GOVERNMENT ARTS AND SCIENCE COLLEGE, MANALMEDU

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Income Tax Law and Practices – E-Learning Study Material

Topic: CAPITAL GAINS

Meaning

Under income tax assessment, Capital Gains is the fourth head of income under which income of an assessee is computed. Capital gain is the income derived through the transfer of a capital asset. A person needs to pay tax on the income derived in the form of capital gains also.

Classification

Capital gains can be classified into two as follows,

(i) Long Term Capital Gain (LTCG)
(ii) Short Term Capital Gain (STCG)

(i) Long Term Capital Gain (LTCG)

Capital gain derived from transfer of long term capital asset is called long term capital gain.

(ii) Short Term Capital Gain (STCG)

Capital gain derived from transfer of short term capital asset is called long term capital gain.

Long Term Capital Asset

An asset which is held by an assessee for more than 36 months of period is called long term capital asset. The period is restricted to 24 months for the movable assets such as jewellery, debt oriented mutual funds etc. The period is restricted to 12 months for the financial assets such as, equity shares, preference shares, securities like debentures, units of UTI, equity oriented mutual funds etc. The above period is calculated between date of purchase and date of transfer.

Long Term Capital Asset

An asset which is held by an assessee for the period of less than 36 months is called short term capital asset. The period is restricted to 24 months for the movable assets such as jewellery, debt oriented mutual funds etc. The period is restricted to 12 months for the financial assets such as, equity shares, preference shares, securities like debentures, units of UTI, equity oriented mutual funds etc. The above period is calculated between date of purchase and date of transfer.

Assets not to be taken as capital asset

Stock in trade (plots held by a Real Estate company), personal assets (jewellery etc.), agricultural land in rural area, gold deposit bonds issued under Gold Deposit Scheme, 6.5% Gold bonds 1977, special bearer bonds 1991 of Central Government.

For these assets capital gains should not be calculated.

Computation of Capital Gains

The method of calculation of capital gain both long term and short term capital gains are presented below.

Format I

Computation of Short Term Capital Gain

	`	`
Sale proceed (selling price)		xxxx
Less: Expenses on transfer (Commission on sales etc.)		xxxx
Net Consideration		xxxx
Less: Cost of Acquisition	xxxx	
Cost of Improvement	xxxx	xxxx
		xxxx
Less: Exemptions (U/S 54B, 54D, 54G, 54GA)		xxxx
Short Term Capital Gain		xxxx

Format II

Computation of Long Term Capital Gain

	`	`
Sale proceed (selling price)		xxxx
Less: Expenses on transfer (Commission on sales etc.)		xxxx
Net Consideration		xxxx
Less: Indexed Cost of Acquisition	xxxx	
Indexed Cost of Improvement	xxxx	xxxx
		Xxxx
Less: Exemptions (U/S 54, 54B, 54D, 54EC, 54F, 54G, 54GA)		xxxx
Long Term Capital Gain		xxxx

Here, Sale proceed – Selling price of the capital asset

Expenses on Transfer – Selling commission, brokerage etc.

Cost of acquisition – Cost of purchase of asset

Cost of improvement – Capital expenses incurred to improve the capital asset (e.g. additional construction in the building, added new part in a machinery etc.)

Indexed cost of Acquisition is to be calculated as follows

$$Cost\ of\ acquition\ x\ \frac{CII\ of\ the\ year\ of\ sales}{CII\ of\ the\ year\ of\ acquition}$$

Indexed cost of improvement is to be calculated as follows

$$Cost\ of\ improvement\ x\ \frac{CII\ of\ the\ year\ of\ sales}{CII\ of\ the\ year\ of\ improvement}$$

CII is referred to Cost of Inflation Index, The Central Government has notified the following cost of inflation index under section 48.

