Budget 2017 – Implications on Capital Gain

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Introduction

A Landmark Budget which evidenced vital changes, has also proposed significant amendments affecting computation of Capital Gains. Most of the amendments seeks to enhance confidence of tax payers as it eases the hardships caused by virtue of the existing provisions. This article is an attempt to clarify only those amendments proposed in the Budget 2017 relating to capital gains.

A) Shifting of Base Year from 1981 to 2001

Budget 2017 proposes shift of the base year for computation of capital gain from 1981 to 2001.

Existing Provisions

- As per Section 55 of the Income Tax Act, 1961 ("the Act"), for computation of capital gains, an assessee shall be allowed deduction for Cost of Acquisition ("COA") of the asset and also cost of improvement, if any.
- However, for computing capital gains in respect of an asset acquired before 01.04.1981, the assessee was allowed an option to consider either the Fair Market Value ("FMV") of the asset as on 01.04.1981 or the actual cost of the asset as COA.
- The assessee is also allowed to claim deduction for cost of improvement incurred after 01.04.1981, if any.

Proposed Amendment

- COA of an asset acquired before 01.04.2001 shall be allowed to be taken as fair market value as on 01.04.2001.
- Cost of improvement shall include only those capital expenses which are incurred after 01.04.2001.
- This amendment will be effective from FY 2017-18.

View

If the assessee has purchased the assets prior to 01.04.1981, the assesse has the option to substitute the FMV as on 01.04.1981 as COA and take the benefit of indexation on such FMV on the basis of Cost Inflation Index ("CII") in the year of sale, as announced by the Government from time to time. It is now proposed to amend Section 55 and shift the date from 01.04.1981 to 01.04.2001 and the cost of improvement shall include only those capital expenses which are incurred after 01.04.2001. This will be beneficial for the tax payers as the price appreciation between the date of acquisition and 01.04.2001 will become fully tax free. The amended base year will apply in respect of long term capital gains arising in FY 2017-18. It may be noted that for COA of the asset acquired before 01.04.2001, the assessee is allowed to take the FMV of the asset as on 01.04.2001.

Example

- Asset Cost as on 1st April 1981 is Rs. 5,00,000
- Asset Fair Market Value as on 1st April 2001 is Rs. 30,00,000
- Asset Sold in August 2017 for Rs. 1,00,00,000
- Cost Inflation Index in FY 1981 is 100
- Cost Inflation Index in FY 2001 is 406
- Cost Inflation Index in FY 2017 is 1125 (Assumed similar to FY 2016 as FY 2017 it is not yet notified)

Capital Gain as per existing provision

Sale consideration	- Rs. 1,00,00,000
Indexed COA (based on 1981 CII)	- Rs. 56,25,000
Taxable Capital Gain	- Rs. 43,75,000

Capital Gain as per budget amendment

Asset Sales	- Rs. 1,00,00,000
Indexed COA (based on 2001 CII)	- Rs. 83,12,808
Taxable Capital Gain	- Rs. 16,87,192

B) Immovable Property – Period of Holding

The holding period for any immovable property to classify as long term assets has been proposed to be reduced from 3 years to 2 years.

Existing Provisions

As per the Section 2(42A) any immovable property (land, building or both) held for less than 36 months will be classified as short term capital assets. Any other assets other than those classified as short term capital asset will be long term capital asset.

Proposed Amendment

Period of holding has been reduced from the existing 36 months to 24 months in case of immovable property, being land or building or both, to qualify as long term capital asset.

View

With a view to promote the real-estate sector and attract investments, it is proposed to amend Section 2(42A) so as to reduce the period of holding from the existing 36 months to 24 months in case of immovable property. The profit on the sale of immovable property is taxable on the basis of period of holding. For immovable property, the holding period requirement is 36 months to qualify as long term assets. It is proposed to reduce this to 24 months. This amendment is beneficial for the tax payers as once the immovable property became long term asset, the assessee needs to pay tax @ 20% on the Gain and also various tax saving options are available to the assessee.

The benefits of indexation are also available to the assessee. It may be noted that short term capital gain on sale of immovable property is treated as normal income and is taxed at the slab rate applicable to the assessee, which is generally higher than 20% and no investment options are available to the assessee.

C) Relaxation for Joint Development Agreements

Under the existing provisions of Section 45, capital gain is chargeable to tax in the year in which transfer takes place except in certain cases.

Existing Provisions

- Under the existing provisions of Section 45, capital gain is chargeable to tax in the year in which transfer takes place except in certain cases.
- The definition of 'transfer', inter alia, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred.
- In such a scenario, execution of Joint Development Agreement (JDA) between the owner of immovable property and the developer triggers the capital gains tax liability in the hands of the owner in the year in which the possession of immovable property is handed over to the developer for development of a project.

