Investors save capital gains tax on shares sold on exchange

Transactions carried out on exchanges attract zero rate of tax on long term gains, whereas transaction off the exchanges attract 20% tax on long term gains.

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The Securities and Exchange Board of India (SEBI) has allowed companies to offer delisting, buyback through the stock exchange routes. This might seem to be a simple act of granting companies more routes to ensure that they are able to conduct their corporate actions through the use of the stock exchange mechanism but this has large implications for small investors. Investors face the issue of determination of the rate of tax of the capital gains that is earned on the investment and in many cases this could result in huge savings on the tax front. Here is a closer look at the entire issue in detail.

Current situation

The existing situation is that while normal trading of shares is undertaken on the stock exchange platform there are several other types of corporate action that do not find a place here. This includes things like buybacks of shares or tendering of shares at the time of delisting. The process that is followed in this act is that the company calls for the shares to be submitted to it and the shares are directly transferred to the demat account of the buyer without using the stock exchange trading platform. While the effort that is involved in this act is an aspect to consider as there has to be extra effort made to fill in the details in the form and other things there is also a wider tax implication that has negative impact on the finances of the individual investor.

Tax implication

There is a tax implication of this situation because of the capital gains that would arise in the transaction and the manner in which this would be taxed. The key part is the rate that would be applicable on the long term capital gains on a transaction. There is a beneficial rate of zero per cent applicable on long term capital gains when the transaction is made on a notified stock exchange and there is securities transaction tax paid on the transaction. While this is present for a normal sale made on the stock exchange it is absent when there is a buyback or a delisting purchase that is made directly from the investor. This means that the investor would not pay any long term capital gains when this is sold on the stock exchange but if the shares are tendered outside the exchange then a 20 per cent tax liability after indexation would arise for the investor.

Change and its impact

With SEBI now allowing companies to undertake the delisting and other transactions through the stock exchange platform it can result in a big relief for the investor. This is because all these kind of transactions will be on the stock exchange and there will be some securities transaction tax paid on it. For those investors who have held the shares for a period of more than one year and then there are gains that are made on the sale then there would not have to be any tax paid on the whole gains. The amount here can be very large especially if these shares have been bought some time ago and the capital gain on the sale price is significant. The benefit that will come to the investor is that they will be able to complete such transactions easily because such sale will be done quite simply without too much of paperwork. The added benefit will be in the form of the lower or zero rate of tax that will be present due to the fact that they would classify for this benefit under the definition that is present in the Income Tax Act. This can turn out to be extremely profitable for the investor in the long run.

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