



Source: IRIS (13 March 2008)

Home Loan: Liability with Tax Breaks!!



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My job was interesting, as I met people from all walks of life, this time my client was, Mr. Shantaram, a lecturer from a very reputed college. His wife was also a passionate lecturer, the clients work profile sometimes is a big give away of their plausible risk appetite. At the behest of one of their friend, they had approached me to seek advice on Home Loan. They were concerned about how the EMI would impact their cash flow, also they were skeptical about the sky-rocketing interest rate on Home Loan.

They wanted to know an ideal break-up of down-payment versus home loan interest. The tenure one should opt for, the structure of loan and property and numerous other queries prevailed as they embarked on acquiring an asset which would engulf a significant amount of their earnings and savings. Having understood their plight, I tried to broach on all possible subtleties with regard to Housing loan and explain to them in the simplest of terms. We started by discussing on the ideal break-up of down-payment and loan amount.

Most financial institutions allow 15% of the amount as down-payment and one can avail a loan for the balance 85%. This would help one avail maximum tax benefit and the excess of liquid funds may be deployed into avenues which yield a return higher than the interest rate paid towards the loan. The term could be ideally 15 years or lesser, with banks allowing upto 20 year terms. However, one needs to ensure that there is no EMI commitment post-retirement. Hence, the term needs to be adjudged with respect to the preferred age of retirement.

Mr. Shantaram interrupted to ask about the benefits that I had mentioned, indeed a meticulous client who religiously lapped up every word of the discussion. Since the client seemed to be interested in knowing every detail for enhancement of his knowledge. I gave him the



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details pertaining to home loan. Whenever there is a house, there can be two scenarios, the house can either be self - occupied or can be let out on rent. Home loans on both have different treatments, first we deal with the simpler one - Self Occupied Property.

The EMI has two components namely the Principal & Interest. The Interest part paid towards the housing loan can be written-off as Loss from House Property, and works like a deduction, restricted to a max. limit of Rs. 1.5 Lakh per annum. This loss can be set-off against any other head of Income which makes this an attractive liability. Any loss which cannot be set off shall be carried forward for next eight years. When the house is let out on rent, there are two cash flows Rental Income and EMI, the first one being Cash Inflow and the latter being cash outflow. We need to bring both into perspective both these cashflows and calculate the loss to be declared. For this we will take a simple example - Let's assume a Rental Income (Net-off Ground Rent / Municipal Taxes) to be Rs. 10,000 per month.

On this one can avail 30% deduction towards maintenance (Rs. 3,000 in this case). The net taxable rent is Rs. 7,000 , let us again assume that the interest component on your housing loan stands at Rs. 12,000 per month. The loss on House Property would be Rs. 5,000 per month. There is no limit on the interest part that can be claimed in the FY. I added that an assessee could show only one Self-occupied house and can show any number of let out properties. Mr. Shantaram reminded me that we had not discussed the Principal part, I smiled and retaliated that it was the next item on the list of things to discuss. The principal part infact would be treated in the same manner under both scenarios, it would be allowed as a deduction u/s 80C which has an overall limit of Rs. 1 Lakh.

It was a relief for the couple to know that both Interest & Principal would help them avail the tax benefit. I added that the tax benefit on home loan would start only after occupation of house, it would not be available during the construction period. This obviously did not go well with my esteemed clients, Mrs. Shantaram retorted, `Then what about the EMI that I pay during the construction period`! - I asked her not to panic and mentioned that the benefit on Pre EMI Interest paid prior to occupation of house can be claimed in 5 equal installments from the year in which they occupy the house. The confused look on their faces nudged me to substantiate this with an example, let's assume that you availed the loan in FY 2004 and the house was eventually occupied in FY 2006 (infact the house has to be built within 3 Yrs of availing the loan), in the years` of construction, the Pre-EMI paid stands at Rs. 1 Lakh, then the person can

avail the tax benefit on not only the amount of EMI paid during the FY 2006 but also on 20% of Rs. 1 Lakh of Pre EMI and the balance in equal installments for each of the subsequent 4 Yrs. Mr. Shantaram observed that the staggering of the Pre-EMI tax benefit over 5 Yrs is subject to the cap of Rs. 1.5 Lakh in a FY on the interest part. This was an intelligent observation and I commended him for the same. Mrs. Shantaram, pointed out that they were planning to construct the house in their native city (Raipur) and post construction, they would continue to reside in Bangalore. This called for the House Rent and EMI cash outflow. The above information was pertinent, in such case Mr. Shantaram could claim both HRA and the Home loan benefit of a Self-occupied property since the place of house construction and rented house was in two different cities. This facility of availing both simultaneously in the same city is not allowed. We had almost finished discussing all about Home loans, the couple looked relieved on having gained sufficient knowledge to undertake an appropriate decision. But before we wound up, Mr. Shantaram raised the all important question of how to structure the loan and property deed. This was infact the most vital of all the points, it is always ideal for working couples to jointly hold the property and loan. This gives them the benefit of availing the tax benefit individually, thereby increasing the composite limit of benefit that can be availed (each of them get the Rs. 1.5 Lakh benefit). I emphasized that both loan & property needs to be held jointly for both to avail the benefit, they can split the benefit in the ratio of their choice. Mr. Shantaram left with ample clarity only to return a couple of weeks later with exact numbers and due research on Home Loans available in the market. We sat down to do some customized number crunching - well that`s another story!

Author is a founder and CEO of Right Horizons, an Investment Advisory and Wealth Management firm that focuses on providing financial solutions that is specific to customer needs.

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