Base Year 2000-01

Financial Year	**CII**	**Financial Year**	**CII**	**Financial Year**	**CII**	**Financial Year**	**CII**
2001-02	100	2006-07	122	2011-12	184	2016-17	264
2002-03	105	2007-08	129	2012-13	200	2017-18	272
2003-04	109	2008-09	137	2013-14	220	2018-19	280
2004-05	113	2009-10	148	2014-15	240	2019-20	289
2005-06	117	2010-11	167	2015-16	254		

The purpose of indexing the cost of acquisition and cost of improvement is to bring the cost of acquisition and improvement into the current value based on inflation rate (CII).

Note: Indexed cost is applicable only for long term capital gain.

Example 1:

Mr.Krishna sold his building on January 1, 2019 for ` 10,00,000. The building was purchased by him on 30.10.2016 for ` 6,00,000. During 2017 he built an additional room in the building for the cost of ` 2,00,000. For sale of the asset he paid brokerage of ` 10,000. Compute capital gain of Mr.Krishna for the assessment year 2019-20.

Answer:

Here, Date of purchase of asset is 30.10.2016

Date of sale of asset is 1.1.2019

Mr.Krishna held the asset for the period of 26 months, it is less than 36 months, hence it is short term capital asset. Hence capital gain should be calculated as per the first format (Short Term Capital Gain).

Here Sale proceed is ` 1,00,000

Expenses on sales is ` 10,000 (brokerage given to sale the building)

Cost of acquisition is ` 6,00,000 (purchase price of the building)

Cost of improvement is ` 2,00,000 (amount spent to construct additional room)

It is STCG hence **NO** Indexed cost to be calculated

Computation of Capital Gain

	`	`
Sale proceed (selling price)		10,00,000
Less: Expenses on transfer (Commission on sales etc.)		10,000
Net Consideration		9,90,000
Less: Cost of Acquisition	6,00,000	
Cost of Improvement	2,00,000	8,00,000
Short Term Capital Gain		1,90,000

The following example presents computation of long term capital gain.

Example 2:

Mr.Krishna sold his building on January 1, 2019 for ` 10,00,000. The building was purchased by him on 30.10.2014 for ` 6,00,000. During 2015-16 he built an additional room in the building for the cost of ` 2,00,000. For sale of the asset he paid brokerage of ` 10,000.

Compute capital gain of Mr.Krishna for the assessment year 2019-20. (CII: 2018-19: 280; 2014-15: 240 and 2015-16: 254)

Answer:

Here, Date of purchase of asset is 30.10.2014

Date of sale of asset is 1.1.2019

Mr.Krishna held the asset for the period of more than 36 months, hence it is long term capital asset. Hence capital gain should be calculated as per the second format (Long Term Capital Gain).

Here Sale proceed is ` 1,00,000

Expenses on sales is ` 10,000 (brokerage given to sale the building)

Cost of acquisition is ` 6,00,000 (purchase price of the building)

Cost of improvement is ` 2,00,000 (amount spent to construct additional room)

It is LTCG hence Indexed cost is to be calculated

Calculation of Indexed cost of acquisition

$$Cost\ of\ acquition\ x\ \frac{CII\ of\ the\ year\ of\ sales}{CII\ of\ the\ year\ of\ acquition}$$

$$= 6{,}00{,}000\ x\ \frac{280}{240}$$

= 7,00,000

Indexed cost of improvement is to be calculated as follows

$$Cost\ of\ improvement\ x\ \frac{CII\ of\ the\ year\ of\ sales}{CII\ of\ the\ year\ of\ improvement}$$

$$= 2,00,000 \, x \, \frac{280}{254}$$

= 2,20,472

Computation of Capital Gain

	`	`
Sale proceed (selling price)		10,00,000
Less: Expenses on transfer (Commission on sales etc.)		10,000
Net Consideration		9,90,000
Less: Indexed Cost of Acquisition	7,00,000	
Indexed Cost of Improvement	2,20,472	9,20,472
Long Term Capital Gain		69,528

EXEMPTION OF CAPITAL GAIN (U/S 54)

The amounts of exemptions are to be calculated according to the following rules and the exemption amount can be deducted from capital gain computed and the net amount will be taxed.

