

# Mutual Fund Taxation in India 2025-26: Complete Guide

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Imagine this: You invested ₹5 lakh in a mutual fund three years ago, and it has grown to ₹8 lakh today. Exciting, right? But before you celebrate those ₹3 lakh gains, there's someone else who wants their share—the Income Tax Department. Understanding **mutual fund taxation in India** isn't just about compliance; it's about maximizing your actual returns after tax.

With significant changes introduced in **Budget 2024** and continuing into **FY 2025-26**, the landscape of **capital gains tax** on mutual funds has transformed dramatically. Whether you're investing in **equity funds**, **debt funds**, or **hybrid** schemes, knowing the exact tax implications can save you thousands—or even lakhs—of rupees.

In this comprehensive guide, we'll break down everything you need to know about **mutual fund tax rules** in 2025-26, including **LTCG** and **STCG** rates, **holding periods**, and practical calculation examples.

If you're new to mutual fund investing, we recommend reading our [comprehensive Mutual Fund Complete Guide](#) first, which covers everything from basics to advanced strategies. In this article, we'll focus specifically on the taxation aspect.

# What Determines Tax on Mutual Funds?

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Before diving into specific rates, it's crucial to understand that [mutual fund taxation](#) depends on two primary factors:

## 1. Type of Fund (Asset Allocation)

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The tax treatment varies based on whether the fund invests primarily in:

- **Equity** (stocks)—65% or more in equity = Equity Fund
- **Debt** (bonds, fixed income)—65% or more in debt = Debt Fund
- **Hybrid** (mix of both)—taxation depends on equity percentage

## 2. Holding Period (How Long You Invested)

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The duration you hold your investment determines whether your gains are:

- **Short-term Capital Gains (STCG)**—Higher tax rate
- **Long-term Capital Gains (LTCG)**—Lower tax rate with potential exemptions

## Equity Mutual Fund Taxation (≥65% Equity Allocation)

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Equity-oriented mutual funds include large-cap, mid-cap, small-cap, flexi-cap, sectoral funds, **ELSS**, equity savings funds, and index funds. These funds follow **equity taxation** rules as long as their equity allocation (including equity derivatives) remains at or above 65%.

### Holding Period Definition

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- **Less than 12 months** = Short-term
- **12 months or more** = Long-term

### Current Tax Rates (Post-Budget 2024, Applicable FY 2025-26)

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| Capital Gain Type | Holding Period      | Tax Rate     | Exemption           |
|-------------------|---------------------|--------------|---------------------|
| <b>STCG</b>       | Less than 12 months | <b>20%</b>   | None                |
| <b>LTCG</b>       | 12 months or more   | <b>12.5%</b> | ₹1.25 lakh per year |

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Equity Mutual Fund Tax Rates — FY 2025-26

### Key Changes from Previous Years:

- **STCG** rate increased from 15% to 20%

- **LTCG** rate increased from 10% to 12.5%
- **LTCG exemption** raised from ₹1 lakh to ₹1.25 lakh

## Understanding the ₹1.25 Lakh LTCG Exemption

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The **₹1.25 lakh LTCG exemption** is a **combined annual limit** across:

- All equity mutual fund redemptions
- Direct stock sales
- Equity-oriented hybrid fund redemptions

It is NOT ₹1.25 lakh per fund or per AMC. If your total long-term equity gains across all sources in a financial year don't exceed this limit, you pay **zero tax**.



### Example: LTCG Tax on Equity Mutual Funds

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If you earned **₹2,00,000 LTCG** from equity funds:

- ✓ First ₹1.25 lakh = **Tax-free**
- ✓ Remaining ₹75,000 × 12.5% = **₹9,375 tax**

💰 Total Tax Payable: ₹9,375

## Securities Transaction Tax (STT)

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Equity fund redemptions also attract **STT at 0.001%** on the sell value. This is separate from **capital gains tax** and is automatically deducted from your redemption proceeds by the AMC.

