Tax Saving Tip: Set-off & Carry Forward

Most of the investors are not aware about the setting-off capital losses on financial instruments such as mutual fund and shares. The recent period of extreme volatility in the Indian debt market has caused large losses to many investors, who had invested either in debt securities, debt mutual funds. The sudden and steep rise in interest rates has led to a significant decline in the market value of debt securities, causing such losses. Here, we are elucidating how these losses may help investors to reduce tax liability.

Capital Gains/Losses: As per income tax Act 1961, Capital Gain/Loss Tax arises out of sale or transfer of sale / transfer of a capital asset. These gains and losses can be Long Term or Short Term on the basis of the holding period.

Particulars	Shares, Debt securities, Mutual Funds	Other Assets
Short Term Capital Gains / Losses	Less than 12 Months	Less than 36 Months
Long Term Capital Gains / Losses	More than 12 Months	More than 36 Months

Income Tax Act has laid down certain principles to carry forward and set-off of capital losses:

- **'Setting off'** of capital gains and losses simply means adjustment of taxable income on the basis of capital losses and capital gains
- **Carry Forward** means if a capital loss cannot be set-off against a capital gain of that particular year, it can be carried forward in the coming years

The Income Tax Act provides the following set off conditions:

Long Term Capital Losses	STGC	LTCG	Speculative Income	Other Heads of Income#	Carried forward upto*
Other Assets	✘	✓	✘	✘	**8 Years**
Debt Mutual Funds	✘	✓	✘	✘	**8 Years**
Equity Mutual Funds	✘	✘	✘	✘	--
Equity Shares	✘	✘	✘	✘	--
Short Term Capital Losses	**STGC**	**LTCG**	**Speculative Income**	**Other Heads of Income#**	**Carried forward upto***
Other Assets	✓	✓	✘	✘	8 Years
Debt Mutual Funds	✓	✓	✘	✘	8 Years
Equity Mutual Funds	✓	✓	✘	✘	8 Years
Speculative Losses**	✘	✘	✓	✘	4 Years

*Successive assessment years, **Speculative losses are the losses incurred during intraday trade

#Other heads of income means salary, rent from house properties, business or profession and other miscellaneous sources

Points to Remember:

- Losses incurred under the income head 'capital gains' cannot be set-off against income earned under other heads of income
- Long-term capital loss can be adjusted (set-off) only against long-term capital gain
- Short-term capital losses first have to be adjusted with any short-term capital gains, and only then with long-term capital gains on transactions not liable to STT
- Loss can be carried forward to the next year only when the loss is properly disclosed in the Income Tax Return and the income tax return is filed before the due date of filing of return

Illustration:

Portfolio of Investor A:

Assets	Investment Date	Investment Amt	Redemption Date	Redemption/ Current Amt (₹)	Profit/Gain (₹)	Tax Status
Equity Mutual Fund	Jan-03	3,00,000	Still Holding	1,50,000	1,50,000	STCL of ₹1,50,000
Debt Mutual Fund	Jan-03	15,00,000	Nov-13	16,00,000	1,00,000	STCG of ₹1,00,000

Investor is liable to pay STCG tax on Debt mutual funds as per his/her income tax slab. We can assume that investor A falls in the highest tax bracket. Hence, investor A has to pay Rs 30,000.

What will happen if he sells his Equity Mutual Fund today?

If he sells his Equity mutual fund today and takes a loss of ₹ 1.5 lakh, he now has made a STCL of ₹ 1.5 lakhs and law says that he is allowed to offset it with any STCG or LTCG. STCL first have to be adjusted with any STCG, and only then with LTCG. So now he can offset this ₹1.5 lakhs STCL in Equity Mutual Fund with his ₹1 lakhs STCG in debt mutual fund. Hence, he can save his tax of that ₹30,000 which he had to pay, also he can carry forward a loss of remaining ₹50,000 which was not offset.

The advantage is that you can save tax on the existing profit and also generate STCL which you can take forward and save tax on future profits. There are many people who make losses and don't bother to show it in their returns, if they don't show it in returns then they will not be able to use it for offsetting purpose in future.

Note: The above case study is just for an example to understand how you can utilize the tax rules to your advantage.

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