

## TYPES OF CAPITAL ASSETS : SHORT-TERM CAPITAL ASSETS AND LONG-TERM CAPITAL ASSETS

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### 3.1 Distinction between short-term capital gains and long-term capital gains

Section 2(42B) of the Act defines 'short-term capital gain' to mean 'capital gain arising from the transfer of a short-term capital asset'.

Section 2(29B) defines 'long-term capital gain' as 'capital gain arising from the transfer of a long-term capital asset'. Section 2(29A) of the Act defines 'long-term capital asset' as capital asset which is not a short-term capital asset.

Transfer of a short term capital asset [**Para 3.3**] gives rise to 'Short Term Capital Gains' (STCG) and transfer of a long term capital asset gives rise to 'Long Term Capital Gains' (LTCG). Identifying gains as STCG and LTCG is a very important step in computing the income under the head Capital Gains as method of computation of gains and tax payable on the gains and treatment of losses is different for STCG and LTCG.

It may be mentioned that long-term capital gains gets more favourable tax treatment as compared to short-term capital gains.

### 3.2 Overview of section 2(42A) - Definition of section 2(42A)

- ◆ General rule : Holding period of 36 months or less before transfer to qualify as short-term asset [**Para 3.3**]

- ◆ Exceptions to the general rule of 36 months or less holding period:
  - 1st proviso : The following assets to be regarded as short-term capital assets if held for 12 months or less before transfer [**Para 3.4**]
    - Security (other than a unit ) listed on a recognised stock exchange in India
    - Units of UTI
    - Units of equity oriented mutual funds
    - Zero Coupon Bond
  - 2nd proviso: Holding period of 12 months or less for unlisted shares and units of mutual fund units transferred during the period 01.04.2014 to 10.07.2014
  - 3rd proviso: Unlisted shares of companies and immovable property to be regarded as short-term capital assets if held for 24 months or less before transfer. [**Para 3.5**]
- ◆ *Explanation 1:* How to compute the holding period..what periods of time to be included or excluded [**Paras 3.6 to 3.6-18**]
- ◆ Minimum holding period for various assets to qualify as long-term capital assets [**Para 3.7**]
- ◆ *Explanation 2:* Definition of 'security' [**Para 3.7-1**]
- ◆ *Explanation 3:* Definition of 'specified security' and 'sweat equity shares' [**Para 3.6-8**]
- ◆ *Explanation 4:* Definition of 'equity-oriented fund [See **Chapter 24**]

### **3.3 Classification of capital asset into short-term capital asset and long-term capital asset**

The incidence of tax on Capital Gains depends upon the length of the time period for which the capital asset was held before the transfer. In terms of section 2(42A) which defines a 'short-term capital asset', ordinarily, a capital asset held for 36 months or less is called a 'short-term capital asset' and the capital asset held for more than 36 months is called 'long-term capital asset'.

Exceptions to the "36 months or less holding period" rule is given in **Paras 3.4** and **3.5** below.

**3.4 Capital assets which will be regarded as STCA if held for 24 months or less**

The following assets shall be regarded as short-term capital assets if held for 24 months or less and long-term assets if held for more than 24 months:

- ◆ Unlisted shares of companies (share of a company not listed in a recognized stock exchange in India)
- ◆ Immovable property, being land or building or both. [See **Para 3.8**]

**3.5 Capital assets which will be held as short-term capital assets if held for 12 months or less before transfer**

The following assets shall be regarded as short-term capital assets if held for 12 months or less and long-term assets if held for more than 12 months:

- ◆ Security (other than a unit) listed in a recognized stock exchange in India
- ◆ Unit of UTI
- ◆ Unit of equity-oriented mutual funds
- ◆ Zero Coupon bond [**Para 3.5-2**]

**Units of debt-oriented mutual funds, GETFs/REITs/InVITs to be held for more than 36 months to qualify as long-term capital assets - Section 2(42A)****3.5-1 Securities transacted through stock exchanges**

When the securities are transacted through stock exchanges it is the established procedure that the brokers first enter into contracts for purchase/sale of securities and thereafter, follow it up with delivery of shares, accompanied by transfer deeds duly signed by the registered holders. The seller is entitled to receive the consideration agreed to as on the date of contract. Thus, it is the date of broker's note that should be treated as the date of transfer in case of sale transactions of securities provided such transactions are followed up by delivery of shares and also the transfer deeds. Similarly, in respect of the purchasers of the securities, the holding period shall be reckoned from the date of the broker's note for purchase on behalf of the investors. In case the transactions take place directly between the parties and not through stock exchanges the date of contract of sale as declared by the parties shall be

treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.

