

## Tax Planning Through Home & Home Loan

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Siddheshwar T. Gadade & CA. Pradeep D. Kamthekar

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### **Abstract**

*Purchase of "Home through Home Loan" is the preferred tax planning option available to salaried people wherein they not only save considerable amount of tax by availing tax benefit under section 24 as well as section 80C of the Income Tax Act, 1961 but also own their dream home through the same. Here one must understand that if anyone already owns a home for his/her residence then also one can go for a 2<sup>nd</sup> home and if possible for a 3<sup>rd</sup> home and so on (can let out the same for a considerable amount of rent), with the help of home loan. This maximizes the tax benefits and earnings of an individual which goes beyond 50% in some cases as shown under this study. In this paper some case studies are undertaken to explain the tax benefits and earnings made by an individual (having salary income) by owning home for residence or for let out purpose. It has been concluded that the "Tax Planning Through Home Loans" is the best tax planning option available to an individual.*

**Keywords:** Tax Planning, Home, Home Loan, Income Tax Benefits

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### **Introduction :**

Tax Planning means saving of tax by way of investment made by an individual in specified securities as per the provisions mentioned in the Income Tax Act, 1961. Many individuals look at the section 80C only, as a tax planning tool, wherein one can invest in the listed securities up to a maximum of Rs. 1,00,000. This limits the scope of tax planning for an individual, especially a salary earner, which forms the major class of the society. Therefore it becomes very important for these people to look for an alternative mode of investment wherein they can save a considerable amount of tax, within the framework of Income Tax Act, 1961.

In this study the decision of purchase of Home through Home Loan has been viewed as :

1. Benefit to Home Loan Borrower
2. Role of Government and Benefit to Government
3. Role of Banks and Benefits to Banks
4. Role of Income Tax Act, 1961
5. Tool of Tax Planning and not of Tax Evasion
6. Illustrative Case Studies

## 7. Capital and Assets Appreciation

## 8. Conclusion

### 1. Benefit to Home Loan Borrower

Purchase of Home through Home Loan decision gives the following benefits to an individual.

- Dream of an individual to own a home (which at times is not possible to have even at the end of retired life with the retirement proceeds) with the help of Home Loan.
- Savings (if at all available with an individual) can be utilized for some other gainful investment (i.e. either in Gold or in the Stock Market etc.).
- There is saving of income tax every year through repayment of home loan as per section 24 and 80C of the Income Tax Act, 1961.
- The market value of Home (i.e. an asset) appreciates over the years which can be used as security to avail top-up loans or loan against property which can be utilized for any purpose like payment of fees for Higher Education, Medical expenses in case of an emergency of heart attacks etc., Marriage expenses and so on.

### 2. Role of Government and Benefit to Government

#### Role of Government :

It is the primary duty of every Government (Welfare State) to provide shelter to its citizens. But it is not feasible for any Government to provide the same to every citizen of the country though it has machinery in the name of Housing and Area Development Authorities and Boards in every state of the country. So the Government has discharged the said duty to a possible extent by inserting tax benefit on home purchase and home loan under section 24 and 80C of the Income Tax Act, 1961. This helps the homeless people to have their dream homes with the help of Home Loans.

#### Benefit to Government :

Government collects huge amount of revenue from those who purchase home, in the name of stamp duty and registration charges which are a major source of income for every state in the country.

### 3. Role of Banks and Benefit to Banks

#### Role of Banks :

Banks grant home loans to borrowers to own home (with certain conditions), under various options within no time (provided the conditions are fulfilled in entirety) and help the Government in discharging its primary obligation of providing shelter to the citizens of the country.

#### Benefits to Banks :

Banks enjoy enormous benefits by granting home loan to their borrowers as follows:

- They earn huge amount of interest income on the home loan, top-up loans and loan against properties granted to their borrowers on the security of home.
- Home is the most secured asset against which the banks finance loan to their borrowers, as compared to other loans.
- Since the dream home of an individual is mortgaged (given as security) for the home loan, top-up loan and loan against security (as the case may be), an individual pays the instalments of the said loan in time every month, hence there is remote chance of such a loan becoming as bad and non-performing asset (NPA) for the banks.

#### 4. Role of Income Tax Act, 1961

Income Tax Act, 1961 gives the following tax benefits to an individual who owns a home through home loan:

##### **Deduction U/s. 24 :**

- **For Self Occupied Property (SOP) :**

Interest paid/payable on home loan is allowed to be deducted from NIL annual value of the home to the tune of Rs. 1,50,000 (if home is acquired on or after 01.04.1999), otherwise Rs. 30,000.

