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**ARTICLE No. 10**

**WHAT IS INDEXATION: -**

Indexation is used to adjust the purchase price of an investment to reflect the effect of inflation on it. Indexation is done through a mechanism that uses the Cost Inflation Index (CII), which adjusts the purchase price of an asset for inflation in the year of its sale.

**HOW DOES INDEXATION WORK: -**

Every financial year, the government and the Central Board of Direct Taxes(CBDT) declare a Cost Inflation Index(CII). From the year in which you purchase your debt mutual fund, the purchase cost is indexed for each financial year till you remain invested. The Capital gains, for taxation purposes, are computed as sale price or redemption price minus the indexed cost of acquisition.

For example, if a person invests in a debt fund on 15th Sept, 2018 at an NAV of Rs. 15 and redeemed the fund on 20th Dec, 2021 at an NAV of Rs. 20.In this case that person is eligible for indexation as he has been invested for more than three years. The CII for F.Y. 2018-19 is 280 and for F.Y. is 317.

In this case purchase cost is indexed as: 317/280\*Rs. 15 = 16.98

Capital gain for the purpose of taxation is: Rs. 20 – Rs. 16.98 = Rs.3.02

Tax payable in this case is: 3.02\*20% = 0.604

Thus on a capital gain of Rs.5, the effective tax paid by the investor is Rs.0.604

As per tax rules, the tax rate applied on long term capital gains from debt fund is **20% using indexation or 10% Flat. In the case of short term capital gain, the tax rate on debt funds is as per the income tax slab of the investor.**

**This scores significantly well when compared to fixed deposits where investors in high tax brackets would pay a 30% plus surcharge.**