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J.B. NAGAR CPE STUDY CIRCLE OF WIRC OF ICAI
TOPIC:- REDEVELOPMENT IMPLICATIONS ON DEVELOPERS & MEMEBERS
ON 21-10-2018 FROM 8:45 AM TO 10:45 AM
VENUE:- HOTEL KOHINOOR CONTINENTAL ANDHERI KURLA ROAD,
JB NAGAR ANDHERI (EAST) MUMBAI-400059
CA VIMAL PUNMIYA

REDEVELOPMENT FROM THE POINT OF VIEW OF A FLAT OWNER

1. DEVELOPMENT RIGHTS:

DEVELOPMENT RIGHTS – WHO ARE ENTITLED – SOCIETIES OR MEMBERS?

In respect of Tenants co-partnership co-operative societies, which are of the nature of “Flat Owners Societies” in which the flats are acquired by the society from the builder on ownership basis and thereafter Society is formed, and land is conveyed to the society and individual members acquire ownership rights over the building and underneath the development rights.

This concept has been recognized under Bombay stamp Act as on the conveyance in favour of the housing societies, stamp duty paid by the purchasers of flats on ownership agreements is deducted from the stamp duty payable on the market value of the property transferred in favour of the society as per proviso to article 25 of schedule 1 of Bombay Stamp Act.

Circular No. F.N. 4 / 28 / 68 – WT DT. 10.0.1969 AND 27.01.1969 explaining the provisions of section 5(1)(iv), the Board clarify that flats vest with individual members of society.

I] Additional Area expected at Redevelopment

Liability of Income/Capital Gain Tax, if any, on:-

A. Additional area in the hands of individual members.

Ans. As per Section 54 of the Income Tax Act, 1961, if any residential property which was held for a period of more than 24 months is sold or given for redevelopment and the new flat is purchased or acquired within a period of 1 year before or 2 years after the sale or constructed within 3 years after the sale then capital gain arising on the transfer of the old flat will be exempt to tax u/s. 54 of the Income Tax Act, 1961 to the extent of the cost of such new flat.

In the case of redevelopment, the new flat to be acquired is treated as constructed for the purpose of the Section 54. Thus, if the new flat is acquired by the owner within a period of 3 years from the surrender of the original flat then the capital gain arising from the sale of the original flat can be claimed to be exempted u/s. 54 of the Income Tax Act.

If the new flat is not acquired by the owner within a period of 3 years then the Assessing Officer at his discretion can disallow the same at any time during the assessment.

However, allotment of a flat or a house by a cooperative society, of which the assessee is the member, is also treated as construction of the house [Circular No. 672, dated 16-12-1993]. Further, in these cases, the assessee shall be entitled to claim exemption in respect of capital gains even though the construction is not completed within the statutory time limit. [*Sashi Varma v CIT* (1997) 224 ITR 106 (MP)]. Delhi High Court has applied the same analogy where the assessee made substantial payment within the prescribed time and thus acquired substantial domain over the property, although the builder failed to hand over the possession within the stipulated period. [***CIT v R.C. Sood (2000) 108 Taxman 227 (Del)***].

Hence, relying upon the above judgments, even if in the case of development, the new flat is acquired by the owner after a period of 3 years from the surrender of the old flat, an assessee can claim exemption u/s. 54.

If the new flat acquired to claim exemption u/s. 54 is sold within a period of three years from the date of purchase then the capital gain exemption claimed earlier would become taxable in the year the new flat is transferred.

Thus, in your case, the Receipt of extra carpet area over and above the existing area could be claimed as exemption u/s. 54 of the Income Tax Act, 1961.

Further, we would like to state that under the definition of "Transfer" according to Sec 2(47) Income Tax Act, 1961, transfer, in relation to a capital asset, includes sale, exchange, or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law.

An exchange involves the transfer of property by one person to another and reciprocally the transfer of property by that other to the first person. There must be a mutual transfer of ownership of one thing for the ownership of another. Hence, the acquisition of new flat would be considered as exchange and would be considered as transfer for the purpose of capital gain.

Argument could not be made that no cost is incurred by any member for the acquisition of the new flat and hence capital gain cannot be computed and the case does not fall within the ambit of Section 55(2). The member is forgoing his

rights in the old flat. And hence, it would be considered as the cost of acquisition of the new flat.

However, if the residential flat is held for a period of less than 24 months than the receipt of extra area by the individual members would be taxable in the hands of the individual members.

B. Cash compensation received upon surrender of entitled additional area, in part or in full, by an individual member.

Ans. If the Individual member is surrendering a part of the existing area then the Individual member would be liable to pay Capital Gain Tax. The sale consideration would be calculated as per **Section 50C of the Income Tax Act**, which is as follows:

“Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall, for the purposes of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

Provided that where the date of the agreement fixing the amount of consideration and the date of registration for the transfer of the capital asset are not the same, the value adopted or assessed or assessable by the stamp valuation authority on the date of agreement may be taken for the purposes of computing full value of consideration for such transfer: (Inserted w.e.f. 1st April, 2017)

Provided further that the first proviso shall apply only in a case where the amount of consideration, or a part thereof, has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of the agreement for transfer (Inserted w.e.f. 1st April, 2017)

Provided also that where the value adopted or assessed or assessable by the stamp valuation authority does not exceed one hundred and five per cent of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration.”

However, if the Individual member is surrendering a part of the additional area then the Individual member would be liable to pay capital gain tax on the same. Because the consideration received in monetary terms as against exchange of old flat and not invested in residential flat as per section 54.

C. The Society for receiving amenities and facilities for the common use of its members and their families.

Ans. If the Society is receiving for amenities and facilities for the common use of its members and their families then the same is not taxable in the hands of the Society or the Individual members as there is no cost of acquisition of the same. In deciding the case of **JETHALAL D.MEHTA V. DY. CIT [(2005) 2 SOT 422 (MUM.)**, Hon. Income Tax Appellate Tribunal mainly relied upon Supreme Court decision in the case of **CIT V. B.C.SRINVASA SHETTY 128 ITR 294** in which it

was decided that if there is no cost no capital gain can be worked out hence amount received is to be treated as exempt receipt.

II] Corpus Money expected at Redevelopment

Liability of Income/Capital Gain Tax, if any, on:-

A. Corpus Money received by the Society from the Developer in lieu of surrender of part entitlement of FSI/Development Rights, such funds being invested by the Society to earn interest income to meet/subsidize the maintenance costs of its Redeveloped premises and property.

Ans. If at the time of Redevelopment, the Society was not in possession of unutilized FSI/Development Rights, then the Society would not be liable to pay any Capital Gain Tax on the receipt of the Corpus Money on surrender of a part of FSI/Development Rights.

Further, if the Society has unutilized FSI/Development Rights in its possession at the time of Redevelopment, then the receipt of the Corpus Money on surrender of the part of FSI/Development Rights would be taxable in the hands of the Society.

Also, in the case of (1) **New Shailaja CHS v. ITO (ITA NO. 512/M/2007. BENCH B dated 2nd Dec, 2008 (mum.)** and (2) **ITO v. LOTIA COURT CO- OP. HSG. SOC. LTD. (2008) 12 DTR (MUMBAI)(TRIB) 396** it was held that *where the assessee, a Co-op. Hsg. Soc. Ltd. Became entitled, by the virtue of Development Control Regulations, to Transferable development Rights (TDR) and the same was sold by it for a price to a builder, the question arose whether the transaction of sale receipt could be taxed. It was held that though the TDR was a Capital Asset, there being no 'cost of acquisition' for the same, the consideration could not be taxed.* The same is held in the cases of **NEW SHAILAJA CHS LIMITED (ITA NO. 512/MUM./2007), OM SHANTI CO-OP. HSG. SOC. LTD. (ITA NO.2550/MUM./2008) & LOTIA COURT CO-OP. HSG. SOC. LTD. (ITA NO. 5096/MUM./2008).**

Further, in the case of **MAHESHWAR PRAKASH 2 CHS LTD. 24 SOT 366 (MUM.)**, it was held that *the assessee-society acquired the right to construct the additional floors by virtue of DCR, 1991 which could not be available to the assessee on expenditure of money. Prior to DCR, 1991, no society had any right to construct the additional floors, so it was not a tradable commodity. Suddenly by virtue of DCR, 1991, the right was conferred by the Government on the assessee. Such right exclusively belonged to the building owned by the society. It could not be transferred to any other building.*

Similarly, similar right belonging to other societies could not be purchased by the assessee for the purpose of constructing additional floors in

its own building. Therefore, such right had no inherent quality of being available on expenditure of money and, therefore, cost of such asset could not be envisaged. Hence, the said view was fully justified in terms of the decision of the Apex Court in the case of *B.C. Shrinivasa Shetty*.

