Taxation of Property in India

International Tax   Management of taxes   Tax voice

08 June 2018

Ram Iyer provides an insight into aspects of real estate taxation

My previous articles were on India’s new GST law and the direct tax system. This article reviews certain aspects of the tax law relating to property, i.e. real estate.

Introduction

Taxation of property in India is governed by the Income Tax Act, 1961 (as amended by the annual Finance Acts) together with indirect taxes like GST, stamp duty and property tax. As with most real estate tax regimes, the legislation affects the entire life-cycle of constructing, owning, renting and using a property as well the depreciation, repairs and improvements, sale and the deployment of sale proceeds.

Rented accommodation

Salaried employees living in rented accommodation get a house rent allowance (HRA) as a salary tax deduction, at the lower of:

1. the actual HRA received from the employer,
2. 50% of basic pay (i.e. pay excluding perks and allowances), and
3. actual rent paid less 10% of basic salary.

The 50% limit applies to big cities, whereas it is 40% otherwise.

So, if an employee in a big city receives 100 per month as the HRA (i) component of his salary, whilst his basic pay is 500 (50% of which is 250 (ii)), and the actual rental he pays his landlord is 120 (which, after deducting 10% of the 500 basic pay comes to 70 (iii), then he gets a tax deduction of 70, which is the lowest of (i) 100, (ii) 250, and (iii) 70.

For businesses, rent, rates, taxes, repairs and insurance paid on rented office or residential property used for business purposes is allowed as an expense.

Purchase

GST

The sale of immovable property has, in specified circumstances, been kept out of the scope of the GST legislation that was introduced in July 2017. The exemption is applicable only when a developer sells a completed unit to a buyer.

An under-construction unit, i.e. for which the developer has not yet received the completion certificate from the local authority, will attract GST at an effective rate of 12%. The developer will, however, get input GST benefits in accordance with the GST law.

Stamp duty

Stamp duty is levied on property transactions at varying rates across the country, with a typical rate ranging from 5-7% of the consideration (it is of note that some states provide a 1% rebate for property registered in a woman’s name).

Property registration

There is, in addition, a property registration charge of approximately 1%.

Tax deduction at source

The buyer of the property is required to deduct 1% as TDS (Tax Deduction at Source, i.e. withholding tax) from the consideration, except where the property value is less than Rupees 5 million (GBP 55,000).

Ownership charges

Immovable property that is not owner-occupied is subject to a tax charge as “income from house property”, representing rental income. This could, for example, be the second home of an individual that is occupied by the owner, left vacant or actually let out, or land and buildings owned by a business that is held for rental or capital appreciation purposes.

The tax is based on the annual value, which is the higher of the:

- rent actually received,
- market rental rates for similar property, and
- a deemed rental value from rate tables published by the local authorities.

A Property Tax, based on rates published by local authorities, is allowed as an expense in the year in which it is actually paid. For example, a new 1,000 square feet apartment in Bangalore could have a property tax of roughly Rupees 5,000 (approximately GBP 55) per annum.

A flat 30% deduction from the annual value is allowed as an expense to cover repairs and maintenance, in addition to property taxes and any interest on borrowings. Interest deduction is capped at Rupees 200,000 (approximately GBP 2,200) per annum.

A property developer awaiting the sale of developed (and vacant) units is exempted from this tax for one year from the end of the accounting year in which he gets the certificate of completion of construction.

Main residence

A taxpayer with more than one property has the option to identify any of his properties as his residence. This will leave the other properties owned by that person to be taxed.

If there is only one property, a portion of which is let out, then only the let portion is subject to tax.

If, however, an owned residential property is vacant because the owner lives in another accommodation provided by his employer, then the taxable value is nil.

In general, all corporate tenants and non-corporate tenants subject to tax audits, (currently, professionals with revenues of Rupees 5 million, i.e. GBP 55,000 and traders at double that threshold) are required to deduct withholding tax at 10% (if the annual rent crosses Rupees 180,000, i.e. GBP 1,980) and individuals at 5% (if the monthly rent crosses Rupees 50,000, i.e. GBP 550).

Sale

The computation

Capital gains tax is levied on the difference between the consideration and the aggregate of the cost of acquisition, improvements, indexation (based on the consumer price index) and directly attributable selling costs.

For businesses that get tax depreciation allowance, capitals gains are computed on a pooled basis, i.e. by considering all tax-depreciated property assets as one pool.

Gains in the pool are the difference between:

- the aggregate consideration on sale of all such assets during the tax year and
- the aggregate of the tax-depreciated written down value (tax wdv) of all assets sitting in that pool, and the selling costs.

So, for example, let’s assume that a business had a tax written down value (wdv) of 100 for its pool of office buildings. It sells one building from that pool for 20, net of selling costs. Therefore, 20 will be deducted from 100, leaving a new tax wdv of 80, with no tax to pay, since the aggregate consideration did not exceed the aggregate tax wdv of the pool.

Rollover relief

Capital gains rollover relief on sale of residential house is available to individuals, for reinvesting the gains in another residential house or in specified bonds issued by the government of India (e.g. by the National Highways Authority or the Rural Electrification Corporation). Relief via a new investment in another residential house is available if the new investment is made in the period from one year before and two years after the sale of the old property (the period is extended to three years after if the buyer constructs the new property).

If the amount invested in the new property is less than the gain on the sale of the old, then the excess gain is taxed.

If the gains are reinvested in specified bonds then a similar relief is available under the condition that the bonds are held for at least five years.

Corporate and non-individual taxpayers get rollover relief only if they reinvest gains in specified bonds.

Other rollover reliefs are also available, for example, to encourage businesses to shift their factories and buildings from urban to non-urban areas or to special economic zones, or to encourage individuals to start entrepreneurial ventures (e.g. where the individual sells a residential property and uses the cash to commence a business).

Tax rates

Taxpayers other than companies are subject to a short-term capital gains tax (i.e. for holding periods less than two years) at the income tax rates and to long-term capital gains tax at 20% with indexation. For companies, the short-term rate is the corporate income tax rate (currently 25% for small companies and 30% for others) and the long-term rate is 20% with indexation.

Sales at below deemed market value (as published by local authorities) are taxed using such market value. With a view to clamping down on under-reported transactions, the difference between the market value and the consideration is taxed in the hands of both the seller and the buyer.

Inheritance

There is currently no inheritance tax in India. However, the sale of an inherited property is taxed on the excess of the consideration over the aggregate of the cost to the previous owner (e.g. cost incurred by the father who transmits the property to the son or daughter), indexation (which, as stated earlier, is based on the consumer price index), indexed cost of improvements and selling costs. Indexation has recently been re-based to 1 April 2001 (from the previous 1 April 1981).

Tax overhaul

The government recently obtained stakeholder inputs to completely overhaul India's direct tax law and to replace it with a new Direct Tax Code. The first official communication and plan of action are expected later in the year. Whenever this law takes shape, it will no doubt also have an impact on the taxation of property.