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Why LTCG tax is a blow to 'Start-up India'

New Delhi | Published: February 14, 2018 2:55 AM

LTCG tax arising on transfer of listed equity shares on or before March 31, 2018, would be tax exempt under the present tax regime, regardless of whether the shares are listed before or after January 31, 2018.

Long-term capital gains (LTCG) arising from the sale of equity shares listed on a recognised stock exchange in India after January 31, 2018, are not grandfathered. Equity shares listed on a recognised stock exchange in India after January 31, 2018, and sold on or after April 1, 2018, after being held for more than 12 months before sale, would be subject to taxation on the entire capital gains at 10% and not just on the incremental capital gains from January 31, 2018. If these shares are sold on or before March 31, 2018, the entire capital gains would be tax exempt under the present tax regime. This ma ale, to prepone their listing on the bourses befor

In his 2018 budget proposal sfer of listed equity shares, units of equity-oriented funds and business trusts on or after April 1 , 2018. LTCG accrued up to January 31, 2018, have been grandfathered and will continue to be tax exempt. To determine the capital gains, the cost of

acquisition for these long-term capital assets acquired on or before January 31, 2018, will be the actual cost or the fair market value (FMV) as on January 31, 2018, whichever is higher. Further, if the full value of consideration on transfer is less than the FMV on January 31, 2018, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition. The benefit of inflation indexation of the cost of acquisition would not be available for computing LTCG under the new tax regime.

This results in taxation of only incremental LTCG arising after January 31, 2018, if the shares or units are sold after April 1, 2018. In the case of a listed equity share or a unit, the FMV means the highest price of such share or unit quoted on a recognised stock exchange on January 31, 2018. However, if there is no trading on January 31, 2018, the FMV will be the highest price quoted on a date immediately preceding January 31, 2018, on which it has been traded. In the case of unlisted units, the net asset value of such units on January 31, 2018, will be the fair market value. While the grandfathering benefit under the new tax regime has been extended to unlisted units of equity-oriented funds and business trusts, it is not made available to unlisted equity shares.

LTCG tax arising on transfer of listed equity shares on or before March 31, 2018, would be tax exempt under the present tax regime, regardless of whether the shares are listed before or after January 31, 2018. Since the shares listed after January 31, 2018, do not get the grandfathering benefit under the new tax regime, it would force companies looking for an IPO combined with an offer for sale to prepone its listing of equity shares before March 31, 2018.

The year 2017 has been a defining year for capital raising in India. About Rs 1.6 lakh crore was raised through the public equity markets, the highest amount ever raised in a calendar year, according to Prime Database. Of the total amount raised, new capital was `86,176 crore (53%) and the balance of `74,940 crore being offers for sale (OFS). It was also the best year ever for the IPO market, mobilising about `68,826 crore. While offers for sale by private equity/venture capital investors accounted for 15% of the total IPO amount raised, those by promoters was significantly higher at 63%. Offer for sale is a segment wherein promoter/promoter group entities/non-promoters can sell their shares in a transparent manner through the bidding platform for the Exchange. The OFS segment earlier allowed only promoter/promoter group entities of listed companies to act as “sellers” to dilute/offload their holding to achieve minimum public shareholding of 25% whereas the segment has now been extended to non-promoters of eligible companies holding at least 10% of share capital of the company.

Lack of grandfathering benefits on unlisted shares will result in taxation of capital gains for start-up entrepreneurs, employees holding ESOP shares, angel investors, angel funds and any other venture capital or private equity funds, for a retrospective period. Grandfathering the gains for units of equity-oriented mutual funds and business trusts and not extending the same benefits to unlisted shares would be a huge set-back for the “Start-up India” programme. The mechanism for determining FMV of unquoted shares is already provided in Rule 11UA of the income-tax rules. The FM should extend the grandfathering benefit as on January 31, 2018, to unlisted shares, similar to unlisted units of equity-oriented funds or business trusts.

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