Therefore, the right acquired by the assessee did not fall within the ambit of section 45 itself. The amended provisions of section 55(2) were also not applicable, since such right was not covered by any of the assets specified in section 55(2)(a).

Therefore, the money` received by the assessee from the developer was not chargeable to tax under section 45. Therefore, the impugned orders passed by the lower authorities were to be set aside.

B. Corpus Money received by the Society from the Developer (as described in A above) and subsequently distributed to its members. Whether such incomes enlisted above at A, & B, if taxable, shall be treated as Capital Gains or deemed to be income earned in the year of receipt.

Ans. As per Maharashtra Co-op. Societies Act, 1960, a Co-operative Society cannot distribute the corpus funds to its Individual member, it can only declare dividends.

However, the declaring of Dividends has lots of restrictions and formalities.

C. Liability of Income Tax, if any, on interest income arising from investment of such Corpus Money by the Society in the Co-operative/other Banks.

Ans. If the Society receives interest income form a Co-operative bank then the same is exempt from tax. And, if the interest income is received from other banks than the same is taxable and the Society has to pay tax on the same.

However, as per Hon`ble **Tribunal Judgment** in the case of **ITO v. Sagar Sanjog C.H.S. Ltd., ITA Nos. 1972 to 1974 and 2231 to 2233/ Mum./ 2005(BCAJ)** it was held that *the interest income earned out of the fund money invested went to reduce the maintenance. According to the tribunal, the interest would have been taxable, had there been surplus left after it being adjusted against the maintenance expenses. The tribunal also noted that there was nothing on record to suggest that the interest income would be given to members on dissolution of the Society.*

Thus, even the interest income received from other than Co-operative Bank and spent on Society's work then the concept of Mutuality will apply and is not liable to tax but this view is not free from litigation.

III] Rent for Temporary Alternative Accommodation including Deposits, if any:

Rental allowance may be received by individual members in the event of need for Relocation during Redevelopment. Such amounts may be utilized in part or in full towards rent paid for alternative premises or may remain entirely unspent if the member already has his/her own alternative accommodation. Such allowance may be received for about three years, either together in one tranche in advance or in installments on a staggered basis.

Liability of Income Tax, if any, on such Rental Allowance, including Deposits, if any, received by the individual members.

A. Whether such income, if taxable, shall be treated as income earned in the year of receipt (if received on a staggered basis) or entirely as income in one year (if received fully in advance)

Ans. In order to get the old building redeveloped, the existing structure of the old building is required to be demolished and hence, it is necessary to vacant the same. To facilitate redevelopment and to compensate the flat owners for the hardship to be faced by them in this regard, the Developer might offer them Rent compensation which they would be paying for the temporary accommodation during the period of redevelopment.

The Rent Compensation so provided by the developer to the owner should be expended by the owners for the purpose of their temporary accommodation and other expenditure related thereto.

If the actual rent paid by the flat owners is less than the Rent compensation received by them from the redeveloper then the excess of such amount received will be taxable under the head **Income from Other Sources**, otherwise, the Rent compensation received by the flat owners from the redeveloper is not taxable.

The Rent Compensation given to the Individual Members shall be taxable in the year of receipt if the Rent Compensation is received on staggered basis and the whole is not spend by the Individual Members on their alternative accommodation.

However, if the Rent Compensation is given to the Individual Members in one tranche in advance, then the Rent Compensation received by the Individual Members would be taxable on proportionate basis if the same is not spend on the Alternative Accommodation.

IV] Hardship Allowance/ Compensation for Inconvenience.

Members opting not to be temporarily relocated during the Redevelopment may receive "Hardship Allowance" from the Developer.

Members agreeing to be temporarily relocated during Redevelopment may receive "Compensation for Inconvenience" from the Developer.

A. Liability of Income Tax, if any, on such Allowance/ Compensation and if taxable, mode of computation i.e. whether as income in the year of receipt or whether on a staggered basis as received.

Ans. Along with extra area and Rent compensation, the redevelopers also offer lumpsum amount to the flat owners in addition to extra area and compensation.

In the case of **CIT V. B.C.SRINVASA SHETTY 128 ITR 294** in which it was decided that if there is no cost no capital gain can be worked out hence amount received is to be treated as exempt receipt.

Hence, the Hardship Allowance and the Compensation for Inconvenience is not taxable in the Hands of the Individual Members as Hardship Allowance and Compensation for Inconvenience can't be worked out in monetary terms and have no cost. Since there is no cost of acquisition, as per Income Tax Act, 1961, the receipt would not be treated as a Capital Receipt and thus, is exempt from tax.

V] Goods/ Household Amenities received by Members from Developer.

A. Liability of Income Tax, if any, on individual members for any property other than immovable property that are sometimes included by Developers in the new premises on a complimentary basis.

Ans. Property other than immovable property which are not attached to the walls of the flat and exceeds 50,000/- in value in totality are not treated as a part of the Flat and are thus taxable in the hands of the Individual Members in the year of receipt of such amenities u/s. **56(2)(X) of the Income Tax Act, 1961**, if property is covered under section, which is as follows:

“(x) where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,—

(c) any property, other than immovable property,—

(A) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

(B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration :

“property” means the following capital asset of the assessee, namely:-

- Immovable property being land or building or both
- Shares and securities
- Jewellery
- Archaeological collections
- Drawings
- Paintings
- Sculptures
- Any work of art
- bullion

The provisions of section 56(2) (X) are inserted, with effect from 01.04.2017, so as to provide that where any property other than immovable property is received by an assessee having fair value of Rs. 50000 or more for without consideration or a consideration which is less than Rs.50,000, from fair value, shall be chargeable to tax in the hands of assessee as income from other sources.

VI] Reimbursement of Expenses from Developer.

A. Liability of Income Tax, if any, on the Society/ individual members for Reimbursement from Developer of Expenses such as Stamp Duty, Fees of Consultants (Architect, Lawyers, Chartered Accountants, etc.) cost of updating members and holding General Body meetings, Administrative Expenses towards the Redevelopment Process, etc. incurred/ to be incurred.

Ans. Anything amount which is reimbursed by the Developer is not taxable either in the hands of the Society or the Individual Members, provided that the entire amount of reimbursement is been spent on the expenses it is reimbursed for.

Thus, if excess amount is reimbursed by the Developer than the amount which is actually spent for the purpose than the excess amount would be taxable on the receipt of the same.

However, in the case of a Society, if excess amount is reimbursed to a Society by the Developer than actually spent by the Society, and the excess amount so received is been used by the Society for payment of expenses which are for the welfare of the Society or the Individual Members than the excess amount received by the Society would not be taxed and hence, would be exempt. Otherwise the excess amount received by the Society would be taxable.

VII] Liquidation & Disbursement of Existing Sinking Fund.

A. Liability of Income/Capital Gain Tax, if any, on the Society/ individual members upon liquidation and disbursement to existing members (with permission from Registrar/any other authority) of existing, unutilized Sinking Fund (generated by annual contributions from members and bank interest earned thereon.) prior to induction of new members arising from saleable portion of Redeveloped premises.

Ans. In our view, the Sinking Fund is to be used on the property itself either for the purpose of development or Heavy Repair.

However, if the Registrar gives permission then the Sinking Fund could be distributed amongst the Individual Members which again has a number of restrictions.

This distribution of Sinking Fund after the permission of the Registrar would be taxable in the hands of the Individual Members to the extent of the

interest on such a fund. The distribution of the principal amount would not be taxable in the hands of the Society or the Individual Members.

VIII] TDS on receipt.

A. Whether tax shall be deducted at Source (TDS) from Corpus Money, Allowances, Compensations, Reimbursement of Fees of Consultants and other Expenses, Rent for Temporary Alternative Accommodation and Deposits or any other form of receipt in the hands of the Society/ its individual members.

