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LTCG hike & how will it affect your returns in India?

Will SIP really generate alpha?

Capital gains taxes are inherently unfair since you are paying taxes on assets purchased with the after-tax income. I am highlighting the changes in taxes proposed in this budget (2024) and its implications on the returns.

Asset	Earlier STCG	Current STCG	Earlier LTCG	Current LTCG	Earlier Holding period	Current Holding period
Listed Assets						
Listed Stocks	15%	20%	10%	12.5%	12 months	12 months
Equity MF	15%	20%	10%	12.5%	12 months	12 months
Debt MF	Slab rate	Slab rate	Slab rate	Slab rate	NA	NA
Listed bonds	Slab	20%	10%	12.5%	12 months	12 months
REIT/ InVIT	15%	20%	10%	12.5%	36 months	12 months
Equity FoF	Slab rate	20%	Slab rate	12.5%	NA	12 months
Overseas FoF	Slab rate	Slab rate	Slab rate	12.5%	NA	24 months
Gold/Silver ETF	Slab rate	20%	Slab rate	12.5%	NA	12 months
Gold Funds	Slab rate	Slab rate	Slab rate	12.5%	NA	12 months
Unlisted Assets						
Physical Real estate	Slab rate	Slab rate	20%	12.5%	24 months	24 months
Unlisted bonds	Slab rate	Slab rate	Slab rate	Slab rate	36 months	24 months
Unlisted stocks	Slab rate	Slab rate	20%	12.5%	24 months	24 months
Foreign equities/ Bonds	Slab rate	Slab rate	20%	12.5%	24 months	24 months

This extra taxation leads to change in the alpha to be generated to beat the index. Following illustration will explain the same.

- Say you earn Rs.100- which happens to be a respectable salary and it leads to you being in the highest tax slab in India (FY25) i.e. ~30%. Again, 30% is the effective rate after all the slab adjusted taxation. The actual percentage will be higher considering cess, etc. **Assumption 1: Effective tax is 30%**
- Deducting Income Tax of Rs.30, you get Rs.70 as your post tax discretionary income. Once again, we will assume that Rs. 70 is used for purchases and GST is zero in the country. **Assumption 2: You pay no GST on any purchase.**
- Say you are rich and you don't spend any of this Rs. 70. Hence you Invest Rs. 70. This is a very liberal assumption yet, for the sake of this discussion, we can assume the same. **Assumption 3: You are rich and you do not spend any of the Rs. 70 that has been saved. It is invested entirely**
- Most mutual funds give less than 15% CAGR. But the top ones give 15- 18% on avg. say you pick all the top ones, you are lucky. At the same time, you also get your timing right and you start investing when the market is down. At 18% CAGR, the Rs. 70 that you have invested get Rs. 160 at the end of year 5. (This is basic compound interest)
- Hence your profit i.e. capital gain in 5 years is 160-70= 90. Now you Pay long term capital gains tax i.e. 12.5% of profits. This amounts to Rs.11.25 LTCG tax on profit of Rs. 90. This leaves you with in-hand gains of Rs. 78.75 only post tax. **Assumption 4: Neglect all STT, brokerage etc. incurred in buying and selling the security.**
- So, basically you get 160-11.25 i.e. Rs. 149 as your capital post year 5.
- The reported inflation in India is 7- 7.5% YoY. Taking into consideration urban unreported inflation (plus shrinkflation, this number is close to 9-10% YoY). We will go with a lower rate of 7.5% as reported by RBI. **Assumption 5: The actual inflation in India (CPI) is 7.5% YoY.** At 7.5% inflation, the original Rs.100 that you had earned as salary is Rs. 141 (This is again basic compound interest).
- So, after all these years, and some very generous assumptions, you have barely beaten inflation i.e. You got Rs. 149 after taking market level risk and the value of the money post inflation itself is Rs. 140.

With the current tax regime, the ONLY way to sustainably beat the market is a CAGR of > 20%. Guess how many Active funds have given that in the last 10 years? 13 out of 1552 schemes (as per AMFI) have given a CAGR of > 20% (direct plan only) in the last 10 years. 0.8% of schemes helped you beat the market. Let that sink in.



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