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## Section 54: Money-lauderer's delight

Section 54 provides a tax-free method to convert unaccounted money into accounted money

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December 27, 2015 Last Updated at 22:41 IST



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There have been widespread media reports on the subdued demand for houses. However, home prices have obstinately refused to fall, despite low demand. It is widely known that residential real estate is used as a vehicle for investing undisclosed (black) money. Most commentators feel that since this is the only investment option that facilitates the investment of black money, it makes the sector immune to the normal law of demand and supply. Given the amount of black money generated every year, the demand for houses from holders of black money is quite high. This keeps the prices constant despite the subdued demand from actual end users.

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70% money in escrow norm to hit realtors' cash flows

This analysis does not take into account an additional factor that makes investing in homes such a magnet for those who hold black money. The tax incentives provided under Section 54 allows exemption of long-term capital gains if the amount of capital gains are reinvested back into another house. Section 54 does not require the entire sales proceeds to be reinvested. It only requires the reinvestment of the capital gains portion into a new house. Also, this can be done for any number of houses that the tax payer owns. Today, the residential real estate market has both kinds of buyers - actual users who in most cases want to pay only fully accounted white money and those who want to pay a substantial portion in unaccounted black money. Section 54 provides a tax-free method to convert unaccounted money into

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sells the house property to a buyer who wants to pay fully accounted white money. Let's say property prices are still constant at Rs 50 lakh. There is no actual capital gains, but because Rs 25 lakh had been paid in unaccounted money initially, there will be capital gains of Rs 25 lakh on paper with taxable capital gains being even lower because of indexation. Assuming indexation of 5.25 per cent, the taxable capital gains will be approximately Rs 21 lakh. This Rs 21 lakh is again invested in another house property and if sold after three years at the same rate of Rs 21 lakh, the entire initial unaccounted money gets converted into accounted money without paying any tax. Essentially, the entire black money gets converted into completely accounted white money in a six-year cycle without paying any tax. Add the returns that will invariably come in an investment and the availability of home loans made cheaper because of tax breaks and it is no surprise that home investment in India is a money launderer's delight.

Something should definitely be done to stop this attractive money laundering scheme. At the same time, smaller investors who don't misuse the provisions should not be affected.

Fortunately, the solution that satisfies both these conflicting objectives is not very difficult to implement. Like Section 54F, the exemption under Section 54 should be made available only if the new asset being bought is the second residential asset for that tax payer. If he buys a third asset within the next three years, then the exemption should be withdrawn. Secondly, the entire sale consideration should need to be invested in the new residential asset for the exemption to be available. These changes will not stop money laundering, but at least it will make it more expensive for the investor and the government will get some revenue from the exercise. Changes are also required in setting off losses from house property for any properties beyond the first two properties. At the same time, these changes will not affect genuine investors who can't dream of owning more than two properties in their name in their lifetimes. Hopefully, these changes will be considered in the next Budget to be announced in February 2016.

*The writer is a Sebi-registered investment advisor*

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