- **For Let Out Property (LOP) :**

Full amount of Interest paid/payable on home loan is allowed to be deducted from annual value of the home, to the tune of Rs. 1,50,000 (if home is acquired on or after 01.04.1999), otherwise Rs. 30,000.

##### **Deduction U/s. 80C :**

Under section 80C of the Income Tax Act, 1961 a deduction of Rs. 1,00,000 (maximum) is allowed subject to payment of the same for purchase of home, construction of home, payment of stamp duty and registration charges on the agreement of purchase/construction of said home and repayment of home loan principal amount.

##### **Set off of Loss Under Section 71B :**

Negative income in case of Income from house property (which is always there for SOP and possible in some cases of LOP) such as set off amount of loss under section 71B of the Income Tax Act, 1961 is allowed to be adjusted against positive income under other heads and contributes to savings in tax, at the applicable rate.

#### 5. Tool of Tax Planning and not of Tax Evasion

Savings of income tax and making tax planning for the same through home loan option, is a well exercised option by a number of individuals from the society. It is well within the framework of law (Income Tax Act, 1961), so it does not amount to tax evasion (which is illegal and not allowed) but amounts to tax planning.

## 6. Illustrative Case Studies

Assumptions of Case Studies of Self Occupied Property:

1. 50% of the Gross Salary has been taken as an eligible amount, which forms the basis of sanction and disbursement of home loan amount and individuals avail the full amount of home loan that they are eligible for.
2. Home Loans under the case studies are taken @10% p.a. of interest for a period of 20 years on reducing balance basis.
3. All the Home Loans under the case studies are purely home loans and none of them are in the nature of top-up and loan against property.
4. All the individuals under the case studies pay their instalments of home loans regularly without any default.
5. Income tax calculations are made as per rates applicable for Assessment Year 2010-2011.
6. An individual is using the home (purchased with the help of home loan) for residence of himself/herself and his/her family and has not let it out to anybody.

### (A) Self Occupied Properties (SOPs) :

Case Study No. 1 (Male)

Gross Salary : Rs. 30,000 per month

Loan Eligible & Availed of : Rs. 15,54,000 @10% for 20 years

Loan EMI : Rs. 15,000

Particulars	Before Home Loan		After Home Loan	
	Rs.	Rs.	Rs.	Rs.
<b>Income from Salary :</b>				
Salary (30,000 x 12)		360,000		360,000
Less : Profession Tax u/s. 16(iii)	2,500	357,500	2,500	357,500
<b>Income from House Property :</b>				
Self Occupied Property (SOP)				
Annual Value			NIL	
Less : Interest on Home Loan u/s. 24 (Maximum Rs. 150,000)			154,241	-150,000
<b>Gross Total Income</b>		357,000		207,500
<b>Less : Deduction U/Chapter VIA :</b>				
U/s. 80C	Providend Fund	18,000		18,000
	Home Loan Principal	18,000	25,759	43,759
		339,000		163,741

<b>Tax on Above</b>		<b>22,454</b>	<b>385</b>
<b>Savings in Tax (Earnings)</b>	22,069		
<b>Amount paid as Instalment</b>	180,000		
<b>Percentage of Earnings</b>	12.26%		

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**Case Study No. 2 (Female)****Gross Salary : Rs. 30,000 per month****Loan Eligible & Availed of : Rs. 15,54,000 @10% for 20 years****Loan EMI : Rs. 15,000**

<i>Particulars</i>	<i>Before Home Loan</i>		<i>After Home Loan</i>	
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
<b>Income from Salary :</b>				
Salary (30,000 x 12)		360,000		360,000
Less : Profession Tax u/s. 16(iii)	2,500	357,500	2,500	357,500
<b>Income from House Property :</b>				
Self Occupied Property (SOP)				
Annual Value			NIL	
Less : Interest on Home Loan u/s. 24 (Maximum Rs. 150,000)			154,241	-150,000
<b>Gross Total Income</b>		357,000		207,500
<b>Less : Deduction U/Chapter VIA :</b>				
U/s. 80C				
Provident Fund		18,000		18,000
Home Loan Principal		18,000	25,759	43,759
		339,000		163,741
<b>Tax on Above</b>		<b>19,364</b>		<b>Nil</b>
<b>Savings in Tax (Earnings)</b>	19,364			
<b>Amount paid as Instalment</b>	180,000			
<b>Percentage of Earnings</b>	10.76%			

