How is tax computed on rental income?

Sandeep Shanbhag

Tax is applicable where there is income and essentially there can be only two kinds of incomes related to property — rental income and capital gains when property is sold.

Tax on rental income

The basis of calculating income from house property is the rental value. This is the inherent capacity of the property to earn income. Property income is perhaps the only income that is charged to tax on a notional basis. This charge is not based on the receipt of any income per se, but is on the inherent potential of the house property to generate income.

The first property that one buys is exempt from income tax, but only if it is not let out on rent. A notional rent value based on the market rental value will be adopted as taxable income from second property onwards, even if it's kept under lock and key.

To put it differently, even if you earn no income whatsoever from the second property, it will be taxable as if you have put it out on rent. Therefore, it is advisable to rent out the second property since you will be obliged to pay tax on an assumed rental value.

When a property is not let out or is self occupied, only that property is exempted from tax.

Tax deduction

There are two types of tax deductions available on income from property apart from the actual municipal taxes paid. The first is standard deduction of 30%. This means 30% of the rental income can be reduced as a standard deduction for repairs, maintenance etc. irrespective of the actual amount spent, if at all, during the financial year.

The second deduction, which is over and above the 30% standard deduction, is to do with interest on mortgage finance if the property is purchased on mortgage.

In case the property is tax-free, the interest deduction is restricted to ₹1.5 lakh. In other words, irrespective of the amount of interest paid, if you do not pay any tax on the property, the deduction on account of the interest paid has a ceiling of ₹1.5 lakh.

However, for properties that are taxable on either actual rent or notional rent, the entire amount of interest paid without any limit is deductible.

Nowadays, due to high property prices, in almost all cases, the interest amount far exceeds the rentals. Investors generally buy properties for the capital appreciation potential and put it on rent so that the asset does not remain idle and is maintained. However, today rental yields have fallen to around 3-4% pa.

For rented properties, the entire amount of interest payable can be adjusted against the rent and any amount that is left over may be carried forward in the tax return as loss from property to the next year.

This is very important from a tax planning point of view. Such carry forward of the unabsorbed interest can be done for a continuous period of eight years. Over the years, as the loan gets paid off, the interest component that is getting set-off against the rental income each year will keep on reducing. On the other hand, typically, the rent would tend to increase (increment) each year. This will go on to lead to a positive differential between the rent received and the interest paid and this difference would be taxable. At this point, the carried forward interest will be extremely useful to reduce tax liability.

If you wish to carry forward loss, it is mandatory to file the tax return by July 31 (for individual taxpayers). Without filing the tax return — and that too by the due date prescribed — carry forward of loss will not be allowed.

Interest deduction on a property can be only after taking possession of it. Often people buy properties under construction where the mortgage payments begin during the construction phase itself. So what happens to the interest paid pre-possession?

Such interest can be claimed for tax deduction in five equal installments starting from the year in which the possession is obtained.

For instance, say someone has bought a property under construction in FY 2008-09 and is paying an annual interest of ₹20 lakh. He gets the possession in FY 2010-11. Therefore, he has paid a pre-possession interest for 2008-09 and 2009-10 of ₹40 lakh. One fifth of ₹40 lakh, that is ₹8 lakh, can be claimed during 2010-11 over and above the ₹20 lakh that he may pay in 2010-11. Therefore, the deduction of interest for 2010-11 would be ₹28 lakh (₹20 + ₹8 lakh) assuming the property is rented or else the deduction is restricted in to ₹1.5 lakh. Next time we shall examine in detail the capital gains that arise from sale of property.

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Parking charges collected are not liable to tax

Mehul Sheth

My client has a land which is used for parking cars by general people by paying parking charges. Is service tax applicable on parking services?

—CA Surinder Mittal

As per the definition of taxable service under the service category renting of immovable property service, taxable service with effect from June 1, 2007 means "any service provided or to be provided to any person, by any other person by renting of immovable property or any other service in relation to such renting for use in the course or furtherance of business or commerce.

SERVICE TAX QUERIES

Explanation 1: For the purposes of this sub-clause, "immovable property" includes:

(i) building and part of a building, and the land appurtenant thereto;

(ii) land incidental to the use of such building or part of a building;

(iii) the common or shared areas and facilities relating thereto; and

(iv) in case of a building located in a complex or an industrial estate, all common areas and facilities relating thereto, within such complex or estate, but does not include—

(a) vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes;

(b) vacant land, whether or not having facilities clearly incidental to the use of such vacant land;

(c) land used for educational, sports, circus, entertainment and parking purposes; and

(d) building used solely for residential purposes and buildings used for the purposes of accommodation, including hotels, hostels, boarding houses, holiday accommodation, tents, camping facilities.

