ISSUES ON CAPITAL GAINS ON TRANSFER OF IMMOVABLE PROPERTIES

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I. INTRODUCTION:

The topic "Income from Capital Gains" is very vast in nature and requires a thorough understanding of the provisions of Section 45 –Section 55A, Section 2(47) which defines the term "transfer", Section 2(14) which defines the term "Capital Asset", Section 2(29A) which defines the term "Long Term Capital Asset" and Section 2(42A) which defines the term "Short Term Capital Asset". Consequential definitions of certain terms namely "Long Term Capital Gain" as enumerated under Section 2(29B) and "Short Term Capital Gain" as defined in Section 2(42B) should also be looked into. A clear understanding of the definition of the term "Transfer" under Section 2(47) of the Income tax Act and the definition of the term "Immovable Property" under Section 269UA(d) of the Income tax Act becomes essential to understand the consequences arising out of the retention and transfer of immovable property and the tax incidence thereon.

1) ***"Transfer"*** *under Section 2(47) includes:*
   - *i) the 'sale', exchange or relinquishment of the asset; or*
   - *ii) the extinguishments of any rights therein; or*
   - *iii) the compulsory acquisition thereof under any law; or*
   - *iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or*
   - *iva) the maturity or redemption of a Zero Coupon Bond; or*

v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or

vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of any immovable property;

Explanation: *For the purposes of sub-clauses (e) and (f), "Immovable Property" shall have the same meaning as in clause (d) of Section 269UA of the Income Tax Act.*

*2) **"Immovable Property"** under Section 269 UA (d) means:*

(i) *any land or building or part of a building, and includes, where any land or any building or part of a building is to be transferred together with any machinery, plant, furniture, fittings or other things, such machinery, plant, furniture, fittings or other things also.*

Explanation: *For the purposes of this sub-clause, 'land, building, part of a building, machinery, plant, furniture, fittings and other things' include any rights therein;*

(ii) *any rights in or with respect to any land or any building or a part of a building (whether or not including any machinery, plant, furniture, fittings or other things therein) which has been constructed or which is to be constructed, accruing or arising from any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement of whatever nature), not being a transaction by way of sale, exchange or lease of such land, building or part of a building;*

The said definition has been linked to the explanation under Section 2(47) of the Income tax Act as mentioned above.

II. CHARGEABILITY OF CAPITAL GAINS:

The power to levy capital gains is enshrined in the provisions of Section 45 of the Income tax Act, which states as follows:

"Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of the previous year in which the transfer takes place".

From the aforesaid definition it is clear that there should be

(i) Profits and gains from

(ii) the transfer

(iii) of a capital asset

for the purpose of invoking the provisions of Section 45(1). Many issues of considerable importance emerge on the taxation of ***"Income from Capital Gains"*** *mainly due to the complex definition of the term* ***"transfer"*** *and the term* ***"capital asset"*** *and some of such issues which are restricted to the Capital Gains arising out of the transfer of immovable properties are highlighted below:*

III. ISSUES ARISING ON TRANSFER OF IMMOVABLE PROPERTY.

1. SALE OF LAND AND BUILDING UNDER COMPOSITE AGREEMENT

It is often observed that both the land and building are sold under one composite agreement for a lump sum consideration without assigning the individual value for each of them. Further in case where the land is considered as a long term capital asset and the building as a short term capital asset due to the respective periods for which such assets were held, it becomes difficult to ascertain the amount taxable as long term and short term capital gains respectively. Therefore in all such cases, it is always better

to clearly mention the value for land and building separately in the instrument of conveyance. It has clearly been held in the cases mentioned below that where the land has been held for the period of more than 36 months and the building for less than 36 months, the capital gains will be taxed as long term and short term respectively.

Refer: CIT Vs Vimal Chand Golecha 201 ITR 442 (Raj)

CIT Vs DR.D.L.Ramachandra Rao 236 ITR 51 (Mad)

CIT Vs C.R. Subramanian(2000)242ITR 342(Kar)

CIT Vs Estate Of Omprakash Jhunjhunwala(2002)254ITR153(Cal)

The Statesman Ltd v Asst.CIT (2007)295ITR(AT)388(Kol-Trib)

2. DEDUCTION OF LIABILITY ATTACHED TO PROPERTY

(i) In many cases immovable properties are purchased by borrowing funds for the purpose. Subsequently when the immovable property is sold, the owner of the immovable property generally clears the liability due to the lender so that the lender releases the documents of title to the borrower to enable him to sell the immovable property. However, it is to be noted that although the amount ultimately received by the owner is after paying the liability, the entire amount received for the same will be taken as the consideration for sale for the purpose of levy of capital gains, i.e., in other words, the liability repaid by the assessee from the sale proceeds cannot be reduced from the consideration for the computation of capital gains. In other words in case of self created mortgage the amount paid to discharge the liability due to the mortgagee cannot be added to the actual cost nor can be reduced from the sale consideration.

