# Bonus-stripping strategy can help reduce capital gains tax

If the change in tax rules for debt funds is worrying you, the 1:1 bonus announced on Infosys shares could help reduce your tax liability. If you buy Infosys shares now and sell half your holding after the bonus date, the notional loss you will incur can be adjusted against gains from debt funds, stocks, gold and even property.

"Selling the (original) shares soon after they are ex-bonus results in a short-term capital loss, which can be set off against any other taxable short-term or long-term capital gains," said Vaibhav Sankla, director with tax consulting company H&R Block.

Savvy investors use this bonusstripping strategy to reduce capital gains tax. Here's how bonus stripping works. You buy 100 shares of Infosys at the current market price of Rs 3,800 each. After the bonus date, the price of the scrip falls. Assuming that it falls 50% to Rs 1,900, you would have 200 shares of Infosys worth Rs 3.8 lakh.

Now you sell the first 100 shares for Rs 1,900 each, incurring a notional loss of Rs 1.9 lakh from the sale. This is because under tax laws, the purchase price of the original 100 shares will be Rs 3,800 each. The acquisition price of the 100 bonus shares will be zero.

The loss from the sale can be adjusted against taxable short-term and long-term capital gains from other investments, including debt funds, gold and real estate. You can also adjust short-term gains from stocks and equity funds against this loss. If the loss cannot be fully adjusted, it can be carried forward for up to eight financial years. However, the interest earned on fixed deposits and bonds is not eligible for such adjustment.

This could be a useful strategy for investors worried about the high tax they have to pay this year on their debt fund investments. The Budget upset their calculations by changing the tax rules for non-equity mutual funds. It extended the holding period for long-term capital gains from one year to three years. If an investor sells before completing three years, the gains are added to income and taxed at the normal rate.

However, the bonus-stripping strategy is a double-edged sword. The investor will have to hold the bonus shares for at least one year or pay tax. "Since the acquisition price of the bonus shares is considered zero, selling them before one year will attract 15% short-term capital gains tax," said Sudhir Kaushik, chief financial officer and co-founder of Taxspanner.com.If you sell the bonus shares before one year is over, the tax outgo will be Rs 28,500, which will pare some of the gains from the bonus-stripping.

Also, keep in mind that this strategy will not work if you have Infosys shares in your portfolio for more than a year. Tax laws follow the principle of first-in-first-out. So, when you sell the shares after the bonus date, it will be deemed that you have sold the shares you already had in your portfolio. If those shares were bought more than a year ago, it would be treated as a long-term capital loss.

Given that long-term capital gains from stocks and equity funds are tax free, there is also no provision to adjust long-term capital losses from these instruments.

*(Economic Times)*