUF ▪ 30%: If the	-	At the time of credit or payment, whichever is earlier

				resident person ▪ Rates in force: If the recipient is a non-resident	recipient is any other resident person ▪ Rates in force or 20%, whichever is higher: If the recipient is a non-resident		
194LC	Income by way of Interest in respect of foreign borrowings	Indian Company or a Business Trust	Non-resident Person or foreign company	▪ Interest payable in respect of long-term bond or rupee denominated bond- 4% if bonds are issued between 1-4-2020 and 30-6-2023 and 9% if bonds are issued on or after 01-07-2023	20% (excluding payment of interest on long-term bonds)	▪ Interest payable in respect of long-term bond or rupee denominated bond- 8% if bonds are issued between 1-4-2020 and 30-6-2023 and 18% if bonds are issued on or after 01-07-2023	At the time of credit or payment, whichever is earlier

				▪ In any other case- 5%		▪ In any other case – 10% *[Refer Note 1]*	
194LD	Income by way of Interest on Rupee Denominated Bonds and Government Securities or municipal debt securities	Any Person	Foreign Institutional Investor or Qualified Foreign Investor	5%	20%	10% *[Note 1]*	At the time of credit or payment, whichever is earlier
194M	Payment to a contractor, commission agent, broker or professional by certain Individuals or HUF	Individual or HUF not liable for deduction under section 194C, 194H and 194J	Resident person	5%	20%	[Refer Note 1]	At the time of credit or payment, whichever is earlier
194N	Cash withdrawal	Banking company, co-operative bank or Post Office	Resident or Non-Resident	▪ 2%: In general, if cash withdrawn exceeds Rs. 1 crore (Rs. 3	20%	-	At the time of payment

				crores in case of co-operative society) ▪ 2%: If the assessee has not furnished return for the last 3 assessment years and cash withdrawn exceeds Rs. 20 lakhs but does not exceed Rs. 1 crore (Rs. 3 crores in case of co-operative society) ▪ 5%: If the assessee has not furnished return for last 3 assessment years and cash withdrawn exceeds Rs. 1 crore (Rs. 3 crores in case of co-			

				operative society)			
195	Long-term Capital Gains exceeding Rs. 1 lakh from the transfer of listed equity shares, units of an equity-oriented mutual fund or business trust as referred to in Section 112A	Any Person	Non-resident Person or foreign company	10%	20%	20%[Note 1]	At the time of credit or payment, whichever is earlier
195	Long-term capital gain from transfer of unlisted shares or shares of a closely held company	Any Person	Non-resident Person or foreign company	10%	20%	20%[note 1]	At the time of credit or payment, whichever is earlier

195	Long-term Capital Gains from transfer of specified assets by a non-resident Indian	Any Person	Non-resident Indian	10%	20%	20%[note 1]	At the time of credit or payment, whichever is earlier
195	Long-term Capital Gains from transfer of any other capital asset	Any Person	Non-resident Person or foreign company	20%	20%	40%[note 1]	At the time of credit or payment, whichever is earlier
195	Short-term Capital Gains from transfer of listed equity shares, units of an equity-oriented mutual fund or business trust on which Securitie	Any Person	Non-resident Person or foreign company	15%	20%	30%[Note 1]	At the time of credit or payment, whichever is earlier

	s Transaction Tax (STT) is paid						
195	Short-term Capital Gains from transfer of any other capital asset	Any Person	Non-resident Person or foreign company	▪ Foreign Company- 40% ▪ Other Non-resident person- 30%	▪ Foreign Company- 40% ▪ Other Non-resident person- 30%	▪ 80%: Foreign Company ▪ 60%: Other Non-resident person [Refer Note 1]	At the time of credit or payment, whichever is earlier
195	Interest income payable by Government or Indian concern on money borrowed or debt incurred in foreign currency (not being interest referred to in Section 194LB or	Any Person	Non-resident Person or foreign company	20%	20%	*See Note 1 & 2*	At the time of credit or payment, whichever is earlier

	Section 194LC)						
195	Income from foreign exchange assets payable to a non-resident Indian	Any Person	Non-resident Indian	20%	20%	*See Note 1 & 2*	At the time of credit or payment, whichever is earlier
195	Royalty [100]	Any Person	Non-resident Person or foreign company	10%	20%	*See Note 1 & 2*	At the time of credit or payment, whichever is earlier
195	Fee for technical services [101]	Any Person	Non-resident Person or foreign company	10%	20%	*See Note 1 & 2*	At the time of credit or payment, whichever is earlier
195	Dividend	Any Person	Any Non-resident	20%	20%	*See Note 1 & 2*	At the time of credit or payment, whiche

[100] Where royalty is payable by the Government or by an Indian concern under an agreement made after 31-03-1961 but before 01-04-1976, the tax shall be deducted at the rate of 50%.

[101] Where Fee for Technical Services is payable by the Government or by an Indian concern under an agreement made after 29-02-1964 but before 01-04-1976, the tax shall be deducted at the rate of 50%

							ver is earlier
195	Any other Income	Any Person	Non-resident Person or foreign company	▪ Foreign Company- 40% ▪ Other Non-resident person- 30%	▪ Foreign Company- 40% ▪ Other Non-resident person- 30%	*See Note 1 & 2*	At the time of credit or payment, whichever is earlier
196 A	Income in respect of units of mutual fund	Any person	Non-resident person	20% (Note 4A)	20%	40%[Note 1]	At the time of credit or payment, whichever is earlier
196B	Income or capital gain arising from units purchased in foreign currency	Any Person	Offshore Fund	10%	20%	20% [Note 1]	At the time of credit or payment, whichever is earlier
196C	Interest, dividend or capital gains arising from	Any Person	Non-resident Person	10%	20%	20% [Note 1]	At the time of credit or payment, whiche

	Bonds or GDRs						ver is earlier
196 D	Income payable in respect of securities to FIIs or specified funds	Any Person	FIIs or Specified Fund	▪ 20%: FIIs ▪ 10%: Specified fund	20%	▪ FIIs: See Note 4 ▪ 20%: Specified Fund [Refer Note 1]	At the time of credit or payment, whichever is earlier

Note 1: Section 206AB provides for deduction of tax at higher rates in case of non-filers of income-tax return. However, this provision does not apply in the following cases:

(a) Where sum (or income or amount) is paid (or payable or credited) to a non-resident who does not have a permanent establishment (PE) in India. PE includes a fixed place of business through which the business of the enterprise is carried on, whether wholly or partly; or

(b) A person who is not required to furnish a return of income for the specified period and is notified by the Central Government in this behalf; or

(c) If tax is deductible under the following provisions

Section	**Description**
194LBC	TDS on income in respect of investment in Securitization Trust
194M	TDS from payment to contractor, commission agent, broker or professional by certain Individuals or HUF
194N	TDS on Cash withdrawal

Note 2: Section 195 requires deduction of tax at source at the rate or rates in force. The term 'rate or rates in force' is defined under Section 2(37A). It provides that for the purpose of deduction of tax, *inter-alia*, under Section 195, the lower of the tax rates specified in this behalf in the Finance Act or the tax rates provided in the DTAA shall apply. The tax rates mentioned in the above table in column (e) are as per the Finance Act. If the tax rates provided under DTAA are lower than the rates provided in column (e) of the above table, the tax shall be deducted at the rates provided under the relevant DTAA. Where Section 206AB applies, the tax shall be deducted at twice the rate specified under the Finance Act [column (e)] or twice of the rate specified under DTAA, whichever is *lower*.

Note 3: The tax shall be deducted by an individual and HUF under these provisions if his total sales, gross receipts or turnover exceed Rs. 1 crore in case of business or Rs. 50 lakhs in case of the profession during the financial year immediately preceding the financial year in which sum is credited or paid.

Note 4: In case of FPIs, Section 196D provides that the tax shall be deducted at the rate of 20% or rate prescribed under DTAA, whichever is lower. If Section 206AB applies, the tax shall be deducted at the rate of 40% or twice of the rate specified under DTAA, whichever is lower.

Note 4A: With effect from 01.04.2023, the tax shall be deducted under Section 196A at the rate of 20% or rate prescribed under DTAA, whichever is lower. If Section 206AB applies, the tax shall be deducted at the rate of 40% or twice of the rate specified under DTAA, whichever is lower.

Note 5: Surcharge and Health & Education Cess

a) In case payment is made to a person, being a resident in India, rate of TDS prescribed above shall not be increased by the surcharge and education cess.
b) In case payment is made to a person, being a non-resident, rate of TDS prescribed above shall be further increased by the surcharge and education cess.

Type of assessee	*Income*	*Surcharge (as a % of TDS rate)*	*Health and Education Cess (as a % of TDS rate plus surcharge)*
Foreign company	Up to Rs. 1 crore	Nil	4%
	More than Rs. 1 crore but up to Rs. 10 crores	2%	4%
	More than Rs. 10 crores	5%	4%
Co-operative society	Up to Rs. 1 crore	Nil	4%
	More than Rs. 1 crore but up to Rs. 10 crores	7%	4%
	More than Rs. 10 crores	12%	4%
Firm/LLP/Local Authority	Up to Rs. 1 crore	Nil	4%
	More than Rs. 1 crore	12%	4%
Association of Persons (AOP) consists of only companies as its members	Up to Rs. 50 Lakh	Nil	4%
	More than Rs. 50 Lakh but up to Rs. 1 crore	10%	4%
	More than Rs. 1 crore	15%	4%

Others	Up to Rs. 50 lakhs (including dividend income and income referred to in Section 111A, Section 112 and Section 112A)	Nil	4%
	More than Rs. 50 lakhs but up to Rs. 1 crore (including dividend income and income referred to in section 111A, Section 112 and section 112A)	10%	4%
	More than Rs. 1 crore but up to Rs. 2 crores (including dividend income and income referred to in section 111A, Section 112 and section 112A)	15%	4%
	More than Rs. 2 crores but up to Rs. 5 crores (excluding dividend income and income referred to in section 111A, Section 112 and section 112A)	25%	4%
	More than Rs. 5 crores (excluding dividend income and income referred to in section 111A, Section 112 and section 112A)	37%*	4%
	More than Rs. 2 crores (including dividend income and income referred to in section 111A, Section 112 and section 112A)	15%	4%

*** From the assessment year 2024-25, where the person's income is chargeable to tax under Section 115BAC(1A), the surcharge rate shall not exceed 25%. Thus, the income exceeding Rs.

5 crores shall be subject to the surcharge rate of 25% instead of 37% in case of a new Section 115BAC(1A) tax regime.

9.2-4 Requirement to get accounts audited under Income Tax

A taxpayer is required to maintain books of account and get them audited. The requirement to maintain the books of account is prescribed under Section 44AA and the requirement to get them audited is mentioned in Section 44AB.

An assessee shall get the books of account audited if its gross turnover or receipts during the relevant previous year exceeds the prescribed threshold limit. If the threshold limit, as specified in the below table, is not crossed, the assessee shall not be required to get the books of account audited by a Chartered Accountant.

Following persons are compulsorily required to get their books of account audited by a Chartered Accountant:

Nature of Business or Profession	**Category of Taxpayer**	**When audit is mandatory?**
Any professions (specified or non-specified)	Any	If gross receipts from profession during the relevant previous year exceeds Rs. 50 lakhs
Business	Cash receipt and payment up to 5% (See Note 1)	If total sales, turnover or gross receipt from business during the previous year exceeds Rs. 10 crore
Business	Any	If total sales, turnover or gross receipt from business during the previous year exceeds Rs. 1 crore
Business eligible for Presumptive Tax Scheme under Section 44AD	Resident Individual or HUF	If income of assessee exceeds the maximum exemption limit and he has opted for the scheme in any of the last 5 previous years but does not opt for the same in current year.
Business eligible for Presumptive Tax Scheme under Section 44AD	Resident Partnership Firm	Taxpayer has opted for the scheme in any of the last 5 previous years but does not opt for the same in current year.

Profession eligible for Presumptive Tax Scheme under Section 44ADA	Resident Assessee	Taxpayer claims that his profits from profession are lower than the profits computed under Section 44ADA and total income exceeds the maximum exemption limit

Note 1: Following conditions are needed to be fulfilled:

(a) Cash receipts, including amount received for sales, turnover or gross receipts, does not exceed 5% of the aggregate amount received during the previous year; and

(b) Cash payments, including amount incurred for expenditure, does not exceed 5% of the aggregate amount paid during the previous year.

For the purpose of computing the limit of 5%, payment or receipt by a cheque drawn on a bank or by a bank draft, which is not account payee, shall be deemed to be the payment or receipt in cash.

The tax audit should be conducted by a Chartered Accountant who is in practice. Hence, intermediaries are required to get their tax audit done if their turnover exceeds the specified limit. The tax audit report has to be furnished in the forms as prescribed below:

Category of Taxpayer	*Form for Audit Report*	*Annexure to Audit Report*
If books of accounts of assessee are required to be audited under any other law	Form 3CA	Form 3CD
In any other case	Form 3CB	Form 3CD

It is mandatory to file the tax audit report before one month prior to the due date of furnishing return of income under section 139(1) i.e. by the following dates:

Situations	**Due date for filing of tax audit report**
If assessee is required to furnish a report of transfer pricing (TP) in Form No. 3CEB	Before 31st October of the relevant assessment year
In any other case	Before 30th September of the relevant assessment year

If any person fails to get his accounts audited or fails to furnish a report of tax audit as required under this provision, the penalty may be imposed under Section 271B. The penalty shall be one-half per cent of total sales, turnover or gross receipts, etc., or Rs. 1,50,000, whichever is less.

9.2-5 Filing of Return of Income

Return of income is the format in which the assessee furnishes information of his total income and tax payable. It is a declaration of income by the assessee in the prescribed format. An assessee is required to furnish the return of income within the due date specified under the Income Tax Act. There are different dates for different set of taxpayers.

The due dates for different class of taxpayers are as below:

Situations	*Due date for filing of return*
If assessee is required to furnish a report of transfer pricing (TP) Audit in Form No. 3CEB	30^{th} November
If assessee is a partner in a firm who is required to furnish a report of Transfer Pricing (TP) Audit in Form No. 3CEB	30^{th} November[102]
If an Individual is a spouse of a person, being a partner in a firm required to furnish a report of Transfer Pricing (TP) Audit in Form No. 3CEB, and the provisions of section 5A applies to such spouse.	30^{th} November[103]
Company assessee not required to furnish transfer pricing audit report in Form No. 3CEB	31^{st} October
If assessee is required to get its accounts audited under Income-tax Act or any other law	31^{st} October
If an individual is a partner in a firm whose accounts are required to be audited.	31^{st} October[104]
If an Individual is spouse of a person, being a partner in a firm whose accounts are required to be audited, and the provisions of section 5A applies to such spouse.	31^{st} October[105]
In any other case	31^{st} July

An assessee may file a revised return for any previous year at any time 3 month before the expiry of the relevant assessment year or before completion of the assessment, whichever is earlier. The last date to file the revised return (or belated return) is 31st December of the relevant Assessment Year.

[102] Inserted by the Finance Act, 2021, with effect from assessment year 2021-22
[103] Inserted by the Finance Act, 2021, with effect from assessment year 2021-22
[104] Inserted by the Finance Act, 2021, with effect from assessment year 2021-22
[105] Inserted by the Finance Act, 2021, with effect from assessment year 2021-22

Review Questions:

1. **Which one of these professionals can opt for the presumptive taxation scheme?**

   (*a*) Architects

   (*b*) Lawyers

   (*c*) Film Artists

   (*d*) All of these

2. **Advance tax is required to be paid in _______ instalments**

   (*a*) 4

   (*b*) 2

   (*c*) 6

   (*d*) 3

3. **How much percentage of advance tax has to be paid on or before December 15 of the previous year?**

   (*a*) At least 75% of advance tax

   (*b*) 100% of advance tax

   (*c*) At least 50% of advance Tax

   (*d*) At least 20% of advance Tax

4. **A business shall get accounts audited if turnover or receipts during the year exceeds ______________**

   (*a*) 1 crore

   (*b*) 5 crore

   (*c*) 80 lakhs

CHAPTER 10: TAXATION – IN THE HANDS OF FOREIGN PORTFOLIO INVESTORS (FPIS)

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Foreign Portfolio Investor
- Tax Treatment of different categories of FPIs for various instruments

10.1 MEANING OF FOREIGN PORTFOLIO INVESTOR

Regulation 2(j) of SEBI (Foreign Portfolio Investors) Regulations, 2019, defines 'Foreign Portfolio Investor (FPI)' as a person who has been registered under Chapter-II of the said Regulation, i.e., SEBI (Foreign Portfolio Investors) Regulations, 2019. An FPI is considered as an Intermediary (Also see *Para 9.1* for the meaning of Intermediary and *Para 1.2-2* for the definition of persons covered within the meaning of Intermediary)

10.1-1. Eligibility criteria for registration as FPI

Regulation 4 of the SEBI (FPI) Regulations, 2019 provides that an applicant should satisfy the following conditions to obtain a registration certificate as FPI:

a) The applicant should not be an Indian resident (*see Para 2.5* for the meaning of Residential Status);
b) The applicant should be a resident of a country whose security market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding or a signatory to bilateral Memorandum of Understanding with the SEBI. However, an applicant being Government or Government related investor shall be considered eligible for registration, if such applicant is a resident in the country as may be approved by the Government of India.
c) In case the applicant is a bank, it must be a resident of a country whose central bank is a member of the Bank for International Settlements. This condition is not applicable in case of an application made by a central bank.
d) The applicant should not be a non-resident Indian or an overseas citizen of India.
e) Non-resident Indians or overseas citizens of India or resident Indian individuals may be constituents of the applicant provided they meet the conditions specified by the Board from time to time.
f) Resident Indians (other than individuals) may also be constituents of the applicant in the following cases:

- Where the applicant is an eligible investment fund

  An eligible fund manager as referred to in section 9A of the Income-tax Act may be the constituents of an eligible investment fund as referred to in said section.

- Where the applicant is an Alternative Investment Fund

  Where the applicant is an Alternative Investment Fund (AIF) set up in the International Financial Services Centres (IFSC) and regulated by the International Financial Services Centres Authority, the sponsor or manager of such applicant may be the constituents thereof. However, the contribution of the sponsor or manager should be up to

  - 2.5% of the corpus of the applicant or US $ 7,50,000, whichever is lower, in case the applicant is a Category I or Category II AIF; or

  - 5% of the corpus of the applicant or US $ 1.5 million, whichever is lower, in case the applicant is a Category III AIF.

g) The applicant is a fit and proper person based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008.

h) The applicant or its underlying investors contributing 25% or more in the corpus of the applicant or identified on the basis of control, shall not be the person(s) mentioned in the Sanctions List notified from time to time by the United Nations Security Council and is not a resident in the country identified in the public statement of Financial Action Task Force as:
   - a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply, or
   - a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

i) any other criteria specified by SEBI from time to time.

The conditions specified above in point no. (a), (b), (c) shall not apply to an applicant incorporated or established in an International Financial Services Centre.

10.2 TAXABILITY UNDER THE HEAD CAPITAL GAINS

The securities held by the FPIs are always treated as capital assets (*see* definition of 'capital asset' in *para 3.1-1*). Thus, gains arising to the FPIs from the transfer of any securities shall be chargeable to tax under the head capital gains (see *Chapter 3* to know more about Capital Gains). Any dividend or interest income received from securities is chargeable to tax under the head 'Income from Other Sources' (see *Chapter 4* to know more about Income from Other Sources).

As FPIs are incorporated / set-up/ formed in foreign countries, their taxability in India is subject to double taxation avoidance agreements ('DTAAs') India has entered into with their respective countries. The DTAAs allocate the taxing rights between the source country and residence country. In almost all DTAAs, the right to levy a tax on the capital gains, arising from the transfer of securities, has been given to the country in which the company whose shares are transferred is incorporated. Thus, the capital gains arising to an FPI from the transfer of securities may be taxable in India under DTAAs, where India has been given the right of taxation. Further, the method of computation of capital gains shall be as prescribed under the provisions of the domestic taxation laws.

As per the Income-tax Act, any income arising from the transfer of a capital asset is chargeable to tax under the head 'Capital Gains'. A capital asset is defined under Section 2(14) of the Income-tax Act. It includes every property held by the assessee, whether movable or immovable.

To compute the capital gains in the hands of the FPIs, it is essential to first bifurcate securities into a short-term capital asset and long-term capital asset on the basis of the period of holding. This distinction is made because the incidence of tax is higher on short-term capital gains as compared to long-term capital gains. In general, a capital asset is deemed as 'short-term' if it is held by an assessee for a period of not more than 36 months, immediately preceding the date of its transfer. If a capital asset is held for more than 36 months then it is considered a long-term capital asset. However, there are a few exceptions wherein an asset, held for more than 12 months or 24 months, are treated as a long-term capital asset. To know more about the manner of computation of the period of holding *see para 3.3*.

The holding period for classification of securities into short-term or long-term has been enumerated in the following table:

Nature of Security	*Holding should be more than the following period to be treated as long term capital asset*	
	Listed Securities	*Unlisted Securities*
Equity Shares	12 months	24 months
Units of Equity Oriented Funds	12 months	12 months
Units of UTI	12 months	12 months
Units of Business Trust	36 months	36 months
Other Units	36 months	36 months
Preference Shares	12 months	24 months
Debentures	12 months	36 months
Government Securities	12 months	36 months
Zero-coupon bonds	12 months	12 months
Other Bonds	12 months	36 months

Other Securities	12 months	36 months

The provisions relating to computation of capital gains from transfer of securities has been discussed as per the following structure:

a) Long-term capital gains from specified securities
b) Long-term capital gains from other securities
c) Short-term capital gains from specified securities
d) Short-term capital gains from other securities

10.2-1. Long-term capital gain from specified securities

Up to Assessment Year 2018-19, the long-term capital gains arising from the transfer of securities, being equity shares, units of equity-oriented mutual funds, high premium ULIP[106] or units of business trust chargeable to Securities Transaction Tax (hereinafter referred to as 'specified securities'), were exempt from tax under Section 10(38) of the Income-tax Act, 1961. However, the Finance Act, 2018 has withdrawn this exemption by inserting a new Section 112A to the Income-tax Act, 1961 with effect from Assessment Year 2019-20.

As per Section 112A of the Income-tax Act, where the total income of an assessee includes long-term capital gain arising from the transfer of listed equity shares, units of an equity-oriented mutual fund, or units of business trust (hereinafter referred to as 'specified securities'), no tax shall be charged on such long-term capital gain if the aggregate amount of such gain during the year is up to Rs. 1,00,000. Where the amount of capital gain exceeds Rs. 1,00,000, the excess amount is chargeable to tax at a concessional rate of 10% without providing the benefit of indexation and foreign currency fluctuation. Further, assessee shall not be entitled to claim deduction under Chapter VI-A, (i.e., deduction under section 80C to 80U of the Income-tax Act) from such income.

10.2-1a. Payment of STT is an essential condition

The concessional tax regime of Section 112A is available only when Securities Transaction Tax (STT) (*see Para 1.4-2* for the rates of STT) is charged at the time of transfer of such securities. In the case of equity shares, there is an additional condition that STT should also be paid at the time of acquisition of such equity shares as well. However, this condition is subject to the following two exceptions.

a) Stock exchange is located in an IFSC

[106] ULIP to which exemption under section 10(10D) does not apply on account of applicability of *fourth and fifth proviso* thereof.

The condition of payment of STT shall not be applicable if the transfer of specified security is undertaken on a recognised stock exchange located in an International Financial Services Centre. This concession is available only when the consideration for such transfer is received or receivable in foreign currency.

b) CBDT gives relaxation in certain transactions

The concessional tax rate under Section 112A is available in case of transfer of equity shares if STT is chargeable both at the time of transfer and at the time of acquisition of shares. However, the CBDT[107] has relaxed this condition of payment of STT for equity shares acquired before 1-10-2004. Further, the notification provides a negative list of transactions of acquisition in respect of which the condition of 'STT being paid on acquisition and transfer' will not be applicable.

The negative list of transactions is as follows:

1. Acquisition of existing listed equity shares in a company (whose equity shares are not frequently traded on a recognised stock exchange of India) by way of a preferential issue if:
   (a) The acquisition has been approved by the Supreme Court, High Court, NCLT, SEBI or RBI;
   (b) The acquisition has been made by any non-resident in accordance with FDI guidelines issued by the Government of India;
   (c) The acquisition is done by a Category-I or Category-II Alternative Investment Fund or Venture Capital Fund (VCF) or a Qualified Institutional Buyer (QIB);
   (d) The acquisition is done through a preferential issue to which SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 does not apply.

2. Acquisition of existing listed equity share in a company (not entered through a recognised stock exchange in India) which has been made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 and:

   (a) Acquisition has been made through an issue of share by a company other than the issue referred to in clause (1) above;
   (b) The acquisition of shares is made by the scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;
   (c) The acquisition has been approved by the Supreme Court, High Court, NCLT, SEBI or RBI;
   (d) The acquisition is done under the ESOP or ESPS scheme framed under SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines,1999;

[107]Notification No. 60/2018, dated 01-10-2018

(e) The acquisition by any non-resident is in accordance with FDI guidelines issued by the Government of India;

(f) The acquisition of shares is made as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011;

(g) The acquisition is made from the Government;

(h) The acquisition is done by Category-I or Category-II Alternative Investment Fund or Venture Capital Fund (VCF) or a Qualified Institutional Buyer (QIB);

(i) The acquisition is made by mode of transfer referred to in Section 47 or Section 50B or Section 45(3) or Section 45(4) if the previous owner or transferor of such shares has acquired shares by any of the following modes:

- Acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue;
- Acquisition of existing listed equity share in a company is not made through a recognised stock exchange in India; or
- Acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with SEBI Act, 1992 and the rules made thereunder.

10.2-1b. Computation of cost of acquisition

After introducing the new tax regime under Section 112A, the tax is charged at the rate of 10% on the long-term capital gains arising from the transfer of specified securities. Due to the paradigm shift in the taxation scheme, an option is provided to the investors to replace the actual cost of acquisitions of the shares with the presumptive cost so that the burden of tax can be reduced. The presumptive cost of acquisition of shares shall be computed in the following manner:

a) For shares acquired before 01-02-2018

If equity shares or units were acquired on or before 31-01-2018, the cost of acquisition of such shares or units shall be *higher* of the following:

1. The actual cost of acquisition of equity shares/units; or
2. *Lower* of the fair market value of such securities as on 31-01-2018 or full value of the consideration received as a result of transfer of such securities.

The highest price of share/unit quoted on a recognized stock exchange as on 31-01-2018 is taken as fair market value. If there is no trading in such share/unit on such exchange on 31-01-2018, the highest price of such share/unit on a date immediately preceding 31-01-2018 when such share/unit was traded shall be the fair market value. In a case where a unit is not listed on a recognised stock exchange, the Net Asset Value of such unit as on 31-01-2018 is taken as fair market value.

However, the fair market value of following equity shares shall be an amount which bears to its cost of acquisition the same proportion as Cost Inflation Index for the financial year 2017-18 bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 01-04-2001, whichever is *later*:

(c) Shares are not listed on recognised stock exchange on 31-01-2018 but listed on such exchange on the date of transfer; or
(d) Shares listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31-01-2018 by way of transaction not regarded as transfer under Section 47.

In general cost of acquisition of the bonus shares are taken to be *nil*, however, if bonus shares are complying with the conditions prescribed in section 112A, the cost of acquisition shall be computed in the manner described above.

b) For shares acquired on or after 01-02-2018

The cost of acquisition of equity shares or units which are acquired on or after 01-02-2018 shall be computed as per general provision (*See Para 3.6-5*)

10.2-2. Long-term capital gain from other securities

Long-term capital gain arising to an FPI from the transfer of any other security shall be computed as per general provisions. Such capital gains are taxable under Section 115AD at the rate of 10% without providing the benefit of indexation and foreign currency fluctuation. Further, FPIs shall not be entitled to claim any deduction under Chapter VI-A, (i.e., deduction under Section 80C to 80U of the Income-tax Act, 1961) from such capital gains.

10.2-3. Short-term capital gain from specified securities

Short-term capital gain arising from the transfer of specified securities, being equity shares, units of equity-oriented mutual fund or units of business trust chargeable to Securities Transaction Tax is chargeable to tax at the rate of 15% under Section 111A of the Income Tax Act, 1961 without providing the benefit of foreign currency fluctuation. Further, FPIs shall not be entitled to claim deduction under Chapter VI-A, (i.e., deduction under section 80C to 80U of the Income-tax Act, 1961) from such capital gains.

This provision applies only when Securities Transaction Tax (STT) (*see Para 1.4-2* for the rates of STT) is chargeable at the time of transfer of such securities. However, the condition of payment of STT at the time of transfer shall not be applicable if the transfer is undertaken on a recognised stock exchange located in an International Financial Services Centre. This concession is available only when the consideration for such transfer is received or receivable in foreign currency.

10.2-4. Short-term capital gain from other securities

Short-term capital gain arising to an FPI from the transfer of any other security shall be chargeable to tax at the rate of 30% under section 115AD without providing the benefit of foreign currency translation. Further, FPIs shall not be entitled to claim deduction under Chapter VI-A, (i.e., deduction under section 80C to 80U of the Income-tax Act, 1961) from such capital gains.

10.3 TAXABILITY OF DIVIDEND INCOME

As securities held by FPIs are always treated as a capital asset and not as stock-in-trade, any dividend income received in respect of such securities shall be taxable under the head 'Income from other sources'. After the abolition of the dividend distribution tax[108], the dividend income is taxable in the hands of the shareholders (see *Chapter 4* to know more about the Dividend Income).

For computation of income from other sources, a taxpayer can follow either a mercantile system of accounting or cash basis of accounting. However, the method of accounting employed by the assessee does not affect the basis of charge of dividend income as Section 8 of the Income-tax Act specifically provides that final dividend including deemed dividend shall be taxable in the year in which it is declared, distributed or paid by the company, whichever is earlier. Whereas, interim dividend is taxable in the previous year in which the amount of such dividend is unconditionally made available by the company to the shareholder. In other words, the interim dividend is chargeable to tax on receipt basis.

