Highlights: Capital Gains

Capital gains means any profit or gains arising from transfer of a capital asset. Such capital asset may be building, non-agricultural land, machinery, shares, jewellery etc. However, stock in trade, agricultural land in rural area and personal effects (other than jewellery) are not 'capital assets'.

From AY 2008-09, archaeological collections, paintings, sculptures will not be treated as 'capital assets'.

Broadly, 'capital gain' is the difference between the price at which the asset was acquired and the price at which the same asset was sold. In technical terms, capital gain is the difference between cost of acquisition and the full value of consideration. Incidental expenditure and cost of improvement is allowable as deduction.

The 'cost of acquisition of capital asset' is to be increased by Cost Inflation Index. The index is announced by Central Government every year. The index was 100 for 1981-82, 172 for 1989-90, 244 for 1993-94, 331 for 1997-98, 351 for 1998-99, 389 for 1999-2000, 406 for 2000-01, 426 for 2001-02, 447 for 2002-03, 463 for 2003-04 and 480 for 2004-05, 519 for 2006-07, 551 for 2007-08, 582 for 2008-09, 632 for 2009-10, 711 for 2010-11 and 785 for 2011-12.

The cost of acquisition will be adjusted on basis of the above index and then capital gain will be calculated. The formula is Cost of acquisition x Cost Inflation Index of the year in which the asset is transferred / Cost Inflation Index of the year of acquisition. If the asset was acquired before 1.4.1981, the Cost Inflation Index of that year will be treated as 100. Thus, if an asset was brought in 1989-90 for Rs one lakh and sold in 1997-98 for Rs three lakhs, the adjusted cost of acquisition will be (1,00,000 x 331)/172 i.e. Rs 1,92,442, and capital gains will be Rs 1,07,558 (3,00,000 - 1,92,442). *Such adjustment is permissible only for long term capital gains and not for short term capital gains.*

Expenditure incurred on any improvement in asset is permitted as deduction and that cost can also be adjusted on the same principles as above.

If a company issues bonus shares, the cost of acquisition of bonus shares will be treated as 'Nil'. Thus, if the bonus shares are sold, net sale proceeds of bonus shares will be liable to capital gains.

Expenditure incurred in connection with transfer (like stamp duty, registration charges, legal fees, brokerage etc.) are allowed as deduction. Capital gain is charged as income of the financial year in which the transfer took place.

Capital gain can be classified as 'short term' or 'long term'. A short term capital gain is when the asset was held by the assessee for a period of upto 36 months. If the asset was held for more than 36 months, the gain will be long term gain. The period is only 12 months (instead of 36 months) in case of shares or any other security listed in stock exchange or units of UTI or units of mutual fund.

The income tax rate is 20% on long term capital gains, while calculating the long term capital gains, indexation of purchase price is required. *Tax on long term capital gain shall be subject to ceiling of 10% of capital gains calculated without indexing.*

The short term gains are added in other income of the assessee and the income tax is payable according to the normal rate applicable to the assessee.

In case of short term gains covered under section 111A of Income Tax Act , the rate is 10% for AY 2008-09 and 15% for Assessment Year 2009-10 onwards. Section 111A is applicable in respect of securities transactions which are subject to securities transaction tax.

Capital gains arising from sale of residential house is exempt if the original asset (i.e. the house) was held for more than three years and a new house was purchased within one year before or two years after the sale of original asset, or a new residential house is constructed within three years. The cost of new asset (residential house) should be more than the amount of capital gains [section 54 of Income Tax Act].