CHAPTER- 3.

CERTAIN ILLUSTRATIONS ON CAPITAL GAINS.

CHAPTER - III

CERTAIN ILLUSTRATIONS ON CAPITAL GAINS

3.1 Introduction:

In the present Chapter, an attempt is being made to discuss the statutory provisions as they are contained in the Income-tax Act, 1961, and accordingly, it is proposed to discuss these provisions elaborately with the help of certain illustrations. An attempt is also made to discuss these provisions individually, with necessary section and sub-section and throw light upon the spirit of these provisions.

The examples discussed herebelow pertain to the assessment year 1990-91 and assistance has been sought from V.G.Mehta's "Income-Tax Ready Reckoner" and Taxmann's "Direct Taxes - Law and Practice, 1989-90" by Dr.Vinod K.Singhania, and some of the examples have been framed by the researcher himself.

3.2 Computation of Capital Gains:

I) Computation of capital gain in the case of conversion of capital asset into stock-in-trade **[Section 45(2)]:**

Example 1

X converts his capital asset (acquired on June 10, 1967, for Rs.70,000, fair market value on April 1, 1974, Rs.

1,80,000) into stock-ir-trade on March 10, 1984 (fair market value Rs.4,80,000) and subsequently sells the stock-in-trade so converted for Rs.7,30,000 on June 10, 1988. Assuming the financial year as the previous year, find out assessable profits.

Solution:

In the given case, the capital asset is converted into stock-in-trade in the previous year relevant to the assessment year 1984-85.

But before the assessment year 1985-86, any conversion of capital assets into the stock-in-trade is not treated as 'transfer'. Hence, profit arising from this conversion is not taken or chargeable under the head 'capital gains'.

By an amendment by the Taxation Laws (Amendment) Act, 1984, the definition of 'transfer' is enlarged with effect from the assessment year 1985-86 to provide that in a case where a capital asset is converted into stock-in-trade of a business carried on by him, such conversion shall also be regarded as a 'transfer' of the asset.

Example 2

Y converts his capital asset (acquired on June 1975 for Rs.1,00,000) into stock-in-trade on 1st March 1985 and fair market value on that date is Rs.4,00,000. Find out capital gains.

Solution

In the given case study, Mr.Y converts his capital asset into stock-in-trade on 1st March 1985. So that this conversion is treated as a transfer, because from the assessment year 1985-86, conversion of capital asset into stock-in-trade is treated as 'transfer' under Section 2(47), hence, it is chargeable to tax under the head 'capital gains'.

		Rs.
	Fair market value on the date of conversion	4,00,000
less:	Cost of Acquisition	1,00,000
	Long Term Capital Gains	3,00,000

Note: Capital gain will be chargeable to the tax in the year in which such stock-in-trade is sold.

II) Computation of capital gains on transfer of partner's asset to firm and vice versa.

(A) Transfer of capital asset by a partner/member to a Firm/ association of person/body of individuals **[Section 45(3)]:**

Example 1

X and Y form a partnership firm. Soon after formation of the firm, X brings on July 10, 1989, the following assets as his capital contributed:

Particulars	Gold	Silver
Fair market value on the date of transfer	Rs 5,40,000	Rs 72,000
Amount recorded in the books of accounts	6,00,000	50,000
Actual cost	30,000	12,000
Year of acquisition	1982	1988

Rs.6,50,000 is credited in the capital account of X in the firm. Is X chargeable to tax in this case?

Solution

From assessment year 1988-89 and onwards, the profits and agains arising from the transfer of a capital asset by a partner/member to firm/association of persons/body of individuals by way of capital contribution or otherwise will be chargeable to tax as his income under head 'capital gains' of the previous year in which such transfer takes place. For this purpose, the amount recoded in the books of account of firm will be taken to be the sale consideration and the capital gains will be computed accordingly [Section 45(3)].

In the given case, the capital gain is as under:

	Particulars	Gold	Silver
	Amount recorded in the books of account	6,00,000	50,000
less:	Cost of acquisition	30,000	12,000
	Long term capital gains	5,70,000	
	Short term capital gains		38,000

In this case, the capital gain arising from gold is long term capital gains because it is held for more than 36 months and capital gain arising from silver is short term capital gain because silver is held for not more than 36 months; hence, it is short term capital asset.

Note: X can also claim deduction under sections 54E, 54F and 48(2).

(B) Transfer of a capital asset by way of distribution of capital assets to its partners/members **[Section 45(4)]:**

Example:

X, Y and Z are the three partners of a firm. On March 10, 1990, the Firm is dissolved.. The following assets are distributed to partners:

Particulars	Residential House (taken by X) Rs.	Shares (taken by Y) Rs.	Land (taken by Z) Rs.
Fair Market value on March 10, 1990	1,20,000	50,000	30,000
Agreed value as per Dissolution Deed	1,70,000	46,000	32,000
Cost of acquisition	40,000	5,000	8,000
Year of acquisition	1949	1988	1982

Determine the amount of capital gains for the assessment year 1980-90.

