



A Study on Proposed Changes in Capital Gains & its Impact on Tax Assesses

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ABSTRACT:

The Union Budget 2024-2025 has ushered in a seismic shift in the capital gains tax framework, poised to impact a vast swathe of the populace reliant on asset sales for various necessities. This study undertakes a comprehensive examination of the proposed changes, with a specific focus on the concomitant effects on tax assesses. Our research reveals that the elevated capital gains tax rates inherent in the new framework threaten to diminish returns on investment, thereby increasing the cost of capital and exerting a depressive influence on overall investment in the economy. This presentation will elucidate the key findings of our study, juxtaposing the theoretical underpinnings of the policy shift against the empirical realities of its implementation. Ultimately, our research aims to contribute meaningfully to the discourse surrounding the proposed capital gains tax reforms, providing actionable insights for policymakers, tax practitioners, and other stakeholders.

Keywords: Capital Gains Tax, Tax Reforms, Investment, Economic Impact, Tax Assesses.

Meaning & Definitions:

- Capital Gain: The increase in the value of an Asset relative to the price that was originally paid for it.
- Capital Gain Tax: Tax paid by an Investor upon selling their Asset, based on the amount by which the Asset appreciated during the time it was held.
- Long Term Capital Gain: Long-term capital gain or loss, for tax purposes, is the gain or loss stemming from the sale of an investment that was held for longer than 12 months before it was sold.
- Short Term Capital Gain: Short-term capital gains are profits realized from the sale of personal or investment property that has been held for one year or less.
- Indexation: Indexation means adjusting a price, wage, or other value based on changes in another price or composite indicator of prices. Indexation can be done to adjust for the effects of inflation, cost of living, or input prices over time.
- CII: The Cost Inflation Index (CII) is used to estimate the increase in the prices of goods and assets year-by-year due to inflation.
- The Cost Inflation Index (CII) is a measure used by the Income Tax Department of India to account for inflation when calculating long-term capital gains on the sale of assets. It was a critical tool for taxpayers; it helped reduce the tax burden on capital gains by adjusting the asset's purchase price for inflation.

Background:

The Union Budget 2024-25 brings significant changes to the taxation of capital gains, aimed at simplifying the tax structure and providing relief to taxpayers. The budget introduces new tax rates for both short-term and long-term capital gains, impacting a wide range of financial and non-financial assets. These revisions reflect the government's commitment to making the tax system more equitable and less burdensome for taxpayers, particularly benefiting the lower and middle-income classes.

Short Term Capital Gains:

Short-term capital gains on specified financial assets shall be taxed at a rate of 20% instead of the previous rate of 15%. All other financial assets and non-financial assets will continue to be taxed at their applicable tax rates, maintaining consistency in the broader tax framework.

Long-Term Capital Gains:

Long-term gains on all financial and non-financial assets will attract a tax rate of 12.5%. To benefit the lower and middle-income classes, increasing the limit of exemption of capital gains on certain financial assets from ₹1 lakh to ₹1.25 lakh per year has been proposed. This increased exemption limit will apply for FY 2024-25 and subsequent years.

The rate for other long-term capital gains on all assets has been rationalized to 12.5% without indexation (Section 112). Previously, this rate was 20% with indexation. This change aims to simplify the taxation of capital gains and facilitate their easy computation.

Variables in Research on Changes in Capital Gains:

Here are some key variables:

Independent Variables:

- **Capital Gains Tax Rates:** The primary variable of interest is the tax rate imposed on capital gains. Researchers examine how changes in these rates affect the realization, timing, and amount of capital gains.
- **Economic Indicators:** Macroeconomic factors such as GDP growth, inflation, interest rates, and unemployment can significantly impact investment decisions and, consequently, capital gains.
- **Investor Sentiment:** The overall mood or confidence of investors can influence their willingness to hold or sell assets, affecting capital gains.
- **Financial Market Conditions:** Factors like stock market volatility, bond yields, and commodity prices can influence the value of assets and, therefore, capital gains.
- **Policy Changes:** Other government policies, such as monetary policy or regulatory changes, can indirectly affect capital gains.