Ans. As per the Income Tax Act, 1961, no TDS is to be deducted on the amount reimbursed by the Developer to the Society or the Individual Members or on other items such as Corpus Money, Allowances, Compensations, Reimbursement of Fees of Consultants and other Expenses, Rent for Temporary Alternative Accommodation and Deposits or any other form of receipt.

However, when the Society makes payments such as Professional Fees, Contractor, etc, the Society is to Deduct Tax at Source at the rate given herebelow and pay the same to the Income Tax Department and file the Quarterly Returns:

Contractor	1% in the case of individual/HUF 2% in the case of others u/s 194C
Rent	10% u/s 194I
Professional Fees	10% u/s 194J
Commission & Brokerage	5% u/s 194H

IX] Tax Planning (Saving) Instrument.

A. Recommendation of umbrella of designated schemes, funds, securities, etc. under which the Society/ its individual members may invest taxable proceeds, if any, to minimize the impact of Income/ Capital Gain Tax.

Ans. In our view, whether there would be any capital gain tax liability arising on account of such transactions of Redevelopment, is not free from litigation, in view of the fact that various litigations are going on in various courts in our country and the issue would finally be settled when the Supreme Court decides the matter.

It is also to be noted that even the Supreme Court changes its view from time to time depending on the frequent amendments in the Income Tax Laws.

Further we would like to state that Income Tax Department have filed appeal before Hon. High Court and, if the court allows them against the assessee then the same would be taxable for the Society otherwise till now it is tax free. Even assuming that Hon High Court decide the case against the assessee then assessee will be liable to pay tax with interest but no penalty can be charged in

view of –decision of Supreme Court decided in the case of **Reliance Petro products Pvt. Ltd. Vs. CIT (2010) 322 ITR 158 (SC)** on the principle that if assessee give all particulars of income in return and claim certain wrong deduction due to ignorance of highly technical law then that will not attract penalty u/s 271(1)(c) of the Income Tax Act, 1961.

Further we would like to say that based on the above, till now the Corpus received by the Society and the individual members is tax free but in case the High Court decides the case against the Society then to be on the safer side and to avoid litigation with the Income Tax Department, we suggest that recipient can invest the same in Specified Bonds to claim exemption u/s. 54EC of the Income Tax Act. One can earn interest by investment in the Bonds for 3 yrs which would be an added benefit. The interest so earned would be taxable.

X] Responsibility/ Liability towards stamp duty.

A. Responsibility/Liability of the Society/its individual members towards Stamp Duty, if any, in transition from surrender of existing premises to the Develop to the occupation and registration of the Redeveloped premises

Ans. Normally, in the cases of Redevelopment, the Stamp Duty and the Registration Charges on surrender of the existing premises to the Developer for the purpose of Redevelopment would be paid by the Developer.

Whereas, when the Individual Members receives the Redeveloped Premises from the Developer, he is liable to pay Stamp Duty and Registration Charges on the same. The Stamp Duty payable would be on the cost of construction of the present area of the Premises and on the market value for the extra area received as per the Ready Reckoner Value published by the Government of Maharashtra every year on 1st January.

XI] Restructuring of Society.

A. Whether the composition of the Society may need to be restructured in any manner so as to facilitate minimization of the tax liability.

B. Whether admission of new members (from saleable portion.) in the existing Society or their Accommodation as an independent new Society would have any bearing on the tax liability of the Society/its individual members.

Ans. No, the composition of the Society need not be restructured in any manner so as to facilitate minimization of the tax liability.

The admission of the new members to the existing Society or their accommodation to the new Society would not make much difference to the tax liability of the Society or its Individual Members.

However, it would be advisable to admit the new members to the existing Society because due to increase in the number of the Members of the Society, the fixed charges or expenses of the Society like maintenance, etc would be distributed amongst the Members.

REDEVELOPMENT FROM THE POINT OF VIEW OF A LAND OWNER

When a Joint Development Agreement is entered between Land Owner and Developer to develop a land The Land Owner shall provide land to Developer for development of project and In Consideration of this, the Developer can provide specified developed area to Land Owner or he can give money as well as developed area to the land owner as per terms agreed between them.

Point of Taxation in the hands of Land Owner and Valuation

Earlier, i.e. before assessment year 2018-19 there was dispute between assessee (land owner) and income tax department for taxation of joint development agreement wherein income tax department levied taxes in hands of land owner at the time of execution of agreement with developer however, land owner prefer to pay tax after receipt of his share of developed area. This was causing lot of hardship to land owner because there was no cash flow at the time of JDA. To remove the considerable hardship faced by land owner and to end the existing dispute an amendment was brought in Finance Act, 2017 for taxation of JDA which are discussed as under :-

The finance act 2017 has inserted a sub section 5A to section 45 which is effective from 01.04.2018 i.e. AY 2018-19 reads as under:-

*“5A. notwithstanding anything contained in sub-section (1), where the capital gain arises to an assessee, being **an individual or a Hindu undivided family**, from the transfer of a capital asset, being land or building or both, under a specified agreement, the capital gains shall be chargeable to income-tax as income of the previous year in which the **certificate of completion for the whole or part of the project is issued by the competent authority**; and for the purposes of section 48, the **stamp duty value**, on the date of issue of the said certificate, of his share, being land or building or both in the project, as increased by the consideration received in*

cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

Provided that the provisions of this sub-section shall not apply where the assessee transfers his share in the project on or before the date of issue of said certificate of completion, and the capital

-gains shall be deemed to be the income of the previous year in which such transfer takes place and the provisions of this Act, other than the provisions of this sub-section, shall apply for the purpose of determination of full value of consideration received or accruing as a result of such transfer.”

Explanation.—for the purposes of this sub-section, the expression—

(i) “Competent authority” means the authority empowered to approve the building plan by or under any law for the time being in force;

*(ii) “Specified agreement” means a **registered agreement** in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash;*

(iii) "Stamp duty value" means the value adopted or assessed or assessable by any authority of Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.

Thus, as per the above provision the capital gain tax will accrue in hands of the landowner (being Individual/ HUF) when they gets ~~his~~their share of developed land with completion certificate from competent authority. Sale consideration in hands of Land Owner will be the Valuation of his Developed Portion workout by Stamp Authority for working of stamp duty as on date of issuing completion certificate. This amount will further increased by the amount of monetary consideration received or receivable under JDA.

For Example:-

Mr. A (Individual) was owner of 10 acre land which was purchased by him in year 2005. During financial year 2017-18 he entered into JDA with developer wherein it is agreed that developer shall give ten lakh rupees and 1000 sq. fit developed area in consideration of land. On 07.07.2019 project completion certificate has issued and on that date stamp duty value of 1000 sq. fit is Rs. 30,00,000/- Now tax-ability in hands of Mr. A will be as follows:-

The gain will be taxed in AY 2020-21 and for this purpose sale consideration of land will be Rs. 40,00,000/- (Rs.30 Lakh Stamp Value of Developed Area and Rs.10,00,000/- monetary consideration received under JDA). Mr. A will be allowed benefit of cost of land against sale consideration and balance gain will be taxable in his hands as capital gain in AY 2020-21. If the land was long term capital asset. Then the benefit of Indexation will also be allowable to Land Owner and he can avail exemption u/s 54, 54EC, 54F etc.

Thus *Land Owners* will require to pay tax in respect of their share of developed area alongwith monetary consideration as agreed in JDA only after obtaining completion certificate from the competent authority.

However, if the land owner is other than individual or HUF, then taxation will govern by old proviso of law. Generally it depends upon the drafting & conditions of agreement. But, generally gain will be taxable in the year when the Possession of property transferred to developer for development.

Nature of Gain

Nature of gain depends upon the classification of assets by the land owner. If the and is classified as Capital Asset (Investment) in books of account. Then the gain will be capital. However, if the Land is classified as Stock in trade, then the gain will be Business Income and will be taxable in the year when Risk & Reward of Land transferred to Developer which may the year when the JDA was executed.

Thus, the tax treatment will depends upon the treatment of land in books of Land Owner.

TDS liability

–Section 194IC deals with TDS in respect to an agreement governed by sub-section (5A) of section 45.