10.3-1. Taxability as per domestic law

The dividend income[109] earned by an FPI, in respect of securities other than units referred under Section 115AB, is chargeable to tax at a concessional rate of 20% under section 115AD of the Income Tax Act. However, where such dividend is received by the investment division of Offshore banking unit (as referred under *para 11.6-5a*), the tax shall be charged at the reduced rate of 10% under Section 115AD of the Income-tax Act. However, this benefit is

[108]Amended by the Finance Act, 2020 with effect from Assessment Year 2021-22

[109] The dividend income shall be chargeable to tax in the hands of FPIs only when dividend is distributed by the companies or mutual funds on or after 1-04-2020. Any dividend distributed prior to the said date shall attract dividend distribution tax in hands of company or mutual funds, and, consequently, exempt in hands of FPIs.

available in respect of the income which is attributable to the investment division of banking units.

The dividend income is charged to tax on a gross basis, without claiming a deduction for any expenses (including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend) incurred to earn such dividend income. Further, no deduction under Chapter VI-A, (i.e., deduction under section 80C to 80U of the Income-tax Act, 1961) shall be allowed from such dividend income.

10.3-2. Taxability as per DTAA

DTAAs allocates the taxing right to the source country to levy a tax on the dividend distributed or paid by the domestic company. Thus, the dividend declared by the Indian companies shall be taxable in India. However, the dividend income shall be taxable as per provisions of the Act or as per relevant DTAA, whichever is more *beneficial* to the FPIs.

As per most of the DTAAs India has entered into with foreign countries, the dividend is taxable in the source country in the hands of the beneficial owner of shares at the rate ranging from 5% to 15% of the gross amount of the dividends.

In DTAA with countries like Canada, Denmark, Singapore, the dividend tax rate may be reduced where the dividend is payable to a company holding a specific percentage (generally 25%) of shares of the other company paying the dividend. However, no minimum time limit has been prescribed in these DTAAs for which such shareholding should be maintained by the recipient company. Therefore, MNCs were often found misusing the provisions by increasing their shareholding in the company immediately before the dividend is declared and offloading the same after getting the dividend.

India is a signatory to the Multilateral Convention (MLI) which shall implement the measures recommended by the OECD to prevent Base Erosion and Profit Shifting. MLI is a binding international legal instrument which is envisaged with a view to swiftly implement the measures recommended by OECD to prevent Base Erosion and Profit Shifting in existing bilateral tax treaties in force. With respect to dividend income, Article 8 (Dividend Transfer Transactions) of MLI provides for a minimum period of 365 days for which a shareholder, receiving dividend income, has to maintain its shareholding in the company paying the dividend to get the benefit of the reduced tax rate on the dividend. However, this condition is applicable only if India and partner county have notified this clause. As of now 4 countries i.e., Canada, Montenegro, Slovak Republic and Slovenia have notified this clause.

10.4 TAXABILITY OF INTEREST FROM SECURITIES

Any income received by the FPIs in respect of securities (other than units referred under Section 115AB), not being dividend and capital gains, shall be taxable at the rate of 20% under Section 115AD of the Income-tax Act. However, where such interest is received by the investment division of Offshore banking unit (as referred under *para 11.6-5a*), the tax shall be charged at the reduced rate of 10% under Section 115AD. However, this benefit is available in respect of the income which is attributable to the investment division of banking units.

Further, where income by way of interest is received or receivable in respect of investment made by an FPI in Rupee-Denominated Bond of an Indian company, Government Securities or municipal debt securities, then tax shall be charged at the reduced rate of 5% under Section 115AD read with section 194LD of the Income Tax Act, 1961. However, the interest should be received or receivable on or after 01-06-2013, but before 01-07-2023 in case of Rupee Denominated Bonds or Government Securities. In respect of municipal debt securities, interest should be received or receivable on or after 01-04-2020, but before 01-07-2023.

The income from securities (including interest on Rupee-Denominated Bond of an Indian Company or Government Securities) is charged to tax on a gross basis without claiming a deduction for any expenses (including interest on loan taken for investing in such securities) incurred to earn such income. Further, no deduction under Chapter VI-A, (i.e., deduction under section 80C to 80U of the Income-tax Act, 1961) shall be allowed from such interest income.

DTAAs allocates the taxing right to the source country to levy a tax on the interest income earned from the securities. However, the interest income shall be taxable as per provisions of the Act or as per relevant DTAA, whichever is more *beneficial* to the FPIs. As per most of the DTAAs India has entered into with foreign countries, the interest is taxable in the source country in the hands of the beneficial owner of interest at the rate ranging from 10% to 20% of the gross amount of the interest.

10.5 DEDUCTION OF TAX AT SOURCE (TDS)

Any person responsible for paying any income to an FPI is liable to deduct tax therefrom as per Section 194LD, Section 196A, Section 196B and Section 196D of the Income-tax Act, 1961. The provisions relating to withholding tax are as follows:

10.5-1. TDS from interest on Rupee Denominated Bonds, Government Securities or Municipal Debt Securities

As per Section 194LD of the Income-tax Act, 1961, any person responsible for making payment of interest to a Foreign Institutional Investor or a Qualified Foreign Investor shall deduct tax therefrom. The tax under this provision shall be deducted from the following interest:

a) Interest payable from 01-06-2013 to 30-06-2023[110] in respect of the investment in Rupee Denominated Bond of an Indian company;
b) Interest payable from 01-06-2013 to 30-06-2023 in respect of the investment in Government Security; and
c) Interest payable from 01-04-2020 to 30-06-2023 in respect of the investment made in municipal debt securities[111].

The tax shall be deducted from interest in respect of rupee-denominated bonds at the concessional rate only if the rate of interest in respect of Rupee Denominated Bonds do not exceed the following rate notified[112] by the Central Government in this behalf:

a) In case of bonds issued before 01-07-2010, the rate of interest shall not exceed 500 basis points over the Base Rate of SBI as on 01-07-2010.
b) In case of bonds issued on or after 01-07-2010, the rate of interest shall not exceed 500 basis points over the Base Rate of SBI applicable on the date of issue of the said bonds.

Tax is required to be deducted at the rate of 5% (*plus* applicable Surcharge and Health & Education Cess).

10.5-2. TDS from income in respect of units

As per Section 196A of the Income-tax Act, 1961 any person responsible for paying any income in respect of units of a mutual fund specified under section 10(23D) of the Income-tax Act, 1961, or specified company referred to in *Explanation* to Section 10(35), is required to deduct tax at source.

Tax is required to be deducted under this provision if the recipient of income is a non-resident, not being a company, or a foreign company. The tax shall be deducted at the rate of 20% under section 196A of the Income Tax Act, 1961. The rate shall be further increased by applicable Surcharge and Health & Education Cess.

However, if the payee is covered under a Double Taxation Avoidance Agreement (DTAA), the tax shall be deducted at the rate of 20% or the rate specified under the DTAA, whichever is lower. This relief is available only to a payee who has submitted a Tax Residency Certificate (TRC) as proof of his residence status[113].

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[110] The date has been extended from 30-06-2020 to 30-06-2023 by the Finance Act, 2020
[111] Inserted by the Finance Act, 2020, with effect from 01-04-2020
[112] Notification No.56/2013 dated 29-7-2013
[113] Inserted by the Finance Act, 2023, with effect from 01-04-2023

10.5-3. TDS on dividend or long-term capital gain arising from units of mutual funds purchased in foreign currency

As per section 196B of the Income-tax Act, 1961, every person responsible to pay any income in respect of the units purchased in foreign currency or capital gain arising on transfer of such units is required to deduct tax at source.

Tax is required to be deducted under this provision only if such income is payable to an offshore fund. The tax shall be deducted at the rate of 10% under Section 196B of the Income Tax Act, 1961.

10.5-4. TDS on dividend or interest income from any other security

As per section 196D of the Income-tax Act, 1961, every person responsible for making payment by way of income in respect of securities to Foreign Institution Investors shall deduct tax therefrom. The tax shall be deducted under this provision if income in respect of securities is payable to a Foreign Portfolio Investor. The tax is required to be deducted at the rate of 20% (*plus* applicable Surcharge and Health & Education Cess). However, where such income is received by the investment division of Offshore banking unit (as referred under *para 11.6-5a*), the tax shall be deducted at the reduced rate of 10%.

If the FPI is a resident of a country with which India has DTAA then the tax shall be deducted at the rate provided under DTAA if that rate is lower than 20% or 10%, as the case may be. For this purpose, the FPI shall be required to furnish the tax residency certificate obtained from the Government of the country in which it resides[114].

No tax shall be deductible under this provision on income in respect of units referred under Section 115AB and income by way of interest referred to in section 194LD.

10.6 RATES OF SURCHARGE AND HEALTH & EDUCATION CESS

If the income of FPI is chargeable to tax in India, the tax thereon is further increased by the amount of surcharge. The surcharge shall be applicable even at the time of withholding of tax from the income of FPI except where income is chargeable to tax as per DTAA. The levy of surcharge in case of FPI depends on status applied while obtaining the Permanent Account Number and total income. FPIs are generally registered as a trust, AOP, BOI or foreign company. The rate of surcharge in case of the following entities are as follows:

Surcharge	
Nature of Income	*Range of Total Income*

[114] This concession in the tax rate has been provided by inserting a *Proviso* to Section 196D(1) by Finance Act, 2021 with effect from 01-04-2021.

	Up to Rs. 50 lakh	*More than Rs. 50 lakh but up to Rs. 1 crore*	*More than Rs. 1 crore but up to Rs. 2 crore*	*More than Rs. 2 crore but up to Rs. 5 crore*	*More than Rs. 5 crore but up to Rs. 10 crore*	*More than Rs. 10 crore*
AOP or BOI or Trust						
Long-term or Short-term Capital gain arising from transfer of securities as referred to in Section 115AD.	*Nil*	10%	15%	15%	15%	15%
Dividend Income	*Nil*	10%	15%	15%	15%	15%
Income taxable under section 115BBE, i.e., income from unexplained sources	25%	25%	25%	25%	25%	25%
Any other Income (if FPI is an AOP consisting of only companies as its members)	Nil	10%	15%	15%	15%	15%
Any other Income*	*Nil*	10%	15%	25%	37%**	37%**
* Where the total income of a person does not exceed Rs. 2 crores but after including the long-term or short-term capital gain from securities as referred to in Section 115AD(1)(b) or dividend income as referred to in Section 115AD(1)(a) (collectively referred to as 'Specified Income'), the total income exceeds Rs. 2 crores then irrespective of the amount of other income, the surcharge shall be levied at the rate of 15% on the amount of tax payable on the aggregate of normal income and specified income. The rate of surcharge on tax payable on specified income cannot exceed 15% of tax on such income in any case. **Where the income of the person is chargeable to tax under new tax regime of Section 115BAC(1A), the rate of surcharge shall not exceed 25%.						
Foreign Company						
Income taxable under section 115BBE, i.e.,	25%	25%	25%	25%	25%	25%

income from unexplained sources						
Any other Income	*Nil*	*Nil*	2%	2%	2%	5%

The amount of income tax and the applicable surcharge shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge. Further, health and education cess shall be levied even at the time of deducting tax from the income of FPI except where income is chargeable to tax as per DTAA.

10.7 TAX TREATMENT OF DIFFERENT CATEGORIES OF FPIs

10.7-1. Categories of FPI

Regulation 5 of SEBI (FPI) Regulations, 2019, provides that an FPI can seek registration under 2 categories – Category-I and Category-II. The entities applying for registration as Foreign Portfolio Investors have to fulfil certain conditions. An applicant incorporated or established in an International Financial Services Centre shall be deemed to be appropriately regulated for this purpose.

10.7-1a. *Category-I FPIs*

10.7-1b.

10.7-1c. Category-I FPIs shall include:

a) Government and Government related investors such as central banks, sovereign wealth funds and international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such Government and Government related investor(s).
b) Pension funds and university funds
c) Appropriately regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker-dealers and swap dealers;
d) Entities from the Financial Action Task Force member countries, or from any country specified by the Central Government by an order or by way of an agreement or treaty with other sovereign Governments, which are
    - appropriately regulated funds;
    - unregulated funds whose investment manager is appropriately regulated and registered as a Category I foreign portfolio investor provided that the investment manager undertakes the responsibility of all the acts of commission or omission of such unregulated fund;
    - university-related endowments of such universities that have been in existence for more than five years;
e) An entity

- Whose investment manager is from the Financial Action Task Force member country and such an investment manager is registered as a Category I foreign portfolio investor. However, such an investment manager should undertake the responsibility of all the acts of commission or omission of the applicant entity; or
- that is at least 75% owned, directly or indirectly, by another entity eligible for registration under point (b), (c) or (d) above. However, such an eligible entity should be from the Financial Action Task Force member country and undertake the responsibility of all the acts of commission or omission of the applicant seeking registration.

10.7-1d. Category-II FPIs

Category-II Foreign Portfolio Investors shall include all the investors not eligible under Category I Foreign portfolio investors such as: -

a) Appropriately regulated funds not eligible as Category-I foreign portfolio investor;
b) endowments and foundations;
c) charitable organisations;
d) corporate bodies;
e) family offices;
f) individuals;
g) appropriately regulated entities investing on behalf of their client, as per conditions specified by the SEBI from time to time;
h) Unregulated funds in the form of limited partnership and trusts.

10.7-2. Exemption from certain provisions to FPIs

10.7-2a. Exemption from the provision of GAAR

The provisions of Chapter X-A i.e., General Anti-Avoidance Rule shall not apply in respect of the following:

(a) A foreign institutional investor who has not taken benefit of the tax treaty and has invested in listed securities, or unlisted securities in accordance with SEBI guidelines;

(b) A non-resident person who has made an investment by way of offshore derivative instruments or otherwise in a Foreign Institutional Investor.

10.7-3. Relaxation to Category - I of FPIs

There are certain provisions of the Act under which some relaxations have been given to Category-I FPIs. Such provisions are as follows:

10.7-3a. Indirect transfer of capital assets

Section 9 of the Income-tax Act, 1961 provides that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India if such share or interest derived, directly or indirectly, its value substantially from the asset located in India.

However, this provision has been relaxed where such asset or capital asset is held by a non-resident by way of investment, whether directly or indirectly, in Category-I FPI. As a result, no income shall be deemed to accrue or arise in India in the hands of a non-resident who transfers his investment made in Category-I FPIs even if such investment derives its value from the assets located in India in form of shareholding of FPIs in Indian Companies. Here it is to be noted that the exemption has been provided to a non-resident who invests in FPIs and not to FPIs themselves. Hence, if FPIs transfer their shareholding in an Indian company to someone else then they shall be liable to pay capital gain tax in India.

Under the SEBI (Foreign Portfolio Investors) Regulations, 2019, FPIs have been re-categorised. Thus, Finance Act, 2020 has amended section 9 of the Income-tax Act, 1961 to provide that the above relaxation shall be available in respect of investment in Category-I FPIs registered under SEBI (Foreign Portfolio Investors) Regulations, 2019.

10.7-3b. Non-applicability of certain conditions under section 9A

Section 9A of the Income-tax Act provides that in case an investment fund, established or incorporated or registered outside India, collects funds from its members and invests in India then such fund shall not be deemed to have a business connection in India just because fund management activity is carried out through a fund manager located in India. However, this provision shall apply only when the investment fund, as well as the fund manager, comply with the conditions as prescribed under section 9A.

Some of the conditions which an investment fund has to comply with are as follows:

a) The fund should have a minimum of 25 members who are, directly or indirectly, not connected persons;
b) Any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;
c) The aggregate participation interest, directly or indirectly, of 10 or fewer members along with their connected persons in the fund, shall be less than 50%.

The CBDT[115] has notified that the aforesaid conditions shall not apply in case of Category-I FPIs registered under SEBI (Foreign Portfolio Investors) Regulations, 2019 or where the fund

[115] Notification No. 41/2020 dated 30 June 2020

manager of the investment fund is located in an IFSC and has commenced its operation on or before 31-03-2024[116].

Further, one more condition which an investment fund needs to fulfil is that the remuneration paid to an eligible fund manager in respect of fund management activity undertaken by him on its behalf shall not be less than the amount calculated in the prescribed manner. A lower rate of 0.1% of the asset under management has been prescribed where such fund is Category-I foreign portfolio investor.

10.7-3c. Exemption in respect of certain income

In case of FPI being an investment division of an offshore banking unit, certain income shall be exempt from tax by virtue of Section 10(4D) *(Refer para 11.6-5)*. Further, any income accruing or arising to or received by its unit-holder from unit or on the transfer of such units, shall also be exempt from tax under Section 10(23FBC).

10.7-3d. Relaxation from provisions of Alternate Minimum Tax (AMT)

An FPI being an investment division of an offshore banking unit (as referred under *para 11.6-5a*) is not subject to the provisions of Alternate Minimum Tax.

[116] Notification No. 59, dated 06-06-2022

Review Questions:

1. Eligibility criteria for registration as FPI includes which of the following?

(*a*) applicant should not be an Indian resident

(*b*) applicant should be a resident of a country whose security market regulator is a signatory to IOSCO

(*c*) any other criteria specified by SEBI from time to time

(*d*) All of these

2. Category-I FPIs include

(*a*) Pension Funds

(*b*) University Funds

(*c*) Sovereign Wealth Funds

(*d*) All of these

3. Category-II FPIs include

(*a*) Charitable organisations

(*b*) Family offices

(*c*) Endowments and foundations

(*d*) All of these

4. Under which of these head(*s*) dividend or interest income received FPIs is chargeable to tax

(*a*) Income from Other Sources

(*b*) Income from House Property

(*c*) Income from Business/Profession

CHAPTER 11: TAX IMPLICATIONS OF IFSC

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Intermediaries in IFSC
- Products listed on IFSC Exchange (debt, equity etc.) and the implication of tax

An International Financial Services Centre (IFSC) caters to customers outside the jurisdiction of the domestic economy. These centres are 'international' in the sense that they deal with the flow of finance and financial products/services across borders which includes banking, insurance, asset management, and most importantly, a well-structured and fully developed capital market for debt, equities, commodities as well as derivatives.

The first IFSC in India has been set up at GIFT City, Gandhinagar, Gujarat.

11.1 STOCK EXCHANGES LOCATED IN IFSC

Stock exchange(s) located in IFSC provides an opportunity to global investors to invest in Indian as well as foreign securities without assuming any currency risk. Any company (whether Indian or foreign) may list its specified securities in such exchange as per the norms specified by SEBI. The benefit of dealing in securities through stock exchanges located in IFSC is that they provide a competitive advantage in terms of tax structure and other regulatory requirements. Currently, only two stock exchanges are operating in IFSC i.e., India International Exchange (India INX) and NSE IFSC.

11.2 PRODUCTS LISTED ON IFSC STOCK EXCHANGE

The Stock Exchanges operating in IFSC may permit dealing in the following types of securities:

(a) Equity shares; and

(b) Convertible securities.

As per Regulation 2(d) of International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 'Convertible securities' means:

Securities which are convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of such securities and includes the following:

(a) Convertible debt instruments; and

(b) Convertible preference shares.

As per Regulation 2(c) of International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021, 'Convertible debt' instrument means an instrument which creates or acknowledges indebtedness and is convertible into equity shares of the issuer at a later date at or without the option of the holder of the instrument, whether constituting a charge on the assets of the issuer or not.

11.3 APPLICABILITY OF THE INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY (ISSUANCE AND LISTING OF SECURITIES) REGULATIONS, 2021

These regulations shall apply to:

(a) an initial public offer of specified securities by an unlisted issuer;

(b) a follow-on public offer of specified securities by a listed issuer;

(c) listing of specified securities by a start-up company or an SME company;

(d) secondary listing of specified securities;

(e) an initial public offer of specified securities by a Special Purpose Acquisition Company;

(f) rights issue and/or preferential issues by a listed issuer;

(g) listing of depository receipts;

(h) listing of debt securities;

(i) listing of ESG debt securities; and

(j) issuance and/or listing of any other securities as may be specified by the Authority from time to time.

11.4 INTERMEDIARIES IN IFSC

The International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 does not define the term 'intermediary'.

As per Regulation 3 of the International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021:

"Words and expressions used and not defined in these regulations but defined in the Act, the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992, the Depositories Act 1996, or any rules or regulations made thereunder shall have the same meanings as respectively assigned to them in those Acts, rules or regulations made thereunder or any statutory modification or re-enactment thereto, as the case may be."

Therefore, the meaning of the term 'intermediary' is taken from the respective applicable regulations.

"Intermediary" shall mean and include the following:

a) Stock brokers,
b) Share transfer agents,
c) Bankers to an issue,
d) Trustees of trust deeds,
e) Registrars to an issue,
f) Merchant bankers,
g) Underwriters,
h) Portfolio managers,
i) Investment advisers
j) Depositories,
k) Participants,
l) Custodians of securities,
m) Foreign institutional investors
n) Asset management company in relation to the SEBI (Mutual Funds) Regulations, 1996
o) Clearing member of a clearing corporation or clearing house
p) Foreign portfolio investors
q) Trading member of a derivative segment or currency derivatives segment
r) Credit rating agencies and
s) Such other intermediaries who may be associated with securities markets in any manner or as specified by the SEBI on time-to-time basis.

11.5 DIFFERENCE BETWEEN A STOCK EXCHANGE HAVING NATIONAL PRESENCE AND STOCK EXCHANGE IN IFSC

Stock exchanges located in IFSC are quite different from ordinary stock exchanges. The major differences between these stock exchanges have been explained in the following table:

Particulars	**Exchange located in IFSC**	**Stock Exchange with National Presence**
Who can set up a Stock Exchange?	An Indian Stock Exchange or clearing corporation or Foreign Stock Exchange or clearing corporation or any regulated depository of a foreign jurisdiction can set up a stock exchange in an IFSC through a subsidiary company. Further, any Indian registered depository may set up a branch - IFSC Depository Services (IDS) at IFSC	Any Indian Company can set up a stock exchange
Listing of Securities	The following entities are eligible to get their securities listed on the stock exchanges in an IFSC: (*a*) A company incorporated in an IFSC/India/ Foreign Jurisdiction can list its securities on the IFSC exchange.	Only an Indian Company can list its securities on the domestic stock exchanges

	(*b*) Any supranational, multilateral or statutory organisation/ institution/ agency provided they are permitted to issue securities as per its constitution and is registered or headquartered in India, IFSC or a Foreign Jurisdiction [limited to listing of debt securities]. (*c*) Any municipality/ statutory body/ board/ corporation/ authority/ trust/ agency or any special purpose vehicle notified by the State/ Central Government including for the purpose of raising fund by the issuer to develop infrastructure or SMART city [limited to listing of debt securities]. (*d*) An entity whose securities are irrevocably guaranteed by a Sovereign (India or a Foreign Jurisdiction) [limited to listing of debt securities].	
Trading Timings	23:50 Hours	06:30 Hours
Commodity Trading	Allowed	Not Allowed
Taxation	Concessional tax regimes and exemptions exclusively for IFSC Stock Exchanges and Companies listed on such exchange	No specific exemption and taxes are higher than in comparison to IFSC
Currency Risk	Protection is available against the risk of currency fluctuation as investments can be made in foreign currency	No protection is available against the risk of currency fluctuation as investments can be made only in Indian currency
Transaction Cost	Lower in comparison to ordinary stock exchanges	Higher than the cost of trading in IFSC stock exchange

11.6 TAX IMPLICATIONS

The Income-tax Act, 1961 contains various provisions wherein special benefits, exemptions and deductions are allowed to the units located in an IFSC. Further, no Securities Transaction Tax (STT) is levied in case of transactions carried out through a stock exchange located in IFSC. These concessional provisions have been discussed below.

11.6-1. No STT on transfer of securities through IFSC stock exchange

As per Section 112A of the Income-tax Act, 1961, where the total income of an assessee includes long-term capital gain arising from the transfer of listed equity shares, units of an equity-oriented mutual fund, or units of business trust (hereinafter referred to as 'specified securities'), no tax shall be charged on such long-term capital gain if the aggregate amount of such gain during the year is up to Rs. 1,00,000. Where the amount of capital gain exceeds Rs. 1,00,000, the excess amount is chargeable to tax at a concessional rate of 10% without providing the benefit of indexation and foreign currency fluctuation.

Similarly, Section 111A of the Income-tax Act, 1961 provides for a concessional tax rate of 15% in case of short-term capital gain arising from the transfer of such specified securities.

The benefit of concessional tax rate under Section 111A and 112A of the Income-tax Act, 1961 is provided subject to certain conditions, *inter-alia*, the transaction should be subject to the securities transaction tax. This condition of payment of STT on the transfer of such specified securities has been relaxed where the transfer is undertaken on a recognised stock exchange located in any International Financial Services Centre (IFSC) and the consideration for such transfer is received or receivable in foreign currency.

11.6-2. No tax on dividend

If a domestic company, being a unit located in the International Financial Services Centre (IFSC), distributes dividend to its shareholders then no tax shall be chargeable either in the hands of the company or the shareholders. However, this provision shall be applicable only when such company derives income solely in convertible foreign exchange and dividend is distributed out of its current income or income accumulated as a unit of IFSC after 01-04-2017.

11.6-3. Concessional tax rate on dividend received by a non-resident from IFSC unit

According to Section 115A, non-residents who receive dividends from IFSC units are eligible for a concessional tax rate. Dividends received from IFSC units are taxed at a reduced rate of 10%[117].

11.6-4. Reduced rate of MAT and AMT

Section 115JB of the Income-tax Act, 1961 provides for levy of MAT at the rate of 15% on the company, if the tax payable by it on income computed as per normal provisions of the Income-

[117] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25.

tax Act, 1961 is less than 15% of book profits. In such a case the book profit is taken as the income of the company and tax is levied on the same at the rate of 15% *plus* applicable surcharge and cess.

Similarly, Section 115JC provides for levy of AMT at the rate of 15% in case of co-operative society or 18.5% in case of any other non-company assessee, if the tax payable by it on income computed as per normal provisions of the Income-tax Act is less than 18.5% or 15% of adjusted total income. In such a case, the adjusted total income is taken as the income of the assessee and tax is levied on the same at the rate of 18.5% or 15%.

However, both these sections provide a concessional rate of 9% to the assessee, being a unit or a company, located in IFSC deriving its income solely in convertible foreign exchange.

11.6-5. Exemption from the transfer of certain securities

In view of Section 47(viiab) of the Income-tax Act, 1961, any transfer of the following securities by a non-resident on a recognised stock exchange located in any IFSC shall not be regarded as transfer provided the consideration is paid or payable in foreign currency:

a) Bonds or GDRs of an Indian Company (including public sector company) purchased in foreign currency;
b) Rupee Denominated Bonds of an Indian company;
c) Derivatives;
d) Foreign currency-denominated bond[118];
e) Unit of a Mutual Fund;
f) Unit of a business trust;
g) Foreign currency-denominated equity shares of a company;
h) Unit of Alternative Investment Fund; and
i) Bullion Depository Receipt with underlying bullion[119]

"Bullion depository receipt with underlying bullion" shall mean such bullion depository receipt listed on the International Bullion Exchange (IBE) operating inside the International Financial Services Centre (IFSC) and is licensed by the IFSC Authority under the IFSC Authority Act, 2019.

It is to be noted that a non-resident being an eligible foreign investor, who doesn't have any income in India other than income from transfer of aforesaid capital assets, shall not be required to file return of income if he furnishes the following details and documents to the stock broker through which the transaction is made[120]:

[118] Securities in point (d) to (h) have been notified *vide Notification S.O. 986 (E)* [NO. 16/2020/F.NO. 370142/22/2019-TPL], Dated 5-3-2020
[119] Notification No. 89/2022, dated 03-08-2022.
[120] Notification No. 119, dated 11-10-2021.

- Name, e-mail id and contact number;
- Address in the country or specified territory of which he is a resident;
- A declaration that he is a resident of a country or specified territory outside India; and
- Tax Identification Number allotted in his home country and if such number is not available, then a unique number on the basis of which he is identified by the Government of his home country

"eligible foreign investor" means a non-resident who operates in accordance with the Securities and Exchange Board of India, circular IMD/HO/FPIC/CIR/P/2017/003 dated 04th January, 2017

11.6-6. Exemption in respect of income of specified fund

Section 10(4D) of the Income-tax Act, 1961, provides an exemption in respect of the certain income of a specified Fund.

11.6-6a. Meaning of Specified fund

'Specified Fund[121]' is defined in the *Explanation (c)* to Section 10(4D) to mean the following funds:

(a) Investment Division of an Offshore Banking Unit

An investment division of an offshore banking unit, being an investment division of a banking unit of a non-resident located in International Financial Services Centre (IFSC) as referred under Section 80LA(1A), shall be treated as a specified fund if it satisfies the following conditions:

- It should be granted a certificate of registration as a Category-I Foreign Portfolio Investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019;
- Its operations must be commenced on or before 31-03-2024;
- It maintains separate accounts for the registered investment division reflecting the true and fair accounts of all transactions relating to such division;
- The direct and indirect expenses relating to the incomes eligible for exemption under this provision and other incomes are properly recorded, accounted for, and apportioned;
- The accounts of the registered investment division are audited by the chartered accountant one month before the due date of filing of return of income and the audit report is filed in Form No. 10-IL by the said date;

[121] The Finance Act, 2021 has substituted the definition of specified fund with effect from Assessment Year 2022-23 to cover investment division of an offshore banking unit. Earlier, only Alternative Investment Funds were covered under the definition of specified fund.

