

Long-term Tax Benefits Removed for Debt Mutual Funds

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Why in News?

- The Union Government, through **Finance Bill 2023**, has proposed changes in taxation of debt mutual funds.

What are Mutual Funds?

- A mutual fund is a pool of money managed by a professional Fund Manager(s).
- That money is used to purchase stocks, bonds and other securities.
- Because mutual funds invest in a collection of companies, they offer instant diversification (thus **lower risk**) to investors. MF investors share in the fund's profits and losses.
- The two most prevalent types of mutual funds are **Equity Mutual Funds** and **Debt Mutual Funds**.

About Equity MFs & Debt MFs

Equity mutual funds are ***equity-oriented mutual funds that invest in shares, bonds, and other securities.***

- Debt mutual funds ***invest primarily in debt securities such as government and corporate debt.***
- ***In terms of safety, debt mutual funds score higher than equity mutual funds.***
 - For instance, when the market falls, the Net Asset Value (NAVs) of your equity funds fall sharply, whereas in case of debt funds, the fall is not as sharp.
- However, ***debt funds can offer only moderate returns, while equity funds, which are highly risky, offer high returns over longer time horizon.***

Taxation on Debt Mutual Funds

- When it comes to the taxation of debt mutual funds, the concept of **indexation** is applicable in long-term capital gains from such funds.
- You will incur a ***capital gain if the redemption value is higher than the amount you invested.***
- Such capital gains will be considered long-term in debt mutual funds if the investment is redeemed after **3 years** (36 months) from the date of investment.
- So, for example, if you invest Rs.1 lakh in debt funds and after 4 years you redeem the fund, which amounts to Rs.1.5 lakhs, the long-term capital gain incurred is Rs. 50,000.
- On this long-term capital gain, a long-term capital gain tax is payable.
- However, the ***tax is calculated after applying for the indexation benefit.***

What is Indexation Benefit?

- Inflation reduces the purchasing power of money. So, ***at the time of redeeming any investment, inflation needs to be considered.***
- For example, if you have invested Rs. 100 in Year 1 and get a return of Rs. 110 in Year 5, the return is not exactly Rs. 10.
- This is because the purchasing power of Rs. 110 would have reduced with time due to inflation.

- ***Indexation benefit is applied to the investment amount to tax your returns fairly, which factors in inflation.***
- Basically, ***indexation helps you to calculate the new value of your investment, considering inflation and also help to get real capital gain.***

Present Status of Indexation Benefit in Debt Mutual Funds

- Currently, in debt mutual funds, the ***long-term capital gains are taxed @20% with indexation benefit.***

Change Brought in Through Finance Bill 2023

- An ***amendment proposed through Finance Bill 2023 aims to remove the benefit of indexation benefit available to debt mutual funds.***
- As per the proposed amendment, ***no benefit of indexation will be provided to debt mutual fund investment made on or after 1st April, 2023.***
 - However, only those debt mutual funds will lose these benefits where equity investment in such schemes is less than 35 per cent.
- From 1st April onwards, such funds will be taxed at income tax rates as per an individual's income.

Impact of the Proposed Amendment

- This proposed change may have an impact on debt mutual funds as ***investors no longer have any advantage of investing in debt funds.***
- This will also affect gold funds and international funds. As a result, ***bank fixed deposits will become more attractive as both debt funds and bank fixed deposits will be subject to the same taxability of maturity proceeds.***
- Going forward, ultra-high net worth and high net worth individuals may choose to invest in safe havens like bank fixed deposits.

Q1) What is the difference between debt and equity finance?

With debt finance you're required to repay the money plus interest over a set period of time, typically in monthly instalments. Equity finance, on the other hand, carries no repayment obligation, so more money can be channelled into growing your business.

Q2) What do you mean by Government Securities?

Government securities are investment products issued by the both central and state governments of India in the form of bonds, treasury bills, or notes.

Source: [Blow for bond markets as long-term tax benefit scrapped for debt MFs](#) | [Economic Times](#)

Source: <https://vajiramandravi.com/current-affairs/long-term-tax-benefits-removed-for-debt-mutual-funds/>

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