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Methods of Computation of Capital Gainswith Reference to Capital Gain Taxation under Income Tax Act, 1961.

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ABSTRACT: This research paper is about methods of computation of capital gainswith reference to capital gain taxation under Income Tax Act, 1961. This paper elaborates the capital gain computation and its peculiarities in case of capital gain arising on account of transactions by Non-Resident Indians especially in case of transfer of financial securities like shares, debentures etc. This paper will highlight the usage of average exchange rates in case of conversion of amounts relevant for the computation of capital gain taxation with reference to transfers resulted by Non residents or capital gain transactions done in foreign currency. Furthermore, the solid differences between long term capital gain and short-term capital gain has also been discussed in required length under this paper. Last but not the least, the concept of cost of acquisition, indexation and disallowance of vague claims of expenses are elaborated and depicted with reference to computation of capital gain taxation.

KEYWORDS:Consideration,NonResident,vague claims, CII, Transfer, Capital Gain,Acquisition.

I. INTRODUCTION

Section 48 of the Act provides following deductions which have to be adjusted against the gross receipts or full value of consideration. The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset: —

1) expenditure incurred wholly and exclusively in connection with such transfer [section 48(i)];
2) the cost of acquisition of the asset and the cost of any improvement thereto [section 48(ii)].

II. Capital gains in case of Non-Resident for certain assets

In the case of an assessee, who is a non-resident, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed

1) by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset,
2) into the same foreign currency as was initially utilised in the purchase of the shares or debentures,
3) and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so,
4) however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter in, and sale of, shares in, or debentures of, an Indian company:

Where assessee who is a non-resident, the capital gain arising from the transfer of shares or debentures in an Indian Company, shall be computed by converting Cost of Acquisition and Expenditure on transfer Sale Consideration into the same foreign currency, in which the asset was purchased. The capital gain so computed in the foreign currency shall be reconverted into Indian Currency.

KEY NOTE:For applicability of first proviso, either shares should be purchased in foreign currency or shares should be repurchased (No need of foreign currency if repurchase). First proviso to Section 48 is mandatory and not optional. Non-resident cannot opt for 2nd Proviso if his case falls under first proviso. This proviso is applicable for computing both Short-term Capital Gains and Long-term Capital Gains. Shares, debentures (include bonds) and bonds of Government Company are also included in first proviso. However, bonds of Central Government, State Government and Reserve Bank of India are not included. First proviso is not applicable to Units of UTI and Mutual Funds. It also does not apply to business trusts. First proviso applies to listed as well as unlisted shares and debentures.

III. Computation Of Capital Gain In Case Of Non-Residents (First Proviso To Section 48]

This proviso is applicable to non-residents only. The non-resident must have acquired shares or debentures of Indian companies using foreign currency. Such non-resident, wanting to transfer such shares will follow the following considerations and conditions:The asset may be short-term or long-term. In other words, this proviso is applicable to long-term as well as short-term capital gains.The capital gain from transfer of such asset shall be computed in the following manner:—

1) Capital gain is computed in the same currency in which shares were acquired.
2) Sale consideration in Indian currency is converted into foreign currency at average exchange rate on the date of transfer.
3) Cost of acquisition in Indian currency is converted into foreign currency at average exchange rate on the date of acquisition.
4) Expenditure incurred in Indian currency on sale is converted into foreign currency at average exchange rate on the date of transfer.
5) Out of sale consideration in foreign currency as per (ii) above cost of acquisition as per (iii) above and expenses on sale as per (iv) above are deducted.
6) Cost of acquisition of such shares and debentures is not to be indexed u/s 48.
7) Balance amount is capital gain which is reconverted into Indian currency at buying rate on the date of transfer.

IV. Average Exchange Rate

It is the average of telegraphic transfer buying rate and telegraphic transfer selling rate of exchange adopted by the State Bank of India for purchasing or selling such currency through telegraphic transfer.

V. Second proviso to section 48 Indexation

“PROVIDED FURTHER that where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words “cost of acquisition” and “cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement” had respectively been substituted."

1) This proviso is not applicable where the first proviso applies.
2) Where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso.

(i) "Indexed cost of acquisition" shall be taken instead of "Cost of acquisition", and

(ii) “Indexed cost of any improvement” shall be taken instead of “cost of any improvement".