Refer: - R.M.Arunachalam Vs CIT 227 ITR 222 (1997) (SC)

(ii) Where the property was mortgaged to the government and thereby interest in property was created in favour of the government, when such property is sold the interest that was created in favour of the government by mortgage could be reduced from the sale price of the property sold by public auction. The analogy adopted by the court in this case was that there is a diversion of income by

overriding title in favour of the government and therefore the amount received directly by the government could not be taken as consideration received by the assessee for the purpose of computation of capital gains.

Refer: CIT Vs Attili Narayana Rao (1998) 233 ITR 10 (AP)

However the Supreme Court has reversed the judgment of the High Court by holding that the liability paid to the Government cannot be reduced from the sale consideration payable to the assessee as per the document of conveyance. The aforesaid decision of the Supreme Court further elaborates the point that the liability towards a self created mortgage cannot be reduced from the sale consideration as held in the case of R.M.Arunachalam (supra).

Refer: CIT Vs Attili Narayana Rao (2001) 252 ITR 881 (SC)

CIT Vs Roshanbabu Mohammed Hussein Merchant 275 ITR 231(Bom)

(iii) Where a mortgage was created by the previous owner during his life time and the same was subsisting on the date of his death, the successor obtains only the mortgagor's interest in the property and by discharging the mortgage debt he acquires the mortgagee's interest in the property and therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgagee's interest in the property which is deductible as cost of acquisition under Section 48.

Refer: Jagadishchandran, V.S.M.R. Vs. CIT (1997) 227 ITR 240(SC)

N.Vajrapani Naidu Vs. ITO (1989) 28 ITD (MAD – TRI)

*3. **CONVERSION OF CAPITAL ASSETS INTO STOCK-IN-TRADE(SECTION 45{2}):***

Conversion by the owner of a capital asset into stock-in-trade or treatment by him of such asset as stock-in-trade of business carried on by him will be taxable as follows:

- *Fair Market Value of the capital asset on the date of conversion minus the value shown in the books will be charged as 'income from capital gains'*

- *The difference between sale value and the Fair Market Value as on the date of conversion will be charged under the head 'profits and gains' from business and profession.*

The incidence of tax on capital gains and business profit will arise only in the year when such stock in trade is sold or otherwise transferred.

The Kolkata Tribunal in the case of ***Octavius Steel and Company limited vs ACIT (2002)83 ITD 87*** *has held that Section 45(2) supersedes all the provisions including Section 45(1) and provides for charging of Capital Gains in the year when such converted stock in trade is sold or otherwise transferred.*

Therefore, it is obviously better to ensure that the Fair Market Value as on date of conversion is on the higher side as the tax rate on capital gain is much less than that on business income. Further the indexation benefit is available on the capital gains.

However, if the assessee has got carry forward business loss or unabsorbed depreciation from any business being carried on or which was carried on by him, it is better to reduce the Fair Market Value on date of conversion so that the business profit becomes more. It is be noted that the proviso to Section 72(1)(i) which provided that the business in which the carry forward loss arose should be carried on in the year of set off was removed with effect from 01/04/2000.

SECTION 45 (2) VIS-À-VIS SECTION 50 C

It is to be noted that when a capital asset gets converted into stock in trade, it ceases to be a "capital asset" and hence the provision of Section 50 C will not be applicable.

It is to be further noted that Section 50 C starts with the wording

"Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset……..". Therefore, as there is no consideration received or accruing when the capital asset is converted into stock in trade the provisions of Section 50 C will not be applicable to such transfer.

Further, if the Capital Asset namely Land is converted into Stock in trade and the assessee commences development of a project on that land the receipts of which are offered for Tax in the year of completion the interest paid on borrowed capital for the project will be allowed as an expenditure as a period cost.

