How investing in 54EC bonds can help you save tax on long-term gains

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REC (formerly Rural Electrification Corporation) launched a new series (XVI) of 54EC Capital Gains Tax Exemption bonds on April 1. Investing in these bonds allows a person to claim tax exemption under Section 54EC on long-term capital gains arising from the transfer of a tract of land or building. The National Highways Authority of India will not issue these bonds.

Save on tax

When you register long-term capital gains by selling property held for at least two years, you have to pay tax on your gains. One way you can avoid paying tax is by investing an amount equivalent to the long-term capital gains in bonds specified under Section 54 EC of the Income-Tax Act. Exemption up to Rs 50 lakh is allowed under this Section.

Both individuals and members of a Hindu Undivided Family can invest in 54EC bonds. However, this investment must be made within six months of transferring the capital asset. These bonds have a face value of Rs 10,000. Investors can apply for a minimum of two and a maximum of 500 bonds.

Safe bet

These bonds enjoy the highest rating. Deepak Jain, chief executive, TaxManager.in, a tax e-filing and compliance management portal, says, “Apart from enabling investors to enjoy tax exemption from long-term capital gains, these bonds, which are ‘AAA’-rated, also offer safety.” The money is yours once the lock-in period ends.

Vishal Dhawan, board member, Association of Registered Investment Advisers, says, “After you have completed five years in these bonds, there is no compulsion to invest in a particular instrument.”

Low, taxable return

These bonds have a few downsides, too. They offer an interest rate of 5 per cent, which is much lower than the Consumer Price Index-based inflation rate (currently at 6.95 per cent). Furthermore, the interest paid is taxable. “The annual 5 per cent interest is compulsorily paid out, so investors don’t get the benefit of compounding the interest they earn from these bonds,” says Dhawan.

The tax benefit can be revoked under certain circumstances. “These bonds come with a lock-in period of five years. If the investor redeems the money invested in them before the end of this period, the tax exemption on capital gains is revoked. The entire capital gains amount becomes taxable in the year of redemption,” says Jain.

Double benefit, a no-no

Experts say investors should not try to avail of double benefit on their investment in these bonds.

Naveen Wadhwa, deputy general manager, Taxmann, says, “If an assessee has claimed exemption for investment in specified bonds, he is not entitled to claim deduction on the same investment under Section 80C as well.”

Investment in these specified bonds should not exceed Rs 50 lakh during the fiscal year in which the asset is transferred and in the subsequent fiscal year. In the past, taxpayers used a loophole in the law to get exemption on

Rs 1 crore of capital gains. They would do so by investing Rs 50 lakh twice in two fiscal years. They would invest once before March 31 and again on or after April 1, within six months of gains. “This is no longer permitted by law,” says Wadhwa.

Who should invest

Investors who are fine with the five-year lock-in may invest in these bonds. “For older investors, or those already overweight on real estate in their portfolios, the alternative of investing more in real estate to save on capital gains tax is not a great idea,” says Dhawan.

If the tax payable on capital gains is minor, or the investor needs the funds immediately, he/she should pay the 20 per cent tax, and not invest in these bonds. On the other hand, if the tax liability is significant, they may be considered. Investors can also pay tax and invest the balance in instruments, such as direct equities and equity mutual funds, which have the potential to offer higher returns. Those having a long horizon may exercise this option.

CAPITAL GAINS A/C: ALTERNATIVE TAX-SAVING ROUTE

- A Capital Gains Account Scheme allows individuals to park their capital gains until they can invest it in property or other permitted investment avenues
- You can deposit the unutilised capital gains and become eligible for capital gains exemption once you reinvest this amount
- This account can be opened in any branch of an authorised bank (most public-sector banks offer it)
- You can avail of either a savings deposit or a fixed deposit under this scheme
- Keep proof of deposit handy, in case the tax department demands proof in the future

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