

JUNE 2017

TDS ON RENT FOR INDIVIDUALS AND HINDU UNDIVIDED FAMILIES

1. INTRODUCTION

The Finance Bill, 2017 had proposed a new Section 194IB to the Income Tax Act, 1961 (the "Act"), to provide that individuals and Hindu Undivided Families ("HUFs") paying rent of INR 50,000 (Indian Rupees fifty thousand) or more per month to a resident, will now have to deduct 5% (five per cent) tax at source ("TDS"). This change will be effective from June 1, 2017.

2. EXISTING PROVISIONS UNDER INCOME TAX ACT

The existing provisions of Section 194-I of the Act provide for TDS at the time of credit or payment of rent to the payee beyond a certain threshold limit. This provision was applicable to individuals or HUFs who were liable for tax audit under Section 44AB of the Act.

However, individuals and HUFs (other than those liable for tax audit), were not liable to deduct tax at source under this section. The new Section 194-IB provides that individuals or an HUF (other than those covered under Section 44AB of the Act), paying rent of over INR 50,000/- (Indian Rupees fifty thousand only) per month to a resident, *will* deduct tax at source of 5% (five per cent).

3. NEW PROVISION UNDER THE ACT

3.1 Section 194-IB

The new Section 194-1B of the Act states the following in relation to the payment of rent by certain individuals or a HUF:

- "(1) Any person, being an individual or a Hindu undivided family (other than those referred to in the second proviso to section 194-I), responsible for paying to a resident any income by way of rent exceeding fifty thousand rupees for a month or part of a month during the previous year, shall deduct an amount equal to five per cent of such income as income-tax thereon.*
- (2) The income-tax referred to in sub-section (1) shall be deducted on such income at the time of credit of rent, for the last month of the previous year or the last month of tenancy, if the property is vacated during the year, as the case may be, to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.*
- (3) The provisions of section 203A shall not apply to a person required to deduct tax in accordance with the provisions of this section.*
- (4) In a case where the tax is required to be deducted as per the provisions of section 206AA, such deduction shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy, as the case may be.*

Explanation. —For the purposes of this section, "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or building or both. "

It should be further noted that the Ministry of Finance (Central Board of Direct Taxes) has (pursuant to a notification dated 8th June, 2017) notified the Income-tax (13th Amendment) Rules, 2017 relating to Section 194IB, containing details on the mechanism for TDS on rent for Individuals or HUFs, and the relevant forms for filing.¹

3.2 Applicability

Pursuant to the budget proposals, the provisions of the Finance Act, 2017 and the website of the Income Tax Department, Section 194-IB will come into force from June 1, 2017².

It is further proposed that the tax shall be deducted on such income at the time of credit of rent, for the last month of the previous year, or the last month of tenancy if the property is vacated during the year, as the case may be, to the account of the payee or at the time of payment thereof in cash, or by issue of a cheque or draft or by any other mode, whichever is earlier.

IndusLaw View:

With this move, the Income Tax Department is aiming to ensure that recipients of large rental incomes are covered under the tax net, as they will be forced to report the full rental income in their tax returns to claim benefit of the TDS amount.

However, there is a possibility now, that landlords receiving rent more than INR 50,000 (Indian Rupees fifty thousand only) may start breaking down rent payment into multiple separate agreements to ensure that the fixed rental component that is earned in the form of rent is capped INR 50,000 (Indian Rupees fifty thousand only). Anything over and above INR 50,000 (Indian Rupees fifty thousand only) might be charged as maintenance expenses or other income, essentially circumventing the new Section 194-IB, which imposes TDS on rent of more than INR 50,000 (Indian Rupees fifty thousand only) in a month.

For example, there is already a prevalent practice amongst landlords to break down the rent under leave and license agreements into license fees and amenities fees under a separate amenity agreement. This break-up saves the payment of excess stamp duty on the leave and license agreement. Now with the introduction of new Section 194-IB, landlords may further use this structure to avoid the TDS requirement, and thus this practice may become more rampant.

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June 12, 2017

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¹ http://www.incometaxindia.gov.in/communications/notification/notification48_2017.pdf

² <http://www.incometaxindia.gov.in/pages/acts/income-tax-act.aspx>