***Refer*– Joint CIT v. K. Raheja P. Ltd. [2007] 290 ITR (AT) 69 (Mumbai)**

4. ***INTRODUCTION OF IMMOVABLE PROPERTY AS CAPITAL CONTRIBUTION INTO A FIRM OR ASSOCIATION OF PERSONS (AOP) OR BODY OF INDIVIDUALS (BOI) AND ITS SUBSEQUENT TRANSFER TO A COMPANY:***

The said method is used where the property is owned by a firm or has been contributed into the firm earlier as capital contribution and the same will now have to be sold to prospective buyers. The methodology adopted in such cases is as follows:

(i) The partners will contribute the immovable property as their capital contribution into a firm, which will be recorded in the books of the firm at cost or at a pre-determined value. Such contribution of immovable property as capital into the firm at book value (which is equal to the original cost of the property) will not involve incidence of capital gains under Section 45(3) of the Income Tax Act. However, if the value recorded in the books of accounts is equal to the value at which the property is likely to be sold, there will be an incidence of capital gains at this stage itself on the difference between the value recorded in the books and the original cost of the property. The contribution of property into the firm is specifically permitted under section 14 of the Indian Partnership Act, 1932.

It is to be noted that unlike section 14 of the Partnership Act, there is no similar provision under the Limited Liability Partnership Act, 2008 read with Limited Liability Partnership Rules, 2009. Further, under the LLP Act the valuation at which the property shall be bought in by a partner as capital contribution shall be prescribed under the LLP Rules as specifically provided in section 32(2) of the LLP Act and

hence there could be an incidence of Capital Gains Tax in the hands of the Partner at this stage itself. Further, as an LLP is an independent legal entity, there would be a stamp duty incidence on such contribution of immovable property.

(ii) Revalue the Immovable property in a year other than the year in which it is introduced and credit the excess on revaluation to the Partners' capital accounts.

(iii) Further it is to be noted that such contribution of immovable property into the firm as capital contribution does not require registration.

Refer: Addanki Narayanappa Vs Bhaskara Krishnappa (1966) AIR 1966 SC 1300

Any property, including immovable property can be brought into the stock of the firm as capital contribution. This would mean that originally when a firm is formed a partner can bring even immovable property into common stock of the firm for it to become the property of the firm. This does not require any registration under the Indian Registration Act, 1908

Refer: Supreme Court case Ratan Lal Vs. Purshottam Harit – AIR 1967 SC 401).

In the above case the Supreme Court held thus "It is well settled now that the share of a partner in the assets of the partnership which has also immovable properties, is movable property and the assignment of the share does not require registration under Section 17 of the Registration Act."

However the Mumbai Tribunal has in a recent judgment in the case of ***Shri Sudhakar M Shetty Vs ACIT ITA No – 1515/ Mum/ 2010 rendered on 09/09/2010 reported in (2011) 9 taxmann.com 274*** *held at assignment/ relinquishing of partnership interest by a retiring partner in favour of continuing partners for a lumpsum consideration would amount to a transfer of a "Capital Asset" U/s 2(47) of the Income Tax Act.*

Section 50C Vis-à-vis Section 45(3)

As the introduction of an immovable property by a partner to a firm does not require registration the provisions of Section 50C will not have any application to such a transfer.

Further as Section 45(3) deems that the consideration for transfer is the amount recorded in the books of the firm, the value adopted or assessed by a Stamp Valuation Authority will not arise in such a case.

(iv) Admit the prospective buyers of the immovable property as partners by bringing as their capitals the amount for which the property was agreed to be sold and ensure that their share of profits is in the excess of 50% before the firm is converted into a Company as this will help in complying with one of the requirements of Section 47(xiii) of the Income tax Act.

(v) Admit three more persons as partners with a nominal capital and a nominal share of profit as it is a pre-requisite to have seven members to register a firm as a joint stock company under Part – IX of the Companies Act.

(vi) Convert the firm into a company by registering the firm as a Joint Stock Company under Part IX of the Companies Act. The immovable property of the firm will vest with the company as per the provisions of Section 575 of the Companies Act and therefore will not require registration.

Ref: Andhra Pradesh High Court in the case of Vali Pattabhirama Rao and Another Vs Sri Ramanuja Ginning and Rice Factory P.Ltd and others reported in Volume 60, Company Cases, Page 569.

