Turning housing loan interest into cost of acquisition during property sale

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From April 2023, the law has been amended to clarify that any interest claimed as a deduction under house property income or under sections 80C or 80EEA cannot be included in the cost of acquisition of the property. (Image: Pixabay)

Summary

- *From April 2023, the law clarifies that any interest claimed as a deduction under house property income cannot be included in the cost of acquisition. However, unclaimed housing loan interest can still help reduce capital gains liability during property sales. Here's how.*

With housing loan interest rates remaining reasonable over the years, many taxpayers have turned to loans to fund their residential property purchases.

Tax laws, however, limit the deduction of housing loan interest for self-occupied properties to ₹2 lakh annually. For rented properties, the entire interest is deductible against rental income. This raises the question: is the interest paid in excess of ₹2 lakh a complete loss for taxpayers, or can it be claimed against taxable income in another way?

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Several tribunal decisions have taken the view that such excess interest, which could not be claimed as a deduction under house property income, may be treated as part of the cost of acquisition when calculating **capital gains** on the sale of the property.

In one instance, a tribunal even held that interest already claimed as a deduction under house property income could again be considered as part of the cost of acquisition for capital gains. However, there have also been contrary rulings stating that such interest cannot be included in the cost of acquisition.

From April 2023, the law has been amended to clarify that any interest claimed as a deduction under house property income or under sections 80C or 80EEA cannot be included in the cost of acquisition of the property. This amendment effectively prevents double deductions.

However, it indirectly supports the position that housing loan interest not claimed as a deduction elsewhere may still qualify as part of the cost of acquisition when computing capital gains.

High courts in Delhi, Andhra Pradesh, Madras, and Karnataka have previously ruled that interest on loans taken to acquire immovable property should be treated as part of the cost of acquisition. This applies even to interest accrued and paid after the acquisition, as the borrowing is directly tied to the purchase of the property. Expenses related to the loan, therefore, form part of the acquisition cost.

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A recent decision by the Mumbai Tribunal confirmed that interest not claimed as a deduction under house property income can be included as part of the cost of acquisition. The case considered a year prior to the 2023 amendment, where the taxpayer claimed only the excess interest not already deducted under house property income. The tribunal upheld this approach, clarifying that the prohibition applies only to double deductions.

What to do with home loan interest

Home loan interest deduction in self occupied houses is capped at ₹2 lakh (Sec 24(B))

But you might have more interest

- You can add remaining interest in cost of acquisition during sale
- In case of let out house property - carry forward loss to later years

Example:

Home purchased	Home loan	Annual Interest*
₹2 cr	**₹1.2 cr**	**₹10 lakh**

Case 1: House on rent earning ₹5 lakh annually

Annual rent	**₹5 lakh**
Less standard deduction	**₹1.5 lakh**
Balance	**₹3.5 lakh**
Less Interest	**₹10 lakh**
Income	**-₹6.5 lakh**
Max loss this year	**-₹2 lakh**
Loss carried forward for up to 8 yrs	**-₹4.5 lakh**

Case 2: Self-occupied

Deduction each year: **₹2 lakh**

You carry forward **₹8 lakh** till sale

After loan paid off after 10 yrs, you sell house for **₹3.5 crore**

Sale Price	**₹3.5 crore**
COA	**₹2 crore**
Add interest for 10 years	**₹80 lakh**
Total COA	**₹2.8 crore**
Capital gains	**₹70 lakh**

*For simplicity assumed constant interest payment each year, rather than reducing balance

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Implications for taxpayers

Taxpayers should, therefore, maintain detailed records of the year-wise interest paid on housing loans and the deductions claimed each year. Interest that has not been claimed as a deduction in previous years can potentially be included as part of the cost of acquisition when calculating capital gains on the sale of the property. However, this is only applicable to housing loan interest not deducted under the "Income from House Property" head.

For let-out properties, there may be situations where the interest is treated as a deduction, but the loss under the "Income from House Property" head is capped at ₹2,00,000. In such cases, the excess loss can be carried forward for up to eight years and set off against future house property income. Since this carried-forward loss is already treated as a deduction, it cannot be included as part of the cost of acquisition for capital gains purposes.

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With the 2023 amendment providing clarity, one hopes tax authorities implement the law in the right spirit, minimizing unwarranted litigation that taxpayers have faced in the past.

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