Dependent Variables:

- **Capital Gains Realizations:** Researchers often measure the total amount of capital gains realized during a specific period.
- **Capital Gains Tax Revenues:** The amount of tax revenue generated from capital gains is another common dependent variable.
- **Investor Behaviour:** Changes in investor behaviour, such as holding periods, portfolio diversification, and risk appetite, can be analysed to understand the impact of capital gains tax changes.

Control Variables:

- **Asset Type:** The type of asset (e.g., stocks, bonds, real estate) can influence the sensitivity of capital gains to tax rate changes.
- **Investor Characteristics:** Factors like income level, wealth, and investment experience can affect how investors respond to tax changes.
- **Time Horizon:** The length of time an asset is held can impact the tax treatment of capital gains.

By analysing the relationships between these variables, researchers can gain insights into the effectiveness of capital gains tax policies and their economic consequences.

Impact of Change in LTCG Rate and Removal of Indexation

- A. Test period = 10 years
 B. Cost of Acquisition = Rs 100 (say)
 C. CII for FY 2024-25 = 363; CII for FY 2014-15 = 240
 D. Indexation factor = $363/240 = 1.51$
 E. Indexed cost of acquisition = $100 \times 1.51 = 151$

| | Sale Consideration | Capital Gains with Indexation of CoA (Old) | Taxation (Old @ 30%) | Capital Gains without Indexation of CoA (New) | Taxation (New @ 12.5%) | Tax Difference (New - Old) | Tax Difference as % of Tax (Old savings as %) |
|--------|--------------------|--|----------------------|---|------------------------|----------------------------|---|
| Case 1 | 400 | 248 | 49.8 | 300 | 37.5 | (-) 12.3 | +24.7% |
| Case 2 | 300 | 149 | 29.8 | 200 | 25 | (-) 4.8 | +16.1% |
| Case 3 | 200 | 49 | 9.8 | 100 | 12.5 | (+) 2.7 | (-)27.6% |

The reduction in the rate will benefit all categories of assets, substantially benefiting taxpayers in most cases. However, where the gain is limited relative to inflation, the benefit may be limited or absent in a few cases. Nonetheless, the new structure is expected to make the taxation process more straightforward and less burdensome for taxpayers.

Literature Review:

- No Indexation for LTCG tax on property bought after July 23, 2024, is unfair; Will deter Long Term Investment

By

Dr Keyur Thaker, ET CONTRIBUTORS, Last Updated: Aug 20, 2024, 10:22:00 AM IST

The amendment tabled in the finance bill is a welcome move as it will provide an option to choose between LTCG tax of 20% with indexation or 12.5% without indexation for property. It would encourage honest tax payment, long-term investment and fair play. However, removal of indexation benefit for properties bought after July 23, 2024 and other Long Term Assets classes must be revisited.

- New capital gains taxation rules: Investors can pick assets purely on merit rather than to optimise tax outgo

Written by Sanket Dhanorkar, ET Bureau, Last Updated: Aug 20, 2024, 12:04:00 PM IST

After the recent budgetary changes, you can build your investment portfolio without being dictated by tax gains.

- Outrage over reform in capital gains tax is overblown.

Even after the recent changes, India's capital gains tax regime remains relatively moderate compared to other nations

Written by Divya Srinivasan, Rakesh Mohan

August 19, 2024 18:08 IST

Indian Express

- Even without Indexation, Real Estate enjoys more breaks than any other Asset

Shipra Singh, 15-Aug-2024, 01:39pm IST, mint

- Facing a backlash over changes to capital gains tax on real estate, govt. relents to grant relief

Finance Ministry proposes to give taxpayers a choice to choose between two tax rates for immovable assets

Published - August 06, 2024 11:34 pm IST - NEW DELHI

[The Hindu Bureau](#)

- Union Budget 2024: Simplification of capital gains tax structure is required, experts call for tax relief for stocks, real estate

With Union Budget 2024 on the horizon, there is a growing expectation for adjustments to be made to the capital gains tax framework, particularly concerning stocks and real estate.