Solution:

From assessment year 1988-89 and onwards, the profit and gains arising from the transfer of a capital asset by way of distribution of capital assets to its partners/members on the dissolution of a firm/association of persons/body of individuals or otherwise, will be chargeable to tax as income of the firm/association of persons/body of individuals under the head 'Capital gains' of the previous year, in which the said transfer takes place. For this purpose, the fair market value of the asset on the date of such transfer will be taken to be the sale consideration and the capital gains will be chargeable accordingly [Section 45(4)].

Hence, in the given case, capital gains is computed as under:

Particulars	Resi.House Rs.	Shares Rs.	Land Rs.
Fair market value on the date of transfer	1,20,000	50,000	30,000
less: Cost of acquisition	40,000	5,000	8,000
Long term capital gains	80,000	45,000	22,000

Notes: 1. The firm can claim exemption under section 54E and deduction under section 48(2).

2. Gain arising from such transfer is treated as long-term capital gain bbecause residential house and land are held for more than 36 months and shares are held for more than 12 months **[Section 2(42A)]**.

III) Computation of capital gains in the case of compulsory acquisition of an asset **[Section 45(5)]**:

Example

Mr.X has a land in Barshi town, worth Rs.30,000 which was purchased in 1985. This land is acquired by the Municipality for Rs.50,000 on 1st January 1989. But this compensation is not agreed to by Mr.X and he made an appeal to the Court. The Court increased the compensation by Rs.20,000 on 15th January 1990. Compute capital gain of Mr.X.

Solution

From assessment year 1988-89 and onwards, in the case of transfer by way of compulsory acquisition under any law, the capital gains computed with reference to the compensation initially awarded shall be deemed the sale proceeds of the assets. From the initially received compensation, deduct the cost of acquisition and cost of improvement and calculate the capital gains.

If such compensation is enhanced by any Court, tribunal or other authority, it will be charged to tax as capital gain of the previous year in which such amount is received, the cost of acquisition and cost of improvement for the purpose of enhanced compensation will be taken to be nil.

If the enhanced compensation is received by a person other than the original transferror, capital gains will be charged in the hands of the recipient.

Hence, in the given problem capital gain is computed as under:

Computation of Capital Gains

Assessment year : 1989-90

		Rs.
	Compensation received	50,000
less:	Cost of acquisition	30,000
	Long Term Capital Gain	20,000

Assessment year : 1990-91

	Enhanced compensation received	20,000
less:	Cost of acquisition and Cost of improvement	nil
	Long Term Capital Gain	20,000

IV) Capital gain on transfer of goodwill **[Section 55(b)(i)]:**

Example:

X transfers the following assets on May 15, 1989:

	Cost Rs.	Fair Market value on Apil 1, 1974 Rs.	Sale Consideration Rs.
Land	20,000	45,000	1,55,000
Goodwill	*	10,000	1,75,000
Tenancy rights	*	30,000	2,00,000

*Self-generated.

Determine the amount of capital gains chargeable to tax for the assessment year 1990-91.

Solution:

In view of the Supreme Court decision in the case of C.I.T. v. B.C.Srinivasa Setty [128, ITR 294 (SC)], self-generated goodwill is not a capital asset and hence, any gain arising on its transfer is not taxable under the head 'capital gains' upto the assessment year 1987-88.

From assessment year 1988-89 and onwards, section 45 has been amended to provide that the "cost of acquisition" in relation to a capital asset being goodwill of the business shall be the purchase price in case the assessee has purchased such goodwill and in any other case, i.e. where the goodwill is self-generated, the cost of acquisition will be taken to be nil. The 'cost of improvement' in relation to the goodwill will be taken to be nil. The capital gain arising from the transfer of goodwill will be liable to capital gains, from assessment year 1988-89 and onwards.

Hence, capital gain in the given example is calculated as under:

*Calculation of Capital Gains for the Assessment Year : 1990-91.

	Particulars	Land Rs.	Goodwill Rs.	Tenancy Rights Rs.
	Sale consideration	1,55,000	1,75,000	2,00,000
less:	Cost of acquisition or Fair market value on April 1, 1974	45,000	nil	-
	Long Term Capital Gain	1,10,000	1,75,000	Not Taxable

Notes:

1. Fair market value of goodwill on April 1, 1974, is not mentioned; hence, cost of acqusition/fair market value on April 1, 1974, is to be taken 'nil' for the calculation of capital gain on goodwill.