## Debt Mutual Fund Taxation: The Major Shift

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**Debt fund taxation** underwent one of the most significant changes in recent years. The rules now differ dramatically based on **when you purchased** the fund units.

### Debt Funds Bought On or After April 1, 2023

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Starting April 1, 2023, the government eliminated the long-term capital gains benefit for debt funds entirely under **Section 50AA**.

**Rule:** All gains from debt funds purchased after March 31, 2023, are treated as **short-term capital gains**, regardless of **holding period**. They are taxed at your **income tax slab rate**.

| Purchase Date         | Holding Period | Tax Treatment        |
|-----------------------|----------------|----------------------|
| April 1, 2023 onwards | Any duration   | Income Tax Slab Rate |
| April 1, 2023 onwards | Even 10 years  | Still Slab Rate      |

Debt Fund Taxation — Purchased After April 1, 2023

This means **debt funds** now have the same tax treatment as fixed deposits—no **indexation** benefit, no preferential **LTCG** rate.

## Debt Funds Bought Before April 1, 2023 (Grandfathering)

If you purchased debt fund units before April 2023, you're partially grandfathered:

### Sold On or After July 23, 2024:

- Holding less than 24 months = **STCG** at slab rate
- Holding 24 months or more = **12.5% LTCG (no indexation)**

### Sold Before July 23, 2024:

- Holding less than 36 months = **STCG** at slab rate
- Holding 36 months or more = **20% LTCG with indexation benefit**

**Impact:** The removal of **indexation benefit** significantly increased the effective tax burden for long-term **debt fund** investors. Previously, indexation could reduce taxable gains by 25-40%.

## Hybrid Fund Taxation: Depends on Equity Percentage

**Hybrid mutual funds** combine equity and debt in varying proportions. The tax treatment depends entirely on the **equity allocation percentage**.

### Category 1: Equity-Oriented Hybrid (≥65% Equity)

Includes aggressive hybrid funds, most balanced advantage funds (BAFs), and **equity savings funds** (which combine equity + arbitrage to maintain ≥65% equity exposure).

| Gain Type   | Holding Period      | Tax Rate                     |
|-------------|---------------------|------------------------------|
| <b>STCG</b> | Less than 12 months | <b>20%</b>                   |
| <b>LTCG</b> | 12 months or more   | <b>12.5%</b> (₹1.25L exempt) |

## Category 2: Moderate Hybrid (Equity 35-65%)

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Includes balanced hybrid funds and multi-asset allocation funds (with equity 35-65%).

| Gain Type | Holding Period      | Tax Rate              |
|-----------|---------------------|-----------------------|
| STCG      | Less than 24 months | Income Tax Slab Rate  |
| LTCG      | 24 months or more   | 12.5% (No Indexation) |

**Note:** The **LTCG holding period** for this category was reduced from 36 months to 24 months in **Budget 2024**.

## Category 3: Debt-Oriented Hybrid (Equity < 35%)

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Conservative hybrid funds and Monthly Income Plans (MIPs) fall here.

## Special Categories in Mutual Fund Taxation

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### ELSS (Equity Linked Savings Scheme)

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ELSS funds are the only mutual funds offering **tax deduction** benefits under **Section 80C**.

#### Key Features of ELSS

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- Investment up to **₹1.5 lakh** qualifies for **Section 80C deduction** (Old Tax Regime only).
- Mandatory **3-year lock-in period** — the shortest among tax-saving options.
- After lock-in, all gains are treated as **LTCG** (holding period always exceeds 12 months).
- **₹1.25 lakh LTCG** is exempt annually; gains above this are taxed at **12.5%**.

**Important:** Under the **New Tax Regime** (default from FY 2024-25), **Section 80C** deduction is NOT available. However, the **LTCG exemption** on gains still applies in both regimes.