Sec 194IC is reproduced for our ready reference

194-IC. Notwithstanding anything contained in section 194-IA, any person responsible for paying to a resident any sum by way of consideration, not being consideration in kind, under the agreement referred to in sub-section (5A) of section 45, shall at the time of credit of such sum 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, deduct an amount equal to ten per cent of such sum as income-tax thereon.

Thus, as per the above provision the developer is required to deduct 10% TDS on Monetary consideration payable to Land Owners while making payment or crediting consideration in Land Owners account maintain in his books of account which ever is earlier.

GST IMPLICATIONS

Schedule III of CGST Act, 2017 prescribes the list of transactions which are outside the purview of GST. Clause 5 of that Schedule is very important of this query which spell as under:-

5. Sale of land and, subject to clause (b) of paragraph 5 of Schedule II, sale of building.

As the sale of Land is outside the purview of GST because it is neither the supply of goods nor supply of service. Therefore, where a transaction is of sale of land, it will be outside the purview of GST. The transfer of land development rights is nothing but an agreement in which ultimately the transfer of title in land takes place on a future date.

In our view land owner are not require to pay GST at the time of JDA.

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REDEVELOPMENT FROM THE POINT OF VIEW OF A DEVELOPER

Charge-ability of income depends upon Revenue Recognition. As the developer is dealing in real estate business. Hence, the Income will be business Income and Guidance Note on “Recognition of Revenue by Real Estate Developer” is relevant for revenue recognition.

Guidance Note on “Recognition of Revenue by Real Estate Developers” is a **re-commendatory in nature**. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.

As Per Section 145 of the IT Act, this refers to the method of accounting regularly employed by an assessee as well as to the notification by the Central Government of the Accounting Standards to be followed by any class of assessee or in respect of any class of income. Pursuant to the powers Under Section 145(2) notification dt. 25th Jan., 1996 was formulated. The notification does not prescribe a method of accounting for any particular class of assessee or classes of income as is evident from the reading of the said notification.

Thus, it is liberty of the assessee that which method he wants to follow for revenue recognition. Presently there are two most accepted methods of accounting i.e. Project Completion Method and Percentage Completion method are acceptable for real estate developers. Both these methods are judicially approved and developer can follow any one method out of above and should maintain consistency in method for recognition of revenue.

Further, CBDT (Central Board of Direct Tax) has also notified 10 ICDS (Income disclosure and computation standard) for the computation of taxable income/Losses which is applicable from the financial year 2016-17 i.e. A.Y. 2017-18 and assessee is required to mandatorily follow these standards for the computation of the income.

Out of these ICDS the ICDS No. III is related to "Construction Contract" wherein the computation of taxable income of the Construction Contract is provided. However, this ICDS is silent whether the same is applicable to Real Estate Developers or not. As the ICDS III does not provide the clear contention that whether it will apply on real estate developer or not. And due to complexity of these ICDS and Business operations of Real Estate Developer, this is not practical to follow these ICDS. Therefore, Direct Taxes Committee of ICAI made detailed representation to Central Board of Direct Taxes during the Direct Tax Workshop with CBDT which was followed by written representation to Chairman, CBDT on 31.03.2016 and Hon'ble Finance Minister, on 7.04.2016. On invitation by CBDT subsequently, the ICAI representatives met Joint Secretary (TPL-I) and Director (TPL-III) at North Block, New Delhi on 18th April, 2016 and 27th April, 2016 and made detailed presentation on difficulties that would be faced by stakeholders on implementation of ICDS. The representations made by ICAI were considered positively by the Expert Committee on ICDS in meeting held on 12.05.2016 and ICAI was asked to prepare detailed FAQs and amendments to ICDS which were submitted on 20.05.2016. The FAQ No. 15 deal with this situation which is as under:-

Question 15: Since there is no specific scope exclusion for Real estate development activity and BOT projects from ICDS IV on Revenue Recognition, please clarify whether ICDS III and IV should be applied by real estate developers and BOT operators. Also, there is no specific exclusion for lease income in ICDS IV. Please clarify whether ICDS IV is applicable for lease income.

Answer: The Accounting Standards Committee has recommended that separate ICDS should be notified for real estate development activity, BOT projects and Leases. A draft ICDS on Leases was also published for public comments but not finally notified. Hence, pending notification of specific ICDS to deal with these revenue items, they shall continue to be governed by existing tax laws. It is clarified that ICDS III and ICDS IV do not apply to these business activities.

Thus, As per ICAI it is clarified that revenue recognition of real estate developer will be governed by old law. As per old law and judicial finding the developer can follow any method with consistency.

However, Recently Central Board of Direct taxes released draft ICDS on Real Estate Transaction on May 11, 2017 wherein real estate developer are require to compulsory follow the percentage of completion method for taxation with cooling period for old projects. Till date that ICDS is not notified. Therefore, we cannot comment on same. Today's Law position can be change as per the final ICDS comes in effect in Future.

Thus the developer's Income will be taxable as Business Income. :-

The **point of taxation** will depends upon the method adopted by the developer. IF adopt Project Completion Method then income will be tax in the year when project gets completed. And if adopt percentage completion method, then income will be taxed in phase manner as per the works completed in respective year.

GST IMPLICATIONS

Coverage under scope

The taxable event under GST is **supply** of "Goods" and "Services". Hence it is important to understand the meaning of both these terms

Definition of Goods – Section 2(52) of GST Act

"Goods" means every kind of movable property other than money and securities but includes actionable claims, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply

Definition of Service – Section 2(102) of GST Act

"Services" : means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

Definition of Supply –

Definition of 'supply' Under section 2(92) read with section 3 'supply' includes all forms of supply of goods and/or services such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business.

Section 7(1) : supply includes :-

- All form of supply made for consideration.

- Activities to be treated as supply as per schedule II.

Schedule II

- 5(b): Construction of complex, building, civil structure or part thereof.

Schedule II specifically cover Construction service. Accordingly, GST will be applicable on Construction service provided by developer to land owner.

In our view construction services provided by Developer to land owner will be liable for GST.

POINT OF TAXATION UNDER GST

The liability of GST on services shall arise at the time of supply, as determined in accordance with provision of section 13.

The time of supply of service shall be the earlier of the followings dates:-

- Date of issuing invoice (or last date by which invoice should have been issued)
- The date of receipt of payment, whichever is earlier

As service provided by developer under JDA is continue supply of service. It is also relevant to refer the following definition of “continues supply of service” under section 2(33) of the Act and section 31(5) dealing with issue of invoice

As per Section 2(33), “continuous supply of services” means a supply of services which is provided, or agreed to be provided, continuously or on recurrent basis, under a contract, for a period exceeding three months with periodic payment obligations and includes supply of such services as the Government may, subject to such conditions, as it may, by notification, specify.

Section 31(5) states issue of invoice in case of continuous supply of services, —

- | |
|--|
| <p>(a) Where the due date of payment is ascertainable from the contract, the invoice shall be issued on or before the due date of payment;</p> <p>(b) Where the due date of payment is not ascertainable from the contract, the invoice shall be issued before or at the time when the supplier of service receives the payment;</p> <p>(c) Where the payment is linked to the completion of an event, the invoice shall be issued on or before the date of completion of that event</p> |
|--|

It may be observed that the builder would not be raising any invoice and would not claim any payment from the landowner. The service being provided by the builder is a continuous supply of service. It may be observed that clauses (a) and (b) of sub section (2) of section 13 are not applicable in this situation, as neither any invoice is raised by the builder on landowner, nor any payment received. As per clause (c) the time at which the landowner shows the receipt of service in his books of accounts would be the time of supply. If the landowner is retaining such units for his own use, he would recognize the same as his capital assets and if the landowner is going to again sell such units, he would recognize the same as his stock in trade. So it can be taken that the builder would be liable to pay GST at the time, when the landowner recognizes the receipt of units from the builder. However from builder’s point of view it would be very difficult to conclude when

the landowner recognizes receipt of service. Thus the determination of time of supply was no less than a mystery.

