Impact of Capital Gain Tax on the Real Estate Sector

I. Introduction

After gaining independence, Chandigarh became the first planned city designed by Le Corbusier, exemplifying modern urban planning. It has significantly influenced the development of new towns and townships. The opening of the economy in 1991, coupled with an influx of people migrating to urban areas in search of better opportunities and improved living standards, led to a boom in the real estate sector. India is currently one of the fastest-growing economies in the world. The real estate sector is a significant contributor to this growth, ranking as the third-largest recipient of Foreign Direct Investment (FDI), the second-largest employer in the country, and contributing approximately 7.3% to the nation's Gross Domestic Product (GDP). Although the government does not publish an official breakdown of how much each sector contributes to various tax revenues, government reports state ₹8,681.34 crore was collected from Long-Term Capital Gains (LTCG) in the fiscal year 2022-23, a 15% increase over the previous fiscal year's collection where the real estate sector also plays a significant role. Therefore, in this paper, we analyze the impact of the current changes in the budget on the real estate sector.

II. Current State of the Indian Taxation System

Today, India levies two types of tax: Direct Tax and Indirect Tax. Direct tax is imposed directly on an individual responsible for paying it, e.g.income tax. In contrast, indirect tax involves a levy on one person, but the responsibility for paying that tax to the government falls on someone else, e.g.Goods and Service Tax.

Income Tax is levied on the income and profits of an individual that he has earned during a financial year. The Income Tax law has categorized all taxable incomes under five heads:

A. **Income under the category of Salary** pertains to the relationship between the payer and the payee, specifically the employer and employee. In this context, the employee receives a certain amount of remuneration in exchange for the services rendered.

B. **Income classified under House Property** includes revenue generated from renting out residential properties, commercial properties, or other real estate.

C. **Income derived from Profits and Gains from Business and Profession** applies to all trade, commerce, and manufacturing activities.

D. **Income under the head Capital Gains** income refers to earnings obtained from the sale of any capital asset, whether movable or immovable, which is considered taxable.

E. Lastly, **income under Other Sources** encompasses any income derived from sources outside the previously mentioned four categories.

III. Understanding Capital Gains Tax

Capital assets are properties typically held for an extended duration and have the potential to yield future economic benefits or services. They can be classified into two categories:

A. A short-term capital asset includes an asset held for 24 months or less. However, in some cases, the holding period is 12 months. For tax purposes, the tax on short-term capital assets is based on the investor's ordinary income bracket and is called Short-term capital gains tax.
B. A long-term capital asset includes an asset held for more than 12 or 24 months, depending on the asset. The tax is calculated based on the profits of any investment they've owned and is called Long-term capital gains tax.

IV. Capital Gain Tax and the Real Estate sector

Real Estate is a fundamental component of capital assets. While exact figures on revenue generated from capital gains tax are not available, there has been a notable increase in declarations of long-term capital gains. The total declared long-term capital gains surged to ₹8.6 trillion in 2023-24, a significant rise from ₹1.4 trillion in 2018-19.[1] Hence, taxes levied on property are a crucial source of revenue for the government, but they can be a burden due to the considerable amount involved. Thus, certain exemptions under the Income Tax Act make property transactions more affordable and encourage property ownership. Some exemptions are:

A. **Section 54** of the Income Tax Act provides an exemption on long-term capital gains from the sale of residential property if the profits are reinvested in purchasing or constructing another residential property within a specified time frame.
B. **Section 54E** allows taxpayers to claim an exemption from long-term capital gains tax. This exemption is available when the proceeds from the sale of a long-term capital asset are invested in specified bonds issued by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation (REC).
C. **Section 54EC** allows for a tax deduction on gains from the transfer of any capital asset, including land and buildings. However, certain criteria must be met to qualify for these exemptions.
D. **Section 54F** of the Indian Income Tax Act, 1961, exempts individuals and Hindu Undivided Families (HUFs) from long-term capital gains tax when they reinvest proceeds from the sale of a long-term capital asset (excluding residential properties) into buying or constructing a residential house.

V. Union Budget,2024

The Union Budget 2024 brought in three key changes[2]:

A. The holding period to classify assets as long-term was standardized at more than 24 months for immovable property.
B. It removed the indexation benefit for properties acquired on or after July 23, 2024, and fixed the long-term capital gains tax at 12.5%
C. Properties acquired before July 23, 2024, were given the option to choose between a 20% long-term capital gain tax rate (with indexation) or a 12.5% tax rate (without indexation), along with cess and surcharge.

Previously, gains were taxed at only 20% with indexation, allowing taxpayers to adjust property purchase prices for inflation.

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[1] https://www.business-standard.com/budget/news/500-increase-in-long-term-capital-gains-declarations-before-tax-increase-124072300798_1.html
[2] https://www.bajajfinserv.in/investments/long-term-capital-gain-tax-on-property

VI. Implications On the Real Estate sector

Recent tax reforms have introduced a dual tax regime, allowing taxpayers to choose the option that best suits their financial interests. This flexibility, especially the reduced tax rates, can be highly beneficial for property sellers. Simplifying the tax structure is expected to enhance compliance and attract greater investor participation in the market. Importantly, the reforms aim to foster long-term investment by encouraging individuals to look beyond short-term market movements and adopt a tax framework that rewards patient capital. A significant development supporting this trend is the surge in housing sales—according to a research report by ANAROCK, the top seven Indian cities recorded a historic high of 251,000 units sold in the first half of 2024, marking a 9% increase over the same period in 2023. The introduced tax flexibility is likely to sustain and promote this growth. Additionally, a consistent holding period helps eliminate ambiguity and reduces the potential for tax misuse. Aligning real estate taxation with other long-term capital assets and removing the misuse of indexation benefits further ensures a level playing field and strengthens overall accountability in the system.