Where securities are acquired in several lots at different points of time, the First-in-first-out (FIFO) method shall be adopted to reckon the period of the holding of the security, in cases where the dates of purchase and sale could not be correlated through specific numbers of the scrips. In other words, the assets acquired last will be taken to be remaining with the assessee while assets acquired first will be treated as sold. Indexation, wherever applicable, for long-term assets will be regulated on the basis of the holding period determined in this manner - *Circular : No. 704, dated 28-4-1995*.

### 3.5-2 Zero Coupon Bond

According to section 2(48) of the Act, “zero coupon bond” means a bond-

- (a) issued by any infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank on or after the 1st day of June, 2005;
- (b) in respect of which no payment and benefit is received or receivable before maturity or redemption from infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank; and
- (c) which the Central Government may, by notification in the Official Gazette, specify in this behalf.

### 3.6 How to compute the holding period of a capital asset?

In *Bharti Gupta Ramola v. CIT* [2012] 20 taxmann.com 762, the Delhi High Court held that the holding period of a capital asset (36 months/24 months/12 months) to be computed as under:

- ◆ **Holding period of capital asset u/s 2(42A) (36 months/24 months/12 months) to be reckoned in calendar months by including both date of its acquisition and date of its transfer and without excluding even a fraction of a day.**
- ◆ The term ‘month’ has not been defined in the Act and, therefore, ‘month’ would have to be understood in the sense of ‘calendar month’ as defined in section 3(35) of the General Clauses Act, 1897.
- ◆ Period of 12 calendar months would begin on the day when the assessee became the holder of the asset and end one day before in

the relevant calendar month, next year. Thus, if an assessee acquires an asset on 2nd January in a preceding year, the period of 12 months would be complete on 1st January, next year and not on 2nd January. This position will apply to all cases, except when an asset is transferred/purchased on 1st January. In such cases, the period of one year or 12 months would expire and would be complete on 31st December in the same year.

- ◆ There is nothing in section 2(42A) to show that the time period would not include fraction of a day.

### 3.6-1 Computation of holding period of share held in a company in liquidation

In the case of a share held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation shall be excluded in determining the period for which such share was held by the assessee. [*Explanation 1(i)(a)* to section 2(42A)]. In other words, the date on which company goes into liquidation shall be included in computing the holding period for determining whether the share was held for 12 or 24 months or less or for more than 12/24 months.

### 3.6-2 Computation of holding period of a capital asset which becomes the property of the assessee in the circumstances mentioned in section 49(1)

A capital asset may become the property of an assessee in the circumstances mentioned in section 49(1) viz :

- (A) on any distribution of assets on the total or partial partition of a Hindu undivided family;
- (B) under a gift or will;
- (C)(a) by succession, inheritance or devolution, or
  - (b) on any distribution of assets on the liquidation of a company, or
  - (c) under a transfer to a revocable or an irrevocable trust, or
  - (d) under any such transfer as is referred to in clause (iv) or clause (v) [Para 5.4] or clause (vi) [Para 5.5] or clause (via) [Para 5.6] or clause (viaa) [Para 5.7] or clause (viab) [Para 5.1] or clause (vib) [Para 5.8] or clause (vic) [Para 5.9] or clause (vica) [Para 5.10] or clause (vicb) [Para 5.11] or clause (vicc) [Para 1.4] or clause (xiii) or clause (xiiib) [Para 5.21 / Para 5.22] or clause (xiv) [Para 5.26] of section 47;

- (D) such assessee being a Hindu undivided family, by the mode referred to in sub-section (2) of section 64 - *i.e.* conversion of self-acquired property of member of HUF into HUF property.

In above cases, the period for which the asset was held by the previous owner shall be **included** in determining the period for which such asset was held by the assessee. [*Explanation 1(i)(b)* to section 2(42A)]. The expression 'previous owner of the property' in relation to any capital asset owned by an assessee means the last previous owner of the capital asset who acquired it by a mode of acquisition other than that referred to section 49(1) - *i.e.* (A) to (D) above.

### **3.6-3 Computation of holding period of a capital asset resulting from conversion of inventory into capital asset**

In case of conversion of inventory into capital asset or treatment of inventory as capital asset, the period for which the resulting capital asset is held shall be reckoned from the date of such conversion or treatment. [*Explanation 1(i)(ba)* to section 2(42A)]

### **3.6-4 Computation of holding period of a share or shares in an Indian company which becomes assessee's property as consideration for transfer in amalgamation of companies**

If a share or shares in an Indian company (amalgamated company) becomes property of assessee (who was a shareholder of amalgamating company) as consideration for his shares in amalgamating company [See section 47(vii)], the period for which shares in amalgamating company were held by the assessee shall be included in determining the holding period of shares in amalgamated company. [*Explanation 1(i)(c)* to section 2(42A)].

