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CAPITAL GAIN TAXATION

Jonty Chaprana

Neha Sandhu

Manav Rachna Faridabad

ABSTRACT

Capital gain taxation refers to the levy imposed on profits realized from the sale of capital assets such as stocks, bonds, real estate and businesses. Capital gains are categorized into short-term and long – term gains, with distinct tax rates depending on the holding period and jurisdiction. While short- term capital gains are typically taxed at higher ordinary income rates, long term capital gains benefit from preferential rates to incentivize long-term investment.

Capital gain taxation plays a crucial role in economic policy, influencing investor behavior, market liquidity and capital formation. Policymakers often balance revenue generation with economic growth by adjusting tax rates, exemptions, and deferral mechanisms such as reinvestment provisions and step – up basis rules. Additionally, the taxation of capital gains has implications for wealth distribution, as higher income individuals derive a significant portion of their earnings from capital gains.

Despite its importance, capital gain taxation remains a subject of debate, with arguments for and against its impact on economic efficiency, fairness, and investment incentives. Some advocates for lower lower rates to promote entrepreneurship and investment, while others argue for higher taxation to reduce wealth inequality and increase Government revenue. Overall, capital gain taxation is a dynamic area of fiscal policy that requires careful consideration to balance economic growth, tax equity and Government revenue needs.

Key words:- Capital gain , policy makers , economic policy , wealth distribution.

INTRODUCTION

A capital gains refer to the increase in a capital asset value that is realized when the asset is sold. These assets include stocks, real estate, bonds, or other investments held by individuals or businesses. Capital gain taxation plays a crucial role in economic policy, influencing investor behavior, market liquidity and capital formation. It is a key indicator of investment performance and plays a significant role in personal wealth building, corporate finance and national economic growth. In recent years, capital gains have become a central topic in economic policy discussions, especially as they relate to income inequality, tax fairness and investment incentives. The treatment of capital gains in tax systems can influence how people invest, how long they hold assets and how wealth is distributed across society. These gains can be a major source of income for individuals and companies that invest in long-term assets.

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DEFINITION AND TYPES OF CAPITAL GAINS TAXATION

A capital gain occurs when an asset is sold for more than it was bought. Basically, when a person or entity sells an asset for a higher price than what they originally paid, these gains are not realized until the asset is sold, this is known as a realized gain.

Capital Gains are divided into two categories:

A. SHORT -TERM CAPITAL GAINS: These are profits from the sale of assets held for one year or less. These gains occur when the selling price of the asset is higher than its purchase price and the holding period is short. In many countries, these gains are taxed at a higher rate than long-term gains and are treated as ordinary income.

Examples are: - 1. Stock market – Buy: you purchase 100 shares of a company at $10 each in March. Sell: In August, you sell them at $15 each. Profit: $15-$10x 100=$500

Since you held the shares for less than a year, the $500 is a short-term capital gain and will be taxed as regular income in many countries.

2.Cryptocurrency – Buy: you buy 2 Bitcoin in January at $25,000 each. Sell: You sell them in March for $30,000 each.

Profits: $30,000-%25,000x2 = $10,000

This is also a short-term capital gain because the holding period was under one year.

B. LONG-TERM CAPITAL GAINS: It is the profit earned from selling a capital asset that has been held for more than one year. These gains are usually taxed at lower rates to encourage long-term investment.

For example, long-term gains in many countries are taxed between 10% and 20%, depending on the investor’s income level and type of asset.

CAPITAL GAINS TAXATION

Taxing capital gains is the major step through which government collect revenue from investors. These steps differ across the countries and are influenced by social goals, economic and political.

PURPOSE OF CAPITAL GAINS TAX

- It reduces income inequality
- It encourages long term investment
- Raise government revenue
- Prevent speculation in financial and property markets

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Examples of Tax Policies:

- INDIA- Different rates are apply for equity and non-equity assets. Long term equity gains over 1 lakh are taxed at 10%, while short -term gains are taxed at 15%.
- UNITED KINGDOM – Offers an annual – tax free allowance with capital gains above that taxed 10% or 20%, depending on income.