However, these reforms incited negative comments as well. Many property investors believe that Properties acquired after July 23, 2024, are subject to the 12.5% rate without indexation, which may result in higher taxes for future sales, potentially affecting investment decisions for new buyers. To address these concerns, the Income Tax Department issued several clarifications[3]. It stated that typical real estate returns range between 12% to 16%, which is considerably higher than the inflation rate. Thus, capital gain tax rates at 12.5% (without indexation) would still be beneficial. The previous regime would be a suitable option only if the real estate returns are between 9% and 11%; however, such cases are rare. However, Opposition lawmakers and industry experts pointed out that eliminating indexing benefits may encourage cash transactions, impacting accountability, revenue, and liquidity within the real estate sector.

Many experts, including Gaurav Karnik, a former partner at Ernst & Young India, emphasize that the answer to which tax regime is better depends on when a person purchased their property and would vary from case to case.[4] He believed that individuals who bought property long ago would be impacted and might have to pay more taxes. Amit Goyal, Managing Director, India Sotheby's International Realty, and Vaibhav Gupta, partner, Dhruva Advisors, stated that the move would bring in uniformity and liquidity, and Indian promoters who want to sell their unlisted businesses could now do it at a lesser tax rate.[5] Anuj Puri, Chairman of Anarock Property, highlighted the emphasis on rental housing in the recent budget.[6] He mentioned that the government has introduced a public-private partnership model to provide affordable rental options. This initiative will be particularly beneficial in major cities like Mumbai, Delhi, and Bangalore, where the urban poor and middle class cannot afford to buy homes.

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[3] https://youtu.be/zYKBeDyPzhc?si=DCIBX8jLzop4Dttd

[4] https://youtu.be/1qvnIOPzcDU?si=euhPgpC3wqjVh-9z

[5] https://www.newindianexpress.com/business/2025/May/04/grant-thornton-bdo-emerge-as-formidable-challengers-to-big-four-in-indias-audit-space

[6] https://www.etnownews.com/budget/budget-2024-ppp-model-to-revolutionize-rental-housing-for-industrial-workers-experts-speak-article-112054908

VII. Impact on Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (InvIT)

The Union Budget for 2024-25 has reduced the long-term holding period for business trusts from 36 months to 12 months. According to the Economic Times,[7] Real Estate Investment Trusts (REITs) have attracted over 230,000 investors in the past five years. This change aligns the units of listed business trusts with other listed shares, making them more appealing than direct investments in the real estate sector. Trusts provide diversification, allowing customers to invest in retail, commercial, and industrial properties. It enhances liquidity and enables relatively small investments.

VIII. Conclusion

According to the FICCI-Anarock report[8], over 59% of Indians consider real estate the most favoured asset class for investment. Compared to other countries, India's capital gains tax rates are relatively moderate, which makes the real estate sector an appealing investment option. The established holding periods and tax rates benefit both property sellers and buyers; however, this may adversely affect the large middle class, which has previously enjoyed advantages through indexation.

Many experts, such as Mohit Gang from Moneyfront, believe the current union budget encourages investments in business trusts and bonds. Although taxes have increased for equity investments, they still represent a better option than real estate.[9] However, the FICCI-Anarock 2023 survey[10] reveals a 3% decline in participants buying property for investment purposes. Since most buyers purchase properties for self-use, they prefer paying outright rather than investing in property bonds. Thus, this change in the Union Budget might not yield the intended results.

The real estate sector contributes approximately 7-8% to India's Gross Domestic Product[11]. While there is no exact data on real estate's contribution to capital gains tax, the volume and value of property sales in India indicate its significance; in 2024, around 577,000 residential transactions were recorded across primary and secondary markets[12]. Following changes to the long-term capital gains tax, many people expressed dissatisfaction with the government for allegedly neglecting middle-class income groups[13]. The government defended its decision, stating

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[7] https://economictimes.indiatimes.com/markets/stocks/news/union-budget-2024-reits-to-become-more-appealing-to-investors-as-holding-period-for-long-term-capital-gains-reduced/articleshow/111964123.cms?from=mdr

[8] https://www.hindustantimes.com/real-estate/over-67-people-buy-property-for-self-use-investors-press-the-pause-button-due-to-rising-prices-ficci-anarock-survey-101729245593029.html

[9] https://youtu.be/7fP0qj26XXA?si=13zRwMry-loaFj7l

[10] https://www.ficci.in/press_release_details/4957

[11] https://www.ibef.org/industry/real-estate-india

[12] https://www.business-standard.com/finance/personal-finance/2024-realty-deals-hit-5-5-lakh-valued-at-rs-4-tn-prices-up-60-in-5-yrs-124123100294_1.html

[13] https://www.business-standard.com/budget/news/budget-2024-cruel-madness-internet-angry-over-capital-gains-tax-hike-124072300979_1.html

that the changes have made the process more straightforward to compute. Nonetheless, many individuals, investors, and critics remain apprehensive about this decision.