- It maintains proper documentation in respect of inbound remittance for buying and selling the investments and the use of inward remittance made to India;
- It maintains bank statement of all accounts of the registered investment division;
- It maintains contract notes relating to purchase and sale of securities by the registered investment division; and
- It maintains a statement of securities issued by the custodian

(b) Alternative Investment Fund

An Alternative Investment Fund (AIF) shall be treated as a specified fund if it satisfies the following conditions:

- It should be established or incorporated in India in the form of a trust, company, LLP or body corporate;
- It should be granted a certificate of registration as Category-III AIF and is regulated under the SEBI (AIF) Regulations, 2012 or the International Financial Services Centres Authority (Fund Management) Regulations, 2022;
- It should be located in an International Financial Services Centre (IFSC);
- It's all the units must be held by non-residents except units held by sponsor or manager. However, if the non-resident unit holder(s) becomes resident or deemed to be resident in India in any previous year subsequent to the year in which units were issued to him, this condition shall be relaxed and exemption shall continue to be available to specified fund provided the following conditions[122] are satisfied:

    i. Such unitholder(s) do not hold more than 5% of the total units issued by the specified fund.

    ii. Such unit holder(s) shall cease to be a unit holder of the specified fund within a period of 3 months from the end of the previous year in which he becomes a resident.

    iii. The specified fund shall maintain the following documents in respect of such unit holder(s):

    - *Name of the unit holder;*
    - *Tax identification number of the unit holder in the country of residence at the time the units were issued;*
    - *PAN, if available;*
    - *Total number of units held;*
    - *Total value of units held;*
    - *Whether the unit holder is a sponsor or manager;*
    - *Previous year in which the unit holder became resident; and*
    - *Date of exit from the specified fund*

[122] Rule 21AIA as inserted by the Income-tax (Seventeenth Amendment) Rules, 2022 vide Notification No. 64/2022, dated 16-06-2022

iv. The specified fund shall certify that it has fulfilled all the above conditions and furnish information in respect of units held by residents in the annual statement of exempt income in Form No. 10-IG.

11.6-6b. Nature of income exempt in the hands of specified fund

Specified funds shall be eligible to claim exemption with respect to income accrued or arisen or received by it which is attributable to units held by a non-resident (not being a PE in India) or to the investment division of offshore banking unit. Such exemption is allowed in respect of the following income:

(a) Income from transfer of a capital asset as referred to in Section 47(viiab) on a recognised stock exchange located in IFSC and consideration is paid or payable in 'convertible foreign exchange';
(b) Income arising from transfer of securities (other than shares in a company resident in India);
(c) Income from securities issued by a non-resident (not being a PE of a non-resident in India) and where such income otherwise does not accrue or arise in India; or
(d) Income from a securitization trust is chargeable under the head 'Profits and gains from business or profession'.

The manner of computation of exemption in the case of specified fund, being a category-III AIF, is prescribed under Rule 21AI[123]. Whereas, the manner of computation of exemption in case of specified fund, being an investment division of an offshore banking unit, is prescribed under Rule 21AJA[124].

11.6-6c. Nature of income exempt in the hands of unitholders of specified fund

Section 10(23FBC) provides that any income accruing or arising to or received by a unit-holder from such specified fund or on the transfer of units in such fund, shall be exempt from tax.

11.6-7. Computation of exemption in case of specified fund being category-III AIF

11.6-7a. Manner of computation of exemption

The exemption under section 10(4D) in respect of the income attributable to units held by non-resident (not being a PE of a non-resident in India) in a specified fund, being a category-III AIF, shall be aggregate of amount computed as per the following formula in respect of all eligible incomes:

[123] Inserted by the Income-tax Amendment (Twenty-second Amendment) Rules, 2021 vide Notification No. 90/2021, dated 09-08-2021

[124] Inserted by the Income tax (1st Amendment) Rules, 2022 vide Notification G.S.R. 15(E) [NO. 6/2022/F.NO. 370142/60/2021-TPL], dated 14-1-2022

$$\textit{Income exempts under Section 10(4D)} = (a) * \frac{(b)}{(c)}$$

Nature of income	*AUM† held by non-resident unitholder*	*AUM† of specified fund*	*Remark*
(a)	*(b)*	*(c)*	
Income from transfer of a capital asset as referred to in Section 47(viiab)	Aggregate of daily AUM held by non-resident unit-holder (Not being PE of non-resident in India)	Aggregate of daily total AUM of specified fund	Daily AUM to be computed for the period of holding of such capital asset
Income from transfer of securities (not being shares in a co. resident in India)	Aggregate of daily AUM held by non-resident unit-holder (Not being PE of non-resident in India)	Aggregate of daily total AUM of specified fund	Daily AUM to be computed for the period of holding of such security
Income from securities issued by a non-resident (not being a PE of a non-resident in India)	AUM held by non-resident unit-holder (Not being PE of non-resident in India)	Total AUM of specified fund	AUM to be computed on the date of receipt of such income
Income from a securitization trust	AUM held by non-resident unit-holder (Not being PE of non-resident in India)	Total AUM of specified fund	AUM to be computed on the date of receipt of such income
† 'Assets Under Management (AUM)' means the closing balance of the value of assets or investments of the specified fund as on a particular date.			

11.6-7b. Furnishing of statement of exempt income

The exemption shall be allowed only when the specified fund furnishes a statement of exempt income annually in Form No. 10-IG [125]. This statement is required to be furnished electronically under digital signature on or before the due date of furnishing the original return of income.

11.6-7c. Treatment of income not exempt under Section 10(4D)

In the following situations, the income of a specified fund shall not be exempt from tax under Section 10(4D):

(a) It earns income from securities which are not specified in para 11.6-6b;

[125] Inserted by the Income-tax Amendment (Twenty-second Amendment) Rules, 2021 vide Notification No. 90/2021, dated 09-08-2021

(b) The income is attributable to the units held by a unit-holder who is either a resident in India or a permanent establishment of a non-resident in India.

The income specified in point (a) above shall be taxable under Section 115AD at a concessional rate. Whereas, the income specified in point (b) shall be taxable at normal tax rate as applicable in its case.

11.6-8. Computation of exemption in case of specified fund being an investment division of offshore banking unit

11.6-8a. Manner of computation of exemption

Rule 21AJA provides a formula specifying that the exemption under section 10(4D) shall be available to investment division of an offshore banking unit only in respect of income arising from capital asset or securities (specified in para 11.6-6b) held by it. Thus, capital asset or securities must be held by investment division itself.

Further, it provides that any expenditure incurred for making or earning such incomes shall not be allowed as deduction from income from any other activity or source.

11.6-8b. Furnishing of statement of exempt income under section 10(4D) by investment division of offshore banking unit

The exemption shall be allowed only when the investment division of the offshore banking unit gets its accounts audited by the chartered accountant one month before the due date of filing of return of income and the audit report is filed in Form No. 10-IL by the said date. Further, it shall also be required to furnish a statement of exempt income annually in Form No. 10-IK.[126]

11.6-8c. Treatment of income not exempt under Section 10(4D)

In the following situations, the income of a specified fund shall not be exempt from tax under Section 10(4D):

(a) It earns income from securities which are not specified in para 1.2;

(b) The income is not attributable to securities held by the investment division of offshore banking unit.

The income specified in point (a) above shall be taxable under Section 115AD at a concessional rate. Whereas the income specified in point (b) shall be taxable as per the normal tax rates as applicable in its case.

11.6-9. Benefit of concessional tax rate

Such Specified Fund (as referred to in *para 11.6-6a*) is allowed to pay taxes at concessional rates prescribed under Section 115AD. However, the provisions of Section 115AD shall apply

[126] Inserted by the Income-tax (Seventeenth Amendment) Rules, 2022 *vide* Notification No. 64/2022, dated 16-06-2022

only to the extent of income that is attributable to units held by non-resident (not being PE of a non-resident in India). However, where such specified fund is an investment division of an offshore banking unit, these provisions shall apply to the extent of income attributable to the investment division of the banking unit. Further, the income so attributable shall be calculated in the manner prescribed in Rule 21AJ and Rule 21AJAA, respectively.

11.6-9a. In case of income from securities

The income arising from securities, other than units as referred to in Section 115AB, is chargeable to tax at a concessional rate of 10%. However, where income is in the nature of interest referred under Section 194LD, the tax shall be charged at the rate of 5%.

Consequently, tax on such income in respect of securities is deductible under Section 196D at the rate of 10%.

11.6-9b. In case of capital gain

Short-term capital gain arising from the transfer of such securities is chargeable to tax at the rate of 30%. However, if the short-term capital gain is arising from the transfer of specified securities, being equity shares, units of equity-oriented mutual fund or units of business trust, as referred to in Section 111A then the tax shall be charged at the rate of 15%.

Whereas, the long-term capital gain is charged to tax at a rate of 10%. However, if the long-term capital gain is arising from the transfer of specified securities as referred to in Section 112A then tax is charged only when the aggregate amount of long-term capital gain from transfer of such securities during the year exceeds Rs. 1,00,000. Where the amount of capital gain exceeds Rs. 1,00,000 then the excess amount is chargeable to tax at the rate of 10%.

11.6-10. Non-applicability of AMT provisions

Such Specified Fund (as referred to in *para 11.6-6a*) are not subject to the provisions of Alternate Minimum Tax.

11.6-11. Exemption in respect of Interest on borrowings

Where a unit located in IFSC has borrowed money on or after 01-09-2019 from a non-resident, interest received or receivable in respect of such borrowings shall be exempt in the hands of such non-resident by virtue of exemption provided under Section 10(15)(ix) of the Income-tax Act, 1961.

11.6-12. Exemption on transfer of shares of domestic company engaged in aircraft leasing business in IFSC

Capital gains arising from the transfer of equity shares of a domestic company by a non-resident or unit of an IFSC shall be exempt from tax under Section 10(4H)[127] subject to the following conditions:

(a) Non-resident or unit of an IFSC must be engaged primarily in the business of leasing of an aircraft;
(b) Domestic company must be a unit of an IFSC as referred to in Section 80LA(1A);
(c) Domestic company must be engaged primarily in the business of leasing of an aircraft;
(d) Domestic company must commence its operations on or before 31-03-2026;
(e) Equity shares of the domestic company must be transferred within 10 years of commencing of its operations. However, if the domestic company commenced its operations before 01-04-2024, the 10-year time limit shall be counted from 01-04-2024.

11.6-13.Exemption in respect of dividend received by an IFSC unit from another IFSC unit

Income by way of dividend received by an IFSC unit primarily engaged in aircraft leasing business shall be exempt from tax under Section 10(34B) of the Income-tax Act, 1961, if the company paying the dividend is also an IFSC unit and engaged in the aircraft leasing business[128].

The Central Government has also specified that no tax is required to be deducted from dividend paid or distributed in such cases. However, to avail of exemption from TDS, the following conditions must be fulfilled[129]:

(a) The IFSC unit receiving the dividend (payee unit) is required to provide a statement-cum-declaration in Form No. 1 to the IFSC unit distributing the dividend (payer unit). The Form shall be furnished for the previous year relevant to the assessment year in which the dividend income eligible for exemption under Section 10(34B) is payable, and the same must be duly verified by the authorized person responsible for signing the return of income; and

(b) The payer unit shall not deduct tax on payment made or credited to the payee unit after the date of receipt of the copy of statement-cum-declaration in Form No. 1 and furnish the particulars of all the payments made to the payee unit on which tax has not been deducted in the TDS statement.

11.6-14. Relaxation from the filing of return of income

The CBDT[130] has exempted a non-resident or a foreign company from the requirement of filing a return of income if it has any income from any investment in Category-I and Category-II

[127] Inserted by the Finance Act, 2023 with effect from assessment year 2024-25.
[128] Inserted by the Finance Act, 2023 with effect from assessment year 2024-25.
[129] Notification No. 52/2023, dated 20-07-2023. The notification shall come into force from 01-09-2023
[130] Notification no. S.O. 2672(e), dated 26-7-2019

Alternative Investment Fund (AIF) set up in an IFSC located in India. This exemption can be claimed subject to the following conditions:

a) Income-tax due on the said income has been deducted at source and remitted to the Central Government by the Investment fund as per the rates prescribed under section 194LBB; and
b) Income from the investment fund is the only income, i.e., there is no other income in respect of which he is liable to furnish his return of income.

However, this relaxation shall not be available where a notice under section 142(1) or 148 or 153A or 153C of the Income-tax Act, 1961 has been issued for filing of a return of income.

11.6-15. Deduction under Section 80LA

Where Gross Total Income (GTI) of an assessee, being a unit of an IFSC, includes any income from business for which it has been approved for setting up in such centre, the assessee shall be eligible to claim deduction of an amount equal to 100% of such income for a period of 10 consecutive assessment years, at the option of the assessee out of 15 years. Further, deduction shall also be allowed in respect of income arising from transfer of an aircraft or a ship which was leased by such unit to a person provided operations of such unit has been commenced on or before 31-03-2024[131].

The period of 15 years shall be reckoned from the beginning of the assessment year relevant to the previous year in which permission under Banking Regulations Act or permission or registration under the SEBI Act, 1992, or the International Financial Services Centre Authority Act, 2019 was obtained.

'Aircraft' means an aircraft or a helicopter, or an engine of an aircraft or a helicopter or an engine of an aircraft or a helicopter or any part thereof.

'Ship' means a ship or an ocean vessel, engine of a ship or ocean vessel, or any part thereof.

11.6-16. No restriction on section 80LA deduction

11.6-16a. While opting for concessional tax regime

Income-tax Act provides for alternative tax regimes in the case of various assessees. Assessees opting for these regimes are taxed at concessional tax rates provided they forego specified exemptions or deductions. These alternative tax regimes are as under:

(a) Section 115BA for domestic companies;
(b) Section 115BAA for domestic companies;
(c) Section 115BAB for domestic companies;
(d) Section 115BAC for Individuals, HUFs, AOP (other than co-operative society), BOI and AJP;
(e) Section 115BAD for resident co-operative societies; and

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[131] Inserted by the Finance Act, 2021, with effect from assessment year 2022-2023

(f) Section 115BAE for resident co-operative societies engaged in manufacturing.

It is to be noted that a person having a unit in IFSC is not restricted from claiming the deduction under section 80LA of the Income-tax Act, 1961 even if it has opted for payment of tax at concessional tax rate under section 115BAA, 115BAC or 115BAD.

Payment of taxes under section 115A

Section 115A of the Income-tax Act, 1961 provides special tax rates in respect of the certain income earned by a non-resident (not being a company) or a foreign company. No deduction can be claimed from such income under Chapter VI-A. However, a unit of an IFSC is not restricted from claiming deduction under section 80LA of the Income-tax Act, 1961 from such income.

11.6-17. Certain exemption to non-residents dealing with unit of IFSC

Any of the following income accrued or arisen to, or received by a non-resident shall be exempt from tax by virtue of Section 10(4E) and Section 10(4F) of the Income-tax Act[132]:

(a) Income from transfer of non-deliverable forward contracts or offshore derivative instruments or over-the-counter derivatives entered into with an offshore banking unit of an IFSC referred under section 80LA(1A) shall be exempt from tax as per Section 10(4E). Further, income arising as a result of the distribution of income on offshore derivative instruments shall also be exempt. The exemption shall be allowed subject to the fulfilment of conditions prescribed in this behalf;

(b) Income by way of royalty or interest, on account of lease of an aircraft or a ship in a previous year, which is paid by an IFSC referred under section 80LA(1A) whose operations are commenced on or before 31-03-2024, shall be exempt from tax under Section 10(4F).

11.6-18. Exemption or allowances in case of certain relocations

11.6-18a. Meaning of Certain Terms

(a) Relocation

Relocation means transfer of assets of the original fund (or of its wholly-owned special purpose vehicle) to a resultant fund on or before 31-03-2025. Consideration for such transfer is to be discharged in the form of share or unit or interest in the resulting fund to the following:

- Shareholder or unitholder or interest holder of the original fund, in the same proportion in which the share or unit or interest was held by them in such original fund, in lieu of their shares or units or interests in the original fund; or

[132] Inserted by the Finance Act, 2021, with effect from assessment year 2022-2023

- The original fund, in the same proportion as referred to in the above point, in respect of which the share or unit or interest is not issued by the resultant fund to its shareholder or unitholder or interest holder.

(b) Original fund

Original fund means

- a fund that fulfils the following conditions:
  - It is established or incorporated or registered outside India;
  - It is not a person resident in India;
  - It collects funds from its members for investing it for their benefit;
  - It is a resident of a country or a specified territory with which a DTAA has been entered into or is established or incorporated or registered in a notified country or a specified territory[133];
  - the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident; and
  - Where a capital asset is transferred by the original fund to a resultant fund being a Category III AIF, the aggregate participation or investment in the original fund by persons resident in India shall not exceed 5% of the corpus of such fund at the time of such transfer[134];
- An investment vehicle in which Abu Dhabi Investment Authority is the direct or indirect sole shareholder or unit holder or beneficiary or interest holder and such investment vehicle is wholly owned and controlled, directly or indirectly, by the Abu Dhabi Investment Authority or the Government of Abu Dhabi[135]; or
- A fund notified by the Central Government subject to such condition as may be specified[136].

(c) Resultant fund

Resultant fund means a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership and which fulfils the following conditions:

- It has been granted a certificate of registration as a Category I or Category II or Category III AIF;
- It is regulated under the SEBI (Alternative Investment Fund) Regulations, 2012 or International Financial Services Centres Authority Act, 2019; and

[133] The Central Government has notified countries and specified territories vide Notification No. 46/2022, dated 27-04-2022.
[134] Rule 21AL as inserted by the Income-tax (21st Amendment) Rules, 2022 vide Notification No. 80, dated 08-07-2022.
[135] Inserted by the Finance Act, 2023 with effect from assessment year 2023-24.
[136] Inserted by the Finance Act, 2023 with effect from assessment year 2023-24.

- It is located in any International Financial Services Centre as referred under section 80LA(1A).

11.6-18b. Transaction not regarded as transfer

Section 47(viiac) provides that any transfer of a capital asset by an original fund to a resultant fund in pursuance of its relocation is not regarded as a transfer for the purpose of computing capital gain.

Similarly, Section 47(viiad) provides that transfer of shares, unit or interest held by an investor in original fund in consideration of share, unit or interest in resultant fund is also not regarded as transfer.

Further, the cost of acquisition of such share, unit or interest in the original fund shall be deemed as its cost of acquisition in the resultant fund.

11.6-18c. Non-applicability of deeming provisions of Section 56

Section 56(2)(x) provides for the taxability under the head 'other sources' if any property is received by any person without or for inadequate consideration. This provision excludes the transfer of property made in relation to the relocation of original fund to the resultant fund. Thus, no taxability shall arise even in the hands of the resultant fund on receipt of a capital asset from the original fund.

Further, where the investment manager entity[137] of the original fund is relocated to the IFSC and a new fund management entity[138] is established there. In this case, shares, interests, or units received by the new fund management entity in the resultant fund shall not be taxable due to the exemption notification issued under Section 56(2)(x) read with Rule 11UAC[139].

To qualify for the tax exemption, the new fund management entity in the IFSC must maintain a similar ownership structure as the investment manager entity of the original fund maintained. At least 90% of the shares, units, or interests in both entities should be held by the same entity(s) or person(s) in the same proportion.

11.6-18d. Exemption on transfer of certain shares

Section 10(23FF)[140] provides exemption on subsequent transfer of capital asset, being shares of a company resident in India, received from the original fund. The exemption provision under Section 10(23FF) are as follows:

(a) The income is on account of transfer of share.

[137] "investment manager entity" means the fund manager of the original fund regulated by the respective regulation of the jurisdiction in which the original fund is located.

[138] "fund management entity" shall have the same meaning as provided in the sub-clause (p) of regulation 2 of the International Financial Services Centres Authority (Fund Management) Regulations, 2022

[139] Notification No. 51, dated 18-07-2023.

[140] Inserted by the Finance Act, 2021 with effect from Assessment year 2022-23

(b) The share is of a company resident in India.

(c) The transfer is made by the resultant fund.

(d) Such shares were transferred from the original fund (either directly or from its wholly-owned special purpose vehicle) to the resultant fund in relocation.

(e) Capital gain on such shares was not chargeable to tax if that relocation had not taken place

(f) Where the resultant fund is a Category-I or Category II AIF, the exemption shall be available to its non-resident unitholders. The exemption is provided to the unitholders as Category I and Category II are provided pass-through status under the Income-tax Act.

(g) Where the resultant fund is a Category-III AIF, the exemption shall be available to the resultant fund itself. However, it should be a specified fund as defined under Section 10(4D). Further, the exemption shall be available only to the extent attributable to units held by a non-resident (not being a permanent establishment of a non-resident in India) in such fund. The manner of computation of exemption, in this case, is provided under Rule 2DD[141] of the Income-tax Rules.

As per Rule 2DD, the amount of exemption shall be computed as per the following formula:

$$\textit{Income exempt under Section 10(23FF) in case of specified fund} = (a) * \frac{(b)}{(c)}$$

Nature of income	*AUM† held by non-resident unitholder*	*AUM† of specified fund*	*Remark*
(a)	*(b)*	*(c)*	
Capital gain from transfer of shares of a company resident in India*	Aggregate of daily AUM of the specified fund which are held by non-resident unit-holder (not being PE of non-resident in India)	Aggregate of daily total AUM of the specified fund	Daily AUM to be computed from the date of acquisition to the date of transfer of such share
† 'Assets Under Management (AUM)' means the closing balance of the value of assets or investments of the specified fund as on a particular date.			
*Capital gain should arise from the shares which were received by the specified fund in relocation from the original fund, or from its wholly-owned special purpose vehicle, and where such capital gains would not be chargeable to tax if the relocation had not taken place.			

As per the said rule, the specified fund shall be required to furnish an annual statement of exempt income in Form 10-II on or before the due date of filing of original return of income.

141 Inserted by the Income-tax (Thirty-Fourth) Amendment Rules, 2021, w.e.f. 27-12-2021 vide Notification G.S.R. 883 (E) [No. 138/2021/F. NO. 370142/58/2021-TPL(PART-II)], Dated 27-12-2021

Further, such annual statement shall be required to be certified from and filed by a Chartered Accountant in Form No. 10-IJ at least one month prior to the due date of filing of return of income. Both Form 10-II and Form 10-IJ shall be required to be filed electronically under a digital signature.

11.6-18e. Relaxation from provisions of Section 79

Section 79 of the Income-tax Act, 1961, restricts carry forward of losses in case of closely held companies where there is a substantial change in the shareholding of the company. However, this section provides that where such change in shareholding has taken place during the year on account of relocation as referred to in Section 47(viiac) and Section (viiad), provisions of this section shall not be applicable to the extent of such change.

11.6-19. Relaxations of conditions to be an eligible investment fund or eligible fund manager

Section 9A of the Income-tax Act, 1961, provides that in the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund. Sub-Section (3) and (4) of this section prescribes the conditions which a fund and manager needs to fulfil for claiming the benefit of this Section.

The Central Government has been empowered to specify that any one or more of such conditions shall not apply or shall apply with certain modifications specified in this behalf if such fund manager is located in an International Financial Services Centre, as defined under Section 80LA and has commenced its operations on or before 31-03-2024.

The conditions which have been relaxed or modified in the case of such eligible investment fund and eligible fund manager are given below[142]:

(a) Minimum number of members - An offshore fund shall be deemed as an eligible investment fund provided the fund has a minimum of 25 members who are, directly or indirectly, not connected persons.

However, this condition is relaxed where the fund manager of an investment fund is located in an IFSC and has commenced its operation on or before 31-03-2024.

(b) Ceiling on participation by members – An offshore fund shall be deemed as an eligible investment fund provided:

- any member of the fund along with connected persons does not have any participation interest, directly or indirectly, in the fund exceeding 10%; and

[142] The conditions are being relaxed or modified by the Central Government vide Notification No. 59, dated 06-06-2022 in exercise of the powers conferred under sub-section (8A) of Section 9A.

- aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than 50%.

However, the above conditions are relaxed where the fund manager of an investment fund is located in an IFSC and has commenced its operation on or before 31-03-2024.

(c) Restriction on other business activities in India - An offshore fund shall be deemed as an eligible investment fund provided the fund does not carry on or control and manage, directly or indirectly, any business in India.

However, if the fund manager of the investment fund is located in an IFSC and has commenced its operation on or before 31-03-2024, this condition is being modified to provide that the fund shall not carry on, or participate in, the day-to-day operations of any person in India. It is to be noted that the monitoring mechanism to protect the investment in a person including the right to appoint directors or executive director shall not be considered as participation in the day-to-day operations of such person in India.

(d) Fund manager should obtain a registration - A fund manager shall be deemed as an eligible fund manager provided, he is registered as a fund manager or an investment advisor in accordance with the specified regulations[143]. The CBDT vide Circular No. 8, dated 10-5-2019 has clarified that 'fund manager' includes an Asset Management Company (AMC) as approved by SEBI under the SEBI (Mutual Funds) Regulations, 1996.

Where the fund manager is located in an IFSC and has commenced its operation on or before 31-03-2024, it should be registered as a portfolio manager or an investment advisor in accordance with the International Financial Services Centres Authority (Capital Market Intermediaries) Regulation 2021 or such other regulations made under the International Financial Services Centres Authority Act, 2019.

11.6-20. Concessional tax rate in case of GDRs issued by certain companies

Where an Indian company or its subsidiary, engaged in information technology, entertainment, pharmaceutical or biotechnology industry, distributes dividend in respect of Global Depository Receipts (GDRs) issued to its employees under an Employees' Stock Option Scheme, the dividend is taxable at a concessional tax rate of 10% under Section 115ACA in the hands of the employee provided he is a resident in India and GDRs are purchased by him in foreign currency. Further, the long-term capital gain arising from transfer of such GDRs shall also be taxable at concessional rate of 10%.

[143] "Specified Regulations" means the Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993 or the Securities and Exchange Board of India (Investment Advisers) Regulations, 2013, or such other regulations made under the Securities and Exchange Board of India Act, 1992 which is notified by the Central Government. The Government has notified SEBI (Mutual Fund) Regulations, 1996 for this purpose vide Notification No. SO 1420(E), dated 20-3-2019.

For this provision, GDR means a mean any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India or in an IFSC and issued to investors against the issue of:

(a) Ordinary shares of issuing company, being a company listed on a recognised stock exchange in India;
(b) Foreign currency convertible bonds of issuing company; or
(c) Ordinary shares of issuing company, being a company incorporated outside India, if such depository receipt or certificate is listed and traded on any IFSC.

11.6-21. Pass-through status to AIFs regulated under International Financial Services Centre Authority Act, 2019

Category-I and Category-II Alternative Investment Funds regulated under the International Financial Services Centres Authority Act, 2019 are provided pass-through status under the Income-tax Act as per Section 115UB *read with* Section 10(23FBA) and Section 10(23FBB). The pass-through entities pass their income (except income chargeable under the head business or profession) to their investors without paying tax thereon and, consequently, such income is chargeable to tax in the hands of the investors.

11.6-22. Lower rate of TDS under Section 194LC

Section 194LC provides for deduction of tax at source on any income payable by way of interest in respect of certain securities to a non-resident, not being a company or to a foreign company by a specified company or a business trust. Tax is required to be deducted at the rate of 5%.

Whereas, if such interest is payable in respect of monies borrowed from a source outside India by way of issue of any long-term bond or rupee-denominated bond on or after 01-04-2020 but before 01-07-2023, which is listed only on a recognised stock exchange located in any International Financial Services Centre (IFSC), tax is deductible at the rate of 4%. However, if the bond is issued on or after 01-07-2023, tax is deductible at the rate of 9%[144].

11.6-23. Relaxation from obtaining or Quoting PAN

A non-resident, not being a company, or a foreign company shall not be required to obtain and quote PAN in following cases:

11.6-23a. To receive Income from units of specified AIF[145]

As per section 139A read with Rule 37BC and Rule 114AAB, a non-resident, not being a company, or a foreign company shall not be required to obtain and quote PAN if the following conditions are satisfied:

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[144] Inserted by the Finance Act, 2023 with effect from 01-07-2023.
[145] Inserted by the Income-tax (Nineteenth Amendment) Rules, 2020, with effect from 10-08-2020.

(a) Assessee has made investment in Category-I and Category-II Alternative Investment Funds (AIFs) located in International Financial Services Centre (IFSC)or a Category III AIF which fulfils the conditions of being a specified fund as referred under Section 10(4D) and income from such investment is the only income;

(b) Income-tax due on such income has been deducted at source and remitted to the Central Government by such AIF at the rates specified in Section 194LBB; and

(c) Assessee has furnished the following details and documents to the AIF:

- Name, e-mail id and contact number;
- Address in the country or specified territory of which he is a resident;
- A declaration that he is a resident of a country or specified territory outside India; and
- Tax Identification Number allotted in his home country and if such number is not available, then a unique number on the basis of which he is identified by the Government of his home country.

Further, Such AIF is required to furnish a quarterly statement electronically in Form No. 49BA and declaration received from assessee, within 15 days from the end of the quarter to which such statement relates.

A non-resident or foreign company having income from investment made in aforesaid Category-III AIF and satisfying the above conditions is exempted from filing return of income as well provided he has not been issued a notice for filing of return of income under provisions of Section 142(1) or Section 148 or Section 153A or Section 153C for the relevant assessment year.[146]

11.6-23b. On transfer of specified securities[147]

As per Rule 114AAB, a non-resident, being an Eligible Foreign Investor (EFI), shall not be required to obtain and quote PAN if the following conditions are satisfied[148]:

(a) He operates in accordance with SEBI's circular[149].

(b) He has made transaction only in the capital asset referred to in Section 47(viiab) which are listed on a recognized stock exchange located in any IFSC;

(c) The consideration on transfer of aforesaid capital asset should be paid or payable in foreign currency;

(d) He does not earn any income in India, other than the income from transfer of aforesaid capital asset; and

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[146] Notification No. 119, dated 11-10-2021

[147] Inserted by the Income-Tax (14th Amendment) Rules, 2021, with effect from 04-05-2021.

[148] Inserted by the Income-Tax (14th Amendment) Rules, 2021, with effect from 04-05-2021.

[149] SEBI Circular No.IMD/HO/FPIC/CIR/P/2017/003, Dated 4-1-2017.

(e) He has furnished the following details and documents to the stock broker through which the transaction is made:

- Name, e-mail id and contact number;
- Address in the country or specified territory of which he is a resident;
- A declaration that he is a resident of a country or specified territory outside India; and
- Tax Identification Number allotted in his home country and if such number is not available, then a unique number on the basis of which he is identified by the Government of his home country.

