Impact of Finance Bill 2017 on Real Estate Industry

Hon'ble Finance Minister Shri Arun Jaitley presented Finance Bill 2017 on 1st February 2017. The bill proposed amendments for various sectors. With Real Estate sector having significant impact on the economy of India, the Hon'ble Finance Minister proposed several amendments to it. The proposed amendments intend to encourage the sector, bring clarity to taxation of certain complex arrangements and also to restrict tax evasion arrangements. The author, in this article, discusses the proposed amendments in Finance Bill 2017 relating to immovable property and those affecting the real estate industry. Read on to know more...

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A] Period of holding of immovable property shortened to qualify it as Long Term

Relevant Section: 2(42A)

Background:

Last year, Finance Act 2016 inserted third proviso to Section 2(42A) of Income-tax Act (Act) which contains the definition of short term capital asset. According to the said proviso, the period of

holding in case of shares of unlisted company was reduced from thirty six months to twenty four months.

Proposed Amendment:

Now, Finance Bill 2017 has extended the eligibility of capital asset to qualify as Long Term to immovable property being land or building or both. Thus as per proposed amendment, the immovable property held as capital asset, will be considered as long term if held for more than twenty four months and hence indexation benefit will be available. This amendment is proposed to promote real estate sector and to make it more attractive for investment.

This amendment is proposed to be effective from 1st April 2018 and hence will be applicable from assessment year 2018-19 onwards.

Possible Impact of Amendment:

Section 54 & 54F affected:

This proposed amendment may call for amendments to Section 54 & 54F. The benefit of exemption from capital gains on sale of residential house property as given under Section 54 & 54F stands withdrawn if the new house property purchased is sold within a period of three years from the date of its purchase. Now in light of the proposed amendment to Section 2(42A), the house property sold after twenty four months would be long term. However, if the said house property was purchased to claim exemption u/s 54 or 54F and now sold on completion of two years then one may lose exemption benefit claimed earlier u/s 54 or 54 F.

Illustration:

Suppose someone has sold the house property and purchased a new house property in April 2015 to claim exemption under Section 54. Considering the revised period for long term asset of 24 months, if he sells the said house property in June 2017, then the gain would be long term capital gain. However, as per the restriction imposed by Section 54(1) & 54F(3), if the new house property purchased in April 2015 is sold before April 2018, then the benefit of exemption claimed by purchasing house property in April 2015 stands withdrawn in year 2018.

To encounter this issue, the relevant clauses u/s 54 & 54F shall also be amended to compliment the proposed amendment to Section 2(42A). The minimum period of holding of new house property shall be amended from three years to two years.

Now in light of the proposed amendment to Section 2(42A), the house property sold after twenty four months would be long term. However, if the said house property was purchased to claim exemption u/s 54 or 54F and now sold on completion of two years then one may lose exemption benefit claimed earlier u/s 54 or 54 F.

B] Notional rent income from stock in trade of real estate developers.

Relevant Section: 23

Background:

Section 23 provides the method of computation of annual value of the house property.

The taxation of rental income in case of real estate developers has always been a matter of litigation. The major issue for litigation has been whether rental income is to be taxed under the head "Income from House Property" or "Business Income". There are judicial precedents in favour of revenue as well as assesse.

In the following cases, it was held that rental income of developer is taxable as Income from House Property and not as Business Income:

- *Shambhu Investment Pvt. Ltd. TS-5004-SC-2003-O*
- *East India Housing & Land Development Trust Ltd. TS-5048-SC-1960-O*
- *Roma Builders Pvt. Ltd. TS-5112-ITAT-2011(Mumbai)-O*

However, Mumbai ITAT in the case of Hiranandani Developers Pvt. Ltd. [TS-5582-ITAT-2009(Mumbai)-O] held that rental income of developer from letting out property for temporary period is to be considered as Business Income.

Proposed amendment:

Finance Bill 2017 has proposed an amendment to Section 23 to cover cases where the building or land thereto is held as stock in trade and not let out during the whole or part of the previous year then the annual value of such property shall be taken as Nil for the period upto one year from the end of the financial year in which completion certificate of construction of property is obtained from competent authority.

This amendment shall be effective from 1st April 2018 and hence applicable from assessment year 2018-19 onwards.