These confusions have been now resolved by Notification No. 4/2018-Integrated Tax (Rate) dated 25th January, 2018. The extract of Notification is as under:-

Notification No. 4/2018-Integrated Tax (Rate)

New Delhi, the 25th January, 2018

G.S.R 72(E).- In exercise of the powers conferred by section 20 of Integrated Goods and Services Tax Act, 2017 (13 of 2017) read with section 148 of the Central Goods and Services Tax Act, 2017 (12 of 2017), the Central Government, on the recommendations of the Council, hereby notifies the following classes of registered persons, namely:-

(a) registered persons who supply development rights to a developer, builder, construction company or any other registered person against consideration, wholly or partly, in the form of construction service of complex, building or civil structure; and

(b) registered persons who supply construction service of complex, building or civil structure to supplier of development rights against consideration, wholly or partly, in the form of **transfer of development rights**,

as the registered persons in whose case the liability to pay integrated tax on supply of the said services, on the consideration received in the form of construction service referred to in clause (a) above and in the form of development rights referred to in clause (b) above, **shall arise at the time when the said developer, builder, construction company or any other registered person, as the case may be, transfers possession or the right in the constructed complex, building or civil structure, to the person supplying the development rights by entering into a conveyance deed or similar instrument (for example allotment letter).**

[F. No.354/13/2018 -TRU]
(Ruchi Bisht)

The clarification brought out in this notification is similar to what existed in the Pre GST Era. As per the notification, the time of supply in case of issue of development rights and construction services in its consideration shall rise at the time when the said developer transfers possession or the right in the constructed complex, building or civil structure, to the person supplying the development rights by entering into a conveyance deed or similar instrument (for example allotment letter).

Thus, the Developer has to pay the GST on developed area given to Land owner at the time of transfer of possession or right in developed area by any document to land owner.

2. CAPITAL GAIN

2.1 CAPITAL ASSET

Definition of Capital asset is given under section 2(14) which is very wide in nature and covered the right in capital asset also. Only those item are not covered under capital asset which are specifically excluded from capital asset.

Some Amendment with respect to Definition of capital asset.

By the provision of "Sec. 2(14) Capital Asset", Rural agriculture land was exempt from capital gain. For being rural agriculture land, land must be satisfied certain condition laid down in section 2(14).The Finance Minister amended this

conditions through Finance Bill 2013-14. For, Simplicity we discuss effect of this amended in two part.

A. Criteria for being rural agriculture prior to 01/04/2013

B. Criteria for being rural agriculture after to 01/04/2013

Criteria for being rural agriculture prior 1-04-2013:

Prior to 01/04/2013 this section are applicable:

2(14)(iii) [Agricultural land in India, not being land situate-

(a) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(b) in any area **within such distance**, not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may, having regard to the extent of, and scope for, urbanization of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette;]

Thus, if these conditions are satisfied than land will agriculture land.

Land is situated in any within the jurisdiction of a municipality or a cantonment board having population of less than 10000.

Land is situated outside the notified distance from jurisdiction of municipality. Govt. can notified maximum distance of 8Km.

If this condition was satisfied than land is rural agriculture land. And not liable for capital gain tax.

How to measure distance was not given in the definition. Therefore it was taken by road. And same view was followed in following judicial pronouncement.

(1) CIT V.LAL SINGH [2010] 195 TAXMAN 420 (PUNJ. & HAR.)

(2) CIT V. SANTINDER PAL SINGH [2010] 188 TAXMAN 54 (PUNJ. & HAR.)

(3) LAUKIK DEVELOPERS V. DY .CIT [2007] 105 ITD 657 (MUMBAI)

Criteria for being rural agriculture After 1-04-2013:

After 01/04/2013 this section are applies as follow:

As Per Section 2(14)" capital asset" means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include-

(iii) Agricultural land in India, not being a land situated

(A) In any area which is comprised within the jurisdiction of a municipality (whether known as municipality, municipal corporation, notified area committee,

town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand [according to the last preceding census of which the relevant figures have been published before the first day of the previous year]; or

b) In any area within the distance, **measured aerially**,

(I) Not being more than two kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten thousand but not exceeding one lakh; or

(II) Not being more than six kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than one lakh but not exceeding ten lakh; or

(III) Not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten lakh.

Explanation.—For the purposes of this sub-clause, "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year;

Thus, if this condition is satisfied then agriculture land will be rural agriculture and accordingly not liable for capital gain tax.

Land is situated in any within the jurisdiction of a municipality or a cantonment board having population of less than 10000.

Distance of land from municipality and population limit.

Distance	Population
<i>Within 2 kilometers</i>	<i>10,000-1,00,000</i>
<i>2 kilometers – 6 kilometers</i>	<i>1,00,000-10,00,000</i>
<i>6 kilometers – 8 kilometers</i>	<i>More than 10,00,000</i>

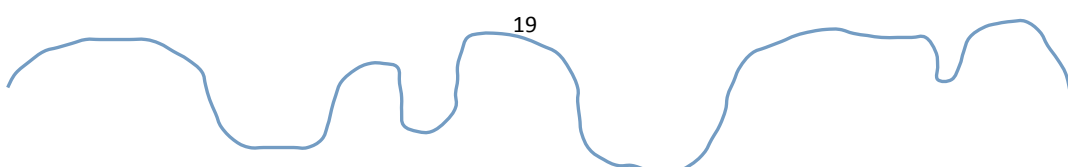
The distance from the Municipal Corporation measurement:

Such distance is to be measured on **straight line aerially** as crow flies. The shortest aerial distance has to be considered. Such shortest aerial distance is defined as “A straight line distance between two places.” A human would travel further to get from one point to another due to obstacles or lack of roads or trails, but a crow can go in a straight line between them. Humans have to follow roads which have their twists and turns. But, a crow does not have to face the barriers that humans face. Hence, we measure the straight line distance between two places.

“The distance as the crow flies is a way to describe the distance between two locations without considering all the variable factors. As an example, traveling from California to maine involves a rather indirect route around, over and through mountain ranges and so forth. The driving distance might be about 3,500 miles, but the distance as the crow flies is about 2,800 miles.

Human

[By road]





Crow's flight straight line distance (aerial measurement)



This amendment apply in relation to assessment year 2014-15 and subsequent assessment years.

Effect of the amendment

- a) Distance from jurisdiction or municipality or cantonment board within which agricultural land is to be considered as urban land has been changed from uniformly 8 kms to within 8 kms depending on population of municipality or cantonment board.
- b) Distance to be measured straight line aerially as crow flies and not by road method which was used by courts in various decision. This amendment overcomes above court decisions which say that distance should be measured by road.
- c) More land will be covered under the urban land because aerially distance covered more area.
- d) Earlier only notified area were covered under the distance criteria but from now any area will be covered under the distance criteria.

2.2 TRANSFER IS A PRE-REQUISITE FOR TAXING CAPITAL GAIN BECAUSE CAPITAL GAIN IS CHARGEABLE IN THE YEAR WHEN ASSET IS TRANSFER:

Capital gain arises only when there is a *transfer* of capital asset. If the capital asset is not transferred or if there is any transaction which is not regarded as transfer, there will not be any capital gain. However w.e.f. AY 2000-2001 section 45(1A) has been inserted to provide that in case of profits or gains from insurance claim due to damage or destruction of property, there will be capital gain on such deemed transfer although no asset has been actually transferred in such case.

Judicial pronouncements — whether a transaction constitutes transfer or not?

- Where an assessee gives up the right to claim specific performance for purchase of immovable property it is relinquishment of a capital asset and thus transfer:

The assessee had entered into an agreement to purchase certain property. Both parties reserved the right to specific performance of the agreement. Nearly four years thereafter, again another agreement was entered into in the nature of deed

of cancellation, by which the assessee agreed for termination of the earlier agreement and allowed the owner of the land to sell the said property to any person and at any price of his choice. As a consideration for this, the assessee was paid a sum of Rs. 6,00,000 apart from being refunded the advance of Rs. 40,000. The question that arose for consideration was as to whether the amount of Rs. 6,00,000 received by the assessee from the vendor could be treated as capital gains in the hands of the assessee.

K.R. Srinath v Asstt. CIT (2004) 268 ITR 436 (Mad)

- There is no transfer in family settlement:

Where a family settlement/ arrangement is arrived at in order to avoid continuous friction and to maintain peace among the family members, the family arrangement is governed by the principles which are not applicable to dealing between strangers. So, such *bona fide* realignment of interest, by way of effecting family arrangements among the family members would not amount to transfer.