Further, the stock broker shall be required to furnish a quarterly statement electronically in Form No. 49BA and upload a declaration received from EFI, within 15 days from the end of the quarter in which such details or documents are received by it.

An eligible foreign investor satisfying the above conditions is exempted from filing return of income as well provided he has not been issued a notice for filing of return of income under provisions of Section 142(1) or Section 148 or Section 153A or Section 153C for the relevant assessment year.[150]

11.6-24. Exemption to a non-resident in respect of income arising from portfolio managed through IFSC

The exemption under section 10(4G)[151] is allowed in respect of income earned by a non-resident from his portfolio subject to the following conditions:

(a) the income is received from the portfolio of securities or financial products or funds;

(b) the portfolio is managed or administered by any portfolio manager on behalf of such non-resident;

(c) the income is received in an account maintained with an Offshore Banking Unit in any IFSC, as referred to in Section 80LA(1A); and

(d) the income accrues or arises outside India and is not deemed to accrue or arise in India.

With effect from assessment year 2024-25, the Finance Act 2023 has extended the scope of this exemption to any income received by a non-resident from the specified activity carried out by the specified person. The Central Government may notify the activity and the person who can carry out such activity. However, the other conditions mentioned earlier shall continue to apply.

For this purpose, "portfolio manager" shall have the same meaning as assigned to it in clause (z) of sub-regulation (1) of regulation (2) of the International Financial Services Centres

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[150] Notification No. 119, dated 11-10-2021

[151] Inserted by the Finance Act, 2022 with effect from Assessment Year 2023-24

Authority (Capital Market Intermediaries) Regulations, 2021, made under the International Financial Services Centres Authority Act, 2019.

As per Regulation 2(1)(z), "portfolio manager" means a person, who pursuant to a contract with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or financial products or funds of the client, as the case may be.

11.6-25. No angel tax on shares issued to AIFs located in IFSC

If shares are issued at a premium by a closely held company, the excess of premium over the fair market value of the shares shall be taxable as income from other sources in the hands of the company as per Section 56(2)(viib) [commonly called as 'angel tax']. However, this provision doesn't apply where consideration for issue of shares is received from Category I or a Category II Alternative Investment Fund (AIF) located in IFSC.

Review Questions:

1. **Stock exchanges located in IFSC have the following advantages for global investor:**

   (*a*) Allows investment in Indian as well as foreign securities

   (*b*) Provides competitive advantage in terms of tax structure and other regulatory requirements

   (*c*) Allows investments without assuming currency risk

   (*d*) All of these

2. **Which of these are Intermediaries in IFSC?**

   (*a*) Merchant banker

   (*b*) Foreign portfolio manager

   (*c*) Credit rating agency

   (*d*) All of these

3. **Units located in IFSC enjoy the following advantages**

   (*a*) No Securities Transaction Tax (STT)

   (*b*) Short-term capital gains are taxed at concessional tax rate of 15%

   (*c*) Long-term capital gains in excess of Rs. 1,00,000 are taxed at concessional tax rate of 10% with no indexation & currency benefits

   (*d*) All of these

4. **Trading in exchanges located in IFSC are permitted to operate for how many hours?**

   (*a*) 22 hours

   (*b*) 24 hours

   (*c*) 23 hours

   (*d*) 23.5 hours

CHAPTER 12: TAX PROVISIONS FOR SPECIAL CASES

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Tax applicability on Bonus issues
- Tax applicability on Split & Consolidation of securities
- Tax applicability on Buyback of Shares
- Tax applicability on Liquidation of Companies
- Tax applicability on Rights issues
- Tax applicability on Mergers & Acquisitions of securities
- Tax applicability on Stock Lending and Borrowing
- Tax applicability on conversion of Bonds or Preference shares in equity shares.
- Tax liability on conversion of stock into capital asset.

In this chapter, you will learn about the special provisions relating to the taxation of the following securities:

1. Bonus Shares *[see Para 12.1]*
2. Split and Consolidation of securities *[see Para 12.2]*
3. Buyback of Shares *[see Para 12.3]*
4. Liquidation of Companies *[see Para 12.4]*
5. Rights issues *[see Para 12.5]*
6. Mergers & Acquisitions of securities *[see Para 12.6]*
7. Stock Lending and Borrowing (SLB) *[see Para 12.7]*

12.1 TAXATION OF BONUS SHARES

12.1-1. Meaning of Bonus shares

Bonus shares are the additional shares issued by a company to the existing shareholders on the basis of shares already owned by them. Bonus shares are issued to the shareholders without any additional cost. These shares are issued to give the shareholders an incentive and increase the equity base of the company.

The tax treatment of bonus issue depends upon whether the shares are held as stock-in-trade or as a capital asset. If they are held as capital assets, any profit or gain arising from the transfer of such shares are taxable as capital gains (see *Chapter 3* to know more about the Capital Gains). If shares are held as stock-in-trade, the gain or loss arising therefrom is taxable under the head PGBP (see *Chapter 8* to know more about the profits and gains from business or profession).

12.1-2. Taxation under the head capital gains

No tax implication arises either in the hands of the company or in the hands of the shareholders at the time of allotment of bonus shares. Gains will be calculated only at the time of transfer of shares by the shareholder. If the bonus shares are held as a capital asset, the profit arising from its transfer shall be taxable under the head capital gains. To calculate the capital gains, one should consider the following provisions.

12.1-2a. Period of holding

The bonus shares may be classified either as long-term capital asset or short-term capital asset on the basis of the period of holding of such shares. The period of holding of bonus shares shall be reckoned from the date of allotment of such shares. If the bonus share is listed on the stock exchange in India, it will be treated as a short-term capital asset if it is held for not more than 12 months immediately preceding the date of transfer, otherwise, they are treated as long-term capital assets. However, in case these shares are not listed on a recognised stock exchange, such a period of 12 months shall be increased to 24 months.

12.1-2b. Cost of acquisition

If bonus shares are allotted to shareholder without any payment on the basis of holding of original shares, the cost of such bonus shares will be *nil* in the hand of the original shareholder. However, if bonus shares are issued to the assessee prior to 01-04-2001, the fair market value as on 01-04-2001, at the option of the assessee, is considered as cost of acquisition.

Where bonus shares are long-term capital assets and they fulfil the conditions prescribed under section 112A (see *Para 10.2-1* to know more about Section 112A), then the cost of acquisition shall be higher of the following:

a) The actual cost of acquisition of bonus shares (which is *nil*); or
b) *Lower* of the fair market value of such shares as on 31-01-2018 or full value of the consideration received as a result of the transfer of such shares.

As the actual cost of acquisition of a bonus share is *nil*, the deemed cost of acquisition of such share shall be lower of its FMV as on 31-01-2018 and full value of the consideration received as a result of the transfer of such shares.

12.1-2c. Sale consideration

The sale consideration arising from the transfer of bonus shares shall be the amount received or receivable by the person transferring the shares. However, where bonus shares are unquoted shares and the consideration received by the shareholder from the transfer of such shares is less than the fair market value, such FMV shall be treated as sale consideration. However, such FMV shall not be deemed as full value of consideration in case any unquoted shares of a company and its subsidiary and the subsidiary of such subsidiary is transferred by an assessee where:

(a) The tribunal, on application moved by Central Government, has suspended the board of directors of such company and has appointed new directors as nominated by the Central Government; and
(b) The share of the company and its subsidiary and the subsidiary of such subsidiary has been transferred pursuant to a resolution plan approved by the tribunal, after affording a reasonable opportunity of being heard to the Jurisdictional Principal Commissioner or Commissioner.

12.1-2d. Computation of capital gains

The capital gains shall be computed in the following manner:

Particulars	*Amount*
Sale Consideration	Xxx
Less:	
- Cost of acquisition/Indexed Cost of acquisition of shares	(xxx)
- Cost of improvement/Indexed cost of improvement	(xxx)
- Expenditure in connection with the transfer	(xxx)
- Amount chargeable to tax under Section 45(4) which is attributable to capital asset being transferred by specified entity[152]	(xxx)
- Exemption under Sections 54 to 54GB, if any	(xxx)
Short-term Capital Gains/Long-term Capital Gains	**Xxx**

12.1-2e. Applicable tax rates

a) *Tax on short term capital gains:* Short-term capital gains arising from the transfer of equity shares (if STT is paid at the time of transfer) are taxable under Section 111A at the rate of 15% (*see Para 10.2-3* to know more about Section 111A). In other cases, gains are added to the total taxable income and are chargeable to tax as per the applicable tax rate according to the status of the assessee.
b) *Tax on long term capital gains:* Long-term capital gains, arising from the transfer of equity shares (if STT is paid at the time of transfer), is chargeable to tax under Section 112A at the rate of 10%. If STT is not paid at the time of transfer of listed equity shares, the long-

[152] Inserted by the Finance Act, 2021, with effect from Assessment Year 2021-2022

term capital gains shall be taxable at the rate of 10% or 20%, as the case may be (see *Para 10.2-1* to know more about Section 112A).

12.1-3. Taxable under the head PGBP

If the bonus shares are held as stock in trade, gains arising at the time of transfer of such bonus shares shall be taxable under the head PGBP. As per ICDS-VIII, the shares held as stock-in-trade shall be initially recorded in the books at their cost of acquisition. As the cost of acquisition of bonus shares is *nil*, the value of shares held as stock-in-trade shall not be enhanced.

Gains or loss from the sale of bonus shares held as stock in trade shall be calculated as follows:

Particulars	*Amount*
Sale consideration	Xxx
Less:	
- Cost of acquisition	(xxx)
- Expenditure relating to such sale	(xxx)
Business Income or loss	**Xxx**

The gains arising in the manner explained above shall be assessable under head 'Profits and gains from business or profession' at the rates of tax as applicable in case of the assessee.

Example 1, Mr A purchased 10,000 shares of X Ltd (a listed co.) at Rs. 105 per share on 01-04-2020. Thereafter, the company announced bonus shares in the ratio of 1:2, *that is*, one bonus share for every two shares. The bonus shares were issued on 01-07-2021. Mr A sold all 15,000 shares at Rs. 120 each on 01-05-2022. Compute the tax liability in his hands.

The capital gains shall be computed for the original shares (10,000 shares) and bonus shares (5,000) separately.

(a) Computation of capital gains from transfer of 10,000 original shares

No. of shares [A]	10,000
Cost per share [B]	Rs. 105
Total purchase value [C= A*B]	Rs. 10,50,000
Date of purchase	01-04-2020
Date of transfer	01-05-2022
Period of holding	25 months
Selling price per share [D]	Rs. 120
Total sale consideration [E=A*D]	Rs. 12,00,000
Long-term capital gains from sale of shares	Rs. 150,000

Tax Rate	10% on capital gain exceeding Rs. 100,000 under Section 112A

(b) Computation of capital gains from transfer of 5,000 bonus shares

No. of shares [A]	5,000
Total purchase value [B]	*Nil*
Date of purchase	01-07-2021
Date of transfer	01-05-2022
Holding period	10 months
Selling price per share [C]	Rs. 120
Total sale consideration [D = A * C]	Rs. 600,000
Short-term capital gains [E = D – B]	Rs. 6,00,000
Tax rate	15% under Section 111A

12.1-4. Bonus Stripping

Section 94(8) of the Income-tax Act - 1961, contains the provisions related to the Bonus stripping.

In a bonus-stripping transaction, securities or units are purchased and sold near to the record date. This practice is adopted to evade tax by generating the losses which arise due to automatic reduction in the market value of the securities or units to the extent of the amount of reserve utilized for allotment of bonus securities or units. Thus, to prevent the avoidance of tax in this manner, this provision provides for disallowance of any loss arising to the unitholder on account of such arrangements.

12.1-4a. When losses are disallowed?

The losses arising from the transfer of securities or unit shall be disallowed, if the following conditions are satisfied:

- *(a)* any person buys or acquires securities or unit ('Original Securities or units') within a period of 3 months prior to the record date;
- *(b)* such person is allotted additional securities or units ('Bonus Securities or units') without any payment on the basis of holding of original securities or units on such date;
- *(c)* such person transfers all or any of his original securities or units within a period of 9 months after such date while continuing to hold all or any of the bonus securities or units.

12.1-4b. How much losses are disallowed?

If the above conditions are satisfied, then the loss, if any, arising to him on account of such purchase and sale of all or any of original securities or units shall be ignored for the purposes of computing his income chargeable to tax. The amount of loss so ignored shall be deemed to be the cost of acquisition of such bonus securities or units as are held by him on the date of such sale or transfer.

12.1-4c. Meaning of Securities, Unit, and Record Date for Bonus Stripping

The terms ‘securities’, ‘unit’, and ‘record date’ are defined for the purpose of Bonus stripping as under:

Meaning of Securities

"Securities" is defined to include includes stocks and shares. Further, it is provided that securities shall be deemed to be similar if they entitle their holders to the same rights against the same persons as to capital and interest and the same remedies for the enforcement of those rights, notwithstanding any difference in the total nominal amounts of the respective securities or in the form in which they are held or in the manner in which they can be transferred.

Meaning of Unit

‘Unit' is defined to mean:

(a) Unit of a Business Trust; or

(b) Unit of a Mutual Fund or UTI; or

(c) Beneficial interest (including shares or partnership interest) of an investor in an Alternative Investment Fund.

Meaning of Record Date

'Record date' means a date fixed by—

(a) a Company; or

(b) a Mutual Fund; or

(c) a Business Trust; or

(d) an Alternative Investment Fund

for the purposes of entitlement of the holder of the securities or units to receive additional securities or units without any consideration.

12.2 TAXATION ON SHARE SPLIT OR CONSOLIDATION OF SHARES

12.2-1. Meaning of Stock split

The process of dividing the outstanding shares into further smaller shares is known as a stock split. A stock split or stock divide increases the number of shares in a company. If a company declares a stock split, the number of shares of that company increases, but the market cap remains the same.

12.2-2. Meaning of Consolidation of shares

Share consolidation is a process conducted by the company with the intention to reduce its number of shares without reducing the share capital. The shares of the company are merged to reduce the number of shares and thereby increasing the market value of the shares. Consolidation of shares would lead to a decrease in the number of shares whilst an increase in the market price per share.

12.2-3. Taxation under the head capital gains

Section 45 provides that any profit or gain arising from transfer of a capital asset is taxable during the previous year in which such transfer takes place. Section 2(47) provides an inclusive definition of the term "Transfer". However, splitting or consolidation of shares is not covered within the definition of transfer. Further, Section 55 provides that the cost of acquisition of such shares shall be determined with reference to the cost of acquisition of the shares or stock from which such asset is derived. Thus, it can be interpreted that no tax will be levied at the time of splitting or consolidation of shares. Tax implications will arise only at the time of sale of such converted shares. In such cases, the capital gains shall be computed as follows:

12.2-3a. Cost of acquisition of shares after consolidation

In the case of consolidation of shares, the cost of acquisition shall be the total amount paid to acquire the original shares apportioned between the consolidated shares. Let's understand this with the help of an example.

Example 2*,* Mr A acquired 2,000 shares of XYZ Ltd. at its face value of Rs. 100 per share. Subsequently, the company announces to consolidate 2 shares of face value Rs. 100 per share into one share having a face value of Rs. 200. After the consolidation, Mr A will hold 1,000 shares of XYZ Ltd. of the face value of Rs. 200 each. The cost of acquisition of such consolidated shares shall be Rs. 200 per share (Rs. 200,000/1,000).

12.2-3b. Cost of acquisition of shares after the split

Amount paid originally by the investor for acquiring the shares shall be divided proportionately to the split shares for the purpose of determining the cost of acquisition of the shares.

Example 3, Mr A purchased 1,000 shares of XYZ Ltd. having face value Rs. 100 for Rs. 150 per share. Subsequently, the company announces to split its one share of Rs. 100 into two shares of face value of Rs. 50 each. Now, after splitting up Mr A will hold 2,000 shares having face value of Rs. 50 each. Cost of acquisition of such shares shall be Rs. 75 per share (Rs. 150,000/2000 shares).

12.2-3c. Period of holding

As referred in *para 12.2-3* above, consolidation or splitting of shares does not amount to transfer and its cost is to be computed with reference to the cost of acquisition of the shares or stock from which such asset is derived, based on said principle it can be interpreted that the period of holding with respect to the split/consolidated shares shall be calculated from the date of acquisition of the original shares.

For other provisions relating to computation of sale consideration, calculation of capital gains and the rate of tax, refer relevant paragraphs of Taxation of Bonus Shares.

12.2-4. Taxation under the head PGBP

If the shares are held as stock-in-trade, gains will be calculated only at the time of transfer of such split up or consolidated shares. As per ICDS-VIII (Securities), the shares held as stock-in-trade shall be recorded in the books at their cost of acquisition.

12.2-4a. Subsequent Valuation

At the end of any previous year, the listed securities, which have been held as stock-in-trade, shall be valued at actual cost initially recognised or net realisable value at the end of that previous year, whichever is *lower*.

For this purpose, the actual cost shall be determined as per the specific identification method. Under this method, specific costs are attributed to the identified items of securities. If the application of this method is not practically possible, then the First-In-First-Out method or Weighted Average method can be applied.

The net realisable value of listed securities, for this purpose, shall be the price at which it is quoted at stock exchange *less* estimated cost to be incurred on its sale.

The comparison of actual cost initially recognised and net realisable value shall be done category-wise and not for each security. For this purpose, securities shall be classified into the following categories:

a) Shares
b) Debt Securities
c) Convertible Securities
d) Any other securities not covered above

Marked-to-market loss, computed as per this ICDS, arising on the subsequent valuation of listed securities held as stock-in-trade shall be allowed as a deduction under Section 36(1)(xviii). If the notional loss is not computed in accordance with this ICDS, it shall be disallowed under Section 40A(13). Whereas if any gain arises due to such valuation, it shall be taxable as business income under Section 28. All these adjustments shall be made in the taxable business profits and will be reflected separately in ITR and tax audit report.

The securities, which are not listed or which are listed but not quoted on a recognised stock exchange, shall be recognised in the books at the actual cost at which it has been recognised initially. The ICDS does not allow to compute the marked-to-market losses in respect of such securities. Thus, if any notional gain or loss is recognized by the assessee in the books, it shall be disallowed by virtue of Section 40A(13).

For other provisions relating to computation of business profits and the rate of tax, refer relevant paragraphs of Taxation of Bonus Shares.

***Example 4**,* Mr Rishabh purchased 10,000 shares of a company at Rs. 400 per share. These shares were held by him as stock-in-trade. Subsequently, the company announces to split the shares from one share having a face value of Rs. 100 each into two shares of Rs. 50 each. He sold all shares (20,000 shares) at Rs. 207 each. Compute his business income.

Answer

After splitting, the cost of acquisition of a share shall be the amount originally paid by the investor for acquiring the shares as divided by the number of shares in hand after split-up. Thus, the cost of acquisition shall be Rs. 200 per share (Rs. 40 lakh/20,000 shares).

As the shares are held as stock-in-trade and sold for Rs. 207 per share, the amount of business income chargeable to tax in the hands of Mr Rishabh shall be Rs. 140,000 [20,000 shares * (Rs. 207 – Rs. 200)].

12.3 TAXATION OF BUYBACK OF SHARES

12.3-1. Meaning of buy-back of shares

‘Buy-back’ of shares means the purchase by a company of its own shares in accordance with the provisions of any law for the time being in force[153] relating to companies.

12.3-2. Domestic co. liable to pay tax

As per section 115QA, if a domestic company purchases its own shares under a buyback scheme, such a company shall be liable to pay tax on the distributed income. On the other hand, the consideration so received by the shareholders under the scheme shall be exempt from tax under Section 10(34A).

"Distributed income" means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for the issue of such shares.

Only domestic company shall be liable to pay tax on the amount of distributed income paid to the shareholders at the time of buy-back of shares (listed or unlisted). However, if a foreign company pays consideration to buy-back shares from its Indian shareholders, the shareholders shall be liable to pay tax on the amount of capital gains arising from such transfer. The capital gains, in such a case, shall be computed in accordance with Section 46A.

12.3-3. How much tax is payable by the company?

The domestic company shall be liable to pay tax at the rate of 20% (*plus* 12% surcharge and 4% cess) of the distributed profit. The effective tax rate shall be 23.296%. The tax payable by the domestic company under this provision is an additional tax liability that shall be payable irrespective of the fact that the regular income tax is payable or not payable by the company on its total income.

12.3-4. Payment of Tax

The tax on the distributed income shall be paid by the company to the credit of the central government through challan No. ITNS 280 within 14 days from the date of payment of any consideration.

The above tax shall be the final payment of tax in respect of the income on buy-back of shares and no credit thereof can be claimed either by the company or by any other person in respect of the tax paid. Further, no deduction under any other provision of the Act is allowed to the company or shareholder in respect of income distributed or the tax paid thereon.

12.3-5. Consequences of Default

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[153] SEBI (Buy-Back of Securities) Regulations 2018 and Section 68 of the Companies Act, 2013

If the tax on distributed income is not paid within the specified time limit, the company shall be liable to pay simple interest at the rate of 1% per month (or part of the month) for the period beginning immediately after the last date on which tax was payable and ending with the date of actual payment. Also, the principal officer of the company and the company shall be deemed to be an assessee-in-default for the amount of tax payable.

Example 5, Mr X subscribed 10,000 shares of ABC Ltd. (a domestic company) at the rate of Rs. 100 per share. The issuer co. announced to buyback the shares at Rs. 125 per share. Discuss the liability in the hands of the company and Mr X.

Answer

(a) Taxability in the hands of Mr X

No income shall be assessable in the hands of Mr X as income arising in the hands of the shareholder due to buy-back of shares is exempt under section 10(34A).

(b) Taxability in the hands of the company

If a domestic company purchases its own shares under a buy-back scheme, such company shall be liable to pay tax on distributed income. The computation of tax shall be as follows:

Particulars	*Amount*
Number of shares bought back [A]	10,000
Issue price [B]	Rs. 100 per share
Buy-back price [C]	Rs. 125 per share
Distributed Income [D=C-B]	Rs. 25 per share
Total amount assessable as distributed income [E = D * A]	Rs. 250,000
Tax payable by the company [E * 23.296%]	Rs. 58,240

12.4 TAXATION OF COMPANIES IN LIQUIDATION

12.4-1. Meaning of Liquidation

The term ‘liquidation’ and ‘winding up’ are used interchangeably. In general terms, winding refers to the process of ending the business of the company while liquidation means selling assets of the company and the term dissolution means official extinction of the corporate person.

In case of liquidation of a company, the assets remaining after payment of all liabilities of the companies are distributed among the equity shareholders. Such distribution of assets to the shareholders is not treated as transfer by the company for the purpose of capital gains. However, the shareholder shall be liable to pay capital gain tax on the market value of the asset so received as consideration for shares held in the company provided the same is not deemed as dividend in accordance with the provisions of Section 2(22)(c).

12.4-2. Tax liability in the hands of the co.

As per Section 46, where the assets of a company are distributed to the shareholders on its liquidation, such distribution is not regarded as transfer by the company. Therefore, no capital gains arise in the hands of the company on account of any distribution of assets to the shareholders. However, if the liquidator sells the assets and distributes the cash so realised to the shareholders, then the company shall be liable to tax on the capital gains arising from the sale of the assets.

12.4-3. Tax liability in the hands of the shareholders

Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not, is treated as deemed dividend taxable under the head income from other sources. It is important to note that any amount distributed over and above the amount treated as dividend is taxable as capital gains in the hands of the shareholder. The provisions are equally applicable to a foreign investor as it is income deemed to accrue or arise in India. In determining the period of holding of shares held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation shall be excluded. The capital gains shall be liable to tax in the year in which assets are distributed to the shareholders.

The capital gains accruing to a shareholder from the distribution of assets by a company in liquidation is determined in accordance with the following provisions:

Particulars	*Amount*
Sales Consideration (Market Value of asset on date of distribution)	xxx
Less:	
Amount treated as deemed dividend under Section 2(22)(c) (chargeable to tax under IFOS)	(xxx)
Less:	
a) Cost of acquisition/Indexed Cost of acquisition of shares	(xxx)
b) Expenditure in connection with transfer	(xxx)
Short-term Capital Gains/Long-term Capital Gains	**xxx**

Example 6, Mr X acquired 20% shareholding in ABC Ltd. for Rs. 20,00,000 (20,000 shares at Rs. 100 each) on 01-01-2010. The company went into liquidation on 30-06-2018. The accumulated profits of the company on the date of liquidation was Rs. 15,00,000. Mr X received machinery worth Rs. 60 lakhs from the liquidator on 01-05-2022. Discuss the taxability in hands of the ABC Ltd. and Mr X.

Answer

(a) Taxability in the hands of ABC Ltd.

Where the assets of a company are distributed to the shareholders on its liquidation, such distribution is not regarded as transfer by the company. Therefore, no capital gains shall arise in the hands of the company on account of distribution of assets to the shareholders.

(b) Taxability in the hands of Mr X

Any distribution to the shareholders on liquidation of co., to the extent it is attributable to the accumulated profits of the company, is treated as deemed dividend taxable under the head income from other sources. In the given example, the accumulated profit of the company on the date of liquidation was Rs. 15,00,000 and the percentage of shareholding of Mr X was 20%. Thus, the dividend taxable in the hands of Mr X shall be Rs. 3,00,000 (Rs. 15,00,000 *20%). The remaining amount shall be taxable as capital gains in the hands of shareholder. The capital gain shall be computed as follows:

Particulars	*Amount*
Sales Consideration (Market Value of asset on date of distribution)	60,00,000
Less: Amount treated as deemed dividend	3,00,000
Less: Indexed Cost of acquisition of shares (20,00,000 * 280/148) [Note]	37,83,784
Long-term Capital Gains (Period of holding 01-01-2010 to 30-06-2018)	**19,16,216**

As the asset is distributed to Mr X on 01-05-2022, any income arising either in the nature of dividend or capital gain shall be taxable in the financial year 2022-23.

Note: The Indexed Cost of acquisition is calculated in a two-step process. The first step is to calculate the cost of acquisition of capital asset. In the second step, such cost of acquisition is multiplied by the CII of the year in which capital asset is transferred and divided by CII of the year in which asset is acquired.

Here, it is to be noted that in determining the period of holding of shares held in a company in liquidation, there shall be excluded the period subsequent to the date on which the company goes into liquidation. Thus, the CII of year in which the company goes into liquidation, that is, year 2018-19 shall be taken as the CII of the year in which asset is transferred. The indexed cost of acquisition shall be calculated in the following manner:

$$\text{Indexed Cost of Acquisition} = \text{Cost of Acquisition (Rs. 20,00,000)} \times \frac{\text{CII of the year 2018-19 (280)}}{\text{CII of the year 2009-10 (148)}}$$

12.5 TAXATION OF RIGHTS ISSUES

12.5-1. Meaning of Right Issue

A rights issue is a way of raising additional capital, wherein, instead of going to the public, the company gives its existing shareholders the right to subscribe to newly issued shares in proportion to their existing holdings.

12.5-2. Taxability at the time of renunciation of right

In general, the existing shareholders are given a right to acquire shares of the company at a price which may be lower than the actual market price. There is an option with the shareholder either to purchase the shares at a given price or renounce his right in favour of some other investor and collect a fee from him for this purpose.

Any right available to a shareholder to subscribe to shares or any other security of a company is treated as a 'capital asset' under Income-tax Act. Capital gains will arise in the hands of the shareholder who renounces his right in favour of any other person. Gains and tax thereon shall be calculated in accordance with the following provisions.

12.5-2a. Cost of acquisition

The cost of acquisition of the rights so renounced shall be *nil*.

12.5-2b. Period of holding

If such capital asset is renounced in favour of any other person, the period of holding of such capital asset shall be reckoned from the date of offer made by the company to the date of renouncement. Such right is deemed as 'short-term' if it is held by an assessee for a period of not more than 36 months, immediately preceding the date of its transfer.

12.5-2c. Sale consideration

The sale consideration shall be the amount received or receivable by the person renouncing the right.

12.5-2d. Computation of capital gains

Particulars	*Amount*
Sale Consideration	xxx

Less: - Cost of acquisition - Expenditure in connection with transfer	 (xxx) (xxx)
Short-term capital gains	**xxx**

12.5-2e. Applicable tax rates

Such gains are generally in the nature of short-term capital gains, which shall be added to total taxable income and are chargeable to tax as per tax rate applicable according to the status of the assessee.

12.5-3. Taxability at the time of sale of shares

12.5-3a. Shares held as capital assets

Capital gains shall arise in the hands of the shareholder at the time of sale of such shares. Such gains shall be computed as under:

Particulars	*Amount*
Sale Consideration *Less:* - Cost of acquisition/Indexed Cost of acquisition of shares - Cost of improvement/Indexed Cost of improvement of shares - Expenditure in connection with the transfer	xxx (xxx) (xxx) (xxx)
Short-term Capital Gains/Long-term Capital Gains	**xxx**

Cost of acquisition of the right shares is the price paid by the shareholder for their acquisition. If assessee buys shares on basis of rights entitlements of an original shareholder, the cost of acquisition of the rights shares so acquired shall be aggregate of the amount paid by him to renouncer (original shareholder) and the amount paid by him to the company for acquiring such rights shares.

The period of holding is reckoned from the date of allotment of such right share or security. Following periods shall be considered while determining whether the same shall be regarded as long-term or short-term capital asset.

Type of shares and period of holding	*Nature of asset*
Unquoted shares held for not more than 24 months	Short term capital asset
Unquoted shares held for more than 24 months	Long term capital asset

Quoted shares held for not more than 12 months	Short term capital asset
Quoted shares held for more than 12 months	Long term capital asset

For other provisions relating to computation of sale consideration and the rate of tax, refer relevant paragraphs of Taxation of Bonus Shares.

12.5-3b. Sale of shares held as stock-in-trade

The profits arising from the transfer of right shares held as stock-in-trade, or from the renunciation of the right (obtained on basis of original shares held as stock-in-trade), shall be taxable as business income. Such business income shall be computed as per general provisions. The cost of acquisition of the rights so renounced shall be deemed to be *nil*.

