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UNIT-4 : CAPITAL GAINS

Question 1

Mrs. Malini Hari shifted her industrial undertaking located in corporation limits of Faridabad, to a Special Economic Zone (SEZ) on 1.12.2006:

The following particulars are available:			Rs.
(a)	Land: Purchased on 20.01.2002		4,26,000
	Sold for		22,00,000
(b)	Building [Construction completed on 14.03.2004]		
	WDV of building as on 01.04.2006		8,20,000
	Sold for		11,39,000
(c)	WDV of cars as on 01.04.2006		7,40,000
	Sold for		6,00,000
(d)	Expenses on shifting the undertaking		1,15,000
(e)	Assets acquired for the undertaking in the SEZ (on or before 25.06.2007):		
	(i)	Land	3,00,000
	(ii)	Building	5,00,000
	(iii)	Computers	1,00,000
	(iv)	Car	4,20,000
	(v)	Machinery (Second hand)	2,00,000
	(vi)	Furniture	50,000

There is no intention of investing in any other asset in this undertaking.

Compute the exemption available under section 54GA for the assessment year 2007-08.

Cost inflation indices are:

Financial year	Index	
2001-02	426	
2006-07	519	(8 Marks)(Nov 2007)

> The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the undertaking was shifted on 1.12.2009 and assets were acquired for the undertaking in the SEZ on or before 25.06.2010. Written down value of the building and cars are given as on 1.4.2009. The cost inflation index for F.Y.2009-10 is 632.

Answer

Where an assessee shifts an existing undertaking from an urban area to a SEZ and incurs expenses for shifting and acquires new assets for the undertaking in the SEZ, section 54GA comes into play.

The capital gain, short-term or long-term, arising from transfer of land, building, plant and machinery in the existing undertaking would be exempt under section 54GA if the assessee, within a period of one year before or three years after the date on which the transfer took place,

(i) acquires plant and machinery for use in the undertaking in the SEZ;

(ii) acquires land or building or constructs building for the business of the undertaking in the SEZ;

(iii) incurs expenses on shifting of the undertaking.

Computation of capital gain:

(a)	Land:	
	Sale price	22,00,000
	Less: Indexed cost of acquisition 4,26,000 x 632/426	6,32,000
	Long-term capital gain	15,68,000
(b)	Building:	
	Sale value	11,39,000
	Less: Opening WDV	8,20,000
	Short-term capital gain under section 50	3,19,000
(c)	Plant:	
	Car	
	Sale value	6,00,000

Less: Opening WDV	7,40,000
Short term capital loss under section 50	(-)1,40,000
Net short term capital gain (Rs. 3,19,000 – Rs.1,40,000)	1,79,000
Total capital gain (LTCG+STCG)	
i.e. Rs. 15,68,000+ Rs.1,79,000	17,47,000

Exemption under section 54GA is available in respect of the following assets acquired and expenses incurred:

	Rs.
Land	3,00,000
Building	5,00,000
Plant:	
Computers	1,00,000
Car	4,20,000
Machinery	2,00,000
Expenses of shifting	1,15,000
Total Exemption	16,35,000

Note:

1. The total exemption available under section 54GA is the lower of capital gains of Rs. 17,47,000 or the amount of investment which is Rs.16,35,000. Hence, the amount of exemption available under section 54GA is Rs.16,35,000.
2. Furniture purchased is not eligible for exemption under section 54GA.
3. There is no restriction regarding purchase of second hand machinery.
4. Computers and car would constitute Plant.

Question 2

Mr. Thomas inherited a house in Jaipur under will of his father in May, 2002. The house was purchased by his father in January, 1980 for Rs.2,50,000. He invested an amount of Rs.7,00,000 in construction of one more floor in this house in June, 2004. The house was sold by him in November, 2006 for Rs.37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was Rs.47,25,000 which was not contested by the buyer, but as per assessee's request, the Assessing officer made a reference to Valuation officer. The value determined by the Valuation officer was Rs.47,50,000. Brokerage @ 1% of sale consideration was paid by Mr. Thomas to Mr. Sunil. The market value of house as on 01.04.1981 was Rs.2,70,000.

