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The Tax Chronicle

INCOME TAX ACT 1961

TAX HARVESTING

Understanding Tax Harvesting: Are you an Investor / Trader in Stock Market?

Tax harvesting is an approach used by investors to minimize their tax liability by offsetting capital gains with capital losses. This concept is particularly relevant for those who actively invest in stocks, mutual funds, and other securities.

- **What is mean by Tax Harvesting?**

Tax harvesting, also known as ***tax-loss harvesting***, involves selling underperforming assets at a loss to offset gains made from other investments. These losses can be used to reduce taxable income and, in some cases, carried forward to future years to offset future gains. This strategy is commonly applied towards the end of the financial year when investors assess their tax obligations.

Offsetting Rules:

Short-term capital losses (STCL) can offset both STCG and LTCG.

Long-term capital losses (LTCL) can only be set off against LTCG

Types of Capital Gains:

Short-term capital gains (STCG): If equity shares or equity mutual funds are sold within one year, gains are taxed at 15% (under Section 111A), for gains from 23rd July, 2024 it is increased to 20%.

Long-term capital gains (LTCG): Gains from equity shares and mutual funds held for more than one year are taxed at 10% (under Section 112A) if they exceed ₹1 lakh in a financial year, further from 23rd July, 2024, if it exceeds Rs. 1.25 lakh in a financial year are subject to a 12.5% tax rate. LTCG from other assets is taxed at 20% with indexation benefits.

Things to be be done,

Identifying Capital Gains: First review your portfolio to determine the capital gains realized during the financial year.

Selling Loss-Making Assets: Then identify assets that have incurred losses and sell them to generate a capital loss.

Offsetting Gains with Losses: The capital losses are then applied to offset the capital gains, thereby reducing the overall tax liability.

Carrying Forward Losses: Any unutilized capital loss can be carried forward for up to 8 assessment years, provided the income tax return is filed on time.

Reinvesting in Similar Assets: To maintain the desired asset allocation, investors often reinvest in similar assets after selling the loss-making securities.

Why Tax Harvesting?

Allows investors to rebalance their portfolio without incurring excessive tax costs

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Considerations and Risks in India

While tax harvesting is beneficial, it requires careful planning and awareness of certain factors:

No Wash-Sale Rule but GAAR Applies: Unlike in the US, India does not have a strict wash-sale rule. However, GAAR provisions can be invoked if the tax department deems the transactions were carried out solely for tax benefits.

Market Fluctuations: Selling assets at a loss may impact long-term investment goals if not reinvested wisely.

Tax Filing Compliance: Capital losses can only be carried forward if the investor files their income tax return on time.

Happy Reading!