Tax savings: Give loan, not gift, to spouse to avoid income clubbing

Documentation of the loan agreement is crucial to avoid treatment as gift

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Taxpayers under the old tax regime are keenly focused on saving taxes. What many don't realise is that including their spouse and children in their tax planning can enable them to reduce their tax burden legally.

Give a loan

A person can reduce their taxes by loaning money to their spouse. For example, if a husband loans money to his wife to open a nail spa, and she agrees to repay it with interest, the money she makes from the business doesn't get clubbed with the husband's income for tax purposes.

"On the other hand, if the husband gifts the money to the wife, there is always the risk that the authorities may decide that the income from the busi-ness should be added to the husband's income under Section 64(1)(ii) of the Income-Tax (I-T) Act," says Varun Chablani, international tax lawyer. He adds that spouses should document the loan agreement for tax-audit purposes so that it is not treated as a gift.

While money or assets gifted to a spouse do not attract tax, income gene-rated from the invested gift gets clubbed with the income of the person who gave the gift. Ankit Jain, partner, Ved Jain & Associates, says, "This is why it is advisable to loan money to your spouse to acquire assets. The loan can be repaid with the income earned from those assets. The income is taxed in the hands of the spouse (the recipient of the gift)."

Gift to save taxes

Tax laws state that if an individual or a Hindu Un-divided Family (HUF) gives gifts worth over Rs 50,000 in a year, in cash or assets, the rec-eiver must pay tax on it. This is considered "income from other sources" according to Section

56 of the I-T Act. Soayib Qureshi, partner, PSL Advocates and Solicitors says, "Any gift, whether movable or immovable, worth more than Rs 50,000 is fully taxed as income."

However, gifts from relatives, regardless of their value, are not taxed. Section 2(41) of the I-T Act defines "relative" to include spouses. Thus, gifts between spouses are exempt from tax. Suresh Surana, founder, RSM India, says, "Income from these gifts will be taxed as the husband's income (if the husband is the giver) because of 'clubbing provisions' under Section 64 of the I-T Act. However, any further money generated from this income will be taxed as the wife's income, not the husband's."

The nature of the transfer also matters. "Assets given to close family members are not taxed. This is assuming it is a non-revocable transaction. If the transfer is revocable, any income from these assets will continue to be taxed in the hands of the transferor," says Pallav Pradyumn Narang, partner at CNK.

Joint home loan

A joint home loan can also result in tax savings. Under Section 24(b) of the I-T Act, a citizen can claim a deduction of up to Rs 2 lakh on the interest paid on a home loan. Jain says, "When your spouse and you take a joint home loan for a co-owned home, both can claim a tax deduction on the interest paid."

Qureshi adds, "A total deduction of up to Rs 4 lakh can be claimed by a married couple (Rs 2 lakh each) on interest paid, provided the home loan is co-borrowed by the spouses in a 50-50 ratio.” If a couple takes a home loan jointly, they can claim a tax deduction on the loan’s principal repayment up to Rs 3 lakh under Section 80C. Qureshi recommends this appr-oach for couples who both pay taxes.

Health insurance premium

By splitting the premium of a family floater plan, your spouse and you can each claim a tax deduction of up to Rs 25,000, amounting to a deduction of Rs 50,000 for the couple.

Other deductions you can avail

You can get a tax deduction under Section 80C for investing in your spouse’s Public Provident Fund account or paying life insurance premium. Simi-larly, says Surana, you can also claim a deduction for interest paid on your spouse’s education loan under

Section 80E, provided certain conditions are met.

Make adult child co-borrower ***Adult children***

Parents can claim tax deduction on interest paid on loans for their child’s higher education under Section 80E

Deduction is available for up to eight years from first interest payment

An employed adult child can become co-borrower in a home loan with parent

They can claim tax deductions on interest and principal repayments under Sections 24 and 80C ***Minor children***

Under Sections 80C and Section 10 of the I-T Act, an individual can get tax deductions for spending on their two children’s education and hostel fees

They can deduct Rs 100 monthly per child for education and another Rs 300 monthly per child for hostel costs (annually up to Rs 2,400 for tuition fees and Rs 7,200 for hostel expenses)

Parents can also claim deduction on a child’s health insurance premium under Section 80D