You are required to compute the amount of capital gain chargeable to tax for A.Y. 2007-08 with the help of given information and by taking CII for the F.Y. 2006-07 as 519 and for F.Y. 2004-05 as 480. (9 Marks)(Nov 2007)

> The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the sale took place in November 2009. The cost inflation index for F.Y.2009-10 is 632 and F.Y.2002-03 is 447.

Answer

Computation of Long term Capital Gain for A.Y. 2010-11

Sale consideration as per section 50C of the Act (Note-I)		47,25,000
Less: Expenses incurred on transfer being brokerage @ 1% of sale consideration of Rs. 37.50 lacs		37,500
		46,87,500
Less: Indexed cost of acquisition (Note-2) $\frac{2,70,000 \times 632}{447}$	= 3,81,745	
Indexed cost of improvement $\frac{7,00,000 \times 632}{480}$	= 9,21,667	13,03,412
Long term capital gain		33,84,088

Notes:

1. As per section 50C, where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the valuation by the stamp valuation authority, such value adopted or assessed by the stamp valuation authority shall be deemed to be the full value of consideration. Where a reference is made to the valuation officer, and the value ascertained by the valuation officer exceeds the value adopted by the stamp valuation authority, the value adopted by the stamp valuation authority shall be taken as the full value of consideration.

Sale consideration	Rs. 37,50,000
Valuation made by registration authority for stamp duty	Rs. 47,25,000
Valuation made by the valuation officer on a reference	Rs. 47,50,000

Applying the provisions of section 50C to the present case, Rs. 47,25,000, being, the value adopted by the registration authority for stamp duty, shall be taken as the sale consideration for the purpose of charge of capital gain.

2. The house was inherited by Mr. Thomas under the will of his father and therefore the cost incurred by the previous owner shall be taken as the cost. Value as on 01.04.81 accordingly shall be adopted as the cost of acquisition of the house property. However, indexation benefit will be given from the year in which Mr. Thomas first held the asset i.e. P.Y.2002-03.

Question 3

Ms. Vasudha contends that sale of a work of art held by her is not exigible to capital gains tax; is she correct? (2 Marks) (May 2008)

Answer

As per section 2(14)(ii), the term "personal effect" excludes any work of art. As a result, any work of art will be considered as a capital asset and sale of the same will attract capital gains tax. Thus, the contention of Ms. Vasudha is not correct.

Question 4

Ms. Vasumathi purchased 10,000 equity shares of Rejesh Co. Pvt. Ltd. on 28.2.2004 for Rs. 1,20,000. The company was wound up on 31.7.2007. The following is the summarized financial position of the company as on 31.7.2007:

Liabilities	Rs.	Assets	Rs.
60,000 Equity shares	6,00,000	Agricultural lands	42,00,000
General reserve	40,00,000	Cash at bank	6,50,000
Provision for taxation	2,50,000		
	48,50,000		48,50,000

The tax liability (towards dividend distribution tax) was ascertained at Rs. 3,00,000, after considering refund due to the company. The remaining assets were distributed to the shareholders in the proportion of their shareholding. The market value of 6 acres of agricultural land (in an urban area) as on 31.7.2007 is Rs. 10,00,000 per acre.

The agricultural land received above was sold by Ms. Vasumathi on 29.2.2008 for Rs.15,00,000.

Discuss the tax consequences in the hands of the company and Ms. Vasumathi.

Cost inflation indices are:

Financial year	Cost Inflation index
2003-04	463
2007-08	551

(8 Marks)(May 2008)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the company was wound up on 31.07.2009 and the summarized financial position as on 31.07.2009 is as given above. Agricultural land has been sold by Ms. Vasumathi on 29.2.2010.

Answer

In the hands of the company:

As per section 46(1), distribution of capital assets amongst the shareholders on liquidation of the company is not regarded as "transfer" in the hands of the company. Consequently, there will be no capital gains in the hands of the company.

In the hands of Ms. Vasumathi (shareholder)

Section 46(2) provides that such capital gains would be chargeable in the hands of the shareholder.

