

DIRECT TAX CODE: INCOME FROM HOUSE PROPERTY

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The Direct Tax Code Bill (henceforth referred as “the Code”) was released in August 2009. Presently, it is under consideration and it is expected that the new income tax law will come in force from 1st April, 2011. There are number of changes proposed in the Code in Income from House Property. There is a sea-change in the concept of ‘Rent from House Property’. The analysis of all the proposed changes is attempted in this article.

Present Provisions As per the Income Tax Act, 1961.

1. As per Section 23, the annual value is considered to be higher of the rent actually received or receivable and rent ordinarily receivable in that area for that property. However, if the house is vacant for want of tenant, rent of that period will not be considered as income. Also, if it is not possible to recover the rent from the tenant, that amount is not considered as income. However, whenever the arrears of rent are recovered, such recovered rent is to be considered as income of the year during which the arrears are received.
2. As per another subsection of Section 23, if the owner is staying in the house (Self Occupied) or the house is meant for Self Occupation but is kept vacant because it is not possible for the owner to stay in the house due to his occupation or service conditions; the house is considered to be “Self Occupied” and the value of such house property is considered to be NIL. However, if one received any benefit from such a house, the benefit of “Self Occupied” property is removed. Also, if the house owner owns more than one house property, he can consider one of them to be self occupied ‘at his choice’.
3. As per Section 24, the following deductions are available:--
 - (a) A sum amounting to 30% of Annual Value.
 - (b) If the house property is purchased, constructed, repaired or renovated from money taken on loan (called Housing Loan) then the interest payable on such loan. However, if the house is self occupied and the loan is taken prior to 1st April, 1999, the interest up to only Rs. 30,000 /- is deductible. If the loan is taken after 1st April, 1999 and the house is purchased or constructed within three years from the date of taking loan, the interest up to Rs. 1,50,000 /- is deductible.

There was a serious drawback in the concept of income from house property. The drawback was in the methods adopted to determine the “Rent Ordinarily Receivable” or “Annual Value”. There is a history to these methods. Up to Assessment Year 1975-76, the definition of ‘Annual Value’ was “ that sum for which the house could be given or rent from year to year”. That meant if the house owner got more rent, that was his tax-free income and if got less rent, he still had to pay

tax on the difference. There was a change in law from 1st April, 1976, the definition was changed and addition was made to include the excess rent received, if any. Also vacancy allowance was introduced, thereby, if the house remained vacant for want of tenant, the deduction was made available for the same.

In the cases *Dewan Daulat Rai Kapoor v. NDMC* (1980) 122 ITR 700 (SC), *Amolak Ram Khosla v. CIT* (1981) 131 ITR 589 (SC) & *Mrs. Shiela Kaushik v. CIT* (1981) 131 ITR 435 (SC); it has been held by the Supreme Court that the annual value of a house property shall be the 'rent that is gettable after consideration of all relevant factors' or 'rent as decided by municipal authorities' whichever is more. However, this amount is limited to 'Standard Rent as decided by the relevant rent control act, wherever rent control act is applicable.' After 1975, this situation was changed and if the rent actually received was more than any of these figures, that actual rent received was considered to be the annual value. The rent control acts in many states have not been revised for ages. Hence, the Standard Rent in those states is very low. Thus, the annual value of the house property that could have been given on rent but was not rented out was very low in certain states. On one hand, this situation created anomaly and on other hand, certain taxpayers (rather tax-non-payers) could actually receive more rent but could show less in their tax returns because the assessment was done on the basis of Standard Rent.

The Finance Act, 2001 removed all the provisions of separate deductions for repairs, rent collection, insurance, ground rent etc. and brought in one standard deduction. Thus only two deductions remained; standard deduction and interest payable on housing loan.

Presently, as per the 1961 Act, if renting of property and machinery can not be separated from each other and if the income from such activity can not be considered as 'Profits and Gains from Business / Profession'; in such a situation, the entire composite rent is considered as 'Income from Other Sources' and deduction is available for expenditure incurred to get the income, for repairs and maintenance, for ground rent, for insurance premium and for depreciation of property as also of machinery.

Provisions as per the Direct Tax Code Bill

Section 23. (1) The income from any house property owned by the person shall be computed under the head "Income from house property".

(2) The income from any house property shall be computed under this head notwithstanding that the letting, if any, of the property is in the nature of trade, commerce or business.

(3) The income from any house property owned by two or more persons having definite and ascertainable shares shall be computed separately for each such person in respect of his share.

(4) The provisions of this section shall not apply,-

(a) to any portion of the property which the person occupies for the purposes of his business, the income from which is computed under the head "Income from business"

(b) to any property which is not ready for use during the financial year.

Section 24. The income from a property shall be the gross rent as reduced by the aggregate amount of the deductions referred to in section 26.

Section 25. (1) The gross rent in respect of a property shall be the higher of the amount of contractual rent and presumptive rent, for the financial year.

(2) The contractual rent referred to in sub-section (1) shall be the rent receivable by the assessee under a contract, whether in writing or otherwise.

(3) The presumptive rent referred to in sub-section (1) shall be six per cent. of –

(a) the ratable value fixed by any local authority in respect of the property; or

(b) the cost of construction or acquisition of the property if no such value has been fixed by the local authority.

