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Dream for Sweet Home: Indian Income Tax Perspective

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Abstract

One of the three basic needs of the people is own house property. Everyone dreams about a house of his own where he can dwell in peace and happiness with his family. It is a vital dream in the life. Lacs of people who had been toiling hard for years to buy or to construct their own house. But it is may not be affordable for all of them. It is because to achieve this everybody has to face some challenging steps like availability of fund, source of fund, pay back capability, scopes to easy pay back, taxation complexities etc. In view of this an effort has been made in this paper to show the adequate planning in the light of taxation, where taxpayer may dream for his sweet home.

Keywords: House property, Tax, Annual value, Deduction, Interest.

Introduction

House property consists of any building or land appurtenant thereto of which the assessee is the owner. The appurtenant lands may be in the form of a courtyard or compound forming part of the building. But such land is to be distinguished from an open plot of land, which is not charged under the head "Income from House Property".

Review of Literature

Taxation Policy has been a widely debated issue all over the world. A large number of studies have been conducted covering different aspects of income tax over the years. Moreover, reports of important committees constituted by Government of India have also been reviewed. A brief review of relevant studies in this regard is given below:

Indian Taxation Enquiry Committee was appointed by Government of India in 1924, Taxation Enquiry Commission (TEC) headed by John Matthai in 1953-54 , Kaldor was invited by the government of India in 1955, Boothalingam was appointed by the Government of India in1968, Direct Taxes Enquiry Committee was appointed by government of India under the chairmanship of Justice K.N. Wanchoo in 1971, Direct Tax Laws Committee was appointed by the Government of India on June 25, 1977 under the chairmanship of N.A. Palkhiwala. Economic Administrative Reforms Commission was constituted by Government of India in 1983, Tax Reforms Committee was constituted by the government of India under the chairmananship of Raja J. Chelliah, Nahar in 1994 tried to examine the impact of personal income tax on household savings with special reference to salaried class in India, Task Force on Direct Taxes constituted under the chairmanship of Mr. Vijay Kelkar by Ministry of Finance, Government of India Datar in 2010.

Objective of the Study

Owning a house is everyone's dream but making this dream come true requires one to make immense sacrifices furthermore putting his savings at stake and or signing a bank loan that will continue to be a liability for the years to come. At this time the tax complexities may complicate the whole process. In this respect this papers has tried to seek the scope of a tax payer to achieve the dream hi sweet home abiding by the provisions of taxation.

Essential Conditions for Taxing Income under the Head u/s 22 of the I.T. Act

Income from house property is taxable in the hands of its legal owner in whose name the property stands. "Owner" for this purpose means a person who can exercise the rights of the owner not on behalf of the owner but in his own right. The following three conditions must be satisfied- a) The property must consist of buildings and lands appurtenant thereto; b) The assessee must be the owner of such house property; c) The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax under " Proft and gains from business or profession".

Types of Income under the Head

1. Rental Income on a let out property,
2. Annual Value of a property which is 'deemed' to be let out for income tax purposes (when there are more than one owned house property),
3. Annual Value of the property which is self occupied.

Here, we shall discuss about for sweet home or property for self occupied purpose.

Self Occupied House Property and Its Tax under Different Situations

Situation A

Self occupied property is one which is owned and used by the owner for his own residential purpose. In other words one has to occupy the property throughout the year and do ensure that no any benefit has derived there from. In this case the annual value of the property is NIL as per sec.23(2)(a) & (b)of the Income Tax Act.

Situation B

If such property cannot be occupied by the owner, by reason of the fact that owing to his employment, business or profession carried on at any other place (other than the place where his self occupied property is there), has been forced to reside at other place in a building not owned by him and no any benefit has been derived from by letting out or any other means. The Annual Value will also be taken as NIL under section 23(3) of the Income Tax Act.

Situation C

When there are more than one house are held by the owner and is in the occupation of the Owner for his residential purpose, then only one residence value, at owner's choice, will be taken as NIL and other will be taxable as if let out (deemed let out) and it will be determined as per Sec. 23(1)(a) of the Income Tax Act.

Situation D

House property, which is partly let out and partly self occupied, in this case the annual value, deductions and the income of the part of the property which is "let out" shall be computed separately under the provisions of let out property and the income of the portion or the part of the property which is self occupied shall be determined as mentioned "self-occupied" category.

When the Annual Value is taken as NIL, no deduction u/s 24 is allowed except in respect of interest paid on capital borrowed for acquisition or construction.

Deduction u/s-24

Under section 24 of the Income Tax Act is allowed to make two deductions from the Net Annual Value of the House Property. Net Annual Value is Gross Annual Value *less* Municipal Taxes paid. In case of a deemed to be let out property, a reasonable rent of a similar place is Gross Annual Value and for a self occupied house property the Gross Annual Value is *Nil*.

Standard Deduction

Standard Deduction is 30% of the Net Annual Value calculated above. This 30% deduction is allowed even when the actual expenditure on the property is higher or lower. Therefore this deduction is irrespective of the actual expenditure incurred on insurance, repairs, electricity, water supply etc. For a self occupied house property, since the Annual Value is *Nil*, the standard deduction is also zero on such a property.