Also Refer—LKG Gold Palace Case122 Company Cases 896 (Mad HC)

(vii) The transfer of immovable property by a firm to a company through the Part IX route will not be hit by the provisions of Section 45(4) of the Income tax Act.

Refer:

(1)Texspin Engineering and Manufacturing works (2003) 263 ITR 345 (Bom)

(2) Wellpack Packaging vs CIT 78 TTJ 448 (Ahd – Trib)}

(3) ACIT Vs M/S Unity Care and Health Services ITA 611/Bang/ 2005-AY 2001-2002 order dated 17-6-2005 reported in 286ITR(AT)121(Bang)

(4) Sachdeva & Sons (EOU) vs Dy CIT(2004)82TTJ (Assam Trib)847

(5) Chetak Enterprises P Ltd vs Asst CIT (2006)281ITR (AT)162(Jodh-Trib)

The decisions of the Andhra Pradesh High Court and the Bombay High Court and the Income Tax Tribunals are based on the language used in Section 575 of the Companies Act which is reproduced below

"All property, movable and immovable (including actionable claims), belonging to or vested in a company at the date of its registration in pursuance of this Part, shall, on such registration pass to and vest in the company as incorporated under this Act for all the estate and interest of the company therein".

The transfer of assets alongwith the liabilities can be also made by the firm to the company thereby reducing the Authorised Capital of the company and the costs involved with incorporating the same.

(viii) Transfer the shares allotted to the original partners (sellers) to the partners admitted (buyers) in the Joint Stock Company subsequent to its formation at a mutually agreed price. This will ensure that the original partners (sellers) will not have any stake in the company which will now own immovable property.

Therefore, in such cases of succession of a firm by a company in the business carried on by the firm which also involves transfer of the immovable properties of the firm to the company, the registration of the firm as a Joint Stock Company under Part IX of the Companies Act 1956 is preferable.

5. ***TRANSFER OF PROPERTY THROUGH RECONSTITUTION OF A FIRM:***

Transfer of immovable property contributed into the firm as capital can be done through reconstitution of the firm ie., by introducing new partners (Buyers) and retiring existing partners (sellers). However, the same will not escape the rigours of Article 40(B)(a) of the Schedule to the Karnataka Stamp Act as the transaction will involve the payment of stamp duty at market value of the immovable property. Further it is be noted that the ***Karnataka High Court has in the recent decision of CIT Vs Gurunath Takies rendered on 7-7-2009 reported in 328ITR 59(2010)*** *held that in case where the partners who contributed the property of the Firm retire from the firm leaving behind the property in the firm, it amounts to a transfer of immovable*

property by the retiring partners in favour of the continuing partners and amounts to "transfer" as understood u/s 45(4) of the Income Tax Act. The decision though unfortunate is bound to be used by the Assessing Authorities in all cases where property was transferred through this methodology. ***The Decision of the Mumbai Tribunal in the case of Shri Sudhakar M Shetty Vs ACIT (supra) also appears to have adopted the same view.***

In order to avoid the rigours of Stamp Duty and Capital Gains as mentioned above it is therefore prudent to ensure that the original partners are retained in the firm with minor shares.

6. ***DISTRIBUTION OF CAPITAL ASSETS ON THE DISSOLUTION OF THE FIRM OR OTHERWISE {SECTION 45(4)}.***

   a) *The Distribution of a capital asset to a retiring partner will come within the ambit of the term "otherwise" as appearing under Section 45(4) of the Income Tax Act.*

Refer: CIT Vs. A.N.Naik Associates and another (2004) 265 ITR 346 (Mum).

The Mumbai Tribunal has in the case of ***Burlingtons' Exports, 45 ITD 424*** *held that the term 'otherwise' will not include withdrawal of assets by a partner for consideration. Therefore if a partner buys an immovable property of the firm, from the firm the provisions of Section 45(4) will not be attracted.*

However, it is interesting to noted that the Madras Tribunal in the case of ***Asst CIT Vs Goyal Dresses reported in 126 ITD 131(2010)*** *held that the provisions of Section 45(4) would apply only when the distribution of capital assets of the firm are made to more than one partner as the term 'distribution' would necessarily mean the parting of the firm's capital assets to more than one partner.*

b) Retirement of a partner from a firm does not amount to transferring any immovable property of the firm in favour of the surviving partners because there is no specific right to specific property. It is also important to note that when a partner retires from a firm he does not transfer any right in the immovable property in favour of the surviving

partners because he has no specific rights with respect to the properties of the firm. Therefore when a partnership is reconstituted by adding a new partner, there is no transfer of assets within the meaning of Section 45(4).

