Long Term Capital Gain Tax Levy on Equity

Levy of Long Term Capital Gain Tax on Equity Announcement – Union Budget 2018 - 2019

The announcement in the Union Budget 2018 – 19, combined with the looming shadow of the General Elections 2019, the controversially debated levy of Long Term Capital Gain Tax ("**LTCG Tax**") on equities, predicted and feared to be forthcoming, has now been announced.

The Finance Minister of India, in his Budget 2018 speech has proposed re-introduction of the LTCG tax on gains arising from the transfer of listed equity shares exceeding ₹ 1,00,000 at 10 percent, without allowing any indexation benefit. Further, all gains up to January 31, 2018 will be grandfathered. He also informed the House that total exempted capital gains from listed shares and units is around ₹ 3,67,000 crores as per returns filed for the AY 2017-2018.

Previously, LTCG arising from transfer of listed equity shares or units of equity oriented fund or units of business trusts, were exempt from income-tax under Section 10(38) of the Income Tax Act, 1961 ("**the Act, 1961**"). The proposal, if implemented, will be introduced under Section 112A of the Act, 1961.

In the interest of comprehensiveness and brevity, LTCG is profit on sale of shares listed on a stock exchange platform after a holding period of one year or more. On the other hand, short term capital gains ("**STCG**"), is the profit on sale of shares held for less than 12 months and is taxed at a flat rate of 15 per cent. Besides these, all stock market transactions also attract securities transaction tax ("**STT"**) in a range between 0.017 per cent and 0.125 per cent.

It has been argued that the STT is a replacement for LTCG, and the exemption was not available to listed entries and not unlisted companies. However, the same has been countered with the statement that the STT was introduced to track equity transactions as there was gross under-reporting. The STT generates only ₹ 7,000-8,000 crore annually even on equity market monthly turnovers worth lakhs of crores.

The Case For Levy of LTCG Tax on Equity

A study by the Bombay Stock Exchange indicates that taxes on long-term capital gains could generate ₹ 49,000 crore per annum. Even if we remove the amount accruing from the Securities Transaction Tax, which is already levied, the long-term capital gains tax would still generate over ₹ 40,000 crore (Securities Transaction Tax raised about ₹ 7,500 crore in 2016-'17).

However, revenue generation would just be one consequence, of the many predicted with the re-introduction of LTCG tax on equity. Other probably, and ultimately harmful impact is that to the investors.

THE CASE AGAINST LEVY OF LTCG TAX ON EQUITY

In terms of first responses, the Sensex had fallen by 463 points to the day's low of 35,501.74 against the previous session's closing of 35,965.02. Nifty had also fallen by 148 points to 10,878.80 against the previous session's closing of 11,027.70 points, after the Finance Minister announced the new LTCG tax.

As per the Budget 2018 speech, the first reports of it stressed the disproportionate focus that the Government seems intent on placing on the agriculture sector, as means of gaining favour before the General Elections 2019. As a result of this, the proposal is being perceived as resulting in a negative impact to investors.

As reactions and responses from stakeholders pour in, the criticism is also focused on the unrelenting understanding of long-term, remaining fixed at one (1) year, and not being realigned to either two (2) or three (3) years as was initially hoped. Another disappointment is the continued levy of STT.

The Investors in a listed company now suffer taxation on multiple fronts, corporate tax paid by their company, then dividend distribution tax paid by their company, then direct incidence of tax in the form of STT when they buy the stock, tax on large cumulative dividends received and now even LTCG tax on exit from their investments (without indexation). The Industry view is of the view that the Finance Minister should have, at the minimum, done away with STT on listed shares and withdrawn the dividend distribution tax. In the absence of any amendments made to the STT provisions, the same has resulted in increasing the probability of India being the only country to have both taxes at the same time.

Overall, most market players, who were earlier dreading the negative impact of LTCG on markets, have now welcomed the move.

The only saving grace appears to be the grandfathering of capital gains (realized or unrealized) till January 31, 2018, being seen as a positive move intended to curb any major knee jerk selling in the market.

There has also been an introduction of a 10% Dividend Distribution Tax (“**DDT**”) on dividend options of equity funds to bring them on par with the growth schemes. This move may impact flows into funds where investors were primarily entering with the expectation of regular dividends. In

comparison to growth schemes, with LTCG below ₹ 1,00,000 being exempt from tax, it is opined that dividend schemes are now slightly disadvantaged.

Stock trading volume is institutional and much of the volume comes from Foreign Portfolio Investors, who operate via subsidiaries located in countries, which have favourable tax treaties with India. They pay tax in one or the other country. A higher capital gains rate could affect Foreign Portfolio Investors' perceptions and bias them in favour of other emerging markets, ones with a tax structure that provides them with a higher degree of relief and lesser costs.

The Article is authored by Palak Sehgal, Associate Advocate, Lex Favios, Advocates & Solicitors

The lawyers at Lex Favios, Advocates & Solicitors are experienced in advising on all aspects of tax issues including interpretation of International Tax Treaties and related legal advisory. If you have questions or queries about the content of this Article, please give us a call at +91-011-41435188 or email at admin@lexfavios.com.