(4) The gross rent shall, regardless of anything to the contrary contained in subsection (1), be taken to be nil if the property consists of a house or part of a house which is not let out.

(5) The provisions of sub-section (4) shall not apply if-

(a) the house or part of the house is actually let during any part of the financial year; or

(b) any other benefit is derived from it by the owner.

(6) The provisions of sub-section (4) shall, in a case where a person owns more than one house, apply only in respect of one house, which the person may specify at his option.

Section 26. (1) The aggregate amount of deductions for the purposes of section 24 shall be the following:-

(a) the amount of taxes levied by a local authority in respect of the property if the amount is actually paid during the financial year;

(b) the amount of tax on services paid to the Central Government in respect of rent, if the amount is actually paid during the financial year;

(c) a sum equal to twenty per cent. of the gross rent determined under section 25, towards repair and maintenance of the property;

(d) the amount of any interest,-

(i) on capital borrowed for the purposes of acquiring, constructing, repairing, renewing or reconstructing the property, or

(ii) on capital borrowed for the purpose of repayment of the capital referred to in sub-clause (i).

(2) The aggregate amount of deduction referred to in sub-section (1) shall be nil in respect of the property referred to in sub-section (4) of section 25.

Section 27. The amount of rent received in advance shall be included in the gross rent in the financial year to which the rent relates.

Analysis of the Proposed Provisions

1. The present concept of 'Annual Value' has given way to a new concept called 'Gross Rent'. Gross Rent means 6 percent of the ratable value of the property as determined by the local self governing body. If such valuation is not done, then six percent of the purchase cost or construction cost will be considered as Gross Rent. The words 'Six Percent' have a meaning. It means that if the house is given on rent, the entire money value of the house will be recovered in 16.66 years (about 20 – 25 years after consideration of reducing value of rupee). This appears to be reasonable. Also, if we see current rent at various places, we find the concept is reasonable. For example, a house costing Rs. 30 Lakh is expected to be given on rent for Rs. 1,80,000 /- a year or for Rs. 15,000 /- a month as per the Code. This appears to be more or less correct assumption. The only problem is that a number of factors affect both purchase cost of a house as well as rent receivable. Especially, if there is a huge time gap between date of acquisition and date when house is given on rent, there may creep in some disparity.
2. Presently, municipal taxes are deducted from Gross Annual Value and Standard Deduction of 30% of the remaining amount as also of interest paid on housing loan is given. As per the Code, the assessee will get deduction of 20% amount of the Gross Rent, of municipal taxes paid and of interest paid on housing loan. We can see the effect by an example. Suppose The cost of house is Rs. 30 Lakh, rent being received per month is Rs. 15,000 /-, municipal tax paid is Rs. 20,000 /- and interest paid on housing loan is Rs. 51,000 /-, the Income from House Property will be as computed below:-

(a) Present Method:

	Rs.	Rs.
Gross Annual Value		1,80,000
(Less) Municipal Taxes Paid	20,000	
Net Annual Value		1,60,000
(Less) Standard Deduction 30%	48,000	
(Less) Interest Paid	<u>51,000</u>	99,000
Income from House Property		61,000 /-

(b) Method as per the Code

	Gross Rent		1,80,000
(Less)	Municipal Taxes	20,000	
(Less)	Standard Deduction 20%	36,000	
(Less)	Interest Paid	<u>51,000</u>	1,07,000
	Income from House Property		73,000 /-

We can see from this example that the taxable income has increased when the standard deduction has reduced to 20% from 30%.

3. As per the Code, if the house property is given on rent for any purpose, the rental income is considered as 'Income from House Property' and NOT as 'Profits and Gains from Business or Profession' or as 'Income from Other Sources.' Presently, if a building (along with installed machinery) is given on rent, such rent is not considered as 'Income from House Property'. The assessee can claim depreciation on both house and machinery. Once the Code becomes law, the assessee will not be able to claim such depreciation.
4. The most controversial provision as per the Code is that as per Section 26(2), if the Annual Rent is NIL, no deduction is applicable. Presently, if the annual value is NIL (that means 'Self Occupied' house) deduction of interest (up to Rs. 1,50,000 /-) on housing loan is available. This one aspect was the basis of tax planning for many individual taxpayers. All such taxpayers will definitely feel this provision to be unreasonable.

If the legislature feels that 'there can be no deduction if there is no income'; there should have been a statement that 'the total of deductions can not exceed the gross rent'. Such statement does NOT exist in the Code. That means there can be loss from this source of income. Then why harass the assesseees – mostly salary earners. Even if they accept the said provision, what about those who had taken house loans earlier? All these things are required to be discussed in depth before the bill is passed.

The Code mentions about advance rent and also about rent receivable; but is silent about rent received late or about rent not received at all. Is some relief available to the assessee if the rent is not received during the relevant financial year? This question remains unanswered.

Second unanswered question is about interest paid prior to year of possession. Presently, the deduction is available in five equal installments starting from the year of possession. Similar provision is required in the Code.

To conclude, it appears that the legislature has made things difficult for certain class of assesseees while making simpler provisions regarding 'Income from House Property' in the Code.