Ref: CIT vs. Kunnamkulam Mill Board (2002) 257 ITR 544 (Ker). However the Mumbai Tibunal in the case of Shri Sudhakar M Shetty Vs ACIT ITA No – 1515/ Mum/ 2010 rendered on 09/09/2010 reported in (2011) 9 taxmann.com 274 has taken a contrary view on a similar set of facts.

c) Where the firm continues after dissolution for the limited purpose of winding up its affairs without distribution of capital assets, no capital gains would arise in the year of dissolution.

Ref: (1) B.Raghuram Prabhu Estate vs JCIT (Assessment), 264 ITR 124 (Kar)

(2) CIT vs. Mangalore Ganesh Beedi Works 265 ITR 658 (Kar)

In other words, if the dissolution of the firm happens in a year in which there is no transfer of assets to the partners which may have happened earlier, the provisions of Section 45(4) may not be applicable.

Ref: CIT vs Vijayalakshmi Metal Industries (2002) 256 ITR 540 (Mad).

d) Amounts received by a partner in excess of his balance in the capital and current account in lieu of goodwill etc., cannot be taxed under Section 45.

Refer: (i) CIT Vs Mohanbhai Pamabhai – 165 ITR 166 (SC) (1987)

(ii) Tribhuvandas G.Patel Vs CIT – 236 ITR 515 (1996) (SC)

(iii) CIT Vs L.Raghu kumar – 141 ITR 674 (AP)

(iv) CIT Vs Seshagiri Rao – 213 ITR 304 (AP)

The above case laws were rendered based on the provisions of Sec 47(ii) of the Income Tax Act which was in force till 1.4.1988 .However the principles enunciated in the said decisions continue to have relevance even as on date in the absence of a specific

provision to tax the amount the excess amount received by the partners as mentioned above.

However the Mumbai Tibunal in the case of Shri Sudhakar M Shetty Vs ACIT ITA No – 1515/ Mum/ 2010 rendered on 09/09/2010 reported in (2011) 9 taxmann.com 274 has taken a contrary view on a similar set of facts.

Therefore, if the firm sells the immovable property belonging to it and distributes the cash to the partners even if it is in excess of the amounts due to them towards their capital and current accounts, will the same be treated as capital receipt in the hands of the partners?

Further reference may be made in this regard to the following case laws which have held that the amount received by a partner on the relinquishment of his share in the firm is a capital receipt.

CIT Vs Tahir Hussain 217 ITR 869 (Allahabad) 1995

Kettlewell Bullen And Co Ltd V CIT (1964) 53 ITR 261 (SC)

Prashanth S Joshi Vs ITO 324ITR 154(Mum)

e) SECTION 45 (4) VIS-À-VIS SECTION 50 C

Section 45(4) of the Income tax Act 1961 states that "The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of the transfer".

As can be seen from the aforesaid provisions, it is the fair market value of the asset on the date of transfer which is deemed as the full value of consideration received or accruing as a result of the transfer for the purpose of Section 45(4), whereas as per the provisions of Section 50C it is the consideration received or accruing as a result of the transfer, the value adopted by the stamp valuation authority, or the value ascertained by the Valuation Officer of the Income tax Department as the case may be which will be deemed to be the full value of consideration received or accruing as a result of the transfer.

Under the circumstances where an immovable property is distributed to a partner on dissolution of the firm or on his retirement, only the market value of the property on the date of distribution will have to be considered as deemed to be the full value of consideration received or accruing as a result of the transfer and Section 50C will have no application in such a case.

It is important to note that the Madras Tribunal in the case of ***Swamy Studio Vs. ITO (1998) 66 ITD 276*** *has held that Section 45(4) itself is a charging provision and therefore Section 2(47) need not be looked into to decide whether the transaction amounts to a "transfer" or not.*

It is also to be noted that immovable property distributed to partners on dissolution of the firm do not require registration as it is only a settlement of pre existing right.