VI. Third Proviso to Section 48 (With effect from assessment year 2017-18) Text of third proviso to section 48

“PROVIDED ALSO that nothing contained in the second proviso shall apply to the long-term capital gain arising from the transfer of a long-term capital asset being a bond or debenture other than—

1) capital indexed bonds issued by the Government; or
2) with effect from assessment year 2017-18, Sovereign Gold Bond issued by the Reserve Bank of India under the Sovereign Gold Bond Scheme, 2015:"

KEY NOTE: Benefit of indexation is not available for bonds/debentures of company whether public sector or private sector company. Indexation benefits is available for Units of UTI/Mutual Funds/Business Trusts. Indexation benefit is available for equity shares and preference shares.

“PROVIDED ALSO that in case of an assessee being a non-resident, any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company subscribed by him, shall be ignored for the purposes of computation of full value of consideration under this section." [With effect from 01.04.2018, the word "subscribed" shall be substituted by word "held" by Finance Act, 2017.]

VII. Fifth Proviso to Section 48-Shares etc. transferred under ESOP

PROVIDED ALSO that where shares, debentures or warrants referred to in the proviso to clause (iii) of section 47 are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of this section.

VIII. Sixth Proviso to Section 48—Securities Transaction Tax (STT)

“PROVIDED ALSO that no deduction shall be allowed in computing the income

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chargeable under the head "Capital gains" in respect of any sum paid on account of securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

Explanation: For the purposes of this section, —

1) "foreign currency" and "Indian currency" shall have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999 (42 of 1999);
2) the conversion of Indian currency into foreign currency and the reconversion of foreign currency into Indian currency shall be at the rate of exchange prescribed in this behalf;
3) "indexed cost of acquisition" means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981[@], whichever is later; [With effect from assessment year 2018-19, the words "1st day of April, 1981" substituted by words "1st day of April, 2001" by Finance Act, 2017] .
4) "indexed cost of any improvement" means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place;
5) "Cost Inflation Index", in relation to a previous year, means such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index (urban) for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify, in this behalf."

IX. The method of computation depends on the nature of capital asset transferred

It is as follows: —

Short-term Capital Gain		Long-term Capital Gain	
(A)	Find out Full Value of Consideration	(A)	Find out Full Value of Consideration
(B)	Deduct:	(B)	Deduct:
(i)	Expenditure incurred wholly and exclusively in connection with such Transfer.	(i)	Expenditure incurred wholly and exclusively in connection with such Transfer.
(ii)	Cost of Acquisition	(ii)	Indexed Cost of Acquisition
(iii)	Cost of Improvement	(iii)	Indexed Cost of Improvement
(iv)	Exemption provided by sections 54B, 54D, 54G & 54GA	(iv)	Exemption provided by sections 54, 54B, 54D, 54EC, 54GA & 54GB
(C)	(A-B) is short-term capital gain	(C)	(A-B) is a long-term capital gain

X. Difference between short-term and long-term capital gain

S.No.	Short-term capital gain	Long-term capital gain
(i)	STCG is included in the Gross total income of the assessee and taxed as per rate applicable to that assessee	LTCG is in Gross total income and is taxed on the flat rate of 20% (10% in certain case or Nil in certain cases)
(ii)	Deductions under sections 80C to 80U are available	Deductions under sections 80C to 80U are not available
(iii)	Set-off of minimum exemption limit is available from all STCGs for resident as well as Non-resident.	Set-off of minimum exemption limit is available only for resident
(iv)	STCL can be set-off against STCG and LTCG	LTCL can be set-off against only LTCG
(v)	Cost of acquisition & Cost of improvement are not indexed in case of STCG	Cost of acquisition & Cost of improvement are indexed in case of long-term capital gains

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XI. Meaning of terminology relevant for the computation of Short Term and Long-Term Capital Gains

For the computation of Short Term and Long Term Capital Gains, it is important to familiarise yourself with the relevant terminology:

1) FULL VALUE OF CONSIDERATION: This refers to the full value of cash/kind that the seller (or transferor) of the asset gains as a result of selling (or transferring) the asset. In the case of an outright sale, the entire amount received by the seller will be considered. In the case of an exchange of an asset, the Fair Market Value of the property or asset will be considered. If the Full Value of Consideration is received in instalments over a few years, the entire value considered will be the Market Value of the property or of the asset given in exchange.
2) FAIR MARKET VALUEThis is the price at which the property (asset) would normally be sold, if it was sold in the open market on a particular date.
3) EXPENSES ON TRANSFERExpenditure incurred wholly and exclusively in connection with the transfer of a capital asset is deductible from the full value of consideration. These include any direct or indirect expenses that are incurred during transfer, such as – brokerage, advertising, stamp duty, registration fees, legal expenditure, etc.Vague claim for expenses is not allowable In the case of B. N. Pinto, it was observed that:"What can be deducted under section 48(i) is expenses incurred wholly and exclusively in connection with the transfer. The damages for mental worry and suffer in on account of wrongful withholding and detention of her property cannot, by any stretch of imagination, be said to be expenses incurred wholly and exclusively in connection with the transfer. The claim in respect of lawyer's fees is also indefinite and vague and is not specific that it was in connection with the transfer, like, for example, drafting of the deed or such purpose intimately connected with the transfer. Similarly, regarding the travelling expenses, it is not specific that it was in connection with the transfer.Therefore, the nature of expenses as represented by the assessee would not bring them within the ambit of section 48(i) of the Income-tax Act, 1961, so as to be a permissible deduction. We, therefore, answer the question in the affirmative and against the assessee, i.e., that the Tribunal was justified in not deducting ⍰41,517 while computing the capital gains."[B. N. Pinto v. CIT (1974) 96 ITR 306 (Mys)] If any expense has already been claimed as a deduction under any other provision of the Income Tax Act, 1961, it cannot be claimed again under Expenses on Transfer under section 48.-[CIT v. Maithrey Pai (1985) 152 ITR 247 (Kar)] Expenditure in connection with transfer need not necessarily to have been incurred prior to passing of title.—[CIT v. P. Rajendran (1981) 127 ITR 810 (Kar)]
4) COST OF ACQUISITION: This refers to the total cost that the seller of the property had incurred when he acquired the property or asset. Registration and other expenses incurred for the purpose of transferring the title are also totalled up and considered as part of the total Cost of Acquisition. There are also cases where assets/properties are acquired as gifts or as inheritance. In such cases, the Cost of Acquisition will be the cost at which the previous owner of the property acquired it,—

a) As a gift, or on the legal demand of a will.
b) As an inheritance, through succession or devolution.
c) As a distributed asset on the liquidation of a business concern.
d) As a distributed asset on the total partition of a Hindu Undivided Family.

In cases where the cost the previous owner of the property paid cannot be established, the previous owner's cost of acquisition will be taken as the fair market value of the asset on the date on which the previous owner acquired it. The interest on credit taken to acquire the capital asset also forms a part of the Cost of Acquisition.

5) COST OF IMPROVEMENT: Any additions, alterations or improvements made to the asset by the owner will be deductible as the Cost of Improvement. If the asset came to be the property of the owner as a gift or through an inheritance, etc., capital expenditure incurred by the previous owner will also be treated as a cost of improvement.
6) INDEXATION USING THE COST INFLATION INDEX: When computing Long Term Capital Gains, the Cost Inflation Index should be used to index the Cost of Acquisition and Cost of Improvement. Indexed Cost = Actual Cost x Cost Inflation Index in the year of sale/Cost Inflation Index in the year of purchase.

KEY NOTE:If the calculation is being done without indexation, the Long Term Capital Gains tax rate will be 10%.

II. CONCLUSION

Looking back on this project, the overall outcome of results to be observed. This can be evaluated by looking at how well our objectives were met. Our first objective was to figure out the full value of consideration and conversion mechanism in case of capital taxation for Non-Resident Indians and capital assets sold by them to figure out the calculations of capital gain Our next objective was to find out the differences and dissimilarities between short term capital gains and long-term capital gains. Our subsequent objective was to know the meaning of terms pertinently used during the application of methods of computation of capital gain after the transfer of capital asset takes place the amount of full value of consideration in case of transfer of different type of capital assets. Finally we can say that computing of capital gains along with full value of consideration and allowable expenditure is not uniform for all kind of transfers of several capital assets and we are in a position to comfortably conclude that section 48 is a very a comprehensive section which deals with computation of capital gains under Income Tax Act. 1961.

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