Business Today, updated Jul 19, 2024, 6:32 PM IST

- On Discarding Indexation for Long-Term Capital Gains | Explained

Why has the Union Finance Minister done away with indexation for computing long-term capital gains (LTCG) tax? What is indexation and how does it help in tax savings? What has been the feedback from corporates and industry regarding the move?

Published - July 31, 2024 11:02 pm IST

[Saptaparno Ghosh](#), The Hindu

- Long Term Capital Gains tax hiked from 10% to 12.5% in Union Budget

The exemption limit for long-term capital gains tax has been increased to Rs 1.25 lakh from Rs 1 lakh. The budget also announced that listed financial assets held for more than a year will be classified as long-term.

Abhinav Kaul, July 25, 2024 09.43 IST, Money Control

For More Reviews:

https://docs.google.com/spreadsheets/d/1PYD3uglCSQfoEsP4nPoqrl8TSrjW99E8/edit?usp=drive_link&ouid=115596294011612009824&rtfop=true&sd=true

Research Gap:

Focus: This study will likely analyse the proposed changes in Capital Gains Taxation & impact on tax assesses. Whereas the previous studies focuses on the potential benefits of the proposed changes, specifically the ability for investors to choose assets based on merit rather than tax optimization.

Data: The study is expected to use data and potentially surveys to assess investor behaviour and tax implications. Whereas the previous studies relies on expert opinions and anecdotal evidence.

Impact: It aims to understand how the changes affect investment decisions, tax planning, and potentially the broader economy. Whereas the previous studies doesn't delve into the actual impact on investor behaviour or tax revenue.

* This study will also highlight the relevance of Indexation in Capital Gains Taxation

Objectives:

1. Assess the Potential Economic Impact.
2. Analyse the Distributional Effects.
3. Examine Behavioural Changes of Tax Assesses.

Hypothesis:

The main objective of the paper is to study on the proposed changes in Capital Gains & its impact on Tax Assesses

Hypothesis 1:

H0: There is no impact on Tax Assesses due to change in Capital Gains

H1: There is an impact on Tax Assesses due to change in Capital Gains

Hypothesis 2:

H0: There is no impact on Tax Assesses due to removal of Indexation

H1: There is an impact on Tax Assesses due to removal of Indexation

Conceptual Model:

1. Independent Variables:

Proposed Changes in Capital Gains Tax:

Tax rate changes (increases or decreases)
Changes in holding periods for preferential rates
Modifications to basis rules
Introduction of new tax incentives or penalties

2. Dependent Variables:

Taxpayer Behaviour:

Investment patterns (e.g., asset allocation, risk tolerance)
Timing of investment decisions
Realization of gains or losses

Tax Burden:

Overall tax liability of individuals and households
Distribution of tax burden across income levels

Economic Well-being:

Consumption patterns
Savings and investment rates
Wealth accumulation
Entrepreneurial activity

Data Collection Sources & Methods:

1. Primary Sources:

Surveys and Questionnaires:

Target Audience: Taxpayers, financial advisors, accountants, and policymakers.

Questions: Focus on perceptions, expectations, behavioural changes, and potential economic implications.

Methods: Online surveys, mail surveys, face-to-face interviews, and telephone surveys.

Interviews:

Target Audience: Taxpayers, financial experts, and policymakers.

Depth: In-depth discussions to uncover nuanced perspectives and motivations.

Methods: Structured, semi-structured, and unstructured interviews.

Focus Groups:

Target Audience: Groups of taxpayers with similar characteristics.

Discussion: Facilitated discussions to explore shared opinions and experiences.

Methods: In-person or online focus groups.

2. Secondary Sources:

Government Data:

Tax Returns: Analyse historical data to identify trends and patterns in capital gains taxation.