Interest on Home Loan

In case of use of home loan for purchase, construction, repair, renewal or reconstruction of the house property – the interest is allowed as a deduction from the Net Annual Value. Deduction for interest on money borrowed is allowed on accrual basis (allowed even though interest may not actually have been paid). Brokerage or commission for arranging the loan and interest of interest will be out of the purview of deduction [Circular No. 28, dated 20-8-1969]. In case of a self occupied house property, this deduction is allowed to be claimed and therefore, in such a case there is a loss under the head House Property. The total amount allowed towards this deduction is Rs 2,00,000 beginning assessment year 2015-16. This deduction of interest can be claimed only when the following conditions are satisfied:-

i) Loan has been taken on or after 1st April 1999 for purchase or construction. ii) The acquisition or construction is completed within 5 years (3 Years till Financial Year 2015-16) from the end of the financial year in which the loan was taken. iii) There is interest certificate available for the interest payable on the loan.

It may be noted that interest deduction may be limited to Rs 30,000 if any one of these conditions is met –a) Loan is borrowed before 1st April 1999 for purchase, construction, repairs or reconstruction of house property. b) Loan is borrowed on or after 1st April 1999 for repairs, renovation or reconstruction of house property.

Various Scopes within The Purview of Taxation

Pre-Construction Interest

The I-T law permits the assessee to claim the total interest paid during the pre-delivery period or preconstruction period as a deduction in five equal installments starting from the financial year in which the construction was completed or acquisition of apartment is done (generally this denotes the date of possession). The deduction for this interest is allowed in 5 equal installments starting from the year in which the apartment or house is purchased or the construction is completed. Though pre-construction interest is allowed to be deducted on the basis of 1/5th each year beginning the year in which the construction is completed – the total amount of pre construction interest and interest on housing loan that can be claimed in a year should not exceed Rs 2,00,000 in any case.

Two Residential Houses

The assessee in this case, should exercise his option to choose one of them as his own residential purpose in such a manner that his taxable income is the minimum. Such option may be changed from year-to-year.

Self Occupied House Property of Co-Owner

Where house property is self occupied by each co-owner:- Where the house property owned by the co-owners is self occupied by each of the co-owner, the annual value of the property for each of such of co-owner shall be nil and each of the co-owner shall be entitled to the deduction of Rs. 2,00,000/30,000 under Sec. 24(b) on account of interest on borrowed money.

Set off and Carry Forward of Interest Payment

As income from a 'self-occupied property' is nil, deduction of interest, in technical parlance, will mean a loss under the head 'Income from house property'. This "loss" can be set off against other income, which includes salary income, in the same year under section 70 of the Income Tax act. This reduces your total tax liability. Any such loss cannot set off within the same year can be carried forward and set off in the next 8 years under section 71(3) of the Income Tax Act. However, in the subsequent years, such set-off is possible only against 'Income from house property'. So even if the assessee has let out your property in the next year, this carry-forward of loss can bring a marginal relaxation in the tax liability.

Early Repayment of Housing Loan

Typically, the longer the loan tenure, the lower is the monthly EMI but higher is the interest out go. The Reserve Bank of India (RBI) has prohibited banks from levying any foreclosure charges if there is pay off the loan prior to its tenure. So any one have the loan in hand, he will be paying a periodical interest and also repaying the principal-in tranches. The I-T law provides for benefits in both instances.

Repayment of Housing Loan

The principal repayment of the housing loan made by the assessee is allowed as a deduction from the Gross Total Income (subject to an overall cap with other eligible investments of Rs 1.5 lakh) under section 80C.

Letting out of Second Residential House

Investing in real estate has become attractive, but has to get sure not to keep the second house (which is not a self-occupied property-as explained above) unoccupied. If second house is locked and empty (with no income accruing from it in the form of rent), but will still attract tax on its 'deemed value' on the basis of expected market rent. But instead if the second house is let out one can deduct the entire amount of interest as are paid on it without any cap from the rent received. If there is a loss, it can even be deducted from taxable income.

TDS Obligations in Case Buying of Higher Value of House or Apartment

As per the I-T law, the buyer of an immovable property worth Rs 50 lakh or more is required to deduct (and deposit) withholding tax at the rate of 1% from the consideration payable to the seller.

Transfer of House

If an individual sells a property before three years, sale will attract short-term capital gains tax chargeable at the rate of 30%. In addition, individual will have to pay stamp duty (6-8%), and brokerage (1-2%) on purchase of a new house. Therefore, a house should be purchased and held on to for at least 3-5 years. Liquidity is another factor to consider before an individual decides to change his/her house. It can take time to sell a house at his/her desired price. Even if he/she wants to change house, wait for at least three years so that his/her profit earned becomes long-term capital gain, because, if the gain is long-term capital gain, he/she can save tax by investing it in another house. Short term capital gain must be avoided on house property. If an individual has transferred/sold any land/building for an amount lesser than the value adopted by the State government"s stamp valuation authority, then the value adopted by the authority will be considered as the sale value for the purpose of computing income-tax. Selling a house even before 5 years is not tax efficient.

House for Poor

Meanwhile under the Pradhanmantri Aawaas Yojna subsidy and monetary concession to the tune of 2.5 lakhs is also being offered to the people so that maximum numbers of people are able to realize their dream of owning a house. At the same time, the banks has also reduced the lending rates to embolden the poor and economically weaker sections of society to come forward and avail the loan services and a special lending system is being brought for women which have a lower rate.

Conclusion

In the aforesaid discussion we see that there are lots of scopes in the provisions of taxation where a tax payer may find the opportunity in dreaming his house. Even someone with a modest salary can construct their sweet home and there by fulfill their dream if they make some sacrifices or plan to buy as well.

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