Example 7, Mr Paul purchased 1,000 shares of ABC Ltd. on 01-04-2022 at Rs. 500 each. On 01-07-2022 the company announced the right issue in the ratio of 2:1 giving the existing shareholders a right to purchase the shares at Rs. 250 each. Ascertain the taxability in the following cases:

(a) Mr Paul renounced his right in favour of Mr X for Rs. 200 per share on 01-08-2022.
(b) Mr Paul exercised his right and the company allotted him 500 right shares as on 01-12-2022. On the date of allotment of right shares, the face market value of the shares was Rs. 510. He thereafter sold the shares at Rs. 520 on 25-01-2023. The shares of the company are listed on stock exchange. Thus, STT was charged at the time of transfer.

(a) Computation of income and tax thereon in case rights are renounced

If Mr Paul has renounced his right to subscribe for shares in favour of any other person. the capital gain arising from transfer of such right will be computed as follows:

Computation of capital gain on renouncement of right	
Particulars	*Amount*
Period of holding (from 01-07-2022 to 31-07-2022)	1 month
Nature of capital gain	Short-term capital gain
Full value of consideration (500 shares * Rs. 200)	Rs. 100,000
Less: Cost of acquisition	*Nil*
Short-term capital gain	Rs. 1,00,000
Tax rate on capital gain	Normal tax rates applicable to Mr Paul

(b) Computation of income and tax thereon in case rights are exercised and shares are subsequently transferred

Computation of capital gain on transfer of right shares	
Particulars	*Amount*
Period of holding (from 01-12-2022 to 24-01-2023)	Less than 2 months
Nature of capital gain (held for not more than 12 months)	Short-term capital gain
Sale Price (500 shares * Rs. 520 each)	Rs. 2,60,000
Less: Cost of Acquisition (500 shares * Rs. 250)	Rs. 1,25,000
Short-term capital gain	Rs. 1,35,000
Tax rate on capital gain	15%†
†As Mr. Paul has paid STT at the time transfer of shares, capital gain shall be chargeable to tax at the rate of 15% under Section 111A of the Income-tax Act.	

12.6 TAXATION IN CASE OF MERGERS &ACQUISITIONS

12.6-1. Meaning of Merger

The term merger and acquisition is not specifically defined under the Income-tax Act. In a general sense, merger is the voluntary fusion of two companies either by closing the existing companies and making a new one or by one company absorbing the other company. Quite often term amalgamation is interchangeably used with mergers.

Under the Income-tax Act, amalgamation is defined as the merger of one or more companies with another company or the merger of two or more companies to form one company (the company which is so merged referred to as the amalgamating company and the company with which it merges or which is formed as a result of the merger, the amalgamated company) in such a manner that:

a) All the property of the amalgamating co(s). ('transferor co.') immediately before the amalgamation becomes the property of the amalgamated co. ('transferee co.') by virtue of the amalgamation;
b) All the liabilities of the amalgamating co. immediately before the amalgamation become the liabilities of the amalgamated co. by virtue of the amalgamation;
c) Shareholders holding not less than 75% in value of the shares in the amalgamating co. (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated co. or its subsidiary) become shareholders of the amalgamated co. by virtue of the amalgamation.

The amalgamation should be otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

12.6-2. Taxability at the time of allocation of shares

In case such shares are held as capital asset, there will be no tax implication in the hands of the shareholder at the time of allotment of shares of the amalgamated company in lieu of shares held as capital asset in the amalgamating company as such transfer is not regarded as transfer as per Sec 47(vii) provided the amalgamated company is an Indian company.

However, where such shares are held as stock-in-trade, income arising at the time of such exchange shall be taxable under the head profit and gains from business or profession. ICDS VIII provides that where security is acquired in exchange for other securities, the fair value of the security so acquired shall be its actual cost. Applying the same principle, it can be concluded that income arising from such conversion shall be computed by treating the fair value of security so acquired as sale consideration of the securities given up. Thus, income arising from such conversion shall be computed as follows:

Particular	*Amount*
FMV of securities acquired in Amalgamating company	xxx
Less: Actual Cost of shares acquired in Amalgamated company	(xxx)
Less: Other expenses (if any)	(xxx)
Income taxable under the head PGBP	**xxx**

12.6-3. ***Taxability at the time of transfer of shares***

If the shares acquired in the amalgamated co. are held as a capital asset, the profits from its transfer shall be taxable under the head capital gains. On the other hands, if such shares are held as stock-in-trade, the profit or losses arising from the transfer shall be taxable under the head profits and gains from business or profession.

12.6-3a. Shares held as capital assets

The capital gains from the transfer of shares acquired in the amalgamated company shall be computed as per general provisions. The cost of acquisition of the shares acquired in the amalgamated company shall be the amount paid by the shareholder at the time of acquisition of original shares of the amalgamating company. The period of holding is reckoned from the date of acquisition of original shares in the amalgamating company.

For other provisions relating to computation of sale consideration and the rate of tax, refer relevant paragraphs of Taxation of Bonus Shares.

12.6-3b. Shares held as stock-in-trade

The gains or loss from the transfer of shares acquired in the amalgamated company shall be computed as per general provisions. Fair value of securities acquired under the scheme of amalgamation, i.e., shares of amalgamated company, shall be treated as actual cost of such securities while determining such income. For provisions relating to computation of business profits, refer relevant paragraphs of Taxation of Bonus Shares.

Example 8, Mr X purchased 10,000 shares of A Ltd on 01-04-2020 for Rs. 58 each for investment purpose. With effect from on 01-07-2020, A Ltd. amalgamated with B Ltd. to form a new company AB Ltd. Mr X was allotted 8,000 shares in the newly amalgamated company. He sold the shares of the amalgamated company for Rs. 100 per share on 01-06-2022. The shares of AB Ltd. are listed on a recognized stock exchange and STT was charged at the time of transfer. Compute his income and tax thereon.

Computation of capital gain on transfer of shares	
Particulars	*Amount*
Period of holding (from 01-04-2020 to 31-05-2022)	26 Months
Nature of capital gain (held for more than 12 months)	Long term capital gain
Sale Price (8,000 shares * Rs. 100 each)	Rs. 800,000
Less: Cost of acquisition of shares in the amalgamating co. (10,000 shares * Rs. 58)	Rs. 580,000
Long-term capital gain	Rs. 220,000
Tax rate on capital gain	10%†
†As Mr X has paid STT at the time transfer of units, capital gain shall be chargeable to tax at the rate of 10% under section 112A of the Income-tax Act on the gains that exceed Rs. 1,00,000. It is irrespective of the fact that STT is paid at the time of acquisition or not as CBDT vide Notification No. SO 5054(E), dated 1-10-2018, has exempted the condition of payment of STT at the time of acquisition in respect of listed shares acquired by any mode of transfer referred under Section 47.	

12.7 TAXATION IN CASE OF STOCK LENDING AND BORROWING

12.7-1. Meaning of Stock Lending and Borrowing

Stock Lending and Borrowing ('SLB') is a system wherein a person can lend his securities to a borrower through an approved intermediary for a specified period with the condition that the borrower would return equivalent securities of the same type or class at the end of the specified period along with all the corporate benefits which have accrued on securities (e.g., dividend) during the period of borrowing. It is temporary lending of securities executed by a lender to a borrower, for a stipulated duration, for a certain fee. The lending and borrowing of securities are regulated by the SEBI through the Securities Lending Scheme, 1997.

12.7-2. How does this scheme work?

The framework for Securities Lending and Borrowing (SLB) was specified by SEBI[154]. As per the circular, all market participants (including retail or institutional) in the Indian securities market are permitted to lend and borrow securities through an Authorized Intermediary (AI). Clearing corporation of NSE and BSE are approved as an Intermediary for this purpose.

The SLB takes place on an automated, screen-based, order-matching platform provided by the AIs which shall be independent of the other trading platforms. Further, only the securities traded in the F&O segment and liquid Index Exchange Traded Funds (ETFs)[155] are eligible for lending and borrowing under the scheme. The SLB contracts can be of different tenures ranging from 1 day to 12 months. But usually, they are entered for 1 month and the lender or borrower is allowed to roll over the contract but the total duration of the contract after taking into account rollovers shall not exceed 12 months from the date of the original contract.

The process of lending and borrowing of securities is as follows:

1) Lender and borrowers place an order with intermediary mentioning the stock, quantity to lend or borrow, time period, and lending fees. Thereafter, order matching takes place similar to trading on an exchange.
2) The lender is required to deposit 25% of the lending price (i.e., the total value of the stock) as a margin. If the lender lends securities on the date of the transaction itself, no margin is required to be deposited.
3) The borrower is required to deposit 100% of the lending price, lending fee, value at risk margins and extreme loss margins on an upfront basis and, thereafter, daily mark to market margin (MTM) is collected.
4) At the end of the contract, the lender gets back the stock and borrower margins are released. If the borrower fails to return the securities, the AIs shall have the right to liquidate the collateral deposited with it, in order to purchase from the market, the equivalent securities of the same class and type for the purpose of returning the equivalent securities to the lender.

12.7-3. Benefit of SLB to borrower and lender

The benefit of SLB for the lender is that it provides an incremental return on an idle portfolio. A person holding shares of a company with an intent to hold them for the long-term may earn an additional return in form of lending fees by lending such shares to the borrower for the short-term.

Whereas, a borrower can borrow securities to cover his short-positions, avoid settlement failure or for arbitrage or hedging strategies.

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[154] Circular No. MRD/DoP/SE/Dep/Cir-14/2007 dated December 20, 2007 as amended from time to time
[155] Introduced vide Circular No. MRD/DP/30/2012, dated 22-11-2012

For example, if the futures of a stock is trading at a discount, then a borrower can take advantage of SLB by selling the borrowed stock at spot price and buying stock futures.

12.7-4. Taxability in hands of lenders

Lenders can earn additional income from the idle portfolio held as they receive a certain fee to lend the stock, depending upon the demand and time value.

Any lending of scrips or security is not treated as exchange even if the lender does not receive back the same distinctive numbers of scrip or security certificate. The transaction of lending of shares or any other security under the securities lending scheme would not result in 'transfer' for the purpose of invoking the provisions relating to capital gains under the Income-tax Act pursuant to section 47(xv) of the Act. The department has also clarified[156] that transactions done in the SLB segment will not be treated as transfer.

However, the fee earned from lending business shall be taxable under the head 'profits and gains from business or profession' or 'Income from other sources'.

12.7-5. Taxability in hands of borrowers

The borrower purchases the stocks with the objective of selling them. Hence, any gains or losses arising to the borrower from the sale of such shares shall be taxable under the head capital gains or PGBP, as the case may be. The fee paid by the borrowers may be claimed as a deduction while computing the income under capital gains or PGBP.

Example 9, In December 2022, Mr A lends 10,000 shares of XYZ Ltd. for one month. He receives the lending fee of Rs. 200,000 (Rs. 20/share * 10,000 shares). As per terms of the contract, Mr A gets back his shares on the first Thursday of the month of Jan'2023. He paid transaction charges of Rs. 2,000 for lending of securities. Compute the amount of income chargeable to tax in hands of Mr A.

Answer

The fee earned from the lending of securities shall be taxable under the head 'profits and gains from business or profession' if the assessee is in the business thereof otherwise income shall be taxable under the head 'income from other sources'. The assessee can claim the deduction of the expenses incurred to earn such income.

Thus, in the given example, the amount of income taxable in the hands of Mr A shall be Rs. 1,98,000 (Rs. 2,00,000 – Rs. 2,000).

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[156]Circular No. 2/2008, dated 22-02-2008

Example 10, Mr B borrowed 10,000 shares of Reliance Ltd. on 01-06-2022 at a lending fee of Rs. 5 per share. On the said date, the share of Reliance Ltd. was trading at stock market at Rs. 1,600 per share. Mr B short-sell 1 lot of 10,000 shares at Rs. 1,600 in anticipation of a decrease in the share price. In order to hedge his position and avoid settlement risk, he bought the call option of Reliance Ltd. (1 lot of 10,000 shares) with an exercise price of Rs. 1,600 at a premium of Rs. 30 per share.

The expiry of the derivatives contracts (i.e., futures and options) of the month of June 2022 was 30-06-2022 and Mr B has to return the shares to the lender on the first Thursday of July 2022, i.e., 07-07-2022.

Compute the amount of income or loss arising to Mr B in the following situations:

(a) If on the date of expiry (30-06-2022) the share price of Reliance Ltd. came down to Rs. 1,500 as anticipated by Mr B. He squared off his short position at Rs. 1,500. Further, the call option that he purchased for the purpose of hedging was transferred at Rs. 10 per share.

(b) If on the date of expiry (30-06-2022) the share price of Reliance Ltd. increased to Rs. 1,700. As Mr B did not anticipate the increase in share price, he exercised the call option to take delivery of 10,000 shares to return them to the lender. The shares so borrowed by him were used to settle the short-position he made in Reliance Futures.

Answer

(a) Situation 1: Share price of Reliance Ltd. reduced to Rs. 1,500

The income or loss arising to Mr B shall be computed as follows:

Particulars	*Amount*
Futures	
- Profit of Rs. 100 per share arising after squaring off the short-position made at Rs. 1,600 per share [10,000 shares * (Rs. 1600 – Rs. 1500)]	10,00,000
Call Option	
- Loss of Rs. 20 per share arising on transfer of call option at Rs. 10 per share [10,000 shares * (Rs. 30 – Rs. 10)]	(-) 200,000
Lending Fees of Rs. 5 per share paid to borrow 10,000 shares	(-) 50,000
Net Profit	**7,50,000**
Tax rate	**Normal slab rate**

(b) Situation 2: Share price of Reliance Ltd. increased to Rs. 1,700

The income or loss arising to Mr B shall be computed as follows:

Particulars	*Amount*
Call option premium (10,000 shares * Rs. 30 per share)	300,000
Lending Fees (10,000 shares * Rs. 5 per share)	50,000
Total Loss	**3,50,000**

12.8 TAXATION IN CASE OF CONVERSION OF PREFERENCE SHARES INTO EQUITY SHARES

As per Section 2(47) of the Income-tax Act, 'transfer' includes the exchange of assets. When two persons mutually transfer the ownership of one thing for the ownership of another, and none of them is money, this transaction is treated as 'exchange'. Any conversion of an asset into another asset is an 'exchange'. It falls within the definition of transfer, and, consequently, the capital gain tax shall be charged on such transfer.

However, the Income-tax Act has specifically excluded certain types of transfer from the scope and meaning of the word 'transfer' in relation to a capital asset. Consequently, no capital gain shall arise on such transfer. These transactions are specified in Section 47 of the Act. The transaction of conversion of preference shares into equity shares has been excluded from the scope of transfer.

Section 47(xb) provides that any transfer by way of conversion of preference shares of a company into equity shares of that company would not amount to transfer. However, when a person subsequently sells equity shares, the cost of acquisition thereof shall be the same as that of the preference share. Further, the period of holding of equity shares shall be reckoned from the date of acquisition of the preference shares.

Example 11, Mr X acquired 20,000 preference shares of ABC Ltd. on 01-01-2010 at Rs. 10 each. The preference shares are converted into equity share on 01-01-2023 at a convertible ratio of 2:1 (1 equity share for every 2 preference shares). As a result, Mr X is allotted 10,000 equity shares of ABC Ltd. The fair market value of the equity share on the date of conversion is Rs. 25 per share. Mr X sold the shares on 25-03-2023 for Rs. 35 per share. Securities Transaction Tax (STT) was paid at the time of transfer of shares. What shall be the tax implications in the hands of Mr X in this case?

Answer

The tax implications in the hands of Mr X shall be as follows:

(a) Tax implication in case of conversion of preference shares into equity shares of the company on 01-01-2023

As per Section 47(xb) of the Income-tax Act, conversion of preference shares of a company into equity shares of that company is not treated as transfer. Thus, no capital gain shall arise on the conversion of preference shares into equity shares.

(b) Tax implication on transfer of equity shares on 25-03-2023

The cost of acquisition of the equity shares of ABC Ltd. acquired on the conversion of the preference shares, shall be the same as that of those preference shares. Further, the period of holding of equity shares shall be reckoned from the date of acquisition of the preference shares.

The capital gain arising on transfer of equity shares shall be computed in the financial year 2022-23 in the following manner:

Computation of capital gain on transfer of equity shares	
Particulars	*Amount*
Period of holding (from 01-01-2010 to 24-03-2023)	13+ Years
Nature of capital gain (Period of holding is more than 12 months)	Long-term capital gain
Full value of consideration (10,000 equity shares * Rs. 35) [A]	350,000
Less: Cost of acquisition (20,000 preference shares * Rs. 10) [B]	200,000
Long-term capital gain [C = A - B]	150,000
Tax rate on capital gain in excess of Rs. 100,000	10%†
†As STT has been paid at the time transfer of shares and acquisition is made by mode of transfer referred to in Section 47, long-term capital gain in excess of Rs. 100,000 shall be chargeable to tax at the rate of 10% under Section 112A of the Income-tax Act.	

12.9 TAXATION IN CASE OF CONVERSION OF STOCK INTO CAPITAL ASSET

Section 28(via) of the Income-tax Act provides that where the inventory of a business is converted into or treated as a capital asset, the income from such conversion shall be taxable under the head 'profit and gains from business or profession'. While determining such income, the FMV of the inventory on the date of conversion shall be considered.

12.9-1. Valuation of fair market value of stock on the date of conversion

Where shares or securities held as stock-in-trade are converted into capital asset then the fair market value of such shares or securities on the date of conversion is determined in the following manner:

12.9-1a. Valuation of quoted shares and securities

If shares and securities are listed on any recognized stock exchange, the fair market value of such shares and securities shall be the lowest price of such shares and securities quoted on any recognized stock exchange on the date of conversion.

Where on the date of conversion there is no trading in such shares and securities on any recognized stock exchange, the fair market value shall be the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the date of conversion when such shares and securities were traded on such stock exchange.

12.9-1b. Valuation of unquoted equity shares

The fair market value of unquoted equity shares shall be determined as per the following formula.

$$\text{Book Value of Assets} \;(\text{less})\; \text{Book Value of Liabilities} \times \frac{\text{Paid-up value of such equity shares}}{\text{Total amount of paid-up equity share capital as shown in the balance-sheet}}$$

Book value of assets: The value of certain assets to be included in the book value of assets shall be determined as per the following provisions:

(a) Value of Jewellery and artistic work as it would fetch in the open market on basis of valuation report obtained from a registered valuer;
(b) Value of shares and securities shall be the fair market value determined in the manner provided in Rule 11UA of the Income-tax Rules, 1962; and
(c) Value of immovable property shall be the value adopted by the authorities for payment of stamp duty in respect of such property.
(d) The book value of assets shall not include the following:
  - Amount of pre-paid taxes (i.e., TDS, TCS, Advance tax) as reduced by the amount of Income-tax refund claimed;
  - Any amount shown in the balance sheet as an asset that does not represent the value of any asset (i.e., unamortized amount of deferred expenditure, deferred tax asset, etc.)

Book value of liabilities: The book value of liabilities shall not include the following:

(a) Paid-up capital in respect of equity shares;
(b) Amount set aside for payment of dividend on preference shares and equity shares if such dividends have not been declared (before the date of transfer) at a general body meeting of the company;
(c) Reserves and surplus (even if the resulting figure is negative) other than those set apart towards depreciation;

(*d*) Excess provision for tax (including deferred tax liability)
(*e*) Provisions for unascertained liabilities;
(*f*) Contingent Liabilities.

Example 12, in the year 00, XYZ Pvt. Ltd. issued 10,000 shares having face of Rs. 10 each to Mr A at Rs. 120 per share. Book value of the assets and liabilities were as follows:

Particulars	*Amount (Rs.)*
Share Capital	1,00,00,000
General Reserves	10,00,000
Creditors	10,00,000
Long-term loans	10,00,000
Provision for tax (Including Rs. 5,00,000, being excess provision for tax)	10,00,000
Contingent liabilities	7,50,000
Total Liabilities and Capital	***1,47,50,000***
Land and building (Stamp Duty Value Rs. 75,00,000)	60,00,000
Jewellery (Fair Market value Rs. 17,00,000)	15,00,000
Plant and machinery	50,00,000
Furniture	4,00,000
Computer and other equipments	2,50,000
Paintings (Fair Market Value Rs. 90,000)	1,00,000
Other assets	9,50,000
Unamortized expenditure	5,50,000
Total Assets	***1,47,50,000***

The Fair market value of the shares shall be calculated as follows:

Amount received by the company	*Amount*
Total value of assets	1,47,50,000
Add/(Less): Adjustment of difference between book value and Fair Market Value	
Land and building	15,00,000

Jewellery Paintings *Less:* Unamortized expenditure	2,00,000 (10,000) (5,50,000)
Book value of asset (A)	*1,58,90,000*
Total value of capital and liabilities *Less:* Share Capital Reserves Provision for tax Contingent liabilities	1,47,50,000 (1,00,00,000) (10,00,000) (5,00,000) (7,50,000)
Book value of liabilities (B)	*25,00,000*
Amount received by the company for issue of shares [C= A - B]	**1,33,90,000**
Paid up value of equity shares held by Mr. A [D = 10,000 * 10]	1,00,000
Total amount of paid-up equity share capital [E]	1,00,00,000
Fair market value of shares held by Mr. A [E= C * D / E]	**1,33,900**
Fair market value per share [F = E / 10,000]	**13.39**

12.9-1c. Valuation of unquoted shares or securities (other than equity shares)

The fair market value of unquoted shares and securities (other than equity shares) in a company shall be estimated to be the price it would fetch if sold in the open market on the date of conversion and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.

12.9-2. Determination of cost of acquisition of converted asset

Where a stock-in-trade is converted into or treated as capital asset, fair market value of the stock on the date of conversion which has been taken into consideration for the purpose of determining the business income shall be considered as the cost of acquisition of the converted capital asset.

12.9-3. Period of holding of converted asset

Where a stock-in-trade is converted into or treated as capital asset, the period of holding of converted capital asset shall be reckoned from the date of the conversion or treatment as a capital asset.

Example 13, XYZ Ltd. was holding 10,000 quoted shares having book value of Rs. 200 each as stock-in-trade. On 01-09-2004, it converted 5,000 shares into capital asset. The lowest price of such share on the recognised stock exchange on the date of conversion was Rs. 219 per share. Such converted shares were transferred on 31-03-2023 for Rs. 250 each and STT paid at the time of transfer. Discuss the tax implications in hands of XYZ Ltd.

Computation of Business Income	
Particulars	*Amount*
FMV of shares on the date of conversion (5,000 * Rs. 219) [A]	10,95,000
Book value of shares converted (5,000 * Rs. 200) [B]	10,00,000
Income taxable under the head PGBP [C = B - A]	95,000

Computation of capital gains	
Particulars	*Amount*
Period of holding (from 01-09-2004 to 30-03-2023)	18+ years
Nature of capital gain (held for more than 12 months)	Long-term capital gain
Sale price (5,000 * Rs. 250) [A]	12,50,000
Cost of Acquisition (5,000 * Rs. 219) [B]	10,95,000
Long-term capital gain [C = A - B]	1,55,000
Applicable tax rate under Section 112A	10%*
*As conversion has taken place before 01-10-2004, requirement as to payment of STT has been exempted vide Notification No. SO 5054(E), dated 1-10-2018, thus, long-term capital gain in excess of Rs. 100,000 shall be chargeable to tax at the rate of 10% under Section 112A of the Income-tax Act even if no STT has been paid at the time of acquisition and transfer of shares.	

12.10 TAXATION IN CASE OF SEGREGATED PORTFOLIOS OF MUTUAL FUNDS

The SEBI[157] has permitted creation of a segregated portfolio of debt and money market instruments by Mutual Fund Schemes. As per the SEBI circular, all the existing unitholders in the affected scheme as on the day of the credit event shall be allotted an equal number of units in the segregated portfolio as held in the main portfolio. However, the SEBI has permitted the creation of a segregated portfolio of unrated debt or money market instruments by mutual fund schemes of an issuer that does not have any outstanding rated debt or money market instruments, subject to the conditions specified in the circular[158]. On

[157] Circular SEBI/HO/IMD/DF2/CIR/P/2018/160, dated 28-12-2018
[158] Circular SEBI/HO/IMD/DF2/CIR/P/2019/127, dated 07-11-2019

segregation, the unit holders come to hold the same number of units in two schemes - the main scheme and the segregated scheme.

Taxability of income arising from transfer of units of the segregated portfolio shall be similar as in the case of normal mutual funds *(refer para 5.8.).* However, the period of holding and cost of acquisition of these units shall be computed as follows.

12.10-1. Period of holding

In the case of a capital asset, being units in a segregated portfolio, the period for which the original units were held in the main portfolio is also included in the period of holding of the units acquired in the segregated portfolio.

Example 14, Mr X acquired units in the main portfolio on 01-06-2021. He was allotted units in the segregated portfolio on 01-04-2022. The period of holding of the units in the segregated portfolio shall be reckoned from 01-06-2021.

12.10-2. Cost of acquisition

Where a mutual fund segregates the portfolios, the cost of acquisition of units in the segregated portfolio shall be computed as follows:

$$\textit{Cost of acquisition of units in segregated portfolio} = \textit{Cost of acquisition of units in the total portfolio} \times \frac{\textit{Net asset value of the asset transferred to the segregated portfolio}}{\textit{Net asset value of the total portfolio immediately before the segregation of portfolios}}$$

Further, the cost of acquisition of these units shall be reduced from the cost of acquisition of units held in the main portfolio.

Example 15, Mr X acquired 1,000 units of a mutual fund on 01-04-2021 at Rs. 15 per unit. The mutual fund segregated the portfolio on 01-06-2022 and allotted 1,000 units of the segregated portfolio to Mr X whose net asset value (NAV) is Rs. 2 per unit. The NAV of the total portfolio on 31-05-2022 was Rs. 12 per unit. Compute the cost of acquisition of units of main portfolio and segregated portfolio after segregation of the portfolios.

Answer

The cost of acquisition of units in the segregated portfolio shall be computed as follows:

$$\textit{Cost of acquisition of units in segregated portfolio} = \textit{Cost of acquisition of units in the total portfolio [1,000 units * Rs. 15 per units]} \; X \; \frac{\textit{NAV of the asset transferred to the segregated portfolio [Rs. 2 per unit]}}{\textit{NAV of the total portfolio immediately before segregation of portfolios [Rs. 12 per unit]}}$$

Thus, the cost of acquisition of units in a segregated portfolio shall be Rs. 2,500 and cost per unit shall be Rs. 2.5 per unit (Rs. 2,500/1000 units).

The cost of acquisition of units in main portfolio shall be Rs. 12,500 [i.e., Original cost of acquisition (Rs. 15,000) *minus* Cost of acquisition of units in segregated portfolio (Rs. 2,500)].

12.11 TAXATION IN CASE OF CONSOLIDATION OF MUTUAL FUND SCHEME OR PLANS

Any transfer of units held by a unit-holder in the consolidating scheme of a mutual fund in consideration of allotment of units in the consolidated scheme of the mutual fund shall not be treated as transfer. The exemption is available provided the consolidation is of two or more schemes of an equity-oriented fund or two or more schemes of a fund other than an equity-oriented fund.

Similarly, any transfer of units held by a unit holder in the consolidating plan of a mutual fund scheme in consideration of allotment of units in the consolidated plan of that scheme shall not be treated as transfer.

Where such units are further transferred, the taxability will be similar as in case of normal mutual funds *(refer para 5.8.).* However, the period of holding and cost of acquisition of these units shall be computed as follows.

12.11-1. Period of holding

Where units of a mutual fund become the property of the assessee in the consolidation scheme of a mutual fund, the period for which the units were held under consolidating scheme is also included in the period of holding of units acquired.

Where units of the consolidated plan become the property of the assessee in the consolidation of the plans within the scheme of a mutual fund, the period for which the unit or units were held under consolidating plan within the scheme is also included in the period of holding of units acquired.

12.11-2. Cost of acquisition

Where units in a consolidated scheme of mutual fund became the property of the assessee in consideration of transfer of any units, held by him in the consolidating scheme of a mutual fund, the cost of acquisition of such units is deemed to be the cost of acquisition of the units held by him in consolidating scheme of the mutual fund.

Similarly, where units in a consolidated plan of mutual fund became the property of the assessee in consideration of any transfer of units, held by him in the consolidating plan of the same mutual fund, the cost of acquisition of such units is deemed to be the cost of acquisition of the units held by him in consolidating plan of the mutual fund.

Review Questions:

1. Which one of these is true with respect to Stock Split or Stock Divide?

(*a*) Process of dividing outstanding shares into smaller shares

(*b*) Stock Split or Stock Divide increases number of shares in the company

(*c*) Market Cap remains the same

(*d*) All of these

2. Which is true in case of liquidation of the company?

(*a*) All the liabilities are paid off first

(*b*) Remaining assets are distributed among the equity shareholders

(*c*) Such distribution of assets not treated as transfer for capital gains

(*d*) All of these

3. Amongst the following, which are the key characteristics of Rights Issue?

(*a*) Raise additional capital

(*b*) Offered to existing shareholders

(*c*) Offered in proportion to existing shares

(*d*) All of these

4. Which one of these is/are true regarding Securities Lending and Borrowing (SLB)?

(*a*) SLB executed on automated, screen-based, order-matching platform

(*b*) Securities traded in F&O segment and liquid Index Exchange Traded Funds (ETFs) are eligible

(*c*) Both (*a*) and (*b*)

Chapter 13: INDIRECT TAXES IN SECURITIES MARKETS

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Goods and Services Tax

The aim of this chapter is to discuss and provide an understanding of the concepts of Goods and Services Tax ('GST') applicable in Securities Markets. This chapter has been compiled keeping in mind the Central Goods and Services Tax Act, 2017 ('CGST Act') and the Integrated Goods and Services Tax Act, 2017 ('IGST Act'). Ordinarily, the provisions, procedures and rules are similar across the States, however, there are some State-specific exception. The present commentary does not cover such exceptional situations.