(v) vacant land, given on lease or licence for construction of building or temporary structure at a later stage to be used for furtherance of business or commerce.

Explanation 2: For the purposes of this sub-clause, an immovable property partly for use in the course or furtherance of business or commerce and partly for residential or any other purposes shall be deemed to be immovable property for use in the course or furtherance of business or commerce [Section 65(105)(zzzz)]

Based on the above definition of taxable service it can be seen that vacant land used for parking purposes is outside the preview of taxable service because of the specific exclusion provided to it under explanation 1 (iv) (c) and hence your client shall not be liable to pay service tax on the parking charges collected by him.

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Use cards judiciously to improve credit score

Abitha Deepak

The average Indian shopper today is likely to have at least two credit cards in his wallet. In fact this number has been on the rise with banks and credit card companies sending free lifetime credit cards with 'attractive features' to anyone who they think fits the bill. These cards sometimes come as a 'surprise gift'.

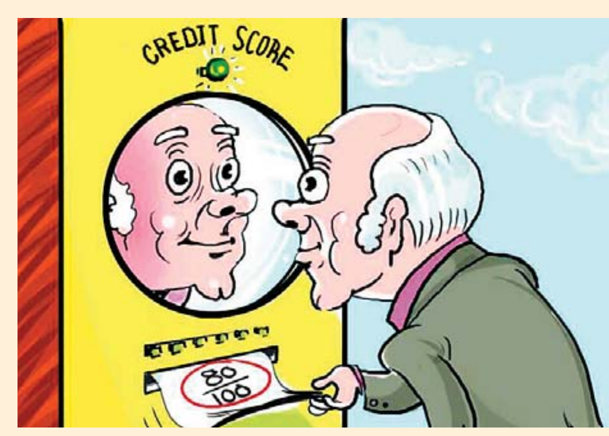
As a customer you have the choice to use the card or return it. If you receive a credit card, which you had not asked for you just need to cut it into two and send it back to the bank, declining the offer.

The more cards you have the more tempted you will be to avail the offers on each of them and at some point in time discipline could give way to reckless spending leading you into a maze of spiralling debt before you realise what hit you.

For a spender who is not disciplined in prompt repayments, debt can mount in accelerated proportions.

If you use your credit cards extensively or even if you use it once in a while, it would be prudent to access your credit report from Cibil (Credit Information Bureau (India) Limited). You can manually access your credit report by placing a request with Cibil, details of which are available at www.cibil.com. Though currently you can pay for this report through Cibil's online payment gateway, you cannot access your credit report online as of now but this will be enabled in future. Once you make your payment Cibil will send you a hard copy of your credit report to your postal address.

Having access to credit reports is a definite step for the genuine borrower with an excellent credit profile to increase his negotiating power. So, how can you ensure your credit report gives you this negotiating power? Well, what can be the doom for a reckless spender can be an excellent tool for the disciplined borrower. It depends on how you use your credit card. This can be the single most important factor in improving and increasing your credit score.



Here are some pointers on what to do and what not to do in order to achieve this.

1. Judicious use: Making use of a credit card judiciously will help you improve your credit score. Just make sure to choose a card that is suited for you from a well known brand.

2. Low credit limit: Keep a tab on the credit limit of your card. Open a credit card account with a company that will provide you with the highest credit limit possible. High credit limits, even if they are not used, will add merit to your credit score and improve it.

3. Closing credit card accounts: The number of years you hold a credit card account has an impact on your credit scores. So keep your oldest credit and if you must close a card opt for the most recent cards and close them one at a time, maybe once a month over a period of time, as closing them too quickly could also affect your credit score as your available credit limit will take a dip in one go.

4. Bargain for a lower interest rate: If you have never defaulted on payment for a few years, make use of your good repayment track record and speak to the bank officials for a better bargain. Request them to lower your interest rate citing the good track record.

5. Request for hike in credit limit: The most recent card has the highest credit limit. The oldest card has the lowest credit limit. What do you do? In such instances, if you have a good repayment track record, approach the bank and negotiate for a higher credit limit especially since you have been their customer for quite a few years. Most banks will facilitate such a request. You can then go ahead and close your most recent card.

6. Keep a self imposed credit limit: Never exceed 40% of your credit limit. This has a beneficial effect on your credit score. This shows your credit limit is high but you have not burnt it up and have plenty in reserve. This logic helps you attain a much higher credit score. The same logic suggests you should not close any credit card accounts, as they collectively will provide you a high credit limit, which is good for the score.

