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WHAT IS EXCHANGE TRADED FUND OR ETF? HOW IS IT TAXED?

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

Exchange traded funds or ETFs are a popular form of passive investing. An ETF invests in a basket of securities that mostly tracks a certain index. ETFs are similar to mutual funds, but the big difference is that the ETFs can be bought and sold only through the stock exchanges. ETFs have a much lower expense ratio compared to mutual funds. They charge between 0.05% to 1% of the net asset value.

Types of ETFs

ETFs can be of four types -- index ETF, gold ETF, sectoral or thematic ETF and international ETF. Index ETFs track indexes like Nifty or Sensex, Gold ETFs are indexed to market price of gold. Thematic ETFs track a specific sector or a theme and international ETFs invest in funds abroad.

How are ETFs taxed?

Index ETFs and sectoral ETFs are treated as equity-oriented schemes for the purpose of taxation. Accordingly, short term capital gains made on ETF units held for less than one year will be taxed at 15%. Long term capital gains on units held for more than one year will be taxed at 10%, without indexation benefit. Long term capital gains upto 1 lakh are not taxed.

For taxation purposes, gold ETF and international ETFs are taxed as non-equity funds. Short terms gains made on ETF units held for a period of less than 36 months are taxed as per the applicable income tax slab rate. Long term capital gains on units held for over one year are taxed at 20% after indexation benefit.

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