Residential Property is Capital Asset, it Attracts Tax on Purchase, Sale

Before buying or selling a house, it would be prudent to know the tax considerations. Here, we discuss the tax implications/benefits of purchasing a house and the taxation of gains from the sale of a house.

OWNING A HOUSE

The Indian Income Tax Act,1961 (IT Act), considers a residential house as a source of income. Under the I-T Act, the owner of a house is taxed on the income, in the form of its annual value, under the head 'Income from House Property. The annual value of a house property is higher of the income earned or the fair rent (expected reasonable rent for properties of a similar size in the same locality). In the case of a self-occupied house, the annual value is nil. However, in the case of more than one house property, only one house property can be considered as self-occupied, and the higher of the rent earned or the fair rent would be treated as annual value for the other house(s). Municipal taxes (including property tax, water tax, etc) are deductible from the annual value (other than from the house property where the annual value is nil); 30% of such net annual value is available as standard deduction from the rental income. In the case of a housing loan, additional deduction is available for the interest paid for the loan. The deduction, however, is restricted to a maximum of.1.5 lakh in the case of self-occupied property where the annual value is taken as nil. In other cases, there is no such restriction on the deduction for interest. In cases where the deduction for interest is higher than the net annual value, the excess of the interest is treated as loss.

Such a loss can be set off against income from other house property or from any other income of the owner for the same year. In the absence of sufficient income, the balance loss can be carried forward to the following year and set off against Income from House Property. However, such a loss cannot be carried forward for more than eight years. Additionally, under section 80C of the I-T Act, the repayment of principal amount of up to.1 lakh is available as deduction from the taxable income of the owner. The proposed Direct Taxes Code (DTC) has similar provisions for the taxability of income from house property. However, the standard deduction, currently at 30% under the I-T Act, has been reduced to 20% under the DTC.

SELLING A HOUSE

Under the I-T Act, a residential house property is treated as a capital asset. Any gain or loss on sale/ transfer of such capital assets is treated as capital gains or loss. If the house property is held by the owner for three years or more, it is treated as a long-term capital asset and capital gains arising from the sale/transfer are accordingly taxable at a reduced rate of 20%.Where the holding period is less than three years, the house property is treated as short-term capital asset and the capital gains on its sale/transfer are taxable at normal rates (as applicable to the taxpayer).In order to compute the capital gains in the hands of the seller, the consideration for sale/transfer is reduced by the cost of the acquisition. In case the assessable value as determined under the Stamp Act of the state concerned (or Indian Stamp Act where applicable) is higher than the consideration, then the same is substituted for consideration while computing capital gains. In the case of sale/transfer of a house property held for a period of three years or more, the cost of acquisition is increased to compensate for the proportionate increase in the cost inflation index. Under the DTC, no distinction is made between short-term and long-term capital assets. Both would be taxable at normal rates (as applicable to the tax payer). However, the benefit of an

increase in the cost of acquisition, proportionate to an increase in cost inflation index, would be available if the house property is held for a year or more.

STAMP DUTY

Typically, the stamp duty is payable on the purchase/sale of the house property. The levy and computation of duty is prescribed under the Stamp Act of each state, or in the absence of a state Act, under the Indian Stamp Act,1899.If borne by the purchaser, the stamp duty would be added to his cost of acquisition of the house property for the purpose of computation of any gain on subsequent sale/transfer. The stamp duty is also payable on lease/leave & licence agreements.

WEALTH TAX

According to the provisions of the Wealth Tax Act,1957,any immovable property, whether residential or commercial, is considered as a taxable asset. However, specific exclusion is provided in respect of the following house properties: those used as stock-in-trade, or occupied for conducting business or profession, or given on rent for more than 300 days in a year. Wealth tax is payable at the rate of 1% on the taxable wealth exceeding.30 lakh. The DTC has proposed to increase this exemption limit from.30 lakh to.1 crore.