CIT v A.L. Ramanathan (2000) 245 ITR 494 (Mad) In this case the court followed the decision of the Supreme Court in general law laid down in the case of **Kale v Deputy Director of Consolidation (1976) AIR 1976 SC 807.**

- Giving up the right to obtain conveyance of immovable property amounts to transfer of a capital asset:

Where the assessee had paid the earnest money and acquired right to obtain conveyance of immovable property, such earnest money paid shall be cost of acquisition of such right and if such right is given up, there is a transfer of a capital asset and the compensation received for giving up such right is the consideration price. **CIT v Vijay Flexible Container (1990) 186 ITR 693 (Bom)**

- In case of litigation pending, no capital gain tax unless the case is decided:

The AO hold that the income accrues on the date when an enforceable debt is created in favour of the Assessee. However, the Court held to consider the issue as to whether the income would accrue even when the very existence of the income is under doubt and a subject matter of litigation. Further, the subject matter of litigation cannot be a subject matter of tax avoidance.

ITO v. M/s. S. P. BUILDERS, CIT(A) XII/ 12(3)(4)/ IT – 184/07-08.

- Enhanced compensation under Compulsory acquisition:-

In relation to compulsory acquisition of a capital asset, any enhanced compensation received pursuant to an interim order of any authority, will be liable to tax in the previous year in which the final order of such authority is made and not on receipt.

2.3 CONVERSION OF CAPITAL ASSET INTO STOCK – IN – TRADE

As per section 45(2) if a capital asset is converted into stock – in – trade, the capital gain is taxable in the year such stock sold, and the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the

full value of consideration received or accruing as a result of the transfer.

2.4 CONVERSION OF STOCK – IN – TRADE INTO CAPITAL ASSET

Earlier there was no specific provision in the Income Act similar to section 45(2) with respect to Conversion of Stock – In – Trade into Capital Asset.

However finance Act 2018 has made amendment in the various sections of Income Tax Act 1961 to provide for a proper Tax Treatment. The extract of the same is discussed below.

(i) Section 28, by inserting clause (via) so as to provide that the fair market value of inventory as on the date on which it is converted into, or treated as a capital asset determined in the prescribed manner shall be charged to tax as business income.

(ii) Section 2(24), by inserting clause (xiia) so as to include such fair market value in the definition of income;

(iii) Section 49, by inserting Sub-Section (9) so as to provide that for the purposes of computation of capital gains arising on transfer of such capital assets, the fair market value on the date of conversion shall be the cost of acquisition;

(iv) Clause (42A) of section 2, by inserting clause (ba) in Explanation 1 clause(i), so as to provide that the period of holding of such capital asset shall be reckoned from the date of conversion or treatment.

2.5 PIECEMEAL TRANSFER

In **AJAI KUMAR SHAH JAGATI V ITO (1995) 55 ITD 348 (DEL.) AND M/S G. G. DANDEKAR MACHINES WORKS LTD V. JCT, ITA NO. 181/MUM/2001, BENCH – F, DATED 28TH FEBRUARY, 2007**, possession of only a part of property was transferred against proportionate consideration received during the relevant assessment year. It was held that capital gains arising only on the said proportion amount of consideration could be charged in the relevant year and not on the entire consideration stipulated in the sale agreement.

2.6 CAPITAL ASSETS CAN EITHER BE SHORT-TERM CAPITAL ASSET OR LONG-TERM CAPITAL ASSET

Short-term capital asset: A capital asset held by an assessee for not more than 36 months *immediately preceding the date of its transfer* is known as a short term capital asset. The criteria of 36 months have been reduced to 24 months in the case of immovable property being land, building, and house property, from FY 2017-18. For instance, if you sell house property after holding it for a period of 24 months, any income arising will be treated as long-term capital gain provided that property is sold after 31st March 2017.

Long-term capital asset: It means a capital asset which is not a short-term capital asset. In other words, if the asset is held by the assessee for more than 24 months or 12 months, as the case may be, such an asset will be treated as a long-term capital asset. The reduced period of aforementioned 24 months is not applicable to movable property such as jewellery, debt-oriented mutual funds etc.

They will be classified as a long-term capital asset if held for more than 36 months as earlier. Some assets are considered short-term capital assets when these are held for 12 months or less. This rule is applicable if the date of transfer is after 10th July 2014 (irrespective of what the date of purchase is).

Key Changes

Time limit of qualifying as a long term capital asset in case of unlisted share and units of mutual funds (other than equity oriented funds) is now reduced from 36 months to 24 months.

Thus, period of holding of a capital asset is relevant for determining whether capital asset is short-term or long-term.

Inclusion of certain period for computing the period of holding of an asset:

<i>Case</i>	<i>Inclusion of period</i>
(ii) Property acquired in any mode given under section 49(1) (e.g. by way of gift will, etc.)	Include the holding period of previous owner also.

Judicial decisions for determining period of holding

Property constructed on a land purchased earlier: In case of property is constructed on a site purchased much earlier, the question arises whether the period of holding the asset *i.e.*, the property, should be reckoned from the date of completion of the construction of the property or from the date of acquisition of the land.

The correct position is that the asset consists of two components: (1) Land and (2) Building. When the property is sold, the period of holding has to be reckoned separately for the land and the building. The consideration received can also be split into two parts relating to each component.

In ***CIT v Vimal Chand Golecha (1993) 201 ITR 442 (Raj)***, the land was purchased in 1962 and building was constructed thereon in the accounting years relevant to assessment years 1968-69, 1969-70 and 1970-71. The building was sold in 1970. It was held that the gains attributable to land were assessable as long-term capital gains. The gains attributed to the building were however, short-term capital gains. Similar decision was held in the cases of ***CIT v Lakshmi B. Menon (2003) 264 ITR 76 (Ker)*** and ***CIT v C.R. Subramanian (2000) 242 ITR 342 (Kar)***.

Agreeing with the above Rajasthan High Court view, it has been held that land can be considered a separate capital asset even if a building is constructed thereon. Thus, where the land is held for more than a prescribed period, the gains arising from the sale of the land can be considered as long-term capital gains even though the building thereon, being a new construction, is held for a period less than the prescribed one .

CIT v Dr. D.L. Ramachandra Rao (1999) 236 ITR 51 (Mad)

CIT v Citibank N.A. (2004) 260 ITR 570 (Bom)

In the above cases, the burden will be on the assessee to satisfy how much of the sale proceeds should be apportioned for the land and how much of the sale proceeds pertained to the structure.

CIT v Estate of Omprakash Jhunjunwala (2002) 254 ITR 152 (Cal)

Period of holding of share in the co-operative housing society: While computing the capital gain tax in case of transfer of his shares by a person who is a member of cooperative housing society, the relevant date would be date on which the member acquires the shares in the cooperative housing society and the date on which member had sold his shares therein. Thus, where the assessee acquired shares in the society on 6-9-1979 and was allotted flat on 15-11-1979. He was given possession of flat in October 1981, and sold the shares of the society along with the flat, on 4-12-1982, the capital gains arising from the sale were long term capital gains, shares having been held for more than 36 months.

CIT v Anilben Upendra Shah (2003) 262 ITR 657 (Guj)

Similarly, the assessee became a member in Venus Apartments (Galaxy Co-operative Housing Society). He was allotted a flat in the building of the society by resolution dated 4-11-1980, passed by the managing committee of the society. On the date of allotment, i.e., 4-11-1980, the property was under construction and came to be completed on 12-9-1983. Physical possession was handed over to the assessee on 12-9-1983. On 30-4-1984, the flat was sold by the assessee for a consideration of Rs. 3,75,000. The assessee worked out long-term capital gains at Rs. 1,59,395. The Assessing Officer did not accept the stand of the assessee that the assessee had become the owner of the property as per resolution dated 4-11-1980.

According to the Assessing Officer the assessee had held the property for a period of less than 36 months and as such was liable to short-term capital gains tax, it was held that the assessee in the present case was allotted a share by the co-operative housing society on 4-11-1980, and the sale of the same took place on 30-4-1984, i.e., after a period of 36 months. The Tribunal was therefore justified in holding that the capital gains arising were long-term capital gains and the assessee was entitled to deduction from such gains as per law.