2. 'Tenancy rights' is a self-generated asset, even though it is not covered under section 55 of the Income_tax Act, 1961; hence, it is not taxed under this head of income.

3.3 Cost of Acquisition:

I) Cost to the previous owner **[Section 49(1)]**:

Example 1

A Hindu uncivided family acquires a residential house at Delhi for Rs.2,10,000 on April 1, 1978. The family undergoes complete partition on November 1, 1987, and the residential house is allotted to Y, a member of the family (fair market value in 1987 is Rs.6,00,000). Y sells the house on March 15, 1990, for Rs.6,90,000. Determine the amount of capital gain chargeable to tax in the case of Hindu undivided family and Y.

Solution

The Hindu undivided family has transferred a house to Y at the time of partition. This transaction is not treated as 'transfer' under section 47(i); hence, surplus arising thereon is not taxable.

Y has sold the house; so it is taxable in his hands as under:

	Particulars	Amount Rs.
	Sale consideration	6,90,000
less:	Cost of acquisition	2,10,000
	Long term capital cain (subject to other deductions & exemptions)	4,80,000

Note: In this problem, the cost of acquisition is to be taken of the previous owner, because it is covered under section 47(i).

Example 2

X is a shareholder in A Ltd. and B Ltd. From the following data, find out the income under the head 'capital gains' of X, A Ltd. and B Ltd.

	A Limited	B Limited
Date of Liquidation	March 1, 1958	March 10, 1985
	Rs.	Rs.
Accumulated profit of the Company on the date of liquidation	nil	2,50,000
* Total paid-up share capital of the Company	10,00,000	27,00,000
* Face-value of shares owned by X	50,000	2,70,000
* Cost of Shares to X purchased by him in 1926	50,000	1,65,000
* Market value of assets (house property) distributed to all shareholders by liquidators	11,40,000	29,00,000
* Cost of the Company	2,00,000	16,00,000
* Date of sale of assets, received by X at the time of liquidation	March 31 1990	March 31 1990
* Sale proceeds of assets sold by X.	1,90,000	6,35,000

Solution

Taxable income will be computed as under:

(a) Capital Gain to A Ltd. and B Ltd. : Under section 46(1), there is no capital gain at the time of distribution of capital asset in kind to shareholder in the case of liquidation.

(b) Capital gain to X:

1) Assessment year 1958-59:

During the previous year 1957-58, X has received assets worth Rs.57,000 at the time of liquidation of A Ltd. Shares in A Ltd. are purchased for Rs.50,000. From this transaction, X has received extra Rs.7,000, but it is not treated as capital gain; because, the Income-tax Act commenced from 1961.

2) Assessment Year 1985-86:

market Value of assets	2,90,000
less: Dividend	25,000
	2,65,000
less: Cost of acquisition	1,65,000
Long Term Capital Gains	1,00,000

Notes:

1. Market Value of Assets:

X has purchased 10% of the total paid up capital; hence, the market value of assets received by X is 10% of the total assets distributed by the liquidator, i.e. Rs.2,90,000.

2. Dividend:

B Ltd. has an accumulated profit of Rs.2,50,000 at the time of its liquidation; hence, 10% of the profit is owned by X; so, it is treated as dividend of Rs.25,000 and is received out of Rs.2,90,000

3) Assessment Year 1990-91

	Assets taken from A Limited Rs.	Assets taken from B Limited Rs.
Sale proceeds of assets	1,90,000	6,35,000
less: Cost of acquisition of the previous owner	10,000	-
Market value of assets on the date of liquidation	-	2,90,000
Long Term Capital Gains	1,80,000	3,45,000

Note: Cost of acquisition is taken in the case of assets taken from A Ltd. is the cost of previous owner, because this asset is received by X before the commencement of the Income-tax Act. This provision is covered under section 49(1)(iii)(c).

But in the case of assets taken from B Ltd., the cost of acquisition is taken the fair market value of the assets on the date of assets received by X. and also the gain arising from this transaction is assessed in the assessment year 1985-86 on the basis of fair market value of the asset at the time of liquidation (Section 49(1)(iii)(c).

Hence, for the assessment year 1990-91, the cost of acquisition of the assets taken from B Ltd. is deemed the fair market value at the time of liquidation (section 55(2)(b)(iii)).

II) Cost of acquisition can be taken as the fair market value as on April 1, 1974 **[Section 55(2)]**.

Example 1

X purchased a house property on April 1, 1968, for Rs.40,000, which he sold for Rs.2,00,000 on December 15, 1989. The expenditure were made by X of Rs.20,000 in January 1973. The fair market value of the house on April 1, 1974, was Rs.1,00,000. Calculate capital gains.