*For example*, Mr. X is a shareholder of ABC Ltd. (amalgamating company) and holds 100 shares in it. He had acquired it two years back. ABC Ltd. is amalgamated into PQR Ltd., an Indian company and he receives 50 shares in PQR Ltd. as consideration for his 100 shares in ABC Ltd. This transfer of ABC Ltd. shares for PQR Ltd. shares is exempt from taxation as capital gains under section 47(vii). Suppose he sells the shares of PQR Ltd. after 6 months. In this case, the holding period of 2 years of shares in ABC Ltd. should be added to the 6 months holding period of shares in PQR Ltd. and holding period of shares of PQR Ltd. shall be treated as 2 years and 6 months and hence shares of PQR Ltd. shall be treated as long-term asset.

**3.6-5 Computation of holding period in case of rights shares/other security issued on rights basis**

In the case of a share or any other security ('financial asset') subscribed to by the assessee on the basis of his right to subscribe or by the renouncee of the right to subscribe (*i.e.* the person in whose favour the right to subscribe is renounced by the assessee), the period shall be reckoned from the date of allotment of such financial asset for determining whether the financial asset was held for 12 months or less or for more than 12 months. [*Explanation 1(i)(d)* to section 2(42A)]

The words used are 'from the date of allotment'. A question arises whether date of allotment is to be included in the holding period or not. *Stroud's Judicial Dictionary* defines "from the date of ....." as under:

"From the date of incorporation of the company" in section 16, Companies (Consolidation) Act, 1908 (c. 69) - see now Companies Act, 1985 (c. 6), section 13 - held to include any portion of the day on which the company was incorporated: see *Re Jubilee Cotton Mills* [1924] A.C. 958."

In *Bharti Gupta Ramola v. CIT* [2012] 20 taxmann.com 762, the Delhi High Court held that the clause [section 2(42A)] refers to the holding period. It will not be appropriate to exclude or include any day of the holding for computing the said period. The date on which the asset is acquired is not to be excluded because the holding starts from the said date.

In view of the above, the date of allotment or any portion of that day has to be included in computing the holding period.

**It must be noted that 'rights share' is a capital asset distinct from 'rights' or the right to subscribe.** *Explanation 1(i)(d)* to section 2(42A) applies to the former. *Explanation 1(i)(e)* to section 2(42A) [See **Para 3.6-6**] applies to the latter.

**3.6-6 Computation of the holding period of the right to subscribe to shares/other security - i.e. 'rights'**

In the case of right to subscribe to any financial asset which is renounced in favour of any other person, the period shall be reckoned from the date of offer of such right by the company or institution making such offer for determining whether the right was held for 12 months or less or for more than 12 months. [*Explanation 1(i)(e)* to section 2(42A)].

As regards the phrase 'from the date of offer', remarks in **Para 3.6-5** above as regards 'from the date of allotment' shall apply here also.

Crucial date is date on which right to subscribe comes into existence. For determining whether the gains/loss of renunciation of right to subscribe is a short-term or long-term gains/loss, the crucial date is the date on which such right to subscribe for additional shares/debentures comes into existence and the date of renunciation [transfer] of such right - *Navin Jindal v. Asstt. CIT* [2010] 187 Taxman 283 (SC).

### **3.6-7 Computation of holding period in case of bonus shares/bonus debentures**

In the case of a financial asset allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of allotment of such financial asset for determining whether the right was held for 12 months or less or for more than 12 months. [*Explanation 1(i)(f)* to section 2(42A)].

As regards the phrase 'from the date of allotment' [See **Para 3.6-5** above]. Bonus shares issued by a company are acquired by a shareholder when they are issued and they must be taken to be held by shareholder from the date of their issue and not from the date when the original shares, in respect of which they are issued, were acquired by the shareholder - *Executive of the Will of Late Shri Manecklal Premchand v. CIT* [1990] 48 Taxman 310 (Bom.)/ *Manecklal Premchand v. CIT* [1990] 186 ITR 554 (Bom.)/ *CIT v. D.V. Paranjape* [2014] 49 taxmann.com 245/226 Taxman 169 (Bom.).

### **3.6-8 Computation of holding period of share/shares in an Indian company which becomes the property of the assessee in consideration of demerger**

If a share or shares in an Indian company (resulting company) becomes property of assessee (who was a shareholder of demerged company) as consideration for his shares in demerged company, the period for which shares in demerged company were held by the assessee shall be included in determining the holding period of shares in resulting company. [*Explanation 1(i)(g)* to section 2(42A)]

### **3.6-9 Computation of holding period of specified security or sweat equity shares**

In the case of a capital asset, being any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employee or employees), the period shall be reckoned from the date of



allotment or transfer of such specified security or sweat equity shares for determining whether the right was held for 12 months or less or for more than 12 months. [*Explanation 1(i)(hb)* to section 2(42A)]

The following definitions may be noted:

- ◆ ‘Specified security’ means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 [*See Para 3.7-1*] and, where employees’ stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;
- ◆ ‘Sweat equity shares’ means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

As regards the phrase ‘from the date of allotment’ [*See Para 3.6-5* above].

