TAX TALK

Capital gains tax & its many nuances

Filing ITR 1 or 4 when you have capital gains will lead to a tax notice

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AS THE DUE date for filing income tax return (ITR) nears, taxpayers are diligently preparing their returns. One of the most common mistakes, however, lies in the reporting of capital gains. Understanding the nuances of capital gain tax on debt and equity investments is crucial for accurate reporting. Here's what you should be aware of before reporting capital gains in your ITR:

Select correct ITR form

Selecting the correct ITR form is the first step. Not all ITR forms contain a schedule for capital gains. Those with business income have to fill up ITR 3 while ITR 2 is for other cases with capital gains. Filing ITR 1 or ITR 4 when you have capital gains will result in a notice for defective returns.

> **For debt funds acquired on or after April 1, 2023, the income tax is calculated at the applicable slab rate**

Classifying capital gains

Capital gains are taxed based on the type of investment and the holding period of the asset.

Equity or equity funds

Short term: Holding period less than 12 months; taxed at 15% + surcharge + cess.

Long term: Holding period above 12 months; taxed at 10% + surcharge + cess on gains above ₹1 lakh. These rates apply even if total income is below ₹2.5 lakh.

Debt funds

For debt funds acquired on or after April 1, 2023, the income tax is calculated at the applicable slab rate and is deemed to be STCG, irrespective of the holding period.

Taxpayers must ensure that capital gains are bifurcated between STCG and LTCG based on the holding period and reported in the applicable section.

Understanding the schedule for capital gains

The schedule for capital gains is divided into two sections – STCG and LTCG. Each section is further divided asset-wise: STCG and LTCG on immovable property, STCG and LTCG on equity shares or equity-oriented mutual funds on which Securities Transaction Tax (STT) is paid and other capital assets. For long-term sales of equity shares or equity-oriented mutual funds on which STT is paid, an additional Schedule 112A is needed. Ensure capital gains are declared in the appropriate section of the schedule.

Necessary information

There are three sets of data required for the computation of capital gains: Sale consideration, cost of acquisition, expenses incurred wholly and exclusively in connection with the transfer. For equity or equity-oriented funds on which STT is paid, Schedule 112A needs additional details such as: ISIN Code, name of the share, number of shares and sale price per share.

For other assets, consolidated values are required and a detailed breakup is not necessary. This information can be found in the securities statement and should be reconciled with the Annual Information Statement.

By selecting the correct ITR form, classifying your capital gains appropriately, understanding the schedule for capital gains, and providing the necessary information for disclosure, you can ensure that your ITR is accurate and complete.

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