Ref: S.V.Chandra Pandian Vs. S.V.Sivalinga Nadar and Others (1995) 212 ITR 592 (SC)

Further in the case of distribution of depreciated assets of the firm to the partners it has been held that the provisions of Section 45(4) and not Section 50(1) would be applicable as what is contemplated under Section 50 is the sale of depreciated assets and not its distribution of assets, ***Refer-CIT Vs Kumbazha Tourist Home(2010) 328ITR 600(Ker).***

7. *PROPERTY ACQUIRED ON LEASE CUM SALE BASIS:*

It is commonly observed that properties are acquired on a lease cum sale basis from the Bangalore Development Authority (BDA) or other equivalent authority, in case of residential plots and from the Karnataka Industrial Area Development Board (K.I.A.D.B) or other equivalent authority in cases of industrial plots. The lease cum sale agreements generally stipulates that the buyer/allottee shall not transfer the rights in the property allotted during the period of lease (normally 10 years) and shall acquire ownership rights to the property only after the expiry of the lease period by getting sale deed executed and registered in his favour from the B.D.A or K.I.A.D.B. etc. The question which often arises is on the taxation of such properties, if they are sold within 36 months from the date of acquiring ownership rights.

In this regard the Honorable Court of Karnataka, in the case of ***Dr.V.V.Modi Vs CIT 218 ITR 1,*** *has clearly held that the asset which was acquired on the lease cum sale basis as mentioned above should be compulsorily held for a period of 36 months from the date of obtaining ownership rights for it to be considered as a long term capital asset.*

The Court went with the analogy that the lease rights enjoyed by the allottee merged with the ownership rights the moment he got the sale deeds executed in his favour and that what was ultimately sold was only ownership rights.

However, in the light of decision of Supreme Court in the case of ***CIT Vs. Podar Cement (P) Ltd (1997) 226 ITR 625 (SC)*** *wherein the Court held that registration is not compulsory to be recognised as a owner of a house property for the purposes of Section 22 of the act, it is to be seen whether the decision rendered by the Hon'ble High Court of Karnataka in Dr.V.V.Modi's case (supra) is good law even today.*

The recent decision of the Delhi Tribunal in the case of ***Smt Sushma Rani Bansal Vs ACIT,Karnal 165 Taxman 145*** *has held that the decision of the Karnataka High Court in the case of Dr VV Modi referred to above needs to be reconsidered in light of the decisions of the Supreme Court in the case of Podar Cements mentioned above and the decision in the case of Mysore Minerals 239ITR 775(SC) and also due to the fact that the decision in DR V V Modi's case was rendered prior to the amendment to Section 2(47)(v) of the Income Tax Act.*

It is heartening to note that the Karnataka High Court has in the case of CIT Central Circle/ DCIT Central circle 1(2) Bangalore vs Smt C. Shakuntala in its order dated 19th September, 2007 also held that the decision in Dr. V.V Modi's case is not good law especially in the light of the amendment to the definition of "transfer" u/s 2(47)(v) with effect from 1/4/1988

It is to be noted the Bangalore Development Authority which had started the practice of issuing the sale deeds even prior to the period of ten years has now reverted back to the original practice of registering the sale deed only after completion of the statutory period of lease by amending the BDA Act and Rules accordingly.

It is further noted that in respect of the properties allotted by the KIADB the lease period stipulated is 6 years.

8. *EXTINGUISHMENT OF RIGHTS IN IMMOVABLE PROPERTIES*

In the case of the person who has entered into a agreement to sell for the purchase of an immovable property and ultimately extinguishes his rights under such agreement in favour of the ultimate buyer for a higher amount after holding such rights for more than 36 months, the income earned from such transaction will be taxed as a long term capital gain. This is due to the definition of the term of "transfer" under Section 2(47) of the Income Tax Act which includes "the extinguishment of any rights therein". The same analogy should be applied for compensation received on extinguishment of tenancy rights in a property.

Refer: Beardsell Ltd Vs., Joint CIT (2002) DTC 402 (Mad 'C' Tri); or 80 ITD 224 (Mad Tri)

CIT vs. Estate of Omprakash Jhunjhunwala (2002) 254 ITR 152 (Cal) or (2002) 172 CTR 325 (Cal)

K.R.Srinath Vs ACIT (2004) 268 ITR 436 (Mad)

CIT vs Vijay Flexible Containers (1990) 186 ITR 693 (Bom)

CIT vs Rasiklal Maneklal (HUF) (1974) 95 ITR 656(Bom)

CIT vs East India Charitable Trust (1994) 206 ITR 152 / 73 Taxman 380 (Cal)

CIT vs D.P.Sandu Bros. Chembur P. Ltd. / Union of India and another vs Cadell Weaving Mill Co. P. Ltd. and Another (2005) 273 ITR 1 (SC)
CIT vs M.N. Enterprises(2007) 293ITR 35(Kar)

9. *INDEXATION BENEFIT FOR SECTION 49(1) CASES:*

Section 49(1) of the Income Tax Act provides that where the capital asset became the property of an assessee under any of the circumstances and events referred to under the said section, the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it.