13.1 INTRODUCTION ABOUT THE GOODS AND SERVICES TAX

The GST is comprehensive indirect taxation that is levied on the supply of goods or services or both at the national level. This new indirect tax has subsumed multiple indirect taxes, *inter-alia*, Services-tax, VAT, Central Excise Duty, Additional Customs Duty, Special Additional Customs Duty, Entertainment Tax, Octroi, Entry Tax, Luxury Tax, etc.

GST is payable by any person making taxable supplies of goods or services or both and whose turnover on a pan-India basis exceeds the threshold limit. This threshold limit is Rs. 20 lakhs (10 lakhs in case of special category States) if the supplier is engaged in the business of supply of services or supply of both goods and services. If a supplier is engaged only in the supply of goods, the threshold limit shall be Rs. 40 lakhs (20 lakhs in case of special category States).

Under GST, generally, the supplier of goods or services is liable to pay GST to the Govt. This mechanism is referred to as forward charge of tax (forward charge mechanism). However, in few cases, the recipient is liable to pay GST and this mechanism is referred to as reverse charge mechanism. The supplies on which GST is required to be paid by the recipient on reverse charge basis are notified by the Govt. either under Section 9(3) or Section 9(4) of the CGST Act and respective State GST Acts. The services of lending of securities, under Securities Lending Scheme, 1997, by the lender is subject to reverse charge. In this case, the borrower of security is liable to pay GST.

GST is levied on all taxable supply of goods and services except the supply of alcoholic liquor for human consumption and specified petroleum products. GST is leviable at each point of supply of goods or services. The supplier of goods or services is entitled to claim credit of input tax except specifically ineligible credit or if it is towards exempt supplies of GST paid by him to the vendor on procurement of goods or services. The Central GST (CGST) and State

GST (SGST) shall be levied on intra-state supply and Integrated GST (IGST) shall be levied on inter-state supply of goods or services.

13.2 GST IMPLICATION ON MUTUAL FUNDS

The definition of 'Goods' and 'Services' under the CGST Act specifically excludes money and securities from its purview. The term 'Securities' shall have the same meaning as assigned to it in the Securities Contracts (Regulation) Act, 1956 ('SCRA').

As per the Securities Contracts (Regulation) Act, 1956, 'securities' include units or any other such instrument which is issued to the investors under any mutual fund scheme. However, Explanation to Section 2(h) of SCRA provides that 'securities' shall not include any unit-linked insurance policy ('ULIP') or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit-risk on the life of the persons and investment by such persons. Therefore, ULIPs will not be considered securities.

It is clear from the above discussion that mutual funds (except ULIPs) would be treated as securities under GST and securities have been specifically excluded from the definition of goods as well as services. Thus, the transaction in mutual fund units would not be liable to GST. Moreover, there will be no GST on the purchase or sale of Mutual Funds or any profit earned from the sale of mutual funds.

However, exit load in the form of a fee (whether or not as a fixed percentage of the investment) is liable to GST. Even if the exit load is in the form of units in the fund, it may be concluded that the consideration towards exit load received in money was later converted to NAV units and, thus, liable to GST.

Further, dividend received by an individual from Mutual Funds would not be subject to GST for being transaction purely in money and not towards the supply of any good or service.

13.3 GST IMPLICATION ON MUTUAL FUND DISTRIBUTOR

A mutual fund distributor is a person responsible for marketing and selling the units of a mutual fund company. In simple language, a mutual fund distributor is a person who arranges or facilitates the supply of mutual funds between the buyer of mutual funds and the Mutual Fund Company.

As per the provisions of Section 2(13) of the IGST Act, 'intermediary' means a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account.

A distributor earns a commission for bringing in investors into the mutual fund schemes. He acts as a mediator between the Mutual Fund Company and the buyer of mutual fund units. As discussed above, mutual funds are covered under 'securities', therefore, mutual fund distributor would qualify as an 'intermediary' under the GST legislation.

13.3-.1. GST Rate and HSN Code

To facilitate transparency, all goods and services have been given a separate HSN Code respectively. As a general rule, all services are subject to GST except where specific exemption has been provided. For services relating to the supply of mutual fund units by mutual fund distributors, the rate of GST shall be 18 per cent and HSN would be 9971.

However, if the turnover (i.e., Commission income and other income from the business, if any) of the Mutual Fund Distributor is up to Rs. 50 lakhs in the preceding financial year, he has an option to opt for the composition scheme of the service provider. In such a case, he shall be liable to pay 6 per cent GST and neither he would be entitled to claim an input tax credit of GST paid by him on procurement of goods or services nor the recipient can avail input tax credit of GST charged by the distributor.

13.3-.2. Registration

A person is required to take GST registration if the value of services rendered by him on a pan-India basis exceeds Rs. 20 lakhs (or Rs. 10 lakhs in case of special category States) except in a few cases where registration is must, *inter-alia*, non-resident taxable persons making taxable supply, liability to pay GST on a reverse charge basis, etc. Therefore, if Mutual Fund Distributor is not covered in the special cases, it would be required to obtain registration where his turnover (i.e., Commission and other income from the business, if any) exceeds Rs. 20 lakhs (or Rs. 10 lakhs in case of special category States) on a pan-India basis.

13.3-.3. Place of Supply

As discussed above, in respect of the intra-state supply of goods or services, CGST and SGST are levied and for inter-state supply, IGST is levied. Whether the supply of service is inter-state or intra-state is decided on the basis of the following two factors:

(a) Location of supplier of service; and
(b) Place of supply of service

If the location of supplier and place of supply both are in the same State, the transaction is referred to as intra-state supply. On the other hand, where the location of the supplier and place of supply are in different states, the supply is referred to as inter-state supply.

As per Section 12(12) of the IGST Act, 2017, the place of supply of banking and other financial services to any person shall be the location of the recipient of services on the records of the supplier of services. The address available on the records of the Bank or Financial Institution or Stock-Broker, which is ordinarily used for communication with the customer, may be considered as the 'Place of Supply'.

Therefore, the place of supply for services provided by distributors would be the location of the service recipient. The recipient of the service would be the person with whom the distributor has executed the contract. In case, the location of recipient of services is not on the records of the supplier, the place of supply shall be the location of the supplier of services.

If the location of the recipient is outside India, the place of supply shall be the location of the supplier of services.

13.3-.4. Time of Supply of Services

The liability to pay tax on supply of services shall arise at the time of supply of services, which shall be earlier of the following:

a) Date of supply of service, if the invoice is not issued within 30 days of supply of service;
b) Date of invoice, if the invoice is issued within 30 days of supply of service;
c) Date on which payment is credited to the bank account; or
d) Date on which payment is recorded in the books of account of the supplier.

Example 1, P of Delhi invested Rs. 10,000 in the ABC mutual funds of AMC Limited through XYZ mutual fund distributor of Mumbai (already registered under GST) on 1st April. The XYZ mutual fund distributor raised the invoice of Rs. 100 on 3rd April on P for its services. The distributor has also earned a commission of Rs. 150 from ABC mutual fund.

AMC Limited has declared a dividend of 2% on ABC Mutual Funds in July and Mr P has received his share of dividend of Rs. 200. These units are sold by P at Rs. 11,000 on 10th August.

Answer

(a) GST implications in the hands of Mr P

The sale and purchase of security would have no GST implications as this qualify as a transaction in securities. The dividend of Rs. 200 is also not subject to GST as this would qualify as transaction in money. The service charges of Rs. 100 charged by distributor will be chargeable to IGST in the hands of distributor, for being inter-State supplies, at the rate of 18%. The GST charged would become cost in the hands of Mr P

(b) GST implications in the hands of XYZ mutual fund distributor

The time of supply of services would be 3rd April, that is, the date of issue of invoice issued within 30 days from supply of service. The place of supply would be Delhi which is the location of recipient and accordingly, IGST at the rate of 18% will be charged on Rs. 100. The Commission charged from AMC Limited of Rs. 150 would also be subjected to GST.

13.4 GST IMPLICATION ON BROKING BUSINESS

Stock-brokers arrange the supply of securities between two or more persons. Like mutual fund distributors, stockbrokers would be treated as 'intermediary' for the purpose of GST. Brokerage earned by the stockbrokers from the broking business is subject to GST.

13.4-.1. Calculation of brokerage amount for GST

If the brokerage amount to be charged by the stock-brokers is inclusive of GST, the GST amount shall be calculated on the gross brokerage earned by the broker as per the following formula:

a) IGST = Gross Brokerage * (18/118)
b) CGST = Gross Brokerage * (9/109)
c) SGST = Gross Brokerage * (9/109)

13.4-.2. GST Rate, HSN-Code, Registration, Place of Supply and Time of Supply

The provisions relating to GST rate, HSN-code, Registration, Place of Supply and Time of Supply will be similar to Mutual Fund distributor. See *Para 13.3* to know about these concepts.

13.4-.3. Advance amount received from clients

If a client provides funds/securities to the stock-brokers in advance for the potential orders/trades, such advances will fall in the category of deposit and will not be considered as payment for supply of service. Deposit of money shall not be charged to GST until the stockbroker applies such deposit as a consideration in his books of accounts towards the supply of broking services.

13.5 GST IMPLICATION ON PMS, INVESTMENT ADVISER

Portfolio managers manage or administer a portfolio of securities or funds of the client. An investment advisor provides advice relating to an investment in securities or investment products for the benefit of the client. There is a hairline difference between services rendered by portfolio managers and investment advisors. Portfolio managers create and maintain an investment account while investment advisors create a plan of action for the benefit of clients.

Services of portfolio management or investment advice to the customers for consideration in the form of fee or commission qualify as 'supply of service' and liable to GST.

13.5-.1. GST Rate and HSN-Code

The HSN-code 997153 includes services relating to managing portfolio of others, on a fee or commission basis, except for pension funds. Portfolio management services are taxable at the rate of 18 per cent GST.

The HSN-code 997156 includes financial advisory services, market analysis and intelligence. Services rendered by investment advisors are taxable at the rate of 18 per cent.

13.5-.2. Registration, Place of Supply and Time of Supply

The provisions relating to GST rate, HSN-code, Registration, Place of Supply and Time of Supply will be similar to Mutual Fund distributor. See *Para 13.3* to know about these concepts.

13.6 GST IMPLICATIONS ON REITS, INVITS, AIF AND ANY OTHER MARKET INTERMEDIARY

The structure of Real Estate Investment Trusts (REITs) or Infrastructure Investment Trust (InvITs) is similar to that of a mutual fund. Sponsors set up the REITs or InvITs to collect money from the general public for investing in income-generating real estate properties or in specific infrastructure sector respectively. Alternative Investment Fund (AIF) functions on a similar structure as that of REITs or InvITs. AIF collects funds from sophisticated investors, whether Indian or foreign, for investing with a defined investment policy for the benefit of its investors.

The investors of REIT, INVIT or AIF are referred to as unit-holders. Incomes earned by REIT, INVIT or AIF are distributed to unit-holders.

13.6-.1. Taxability of REIT, INVIT and AIF

13.6-1a. Sale of units

Securities are outside the ambit of GST and accordingly sale of units of REITs or InvITs or AIF will not attract GST.

13.6-1b. Rental Income

GST is chargeable on the rental income earned by the REITs or InvITs or AIF at the rate of 18 per cent.

With effect from July 18, 2022, the services by way of renting of residential dwelling when provided by any person to a registered person are liable to GST under reverse charge and such a registered tenant would be liable to pay GST on such services. Notably, the liability under reverse charge would arise irrespective of whether the residential dwelling is used for commercial or residential purpose by the registered person. Therefore, where REITs or InvITs are providing rental service by way of renting of residential dwelling to the registered person then GST would be liable to paid by the registered tenant on reverse charge basis.

It is pertinent to note that where a residential dwelling is rented to a person other than a registered person and is used as a residence, the service of renting of such residential dwelling is exempt from GST. Notably, the said exemption entry also covers the services by way of renting of a residential dwelling to a registered proprietor where the residential dwelling is used in his personal capacity for use as his own residence, and such renting is on his own account and not that of the proprietorship concern.

13.6-1c. Sale of immovable property

GST is levied on the supply of goods or services or both. The term goods have been defined to include only movable property. Therefore, the supply of immovable property is outside the ambit of GST.

Notably, the supply of under-construction property where the entire consideration has been received before the issuance of completion certificate by the competent authority is treated as a supply of taxable service under GST.

However, the supply of a complex, building, civil structure or a part thereof for the purpose of sale to a buyer where the entire consideration has been received after the issuance of completion certificate by the competent authority, it shall not be treated as supply of taxable service and therefore not liable to GST.

13.6-.2. Taxability of Unit-holders

13.6-2a. Interest Income

Interest received by way of extending deposits, loans or advances is exempt from GST.

13.6-2b. Dividend Income

Income by way of dividend is not covered in GST ambit.

13.6-2c. Sale of units of REIT/INVIT

Securities are outside the ambit of GST and accordingly sale of units will not attract GST.

Example 2, An Infrastructure Investment Trust ('INVIT') has distributed the following incomes to the unit holders:

(a) Interest of Rs. 100 lakhs

(b) Dividend of Rs. 150 lakhs

The Trust has sold the units amounting to Rs. 50 lakhs. It also received rental income of Rs. 200 lakhs from leasing out the commercial properties.

(a) Taxability in the hands of unitholders

GST will not be levied on interest income of Rs. 100 lakhs as it is specifically exempted from GST. Similarly, no GST to be charged on the dividend income of Rs. 150 lakhs as it is a transaction in money, hence, outside the scope of GST.

(b) Taxability in the hands of 'INVIT'

Rs. 50 lakhs received from the sale of units will not attract GST as securities are outside the ambit of GST. However, the rental income of Rs. 200 lakhs from renting of commercial properties shall be subjected to GST at the rate of 18%.

13.6-.3. Taxability in case of lending of securities

The SEBI has prescribed the Securities Lending Scheme, 1997 for the purpose of facilitating lending and borrowing of securities. Under the Scheme, the lender of securities lends securities to a borrower through an approved intermediary under an agreement for a specified period. The borrowing is subject to the condition that the borrower will return equivalent securities of the same type or class at the end of the specified period along with the corporate benefits accruing on the securities borrowed. The transaction takes place through an electronic screen-based order matching mechanism provided by the recognised stock exchange in India.

13.6-3a. Lending fees earned by lenders

The lenders earn lending fee for lending their securities to the borrowers. The activity of lending of securities is not a transaction in securities as it does not involve the disposal of securities. The lending fee charged from the borrowers of securities has the character of consideration and this activity is taxable in GST at the rate of 18%.

The lending fees are liable to GST on the reverse charge mechanism. The borrower of securities shall be liable to discharge GST. The nature of GST to be paid shall be IGST under RCM.

13.6-3b. Commission earned by Intermediary

The activities of the intermediaries facilitating lending and borrowing of securities for commission or fee are also subjected to GST at the rate of 18%.

Review Questions:

1. Which one of these is true about Goods and Services Tax ('GST')

(*a*) Comprehensive indirect tax

(*b*) Levied at national level

(*c*) Applicable on supply of goods & services

(*d*) All of these

2. Whether the supply of service is inter-state or intra-state is decided on the basis of:

(*a*) Location of supplier of service

(*b*) Place of supply of service

(*c*) Both location and place of supplier of service

(*d*) None of these

3. SGST amount is calculated on Gross Brokerage on the basis of

(*a*) Gross Brokerage × (9/109)

(*b*) Gross Brokerage × (18/118)

(*c*) Gross Brokerage × (36/118)

4. Which one of these is/are correct with reference to GST applicability for REITs, InvITs and AIFs?

(*a*) Sale of units by REITs, InvITs and AIFs do not attract GST

(*b*) GST at the rate of 18 percent is chargeable on rental income earned by REITs, InvITs and AIFs

(c) **Both (a) and (b)**

ANNEXURES

Annexure A: Maintenance of Accounts

As per Section 44AA of the Income-tax Act, an assessee shall maintain books of accounts to enable the Assessing Officer (AO) to compute his total income. Such books of accounts are required to be maintained if their income or gross turnover/receipts during the specified period exceeds the prescribed threshold limit. If the threshold limit, as specified in the below table, is not crossed, the assessee shall not be required to maintain books of accounts in accordance with this provision. However, certain professionals are required to maintain their books of accounts irrespective of their gross receipts and income.

The books of account and documents should be kept and maintained for a period of 6 years from the end of the relevant assessment year. However, where assessment in relation to any assessment year has been reopened under Section 147 within the prescribed period, all the books of account and other documents which were kept and maintained at the time of reopening of the assessment should be kept and maintained till the assessment so reopened has been completed.

The table below demonstrates the requirement for maintaining books of accounts by different taxpayers. If a taxpayer exceeds either the threshold of income or gross turnover, he shall be required to maintain the books of account.

Nature of Business or Profession	*Category of Taxpayer*	*Threshold Limits*	
		For Income	*For Gross Turnover or Receipts*
Specified Professions [Note 1]	Any	Mandatory in every case except where presumptive taxation scheme under Section 44ADA is opted by the assessee	
Non-Specified Professions	Individual or HUF	More than Rs. 2,50,000 in any of the 3 years immediately preceding the previous year[Note 2]	More than Rs. 25 lakhs in any of the 3 years immediately preceding the previous year[Note 2]
Non-Specified Professions	Others	More than Rs. 1,20,000 in any of the 3 years immediately preceding the previous year[Note 2]	More than Rs. 10 lakhs in any of the 3 years immediately preceding the previous year[Note 2]
Business	Individual or HUF	More than Rs. 2,50,000 in any of the 3 years immediately	More than Rs. 25 lakhs in any of the 3 years immediately preceding the previous year[Note 2]

		preceding the previous year[Note 2]	
Business	Others	More than Rs. 1,20,000 in any of the 3 years immediately preceding the previous year [Note 2]	More than Rs. 10 lakhs in any of the 3 years immediately preceding the previous year[Note 2]
Business eligible for Presumptive Tax Scheme under Section 44AD	Resident Individual or HUF	Where the assessee has opted for the presumptive taxation scheme in any of the last 5 years but does not opt for the same in the current year and his income exceeds the maximum exemption limit in any previous year	
Business eligible for Presumptive Tax Scheme under Section 44AD	Resident Partnership Firm	Where the assessee has opted for the presumptive taxation scheme in any of the last 5 years but does not opt for the same in the current year.	
Assessee eligible for presumptive taxation scheme prescribed under Section 44ADA	Resident Individual	Assessee claims that his profit and gains from the profession are lower than 50% of total gross receipts and his total income exceeds the maximum exemption limit	
Assessee eligible for presumptive taxation scheme prescribed under Section 44ADA	Resident Partnership Firm	Assessee claims that his profit and gains from the profession are lower than 50% of total gross receipts	

Note 1: Meaning of Specified Profession:

a) Legal
b) Medical
c) Engineering
d) Architectural
e) Technical Consultancy
f) Interior decoration
g) Film artist
h) Authorized Representative[159]
i) Accountancy Profession
j) Company secretary

159 'Authorised Representative' means a person, who represents any other person, in lieu of fee or remuneration, before any Tribunal or statutory authority, but does not include an employee of the person so represented or a person carrying on legal profession or a person carrying on the profession of accountancy.

k) Information Technology

Note 2: Where business or profession has been set up during the previous year, the threshold limit of income or gross receipts of the current year shall be checked. In other words, in case of new business or profession, if income or turnover or receipt of current year, as the case may be, are not likely to exceed the threshold limit, the assessee shall not be required to maintain the books of account.

Annexure B: Due Date for Filing of Income-tax Return

(A) Due date for Filing of Original Return

Situations	*Due date for filing of return*
If the assessee is required to furnish a report of transfer pricing (TP) Audit in Form No. 3CEB	30th November
If the assessee is a partner in a firm who is required to furnish a report of Transfer Pricing (TP) Audit in Form No. 3CEB	30th November
If an Individual is a spouse of a person, being a partner in a firm required to furnish a report of Transfer Pricing (TP) Audit in Form No. 3CEB and the provisions of section 5A applies to such spouse.	30th November
Company assessee not required to furnish transfer pricing audit report in Form No. 3CEB	31st October
If an assessee is required to get its accounts audited under Income-tax Act or any other law	31st October
If the assessee is a partner in a firm whose accounts are required to be audited	31st October
If an Individual is spouse of a person, being a partner in a firm whose accounts are required to be audited, and the provisions of section 5A applies to such spouse.	31st October
In any other case	31st July

(B) Due Date for Filing of Revised or Belated Return

Assessment Years	*Limitation period for filing of revised return*	*Limitation period for filing of belated return*
From Assessment Year 2021-22 onwards[160]	3 months before the end of the relevant assessment year or completion of the assessment, whichever is earlier.	3 months before the end of the relevant assessment year or completion of the assessment, whichever is earlier.
From Assessment Year 2018-19 to Assessment Year 2020-21	End of the relevant assessment year or completion of the assessment, whichever is *earlier.*	End of the relevant assessment year or completion of the assessment, whichever is *earlier.*
For Assessment Year 2017-18	Within 1 year from the end of the relevant assessment	

[160] The limitation period has been reduced by the Finance Act, 2021, with effect from assessment year 2021-22

	year or completion of the assessment, whichever is *earlier.*	End of the relevant assessment year or completion of the assessment, whichever is *earlier.*
Up to Assessment Year 2016-17	Within 1 year from the end of the relevant assessment year or completion of the assessment, whichever is *earlier.*	Within 1 year from the end of the relevant assessment year or completion of the assessment, whichever is *earlier.*

(C) ***Due date for filing of updated return***

An updated return[161] can be filed by an assessee within 24 months from the end of the relevant assessment year (subject to certain conditions) irrespective of the fact whether the taxpayer has earlier filed the original, revised or belated return in respect of the relevant assessment year or not.

(D) ***Due dates of earlier years***

The CBDT sometimes extends the due date for furnishing of return of Income to remove the genuine hardships caused to the taxpayers. Where an assessee furnishes his return of income within such an extended period, it shall be deemed that the return has been filed on or before the due date. Here is a list of extended due dates for the last 6 assessment years:

Assessment Year	*Person required to file return by 30th November*	*Person required to file return by 30th September/31st October*[162]	*Person required to file return by 31st July*
2022-23	30-11-2022	07-11-2022[163]	31-07-2022
2021-22[164]	15-03-2022	15-03-2022	31-12-2021
2020-21[165]	15-02-2021	15-02-2021	10-01-2021
2019-20[166]	30-11-2020	30-11-2020	30-11-2020
2018-19	30-11-2018	31-10-2018[167]	31-08-2018[169]

[161] Inserted by the Finance Act, 2022, w.e.f. Assessment Year 2022-23.
[162] The due date has been changed from 'September 30' to 'October 31' by the Finance Act, 2020, with effect from Assessment Year 2020-21.
[163] The due date has been extended from October 31, 2022 to November 7, 2022 vide Circular No. 20/2022, dated 26-10-2022.
[164] Circular No. 17, dated 09-09-2021
[165] Notification S.O. 4805(E), dated 31-12-2020
[166] Order F.No. 225/150/2020-ITA-II, dated 30-09-2020
[167] Order [F.NO.225/358/2018/ITA-II], Dated 8-10-2018
[169] Order [F.NO.225/242/2018-ITA.II], Dated 26-7-2018

		(For Kerala –28-02-2019)[168]	(For Kerala – 15-09-2018)[170]
2017-18	30-11-2017	07-11-2017	05-08-2017
2016-17	30-11-2016 (For J&K –31-12-2016)	17-10-2016 (For J&K –31-12-2016)	05-08-2016 (For J&K –31-12-2016)
2015-16	30-11-2015	31-10-2015	07-09-2015

[168] Order F.No. 225/15/2019/ITA.II, Dated 27-2-2019
[170] Order [F.NO.225/242/2018/ITA.II], Dated 28-8-2018

Annexure C: Penalty for non-compliance

Under Income-tax Act, 1961 an assessee is required to comply with various requirements prescribed under the act. In case he fails to fulfil any such requirement he is liable for payment of penalty prescribed. Provisions relating to penalties under Income-tax Act, 1961 are as follows:

Section	*Description*	*Amount of Penalty*
221	Default in making payment of tax within the prescribed time	Such amount as the Assessing Officer may impose subject to a maximum limit of tax in arrears.
270A	Under-reporting of income	50% of tax payable on underreported income
270A	Under-reporting of income in consequence of misreporting of income	200% of tax payable on underreported income
271A	Failure to keep, maintain, or retain books of account or documents as required under section 44AA	Rs. 25,000
271AA	*(a)* Failure to keep and maintain prescribed information and documents referred to in Section 92D or failure to report such transaction. *(b)* Maintaining or furnishing incorrect information or document	2% of the value of each transaction
271AA	Where any person (a constituent entity of an international group referred to in section 286) fails to furnish the information and document in accordance with Section 92D.	Rs. 500,000
271AAB	Undisclosed income found in the search proceedings initiated on or after 15-12-2016	30% or 60% of the undisclosed income
271AAC	Income determined in case of an assessee includes any unexplained income (if such income is not included by the assessee in his return of income or tax has not been paid thereon in accordance with section 115BBE)	10% of the tax payable on unexplained income under Section 115BBE

271AAD	Where books of account maintained by any person include a false entry or any entry relevant for computation of total income has been omitted to evade tax liability.	Equals to the aggregate amount of such false entry or omitted entry.
271AAE[171]	Where any fund, trust, institution, university, etc. have violated the provisions of section 13(1)(c) or 21st proviso to section 10(23C)	For the first violation – to the extent income applied for the benefit of the person referred to in Section 13(3) For any violation in the subsequent year – Double the amount of income which was applied for the benefit of the person referred to in Section 13(3)
271B	Failure to get accounts audited or furnish such report as is required under section 44AB	0.5% of total sales, turnover or gross receipts or Rs. 150,000, whichever is *less.*
271BA	Failure to furnish report from a Chartered Accountant by any person who entered into an international transaction or specified domestic transaction as required under Section 92E.	Rs. 100,000
271C	Failure to deduct tax at source, failure to pay dividend distribution tax, or failure to pay or ensure payment of tax on winning in kind under Section 194B, failure to ensure payment of tax on winnings from online games in kind under Section 194BA, or failure to ensure payment of tax on benefit or perquisite provided in kind under Section 194R or failure to ensure payment of tax under Section 194S	100% of tax a person has failed to deduct or pay

[171] Inserted by the Finance Act, 2022, with effect from Assessment Year 2023-24.

	where the consideration for transfer of VDA is in kind[172]	
271CA	Failure to collect tax at source	100% of tax a person has failed to collect
271D	Accepting loan or deposit or specified sum in cash or in any mode in contravention to Section 269SS	100% of loan or deposit so taken or accepted
271DA	Receiving Rs. 2,00,000 or more in cash or in any mode in contravention to Section 269ST.	100% of the amount so received
271DB	Failure to provide a facility for acceptance of payment through prescribed electronic modes as referred to in Section 269SU	Rs. 5,000 per day
271E	Repayment of any loan or deposit or specified advance in cash or in any mode in contravention to Section 269T	100% of loan or deposit so repaid
271FA	Failure to furnish Statement of Financial Transaction or Reportable Account	Rs. 500 to Rs. 1,000 per day of default
271FAA(1)	Furnishing inaccurate information in the Statement of Financial Transaction or Reportable Account	Rs. 50,000
271FAA(2)[173]	Furnishing inaccurate information by the reporting financial institution in the Statement of Reportable Account due to false or inaccurate information submitted by the holder of the reportable account.	Rs. 5,000 for each inaccurate reportable account
271FAB	Failure to furnish a Statement by an eligible investment fund in Form 3CEK as required under Section 9A	Rs. 500,000
271G	Failure to furnish any information or document, relating to an international transaction or specified domestic transaction, as required under Section 92D(3)	2% of the value of the transaction for each failure

[172] The Finance Act, 2023 has amended Section 271C and such amendment will come into effect from 01-04-2023 for Sections 194B, 194R, and 194S, and from 01-07-2023 for Section 194BA.

[173] The Finance Act, 2023, with effect from 01.04.2023, has imposed an additional penalty of Rs. 5,000 on the reporting financial institutions if there is any inaccuracy in statement of reportable account and such inaccuracy is due to false or inaccurate information submitted by the holder of reportable accounts.

271GA	Failure by an Indian concern to furnish any information or document as required under Section 285A	2% of the transaction value if the right of management or control is transferred or Rs. 500,000 in any other case
271GB(1)	Failure to furnish report under section 286(2) in respect of international group	Rs. 5,000 per day (if the period of default does not exceed 1 month), otherwise Rs. 15,000 per day
271GB(2)	Failure to produce information or document to the prescribed tax authority under Section 286(6)	Rs. 5,000 per day (beginning immediately following the day on which the period for furnishing the information expires)
271GB(3)	Continuity of failure even after the order directing to pay penalty under section 271GB(1)/(2) has been served	Rs. 50,000 per day from the date of service of penalty order
271GB(4)	Furnishing inaccurate report under section 286(2) in respect of international group	Rs. 500,000
271H	Failure to furnish TDS/TCS Statement or on furnishing inaccurate information in such statement	Rs. 10,000 which can be extended up to Rs. 1 lakh
271-I	Failure to furnish information or furnishing inaccurate information in respect of payment made to a non-resident	Rs. 100,000
271J	Furnishing inaccurate information in a report or a certificate issued by a Chartered Accountant, Merchant Banker or a Registered Value	Rs. 10,000 for each certificate or report
271K	Failure to furnish a statement of donation or failure to issue a certificate	Rs. 10,000 which can be extended up to Rs. 1 lakh
272A	Failure to co-operate with income-tax authorities or failure to comply with the statutory requirements.	Rs. 10,000 for each default or Rs. 500 for every day during which default continues, as the case may be
272AA	Failure to furnish the information to the tax authorities entering into the place of business to collect certain information.	Up to Rs. 1,000
272B	Failure to comply with the provision of Section 139A such as failure to obtain	Rs. 10,000 for each default

	PAN, failure to quote PAN or Aadhaar, failure to authenticate PAN, etc.	
272BBB	Failure to obtain or Quote TAN	Rs. 10,000

Note: No penalty is imposable for any failure under sections 271(1)(*b*), 271A, 271AA, 271B, 271BA, 271BB, 271C, 271CA, 271D, 271E, 271F, 271FA, 271FAB, 271FB, 271G, 271GA, 271GB, 271H, 271-I, 271J, 272A(1)(*c*), 272A(1)(*d*), 272A(2), 272AA(1), 272B, 272BB(1), 272BB(1A) and 272BBB(1), 273(1)(b), 273(2)(b), 273(2)(c), if the person or assessee proves that there was reasonable cause for such failure (section 273B).