Possible Impact of Amendment:
The proposed amendment is applicable to the cases in which property is held as stock in trade and not let out during the year or part of the year. Further, the term used is property and hence it covers commercial as well as residential properties held as stock in trade. Thus, the amendment classifies the rental income of developers as Income from House Property and consequently the notional rental income for the vacant period can be taxed after expiry of one year from the end of financial year in which completion certificate is obtained. Once notional rent is taxed under the Income from House Property, then actual rent may also be taxed under the same head of income instead of taxing it as Business Income.

Tax Authorities may consider this amendment as clarificatory in nature and apply this principle to pending litigation matters and assessments to tax rental income as Income from House Property and also notional rent on vacant properties.

Considering the overall slowdown in real estate sector, the developers having high inventory may face difficult situation due to taxation of notional rent on unsold units.

C] The ceiling introduced on House Property Loss set off

Relevant Section: 71
Background:
As per existing provision, the deduction of interest on housing loan on self occupied house property is allowed to the extent of rupees two lakhs. In case of house property let out or deemed to be let out, there is no maximum ceiling on the amount of deduction of Interest on housing loan. Hence, one can claim deduction of actual housing loan interest payable which may result into loss under the head Income from house property and can be set off against other heads of income in the same year. As per Section 71B, the balance of loss under the head income from house property can be carried forward to eight subsequent years and can be set off only against the income under the head income from house property.

Considering the overall slowdown in real estate sector, the developers having high inventory may face difficult situation due to taxation of notional rent on unsold units.

Proposed Amendment:
Finance Bill 2017 has proposed an amendment to Section 71 restricting set off of the interesting on housing loan on let out or deemed let out house property only to the extent of rupees two lakhs.

This amendment is applicable from 1st April 2018 which is applicable from assessment year 2018-19 onwards.

Possible Impact of Amendment:
The deduction of entire amount of housing loan interest payable can be claimed while computing income under the head Income from House Property which may result into loss under the said head. However, said loss can be set off only to the extent of rupees two lakhs against income under the other head in the same year.

The provisions relating to carry forward and set off of loss from house property in subsequent years is same as specified under Section 71B of the Act. The loss can be carried forward for subsequent eight years and can be set off only against Income from House Property.

D] Capital gain on land transfer Joint Development Arrangement in the year of completion

Relevant Sections: 2(47) (v), 45(5)
Background:
As per the existing provisions, transfer of capital asset involving the allowing of the possession of any immovable property is to be taken or retained in part performance of a contract as referred in Section 53A of the Transfer of Property Act, 1882. Hence, the transfer of possession of land even without transfer of legal title is considered as transfer of capital asset resulting into capital gains. Considering this situation, at present, when a land owner enters into Joint Development Arrangement (JDA) with the developer and transfers possession of the land, it triggers capital gains at initial stage resulting into hardship to the land owner. The land owner in most of the cases receives the consideration in the form of cash or built up area at a much later stage of the project. However, the capital gains liability arises at the time when JDA is entered into.

Considering the appreciation in property prices from 1981 to 2001, the fair market value of property as on 1st April 2001 would be beneficial for the assessee, especially in the cases where it is an immovable property acquired by ancestors. The deduction for expenditure as cost of improvement will be allowed only for those expenses which are incurred after 1st April 2001.

Proposed Amendment:

To encounter the hardship to the land owner, Finance Bill 2017 has proposed a new Section 45 (5A) to provide that in case of an assessee being individual or Hindu Undivided Family (HUF), who enters into specific arrangement for development of a project, the capital gains shall be chargeable to income tax as income of the previous year in which certificate of completion for whole or part of the project is issued by the competent authority.

The aggregate of stamp duty valuation of the land or building or both on the date of issuing the certificate of completion by the competent authority and additional consideration received by the landowner is to be considered as full value of consideration for the purpose of computation of capital gains.

The benefit of proposed Section 45(5A) will not be available to the assessee who transfers his share in the project on or before the date of issue of said certificate of completion.

Further, new Section 194IC is proposed to be inserted to identify the cases of JDA. In case if cash consideration is payable under the JDA, then developer has to deduct tax at source at the rate of 10% from the payment of such cash consideration.

These amendments shall be effective from assessment year 2018-19.

Possible Impact of Amendment:

The stamp duty value in the year of completion would be higher as compared to the year in which project starts. It is likely to result into higher full value of consideration and consequently higher capital gains tax liability. As the capital gain liability will be postponed till the year the project is completed in part or full, it will be a big relief to the land owners entering into Joint Development Arrangements.

