



Global Business Tax Alert Sharp Insights

No capital gains at the time of roll over of the units of a Mutual Fund under the Fixed Maturity Plans

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Background

- The provisions of the Income-tax Act, 1961 (“the Act”) prior to the amendment made by the Finance (No.2) Act, 2014 considered assets in the nature of shares, listed securities, units of mutual funds and zero coupon bonds as long-term capital assets if such assets are held for a period of more than twelve months. Accordingly, units of a mutual fund under the Fixed Maturity Plans (“FMPs”) held for a period of more than 12 months qualified as long-term capital asset.
- For qualification as long-term capital assets, the Finance (No.2) Act, 2014 amended the holding period in case of unlisted shares and units of a mutual fund (other than an equity oriented fund) to more than 36 months. As a result, any capital gains arising after 10 July 2014 on redemption of units of FMP, held for 36 months or less, would be taxed as short-term capital gains.
- FMPs are closed ended funds having a fixed maturity date wherein the duration of investment is decided upfront. The funds collected by FMPs are invested by the Asset Management Companies (“AMCs”) in securities having similar maturity period.
- To enable the FMPs to qualify as a long-term capital asset, certain AMCs offered extension of the duration of the FMPs to a date beyond thirty-six months from the date of the original investment by providing an option of roll-over of FMPs in accordance with the provisions of Regulation 33(4) of the SEBI (Mutual Funds) Regulations, 1996.
- Representations were made before the Central Board of Direct Taxes seeking clarification regarding applicability of capital gains tax in the hands of the unit holder at the time of roll-over of FMPs.

Clarifications by CBDT

- Regulation 33(4) of the SEBI (Mutual Funds) Regulations, 1996 allows the roll-over of close-ended schemes. SEBI clarified that in case of roll over of such FMPs, the scheme remains the same and it does not constitute a different scheme.

- Unit of a mutual fund constitutes a capital asset and any sale, exchange or relinquishment of such unit is a 'transfer' under clause (47) of section 2 of the Act.
- The roll over in accordance with the aforesaid SEBI regulation will not amount to transfer as the scheme remains the same. Accordingly, no capital gains will arise at the time of exercise of the option by the investor to continue in the same scheme.
- The capital gains will arise at the time of redemption of the units or opting out of the scheme, as the case may be.

Comments

The aforesaid clarification provides clarity on the applicability of tax in the hands of the unit holder at the time of exercise of roll-over option of closed ended FMPs schemes.

Source: Circular No. 6/2015 dated 9 April 2015 issued by the Central Board of Direct Taxes

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