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Guidance value cut: A gift for whom?

It benefits those who under-register property transactions; a cut in stamp duty, instead, would have benefited all property buyers

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Terming it a 'new year gift,' Karnataka Revenue Minister R Ashoka recently announced a 10% reduction in guidance value for all properties until March 2022. Interestingly, the minister chose to follow Delhi, which cut its circle rates (equivalent to guidance value) last year, and not Maharashtra, which cut stamp duty across the board. Reducing stamp duty helps all property buyers while reducing guidance value helps only those who don't report the true value of a property transaction. Moreover, the three-month validity of the cut suggests that the government is targeting specific outcomes rather than energising the whole market. Therefore, it begs the question, who is this gift intended for?

Clearly, there are legitimate reasons why guidance values need to be cut sometimes. Cities have raised these values for years to raise revenues. It was okay as along as property prices were rising faster. But with falling demand (especially in the pre-Covid years), market prices fell faster than the guidance values. In many areas, especially in the NCR and Mumbai markets, market prices fell below guidance values. This meant that buyers would have had to pay stamp duty on a value higher than the price they had paid for the property! Since our regulatory approach assumes dishonest behaviour as a default, registering at the true price would have unleashed the income tax authorities on the hapless buyer. Cutting guidance value, therefore, is the right way to correct this anomaly.

Who benefits from a cut in guidance value?

Current rules require buyers to pay stamp duty on the higher of the guidance value and the actual transaction value. A cut in guidance value will, therefore, benefit only those buyers who are registering at (or close to) the guidance value, even if the actual transaction value is higher. Basically, it benefits those who promote the black economy.

Most salaried professionals and middle-class buyers who seek home loans would find it hard to under-register. For one, banks and housing finance companies require independent valuation. Secondly, the size of the home loan is based on this independent value or the registered value, whichever is lower. So, registering at a lower value would force buyers to bring in more equity. If the borrowers choose loan against property (LAP) instead, then they may get higher loans but they would have to lose income tax benefit on the interest.

In short, this cut in guidance value is not going to benefit honest taxpayers who borrow from formal financial institutions to buy their homes. It will benefit those who transact in land (where guidance values are notoriously low compared to actual market value and most registrations happen at guidance values) and those who self-finance their property purchase and under-report during registration to save on stamp duty (and possibly to deflect scrutiny of their income sources).

Will the cut in guidance value reduce real estate prices?

Unlikely. Guidance value is an imperfect estimate of market value used in determining stamp duty. In most of the Bengaluru metropolitan area (the largest real estate market in Karnataka), guidance value lags market value, suggesting that they do not capture real demand and supply factors well. In fact, they have not been revised since 2019 though property prices have risen since then. Therefore, arbitrary changes to this metric, like the proposed cut, will have no impact on the underlying market value. In fact, prices may increase if the reduction in guidance value raises the demand for properties.

Would a guidance value cut increase demand?

Probably, but the chances are not high. Even before Covid, the Karnataka government faced a deficit of Rs 2,000 crore in revenue and the pandemic would have certainly worsened the finances of the state. With the cut in guidance value, the shortfall will widen, unless there is an increase in new registrations following the cut. Though there was an increase in stamp duty collections in Delhi last year, it is unclear how much was due to the circle-rate cut since registrations increased even for cities that neither reduced stamp duty nor their guidance values.

Is there a better way?

Yes. A reduction in stamp duty across the board could have achieved the government's objective of stimulating demand and raising revenues without tacitly promoting under-reporting in the property market. Moreover, it would not have any of the unintended effects that lower guidance values (without a reduction in market value) would bring in, given that these values are used by the income tax authorities, courts, etc., for other purposes.

This policy move, at best, is a desperate attempt to raise revenue before the financial year closes. At worst, it aims to promote transactions in land and actively encourage the growth of the black economy in real estate. It would be sad for the country and honest taxpayers if it is the latter.

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