Solution:

Capital Gain for Assessment Year 1990-91.

	Sale Price	Rs.2,00,000
less:	Cost of acquisition	1,00,000
	Long Term Capital Gain	1,00,000

Note According to section 55(2), the assessee may take at his option either the actual cost or the fair market value of the asset, as on April 1, 1974, as the cost of acquisition, except the depreciable assets.

If the assessee has taken the fair market value of the asset on April 1, 1974, as the cost of acquisition, the expenditure incurred before April 1, 1974, does not qualify for deduction as a cost of improvement.

Example 2

X has purchased a house property on April 1, 1965, for Rs.50,000, which he gifted to his son Y on April 1, 1969. The following expenditure on improvements were made by X and Y: addition of one room in January 1973 - Rs.24,800; major repairs in November 1976 [deducted to the extent of Rs.12,800 under section 24(I1)(a)] - Rs.24,000; and renovation of the house in September 1979 - Rs.8;,800. Y sold the house on March 17, 1990, for Rs.2,00,000.

What will be the amount of capital gains if Y opts to take the fair market value of Rs.85,000 as on April 1, 1974?

Solution

Computation of Capital Gains

Assessment Year : 1990-91

	Sale proceeds		Rs.2,00,000
less:	Cost of acquisition (being the fair market value on April 1, 1974)		85,000
			1,15,000
less	Cost of Improvement		
	i. Major repairs (i.e.Rs.24,000 - Rs.12,800)	11,200	
	ii. Renovation	8,800	20,000
	Capital gain chargeable to tax		95,000

Notes:

1. According to section 55(2), the assessee has an option either to take the actual cost or fair market value of the asset on April 1, 1974.

2. Expenditure on improvement of asset before April 1, 1974, does not qualitify for deduction, if the assessee opts to substitute fair market value of the asset on April 1, 1974, as cost of acquisition; hence, only expenditure incurred afterr April 1, 1974, are deductible.

III) Cost in the case of depreciable asset **[Section 50].**

Example

X starts a new business on April 18, 1989. For this he acquired Plant A whose cost of acquisition is Rs.26,000 and the rate of depreciation is 100 per cent. He also acquires Plant B for Rs.30,000 (rate of depreciation is 50 per cent) on March 31, 1990. On May 10, 1990, he sells Plant A for Rs.22,000 and Plant B for Rs.17,000 (expenditure incurred in connection with transfer is Rs.1,000 and 500 respectively).

He, however, acquires the following plants during the previous year 1990-91.

Particulars	Cost Rs.	Rate of Depreciation (per cent)
Plant C	18,000	100
Plant D	12,000	50
Plant E	21,000	33.33

Depreciation and Capital gain will be determined as under:

Depreciation Chart

	Particulars	First Block plant, rate of depreciation 100% Rs.	Second Block plant, rate of depreciation 50% Rs.	Third Block plant, rate of depreciation 33.33% Rs.
	Written down value on April 1, 1989	nil	nil	nil
add:	Cost of assets acquired during the previous year 1989-90	26,000	30,000	nil
		26,000	30,000	nil
less:	Sale consideration of assets sold during the year	nil	nil	nil
	Written down value for the previous year 1989-90	26,000	30,000	nil
less:	Depreciation	26,000	15,000	nil
	Depreciated value on April 1, 1990	nil	15,000	nil
add:	Cost of assets acquired during the previous year 1990-91	18,000	12,000	21,000
		18,000	27,000	21,000
less:	Sale consideration of assets sold during the previous year 1990-91	22,000	17,000	nil
		nil	10,000	21,000

less: Depreciation for the previous year 1990-91	nil	5,000	7,000
Depreciated value on April 1, 1991	nil	5,000	14,000

Capital Gains - Assessment Year : 1991-92

	Particulars	First Block Rs.	Second Block Rs.
a)	Sales consideration of Plant A and B on May 10, 1990.	22,000	17,000
b)	Expenditure in connection with transfer	1,000	500
c)	Written down value of the block on April 1, 1990	nil	15,000
d)	Cost of assets acquired during the previous year 1990-91	18,000	12,000
	Short Term Capital Gains [a - (b+c+d)]	3,000	-

Note: According to section 50(1) of the Income-tax Act, the capital gains arising from the transfer of depreciable capital asset is to be calculated after deducting the following items from sales consideration:

a) Expenditure incurred wholly or exclusively in connection with such transfer;

b) The written down value of the block of assets at the beginning of the previous year; and

c) The actual cost of any asset falling within the block of assets acquired during the previous year.