Annexure D: Summarized Tax Table – Product-wise

(A) Equity Products

Product	***Period of holding to qualify for long-term capital asset (in months)***	***Tax on short-term capital gain***			***Tax on long-term capital gain [Note 1]***			***Tax on dividend income***		
		In case of resident	*In case of non-resident*	*In case of FPIs or Specified fund [Note 6]*	*In case of resident*	*In case of non-resident*	*In case of FPIs or Specified fund [Note 6]*	*In case of resident* **[Note 7]**	*In case of non-resident* **[Note 8]**	*In case of FPIs or Specified fund [Note 6]*
Listed equity shares (STT Paid)	12	15%	15%	15%	10% **[Note 2]**	10% **[Note 2]**	10% **[Note 2]**	Normal tax rate	10% if received from IFSC unit otherwise 20%	• FPIs-20% • Specified Fund-10%
Listed equity shares (STT not paid)	12	Normal tax rate	Normal tax rate	30%	20% with indexation or 10% without indexation	20% with indexation or 10% without indexation	10%	Normal tax rate	10% if received from IFSC unit otherwise 20%	• FPIs-20% • Specified Fund-10%
Unlisted shares	24	Normal tax rate	Normal tax rate	30%	20% with indexation	10%without indexation and forex	10%	Normal tax rate	10% if received from IFSC	• FPIs-20% • Specified

						fluctuation			unit otherwise 20%	Fund- 10%
Listed Preference shares	12	Normal tax rate	Normal tax rate	30%	20% with indexation or 10% without indexation	20% with indexation or 10% without indexation	10%	Normal tax rate	10% if received from IFSC unit otherwise 20%	• FPIs- 20% • Specified Fund- 10%
Unlisted Preference shares	24	Normal tax rate	Normal tax rate	30%	20% with indexation	10% without indexation and forex fluctuation	10%	Normal tax rate	10% if received from IFSC unit otherwise 20%	• FPIs- 20% • Specified Fund- 10%
GDRs [Note 3]	36	Normal tax rate	Normal tax rate	30%	10% under section 115ACA and 20% with indexation in other cases	10% under section 115AC and 20% with indexation in other cases	10%	10% in section 115 ACA and Normal tax rate in other cases	10% if section 115AC applies or received from IFSC Unit and 20% in other cases	• FPIs- 20% • Specified Fund- 10%
Share warra	-	Normal	Normal	30%	-	-	-	-	-	-

nts [Note 4]		tax rate	tax rate							
Equity Oriented Mutual Funds (if STT Paid)	12	15%	15%	15%	10% [Note 2]	10% [Note 2]	10% [Note 2]	Normal tax rate	10% if received from IFSC unit otherwise 20%	• FPIs- 10% if unit purchased in foreign currency otherwise 20% • Specified Fund- 10%
Equity Oriented Mutual Funds (if STT not Paid)	12	Normal tax rate	Normal tax rate	30%	20% with indexation	20% with Indexation	10%	Normal tax rate	10% if received from IFSC unit otherwise 20%	• FPIs- 10% if unit purchased in foreign currency otherwise 20% • Specified Fund- 10%
Derivatives [Note 5]	-	-	-	30%	-	-	-	-	-	-

Note 1: Where the long-term capital gain is charged to tax at the rate of 20%, the benefit of indexation shall be allowed at the time of computing capital gain to the assessee. Further, a non-resident assessee, who has acquired shares or debentures in foreign currency, shall be allowed to compute capital gain in foreign currency in case of transfer of shares or debentures of an Indian company. However, if the long-term capital gain is charged to tax at the rate of 10% then no benefit of indexation and foreign currency fluctuation shall be allowed while computing capital gain.

Note 2: Tax on long-term capital gain arising from transfer of equity shares, units of an equity-oriented mutual fund, high premium ULIPs or units of REITs/ InVITs, chargeable to STT, shall not be levied if the aggregate amount of long-term capital gain earned during the year from transfer of said capital assets does not exceed Rs. 1,00,000.

Note 3: Tax rate in case of conversion of GDR into other security would be same as applicable at the time of transfer of GDRs.

Note 4: Tenure of share warrants shall not exceed 18 months from the date of their allotment in the IPO or Right Issue or FPO, as the case may be. Thus, short-term capital gain shall arise in every situation on the transfer of share warrants or conversion thereof into shares.

Note 5: Income from derivatives is considered as business income in case of every person other than FPIs and tax is charged as applicable tax rates. Transfer of derivatives would not lead to arise of long-term capital gains as the maximum holding period of derivatives is 3 months. However, in case of FPIs, the resultant gains from derivatives shall always be short-term capital gains.

Note 6: Specified funds mean Category III Alternative Investment Fund located in IFSC, entire units of which are held by non-residents (other than units held by sponsors or managers) or investment division of banking unit granted a certificate of registration as Category – I FPI as located in IFSC.

Note 7: A resident shareholder is allowed deduction of interest expenditure incurred to earn dividend income to the extent of 20% of total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person earn such dividend.

Note 8: A non-resident person or foreign company or FPI, as the case may be, shall not be allowed to deduct any expenditure from dividend income. Further, deduction under Chapter-VIA (i.e., section 80C to 80U) shall not be allowed from such income.

Note 9: The benefit of indexation will not be allowable in case a non-resident has purchased shares in, or debentures of an Indian company **in foreign currency.**

(B) Debt Products

Product	*Period of holding to qualify for long-term capital asset (in months)*	*Tax on short-term capital gain*			*Tax on long-term capital gain*			*Tax on interest/dividend income*		
		In case of resident	*In case of non-resident*	*In case of FPIs*	*In case of resident*	*In case of non-resident*	*In case of FPIs*	*In case of resident*	*In case of non-resident*	*In case of FPIs or specified fund [1]*
Sovereign Gold Bond (Listed) *[Note 1]*	12	Normal tax rate	Normal tax rate	-	20% with indexation or 10% without indexation	20% with indexation or 10% without indexation	-	Normal tax rate	Normal tax rate	-
Capital Indexed Bond (Listed)	12	Normal tax rate	Normal tax rate	30%	20% with indexation or 10% without indexation	20% with indexation or 10% without indexation	10% without indexation	Normal tax rate	Normal tax rate	• FPIs-20% • Specified Fund- 10%
Capital Indexed Bond (Unlisted)	36	Normal tax rate	Normal tax rate	30%	20% with indexation	10% without indexation	10% without indexation	Normal tax rate	Normal tax rate	• FPIs-20% • Specified Fund- 10%
Zero-coupon Bond	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	-	-	-
Rupee-denominated Bond or Masala Bond (Listed)	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	• Bonds listed on stock exchange located in IFSC- 4% if bonds are issued before 01-07-2023 and 9% if bonds are issued on or after 01-07-2023. • In any other case-5%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Rupee-denominated Bond or	36	Normal tax rate	Normal tax rate	30%	20% without indexation	10% without indexation	10% without indexation	Normal tax rate	5%	• FPIs-5% if covered under

Masala Bond (Unlisted)										Section 194LD otherwise 20% • Specified Fund- 10%
Foreign Currency Bond (Listed)	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	• Bonds listed on stock exchange located in IFSC- 4% if bonds are issued before 01-07-2023 and 9% if bonds are issued on or after 01-07-2023. • In any other case-5%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Foreign Currency Bond (Unlisted)	36	Normal tax rate	Normal tax rate	30%	20% without indexation	10% without indexation	10% without indexation	Normal tax rate	5%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Foreign Currency Convertible Bond (FCCB) (Listed)	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	10%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Foreign Currency Convertible Bond (FCCB) (Unlisted)	36	Normal tax rate	Normal tax rate	30%	20% without indexation	10% without indexation	10% without indexation	Normal tax rate	10%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%

Any other Bond (Listed)	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs- 20% • Specified Fund- 10%
Any other Bond (Unlisted)	36	Normal tax rate	Normal tax rate	30%	20% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs- 20% • Specified Fund- 10%
Treasury Bills (T-Bills)	-	Normal tax rate	Normal tax rate	30%	-	-	-	-	-	-
Dated Government Securities (Dated G-Secs) (Listed)	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Dated Government Securities (Dated G-Secs) (Unlisted)	36	Normal tax rate	Normal tax rate	30%	20% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Municipal Debt Securities	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs-5% if covered under Section 194LD otherwise 20% • Specified Fund- 10%
Commercial Papers	-	Normal tax rate	Normal tax rate	30%	-	-	-	-	-	-
Debentures (Listed)	12	Normal tax rate	Normal tax rate	30%	10% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs- 20% • Specified Fund- 10%
Debentures (Unlisted)	36	Normal tax rate	Normal tax rate	30%	20% without indexation	10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs- 20% • Specified Fund- 10%
Market Linked Debentures (MLDs)	-	Normal tax rate	Normal tax rate	30%	Normal tax rate	Normal tax rate	30%	-	-	-
Specified Mutual Funds (SMFs) *[Note 2]*	-	Normal tax rate	Normal tax rate	30%	Normal tax rate	Normal tax rate	30%	Normal tax rate	20%	• FPIs- 10% if purchased in foreign currency otherwise 20% • Specified Fund- 10%

Other Mutual Funds[Note 2]	36	Normal tax rate	Normal tax rate	30%	20% with indexation	20% with indexation if listed otherwise 10% without indexation	10% without indexation	Normal tax rate	20%	• FPIs- 10% if purchased in foreign currency otherwise 20% • Specified Fund- 10%

Note 1: Capital gain arising to an Individual on redemption of Sovereign Gold Bond shall not be chargeable to tax under section 47 of the Income-tax Act.

Note 2: A resident shareholder is allowed deduction of interest expenditure incurred to earn dividend income from specified or debt-oriented mutual funds to the extent of 20% of total dividend income. No further deduction shall be allowed for any other expenses including commission or remuneration paid to a banker or any other person for the purpose of realising such dividend. However, a non-resident person or foreign company or FPI, as the case may be, shall not be allowed to deduct any expenditure from dividend income. Further, deduction under Chapter-VIA (i.e., section 80C to 80U) shall not be allowed from such income.

(C) Other Products

1. Shares issued under Employee Stock Option Scheme (ESOPs)

Point of Taxation	***Nature of Income***	***Computation of Income***	***Tax Rate***	
			Resident	*Non-resident*
At the time of allotment of shares	Perquisite	FMV of shares at the time of exercising of option *minus* amount recovered from the employee	Normal Tax Rate	Normal Tax Rate
At the time of sale of shares	Short-term capital gain	Sale Consideration *minus* Cost of Acquisition *[Note 2]*	15% in case shares are chargeable to STT otherwise normal tax rate	15% in case shares are chargeable to STT otherwise normal tax rate
	Long-term capital gain	Sale Consideration *minus* Cost of Acquisition *[Note 2]*	10% without indexation in case shares are chargeable to STT *[Note 1]*	10% without indexation [Note 1 and 2]

			otherwise 20% with Indexation	

Note 1: In case shares are chargeable to STT, no tax shall be levied if the aggregate amount of long-term capital gain doesn't exceed Rs. 1,00,000. If the amount of capital gain exceeds Rs. 1,00,000 then tax shall be levied at the rate of 10% on the amount of capital gain in excess of Rs. 1,00,000.

Note 2: Cost of acquisition of shares allotted under ESOP shall be the FMV of shares at the time of exercising of option by the assessee.

2. National Pension System (NPS)

National pension system (NPS)	***Taxability***
Contribution to NPS	
d) Employees' contribution to NPS	The deduction is allowed under section 80CCD up to 10% of salary *plus* additional deduction is allowed up to Rs. 50,000.
e) Employers' contribution to NPS	The deduction is allowed up to 14% of salary in case of Central or State Government employees. In case of any other employer, the limit is 10% of salary.
f) Any other person not being an employee	Up to 20% of the gross total income of such person *plus* an additional deduction of Rs. 50,000 is allowed.
Accumulation	Tax-free
Lump-sum withdrawal	
f) Partial withdrawal	Exempt only in case of employees to the extent of 25% of employee's contribution to NPS.
g) Final withdrawal at the time of closure of account or opting out of the scheme (employee as well as non—employee)	Exempt up to 60% of the total corpus available in the NPS account of the subscriber.
h) Amount received by the nominee on the death of subscriber	Fully exempt

Pension Income	
Pension received out of NPS or annuity plan of LIC or any other insurer	Fully Taxable

3. Real Estate Investment Trust (REITs) or Infrastructure Investment Trusts (InVITs)

Nature of sum received	*Taxability in the hands of*		
	REIT	*InVIT*	*Unit holders*
Interest from SPV	Exempt [Section 10(23FC)(a)]	Exempt [Section 10(23FC)(a)]	Taxable [Income from business]
Dividend from SPV (SPV has exercised option under Section 115BAA)	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FC)(b)]	Taxable [Income from business/other sources]
Dividend from SPV (SPV has not exercised option under Section 115BAA)	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FC)(b)]	Exempt [Section 10(23FD)]
Rental income from property owned by trust	Exempt [Section 10(23FCA)]	Taxable [Income from business]	Taxable (if received from REIT) [Income from business]
Other sum or income (if taxable in hands of business trust)	Taxable [Income from business/capital gain/ other sources]	Taxable [Income from business/capital gain/ other sources]	Exempt [Section 10(23FD)]
Other sum or income (if not taxable in the hands of business trust)	Not taxable	Not taxable	Taxable [Income from other sources under section 56(2)(xii)]

Tax on capital gain arising to unit holder from redemption or transfer of units of REITs/InVITs		
Nature of Income	*Tax Rates*	
	Resident	*Non-Resident and foreign company*
Redemption of units of business trust	Normal tax rate [Income from other sources under Section 56(2)(xii)]	

Short-term capital gains from transfer of units of business trust (other than redemption)	*(c)* 15% under Section 111A (in the case of listed units) *(d)* Applicable rate (in case of unlisted units)	
Long-term capital gains from the transfer of units of business trust (other than redemption)	*(c)* 10% under Section 112A (listed units) *(d)* 20% under Section 112 (unlisted units)	*(c)* 10% under Section 112A (listed units) *(d)* 10% under Section 112 (unlisted units)
* No benefit of indexation and foreign exchange fluctuation shall be allowed where the long-term capital gain is taxable at the rate of 10%.		

4. Alternative Investment Fund (AIFs)

Category of AIF	*Nature of Income*	*Tax implication in hands of AIF*	*Tax implication in hands of unit-holders*
Category I and Category II AIF	Business Income	*(a)* Taxable as per applicable tax rate if AIF is a Company or a Firm *(b)* Taxable at a maximum marginal rate of 42.744% if AIF is registered as any other body corporate [Section 115UB]	Exempt [Section 10(23FBB)]
	Other than business income	Exempt [Section 10(23FBA)]	Taxable as per applicable tax rate [Section 115UB]
Specified Category III AIF	Income from securities other than units referred under section 115AB	Taxable, unless exempt under Section 10(4D), as per the following tax rates: *(a)* Interest or Dividend: 10%; *(b)* Short-term capital gain: 15% or 30%; *(c)* Long-term capital gain: 10% [Section 115AD]	Exempt [Section 10(23FBC)]
	Other Income	Taxable as per applicable tax rate	Exempt [Section 10(23FBC)]
Other Category III AIF	Any Income	Taxable as per applicable tax rate	Taxable as per applicable tax rate

Annexure E: Tax Rates for Assessment Year 2024-25

1. Individual or HUF

1.1. Normal tax rates as applicable in case of Individual/ HUF

Net income range	*Resident Super Senior Citizen*	*Resident Senior Citizen*	*Any other Individual/HUF*
Up to Rs. 2,50,000	*Nil*	*Nil*	*Nil*
Rs. 2,50,001- Rs. 3,00,000	*Nil*	*Nil*	*5%*
Rs. 3,00,001- Rs. 5,00,000	*Nil*	*5%*	*5%*
Rs. 5,00,001- Rs. 10,00,000	20%	20%	20%
Above Rs. 10,00,000	30%	30%	30%

1.2. Alternative tax rates applicable to Individual/HUF under section 115BAC

Net Income Range	***Assessment Year 2024-25***
Upto Rs. 3,00,000	-
Rs. 3,00,001 to Rs. 6,00,000	5%
Rs. 6,00,001 to Rs. 9,00,000	10%
Rs. 9,00,001 to Rs. 12,00,000	15%
Rs. 12,00,001 to Rs. 15,00,000	20%
Above Rs. 15,00,000	30%

1.3. AMT

An individual is liable to pay Alternative Minimum Tax where tax payable by him, on his total income computed as per normal provisions of the Act, is less than 18.5% of 'adjusted total income'. In such a case the 'adjusted total income' is taken as income of such individual and he shall be liable to pay tax at the rate of 18.5% *plus* surcharge and cess (*please refer Annexure E for relevant rates*) of such 'adjusted total income'. The tax rate shall be 9% if the assessee is located in an International Financial Services Centre (IFSC) and derives income solely in convertible foreign exchange.

If he opts to compute his income tax liability as per the provisions of section 115BAC, he will not be required to pay AMT.

1.4. Rebate under Section 87A

In case of a resident individual, a rebate of up to Rs. 12,500 is allowed under Section 87A from the amount of tax if the total income of such individual does not exceed Rs. 500,000. However, a resident individual paying tax as per the new tax regime under Section 115BAC shall be allowed a higher amount of rebate under Section 87A if total income is upto Rs. 7,00,000. Further, even if the total income of the resident individual exceeds Rs. 7,00,000, he will still be eligible for the rebate with marginal relief. This means that the rebate amount will be gradually reduced as the income level increases, instead of being abruptly removed, providing some relief to resident individuals with slightly higher income[174].

However, no rebate shall be allowed from tax on long-term capital gain covered under section 112A.

1.5. Surcharge on tax whether computed as per the normal tax rates or new tax regime under section 115BAC

Nature of Income	*Range of Total Income*				
	Up to Rs. 50 lakh	*More than Rs. 50 lakh but up to Rs. 1 crore*	*More than Rs. 1 crore but up to Rs. 2 crore*	*More than Rs. 2 crore but up to Rs. 5 crore*	*More than Rs. 5 crore*
Short-term capital gain covered under Section 111A or under Section 115AD	*Nil*	10%	15%	15%	15%
Long-term capital gain covered under Sections 112, 112A and 115AD	*Nil*	10%	15%	15%	15%
Dividend income (not being dividend income chargeable to tax at a special rate under sections 115A, 115AB, 115AC, 115ACA)	*Nil*	10%	15%	15%	15%

[174] Amendment made by the Finance Act, 2023 with effect from Assessment Year 2024-25.

Unexplained income chargeable to tax under Section 115BBE	25%	25%	25%	25%	25%
Any other income	*Nil*	10%	15%	25%	37%*

* From the assessment year 2024-25, the surcharge rates on other income for assessee opting to pay tax under the new tax regime of Section 115BAC shall not exceed 25%. Thus, the income exceeding Rs. 5 crores shall be subject to the surcharge rate of 25% if the assessee opts for the new tax regime of Section 115BAC.

1.6. Health and education cess

The amount of income tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge.

2. AOP/BOI/ Artificial Judiciary person

2.1. Normal tax rates

Net income range	*Tax rate*
Up to Rs. 2,50,000	*Nil*
Rs. 2,50,001- Rs. 5,00,000	*5%*
Rs. 5,00,001- Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

2.2. Alternative tax rates applicable to AOP/BOI/AJP under section 115BAC

Net Income Range	***Assessment Year 2024-25***
Upto Rs. 3,00,000	-
Rs. 3,00,001 to Rs. 6,00,000	5%
Rs. 6,00,001 to Rs. 9,00,000	10%
Rs. 9,00,001 to Rs. 12,00,000	15%
Rs. 12,00,001 to Rs. 15,00,000	20%
Above Rs. 15,00,000	30%

2.3. AMT

An individual is liable to pay Alternative Minimum Tax where tax payable by him, on his total income computed as per normal provisions of the Act, is less than 18.5% of 'adjusted total income'. In such a case the 'adjusted total income' is taken as income of such individual and he shall be liable to pay tax at the rate of 18.5% of such 'adjusted total income'. The tax rate shall be 9% if the assessee is located in an International Financial Services Centre (IFSC) and derives income solely in convertible foreign exchange.

2.4. Surcharge

Nature of Income	*Range of Total Income*				
	Up to Rs. 50 lakh	*More than Rs. 50 lakh but up to Rs. 1 crore*	*More than Rs. 1 crore but up to Rs. 2 crore*	*More than Rs. 2 crore but up to Rs. 5 crore*	*More than Rs. 5 crore*
Short-term capital gain covered under Section 111A or Section 115AD	*Nil*	10%	15%	15%	15%
Long-term capital gain covered under Sections 112,112A and 115AD	*Nil*	10%	15%	15%	15%
Dividend income (not being dividend income chargeable to tax at a special rate under sections 115A, 115AB, 115AC, 115ACA)	*Nil*	10%	15%	15%	15%
Unexplained income chargeable to tax under Section 115BBE	25%	25%	25%	25%	25%
Any other income[See Notes]	*Nil*	10%	15%	25%	37%

***Note 1:** The surcharge on dividends earned by non-corporate Foreign Portfolio Investors shall be capped at 15%.**Note 2:** The rate of surcharge is capped to 15% in case of an AoP consisting of only companies as its members.*

***Note 3**: Where the total income of a specified fund, as referred to in Section 10(4D), includes income (other than capital gains) received in respect of securities taxable under Section 115AD, no surcharge shall be levied on tax on such income.*

***Note 4:** From the assessment year 2024-25, the surcharge rates on other income for AOP, BOI, or AJP opting to pay tax under the new tax regime of Section 115BAC shall not exceed 25%. Thus, the income exceeding Rs. 5 crores shall be subject to the surcharge rate of 25% instead of 37% if the assessee opts for the new tax regime of Section 115BAC.*

2.5. Health and education cess

The amount of income tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge. However, where the total income of a specified fund, as referred to in Section 10(4D), includes income (other than capital gains) received in respect of securities taxable under Section 115AD, no health and education cess shall be levied on tax on such income.

3. *Firm/ LLP*

3.1. Tax rate

A firm including an LLP shall be charged income tax at the rate of 30% on normal taxable income.

3.2. AMT

An individual is liable to pay Alternative Minimum Tax where tax payable by him, on his total income computed as per normal provisions of the Act, is less than 18.5% of 'adjusted total income'. In such a case the 'adjusted total income' is taken as income of such individual and he shall be liable to pay tax at the rate of 18.5% of such 'adjusted total income'. The tax rate shall be 9% if the assessee is located in an International Financial Services Centre (IFSC) and derives income solely in convertible foreign exchange.

3.3. Surcharge

Income range	Rate of surcharge
Up to Rs. 1crore	Nil
Exceeding Rs. 1 crore	12%

3.4. Health and education cess

The amount of income tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge.

4. *Companies*

4.1. Tax rates

Section	*Conditions*	*Tax Rates*
Domestic companies		
Section 115BA	1. The company is set up and registered on or after 01-03-2016; 2. It is engaged in manufacture or production of any article or thing; and 3. It does not claim specified exemption, incentive or deduction.	25%
Section 115BAB	1. The co. is set up and registered on or after 01-10-2019;	• Income from manufacturing activities or

	2. It is engaged in manufacture or production of any article or thing; 3. It is engaged in business of generation of electricity 4. It commences manufacturing on or after 01-10-2019 but on or before 31-03-2024; and 5. It does not claim specified exemption, incentive or deduction.	short-term capital gain from depreciable assets -15% • Income from non-manufacturing activities or short-term capital gain from non-depreciable assets -22%
Section 115BAA	If co. does not claim specified exemption, incentive or deduction.	22%
First Schedule to Finance Act	If total turnover or gross receipts during the financial year 2021-22 does not exceed Rs. 400 crore	25%
First Schedule to Finance Act	Any other domestic company	30%
Foreign companies		
First schedule to Finance Act	Any foreign company	40%

4.2. MAT

A domestic company is liable to pay Minimum Alternative Tax where tax payable by it, on total income computed as per normal provisions of the Act, is less than 15% of 'book profit'. In such a case the 'book profit' is taken as the income of the company and it shall be liable to pay tax at the rate of 15% of such 'book profit'. The tax rate shall be 9% if the assessee is located in an International Financial Services Centre (IFSC) and derives income solely in convertible foreign exchange.

However, if the company opts for a concessional tax regime either under section 115BAA or 115BAB, it will not be required to pay MAT. Additionally, the provisions of MAT do not apply in case of foreign companies if it does not have a permanent establishment (PE) in India or opts for presumptive taxation scheme of Section 44B, Section 44BB, Section 44BBA or Section 44BBB.

4.3. Surcharge

Company	*Range of Total Income†*		
	Rs. 1 crore or less	*Above Rs. 1 crore but up to Rs. 10 crore*	*Above Rs. 10 crore*
Domestic Company opting for section 115BA	*Nil*	7%	12%
Domestic Company opting for section 115BAA	10%	10%	10%
Domestic Company opting for section 115BAB	10%	10%	10%
Any other domestic company	*Nil*	7%	12%
Foreign company	*Nil*	2%	5%

4.4. Health and education cess

The amount of income tax and the applicable surcharge, shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge.

5. Co-operative societies or co-operative banks

5.1. Normal tax rates

Income range	*Tax rates*
Up to Rs. 10,000	10%
Rs. 10,001- Rs. 20,000	20%
Above Rs. 20,000	30%

5.2. Tax rates for co-operative societies opting for section 115BAD

Section	Particulars	Tax rates
Section 115BAD	Income of the co-operative societies opting for this scheme shall be computed without providing various exemptions, deductions etc.	22%

5.3. Tax rates for co-operative societies opting for section 115BAE

Section	Particulars	Tax rates
Section 115BAE	1. The co-operative society is set up and registered on or after 01-04-2023; 2. It is engaged in the manufacture or production of any article or thing; 3. It commences manufacturing on or before 31-03-2024; and 4. It does not claim specified exemption, incentive or deduction.	• Income from manufacturing activities or short-term capital gain from

		depreciable assets -15% • Income from non-manufacturing activities or short-term capital gain from non-depreciable asset -22%

5.4. AMT

A co-op. society is liable to pay Alternative Minimum Tax where tax payable by it, on total income computed as per normal provisions of the Act, is less than 15% of 'adjusted total income'. In such a case the 'adjusted total income' is taken as the income of the co-op. society and it shall be liable to pay tax at the rate of 15% of such 'adjusted total income'.

However, if the co-operative society opts to compute its income in accordance with section 115BAD or section 115BAE, AMT provisions will not be applicable in its case.

5.5. Surcharge

Tax is computed as per normal tax rates	
Income Range	*Rate of surcharge*
Income up to Rs. 1 crore	Nil
Income exceeding Rs. 1 crore but up to Rs. 10 crore	7%
Income exceeding Rs. 10 crore	12%
Tax Computed under section 115BAD or section 115BAE	
Any income	10%

5.6. Health and education cess

The amount of income tax and the applicable surcharge shall be further increased by health and education cess calculated at the rate of 4% of such income tax and surcharge.