7. Paying off credit card dues quickly: This will dramatically improve your credit score. Try not to accumulate too much credit card debt. Be wise and pay the dues quickly and keep rotating your cards. Paying off dues timely will spike your credit score.

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Shun equity investments to your own peril

Harshvardhan Roongta

Are you scared of investing in equities thinking the current market scenario will erode your hard earned money? Such fears may be unfounded, for it is possible to protect your capital through a prudent mix of equity and debt investments.

Indeed, though the risk averse may be laughing their hearts out right now —- given the doldrums the equity markets are in —- not including equities in your portfolio may prove a far more risky decision as we move forward.

Let me give you a sample portfolio and demonstrate how you can invest a part of your money in equities, which will boost your overall returns.

Say you have a lump sum of ₹1 lakh to invest with a five-year time horizon. Taking advantage of the high interest rate scenario at present, you could invest 70%, or ₹70,000, in fixed income securities such as bank fixed deposit or debt schemes of mutual funds. You are likely to get about 9-9.5% on this investment. The balance 30%, or ₹30,000, can be invested in good-quality stocks or equity mutual funds. One can expect equities to deliver a return of about 15% over a five-year period. But even if this does not happen, do not fear, for you will not loose a penny of your capital, i.e. ₹1 lakh. The only loss, if at all, will be the potential interest you could have earned on ₹30,000.

The table below will help you understand what you can expect from your portfolio under different circumstances.

You will notice that your capital, i.e. ₹100,000, is safe as the ₹70,000 you have invested in debt has become ₹107,703. The balance amount you invested in equity has the potential to give the push in the total returns on your investments.

In case you do not wish to manage the investments yourself, you could opt for investing in monthly income plans (MIPs) offered by mutual funds, which have a debt: equity mandate of 70:30 or 80:20, as the case may be.

Other scenarios you might be interested to know:

- If the value of equity investments remains the same after 5 years, then the effective return on your entire investment will be 6.60% p.a. compounded.
- If the value of equity investments becomes half after 5 years, then the effective return on your entire investment will be 4.17% p.a. compounded.

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Scenario analysis

Investing ₹1 lakh over 5 years

Option 1	(100% in fixed income product) Bank fixed deposit
Amount	1,00,000
Returns	9% p.a. Compounded
Total value after five years	₹153,862

Option 2	Debt 70%	Equity 30%
Amount	70,000	30,000
Returns	9% p.a. compounded	15% p.a. compounded
Value after five years	₹107,703	₹60,340
Total Value after five years	₹1,68,043	

Thus, the effective return on investment is 10.93%, returns on equity investments being tax-free at present.

Pre-payment charges on floating rate loans end

Continued from Page 1

The rationale?

"Floating rate loans pass on the interest rate risk from banks, which are much better placed to manage it, to borrowers and, thus, banks only substitute interest rate risk with potential credit risk," the RBI circular said.

Currently most banks levy a prepayment charge of up to 2% on the amount being prepaid.

"The high pre-payment charges were a dampener, so much that people used to drop their plans to close their loans," says Dhirendra Kumar, chief executive officer, Value Research, an independent investment information provider.

Still, not many are excited by the RBI move.

To be sure, the number of people who want to prepay their home loans is not significant. "It forms only 2-3% of the total number of people going for a floating rate scheme, and these people are usually from the affluent class," said Kumar.

Raunak Roongta of Motilal Oswal Securities also feels this won't be a big deal. "Usually customers prepay their long term loans within eight years. Also, not all bank charge enormous pre-payment charges. So this may not be as beneficial as it is made out to be," he said.

According to the RBI circular, the Indian Banks Association (IBA) would now standardise the most important terms and conditions for at least ten banking transactions and circulate among banks for adaptation. On issues pertaining to monetary compensation to the customer in case of mental harassment by banks, the RBI/IBA would look into the matter and decide the kind of compensation.

The central bank has also directed banks that in case of any dispute in electronic transactions or transactions through the automated teller machines, the onus will be on the bank to prove the customer wrong. Customer must be compensated for the losses arising out of customers' non-authorised transactions.

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Auto parts makers...

Car air-conditioning supplier Subros has also spoken of deferring a `80 crore investment, which would have raised its capacity by a half-a-million units.

Chairman Ramesh Suri said this investment would be made as soon as car sales improve.

Going by estimates of the Auto Component Manufacturers Association, the industry would witness about $3 billion investment this year, up from $2-2.5 billion in FY11.

Mint Road...

Moreover, in its first avatar, it was available only in longer tenures, which was a put-off.