The question which, arises for the consideration is the indexation value or figure to be adopted when the property is ultimately sold i.e., whether the figure related to the year in which the previous owner acquired the property or the year in which the present owner acquired the property is to be considered. For eg., if the property was acquired by the previous owner in March 1983 and became the property of assessee under a gift in March 1997, whether the indexation figure of 109 related to 1982-83 or 305 related to 1996 - 97 should be adopted when the property is sold.

It is to be noted that the term 'indexed cost of acquisition' is defined under explanation (iii) to Section 48 as follows:

"Indexed Cost of Acquisition" *means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April, 1981, whichever is later".*

From the aforesaid definition, it appears that the indexation figure to be adopted will be 305 in the aforesaid assessee's case as he has held the asset for the first time in March 1997 only.

However, another view, that could be taken is that the indexation figure to be adopted should be 109 ie., the figure related to the financial year 1982-83, in which the previous owner first held the asset. This is because of the rulings by the various courts that "one should not while interpreting the taxations statute, take a literal construction of the relevant provisions, which leads to absurdity, unjust results and the creations or the perpetuation of the mischief which is sought to be avoided".

It is also to be noted that in explanation (i) (b) to Section 2(42A) which defines short term capital asset, it has been clearly provided that in case the capital asset became a property of the assessee in the circumstances mentioned in Section 49(1), the period for which the asset was held by the previous owner should also be taken into account.

It is heartening to note that Income Tax Appellate Tribunals , have held in the cases mentioned below that the indexation benefit should be reckoned from the year in which the asset was held by the previous owner:

Refer: Mrs.Puspa Safat Vs. ITO (Chd) 81 ITD page 1

DCIT Vs. Meera Khera, ITA No. 5258 / Mum / 98 'F' Bench

Smt Meena Deogun Vs ITO(2008) 117 TTJ(KOL)121 and recently in

DCIT(Mumbai) vs Manjula J Shah (ITAT-Mumbai Special Bench B-1) ITA No. 7315/MUM 2007 (Assessment Year 2004-2005)- **Decided on** : 16.10.2009 reversing the decision in the case of **Kishore Kanugo 102 ITD 437(Mum)**

10. *SALE OF BUILDINGS ON WHICH DEPRECIATION HAS BEEN CLAIMED– ELIGIBILITY FOR DEDUCTION UNDER SECTION 54E, 54EC ETC:-*

In case of transfer of depreciable asset, it is clear that if the consideration received for sale exceeds the blocks of assets in which the asset transferred was part of prior to transfer, the assessee is liable to be taxed on the excess as short term capital gains as per the specific provisions of Section 50 .The question which arises is that if such depreciable asset was held for more than 36 months prior to its transfer, will it be treated as a sale of a long term capital asset for the purpose of investments required to be made under the earlier Section 54E, 54EC etc.

It has been held by the Gauhati High Court in the case of ***CIT vs Assam Petroleum Industries Private Limited (2003) 262 ITR 587*** *that investment of net consideration in specified assets under Section 54E is eligible even in the case of transfer of an asset which is a depreciable asset which has been held for more than 36 months. The analogy adopted by the High Court in rendering this decision is that Section 54E is not controlled by Section 50 and Section 50 only provides that if depreciation is allowed under the act on the capital asset, the capital gain will be computed under Section 50 and not under Section 48 and 49 of the act.*

Similarly in ***Dr.Roy's case reported in 77 TR A-45 (2004)*** *it has been held that deduction can be claimed under Section 54EC even in the case of a depreciable asset*

which was sold and whose value exceeded the block of assets, based on the analogy adopted by the Gauhati High Court as mentioned in the aforesaid para.