1. **Capital gain on sale of residential house (U/S 54)**

   Eligible assesses:

   Individuals and HUF (Hindu Undivided Family)

   Conditions:

   (a) A residential house should be transferred.

   (b) It must be a long term capital asset. (if short term capital asset, no exemption is available)

   (c) From the transfer, another residential house should be purchased within one year before the date of transfer or 2 years after the date of transfer. (or)

   (d) It should be constructed within 3 years after the date of transfer.

   Amount of Deduction

   The least (lowest) of the following is exempted from tax.

   (i) The cost of new residential house purchased or constructed

(or)

(ii) Long term capital gain

2. Capital gain on transfer of agricultural land (U/S 54B)

Eligible assesses:

Individuals and HUF (Hindu Undivided Family)

Conditions:

(a) Urban agricultural land should be transferred.
(b) The land must have been used for agricultural land atleast for 2 years before the transfer.
(c) Another agricultural land (Rural or Urban) should be purchased within 2 years from the date of transfer.

Amount of Exemption

The least (lowest) of the following is exempted from tax.

(i) The cost of new land purchased

(or)

(ii) Capital gains

3. Capital gain on transfer by way of compulsory acquisition of land and building of an industrial undertaking (U/S 54D)

Eligible assesses:

All type of assesses

Conditions

(a) There must be compulsory undertaking.
(b) The land and building should have been used atleast for 2 years for business from the date of acquisition.
(c) The assessee must purchase another land or building or construct building in order to shift the industrial undertaking.
(d) It may be short term capital asset also.

Amount of Exemption

The least (lowest) of the following is exempted from tax.

(i) The cost of new land or building purchased or constructed

(or)

(ii) Capital gains

4. **Capital gain not chargeable on investment in certain bonds (U/S 54EC)**

Eligible assesses:

All type of assesses

Conditions

(a) A Long term capital asset should be transferred (land, building or both)
(b) That should be depreciable asset
(c) The capital gain should be invested in a long term specified asset within 6 months from the date of transfer.
(d) Long term specified assets includes, specified bonds redeemable after 5 years and issued on or after 1.4.2018 by National Highway Authority of India or the Rural Electrification Corporation Ltd. or any other bond notified by the Central Government.
(e) Such investment should not exceed ` 50,00,000
(f) The assessee should not transfer the bonds or borrow loan on the bonds for the period of 5 years from the date of purchase.

Amount of Exemption

The least (lowest) of the following is exempted from tax.

(i) The amount invested in bonds

(or)

(ii) Capital gains

5. **Exemption of capital gain on investments in notified units of specified funds (U/S 54EE)**

Eligible assesses:

All type of assesses

Conditions

(a) There should be long term capital gain.

(b) Should be invested in the notified units which should be issued before 1.4.2019.

(c) The fund should be notified by the Central Government in this behalf.

Amount of Exemption

The least (lowest) of the following is exempted from tax.

(i) The amount invested in the notified units of bonds

(or)

(ii) Long term capital gains

6. Investment of capital gains in residential house (U/S 54F)

Eligible assesses:

Individuals or HUF.

Conditions

(a) There should be long term capital gain.

(b) It should not be residential house, but it may be plot of land.

(c) A new residential house (one house) should be purchased within one year before the date of transfer or two years after the date of transfer of long term capital assets.

(d) If house is constructed, It should be constructed within 3 years from the date of transfer of long term capital assets.

(e) The assessee should not own any other residential house on the date of transfer.

(f) The assessee should not purchase any other residential house within the period of 2 years or construct within the period of 3 years from the date of transfer of original long term capital asset.

Amount of Exemption

(i) If the cost of new residential house is higher than net sale consideration of original capital assets.

The entire capital gains are exempted.

(ii) If the cost of new residential house is lower than net sale consideration of original capital assets.

The exemption should be calculated as follows

$$Long\ Term\ Capital\ Gain\ x\ \frac{Amount\ invested\ in\ new\ residential\ house}{Net\ sale\ consideration}$$

Note: Refer Illustration Problems in your text books (provided earlier) for the above rules.