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Jaswant waves capital gains carrot

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MUMBAI: It's a dangled carrot. Finance Minister Jaswant Singh's stated intention to extend the exemption on long-term capital gains for listed equities by three years is meant to tempt the small investor into pulling out hard-earned money from low-interest paying instruments to play the stock market.

But investors may well desist from taking the bait.

Tax experts warn that Singh's announcement is still only a statement of intent — its fructification is based on the assumption that the same government will come back to power and make good its promise.

"The government has to stop ad hocism and take a stand on long-term capital gains exemption instead of extending it year after year. FIIs who come in through the Mauritius route get tax benefits, so why should Indian residents have to rely on changing government policies," said a spokesperson for tax consultancy **Nishith Desai Associates**.

Besides exemption on listed equities, tax exemption on dividends from open-ended equity MFs will also lapse at the end of this financial year.

This exemption was granted two years ago to urge investors towards open-ended, equity-based MFs and help UTI retain customers in its flagship US-64 equity scheme.

However, the industry feels that equity MFs should have been treated on a par with individual stocks and the capital gains tax exemption should have been extended to all equity schemes.

"If the government wants to abolish tax-free dividends, then it should also exempt equity schemes from capital gains because MFs are one of the primary channels for investors entering the stock market," said Hemendra Kothari, chairman, DSP Merrill Lynch. "This is a wrong move by the government."

As for the road ahead, optimists encourage investors to take a chance. Karvy Stock Broking analyst Urmik Chhaya says: "Investors can hold on to their portfolios and wait for the present government to get re-elected and extend the capital gains tax exemption provisions."

As for dividend tax exemption, some market players say this has been prone to abuse by short-term investors, especially large corporates.

Firms have used this exemption to indulge in dividend stripping by buying MF units before a dividend announcement and then selling them at a lower price after pocketing the dividend, thereby booking tax-free dividend income and a capital gains loss that is then offset against other market gains.

"This anomaly has to be corrected because it has evolved into a short-term play for investors, making the market more volatile," said Abhay Aima, head of private banking at HDFC Bank.

"Besides, with UTI back in the black, there is little need for the government to continue with such an exemption," a broker pointed out.