Such excess shall be deemed to be short-term capital gains. Hence, in the first case, we have to deduct expenditure incurred in connection with such transfer of cost of assets acquired during the year from the sale consideration and calculate the capital gains. The capital gain arising from the first block is Rs.3,000 (i.e. Rs.22,000 - (Rs.1,000 + Rs.18,000)). It is a short-term capital gain.

And also in case of the second block of assets, we have to deduct expenditure incurred in connection with such transfer, opening balance of the written-down value of block of asset and cost of asset acquired during the year, from sales consideration. In the second case, capital gain is nil (i.e. Rs.17,000 - Rs.5,000 - Rs.15,000 - Rs.12,000).

In the assessment year 1991-92, Rs.3000 is chargeable to tax under the head 'capital gains'. The capital gain arising from such transfer is known as 'short-term capital gain' under section 50(1).

IV) Cost of acquisition in the case of bonus shares and rights shares:

<u>Example</u>

X purchases 500 equity shares of ABC Ltd., on December 27, 1963, for Rs.44 per share and incurs an expenditure of Rs.800 on brokerage. On June 30, 1978, he receives 300 shares as bonus shares. On January 1, 1980, he gets 200 right shares for Rs.10 per share. Determine the amount of capital gain if he sells 900 shares on September 15, 1989, for Rs.179 per share.

Solution

Average Cost of Acquisition

	Particularss	Rs.
i.	500 equity shares acquired on December 27, 1963, at Rs.44 per share.	22,000
ii.	Brokerage	800
iii.	300 bonus shares acquired on June 30, 1978	nil
iv.	200 right shares acquired on Jaunary 1, 1980, at Rs.10 per share	2,000
	Total cost of 1,000 shares	24,800
	Average cost of acquisition per share	Rs.24.80

Computation of Capital Gains for
Assessment Year : 1990-91

	Particulars	Rs.
	Sale proceeds (i.e.900x179)	1,61,100
less:	Cost of acquisition (i.e. 900x24.80)	22,320
	Capital Gains	1,38,780

Explanation:

In the given problem, X purchased 500 equity shares for Rs.22,000 and he received 300 bonus shares also. He acquired 200 rights shares for Rs.2000. X also incurs an expenditure of Rs.800 on brokerage at the time of purchase of 500 shares. Hence, the cost of acquisition becomes Rs.24,800 (i.e.Rs.22,000 + 2,000 + 800) on September 15, 1988, he sells 900 shares for Rs.1,61,100 (i.e. 900 x 179).

According to Income-tax Act and the Supreme Court decisions, the cost of acquisition of bonus shares and right shares is the average cost of old shares and bonus shares and expenses incurred on them. Hence, in the given example, the average cost of 1,000 shares becomes Rs.24,800 and the average cost of acquisition per share is Rs.24.80 (i.e. 24,800 ÷ 1,000). Hence, cost of acquisition of 900 shares is taken Rs.22,320 (i.e. 900 x Rs.24.80). In the above example, X is chargeable to tax under 'capital gains' for Rs.1,38,780, subject to deduction under section 48(2).

Case: *Shekhawati General Traders Ltd. V. ITO.*

The Supreme Court held in Shekhawati General Traders Ltd. v. ITO, the above principle of averaging by spreading the cost over the old shares and the new bonus shares applies only where the assessee claims to deduct the actual cost of acquisition.

3.4 Exemptions:

I) Capital gains arising from the transfer of building and land appurtenant thereto **[Section 53]**.

Example

X sells a residential house property on April 24, 1989, for Rs.12,00,000. He does not own any other house. The house was acquired in 1972 for Rs.4,00,000 and its fair market value on April 1, 1974, was Rs.5,10,000. Determine the amount of exemption under section 53.

Solution

Assessment Year : 1990-91

	Particulars	Amount Rs.
	Sales Proceeds	12,00,000
less:	Cost of acquisition, i.e. fair market value on April 1, 1974	5,10,000
	Capital gains	6,90,000
less:	Exemption under section 53 i.e. $\frac{2,00,000}{12,00,000} \times 6,90,000$	1,15,000
	Capital gain chargeable to tax (subject to other deductions)	5,75,000

Explanation:

Under section 53, an assessee gets exemptions if he is an individual or a Hindu undivided family and the asset transferred is a long-term capital asset. But it is important that the asset must be a residential house property or lands appurtenant thereto and the income on which is chargeable under the head "Income from house property". Finally, on the date of transfer, the assessee does not own any other residential house.

The amount of deduction under section 53

If the asset is transferred for Rs.2,00,000 or less than Rs.2,00,000, the entire capital gain is exempt from tax. If the asset is transferred for more than Rs.2,00,000, the capital gain would be exempted proportionately.

In the given example, X has fulfilled all the conditions; hence, he is eligible to get deduction under section 53.

The amourt of exemption is the proportion of Rs.12,00,000, i.e. Rs.1,15,000.