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**Summary of Case Studies : Self Occupied Properties (SOPs)**

<i>Case Study No</i>	<i>Male / Female</i>	<i>Salary p.m.</i>	<i>Loan Amount</i>	<i>EMI Amount</i>	<i>I. Tax Before Home Loan</i>	<i>I. Tax After Home Loan</i>	<i>(%) of Savings in I Tax</i>
1	Male	30,000	15,54,000	15,000	22,454	385	12.26
2	Female	30,000	15,54,000	15,000	19,364	Nil	10.76
3	Male	35,000	18,13,000	17,500	34,299	5,814	13.56
4	Female	35,000	18,13,000	17,500	31,209	2,724	13.56
5	Male	40,000	20,72,000	20,000	46,041	11,242	14.50
6	Female	40,000	20,72,000	20,000	42,951	8,152	14.50
7	Male	45,000	23,31,000	22,500	58,865	18,923	14.79
8	Female	45,000	23,31,000	22,500	55,775	15,833	14.79
9	Male	50,000	25,90,000	25,000	76,478	29,781	15.57
10	Female	50,000	25,90,000	25,000	73,388	26,691	15.57
11	Male	55,000	28,50,000	27,500	94,091	40,660	16.19
12	Female	55,000	28,50,000	27,500	91,001	37,570	16.19
13	Male	60,000	31,09,000	30,000	111,704	51,519	16.72
14	Female	60,000	31,09,000	30,000	108,614	48,429	16.72
15	Male	65,000	33,68,000	32,500	130,244	65,752	16.54
16	Female	65,000	33,68,000	32,500	127,154	62,662	16.54

From the above cases it is clear that an individual (male or female) can earn 10% to 17% on the investment in home purchased with the help of home loan. Here principal amount of loan repaid as well as interest paid on the same are treated as investment in home. Principal amount paid towards repayment of loan is always an investment in home but interest also needs to be treated as an investment in the home because one can recover the same over a period of time through an increase in the market value of the home. Also interest is the payment made for utilizing bank's money to own the home which otherwise would not have been possible. So interest on home loan is always to be considered as a part of the investment in the home. This type of return with 100% guarantee and with pleasure of owning and using the dream home is an unique example of tax planning.

**(B) Let Out Properties (LOPs) :**

**Assumptions of Let Out Property Case studies :**

1. An individual is using the home (purchased with the help of home loan) for residence of himself/herself and his/her family members and has not let it out to anybody.
2. 85% of 50% of EMI is taken as Rent received (net of society maintenance and non-occupancy charges).
3. 15% of the amount of rent received is assumed as municipal taxes paid by the

owner.

4. Computation of Income from house property is taken as  
 Rent received  
 (-) Municipal taxes – 15% of rent received  
 (-) 30% of rent received towards standard deduction  
 (-) Interest on Home Loan.

#### Case Study No. 1

Income from Let Out Property

Rent received	
(50% of Rs. 17,500 x 12)	1,05,000
Less : Municipal taxes paid	
(15% of 50% of Rs. 17,500 x 12)	15,750
Less : 30% standard deduction	(26,775)
Less : Interest on Home Loan	(1,79,947)
Income from House Property	(1,17,472)

#### Case Study No. 1 (Male) (LOP)

Gross Salary : Rs. 35,000 per month

Loan Eligible & Availed of : Rs. 18,13,000 @10% for 20 years

Loan EMI : Rs. 17,500

Particulars	Before Home Loan		After Home Loan	
	Rs.	Rs.	Rs.	Rs.
<b>Income from Salary :</b>				
Salary (35,000 x 12)		420,000		420,000
Less : Profession Tax u/s. 16(iii)	2,500	417,500	2,500	417,500
<b>Income from House Property :</b>				
Let Out Property (LOP)				(117,472)
<b>Gross Total Income</b>		417,500		300,028
<b>Less : Deduction U/Chapter VIA :</b>				
U/s. 80C				
Providend Fund		21,000		21,000
Home Loan Principal		21,000	30,053	51,053
		396,500		248,975
<b>Tax on Above</b>		<b>34,299</b>		<b>9,165</b>

<b>Rent Received</b> (85% Net)	89,250
<b>Savings in Tax (Earnings)</b>	25,134
<b>Total Earnings</b>	114,384
<b>Amount paid as Instalment</b>	210,000
<b>Percentage of Earnings</b>	54.47%