### Arbitrage Funds

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Despite having risk profiles similar to liquid funds, **arbitrage funds** are classified as equity funds for tax purposes because they maintain  $\geq 65\%$  equity exposure (equity + derivatives).

| Gain Type          | Tax Rate |
|--------------------|----------|
| STCG (< 12 months) | 20%      |

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| Gain Type                | Tax Rate                               |
|--------------------------|--|
| LTCG ( $\geq 12$ months) | 12.5% ( $\text{₹}1.25\text{L}$ exempt) |

This makes **arbitrage funds** more **tax-efficient** than liquid funds or short-term **debt funds** for parking money temporarily.

## International Funds — Two Categories

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### a) International ETFs Listed on Indian Exchanges:

| Gain Type | Holding Period      | Tax Rate              |
|-----------|---------------------|-----------------------|
| STCG      | Less than 24 months | Slab Rate             |
| LTCG      | 24 months or more   | 12.5% (No Indexation) |

### b) International Fund of Funds (FoFs) — Bought After April 1, 2023:

Under **Section 50AA**, all gains are taxed at your **income tax slab rate**, regardless of **holding period**. No **LTCG** benefit available.

## Gold Funds — Two Categories

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### a) Gold ETFs (Listed on Indian Exchanges):

| Gain Type | Holding Period      | Tax Rate              |
|-----------|---------------------|-----------------------|
| STCG      | Less than 24 months | Slab Rate             |
| LTCG      | 24 months or more   | 12.5% (No Indexation) |

### b) Gold Fund of Funds (Bought After April 1, 2023):

Under **Section 50AA**, all gains taxed at **slab rate**. No **LTCG** benefit.

## Surcharge and Cess: The Hidden Tax Layer

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When calculating your final **mutual fund tax** liability, don't forget **surcharge and cess**—these can add 4-15% to your base tax.

| Total Annual Income     | Surcharge Rate    |
|-------------------------|-------------------|
| Up to $\text{₹}50$ lakh | 0% (No surcharge) |

| Total Annual Income  | Surcharge Rate |
|----------------------|----------------|
| ₹50 lakh to ₹1 crore | 10%            |
| ₹1 crore to ₹2 crore | 15%            |
| ₹2 crore to ₹5 crore | 25%            |
| Above ₹5 crore       | 37%            |

Surcharge Rates Based on Total Annual Income

### ⚠ Critical Notes on Mutual Fund Taxation

- For **capital gains** (both equity and debt), surcharge is **capped at 15%**, even if your income exceeds ₹2 crore.
- Under the **New Tax Regime**, the maximum surcharge on total income is **capped at 25%**. The **37% surcharge** applies only in the Old Regime for income above ₹5 crore.

### Health & Education Cess

A flat **4% cess** applies to everyone, calculated on (Tax + Surcharge).

### Complete Tax Calculation Example:

Suppose you're in the ₹60 lakh income bracket and earned ₹2 lakh **LTCG** from **equity funds**:

1. LTCG Tax:  $(₹2L - ₹1.25L) \times 12.5\% = ₹9,375$
2. Surcharge (10%):  $₹9,375 \times 10\% = ₹938$
3. Subtotal:  $₹9,375 + ₹938 = ₹10,313$
4. Cess (4%):  $₹10,313 \times 4\% = ₹413$
5. **Total Tax = ₹10,726**

### SIP Taxation: Each Installment is Separate

If you invest through **Systematic Investment Plans (SIPs)**, each monthly installment is treated as a **separate purchase** with its own **holding period**. When you redeem, the **FIFO** (First In, First Out) method is used.

### Example:

- Started SIP in January 2024 (₹10,000/month in equity fund)
- Redeemed entire investment in February 2025

### Tax Treatment:

- January 2024 installment: Held >12 months = **LTCG at 12.5%**
- February to December 2024 installments: Held <12 months = **STCG at 20%**
- January 2025 installment: Held <12 months = **STCG at 20%**

Only the first installment qualifies for the lower **LTCG** rate. This is why SIP investors should plan redemptions carefully.

## Dividend Taxation (IDCW)

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Since FY 2020-21, dividends from mutual funds (now called **Income Distribution cum Capital Withdrawal or IDCW**) are taxable in the hands of investors.