II) Capital gains arising from transfer of residential house. **[Section 54]:**

Example 1

Mr.Sharad Shinde sells a residential let-out house property for Rs.6,05,000 on March 13, 1990, which was purchased by him in 1949 for Rs.1,35,000. Its fair market value on April 1, 1974, was Rs.2,67,000. On June 25, 1990, he purchases a new house property in New York for Rs.1,20,000 for his own residence. Determine the amount of capital gains chargeable to tax for the assessment year 1990-91.

Solution

Capital Gains for the Assessment Year 1990-91

	Particulars	Amount Rs.
	Sale proceeds	6,05,000
less:	Fair market value on April 1, 1974	2,67,000
	Capital Gains	3,38,000
less:	Exemption under section 54	1,20,000
	Long term capital gains (subject to other deductions)	2,18,000

Explanation

According tc section 54, Mr.Shinde has got deduction of Rs.1,20,000, because he has purchased a house within a specified period. The period mentioned under section 54 is, one year before the transfer or two years after the transfer, if he purchases or if he constructs a new house within the period of three years from such transfer.

But, if he sold the newly constructed or purchased property within a period of three years from the date of its construction or purchase, as the case may be, the whole amount of sale proceeds will be treated as short-term capital again and will be included in the gross total income of the year in which such new property is sold or transferred and its cost of acquisition will be taken to be nil, in case of exemption allowed under section 54.

He may also get deduction under section 53, if he has not any other residential house on March 13, 1990, of Rs.1,11,736 (i.e. Rs.2,00,000 ÷ Rs.6,05,000 x 3,38,000).

Note: Under section 54, the assessee will get deduction, if he purchases or constructs a residential house within the specified period in India or any other country.

Example 2

Mr.Mule is the owner of more than one residential house since 1975. He transfers one of the residential house for Rs.2,80,000 on 30.6.1989, which he had purchased in 1975 for Rs.80,000. The long-term capital gain as a result of transfer is Rs.2,00,000. As he owns other residential houses on 30.6.1989, he is not entitled to exemption under section 53.

Comments:

i) If Mr.Mule constructs a residential house costing

Rs.2,00,000 after 30.6.1989, but on or before 29.6.1992, then also the long-term capital gains of Rs.2,00,000 is not included in his gross total income for the assessment year 1990-91.

ii) If Mr.Mule purchases on or after 1.7.1988 but before 30.6.1991 a residential house for or more than Rs.2,00,000, the long-term capital gain of Rs.2,00,000 is not included in his gross total income for the assessment year 1990-91.

But it is necessary if the amount of capital gain is not appropriated or utilized for the acquisition of the new residential house before the due date of furnishing a return of incomee for the assessment year 1990-91, Mr.Mule will have to deposit the unappropriated or unutilized amount of capital gain in an account with any specified bank or institution before the due date of furnishing the return of income under section 139(1).

iii) In the above example, if the cost of construction or purchase of new property is less than Rs.2,00,000, suppose Rs.1,50,000, then, the long-term capital gain of Rs.50,000 (i.e. capital gain - cost of new property) is to be included in the gross total income for the assessment year 1990-91.

If Mr.Mule sold or transferred the new property either purchased or constructed within a period of three years, out of the property purchased from capital gain, which is deducted under section 54, the cost of acquisition of such property to be treated as nil, and the gain arising from such transfer is to be treated as short-term capital gain.

III) Capital gain arising from the transfer of land used for agricultural purpose **[Section 54B]**:

Example

Mr.Mundhe sells agricultural land in Calcutta for Rs.20,00,000 on July 1, 1989, which was purchased by him in 1976, for Rs.8,80,000. On July 13, 1989, he purchased agricultural land of Rs.1,50,000 in Delhi. On June 30, 1990, he deposits Rs.8,00,000 in the deposit account. Determine the amount of exemption under section 54B.

Solution

Calculation of Capital Gain for the Assessment Year : 1990-91

	Particulars		Amount Rs.
	Sale proceeds		20,00,000
less:	Cost of acquisition		8,80,000
	Capital Gains		11,20,000
less:	Exemption under section 54B		
	i. Cost of acquiring the land	1,50,000	
	ii. Amount deposited in Deposit Account	8,00,000	9,50,000
	Capital Gains		1,70,000

Explanation

Mr.Mundhe gets an exemption of Rs.9,50,000, because he has purchased agricultural land worth Rs.1,50,000 within the specified period of two years from such transfer and he has also deposited Rs.8,00,000 in the Deposit Account before furnishing the return of income of the assessment year 1990-91.

