

# Capital gains tax

## Our discussion with tax officials



JS Global Capital Limited

After Capital gains tax (CGT) implementation was made official in last week's budget announcement, certain areas still remain grey. Hence, in order to seek further clarity over the issues, we met with tax officials and presented our concerns regarding this new tax. Below are key takeaways from our meeting with them.

**Q1. Will the CGT be applicable on cash settled futures and deliverable futures?**

**Ans.** CGT will be applicable on both cash settled futures and deliverable futures, as these terms are covered in the definition of Redeemable capital.

**Q2. Will CGT be applicable for unit holders on redemption of Income & Balanced funds?**

**Ans.** Yes, it will be applicable to unit holders on redemption of both of Income & Balanced funds.

**Q3. Will borrowed cost & incidental expenses be adjustable when computing CGT?**

**Ans.** For securities purchased through borrowed capital or by way of pledged borrowing. Taxpayers may adjust the borrowing cost from the capital gains. Further, other verifiable expenses such as interest cost, salaries, telephone expenses, et al incurred exclusively in the process of earning capital gains will also be allowed.

**Q4. Will Advance tax be applicable on Individuals? (Under Section 147)**

**Ans.** Advance tax will be applicable on Individuals whose income exceeds Rs500,000 per annum.

**Q5. What will be the method of valuation under CGT regime; FIFO or LIFO?**

**Ans.** The matter is still under discussion and a final decision yet to be reached. One of the methods in consideration for implementation from July 1, 2010 is FIFO.

For example assuming we had 20,000 shares of OGDC on Jun 30, and we bought 10,000 shares each on July 1, July 2 and July 3 – with total inventory building up to 50,000 shares. Now if we go on to sell 32,000 shares of OGDC on July 5, inventory for selling purposes will be first taken from the stock of July 1, followed by July 2 and then July 3. As this totals 30,000 shares, the additional 2,000 shares will be taken from the stocks before 30 Jun. CGT will now be charged on gains made on shares bought after July 1, i.e. 30,000 shares, while no tax will be charged on gains made on the 2,000 shares, which were purchased before July 1. This is illustrated via the table on the following page.

Taking this example further, if we had bought an additional 10,000 shares on July 4, the remaining stock of 2,000 shares would be taken up from this purchase and not the position held at Jun 30, and therefore be liable to CGT.

However, a final decision regarding the exact method is yet to be made.

**Capital gains tax slabs**

Tax year	Less than 6M holding	Holding between 6-12M
2010	10.0%	7.5%
2011	10.0%	8.0%
2012	12.5%	8.5%
2013	15.0%	9.0%
2014	17.5%	9.5%
2015	17.5%	10.0%

Source: Finance bill 2010

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**CGT hypothetical example**

Date	Shares purchased	Price	Total holding	Shares sold *	Gain/share (Rs)	Total gain (Rs)	CGT (Rs)
30-Jun	20,000	125	20,000	(2,000)	13	260,000	
1-Jul	10,000	130	30,000	(10,000)	8	80,000	8,000
2-Jul	10,000	135	40,000	(10,000)	3	30,000	3,000
3-Jul	10,000	140	50,000	(10,000)	(2)	(20,000)	(2,000)
5-Jul	(32,000)	138	18,000				
<b>Final position</b>			<b>18,000</b>				<b>9,000</b>

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3-Jul	10,000	140	50,000	(10,000)	(2)	(20,000)	(2,000)
4-Jul	10,000	135	60,000	(2,000)	3	6,000	600
5-Jul	(32,000)	138	28,000				
<b>Final position</b>			<b>28,000</b>				<b>9,600</b>

Source: JS Research

\* In order of purchases made Jul 1st, 2010 onwards i.e. FIFO

**Q6. What will be the treatment of Bonus/Right shares?**

**Ans.** As there is no cost of Bonus shares, issuance of such shares (Bonus, Rights) reduces the cost of shares held. Implementation of FIFO method will aim to neutralize the benefit, as partial selling of original expensive shares at a loss will be offset with the eventual sale of shares acquired at zero (Bonus) or low cost (Rights).