### Tax Treatment:

- Added to your total income
- Taxed at your **income tax slab rate**
- **10% TDS** deducted if annual dividend from a single AMC exceeds **₹10,000** (threshold raised from ₹5,000 in Budget 2025, applicable from FY 2025-26)

For most investors, the **growth option** is more **tax-efficient** than the dividend/IDCW option, as you control when to realize gains and can utilize the **₹1.25 lakh LTCG exemption**.

## Master Summary: All Mutual Fund Tax Rates (FY 2025-26)

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| Fund Type                       | STCG Rate         | LTCG Rate                   | Holding for LTCG |
|---------------------------------|-------------------|-----------------------------|------------------|
| Equity Funds (≥65% equity)      | 20%               | 12.5% (₹1.25L exempt)       | >12 months       |
| ELSS                            | N/A (3yr lock-in) | 12.5% (₹1.25L exempt) + 80C | Always LTCG      |
| Arbitrage Funds                 | 20%               | 12.5% (₹1.25L exempt)       | >12 months       |
| Equity Savings Funds (≥65%)     | 20%               | 12.5% (₹1.25L exempt)       | >12 months       |
| Aggressive Hybrid (≥65% equity) | 20%               | 12.5% (₹1.25L exempt)       | >12 months       |
| Balanced Hybrid (35-65% equity) | Slab Rate         | 12.5% (no indexation)       | >24 months       |

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| Fund Type  | STCG Rate | LTCG Rate             | Holding for LTCG |
|--|-----------|-----------------------|------------------|
| <b>Conservative Hybrid (&lt;35%)</b> — post Apr 2023 | Slab Rate | Slab Rate             | No LTCG benefit  |
| <b>Conservative Hybrid (&lt;35%)</b> — pre Apr 2023  | Slab Rate | 12.5% (no indexation) | >24 months       |
| <b>Debt Funds</b> (post Apr 2023)                    | Slab Rate | Slab Rate             | No LTCG benefit  |
| <b>Debt Funds</b> (pre Apr 2023)                     | Slab Rate | 12.5% (no indexation) | >24 months       |
| <b>Gold ETFs</b> (listed)                            | Slab Rate | 12.5% (no indexation) | >24 months       |
| <b>Gold FoF</b> (post Apr 2023)                      | Slab Rate | Slab Rate             | No LTCG benefit  |
| <b>International ETFs</b> (listed)                   | Slab Rate | 12.5% (no indexation) | >24 months       |
| <b>International FoF</b> (post Apr 2023)             | Slab Rate | Slab Rate             | No LTCG benefit  |
| <b>Dividends / IDCW</b>                              | Slab Rate | —                     | —                |

**Master Summary: All Mutual Fund Tax Rates — FY 2025-26**



### Calculate Your Mutual Fund Returns & Tax Instantly

Want to know your exact post-tax returns? Use our free Mutual Fund Calculator to estimate your gains, tax liability, and net returns in seconds.

[Use Mutual Fund Calculator →](#)

## Tax-Saving Strategies for Mutual Fund Investors

### 1. Maximize the ₹1.25 Lakh LTCG Exemption

Strategically book equity profits each year to stay within the exemption limit. Consider partial redemption and reinvestment annually.

### 2. Hold for LTCG Qualification

Whenever possible, hold **equity funds** for at least 12 months and non-equity funds for 24 months to benefit from lower **LTCG** rates.

### 3. Tax-Loss Harvesting

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Offset **capital gains** by selling loss-making investments in the same financial year.

#### Important Rules:

- **Short-term capital losses** can be set off against **both STCG and LTCG**
- **Long-term capital losses** can ONLY be set off against **LTCG, not STCG**
- Unabsorbed capital losses can be carried forward for **8 years**

### 4. Choose Growth Over Dividend

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Unless you need regular income, opt for growth plans to control when you pay tax and utilize the **LTCG exemption**.

### 5. Consider ELSS for 80C Benefits

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If you're in the **Old Tax Regime**, **ELSS** gives dual benefits: tax deduction on investment AND capital gains exemption on redemption.

