Deduction on home loans: How helpful is it?

Sanjay Kumar Singh | New Delhi Mar 01, 2016 10:40 PM IST

Finance Minister Arun Jaitley brought cheer to first-time home buyers by offering an additional deduction of Rs 50,000 on interest repayment under Section 80EE. Homebuyers already enjoy a deduction of Rs 2 lakh on interest repayment under Section 24 for a self-occupied property, and a deduction to the extent of Rs 1.5 lakh on principal repaid under Section 80C. This new benefit, however, comes with a number of limitations.

Depending on the tax bracket under which you fall, this new deduction will allow you to make tax savings in the range of Rs 5,150-Rs 15,450.

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Next, let us examine the case of a person who takes a loan of Rs 35 lakh at the rate of 9.5 per cent for a tenure of 15 years. His equated monthly instalment (EMI) comes to Rs 36,548. His interest repayment in the first year comes to about Rs 3.28 lakh. The total deduction he can claim on interest repayment is Rs 2.50 lakh (combining sections 24 and 80EE). Thus, he still can't claim benefit on the entire interest amount repaid (in this case). Moreover, he will be able to reap the benefit of Section 80EE only for nine years out of the tenure of 15 years. After nine years his interest repayment will fall below Rs 2 lakh, so the benefit will become redundant.

One option before this individual is to reduce the amount he borrows to Rs 27 lakh (instead of Rs 35 lakh), in which case his interest repaid from the first year will drop to around Rs 2.5 lakh.

The other option is to take a joint home loan along with his spouse. Once he takes a joint home loan, however, Section 80EE does not come into the picture, according to a note from EY LLP. The spouse's Section 24 deduction alone will suffice to account for the entire interest repaid. The proportion in which a joint home loan is taken is important. "If the spouse in the higher tax bracket takes a higher proportion of the loan, the tax saving will be higher," says Alok Agrawal, partner, Deloitte, Haskins and Sells. Another point to remember about opting for a joint loan is that both partners should have their own incomes to pay the EMI, and both must be first-time buyers.

Section 80EE comes with pre-conditions. The loan must be sanctioned in financial year 2017.

This should be the buyer's first purchase. The cost of the property should not exceed Rs 50 lakh and value of the loan should not exceed Rs 35 lakh. "Due to restrictions around cost of property and value of loan, people living in bigger metros like Delhi and Mumbai will not be able to avail the benefit. It will be more beneficial for those in Tier-II cities and smaller towns," says Ranjit Punja, chief executive officer, Creditmantri.com.

The Section 80EE benefit has been made available for only one year. According to Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors, "People living in major metros should examine the rent versus buy equation properly and not feel forced into buying a house in a hurry just because this additional benefit has become available for a year."

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Investing in NPS is more attractive now

Tinesh Bhasin | Mumbai Mar 08, 2016 10:46 PM IST

Finance Minister Arun Jaitley has withdrawn the proposed tax on the employees' provident fund (EPF). He, however, said the changes proposed for the National Pension Scheme (NPS) would be tabled in Parliament as they are. If his proposals are accepted, the NPS will become an attractive avenue for retirement savings than it was earlier.

Until the current financial year, the NPS did not have many voluntary takers despite the government providing an additional deduction of Rs 50,000 under Section 80CCD (1B) of the Income Tax Act. That's because the entire corpus was taxable at the time of withdrawal.

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Tapati Ghose, partner with Deloitte Haskins & Sells, explains: “According to the structure of the scheme, it is mandatory for an investor to buy an annuity plan with at least 40 per cent of the corpus. One could withdraw the balance amount after paying tax on it.” Many investors felt that to save tax, they would be forced to buy annuity with the entire money on retirement.

The Budget has rationalised the tax on NPS. While the structure of the scheme remains the same, a person can now withdraw up to 40 per cent of the corpus without paying any tax on it. And, if a person chooses to withdraw 60 per cent as a lump sum, he will need to pay tax only on 20 per cent of the total corpus. “This is a bonanza for NPS investors,” says Ghose.

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Let us examine the following case. A person invests Rs 50,000 every year into NPS to benefit from tax deductions for the next 25 years. Assume that the person opted for Asset E, wherein 50 per cent of the contribution is allocated to equities, and earns an average annual return of 12 per cent. On retirement, the person will have a kitty of around Rs 75 lakh.

According to the existing provisions, the person will need to buy an annuity with 40 per cent of the corpus, which will be Rs 30 lakh. If he withdraws the balance amount of Rs 45 lakh, there will be 30 per cent tax, which works out to Rs 13.5 lakh. The person, then, ends up with a corpus of Rs 31.5 lakh in hand.

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If one makes changes to these calculations based on the recommendations in the Budget, the individual will end up with Rs 40.5 lakh in hand. That is a significant difference of Rs 9 lakh or a saving of 12 per cent, as compared to the existing norms.

Here’s how it works out to be so. The person buys the mandatory annuity plans with Rs 30 lakh (40 per cent of Rs 75 lakh corpus). Of the remaining money, there will be no tax on Rs 30 lakh (40 per cent of the corpus) on withdrawal. On the remaining amount of Rs 15 lakh (20 per cent of corpus) the investor will need to pay 30 per cent tax, which will work out to Rs 4.5 lakh. The total money in hand of the individual thus be Rs 40.5 lakh.

If you are an employee, whose organisation has moved to NPS you will end up with similar savings on your total corpus at the time of retirement. The returns may or may not be as high as the EPF (depending, among other factors, on the amount you allocate to equities in NPS) but the proposed changes in the Budget will definitely put more money in your hands at the time of retirement.

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