Particulars	Amount (Rs.)
Ms. Vasumathi holds 1/6th of the shareholding of the company	
Market value of agricultural land received (1acre @ Rs.10 Lakhs)	10,00,000
Cash at bank [1/6th of (Rs. 6,50,000 – Rs. 3,00,000)]	58,333
	10,58,333
Less: Deemed dividend under section 2(22)(c) - 1/6th of (Rs.40,00,000-Rs.50,000)	6,58,333
Consideration for computing Capital Gain	4,00,000
Less: Indexed cost of acquisition of Shares (Rs. 1,20,000 x 632/ 463)	1,63,801
Long term capital gains	2,36,199

Notes -

1. Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution. Hence, the short-term capital gains in the hands of Ms. Vasumathi (shareholder) at the time of sale of urban agricultural land should be computed as follows:

Particulars	Rs.
Sale consideration	15,00,000
Less : Fair market value of the agricultural land on the date of distribution	10,00,000
Short term capital gain	5,00,000

2. Dividend under section 2(22)(c) amounting to Rs.6,58,333 will be exempt under section 10(34).
3. Since the question states that there is refund due to the company, it is assumed that the provision for taxation of Rs. 2,50,000 shown in Balance Sheet is in respect of dividend distribution tax. Therefore, the tax liability in respect of dividend distribution tax ascertained at Rs. 3,00,000 has to be reduced from bank balance while computing full value of consideration under section 46(2). Rs. 50,000, being the difference between Rs. 3,00,000 and Rs. 2,50,000, has to be reduced from General Reserve for calculating deemed dividend under section 2(22)(c).

Question 5

State with reasons whether the following statements are true or false having regard to the provisions of the Income-tax Act, 1961:

(a) Capital gain of Rs.75 lakh arising from transfer of long term capital assets will be exempt from tax if such capital gain is invested in the bonds redeemable after three years, issued by NHAI under section 54EC of the Act. (2 Marks)(Nov 2008)

(b) As per section 49(2A) read with section 47(xa) of the Income-tax Act, 1961, no capital gains on conversion of foreign currency exchangeable bonds into shares or debentures, for facilitating the issue of FCEBs by companies. (2 Marks)(Nov 2009)

Answer

(a) False

The exemption under section 54EC has been restricted, by limiting the maximum investment on or after 1.4.07 in long term specified assets (i.e. bonds of NHAI or RECL, redeemable after 3 years) to Rs.50 lakh during any financial year. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of Rs.50 lakh.

(b) True

As per section 47(xa) any transfer by way of conversion of bonds referred to in section 115AC into shares and debentures of any company is not regarded as transfer. Therefore, there will be no capital gains on conversion of foreign currency exchangeable bonds into shares or debentures.

Question 6

Mrs. X, an individual resident woman, wanted to know whether income-tax is attracted on sale of gold and jewellery gifted to her by her parents on the occasion of her marriage in the year 1979 which was purchased at a total cost of Rs.2,00,000? (4 Marks)(Nov 2008)

Answer

The definition of capital asset under section 2(14) includes jewellery. Therefore, capital gains is attracted on sale of jewellery, since jewellery is excluded from personal effects. The cost to the previous owner or the fair market value as on 1/4/1981, whichever is more beneficial to the assessee, would be treated as the cost of acquisition. Accordingly, in this case, long term capital gain @ 20% will be attracted in the year in which the gold and jewellery is sold by Mrs.X.

Question 7

Mr. Kumar is the owner of a residential house which was purchased in September, 1992 for Rs. 50,00,000. He sold the said house on 5th August, 2008 for Rs. 24,00,000. Valuation as per stamp valuation authority of the said plot of land was Rs. 35,00,000. He invested Rs. 8,00,000 in NHAI Bonds on 12th January, 2009. He purchased a residential house on 8th September, 2008 for Rs. 12,00,000. He gives other particulars as follows:

Interest on Bank Deposit	Rs. 32,000
Investment in public provident fund	Rs. 12,000

You are requested to calculate the taxable income for the assessment year 2009-2010 and the tax liability, if any.

Cost inflation index for F.Y. 1992-93 and 2008-09 are 223 and 582 respectively.

(8 Marks)(June 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. the sale of house and investment in bonds took place on 5.08.2009 and 12.1.2010, respectively. New house was purchased in September 2009. The cost inflation index of F.Y.2009-10 is 632.