6. Special tax rates

Income-tax Act prescribes the following special tax rates in respect of certain income:-

6.1. In case of capital gains

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 111A	Any Person	Short-term capital gains arising from transfer of equity shares or units of equity-oriented mutual fund or units of business trust if the transfer of such capital asset is chargeable to Securities Transaction Tax (STT)	15%
Section 112	Any person	Long-term capital gains arising from transfer of listed securities (other than a unit) or zero-coupon bonds without giving effect to benefit of indexation.	10%
	Non-resident or foreign co.	Long-term capital gains arising from the transfer of unlisted shares or shares of closely held companies without giving effect to benefit of indexation and currency translation.	10%
	Any Person	Any other long-term capital gains	20%
Section 112A	Any Person	Long-term capital gains, in excess of Rs. 1 lakhs, arising from transfer of equity shares, units of equity-oriented mutual fund or units of business trust if the transfer of such capital asset is chargeable to Securities Transaction Tax (STT)	10%
Section 115AB	Overseas financial organization or offshore funds	Long-term capital gain arising from transfer of units of specified Mutual Funds or UTI purchased in foreign currency	10%
Section 115AC	Non-resident	Long-term capital gains arising from transfer of Bonds or GDRs of an Indian Company or Public sector company (PSU) purchased in foreign currency	10%
Section 115ACA	Resident Individual	Long-term capital gains arising from transfer of GDRs issued by an Indian company, engaged in specified knowledge-based industry or service, to its employees if such GDRs are purchased in foreign currency and capital gain is computed	10%

		without taking benefit of foreign exchange fluctuation and indexation.	
Section 115AD	Foreign Institutional Investors or specified fund (Refer chapter 11)	Short-term capital gains arising from transfer of equity shares or units of equity-oriented mutual fund or units of business trust as covered under Section 111A	15%
		Short-term capital gains arising from transfer of any other securities	30%
		Long-term capital gains in excess of Rs. 1 lakh arising from transfer of equity shares or units of equity-oriented mutual fund or units of business trust as covered under Section 112A	10%
		Long-term capital gains arising from transfer of other securities provided capital gain is computed without taking benefit of foreign exchange fluctuation and indexation.	10%
Section 115E	Non-resident Indian	Long-term capital gains arising from transfer of specified asset purchased in foreign currency	10%
Section 115BBH	Any Person	Income from transfer of any Virtual Digital Asset (VDA)	30%

6.2. In case of interest income

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or Foreign Co.	Interest received from Government or an Indian concern on monies borrowed or debt incurred by such Government or Indian concern in foreign currency	20%
	Non-resident or Foreign Co.	Interest received from notified Infrastructure Debt Fund as referred to in Section 10(47)	5%

	Non-resident or Foreign Co.	Interest received from an Indian Co. or business trust as specified in Section 194LC, i.e., interest in respect of monies borrowed by them in foreign currency or long-term infrastructure bonds or rupee-denominated bonds.	• Interest payable in respect of long-term bonds or rupee-denominated bonds listed on a recognised stock exchange in IFSC- 4% if bonds are issued before 01-07-2023 and 9% if bonds are issued on or after 01-07-2023. • In any other case- 5%
	Non-resident or Foreign Co.	Interest on rupee-denominated bonds of an Indian Co. or Government Securities or municipal debt securities as referred to in Section 194LD	5%
	Non-resident or Foreign Co.	Interest income distributed by business trust to its unitholders as referred to in Section 194LBA.	5%
Section 115AC	Non-resident	Interest on bonds of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10%
Section 115AD	Foreign Institutional Investor	Interest on rupee-denominated bonds of an Indian Company or Government Securities or municipal debt securities	5%
Section 115AD	Foreign Institutional Investor	Other Interest from securities (other than income from units of specified mutual fund or units of UTI purchased in foreign currency)	20%

Section 115AD	Specified fund (Refer chapter 11)	Interest income from securities (other than income from units of specified mutual fund or units of UTI purchased in foreign currency)	10%

6.3. In case of dividend income

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or foreign co.	Dividend income	10% if dividend is received from a unit in an IFSC otherwise 20%
Section 115AC	Non-resident	Dividend on GDRs of an Indian Company or Public Sector Company (PSU) purchased in foreign currency	10%
Section 115ACA	Resident Individual	Dividend on GDRSs issued by an Indian company, engaged in specified knowledge-based industry or service, to its employees if such GDRs are purchased in foreign currency	10%
Section 115AD	Foreign Institutional investor	Dividend income from securities (other than dividend from units of specified mutual fund or units of UTI purchased in foreign currency)	20%
Section 115AD	Specified fund (Refer chapter 11)	Dividend income from securities (other than dividend from units of specified mutual fund or units of UTI purchased in foreign currency)	10%
Section 115AB	Overseas financial organization or offshore funds	Dividend income from units of specified Mutual Funds or of UTI purchased in foreign currency	10%

6.4. In case of other income from securities

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or Foreign Co.	Income received in respect of units of specified Mutual Funds or UTI purchased in foreign currency	20%
Section 115AB	Overseas financial organization or offshore funds	Income from units of specified Mutual Funds or of UTI purchased in foreign currency	10%
Section 115AD	Foreign Institutional investor	Income from securities (other than income from units of specified mutual fund or units of UTI purchased in foreign currency)	20%
Section 115AD	Specified fund (Refer chapter 11)	Income from securities (other than income from units of specified mutual fund or units of UTI purchased in foreign currency)	10%
Section 115E	Non-resident Indian	Income from the specified asset purchased in foreign currency	20%

6.5. In case of other incomes

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115A	Non-resident or Foreign Co.	Income by way of royalty or fees for technical services received from India concern or Government in pursuance of an approved agreement made after 31-3-1976. However, the benefit shall not be available if royalty or fees for technical services is connected with the assessee's Permanent Establishment (PE) in India.	20%
Section 115B	Assessee engaged in life insurance business	Profit and gains of life insurance business	12.5%

Section 115BB	Any person	Income by way of winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting of any form or nature whatsoever.	30%
Section 115BBA	Non-resident sportsman (foreign citizen)	Income of a sportsman: a) from participation in any game in India; b) advertisement; or c) from contribution of articles relating to any game or sport in India in newspapers, magazines or journals	20%
	Non-resident sport association	Any amount guaranteed to be paid or payable to a non-resident sports association concerning any game or sport played in India	20%
	Non-resident entertainer (foreign citizen)	Income of an entertainer from performance in India	20%
Section 115BBE	Any person	Undisclosed income as referred to in Sections 68, 69, 69A, 69B, 69C and 69D	60%
Section 115BBF	Resident person	Income by way of royalty in respect of a patent developed and registered in India	10%
Section 115BBG	Any person	Any income by way of transfer of carbon credits	10%
Section 115BBH	Any Person	Income from transfer of any Virtual Digital Asset (VDA)	30%
Section 115BBJ	Any Person	Income by way of winning from Online Games	30%

6.6. In case of trusts or investment funds

Section	*Assessee*	*Particulars*	*Tax Rate*
Section 115BBC	Any person	Anonymous donation	30%

Section 115BBI	Trust or institutions	Specified incomes of trusts or institutions as referred to in section 10(23C)(iv)/(v)/(vi)/(via) or section 11	30%
Section 115TD	Charitable and religious trust	Accreted income of trusts or institutions that voluntarily wind up its activities or merge with any other non-charitable institution or convert into a non-charitable organization.	Maximum Marginal Rate
Section 115UA	Business Trust	Income of a business trust (other than capital gain covered under Section 111A and Section 112) if not exempt from tax.	Maximum Marginal Rate
Section 115UB	Investment fund	Business income of Category-I or Category-II Alternative Investment Fund, where such fund is a domestic company or firm	30%
		Business income of Category-I or Category-II Alternative Investment Fund, where such fund is a foreign company	40%
		Business income of Category-I or Category-II Alternative Investment Fund, where such fund is any other person	Maximum Marginal Rate
Section 161	Trust	Profits and gains of a business in the case of trust except where such trust is declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him.	Maximum Marginal Rate
Section 164	Private discretionary trust	Income of trust where shares of the beneficiary are indeterminate.	Maximum Marginal Rate
Section 164A	Oral trust	Income of an oral trust	Maximum Marginal Rate

Section 167B	AOP or BOI	Income of AOP or BOI if shares of members are unknown	Maximum Marginal Rate
		Income of AOP or BOI if shares of members are unknown and total income of any member is chargeable to tax at a rate higher than the maximum marginal rate	Higher rate
		Income of AOP or BOI if shares of members are determinate and total income of any member does not exceed the maximum amount not chargeable to tax	Normal slab Rates
		Income of AOP or BOI if shares of members are determinate and total income of any member exceeds the maximum amount not chargeable to tax	Maximum Marginal Rate
		Income of AOP or BOI if shares of members are determinate and total income of any member is chargeable to tax at a rate higher than the maximum marginal rate	Higher rate on income attributable to such member Maximum Marginal Rate on the remaining income

Annexure F: Deductions under Income-tax Act

S. No.	*Section*	*Eligible investment or incomes*	*Who can claim?*	*Maximum deduction*
1.	Section 80C	Payment for life insurances, education expenses, contribution to provident fund, repayment of housing loan, contribution to certain small saving schemes, contribution to pension funds, or fixed deposits.	Individual or HUF	Rs. 150,000
2.	Section 80CCC	Amount deposited or paid to annuity pension plan of LIC or other insurers	Individual	Rs. 150,000
3.	Section 80CCD(1)	Contribution to National Pension Scheme (NPS) or Atal Pension Yojana	Individual	10% of Salary in case of an employee otherwise 20% of gross total income
	It should be noted that the aggregate amount of deduction under Section 80C, Section 80CCC and Section 80CCD(1) cannot exceed Rs. 150,000.			
4.	Section 80CCD(1B)	Additional contribution to NPS or Atal Pension Yojana	Individual	Rs. 50,000
5.	Section 80CCD(2)	Employer's contribution to NPS	Individual	14% of salary in case of Central or State Government's employee otherwise 10% of salary
6.	Section 80CCH	Contribution to Agniveer Corpus	Individual	100% of contribution
7.	Section 80D	Amount paid for health insurance policy, preventive health check-up, contribution to CGHS and expenditure on medical treatment	Individual or HUF	▪ Rs. 75,000 [where individual (incl his family) is less than 60 years of age and his parents

				are senior citizen) ▪ Rs. 1,00,000 [where both individual (incl. his any member of family) and his parents are senior citizens]
8.	Section 80DD	Incurs medical expenditure, or pays an insurance premium for the benefit, of a family member suffering from disability.	Resident Individual or HUF	▪ Rs. 75,000 (in case of disability) ▪ Rs. 125,000 (in case of severe disability)
9.	Section 80DDB	Amount incurred for medical treatment of prescribed disease or ailment.	Resident Individual or HUF	Rs. 40,000 (Rs. 100,000 in case of senior citizen)
10.	Section 80E	Interest paid on education loan taken for the higher education	Individual	Interest paid during the year
11.	Section 80EE	Interest payable on loan taken for acquisition of residential property. The loan should be sanctioned between 01-04-2016 and 31-03-2017.	Individual	Rs. 50,000
12.	Section 80EEA	Interest payable on loan taken for acquisition of residential property. The loan should be sanctioned between 01-04-2019 and 31-03-2022[175].	Individual	Rs. 150,000
13.	Section 80EEB	Interest payable on loan taken for acquiring an electric vehicle	Individual	Rs. 150,000
14.	Section 80G	Donation to specified institution or funds	Any assessee	50% to 100% of donation made

[175] The Finance Act, 2021 has extended the outer date from 31-03-2021 to 31-03-2022

15.	Section 80GG	Payment of rent for residential house property	Individual	Least of the following: ▪ Rent paid in excess of 10% of total income; ▪ Rs. 5,000 per month; or ▪ 25% of total income
16.	Section 80GGA	Donation for scientific research or rural development	Any assessee not having income from business or profession	100% of donation made
17.	Section 80GGB	Donation to a political party or an electoral trust	Indian company	100% of donation made
18.	Section 80GGC	Donation to a political party or an electoral trust	Any person, other than local authority or AJP funded by Govt.	100% of donation made
19.	Section 80-IA	Profits and gains derived from the following eligible businesses: *(a)* Developing, operating or maintaining Infrastructure Facility;	Any assessee	100% of profits (for 10 years out of 20 years[176])
		(b) Telecommunication Services;		100% of profits in first 5 years and 30% in next 5 years (for 10 years out of 15 years)
		(c) Developing, operating or maintaining an Industrial Park or SEZ;		100% of profits (for 10 years out of 15 years)

[176] Deduction shall be allowed for 10 years out of 15 years if infrastructure facility is a port, airport, inland waterway, inland port or navigational channel in the sea.

		(d) Generating or distributing power; or		100% of profits (for 10 years out of 15 years)
		(e) Reconstruction or revival of power generating plant.		100% of profits (for 10 years out of 15 years)
20.	Section 80-IAB	Profits and gains derived from any business of developing a Special Economic Zone (SEZ)	Any assessee	100% of profit (for 10 years out of 15 years)
21.	Section 80-IAC	Profits and gains derived by an eligible start-up	Company or an LLP	100% of profit and gains (for 3 years out of 10 years)
22.	Section 80-IB	Profits and gains derived from the following eligible businesses: *(a)* Industrial undertaking in backward area;	Any assessee	100% of profits in first 5 years and 25%/30% in next 5 years (for 10/12 years out of 15 years)
		(b) Undertaking engaged in production or refining of mineral oil or natural gas;		100% of profits (for 7 years)
		(c) Housing project; and		100% of profits from a housing project
		(d) Processing, Preservation and Packaging of specified food products.		100% of profits in first 5 years and 25%/30% in next 5 years
23.	Section 80-IBA	Profits derived from the business of developing and building housing projects	Any assessee	100% of profits from a housing project
24.	Section 80-IC	Profits derived from the business of manufacturing or production of articles in certain special category States	Any assessee	100% of profits in first 5 years and 25%/30% in next 5 years
25.	Section 80-IE	Profit derived from specified services and manufacturing activity in the States of Arunachal	Any assessee	100% of profits for 10 years

		Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura (North-Eastern States)		
26.	Section 80JJA	Income from collection and processing of bio-degradable waste	Any assessee	100% of profits for 5 years
27.	Section 80JJAA	Incurring cost on additional employees	Any assessee	30% of additional employee cost(for 3 years)
28.	Section 80LA	Income from offshore banking unit in SEZ or unit of an IFSC	Banks having an offshore banking unit in SEZ or a unit of IFSC	▪ 100% of profits in case of unit of IFSC (for 10 years out of 15 years) ▪ 100%[177] of profits for 10 years in case of offshore banking unit in SEZ
29.	Section 80M	Income by way of dividend received from a domestic company, a foreign company or a business trust	Domestic company	100% of dividend further distributed
30.	Section 80P	Interest income, dividend income and profits derived from business	Co-operative society	100% of specified income
31.	Section 80PA	Profit derived from processing or marketing of agricultural produce.	Producer Company	100% of profits
32.	Section 80QQB	Royalty or copyright fees in respect of books	Resident Individual	Rs. 300,000
33.	Section 80RRB	Royalty in respect of patents	Resident Individual	Rs. 300,000
34.	Section 80TTA	Interest earned on deposits in saving bank account	Individual or HUF	Rs. 10,000

[177] The Finance Act, 2023 has increased the amount of deduction available to the eligible assessees under section 80LA(1) from 50% to 100% with effect from assessment year 2023-24. Earlier, 100% deduction was allowed for the first 5 years and for the next 5 years, the deduction was reduced to 50% of specified income.

35.	Section 80TTB	Interest income earned from any bank deposits including fixed deposit	Resident Senior Citizen	Rs. 50,000
36.	Section 80U	A person suffering from a disability or severe disability	Resident Individual	▪ Rs. 75,000 (in case of disability) ▪ Rs. 125,000 (in case of severe disability)

Annexure G: Exemptions under Income-tax Act

(A) Income exempts under the head 'Salary'

Section	*Nature of Income*
Section 10(5)	Leave Travel Concession
Section 10(6)(ii)	Remuneration of specified diplomats and their staff
Section 10(6)(vi)	Remuneration of an employee of a foreign enterprise for services rendered by him during his stay in India
Section 10(6)(viii)	Remuneration of a foreign employee on a foreign ship
Section 10(6)(xi)	Remuneration of a foreign trainee
Section 10(7)	Allowance/perquisites to Government employee for rendering service outside India
Section 10(8)[178]	Income of foreign government employee under co-operative technical assistance programme
Section 10(10)	Gratuity
Section 10(10A)	Pension
Section 10(10AA)	Leave Salary
Section 10(10B)	Retrenchment Compensation
Section 10(10C)	Voluntary Retirement Compensation
Section 10(10CC)	Tax on non-monetary perquisites paid by the employer
Section 10(12)	Amount received from recognized Provident Fund subject to prescribed limit
Section 10(12C)[179]	Amount received from Agniveer Corpus Fund
Section 10(13)	Payment from an approved superannuation fund
Section 10(13A)	House Rent Allowance
Section 10(14)	Office Duty Allowances and Personal Allowances
Section 10(18)	Pension to gallantry award winner
Section 10(19)	Family pension received by the family members of armed forces

(B) Income exempt under the head 'Capital Gains'

Section	*Nature of Income*
Section 10(4E)	Any income from transfer of certain non-deliverable forward contracts or offshore derivative instruments or over-the-counter derivatives by a

[178] This exemption has been withdrawn by the Finance Act, 2022 with effect from Assessment Year 2023-24.
[179] Inserted by the Finance Act, 2023 with effect from Assessment Year 2023-24

	non-resident. Income distributed in respect of offshore derivative instruments is also exempt from tax[180].
Section 10(4H)[181]	Any income earned by a non-resident or unit of an IFSC on the transfer of shares of a domestic company engaged in the aircraft leasing business in IFSC.
Section 10(10D)	Any sum received under a life insurance policy except certain excessive and high premium life insurance policies (including ULIPs).
Section 10(23FF)	Capital gains from transfer of shares of a company resident in India on account of relocation of offshore funds[182]
Section 10(33)	Capital gains on transfer of unit of Unit Scheme – 1964
Section 10(37)	Capital gains on compulsory acquisition of urban agricultural land
Section 10(37A)	Capital gain on transfer of specified capital assets under land pooling scheme of the Andhra Pradesh Government.

(C) Income exempt under the head 'Income from other sources'

Section	*Nature of Income*
Section 10(4)(i)	Interest on notified securities and bonds
Section 10(4)(ii)	Interest on NRE account
Section 10(4C)	Interest on Rupee Denominated Bonds
Section 10(10BB)	Compensation for Bhopal Gas Leak Disaster
Section 10(10BC)	Compensation on account of any disaster
Section 10(11)	Amount received from public provident fund subject to prescribed limit
Section 10(11A)	Amount received from Sukanya Samriddhi Account
Section 10(12A)	Payment from the National Pension Scheme
Section 10(12B)	Partial withdrawal from NPS
Section 10(15)	Interest on specified securities as prescribed

(D) Income exempt under the head 'Profit and Gains from business and profession'

Section	*Nature of Income*
Section 10(2A)	Partner's share in the profit of the firm
Section 10(4F)	Royalty or interest income received by a non-resident from lease of aircraft or ship[183]
Section 10(6A)	Tax paid on behalf of foreign company on the royalty and fees for technical services

[180] Amendment made by the Finance Act, 2023 with effect from assessment year 2024-25
[181] Inserted by the Finance Act, 2023 with effect from assessment year 2024-25.
[182] Inserted by the Finance Act, 2021 with effect from Assessment year 2022-23

Section 10(6B)	Tax paid on behalf of foreign company or non-resident in respect of income not being salary, royalty or fees for technical services
Section 10(6BB)	Tax paid on behalf of foreign Government or foreign enterprise deriving income by way of lease of aircraft or aircraft engine
Section 10(6C)	Technical fees received by a notified foreign company
Section 10(6D)	Royalty/Fees received by non-resident from National Technical Research Organisation
Section 10(8A)/(8B)/(9)[184]	Remuneration in connection with technical assistance programme
Section 10(15A)	Lease rent of an aircraft
Section 10(30)	Subsidy from the Tea Board
Section 10(40)	Grants received by specified subsidiary company
Section 10(48)	Income on account of import of crude oil etc.
Section 10(48A)	Income on account of storage and sale of crude oil
Section 10(48B)	Income on account of sale of leftover stock of crude oil
Section 10(48C)	Income on account of replenishment of crude oil
Section 10(50)	Income which is subject to equalisation levy

(E) Income exempt of certain specified assessees

Section	*Nature of Income*
Section 10(2)	Amount received by member of HUF
Section 10(4D)	Certain Income arising to Specified fund (refer *para 11.6-5a*) to the extent units held by non-resident (not being the permanent establishment of a non-resident in India) or the investment division of offshore banking unit, as the case may be[185]
Section 10(4G)[186]	Income of a non-resident arising from portfolio of securities or financial products or funds, managed through IFSC or from the specified activity carried out by the specified person[187]
Section 10(20)	Income of local authority
Section 10(21)	Income of research association
Section 10(22B)[188]	Income of a news agency
Section 10(23A)	Income of a professional association
Section 10(23AA)	Income received on behalf of Regimental Fund
Section 10(23AAA)	Income of a fund established for welfare of employees

[184] This exemption has been withdrawn by the Finance Act, 2022 with effect from Assessment Year 2023-24.
[185] Amended by the Finance Act, 2021, with effect from assessment year 2022-2023
[186] Inserted by the Finance Act, 2022 with effect from Assessment Year 2023-24
[187] Amendment made by the Finance Act, 2023 with effect from assessment year 2024-25.
[188] The exemption under Section 10(22B) has been omitted by the Finance Act 2023 with effect from assessment year 2024-25.

Section 10(23AAB)	Income of pension fund
Section 10(23B)	Income from Khadi or village industry
Section 10(23BB)	Income of Khadi and Village Industries Boards
Section 10(23BBA)	Incomes of statutory bodies for the administration of public charitable trust
Section 10(23BBB)	Income of European Economic Community
Section 10(23BBC)	Income of SAARC fund
Section 10(23BBE)	Income of IRDAI
Section 10(23BBG)	Income of Central Electricity Regulatory Commission
Section 10(23BBH)	Income of the Prasar Bharati
Section 10(23D)	Income of mutual fund
Section 10(23DA)	Income of a securitisation trust
Section 10(23EA)/ 10(23EC)/ 10(23ED)	Income of Investor Protection Fund set up by stock exchange
Section 10(23EE)	Income of Core Settlement Guarantee Fund
Section 10(23FB)	Income of a venture capital fund or a venture capital company from investment in a venture capital undertaking
Section 10(23FBA)	Income of an investment fund
Section 10(23FC)]	Income of a Business Trust
Section 10(23FCA)	Certain income of a business trust, being a real estate investment trust
Section 10(23FE)	Certain income of wholly-owned subsidiary of Abu Dhabi Investment authority or Sovereign wealth fund or pension fund
Section 10(24)	Income of a registered trade union
Section 10(25)	Income of employee welfare funds
Section 10(25A)	Income of the Employees’ State Insurance Fund
Section 10(26)	Income of a member of a Scheduled Tribe
Section 10(26AAA)	Income of a Sikkimese individual
Section 10(26AAB)	Income of an Agricultural Produce Marketing Committee/Board
Section 10(26B)	Income of certain corporation established for promoting the interest of members of Scheduled Caste
Section 10(26BB)	Income of a corporation established for promoting the interest of minority caste
Section 10(26BBB)	Income of a corporation established for ex-servicemen
Section 10(27)	Income of a co-operative society formed for promoting the interests of the members of Scheduled Castes or Scheduled Tribes
Section 10(29A)	Income of coffee board, rubber board, etc.
Section 10(32)	Income of a minor child up to a certain limit and conditions
Section 10(39)	Income from an international sporting event
Section 10(42)	Income of certain non-profit body or authority

Section 10(44)	Income of New Pension System Trust
Section 10(46)	Exemption of specified income of notified body/ authority/trust/board/commission other than those covered under Section 10(46A)
Section 10(46A)[189]	Income of bodies or authorities or trusts or commissions that are established or constituted with the specific purposes of dealing with and satisfying the need of housing accommodation, planning, development or improvement of cities, towns or villages, regulating or regulating and developing any activity for the benefit of the general public, or regulating any matter, for the benefit of the general public.
Section 10(46B)[190]	Income of National Credit Guarantee Trustee Company Limited(NCGTC), Credit guarantee funds managed by NCGTC and Credit Guarantee Fund Trust for MSMEs
Section 10(47)	Any income of a notified infrastructure debt/fund
Section 10(48D)[191]	Any income accruing or arising to an institution established for financing the infrastructure and development
Section 10(48E)[192]	Any income accruing or arising to a developmental financing institution, licensed by the RBI

(F) Income exempt of certain funds, trust and institutions

Section	*Persons covered*
Section 10(23C)(i)	PM National Relief Fund and PM CARES Fund
Section 10(23C)(ii)	PM Fund for promotion of Folk Art
Section 10(23C)(iii)	PM Aid to Students Fund
Section 10(23C)(iiia)	National Foundation for Communal Harmony
Section 10(23C)(iiiaa)	Swachh Bharat Kosh
Section 10(23C)(iiiaaa)	Clear Ganga Fund
Section 10(23C)(iiiaaaa)	CM Relief Fund or Lieutenant Governor Relief Fund
Section 10(23C)(iiiab)	University or educational institution wholly or substantially financed by the government
Section 10(23C)(iiiad)	University or educational institution whose annual receipts do not exceed Rs. 5 crore[193]

[189] Inserted by the Finance Act, 2023 with effect from Assessment Year 2024-25.
[190] Inserted by the Finance Act, 2023 with effect from 1st April, 2024.
[191] Inserted by the Finance Act, 2021 with effect from assessment year 2022-2023
[192] Inserted by the Finance Act, 2021 with effect from assessment year 2022-2023
[193] The Finance Act, 2021 extended limit for annual receipts from Rs. 1 crore to Rs. 5 crore

Section 10(23C)(vi)	University or educational institution approved by the Principal Commissioner or Commissioner
Section 10(23C)(iiiac)	Hospital or other specified institution wholly or substantially financed by the government
Section 10(23C)(iiiae)	Hospital or other specified institution whose annual receipts do not exceed Rs. 5 crore[194]
Section 10(23C)(via)	Hospital or other specified institution approved by the Principal Commissioner or Commissioner
Section 10(23C)(iv)	Charitable Institution approved by the Principal Commissioner or Commissioner
Section 10(23C)(v)	Trust for Public religious and charitable institution approved by the Principal Commissioner or Commissioner

(G) Income exempt in the nature of distributed Income

Section	*Nature of Income*
Section 10(4E)	Income distributed by an IFSC banking unit to a non-resident in respect of offshore derivative instruments[195].
Section 10(23FBB)	Income referred to in section 115UB of a unit holder of an investment fund
Section 10(23FBC)	Income received by a unit holder of Category III AIF
Section 10(23FD)	Certain distributed Income of a Unit Holder from the Business Trust
Section 10(34A)	Income of a shareholder on account of buy back of shares by the company
Section 10(34B)[196]	Dividend income of an IFSC unit engaged in the aircraft leasing business from a company which is also an IFSC Unit engaged in the aircraft leasing business
Section 10(35A)	Income of an investor received from a securitisation trust

After the abolition of dividend distribution tax, no exemption is available under Section 10(34) and Section 10(35) for the dividend distributed by a company or a mutual fund, as the case may be.

(H) Others

Section	*Nature of Income*
Section 10(1)	Agriculture Income
Section 10(16)	Educational scholarship

[194] The Finance Act, 2021 extended limit for annual receipts from Rs. 1 crore to Rs. 5 crore
[195] Amendment made by the Finance Act, 2023 with effect from assessment year 2024-25.
[196] Inserted by the Finance Act, 2023 with effect from assessment year 2024-25

Section 10(17)	Daily allowance to a Member of Parliament or State Legislature
Section 10(17A)	Awards and Rewards
Section 10(19A)	Annual value of one palace
Section 10(43)	Loan in the case of reverse mortgage

Annexure H: Tax on transfer of securities

(A) Securities Transaction Tax (STT)

STT is charged on any transaction (other than the transaction in debt securities or debt mutual fund) carried out through a stock exchange in India. The rates of STT are as follows:

Transaction	*STT rate*	*Payable on*	*Payable by*
Purchase and sale of equity shares or units of business trust (Delivery based)	0.1%	Sale/Purchase price	Buyer and Seller
Purchase and sale of equity shares or unit of an equity oriented mutual fund or units of business trust (Intraday)	0.025%	Sale Price	Seller
Sale of an option in equity shares	0.0625%	Option Premium	Seller
Sale of an option in securities, where the option is exercised	0.125%	Settlement Price	Purchaser
Sale of a future in equity shares	0.0125%	Price at which future is traded	Seller
Sale/Redemption of units of equity-oriented mutual fund	0.001%	Sale Price	Seller
Sale or surrender or redemption of a unit of an equity-oriented fund to an insurance company, on maturity or partial withdrawal, with respect to ULIP issued by such insurance company on or after 01-02-2021[197].	0.001%	Sale Price	Seller
Sale of unlisted equity shares or unlisted units of business trust under an Initial Public Offer (IPO)	0.2%	Sale Price	Seller

(B) Commodities Transaction tax [CTT]

Commodities Transaction Tax (CTT) is a tax charged on transaction of sale of commodity derivatives or sale of commodity derivatives based on prices or indices of prices of commodity derivatives or option on commodity derivatives or option in goods in respect of commodities, other than agricultural commodities, traded in recognised stock exchange. CTT is chargeable as follows –

Taxable commodities transaction	*Rate*	*Payable on*	*Payable by*

[197] Inserted by the Finance Act, 2021

Sale of a commodity derivative	0.01%	Price at which derivative is traded	Seller
Sale of commodity derivatives based on prices or indices of prices of commodity derivatives	0.01%	Price at which derivative is traded	Seller
Sale of an option on commodity derivative	0.05%	Option Premium	Seller
Sale of option in goods	0.05%	Option Premium	Seller
Sale of an option on commodity derivative, where option is exercised	0.0001%	Settlement Price	Purchaser
Sale of option in goods, where option is exercised resulting in actual delivery of goods	0.0001%	Settlement Price	Purchaser
Sale of option in goods, where option is exercised resulting in a settlement otherwise than by the actual delivery of goods	0.125%	Difference between the settlement price and the strike price	Purchaser

(C) Stamp Duty

Stamp duty is levied by States, thus, the rate of duty varies from state to state. However, with effect from July 1, 2020, stamp duty shall be levied at unified rates across India in respect of listed securities. The same rate shall apply even in case of off-market transactions. The unified rates of stamp duty shall be as follows:

Security	***Rate of stamp duty****
Debentures	
- In case of issue	0.005%
- In case of transfer	0.0001%
Derivatives	
- Futures	0.002%
- Options	0.003%
- Currency and interest rate derivatives	0.0001%
- Others	0.002%
Government securities	0%
Repo on corporate bonds	0.00001%
Other securities	
- In case of issue	0.005%
- In case of transfer on delivery basis	0.015%

- In case of transfer on non-delivery basis	0.003%
**Stamp duty is levied on the market value of security where the transaction is done through a stock exchange. Whereas, in the case of off-market transactions, the stamp duty is levied on the consideration amount.*	

The mechanism for collection and payment of stamp duty shall be as follows:-

Transaction	*Collected by*	*Payable by*	*Payable on*	*Payable to*
Issue of securities through stock exchange or depositories	Stock exchange or depository	Issuer of securities	Total market value of securities	State Government where the residence of the buyer is located and in case the buyer is located outside India, to the State Government having the registered office of the trading member or broker of such buyer.
Issue of securities otherwise than through stock exchange or depositories	_	Issuer of securities	Total market value of securities	State Government where registered office of issuer is located
Transfer of securities through stock exchange	Stock exchange	Buyer of securities	Market value of securities at the time of settlement of transaction	State Government where the residence of the buyer is located and in case the buyer is located outside India, to the State Government having the registered office of the trading member or broker of such buyer.
Transfer of securities otherwise than through stock exchange	Depository if transfer is done through depository otherwise duty shall be	Transferor of securities	Amount of consideration	State Government where the residence of the buyer is located and in case the buyer is located outside India, to the State Government

	payable directly to State Government			having the registered office of the trading member or broker of such buyer.

Annexure I: Cost Inflation Index

Cost Inflation Index (CII) is the inflation rate used to bring the cost of goods in line with the increased prices in the market. Under Income-tax Act, it is used to compute the indexed cost of acquisition and indexed cost of improvement of a long-term capital asset. CII for every year is notified through an official gazette each year.

Financial Year	***CII***
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254
2016-17	264
2017-18	272
2018-19	280
2019-20	289
2020-21	301
2021-22	317
2022-23	331
2023-24	348