Q2

# Comment on the important changes introduced in respect of the Long term Capital Gains Tax (LCGT) and Dividend Distribution Tax (DDT) in the Union Budget for 2018-2019. (150 Words, 10 Marks).

UPSC Civil Services Mains 2018 · GS III · 10 marks · Government Budgeting

Government Budgeting.

## Core demand of the question

- State the Long Term Capital Gains Tax change in Union Budget 2018-19 on listed equity
- State the Dividend Distribution Tax change for equity-oriented mutual funds
- Comment on fairness, markets and the small investor

## Revision summary

Budget 2018-19 withdrew the section 10(38) exemption on long-term listed equity gains.

Section 112A taxes such LTCG above Rs 1 lakh at 10 per cent without indexation, with grandfathering to 31 January 2018.

Short-term equity gains stayed at the existing STT-linked 15 per cent rate.

Equity-oriented mutual funds were brought under DDT at 10 per cent under section 115R.

The aim was equity of taxation; markets need the new rates to remain predictable.

## Introduction

Union **Budget 2018-19** changed how India taxes **listed equity wealth** and **mutual-fund dividends**. For years, long-term gains on shares and equity funds were largely exempt if securities transaction tax was paid. The Budget withdrew that exemption and put a **dividend distribution tax** on equity-oriented funds. The stated aim was horizontal equity with other income; the market fear was a hit to household savings in shares.

## Body

## Long Term Capital Gains Tax (LCGT)

- Until this Budget, **long-term capital gains** on listed equity shares and equity-oriented mutual funds were exempt under **section 10(38)** when **securities transaction tax (STT)** had been paid.
- **Section 112A was inserted: gains above Rs 1 lakh** in a year on such assets, held more than **12 months**, are taxed at **10 per cent** without indexation and without the old exemption.
- **Grandfathering protected past appreciation: for shares bought before 1 February 2018**, the cost of acquisition is taken so that gains accrued till **31 January 2018** are not taxed under the new rule.

- Short-term capital gains on the same assets continued at the existing **15 per cent** STT-linked rate.
- The policy logic was that a permanent zero tax on equity LTCG was a **privilege** relative to interest, property and unlisted shares.

## Dividend Distribution Tax (DDT)

- Companies already paid **DDT under section 115-O** on dividends distributed (a 15 per cent base plus surcharge and cess), and the dividend was then largely tax-free in many shareholders' hands, subject to the extra levy on very large dividend income.
- Budget 2018-19 levied **DDT at 10 per cent** (plus surcharge and cess) on **equity-oriented mutual funds** under **section 115R**. Those fund dividends had been tax-free for unit holders; debt funds already faced DDT.
- The change aligned **equity-fund payouts** with other distributed surplus and reduced the incentive to take return as dividend rather than as capital gain.

## Comment

- The LTCG design (threshold plus grandfathering) tried to spare **small, patient investors** and not rewrite old prices overnight.
- DDT on equity funds hits **payout schemes** more than growth schemes; it can push savers toward accumulation plans.
- Both measures widen the **tax base on financial income**. They also add complexity and can affect foreign and domestic flows if rates look unstable.
- Fairness improved relative to wage and interest income; **predictability** of the equity tax regime remains part of the cost of capital.

## Flow diagram

> Budget 2018-19 -> LTCG 10 percent section 112A
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> Budget 2018-19 -> DDT 10 percent equity funds
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> LTCG 10 percent section 112A -> Grandfather 31 Jan 2018
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> LTCG 10 percent section 112A -> Threshold Rs 1 lakh
>
> DDT 10 percent equity funds -> Align fund dividends with other payouts

## Conclusion

Budget 2018-19 ended the LTCG holiday on listed equity above Rs 1 lakh at 10 per cent with grandfathering, and put DDT on equity-oriented mutual fund dividends. The shift is more equal across income types. It will work if the new rates stay stable so households still use equity for long-term saving.

## Facts & figures

> **Section 112A**
> Finance Act 2018 provision: 10 per cent tax on long-term capital gains over Rs 1 lakh on STT-paid listed equity and equity-oriented funds, without indexation.

> **Section 10(38)**
> Old exemption for such LTCG; withdrawn from Assessment Year 2019-20 after Budget 2018-19.

### Grandfathering

Gains accrued till 31 January 2018 on pre-1 February 2018 holdings are kept out of the new LTCG charge through a deemed cost rule.

### Section 115R DDT

Budget 2018-19 extended dividend distribution tax at 10 per cent (plus surcharge and cess) to equity-oriented mutual funds.

### STT

Securities Transaction Tax already levied on cash-market trades; it remained the base for concessional equity capital-gains treatment.