Taxation Amendment May Reduce Inflows In Gold ETFs, Say Experts

Sovereign gold bonds are a "more tax efficient" alternative, says Vishal Dhawan Of Plan Ahead Wealth Advisors.

Smriti Chaudhary 25 Mar 2023, 09:14 AM IST

Gold Exchange Traded Funds are likely to see a drop in inflows following an amendment on taxation of such funds by the government, according to market experts.

"Instead of gold ETFs or gold mutual funds, investing in sovereign gold bonds would be a better option," said Anant Ladha, founder of Invest Aaj For Kal.

The gains arising from any mutual fund with an equity allocation of less than 35% will be considered as short-term capital gains, starting April 2023, and taxed at the slab rate. This means an individual in the highest tax bracket will pay a tax of 30%.

Currently, gains arising from such mutual fund schemes are considered long-term after a period of three years and taxed at 20% with indexation benefits.
As things stand, all investments made on or after April 1 this year will be covered under the proposed amendment. While there is no explicit grandfathering clause, the reading of the proposed change suggests that investments prior to April 2023 will not be impacted.

Although Ladha spoke against redeeming the gold ETFs and mutual funds that investors currently hold, he said that sovereign gold bonds would be a "more attractive" alternative for fresh investments.

Sovereign gold bonds bear a 2.5% p.a. interest rate and do not attract capital gains tax if redeemed on maturity after eight years.

Sovereign gold bonds were always a "more tax-efficient instrument" as compared to gold mutual funds, said Vishal Dhawan, founder and chief executive officer at Plan Ahead Wealth Advisors. "The choice of instrument will depend on their ability to hold it for a particular period of time," he said.

Gold ETFs are majorly preferred by shorter-term investors, who do not want to hold for as long as eight years, he said. ETFs and gold mutual funds also give the option to invest in smaller lots through systematic investment plans.

Moreover, it is unlikely that an investor would move to buying physical gold. "Physical gold is a hassle to buy and store," said Amol Joshi, founder at Plan Rupee.

Large institutions with excess liquidity were the biggest takers of debt mutual funds, Ladha said. "They would invest in these funds purely to get the benefit of indexation", which will no longer be there.