CIT v Jindas Panchand Gandhi (2005) 279 ITR 552 (Guj)

Right to acquire any house property: Where a flat is booked with a builder under a letter of allotment or an agreement for sale, this would represent only a right to acquire a flat and if such right is acquired more than 36 months back, it becomes a long-term asset. However, when the possession of the flat is taken, the period of holding would once again commence from the date of the possession of the flat as the small right to acquire a flat merged into larger right and small right upon a merger would lose its existence.

2.7 COST OF ACQUISITION

Cost of acquisition of an asset is the value for which it was acquired by the

assessee. Expenses of capital nature for completing or acquiring the title of the property are includable in the cost of acquisition.

Judicial decision on cost of acquisition:

Cost of acquisition of an asset acquired from the previous owner in any mode given u/s 49(1): In this case, the cost of acquisition is taken as the cost to the previous owner and it is this cost which will have to be indexed. For the purpose of indexation the year in which the asset was *first held* by the assessee (not the previous owner) is to be considered. The indexation will be done as under:

Cost of acquisition to the previous owner ×

$$\frac{\text{CII of the year of transfer}}{\text{CII of the year in which the asset is first held by the assessee}}$$

However, in the case of *Mrs. Pushpa Sofat (2002) 81 ITD 1 (Chd)(SMC)*, the indexation of cost was allowed from the date of acquisition of the asset by the previous owner and not the date when the asset was acquired by the assessee from the previous owner under any mode given under section 49(1).

–Now, the Hon’ble Bombay High Court also take a same view in case of *CIT V/S Manjula J. Shah [2012]204TAXMAN691(Bom HC)* that under any mode given under section 49(1) *indexation will be allowed from the date when previous owner acquired property.*

2.8 VALUATION AS ON 1.4.2001

Reference to the DVO can be made u/s 55A when the AO is of the opinion that the value of the capital asset is in variance with fair market value of the property as on 01.04.2001.

2.9 FORFEITURE OF ADVANCE AGAINST CAPITAL ASSET

Earlier by virtue of section 51 forfeiture of advance received for transfer of capital asset was reduced from the cost of acquisition which result into loss to tax payer at the time of sale of capital asset. Because on sale of capital asset he loos the indexed benefit if the advance was not forfeited. Therefore, to avoid this loophole new section 56(2)(ix) was introduced **vide Finance (No.2) Act, 2014** and as per new section cost will remain same and advance will be taxed under “Income from other source”.

Ex.:- Cost of asset as on 1.4.1981 RS. 1,00,000/-, Advance forfeited in A.Y. 2014-15 Rs. 50,000/-, Index of A.Y. 1981 = 100, Index of A.Y. 2014 = 1024, Final Sale for = Rs. 15,00,000/-, Sale in A.Y. 2014-15

Earlier Provision		Proposed Provision	
Income From Capital Gain		Income From Capital Gain	
Sale	Rs. 15,00,000/-	Sale	Rs. 15,00,000/-
Less: Index Cost (1,00,000 – 50,000)*1024/100	Rs. 5,12,000/-	Less: Index Cost 1,00,000*1024/100	Rs. 10,24,000/-
Long Term Capital Gain	Rs. 9,88,000/-	Long Term Capital Gain	Rs. 4,76,000/-
		Other Source Income	
		Forfeiture of Advance	Rs. 50,000/-
Total Income	Rs. 9,88,000/-	Total Income	Rs. 5,26,000/-

2.10 EXEMPTION OF CAPITAL GAINS U/s. 54, 54B, 54EC & 54F, 54EE

a) Profit on transfer of house property used for residence [Section 54]:

Benefit of section 54 is confined to sale of a residential house after 24 months and reinvestment in a residential house. Reinvestment benefits are available both for purchase and construction of the house. Purchase has to be either one year before or two years later. Construction has to be completed within three years of the sale of the asset in respect of which benefit of reinvestment is claimed. There have been many decisions on purchase/construction of the house. Further, certain clarifications have also been issued in this regard. These have been summarized as under:

i. House includes part of the house: House property does not mean a complete independent house. It includes independent residential units also, like flats in a multi-storeyed complex. The emphasis is not on the type of the property, but, on the head under which the rental income is assessed. [*CIT (Addl.) v Vidya Prakash Talwar* (1981) 132 ITR 661 (Del)].

ii. Release deed may also be treated as purchase: Where a property is owned by more than one person and the other co-owner or co-owners release his or their respective share or interest in the property in favour of one of the co-owners, it can be said that the property has been purchased by the releasee. Such release also fulfils the condition of section 54 as to purchase so far as releasee-assessee is concerned [*CIT v T.N. Aravinda Reddy* (1979) 120 ITR 46 (SC)]

iii. Addition of floor to the existing house eligible for exemption under section 54: The assessee sold his residential property and invested the capital gain within the stipulated time in the construction of a new floor on another house owned by him by demolishing the existing floor, it was held that he was entitled to exemption under section 54. [*CIT v Narasimhan (PV)* (1990) 181 ITR 101 (Mad)].

iv. No exemption under section 54 if land only is sold: The house property concerned must be building or land appurtenant to building. The basic test was whether the land appurtenant to building could be used independent of the user of the building. If so, it cannot be said to be land appurtenant to building. Further, the basic requirement is that the capital gain should arise from the transfer of building or land, the income of which is chargeable under the head Income from house property. If the land alone is sold, the provisions of section 54 will have no application inasmuch as the income from land is not chargeable under the head Income from house property. [*CIT v Zaibunnisa Begum* (1985) 151 ITR 320 (AP)].

v. Successor is entitled to benefit of exemption in case of death of the assessee:

In case of assessee's death during the stipulated period, benefit of exemption under section 54(1) is available to legal representative if the required conditions are satisfied by the legal representative. [*Ramanathan (CV) v CIT* (1980) 155 ITR 191 (Mad)].

vi. Purchase of limited interest in the house eligible for exemption under section 54: Where an assessee had sold the residential house and acquired only 15% interest in another house and such other house was already used for residence prior to purchase, it was held that the benefit should be available to the assessee. [*CIT v Chandaben Maganlal* (2000) 245 ITR 182 (Guj)]. In coming to the conclusion, the High Court followed its own earlier decision in *CIT v Tikyomal Jasanmal* (1971) 82 ITR 95 (Guj). In that case, what was purchased was a unit of house property, while in the present case before the High Court, it was a limited interest in the property.

vii. Construction in another property not eligible for exemption: An assessee gifted some land to his wife. He, thereafter constructed a building on the said land. The Government acquired the land and building and paid compensation for land to the wife and for the building to the assessee (husband). It was held that capital gain on land was assessable in the hands of the husband by virtue of section 64 but he was not entitled to exemption under section 54 in respect of capital gain on the acquisition of the land of the wife as the capital gain to the wife did not arise on transfer of a residential house. [*T.N. Vasavan v CIT* (1992) 197 ITR 163 (Ker)].

viii. House of the firm used by partners: Where a firm's property is used for residence of partners and thereafter distributed to the partners upon dissolution of the firm and the partner sells the same, exemption can be claimed by the partner under section 54. For this purpose, period for which this property was held by the firm shall also be taken into account for determining the question whether the house property in exemption was a long-term capital asset or not. [*CIT v M.K. Chandrakanth* (2002) 258 ITR 14 (Mad)].

ix. There can be both purchase and construction: Where the assessee had partly invested the capital gains on the purchase of another house and partly on the construction of additional floor to the house so purchased within the prescribed time limit, it was held that the Income-tax Officer was not justified in restricting exemption to investment on purchase only, holding that the exemption under section 54 was admissible either for purchase or for construction but not for both. [*Sarkar (B.B.) v CIT* (1981) 132 ITR 661 (Del)].

x. Construction can start before the sale of asset: The construction of the new

house may start before the date of transfer, but it should be completed after the date of transfer of the original house. [*CIT v J.R. Subramanya Bhat* (1987) 165 ITR 571 (Karn)]. The very fact that purchase of another house as also the construction can take place before the sale means that cost of purchase or new construction need not flow from the sale proceeds of the old property. [*CIT v H.K. Kapoor (Decd)* 1998 234 ITR 753 (All) and *CIT v M. Vasudevan Chettiar* (1998) 234 ITR 705 (Mad)].