Economic Indicators: Examine GDP, inflation, and investment trends to assess the broader economic context.

Policy Documents: Review government reports, white papers, and legislative proposals.

Academic Research:

Peer-Reviewed Studies: Explore existing research on capital gains taxation, tax avoidance, and economic behaviour.

Scholarly Articles: Identify key findings and theoretical frameworks.

Industry Reports:

Financial Institutions: Analyse reports from banks, investment firms, and accounting firms.

Trade Associations: Review publications from industry organizations.

Media Reports:

News Articles: Track media coverage of proposed changes and public reactions.

Opinion Pieces: Examine expert opinions and analyses.

Questionnaire:

Section A: Demographic Information

1. What is your age?
2. What is your occupation?
3. What is your annual income?
4. Are you a tax assessee? (Yes/No)

Section B: Awareness and Understanding of Capital Gains Tax

1. Are you aware of the proposed changes in capital gains tax? (Yes/No)
2. How do you currently calculate and pay capital gains tax?
3. What do you think is the primary purpose of capital gains tax?

Section C: Impact of Proposed Changes on Tax Assessee

1. How do you think the proposed changes in capital gains tax will affect your tax liability?
2. Do you think the proposed changes will increase or decrease your tax compliance burden? (Scale: 1-5, where 1 is "decrease significantly" and 5 is "increase significantly")
3. How do you think the proposed changes will impact your investment decisions?

Section D: Perceptions of Fairness and Effectiveness

1. Do you think the current capital gains tax regime is fair? (Yes/No)
2. How do you think the proposed changes will affect the fairness of the tax regime? (Scale: 1-5, where 1 is "make it less fair" and 5 is "make it more fair")
3. Do you think the proposed changes will be effective in achieving their intended goals? (Yes/No)

Section E: Suggestions and Recommendations

1. What suggestions do you have for improving the capital gains tax regime?
2. What recommendations do you have for the government to minimize the impact of the proposed changes on tax assessee?

Section F: Additional Comments

Is there anything else you would like to share about the proposed changes in capital gains tax and their impact on tax assessee?

Sample Design:

1. Population of your research – Tax Assessee
2. Sample Size – 50

3. Sample selection technique – Random Sampling
4. Sampling unit – Residents in Guntur

Limitations of the Study:

Data Availability and Quality:

Incomplete or Inaccurate Data: The availability and quality of data can vary, especially for historical or longitudinal studies. This can affect the accuracy of findings.

Self-Reported Data: Surveys and interviews often rely on self-reported data, which may be subject to biases or inaccuracies.

Generalizability:

Sample Size and Representation: The generalizability of findings depends on the representativeness of the sample. A small or biased sample may limit the ability to draw conclusions about the broader population.

Contextual Factors: The impact of capital gains taxation can be influenced by various contextual factors, such as economic conditions, industry-specific factors, and individual circumstances. This can make it difficult to draw universally applicable conclusions.

Causality:

Correlation vs. Causation: Establishing a causal relationship between changes in capital gains taxation and the behaviour of tax assesses can be challenging. Correlation does not necessarily imply causation.

Other Factors: The impact of capital gains taxation may be influenced by other factors, such as changes in interest rates, economic growth, or investment opportunities. Isolating the specific impact of taxation can be difficult.

Policy Implementation and Evaluation:

1. **Unintended Consequences:** Policy changes can have unintended consequences that may not be captured in initial studies.
2. **Long-Term Effects:** The long-term effects of tax policy changes may take time to materialize, making it difficult to assess their full impact.
3. **Ethical Considerations:**
4. **Privacy and Confidentiality:** Ensuring the privacy and confidentiality of participants can be challenging, especially when dealing with sensitive financial information.
5. **Bias:** Researchers may have biases that can influence their data collection, analysis, and interpretation.
6. Despite these limitations, carefully designed and executed studies can provide valuable insights into the potential impact of proposed changes in capital gains taxation on tax assesses. By acknowledging and addressing these limitations, researchers can enhance the credibility and relevance of their findings.