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NRIs – Overview of Capital Gains Tax in India on sale of mutual funds

Q1. How are mutual funds taxed in India?

There are no tax implications in India when you are buying or holding units of mutual fund. The profit you make from selling these units is typically considered as Capital Gains and is taxable in India. The rate of tax depends on the type of mutual fund (equity-oriented, specified mutual fund or others) and the duration for which you have held these units. Broadly, mutual funds are classified into:

(i) Equity-oriented funds;
(ii) Specified mutual funds which focus mainly in investing in debt funds/ instruments;
(iii) Other mutual funds being residuary in nature which is not covered under above.

It is therefore important to carefully assess the specific type of mutual fund you hold, as the tax implications vary significantly based on this classification. Each of the funds has criteria/ limit defined for investments which needs to be fulfilled.

Q2. What are the tax rates applicable to the gains on sale of mutual funds?

(i) **Equity-oriented funds**: If the holding period is more than 12 months, the gains are considered Long-Term Capital Gains (LTCG). For holding periods of 12 months or less, the gains are Short-Term Capital Gains (STCG). The tax rates are as follows:

✓ Short-term capital gain:
  - 15% (to be increased by applicable surcharge and 4% cess) for sale transactions undertaken before July 23, 2024.
  - 20% (to be increased by applicable surcharge and 4% cess) for sale transactions undertaken on or after July 23, 2024.

- ✓ Long-term capital gain in excess of the overall tax exemption of INR 1.25 lakh applicable from Financial Year 2024-25 to sale of listed shares/ equity oriented mutual funds:

  - 10% (to be increased by applicable surcharge and 4% cess) without indexation benefit for sale transaction undertaken before July 23, 2024.
  - 12.50% (to be increased by applicable surcharge and 4% cess) without indexation benefit for sale transaction undertaken on or after July 23, 2024.

(ii) **Specified mutual funds**: The profit arising from selling units of these funds shall always be considered to be Short – term capital gain and will be taxed as per the slab rates applicable to the individual regardless of the period of holding. This will apply however only to the units acquired on or after April 1, 2023. The taxation of specified mutual funds acquired till March 31, 2023 would be similar to the taxation of mutual funds falling under the residuary category.

(iii) **Other listed mutual funds not covered above:** For sale transactions undertaken on or after July 23, 2024, if the holding period is more than 24 months, the gains are considered long-term. If held for 24 months or less, they are treated as short-term. For sale transactions undertaken prior to July 23, 2024, the earlier rules will apply including the benefit of indexation being available in case of LTCG.

The tax rates are as follows:

- ✓ Short-term capital gain will be taxed as per the slab rates applicable to the individual

- ✓ Long-term capital gain:

- 20% (to be increased by applicable surcharge and 4% cess) for listed mutual funds with indexation benefit for sale transaction undertaken before July 23, 2024.
- 12.50% (to be increased by applicable surcharge and 4% cess) without indexation benefit for sale transaction undertaken on or after July 23, 2024.

Q3. Are there any specific benefits under the relevant DTAA on sale of mutual funds which NRIs need to be aware of?

The tax treatment of sale of mutual fund for NRIs depends on the structure of the fund and the terms of the applicable Double Taxation Avoidance Agreement (DTAA) between India and the country of residence. If your country has a DTAA with India, you may get tax benefits that can reduce your tax liability in India, but this requires a case-by-case assessment.

Few Appellate Tribunal rulings under India's DTAAs with UAE, Singapore, and Switzerland have held that mutual funds are not treated as shares. Therefore, capital gains from their sale are taxable only in the investor's country of residence, not in India. However, these rulings may result in the gains being taxed neither in India nor in the resident country, which goes against the basic purpose of DTAAs. So, it is important to consult a tax advisor to understand how the specific DTAA applies to your situation. To claim treaty benefits, you must qualify as a tax resident of the treaty country and obtain a Tax Residency Certificate (TRC) from that country's tax authorities. Also, the Principal Purpose Test (PPT) introduced in many DTAAs to align with the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan to prevent misuse, must be considered to determine if you are eligible for treaty benefit.

The information provided herein is for general guidance and informational purposes only. The applicability of laws, regulations, and tax provisions may have some additional requirement and may vary significantly depending on the specific circumstances of each case. Therefore, it is strongly recommended to consult a qualified tax expert or legal professional for personalized advice tailored to your unique situation. We disclaim any liability for decisions made or actions taken based solely on the content provided, as it does not constitute professional advice or a

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