### 6. Evaluate Debt Fund Alternatives

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Post-April 2023, **debt funds** lost their tax advantage. Consider:

- **Arbitrage funds** for better post-tax returns (equity taxation)
- Direct bonds or SDLs for fixed income exposure
- Debt funds only when portfolio diversification or professional management is priority

### 7. New vs Old Tax Regime Planning

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- **Capital gains tax rates (STCG 20%, LTCG 12.5%)** remain the **same in both regimes**
- **Section 80C (ELSS)** deduction available **only in Old Regime**
- Choose your regime based on overall tax planning, not just **mutual fund taxation**

### Frequently Asked Questions

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Long-term capital gains on equity mutual funds are taxed at **12.5%** for gains exceeding ₹1.25 lakh in a financial year. The first ₹1.25 lakh of LTCG is completely tax-free. This applies to funds held for more than 12 months with at least 65% equity allocation.

No, debt mutual funds purchased after April 1, 2023, have lost their long-term capital gains tax advantage under Section 50AA. All gains are now taxed at your income tax slab rate, regardless of holding period, making them equivalent to fixed deposits from a tax perspective.

Each SIP installment is treated as a separate purchase with its own holding period. When you redeem, the FIFO (First In, First Out) method is used. Early installments may qualify as LTCG (lower tax rate) while recent installments may be classified as STCG (higher tax rate). For equity funds, installments held over 12 months get LTCG treatment at 12.5%, while those held less than 12 months are taxed at 20% STCG.

The ₹1.25 lakh LTCG exemption is a **combined annual limit** across all equity mutual funds, direct stocks, and equity-oriented hybrid funds in a financial year. It is NOT per fund or per AMC. Your total long-term equity gains from all sources are aggregated, and only the amount exceeding ₹1.25 lakh is taxed at 12.5%.

Only **ELSS (Equity Linked Savings Scheme)** mutual funds qualify for tax deduction under Section 80C, allowing deduction up to ₹1.5 lakh per year. This benefit is available only under the Old Tax Regime, not the New Tax Regime. ELSS has a mandatory 3-year lock-in period, the shortest among all 80C options.

STCG (Short-term Capital Gains) applies when you sell before the minimum holding period — 12 months for equity funds, 24 months for non-equity listed funds. It is taxed at higher rates (20% for equity, slab rate for others). LTCG (Long-term Capital Gains) applies after the minimum holding period and is taxed at lower rates (12.5% for equity with ₹1.25L exemption, 12.5% without indexation for non-equity listed funds).

## Conclusion

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Understanding [mutual fund taxation in India](#) is no longer optional—it's essential for maximizing your investment returns. The **Budget 2024** changes, which continue into **FY 2025-26**, have made tax planning more critical than ever.

### **Key Takeaways: Mutual Fund Taxation (FY 2025–26)**

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- **Equity funds remain tax-advantaged** with the ₹1.25 lakh LTCG exemption.
- **Debt funds** purchased after April 2023 have lost LTCG benefits under Section 50AA.
- **International & Gold FoFs** (post-April 2023) follow slab rate taxation.
- **Hybrid fund taxation** depends critically on equity allocation percentage.
- **ELSS** continues to offer the best tax benefits under Section 80C (Old Regime).
- **Surcharge** on capital gains is capped at 15% regardless of income level.
- Don't forget **4% Health & Education Cess** on your total tax liability.

Before making any investment or redemption decision, calculate the **post-tax returns** considering your income bracket, **holding period**, and fund type.

Remember: It's not about how much you earn; it's about how much you keep after tax.

## **Disclaimer**

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Tax laws are subject to change. This article is based on current **FY 2025–26 regulations** as per **Budget 2024** and **Budget 2025** announcements. For personalized advice, consult a certified tax professional or chartered accountant.

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**Abhishek Chouhan** is a financial educator and market practitioner with over **15 years of experience** in the Indian stock market and mutual funds. As the founder of **MoneyBlasters.com**, he is dedicated to financial awareness, investor education, and long-term wealth creation strategies based on real market experience and data-driven analysis.

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