Proposed Amendment

- With a view to minimise the genuine hardship which the owner of land may face in paying capital gains tax in the year of transfer, it is proposed to insert a new sub-section (5A) in Section 45.
- In case of an assessee being an Individual or Hindu Undivided Family (HUF), who enters into a specified agreement for development of a project, the capital gains shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority.

View

Execution of JDA between the owner of immovable property and the developer triggers the capital gains tax liability in the hands of the owner in the year in which the possession of immovable property is handed over to the developer for development of a project. To minimise the hardship which the owner of land is facing in paying capital gains tax in the year of transfer, it is proposed to insert Section 45(5A) to provide that in case of an assessee being an individual or Hindu Undivided family, who enters into a JDA for development of a project, the capital gains shall be chargeable to income-tax as income of the year in which the certificate of completion for the whole or part of the project is issued by the competent authority.

It is also proposed that the stamp duty value of land, building, or both, at the time of issue of completion certificate along with any additional monetary consideration will be treated as the full value of consideration in the hands of land owner.

It is also proposed that the benefits of such amendment will not apply if the assessee transfer his share in projects to any other person on or before the date of issue of said certificate of completion. In such a situation, the capital gains as determined under general provisions of the Income tax Act shall be deemed to be the income of the previous year in which such transfer took place and shall be computed as per provisions of the Act without taking into account the proposed amended provisions.

It is also proposed to insert a new Section 194-IC in the Income tax Act so as to provide that in case any monetary consideration is payable on or after 1st April, 2017 under the JDA, TDS at the rate of 10% shall be deductible from such payment. The taxation in case of JDA was an area of litigation and big dispute. This amendment will help in putting a curtain on such uncertainty and reduce the litigation.

D) Expanding the Scope of Long Term Bonds under Section 54EC

The existing provision of Section 54EC provides that capital gain to the extent of Rs. 50 lakhs arising from the transfer of a long-term capital asset shall be exempt if the assessee invests the whole or any part of capital gains in certain specified bonds, within the specified time. Currently, investment in bonds issued by the National Highways Authority of India or by the Rural Electrification Corporation Limited is eligible for exemption under Section 54EC.

In order to widen the scope of this Section for assessees and for sectors which may raise funds by issue of bonds which are eligible for exemption, it is proposed to amend Section 54EC so as to provide that investment in any bond redeemable after 3 years which has been notified by the Central Government shall also be eligible for exemption with effect from 1st April, 2017.

E) Exemption of Long Term Capital Gain Tax under Section 10(38)

Any income arising from the transfer of long term capital assets being Equity Shares of Company or Units of Equity oriented funds, is exempt from the tax if the transaction of sale is undertaken on or after 1st October, 2014 and is chargeable to Securities Transaction Tax (STT).

This provision has been grossly misused by people for money laundering and for declaring the unaccounted income as exempt long term capital gains. To prevent the misuse of this section, it is proposed to amend Section 10(38) and the budget provides an additional condition in respect of equity shares acquired after 1st October 2004 being the date on which STT became applicable. The budget provides, that for such shares, the long term capital gains shall become exempt only if STT has been paid on purchase of such shares as well. The government is being authorised to notify some other acquisitions on which, though no STT has been paid, will still continue to be exempt under Section 10(38). This notification may include the shares acquired under IPO, FPO, bonus shares, ESOPs etc. to carve out genuine transaction of acquisition of listed shares.

F) Conversion of Preference Shares to Equity Shares

Section 47 of the Income Tax Act provides that the conversion of debentures or bond into the equity of the Company is not considered as transfer, however the same provisions was not applicable for the transfer of preference shares. It is proposed to amend Section 47 by inserting new clause (xb) so as to provide that the conversion of preference shares of a company into its equity shares shall not be regarded as transfer. With regard to the same, amendments are also proposed in respect of cost of acquisition and period of holding. The period for which the preference shares were held shall also be included for computing period of holding of resulting equity shares on conversion for the purpose of determining whether equity shares are short-term capital asset or long-term capital asset. Where the capital asset, being equity share of a company, became the property of the assessee in consideration of a transfer referred to in clause (xb) of Section 47, the cost of acquisition of the asset shall be deemed to be that part of the cost of the preference share in relation to which such asset is acquired by the assessee.

G) Fair Market Value of Unquoted Shares

New Section 50CA is inserted to provide that where the consideration declared for transfer of unquoted shares of a company is less than the FMV of such share, the FMV of such shares shall be deemed to be the full value of consideration for the purpose of capital gains.

Conclusion

The amendments proposed, indeed, eases the hardships caused to the assessees. The simplified tax provisions along with effective monitoring would promote growth. Capital Gain Tax is largely misinterpreted by the assesse and subject to several litigation. Similar changes in other tax provisions and simplification of the tax code should promote effective compliance.

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