Government removed the LTCG tax benefit from debt mutual funds

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In news- The government has recently passed amendments to the Finance Bill 2023. One of the major highlights was removing the long-term capital gains (LTCG) tax benefit from debt mutual funds.

What is LTCG?

- LTCG is 10% for gains in stocks and equity mutual funds. It is 20% for gains in real estate, debt funds and other assets along with the benefit of indexation.
- Assets hold before the specified holding periods are subject to Short Term Capital Gains Tax (STCG). This is generally imposed at slab rate.
- There was no LTCG on stocks and mutual funds before 2018, however Budget 2018 introduced LTCG of 10% for these assets.

Key amendments-

- According to the amendments announced by Union Minister of Finance, **debt mutual funds having not more than 35 per cent invested in equity shares would be taxed** at the income tax slab level.
- In effect, t**hey will be treated as short-term capital gain (STCG**), in much the same way as bank fixed deposits (FDs).
- **At present, debt mutual funds are treated as long-term investments** if held for three years and taxed as long-term capital gains (LTCG) at 20 per cent with indexation benefit.
- If held for less than three years, they are treated as

STCG and taxed in accordance with the investor’s income tax slab.
- This is in addition to taxation of market linked debenture proposed in the original bill.
- The changes will come into effect from April 1, 2023 onwards.

Effects of these changes-

- According to experts, **the change could lead to people shifting to safer bank FDs** because of two reasons.
- FDs are safer than debt mutual funds as they offer guaranteed returns unlike the later which are subject to market conditions.
- Second, the similar taxation of debt funds to FDs have now robbed debt funds of the taxation benefit they enjoyed over FDs.
- Pure debt fund will lose its attraction over fixed deposits as far as tax benefits are concerned. Further **life insurance products would be superior to debt mutual funds for annual investments** up to Rs. 5 lakh.
- The new regulations may impede the development of India’s debt capital market to some extent in this way. However, this **amendment shall only be applicable in respect of investments made post April 1, 2023 and there shall be no impact on investment made on or before March 31, 2023**.