E] The base year for capital gains computation shifted from 1981 to 2001

Relevant Section: 55

Background:

As per existing Section 55 of the Act, the computation of capital gains in respect of capital assets acquired before 1st April 1981, the assessee has an option of either to take actual cost of acquisition of asset or fair market value of the asset as on 1st April 1981. The cost of acquisition incurred after 1st April 1981 only is to be considered for the claim of deduction. Thus the base year is considered as 1981 which is over three decades old resulting into difficulties in arriving at fair market value for the assessee.

Proposed Amendment:

Finance Bill 2016 has proposed amendment to Section 55 of the Act to shift the base year from 1981 to 2001. It is proposed that the cost of acquisition of capital assets acquired before 1st April 2001 shall be taken at the option of the assessee either the actual cost of acquisition or fair market value as on 1st April 2001.

These amendments are proposed to take effect from 1st April 2018 and hence will be applicable from assessment year 2018-19.

Possible Impact of Amendment:

Considering the appreciation in property prices from 1981 to 2001, the fair market value of property as on 1st April 2001 would be beneficial for the assessee, especially in the cases where it is an immovable property acquired by ancestors. The deduction for expenditure as cost of improvement will be allowed only for those expenses which are incurred after 1st April 2001.

F] Section 80IBA

Background:

Last year, Finance Bill 2016 introduced Section 80IBA which provides for 100% deduction of profits derived from developing and building housing projects subject to certain conditions. Those conditions included the limit of 30 square meters for built up area of residential unit in respect of project located in Chennai, Delhi, Kolkata and Mumbai or within 25 kms. from Municipal Limits of these four cities. Further, the said project shall be completed within a period of three years.

Proposed Amendment:

Now, Finance Bill 2017 has proposed changes to these conditions which are as follows:

1. The size of the residential unit shall be measured as "Carpet area" as defined under Real Estate (Regulation & Development) Act, 2016 and not as "built-up area".
2. The restriction of 30 square meters on the size of the residential unit shall not apply to the projects located within a distance of 25 kms from the Municipal limits of Chennai, Delhi, Kolkata or Mumbai.
3. The period for completion of construction is extended from three years to five years.

These amendments shall take effect from 1st April 2018 and hence will apply from assessment year 2018-19 onwards.

Possible Impact of Amendment:

The section is silent about deduction in case of part completion of the project. Hence, extension of period for completion from three years to five years will be useful.

Change of measurement from "Built up" to "carpet area" is likely to result into increase in saleable area of the residential unit.

G] Widening the scope of TDS on rent:

Relevant Section: 194IB

Background:

Presently, individual or HUF to whom tax audit under Section 44AB is applicable for any financial year immediately preceding the financial year in which rent in excess ₹180,000 is paid is required to deduct tax at source at the rate of 10% under Section 194I of the Act.

Proposed Amendment:

Finance Bill 2017 has proposed to introduce new Section 194IB according to which the TDS requirement is extended even to those individual and HUFs to which tax audit under Section 44AB

It may restrict false House Rent Allowance claims where high amount of rent payments are shown to claim HRA benefit. The information relating to property owners earning high amount of rent will be available with tax authorities and possible tax evasion on said rental income can be plugged.

is not applicable and the amount of rent paid to resident is exceeding ₹50,000 per month or for part of the month. The proposed rate of TDS is 5% on the amount of rent. The said TDS is required to be done only once in a year at the time of crediting rent for the last month of the previous year or in case if tenancy ends during the year, then at the time of last rent credited at the end of tenancy.

As proposed Section 194IB is applicable to those individuals and HUFs to whom tax audit under Section 44AB is not applicable, the said deductors are not required to obtain Tax deduction Account Number (TAN) as per Section 203A of the Act.

It is further proposed that if deductor under this section is required to deduct tax under Section 206AA, then the amount of deduction shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy, as applicable.

This amendment is proposed to be effective from 1st June 2017.

Possible Impact of Amendment:

It may restrict false House Rent Allowance claims where high amount of rent payments are shown to claim HRA benefit. The information relating to property owners earning high amount of rent will be available with tax authorities and possible tax evasion on said rental income can be plugged.

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To conclude, it can be said that the Union Budget 2017 has proposed several positive measures to strengthen and promote the structure of the Indian Real Estate Sector that shall have significant impact on the economy of India. ■

Even if you are on the right track, you will get run over if you just sit there. - Will Rogers