CAPITAL ASSETS

It is any property or investment that a person or business owns and can be transferred like land, buildings, shares, patents, trademarks, machinery, jewelry, vehicles, mutual funds goodwill etc.

Capital assets are not bought or sold in the normal course of business but they can generate profit when sold and that profit is known as capital gain.

The assets which are not considered as capital assets: -

1. Agricultural land in rural areas.
2. Personal items like clothes or furniture
3. Business equipment and machinery
4. Stock in trade

TAX EXEMPTION ON CAPITAL GAIN

- SECTION 54- Reinvestment in Residential property – if you sell or buy a residential property within a specific period, your long-term capital gains may be exempt. But property sold must be a long-term capital asset (held for 2+ years). you must purchase another house within 1 year before or 2 years after the sale or construct a new house within 3 years.
- Case law related to the above section - Ms. Moturi Lakshmi v the Income Tax Officer 2020.**Issue** of this case is whether an advance payment made by the taxpayer for the purchase of residential unit , comprises a part of the purchase price for the purposes of section 54. **Judgement of the court** :- The Madras High Court upheld the benefit under section 54 in relation to the taxpayer's advance payment made for the acquisition of a flat prior to the date of sale of the original apartment . It went on to say that the legislature's objective was to buy before or after date of sale.
- SECTION 54EC- Investment in capital gains bonds – you can avoid tax on capital gains from land or building by investing in bonds. But some conditions are: Invest the gain in REC or NHAI bonds within 6 months of sale. Lock in period is for 5 years and exemption limit will be 50 lakhs per financial year.

- SECTION 54B-Agricultural land exemption – if you sell agricultural land and buy other agricultural land, capital gains may be exempt. But the land sold must have been used for agriculture by the taxpayer and new agricultural land must be bought within 2 years.

Case law related to the above section - Commissioner of income tax v Smt. Savita Rani

Issue - weather Smt. Savita Rani was entitled to the exemption under section 54B of the Income tax Act.

Court's Finding-The court found that the land sold was indeed used for agricultural purposes by the assessee.the sale were reinvested in purchasing agricultural land within the prescribed two-year period.The assessee provided sufficient evidence, including registered sale deeds and agricultural records, to support her claim.

Exemption for charitable donations- In many countries, if you donate an asset directly to a registered charity then you may avoid capital gains tax and can claim a tax deduction.

- Section 54Fof the Income Tax Act allows one to claim exemption from tax on long-term capital gains, if the same is used for the purchase or construction of a house within specified time limits. Following are the key points in respect of this section:
- Assessee is an Individual or HUF.
- Capital Gain arises from the Sale of any capital asset other than Residential House.
- Time limit of Purchase or Construction: Purchase should be made within 1 year before or 2 years
- after the date of transfer; Construction should be complete within 3 years from date of transfer.
- Issue: Can exemption under section 54F be denied solely on the ground that the new residential house is purchased by the assessee exclusively in the name of his wife?
- Reply: Reference- [2013]30 taxmann.com 34 (Delhi) HIGH COURT OF DELHI, Commissioner Income-tax-XII v. Kamal Wahal.
- In the above case, the seller has sold a property owned by him; in order to claim the exemption u/s 54F he made an investment in a new property in the name of his wife. However, she had not contributed any fund to purchase the said property. In this case, the High court has clarified that a new residential house need not be purchased exclusively in the name of the seller. Further the court held that the assessee had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased in the name of his wife. In addition to the above, the entire investment for purchase of the new residential house had come out of the sale proceeds of the asset of the seller.

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- Hence, the assessee is entitled to claim exemption under Section 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife.

CONCLUSION

Capital gain plays an important role in generating or increasing government revenue, encouraging long term investment, and promoting economic fairness. It is part of modern tax systems aimed at taxing the profits earned from the sale of capital assets such as property, stocks, and investments. It represents the profit earned when a person or business sells a capital asset such as gold, property etc. These gains can be for short term or long term, it depends on how long the asset was held before being. It also allows governments to collect revenue through capital gain taxes, while offering exemptions and incentives to encourage long – term investments and economic growth.

In Summary, capital gains tax is not just a tool for revenue collection, but also a mechanism to shape investment behavior, reduce income inequality and support sustainable economic development.