Change in tax rules that Dalal Street is talking about

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NEW DELHI: Prime Minister Narendra Modi's assertion that gains from capital markets are getting away with low tax triggered intense speculation that the coming Budget may change the tax rules for stock investments. However, Union finance minister Arun Jaitley on Sunday rejected possibilities of any hike in longterm capital gains tax on market participation.

One change could be a longer holding period for stocks and equity funds to qualify for tax exemption of long-term capital gains. Currently , if stocks and equity funds are held for one year, the gains are tax free. “The last Budget had increased the minimum holding period for unlisted securities to two years. The government might use this as an excuse to extend this rule to listed stocks this year,“ says Mehraboon Irani, head (private client group), Nirmal Bang Securities.

Apart from the minimum holding period, tax professionals also expect changes in the tax rate on short-term capital gains. “Instead of 15%, short-term capital gains could taxed at 20% or added to the income of the investor and taxed at the marginal rate applicable to him,“ says Amit Maheshwari, partner in Delhi-based tax firm Ashok Maheshwary & Associates. Maheshwari points out that the government has already amended the tax treaties with Mauritius, Singapore and Cyprus to remove the tax advantage that foreign institutional investors (FIIs) have long enjoyed over domestic investors.

Though the changes in tax rules might cause some disruption in the market, some experts believe they could also encourage stock investors to take a longer-term perspective. “The tax-free party is over for investors. It is time to give the returns gift,“ says investment expert Vijay Kedia. If shortterm gains from stock investments will be taxed at a higher rate, investors will hold their investments for longer periods to escape the tax. “It might stop people from treating the stock market like a gambling den where they can make big money in the short term,“ says Kedia.

Others feel higher taxes could push stock investors to mutual funds. “Mutual funds are passthrough instruments and don't get taxed for the gains made from buying and selling securities,“ says ER Ashok Kumar, CEO of Scripbox.com.

He says a longer holding period for long-term capital gains exemption will be good for investors. “It will inculcate discipline among small investors,“ he says.

Though the possibility is remote, some even expect longterm capital gains to be taxed. However, if the introduction of long-ter m capital gains tax means the removal of the securities transaction tax (STT), the potential gains from the higher tax will be neutralised.

“STT brings in around Rs 7,000 crore every year. If it is removed, the government will need to earn Rs 7,000 crore more in capital gains tax. Assuming the long-term capital gains tax is 10%, this requires investors to earn around Rs 70,000 crore more. Investors are not making that much in a year,“ says Kedia.

Meanwhile, mutual funds are hoping that the tax rules for equities will remain unchanged. “There are too many loopholes in equity taxation that need to be closed,“ says Nilesh Shah, managing director of Kotak Mutual Fund. “Zero coupon bonds are listed and get same tax treatment as equities. Bonus stripping continues unabated. The Budget should remove these anomalies first before looking at capital gains tax,“ says Shah.