Union Budget 2024: How to rejig your MF portfolio after change in tax structure

By Surbhi Khanna, Published on: 25th July 2024

After Finance Minister Nirmala Sitharaman announced changes in tax structure for mutual funds and budget allocation to different sectors, investors are looking out for options to make fresh investments by trying to identify profitable sectors/themes. ET Mutual Funds reached out to experts to know their views on the same.

Sitharaman on Tuesday announced changes to the tax rates on financial assets, specifying that short-term gains on specified financial assets will now be taxed at 20% instead of the previous 15%. However, the applicable tax rates for other financial and non-financial assets remain unchanged.

Long-term gains on all financial and non-financial assets will attract a 12.5% tax rate. Effective from July 23, 2024, equity mutual funds and shares with a 12-month holding period will continue to attract a 20% tax for short-term capital gains (STCG) and 12.5% for long-term capital gains (LTCG).

“We believe that the budget had two clear directions - firstly; it has tried to shift the focus for investors to invest longer term by increasing the differential between short term and long term capital gains rates in equity from 5% to 7.5% and secondly it has made asset classes relatively tax neutral allowing investors to invest on the merit of the asset class basis their risk tolerance, investment time horizon and financial goals, rather than making decisions basis more attractive tax rates for one asset class over another,” recommended Vishal Dhawan, CEO, Plan Ahead Wealth Advisors, a wealth management firm in Mumbai. An advisor recommends that the asset allocation should be based on financial goals and risk tolerance rather than taxation.

“An investor’s asset allocation should be primarily driven by his financial goals and risk tolerance rather than taxation. Taxation is something which is not in an investor’s control and hence the only thing that an investor can do is to work around it by investing in a tax efficient product within a chosen asset class,” said Nilesh D Naik, Head of Investment Products, Share. Market.

He also added, “From that perspective, in this budget, we have seen an attempt to bring most of the products at par, from taxation perspective. For long term wealth creation, equity funds continue to be the right investment choice, despite the recent changes in taxation. For diversification and hedging against inflation, the change in taxation of funds in categories such as gold funds, overseas fund of funds, etc will now provide more tax efficient options to investors.”

Another expert believes that post-budget, the investment landscape has shifted. Equity-oriented funds remain attractive for long-term wealth creation due to potential tax benefits. However, debt funds have become less appealing.

“Post-budget, the investment landscape has shifted. Equity-oriented funds remain attractive for long-term wealth creation due to potential tax benefits. However, debt funds have become less appealing due to the removal of indexation benefits. Investors should carefully evaluate their risk tolerance and investment horizon before making decisions.

A balanced approach, considering both equity and debt, might be prudent. Investors might refrain from making long-term investments in real estate after the removal of indexation benefits in tangible assets as well,” suggested Sonam Srivastava, Founder and Fund Manager at Wright Research.

The finance minister in the budget, announced allocations to several sectors such as Rs 1.52 lakh crore for agriculture and allied sectors, Rs 4.54 lakh crore for Defence sector, and Rs 26,000 crore for infrastructure sector, according to a report by the Fisdom Research. Post the budget allocation made to some sectors, which sectors or themes are likely to perform, and which sector/theme should mutual fund investors choose for investments going forward?

Naik of Share Market recommends that events such as this create a lot of excitement among investors, one doesn’t necessarily need to react to every news.

He said, “When it comes to mutual fund investing, it’s important to take a long-term view and invest based on a proper investment plan aligned with your overall investment objectives and risk tolerance. While events such as this create a lot of excitement among investors, one doesn’t necessarily need to react to every news. Good investing is often boring. For most investors, there may not be a real need to have sectoral or thematic funds in their portfolios to achieve their long-term financial goals. Moreover, if a particular sector or theme is poised to do well, then nothing stops the diversified funds from being flexible to increase allocation to it and yet provide the benefit of necessary diversification required in the fund’s portfolio.”

Vishal Dhawan suggested that “We believe that most sectors and themes continue to be at premiums to long term average and the budget has not created opportunities from a thematic basis. On a relative basis, as private banks are probably one of the spaces that are at a discount to long term averages, one can explore these from a longer-term perspective.”

Another expert believes that the Union Budget's allocation for infrastructure, while maintaining its importance, fell short of expectations given the anticipated surplus from the RBI dividend.

“The Union Budget's allocation for infrastructure, while maintaining its importance, fell short of expectations given the anticipated surplus from the RBI dividend. This could temper investor enthusiasm for the sector, though its long-term prospects remain positive due to the government's consistent emphasis on infrastructure development,” said Sonam Srivastava.

She also mentioned, “A notable shift towards the consumption sector is evident, with increased focus on agriculture, horticulture, and housing finance. This could benefit sectors like FMCG, consumer durables, and cement. While infrastructure might witness a more gradual uptick, the consumption-oriented sectors are poised for accelerated growth in the near term. Overall, the budget has laid a foundation for balanced growth, with infrastructure as a steady driver and consumption as a potential catalyst.”

In the budget announcement, the finance minister announced that the holding period for equity FoFs, overseas FoFs (international funds) and gold mutual funds has been reduced from more than 36 months to more than 24 months. The Long-Term Capital Gains (LTCG) tax rate has been adjusted to 12.5% from earlier of being taxed as per tax slab rate, while the Short-Term Capital Gains (STCG) tax rate remains unchanged.

After a change in taxation for international funds, gold funds, and equity FoF, will these categories become more attractive?

“Recent tax changes have made international funds, gold funds, and equity FoFs more attractive investment options due to the implementation of a flat 12.5% long-term capital gains tax. These changes offer investors potential tax benefits and diversification opportunities. While these categories have become more tax-efficient, their performance will ultimately be determined by market conditions and the funds' underlying holdings,” said Sonam Srivastava.

“With rationalisation of tax rates and holding periods, the relative attractiveness of domestic equity via a vis international equities has reduced, and thus investors can consider more diversified portfolios in equity, along with allocations to debt that can gain from the fiscal prudence and stable government borrowing program, with gold as an asset class that could gain from lower interest rates globally and protect against INR weakness against the US dollar,” said Vishal Dhawan.

And lastly, Nilesh D Naik said, “Taxation for funds in these categories was hit adversely post the changes announced in the Finance Act 2023, as the indexation benefit was taken away and they were getting taxed at slab rate. However, post the changes announced in this budget wherein investments held in these funds for over 24 months will qualify for long term capital gains taxation, funds in these categories will definitely become more attractive from a taxation perspective. As previously mentioned, one should look at them for investing only after evaluating whether they fit into one’s asset allocation needs based on their goals and risk tolerance and not just due to favourable tailwinds in terms of taxation.”