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How to reduce your capital gains tax liability for the year

Taxpayers can reduce their long-term capital gains tax liability to meet their overall financial goals

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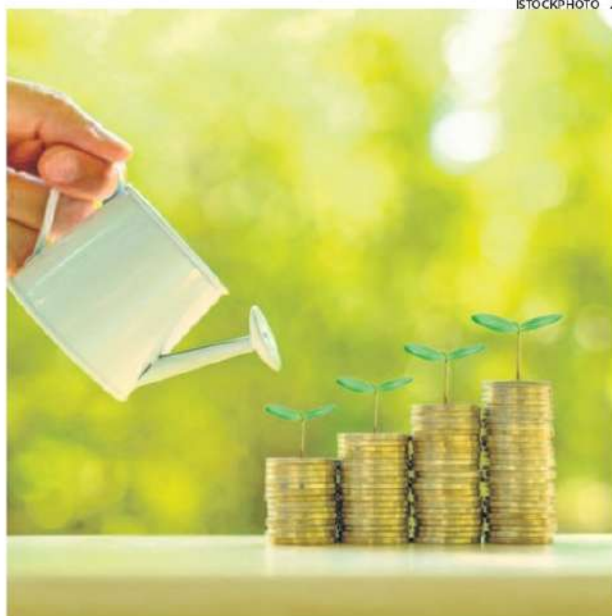
The financial year is coming to a close. Some of you may be sitting on handsome gains if you'd made equity investments in time, as the markets have gone up around 90% in the past one year. If so, it is important to plan your long-term capital gains in equities as they are no longer tax free. Capital gains earned over and above ₹1 lakh on selling equities, including shares and mutual funds, after one year are called long-term capital gains (LTCGs). These LTCGs are taxed at the rate of 10% now. We explain how taxpayers can reduce their LTCG liability in case of equities using the various provisions of the income tax law.

Tax harvesting: Under this method, the taxpayer can book long-term gains in equities to the extent of ₹1 lakh and reinvest the same. The value at which the equities are reinvested is the new cost of acquisition. This process can be repeated every year to take advantage of the ₹1 lakh exemption in case of LTCG. Through this, one can save tax of up to ₹10,000 every year. This exemption is available on the aggregate long-term capital gains from equity-oriented mutual funds and stocks.

Let's take an example to understand how tax harvesting works. Suppose you bought 10,000 equity mutual fund units at ₹50 each in March 2018. There is a grandfathering clause in case of equity instruments under which LTCG till 31 January 2018 are tax free. So, in case a person has invested in equities before this date, the higher of either the value of shares or equity mutual funds as on 31 January 2018, or the actual purchase price will be considered the cost of acquisition. So, in this case, as the investment is made after 31 January 2018, grandfathering clause will not apply. So, if the net



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Learning curve

Points to keep in mind

- **LONG-TERM** capital gains on equities up to ₹1 lakh are tax free.
- **IN TAX** harvesting, you should ideally reinvest the gains at the same price.
- **ONE CAN** save around ₹10,000 per year through tax harvesting.
- **SHORT-TERM** capital loss can be set off against both LTCG and STCG, while long-term capital loss can be set off against LTCG only.
- **BOTH SHORT-** and long-term capital losses can be carried forward over the next eight years .
- **THERE IS** no restriction on set-off of capital losses of one asset against another asset.

asset value (NAV) of the equity mutual funds is ₹75 now, the person can sell around 4,000 units, where LTCG will be around ₹1 lakh. So, one can book gains in these units and reinvest the same.

However, experts advise that tax harvesting is a good technique to save taxes, but investors have to be mindful of the fact the money should be invested immediately after the gains are booked.

"Besides evaluating the LTCGs correctly, it is very important to reinvest the amount immediately without wasting any time. At times, people wait too long to reinvest, or reinvest only partially. When the money comes in the bank, some routine purchases become essential and the money gets spent, without realizing that such an action can seriously hamper your financial goals. Because

> Investors have to note that under tax harvesting, money must be invested immediately after the gains are booked

the money is in the bank, investors try to time the market which is not easy. Finally they end up not investing or investing unfavourably," said Sanjeev Govila, a Sebi registered investment advisor (RIA), and chief executive officer, Hum Fauji Initiatives, a financial planning company.

Also, it may be practically difficult to reinvest at the same price as, in the case of mutual funds, the proceeds may not be credited on the same day. So, the investor may sometimes need additional money for the same. Similarly, in the case of shares, as the prices keep fluctuating, it may not be possible to invest at the same price.

It is also important that one considers the cost involved in tax harvesting. "While you save 10% on LTCGs amount, you incur small charges in the form of security transaction tax, stamp duty, brokerage and so on, which are most likely not more than 1% of the amount," said Govila.

Setting off and carrying forward losses: Another way of reducing your capital gains tax liability is by setting off gains with losses. One should understand the rules first. "Short term capital losses are eligible to be set off against both long term capital gains and short term capital gains (STCG), while long term capital losses can only be set off against LTCG," said Sandeep Sehgal, director, tax and regulatory, AKM Global, a consulting firm.

"There are no restrictions on set off of capital losses of one asset like equity against a different category of asset like land, provided both such losses have been under the head capital gain," said Suresh Surana, founder, RSM India. So, in case you have a long-term capital loss by selling land, you can set off the same with LTCG from equity investments.

Also, both short- and long-term capital losses can be carried forward over the next eight years. This means you can set off current year's losses against a future year's gains. "Another important aspect a taxpayer needs to take into consideration at the time of carry forward of losses is that the income tax return should be duly filed within the due date specified u/s 139 of the IT Act. Otherwise, such capital losses may lapse and would not be allowed to be carried forward," said Surana.

Using exemptions from capital gains: If you want to book long-term gains from equity investments, there is an option to invest the same in 54EC bonds, which are also known as capital gain bonds. However, advisors generally don't recommend this option. "We don't recommend this because the lock-in is 5 years and the current returns are 5% on these bonds," said Suresh Sadagopan, a Sebi registered advisor and founder, Ladder7 Financial Advisories.

Also, one can invest in property to save LTCG on equities. "54F of the IT Act provides exemption for LTCG on assets other than a residential house when the amount is invested in purchasing or constructing a new residential house property," said Tarun Arora, partner, VPTP and Co., a chartered accountancy firm. The property must be bought within 2 years of the date of transfer or 1 year before the transfer. If it's a new house property being constructed by the assessee, this must be done within 3 years of the transfer.

Income tax is an unavoidable expense. However, there are provisions under the income tax law that allow taxpayers to reduce their tax liability. As someone once said, "A penny saved is a penny earned", it is always good to utilize these provisions to save taxes. However, experts say, people should use these options if these are in line with their overall financial goals. Take the advice of an expert if you are unable to do it on your own.