But it is necessary that Mr.Mundhe can utilise the amount deposited in the Deposit Account for acquiring agricultural land at any time before July 1, 1991. The amount not utilised before 1, 1991, will be chargeable to tax as long term capital gains for the assessment year 1992-93.

In this example, it is treated that Mr.Mundhe has continuously used the agricultural land for agricultural purposes.

If Mr.Mundhe sold new agricultural land purchased out of the amount which is exempt under section 54B, the cost of acquisition of such land to be taken nil and the gain arising from such transfer is to be treated short term capital gain.

IV) Capital gain on compulsory acquisition of land and buildings forming part of industrial undertaking **[Section 54D]**:

Example

AMJ Limited has an industrial undertaking in Maharashtra. One cf its godowns (cost of acquisition: Rs.2,80,000) is compulsory acquired by the Government of Maharashtra on June 23, 1989. The State Government pays Rs.13,80,000 as compensation under an award. The company purchase a building for the purpose of industrial undertaking, for Rs.8,00,000 on May 13, 1990. Calculate capital gain.

Solution

Calculation of Capital Gain for the Assessment Year : 1990-91.

	Particulars	Amounts Rs.
	Compensation received	13,80,000
less:	Cost of acquisition	2,80,000
	Capital Gains	11,00,000
less:	Exemption under section 54D	8,00,000
	Long-term Capital Gains chargeable to tax	3,00,000

Comments:

i) AMJ Limited has got an exemption under section 54D of Rs.8,00,000, because the Company has purchased building for the purpose of industrial undertaking within the specified period.

ii) AMJ Limited may also postpone its tax liabilities of Rs.3,00,0000 for three years, if the Company deposits that amount in a Deposit Account in any Branch (except a rural branch) of a public sector Bank in accordance with Capital Gains Accounts Scheme, 1988 (Notified vide GSR No.724(E) dated June 22, 1988).

Notes: It is assumed that AMJ Limited has used such godown for industrial undertaking for atleast two years preceding the date of compulsory acquisition.

V) Capital gains on transfer of long-term capital asset **[Section 54E]**:

Example 1

Mr.Sanjay Chavan transfers shares of companies on 5.6.89

for a net consideration of Rs.75,000. The shares were purchased by him on 1.5.1988 for Rs.30,000. The capital gain on the sale of such capital asset is Rs.45,000.

Comments:

a) If Mr.Sanjay Chavan invests the net consideration of Rs.75,000 in specified financial assets within six months from 5.6.1989, the whole of capital gain of Rs.45,000 will be exempt from the payment of tax.

b) If Mr.Sanjay Chavan invests only Rs.25,000 being part of the net consideration in specified financial assets within six months from 5.6.1989, in that case, only proportionate capital gain will be exempt as under:

Capital gain		Rs.45,000
less:	Proportionate capital gain on Rs.25,000 being the amount of investment made (i.e.	
Capital gain of Rs.45,000 X Investment of Rs.25,000 ÷ Net consideration of Rs.75,000		15,000
Long term capital gain		30,000

(Subject to deduction under Section 48(2):

c) If Mr.Sanjay Chavan transfers or converts the said investment made in the specified financial assets into money, before 3rd October, 1990, say on 1.11.1990, the exemption allowed under section 54E will stand forfeited and the long-term capital gain of Rs.45,000 or Rs.15,000, as the case may be, will be included in the gross total income, for the assessment year 1991-92, with a right to claim deduction under section 48(2). It may be noted that in the event of any gain or loss arising as a result of transfer of such specified financial asset, the same will be treted as short-term capital gain or short-term capital loss for the assessment year 1991-92.

Notes:

1. The investment is required to be made in any specified financial asset as enumerated under Explanation 1 of section 54(E)(1).
2. The assessee has invested or deposited within a period of six months the whole or part of the net consideration in specified assets by initially subscribing to such new asset.
3. The assessee does not take any loan or advance on the security of such specified financial asset during a period of three years from the date on which investment in such specified financial asset is made, and
4. It is assumed the new asset is held for a period of more than thirty-six months.

Example 2:

1.	Mr.A sells his residential house on 1.8.1989 for a net consideration amounting to	Rs.3,80,000
2.	Mr.A has purchased this house on 1.7.76 for	2,30,000
3.	Long-term capital gain accrued on 1.8.1989 in respect of residential house is	1,50,000
4.	Mr.A purchased another residential house on 22.1.1990 for	1,02,500

5.	Mr.A invested in National Rural Development Bonds (Second Issue) on 31.1.1990	87,500
6.	Mr.A had another residential house at his native place on 1.8.1989	50,000

Solution:

	Long-term Capital Gains	1,50,000
less:	Exemption under section 54(1) for new residential house purchased 22.1.1990	1,02,500
		47,500
less:	Proportionate exemption under section 54E for investment made in specified asset, i.e. Capital gain Rs.1,50,000 X Investment in Bonds Rs.87,500 ÷ Net consideration Rs. 3,50,000	37,500
	Long-term Capital Gain (subject to deduction u/sec.48(2))	10,000

Notes:

1. The provisions of section 54E and sections 53, 54, 54B, 54D or 54F are not mutually exclusive. Hence, Mr.A has got exemptions under sections 54(1) and 54E.
2. Long-term capital gain of Rs.10,000 so arrived at is subject to deduction under section 48(2) with the result that taking together the exemptions under sections 54 and 54E and deductions under section 48(2) of Rs.10,000, Mr.A will not be required to pay tax in respect of long term capital gain.
3. As Mr.A owns other residential house on 1.8.1989, he is not entitled to exemption under section 53.

VI) Capital gains on transfer of a long-term capital asset other than a house property **[Section 54F]:**

Example

Mr.Anant Jadhav transfers convertible debentures (or any assets other than a residential house) on 5.6.1989 for a consideration of Rs.78,000. The convertible debentures were acquired on 1.6.1984 for Rs.30,000. The expenses exclusively on transfer is Rs.3,0000. Capital gain on sale is Rs.45,000.

Comments

a. If Mr.Anant Jadhav purchases a residential house after 5.6.1988, but before 5.6.1991, the whole long term capital gain of Rs.45,000 will be exempt, provided Mr.Anant Jadhav does not own any other residential house on 5.6.1989 or purchase another new residential house before 5.6.1991 cr does not construct any other residential house before 5.6.1992.

b. In the above case, if the investment in the residential house (by purchase or construction, as the case may be) is only Rs.25,000, then only the proportionate capital gain will be exempt as under:

Capital gain	Rs.45,000
less Exemption under section 54F, i.e. Capital gain 45,000 X Investment 25,000 ÷ Net considera tion 75,000	15,000
Long-term capital gain (subject to deduction u/sec.48(2))	30,000

c. If Mr.Anant Jadhav transfers the new residential house within the period of three years, then the long-term capital gain of Rs.45,000 or Rs.15,000 which was exempted earlier will be deemed to be the long-term capital gain of that year in which such asset was transferred.

d. If Mr.Anant Jadhav purchases yet another residential house before 5.6.1991 or constructs another residential house before 5.6.1992, then also, the long-term capital gain of Rs.45,000 or Rs.15,000 which was exempted earlier will be charged to tax as long-term capital gain of the assessment year in which the second residential house was purchased or constructed with a right to claim deduction under section 48(2) in that year.

e. If Mr.Anant Jadhav has not purchased or constructed a residential house before the date of furnishing of return of income of the assessment year 1990-91, he will have to deposit the unutilized amount of net consideration in an account with any specified bank or institution before the due date for furnishing the return of income under section 139(1).

VII) Capital gains on transfer of assets in cases of shifting of industrial undertaking from urban area **[Section 54G]**:

Example

X Limited owns an industrial undertaking at Kanpur. The undertaking is situated in an urban area. As per policy of the State Government, the industrial undertaking is shifted to a rural area. In the process of shifting, the company sells the following assets:

Particulars / Asset	Plant and Machinery	Building	Furniture
Year of acquisition	1977	1978	1976
	Rs.	Rs.	Rs.
Cost of acquisition (as per Section 50)	9,50,000	10,75,000	25,000
Sale proceeds (date of sale March 25, 1990)	17,92,000	38,90,000	32,000
Cost of assets acquired during April-May, 1989, for the purpose of shifting the undertaking to a rural area	30,50,000	4,00,000	3,70,000

Find out the capital gains chargeable to tax for the assessment year 1990-91.

Solution

Calculation of Capital gains for the Assessment Year : 1990-91

Particulars / Asset	Plant and Machinery Rs.	Building Rs.	Furniture Rs.
Sale proceeds	17,92,000	38,90,000	32,000
less: Cost of acquisition	9,50,000	10,75,000	25,000
Short term capital gain	8,42,000	28,15,000	7,000

Short-term capital gain which is qualified for the purpose of section 54G (i.e.Rs.42,000 + Rs.28,15,000)	36,57,000
less: Exemption under section 54G (i.e. Rs.30,50,000 + Rs.4,00,000)	34,50,000
Short-term capital gain on plant, machinery and building	2,07,000
add: Short-term capital gain on furniture	7,000
Short-term capital gain chargeable to tax for the assessment year 1990-91	2,14,000

Notes:

1. By virtue of section 50, the gain arising from such transfer, it will be treated as short-term capital gain.
2. On sale of furniture, the exemption is not available under section 54G.
3. It is assumed that the industrial undertaking is shifted in the rural area.