"People are used to straight bond transactions, while the inflation indexed bond is a more convoluted one. Also, if I get adjusted returns after 10 years, then it is really not an appealing product. If the RBI decides on shorter tenures for such products, say 3 or 5 years, people may be more interested," said Dwijendra Srivastava, head of fixed income at Sundaram Mutual Fund.

Another issue is that such bonds are focussed on protecting the retail customer, whereas a majority of investors in India's debt market are institutions.

"Also, for such a product you need an inflation index which shows the reality. However, the Wholesale Price Index is not very accurate and the Consumer Price Index too has a few volatile components," argues K Ramanathan, chief investment officer with ING Investment Management India.

Talking about the long-drawn discussions on full capital account convertibility, the governor said the RBI will take a "make haste slowly".

"There are no benign soutions to complex, real macroeconomic problems. We have to make choices under uncertainty. We will of course open up capital account convertibility fully, but we will do it slowly," Subbarao said.

Swiss stun all

"If the economic outlook and deflationary risks so require, the SNB will take further measures," it said.

The SNB has warned that economic growth — already flagging in the second quarter — is set to slow sharply in the coming months as the strong franc makes Swiss exports, from luxury watches to drugs, prohibitively expensive.

The franc nearly touched parity with the common currency on August 9.

It dived 8.5 percent against the euro after Tuesday's announcement to 1.203 francs at 1051 GMT and dropped almost 8 percent against the dollar to 0.848.

"That was the single largest foreign exchange move I have ever seen," said World First chief economist Jeremy Cook. "This dwarfs moves seen post Lehman Brothers, 7/7, and other major geopolitical events in the past decade."

Swiss stocks, hurt of late by the strong franc, jumped, with the blue-chip SMI index trading up 4.3%. Reuters

Should you opt for LIC's Jeevan Arogya or SBI Life's Hospital Cash?

Aswathy Varughese ● MUMBAI

Are you looking to buy a health insurance product? There is a new one in the market. SBI Life Insurance, a joint venture between State Bank of India and PNB Paribas Cardif, has forayed into the health insurance business by launching Hospital Cash, a fixed benefit health insurance plan.

At face value, SBI Life's Hospital Cash plan looks very similar to Life Insurance Corporation of India's (LIC) Jeevan Arogya. However, both have different features and to understand it better let us dissect each feature individually.

SBI Life's Hospital Cash plan gives fixed daily allowance to the policy holder for every day of hospitalistion, irrespective of the hospital bill amount. "Daily hospitalisation cash benefit (DHCB) provided under the health plan pay from first day of hospitalisation without any deductible," says Abhay K Raj, head - products and marketing, SBI Life. Expenses incurred before, during and after discharge are covered through the allowance.

LIC's Jeevan Arogya is also a fixed benefit plan which covers hospital cash benefit, day care procedure benefit, fixed benefit irrespective of the medical cost, no claim benefit and ambulance expenses.

During the first year of the policy, LIC's product provides hospitalisation benefits for 30 days while in the second year it is 90 days. Hospital Cash during the first and second years of policy provides hospitalisation benefit for 100 days.

As for payouts, Hospital Cash payout starts from day one of hospitalisation. Coverage of pre-existing diseases after 2 years, guaranteed coverage up to 75 years, premium guarantee for 3 years, enhanced sum assured and increased payouts on each policy anniversary in case of no claim and tax benefit under sec 80 D of IT Act are the other features of this plan.

It also provides an additional fixed lump sum of Rs 10,000 which is payable to policyholders covering two or more family members under the plan. Bonus upto 40% of enhanced sum assured without increase in premium, discount of 2.5% on premium on renewal of policy, family rebates upto 10% and premium guarantee for three years are other features of the plan.

Under SBI Life's plan, hospitalisation at (ICU) will be available for 50 days each year of the policy tenure, whereas LIC's Arogya offers only 380 days of intensive care hospitalisation for the entire policy period. When admitted in ICU, the SBI Life policyholder will receive an amount twice that of DHCB.

Jeevan Arogya provides health insurance cover against certain specified health risks. It covers major surgical expenses too. Hospital Cash plan, on the other hand, does not cover any surgical expenses.

For Jeevan Arogya, the minimum age for entry is and the maximum is 65 and tax benefit is available to policy holders.

Jeevan Arogya is a comprehensive non-linked health insurance plan whereas SBI Life's product is not a comprehensive one. According to SBI Life's appointed actuary Sanjeev Pujari, compared to other health plans Hospital Cash plan is a lower benefit plan and hence it is cheaper too.

MN Rao, MD & CEO, SBI Life said, "Our foray into health insurance is to address the issues of rising healthcare costs and acute under penetration of health insurance in India." SBI plan is available online too.