Short-term capital gain tax on mutual funds – everything you need to know

Are you tired of trying to navigate the complex world of taxes and investments? Look no further! In this article, we will be diving into the ins and outs of short-term capital gain tax on mutual funds in India. Whether you are a seasoned investor or just starting out, understanding the tax implications of your investments is crucial to maximising your returns. So grab a cup of chai, get comfortable, and let's get started!

Short-Term Capital Gain (STCG) tax on mutual funds explained

In India, a tax is levied on the profits earned from the sale of mutual fund units. These profits are known as capital gains and can be categorised as short and long-term.

Short-term capital gain tax is a tax that is levied on the profits earned from the sale of mutual fund units that have been held for a short period. This period can differ for different types of mutual funds depending on the securities they invest in.

The following sections can help you understand this in detail.

Short-term capital gain tax on equity mutual fund

Equity mutual fund schemes primarily invest in equities and equity-related instruments. As far as equity mutual fund taxation is concerned, a holding period of less than 12 months is considered short-term. Gains earned from an equity mutual fund scheme held for less than 12 months are thus classified as short-term capital gains and are taxed at 15% plus surcharge and cess, as applicable under Section 111A. In addition, the Securities Transaction Tax (STT) is also charged on the redemption of equity mutual fund units.

For example, consider a scenario where you invest in a lump sum in an equity mutual fund scheme in January 2022 and redeem the units in November 2022. Since the holding period is less than 12 months, you will pay 15% tax plus surcharge, cess, and STT. Let's assume you made a gain of Rs 5,000. In this case, you will pay 15% of 5,000, i.e., Rs 750, plus surcharge, cess, and STT.

Short-term capital gain tax on debt mutual funds

Debt mutual fund schemes primarily invest in bonds or other debt securities. As far as debt mutual fund taxation is concerned, a period of less than 36 months is considered short-term. Gains earned from a debt mutual fund scheme held for less than 36 months are thus classified as short-term capital gains and are taxed as per your tax slab rate, depending on the total income for the financial year.

For example, if you are 40 years old, filing under the old tax regime and fall in the highest tax bracket (i.e., above Rs 10 lakh per year), the STCG tax rate on mutual fund profits will be 30%.

Short-term capital gain tax on hybrid mutual funds

Hybrid mutual fund schemes invest in a combination of equities and debt securities. Tax on mutual funds such as these depends on their precise asset allocation. Hybrid funds with an equity component of 65% are taxed as equity funds, whereas those with less than 65% are taxed as debt funds, as explained above.

Short-term capital gain tax on SIPs

Systematic Investment Plans (SIPs) are a method of investing in mutual fund schemes. SIPs allow you to invest a fixed amount of money at regular intervals (e.g., monthly, quarterly, etc.) rather than investing a lump sum all at once. The taxation on SIPs depends on when the SIP was made and when the units were redeemed. Since SIPs can continue for years, understanding this can be a bit complicated.

Here's an example that can help:

Consider an example where you start SIPs of Rs 5,000 per month in an equity mutual fund scheme in January 2022. You decide to redeem these units in Feb 2023. The units purchased in the first month, i.e., January 2023, have been held for more than 12 months. Hence the profits made on these will be subject to long-term capital gains tax. However, units that were bought in July or December 2022 have not been held for 12 months. Hence, the gains on these will be subject to short-term capital gains. In this case, you will pay 15% tax plus surcharge, cess, and STT. For simplification, each SIP instalment is considered a separate investment while calculating capital gains tax.

International mutual fund taxation

International mutual funds invest in markets outside India. These are considered non-equity-oriented mutual fund schemes (debt schemes) in India for the purpose of taxation and are taxed as per your applicable income tax slab.

Table of short-term capital gain tax on mutual funds in India

Type of fund	Holding period	Short-term capital gain tax
Equity mutual fund scheme	Less than 12 months	15% + cess + surcharge + STT
Debt mutual fund scheme	Less than 36 months	As per the applicable tax slab
Equity-oriented hybrid mutual fund scheme	Less than 12 months	15% + cess + surcharge + STT
Debt-oriented hybrid mutual fund scheme	Less than 36 months	As per the applicable tax slab
International mutual funds	Less than 36 months	As per the applicable tax slab

Conclusion

It is essential to be aware of the tax implications of your investments in mutual fund schemes and to consider them while making investment decisions. When investing and redeeming mutual fund units, you should also consider your financial goals and risk appetite.