**Case Study No. 2****Income from Let Out Property**

<b>Rent received</b>	
(50% of Rs. 17,500 x 12)	1,05,000
<b>Less : Municipal taxes paid</b>	
(15% of 50% of Rs. 17,500 x 12)	15,750
<b>Less : 30% standard deduction</b>	(26,775)
<b>Less : Interest on Home Loan</b>	(1,79,947)
<b>Income from House Property</b>	(1,17,472)

**Case Study No. 2 (Female) (LOP)****Gross Salary : Rs. 35,000 per month****Loan Eligible & Availed of : Rs. 18,13,000 @10% for 20 years****Loan EMI : Rs. 17,500**

<i>Particulars</i>	<i>Before Home Loan</i>		<i>After Home Loan</i>	
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
<b>Income from Salary :</b>				
Salary (35,000 x 12)	420,000		420,000	
Less : Profession Tax u/s. 16(iii)	2,500	417,500	2,500	417,500
<b>Income from House Property :</b>				
Let Out Property (LOP)				(117,472)
<b>Gross Total Income</b>		417,500		300,028
<b>Less : Deduction U/Chapter VIA :</b>				
U/s. 80C				
Providend Fund		21,000		21,000
Home Loan Principal		21,000	30,053	51,053
		396,500		248,975
<b>Tax on Above</b>	31,209		6,075	

<b>Rent Received</b> (85% Net)	89,250
<b>Savings in Tax (Earnings)</b>	25,134
<b>Total Earnings</b>	114,384
<b>Amount paid as Instalment</b>	210,000
<b>Percentage of Earnings</b>	54.47%

#### Summary of Case Studies : Let Out Properties (LOPs)

Case Study No	Male / Female	Salary p.m.	Loan Amount	EMI Amount	I. Tax Before Home Loan	I. Tax After Home Loan	Net Rent Received	(%) of Earnings
1	Male	35,000	18,13,000	17,500	34,299	9,165	89,250	54.47
2	Female	35,000	18,13,000	17,500	31,209	6,075	89,250	54.47
3	Male	40,000	20,72,000	20,000	46,041	12,865	102,000	56.32
4	Female	40,000	20,72,000	20,000	42,951	9,775	102,000	56.32

From the above cases it is evident that an individual can make almost more than 50% earnings in the form of tax savings and rent received (net of municipal taxes paid) by letting out the home purchased with the help of home loan.

#### 7. Capital and Assets Appreciation

Home purchased with the help of home loan further gives the following benefits to an individual :

- Home value always goes on increasing with the passage of time, due to short supply of homes in comparison to high demand.
- Appreciation in the Home value is normally more than the interest paid on the home loan over the years.
- **Example:** the market value of the flat purchased by one of the respondents under the case study is Rs. 90,00,000. today as against Rs. 12,55,200 in 2001.

Total interest paid by the said respondent to date for the last 10 years is approx.

Rs. 13,00,000.

#### 8. Conclusion

Purchase of home through home loan gives an option to an individual to either use the same for his/her residence or let it out for gainful rent with minimizing the tax burden.

This further benefits the people who are homeless and cannot afford to own a home on their own but can take the same on rental basis.

This also benefits the Government directly as on the one hand, it gets a satisfaction of discharging its obligation of providing shelter to the people (which is the primary

duty of any welfare state), and indirectly by providing income tax benefit under section 24 and 80C of the Income Tax Act, 1961; on the other hand it brings huge amount of revenue to the government in the form of Stamp Duty and Registration Charges on the agreement of the purchase and sale of such homes. This also benefits Banks like State Bank of India, ICICI Bank, HDFC Bank etc. and non-banking finance companies like Indiabulls Home Finance Ltd., Reliance Home Finance Ltd. etc. which are still waiting for their banking licence, as they are getting huge amount of income in the form of interest on home loans, top-up loans, loan against properties and in the name of processing fees etc., on the most secured type of loan i.e. Home Loan.

Purchase of home by an individual (as SOP or as LOP) through home loan is a win-win situation for everyone who is associated with it, may it be an Individual Borrower, Government, Banker, or Homeless Individual.

Also purchase of home through home loan gives the maximum rate of earnings which no other investment decision gives and it further allows an individual to own and use his dream home.

So we conclude that "Tax Planning through Home Loan" is the best tax planning tool available to an individual.

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**Dr Siddheshwar T. Gadade**, Principal, Changu Kana Thakur Arts, Commerce and Science College, New Panvel & Dean, Faculty of Commerce, University of Mumbai, Mumbai.

**CA Pradeep D. Kamthekar**, Senior Lecturer R. A. Podar College of Commerce & Economics, Matunga, Mumbai