ii-xi. Allotment of a flat by DDA under the Self-Financing Scheme shall be treated as construction of the house [Circular No. 471, dated 15-10-1986]. Similarly, allotment of a flat or a house by a cooperative society, of which the assessee is the member, is also treated as construction of the house

xii. [Circular No. 672, dated 16-12-1993]. Further, in these cases, the assessee shall be entitled to claim exemption in respect of capital gains even though the construction is not completed within the statutory time limit. [*Sashi Varma v CIT* (1997) 224 ITR 106 (MP)]. Delhi High Court has applied the same analogy where the assessee made substantial payment within the prescribed time and thus acquired substantial domain over the property, although the builder failed to hand over the possession within the stipulated period. [*CIT v R.C. Sood* (2000) 108 Taxman 227 (Del)].

xiii. As per a circular of CBDT, the cost of the land is an integral part of the cost of the residential house, whether purchased or constructed. [Circular No. 667, dated 18-10-1993].

xiv. Where an assessee who owned a house property, sold the same and purchased another property in the name of his wife, exemption under section 54 shall be allowable. [***CIT v V. Natarajan* (2006) 154 Taxman 399 (Mad)**].

xv. Where the assessee utilised the sale consideration for other purposes and borrowed the money for the purpose of purchasing the residential house property to claim exemption under section 54, it was held that the contention that the same amount should have been utilised for the acquisition of new asset could not be accepted. [*Bombay Housing Corporation v Asst. CIT* (2002) 81 ITD 454 (Bom). **Also followed in *Mrs. Prema P. Shah, Sanjiv P. Shah v ITO* (2006) 282 ITR (AT) 211 (Mumbai)**].

ii-xvi. Where non-resident Indian sold property in India and purchased residential property in U.K. and claimed deduction under section 54, it was held that it was not necessary that residential property should be purchased in India itself. [***Mrs. Prema P. Shah, Sanjiv P. Shah v ITO* (2006) 282 ITR (AT) 211 (Mumbai)**].

But, After the Amendment vide Finance (No.2) Act, 2014, exemption is no longer allowed on Investment in residential house outside India.

b) Capital gain on transfer of land used for agricultural purposes [Section 54B]:

Any capital gain (short-term or long-term), arising to an assessee (only individuals), from the transfer of any agricultural land which has been used by the assessee or his parents for at least a period of 2 years immediately preceding the date of transfer, for agricultural purposes, shall be exempt to the extent such capital gain is invested in the purchase of another agricultural land within a period of 2 years after the date of transfer to be used for agricultural purpose, provided the new agricultural land purchased, is not transferred within a period of 3 years from the date of its acquisition.

Section 54B is applicable only to individuals and not to any other assessee this is because the section uses the expression used by "his or a parent of his" which clearly indicate that the "assessee" refers to an individual. [*CIT v Devarajalu (G.K.)* (1991) 191 ITR 211 (Mad)].

c) Capital gain on transfer of long-term capital assets not to be charged on investment in certain bonds [Section 54EC]:

Any long-term capital gain, arising to any assessee, from the transfer of any capital asset on or after 1-4-2000 shall be exempt to the extent such capital gain is invested within a period of 6 months after the date of such transfer in the long-term specified asset provided such specified asset is not transferred or converted into money within a period of 3 years from the date of its acquisition.

Exemption under section 54EC not available in respect of deemed capital gains on amount received on liquidation of a company: Section 54E (now section 54EC) permits reinvestment benefit, if the sale proceeds/capital gains on sale of long-term capital assets are invested in the manner required by the section. Where a shareholder is made liable for deemed capital gains on amount received on liquidation of a company, is he eligible for reinvestment benefit under section 54E (now 54EC)? It was held that section 54E (now 54EC) would have application only where there is an actual transfer and not in a case, where there is only a deemed transfer. [*CIT v Ruby Trading Co. Pvt. Ltd.* (2003) 259 ITR 54 (Raj)].

Benefit under section 54EC, etc. available even on transfer of depreciable assets: Although as per section 50 the profit arising from the transfer of depreciable asset shall be a gain arising from the transfer of short term capital asset, hence short-term capital gain but section 50 nowhere says that depreciable asset shall be treated as short-term capital asset. Section 54E [or say 54EC or 54F, etc.] is in independent provision which is not controlled by section 50. If the conditions necessary under section 54E are complied with by the assessee, he will be entitled to the benefit envisaged in section 54E, even on transfer of depreciable assets held for more than 36 months. [*CIT v Assam Petroleum Industries (P.) Ltd.* (2003) 131 Taxman 699 (Gau). See also *CIT v ACE*

Builders Pvt. Ltd. (2005) 144 Taxman 855 (Bom)].

On the same analogy benefit under section 54EC or 54F shall be available in the case of depreciate asset if these are held for more than 36 months and 24 months in case of immovable property. ↘

✚ **Celling limit of Rs.50 lakh under section 54EC:**

Earlier due to Various Decision of Courts ceiling limit of Rs. 50Lakh was taken as per financial year. Because the words used in proviso to Section 54EC is “any financial year” and not “relevant financial year”.

This means that the assessee cannot invest more than Rs. 50 lacs during on financial year under 54EC bonds but he can do so in two different financial years provided that the financial year falls within the six months time limit after the sale of asset.

✚ **Reliance is placed on:**

Aspi Ginwala v. Asstt. CIT [2012] 20 taxmann.com 75 (Ahd. - Trib.)

But, After the Amendment vide Finance (No.2) Act, 2014 The investment in capital gains bonds for section 54EC exemption is now being restricted to Rs.50 lakh both in the year of transfer of the capital asset and in the subsequent year, so that one can't claim exemption of Rs.100 lakh for investments made in both the years.

The above amendment has taken effect from **01.04.2014**

d) Capital Gain on transfer of asset, other than a residential house [Section 54F]:

Any long-term capital gain, arising to an individual or HUF, from the transfer of any capital asset, *other than residential house property*, shall be exempt in full, if the entire net sales consideration is invested in purchase of one residential house within one year *before* or two years *after* the date of transfer of such an asset or in the construction of one residential house within three years after the date of such transfer. Where part of the net sales consideration is invested, it will be exempt proportionately.

The above exemption shall be available only when the assessee does not own *more than one residential house property on the date of transfer* of such asset exclusive of the one which he has bought for claiming exemption under section 54F.

Section 54 and 54F are comparable in many respects. Hence, the law and precedents relating to section 54 as to whether the house property on which investment is made is residential or not, the law relating to time limits, the precedent that construction could start earlier though completed within three years are all equally applicable for section 54F. Hence, for judicial decisions for section 54F, refer to the judicial decisions given under section 54.

- e) Capital gain on transfer of long-term capital assets not to be charged on investment in certain bonds [Section 54EE]:

A new section 54EE is inserted w.e.f 01.04.2017. This section is introduced on the same lines as Sec 54EC.

2.11 CAPITAL GAIN ON THE TRANSFER OF LAND, FORMING PART OF BUILDING WHICH IS DEPRECIABLE, CAN BE LONG-TERM

Section 50 provides for determination of the cost of construction of superstructure and it does not apply to land as land is not a depreciable asset. Hence, if the building comprising of the land is sold, the capital gain on superstructure shall be short-term capital gain in terms of section 50 and the capital gain on land, if held for more than 24 months, shall be long-term capital gain. This is because the land is independent and identifiable capital asset and it continues to remain so even after construction of the building thereon. [*CIT v CITY Bank NA* (2003) 261 ITR 570 (Bom)].

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2.12 BLOCK OF ASSETS – SECTION 2(11).

Where land and building were used for the business, an important issue arises whether the new constructed area received can be added to the block of assets. The new constructed area will not be a building used for the purpose of the business. If it is not an asset which will be used as a “Building” for the purpose of business, it may not become a part of the Block of Assets.

For the purpose of redevelopment, the old building has to be demolished. Such building may be part of the block of asset. Issue arises as to whether indexed cost of structure can be deducted to arrive at the long term capital gains on the sale of land. Indexation u/s. 48 is allowed only in respect of cost of acquisition or cost of improvement of the capital asset transferred. Therefore, one may contend that only the land is transferred and not the building, which will be demolished to enable the development of land, hence the cost of structure cannot be taken into consideration and only index cost of land will be considered.

Thanking You