Answer

Computation of total income and tax liability of Mr. Kumar for the A.Y.2010-11

Particulars	Rs.	Rs.
Capital Gains:		
Sale price of the residential house	24,00,000	
Valuation as per Stamp Valuation authority	35,00,000	
(Value to be taken is the higher of actual sale price or valuation adopted for stamp duty purpose as per section 50C)		
Therefore, Consideration for the purpose of Capital Gains	35,00,000	
Less: Indexed Cost of Acquisition = 50,00,000 x 632 / 223	1,41,70,403	
Long-term Capital Loss (to be carried forward to the succeeding year for set-off against only long-term capital gains - can be carried forward for a maximum of 8 years)	(1,06,70,403)	

Income from other sources:	
Interest on bank deposits	32,000
Gross Total Income	32,000
Less: Deduction under Chapter VI-A	
Section 80C – Investment in PPF	12,000
Total Income	20,000
Tax liability (There is no tax liability since the total income is less than the basic exemption limit)	Nil

Question 8

Mr. Abhik's father, who is a senior citizen had pledged his residential house to a bank under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhik's father did not repay the loan on maturity and gave possession of the house to the bank to discharge his loan. How will the treatment of long-term capital gain be made on such reverse mortgage transaction? (3 Marks)(June 2009)

Answer

The Finance Act, 2008 has inserted clause (xvi) in section 47 to provide that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the transaction made by Mr. Abhik's father will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installment, in a transaction of reverse mortgage would be exempt from income-tax.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

Question 9

Mr. Pranav, a resident individual had purchased a plot of land at a cost of Rs.75,000 in June, 1998. He constructed a house for his residence on that land at a cost of Rs.1,25,000 in August, 2000. He sold that house in May, 2008 at Rs.15,00,000 and purchased another residential house in June, 2008 for Rs.8,00,000. He furnishes other income and investment as follows:

	Rs.
Net of interest on fixed deposit with a Bank	44,850
TDS made by bank	5,150
Investment in NSC VIII issue	20,000

Cost inflation index for financial year 1998-99, 2000-01 and 2008-09 are 351, 406 and 582 respectively

You are required to compute taxable income and tax payable by Mr. Pranav for the assessment year 2009-10. (7 Marks)(Nov 2009)

The provisions of the Income-tax Act, 1961 relevant for Assessment Year 2010-11 should be taken into consideration while solving the question. Accordingly, the facts given above may be taken as relating to financial year 2009-10 i.e. he sold his house in May, 2009 and purchased another in June 2009. The cost inflation index for the F.Y.2009-10 is 632.

Answer

Computation of taxable income and tax payable by Mr. Pranav for the A.Y. 2010 -11

		Rs.	Rs.
1.	Income from Capital Gains		
	Full value of consideration		15,00,000
	Less : Indexed cost of acquisition of land		
	Rs. $\frac{75,000 \times 632}{351}$		1,35,043
			13,64,957
	Less : Indexed cost of construction of house		
	Rs. $\frac{1,25,000 \times 632}{406}$		1,94,581
			11,70,376
	Less : Deduction under section 54		
	Cost of new residential house		8,00,000
	Long term capital gains		3,70,376
2.	Income from other sources		
	Interest on Bank deposit	44,850	
	Add:		
	Tax deducted at source	5,150	50,000
	Gross total income		4,20,376
	Less: Deduction under Chapter VIA :		
	Deduction under section 80C		

Investment in NSC		20,000
Taxable income		4,00,376
Taxable income (rounded off)		4,00,380
Components of Total income		
Special income		
Long-term Capital gains	3,70,380	
Normal Income	30,000	
	4,00,380	
Tax on normal income of Rs.30,000		Nil
Tax on LTCG		
LTCG (Maximum amount not chargeable to tax - Normal Income) @ 20% u/s.112 = {Rs. 3,70,380 – (1,60,000 – 30,000)} x 20%		48,076
		48,076
Add : Education cess @ 2%		962
Secondary and higher education cess @ 1%		481
Tax payable		49,519
Tax payable (rounded off)		49,520