#### **3.6-10 Computation of holding period of unit of business trust allotted pursuant to transfer of shares**

In the case of a capital asset, being a unit of a business trust, allotted pursuant to transfer of share or shares as referred to in clause (xvii) of section 47 [*see Para 5.29*], there shall be included the period for which the share or shares were held by the assessee. [*Explanation 1(i)(hc)* to section 2(42A)].

#### **3.6-11 Computation of holding period of units which become property of the assessee in consideration of transfer referred to in Section 47(xviii)**

In the case of a capital asset, being a unit or units, which becomes the property of the assessee in consideration of a transfer referred to in clause (xviii) of section 47 [*see Para 5.30*], there shall be included the period for which the unit or units in the consolidating scheme of the mutual fund were held by the assessee. [*Explanation 1(i)(hd)* to section 2(42A)].

#### **3.6-12 Computation of holding period of shares acquired by non-resident on redemption of GDRs**

In the case of a capital asset, being share or shares of a company, which is acquired by the non-resident assessee on redemption of Global Depository Receipts [*See clause (b)* of sub-section (1) of section 115AC]

held by such assessee, the period shall be reckoned from the date on which a request for such redemption was made. [*Explanation 1(i)(he)* to section 2(42A)].

**3.6-13 Computation of holding period of equity shares acquired by way of conversion of preference shares into equity shares**

In the case of a capital asset, being equity shares in a company, which becomes the property of the assessee in consideration of a transfer referred to in clause (xb) of section 47, there shall be included the period for which the preference shares were held by the assessee; [*Explanation 1(i)(hf)* to section 2(42A)].

**3.6-14 Computation of holding period of unit or units acquired in consideration of a transfer referred to in clause (xix) of section 47**

In the case of a capital asset, being a unit or units, which becomes the property of the assessee in consideration of a transfer referred to in clause (xix) of section 47, there shall be included the period for which the unit or units in the consolidating plan of a mutual fund scheme were held by the assessee. [*Explanation 1(i)(hg)* to section 2(42A)].

**3.6-15 Holding period in case of unit or units in segregated portfolios**

SEBI has *vide* circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018, permitted creation of segregated portfolio of debt and money market instruments by Mutual Fund Schemes. As per the SEBI circular, all the existing unit holders in the affected scheme as on the day of the credit event shall be allotted equal number of units in the segregated portfolio as held in the main portfolio. On segregation, the unit holders come to hold same number of units in two schemes –the main scheme and segregated scheme.

In view of the above, the Finance Act, 2020 has inserted a new clause (hh) in *Explanation 1* to sub-section (42A) of section 2 of the Act to provide that in the case of a capital asset, being a unit or units in a segregated portfolio, referred to in sub-section (2AG) of section 49, there shall be included the period for which the original unit or units in the main portfolio were held by the assessee.

Further, a new sub-section (2AG) has been inserted by the Finance Act, 2020 in section 49 of the Act to provide that the cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears to the cost of acquisition of a unit or units held by the assessee in the total

portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.

Sub-section (2AH) has been inserted in the said section to provide that the cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under the proposed sub-section (2AG).

The Explanation below these two new sub-sections, as inserted by the Finance Act, 2020, provide that for the purposes of sub-sections (2AG) and (2AH), the expressions “main portfolio”, “segregated portfolio” and “total portfolio” shall have the meaning respectively assigned to them in the said circular dated 28th December, 2018 issued by SEBI.

These amendments will take effect from 1st April, 2020 and will, accordingly, apply in relation to the assessment year 2020-21 and subsequent assessment years.

**3.6-16 Computation of holding period of a share or debenture which becomes the property of the assessee in the circumstances mentioned in clause (x) of section 47**

In the case of a capital asset, being a share or debenture of a company, which becomes the property of the assessee in the circumstances mentioned in clause (x) of section 47 [see **Para 5.17**] of the Act, there shall be included the period for which the bond, debenture, debenture-stock or deposit certificate, as the case may be, was held by the assessee prior to the conversion. [*Explanation 1(ii)* to section 2(42A); Rule 8AA].

Where assessee was allotted convertible debentures and later on same were converted into shares, while computing capital gains arising from sale of said shares, it would be logical to reckon date of acquisition of convertible debentures as date of acquisition of such shares - *CIT v. Naveen Bhatia* [2015] 62 taxmann.com 87/235 Taxman 178 (Punj. & Har.).

**3.6-17 Computation of holding period of a capital asset declared in IDS, 2016**

In the case of a capital asset, declared under the Income Declaration Scheme, 2016,—

- ◆ being an immovable property, the period for which such property is held shall be reckoned from the date on which such property is acquired if the date of acquisition is evidenced by a deed registered with any authority of a State Government; and