The following tribunal decisions are also to be noted which have supported the decision of the Gauhati High Court as mentioned above

Refer : Ace Builders Private Limited Vs ACIT 71 TTJ 188 (Mum)

Weikfield Products Company Private Limited Vs DCIT 71 TTJ 518 (Pune)

SECTION 50 VIS-À-VIS SECTION 50 C OF THE INCOME TAX ACT

In case of an assessee who owns a building which is being used as a business asset which forms part of the "block of assets" as defined under Section 2(11) of the Income tax Act, when such building is sold the value to be deleted from the block of assets will be the consideration received or accruing as a result of the transfer of the capital asset as per the specific provisions of Section 50. It is to be noted that Section 50-C deems the full value of the consideration received or accruing as the result of such transfer to be the value as adopted by the Stamp Valuation Authority if the same is higher than the actual consideration received, for the limited purposes of Section 48 only and therefore, a case can be made out to state that Section 50-C will have no applicability in the case of sale of depreciable assets to which the provisions of Section 50 applies.

11. COMPENSATION FOR COMPULSORY ACQUISITION

In the case of transfer of a capital asset by way of compulsory acquisition under any law as understood under Section 45(5) of the Income tax Act, the question arises as to the date of the transfer and the consequent incidence of the capital gain arising from the compulsory acquisition in cases where the compensation is received before the date of the award. It has been held in the cases mentioned below that the date of award is to be regarded as the date of transfer and not the date on which the amount is received where the same is received prior to the date of award.

Refer: CIT Vs C.P.Lonappan and Sons (2004) 265 ITR 101 (Ker)

CIT Vs Purshottambhai Maganbahi Hatheesing (HUF) (1985) 156 ITR 150 (Guj)

CIT Vs Shiv Chand Satnam Paul (1998) 229 ITR 745 (P & H)

12. ***SECTION 50 C VIS-À-VIS SECTION 54, 54EC AND 54F***

A plain reading of provisions of Section 50 C helps you to come to a conclusion that the actual consideration received or accruing as a result of the transfer or the value adopted by the Stamp Valuation Authority for the purpose of stamp duty whichever is higher shall be deemed to be the full value of the consideration for purpose of levy of capital gains.

Section 48 of the Income tax Act provides that the income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer ……

While Sections 54 and 54EC provides that the capital gains arising from the sale of a residential house and a long term capital asset respectively should be invested in a house property or in bonds as the case may be to avoid or minimize the capital gain liability, Section 54F provides that the net consideration arising from the sale of a long term capital assets should be invested in a house property wholly or partly to avoid or minimize the capital gain liability.

Section 54F further provides that the "net consideration" in relation to a transfer of a capital asset means the full value of the consideration received or accruing as a result of a transfer of the capital asset……..."

From the above requirements of the respective sections it is clear that the capital gains to be invested in the cases of Section 54 and 54EC and the net consideration to be invested in the case of Section 54F will be computed taking into account that value adopted by the Stamp Valuation Authority for the purpose of payment of stamp duty in case such value is higher than the actual consideration received or accrued.

This will be lead to an absurd situation of an assessee being liable for capital gains on an amount, which he has never received, i.e., the difference between the valuation

adopted by the Stamp Valuation Authority and the actual consideration received. This may put a lot of assessees into genuine hardship especially in cases where the guideline values fixed are much higher than the actual market value of the properties in the locality or area concerned.

It is interesting to note that the ***Jaipur Tribunal has in the case of Gyan Chand Botra Vs ITO 6ITR (Trib) 147(Jaipur) also reported in (2010)195 Taxmann (BN-V)*** *held that for the purpose of claiming the exemption under Section 54F , it is the actual value of consideration received which has to be reckoned and not the deemed value as determined under Section 50C on the analogy that the deeming fiction of determining the full value of consideration for the limit purposes of computation u/s 48 of the Income Tax Act and will not apply to the term "net consideration" under the explanation to Section 54F(1). This decision could provide a great relief to assesses if it is followed by other tribunals as well and further upheld by the higher tax judicial authorities,*

The Constitutional Validity of the provisions of Section 50C have been upheld by the Madras High court in the case of K R Palaniswamy and Others V Union of India 2008-TMI-30601 in Appeal No W.P No 4387 of 2003 vide order dated 5-8-08.

However, the provisions of Section 50C will not be applicable to the Purchaser and the difference between the Stamp duty Value and the actual consideration received cannot be taxed in the hands of the purchaser by invoking the provisions of Section 69B of the Income Tax Act. ***Refer- ITO Vs Harley Street Pharmaceuticals Ltd(2010) 6 ITI(trib) 182 (Ahmedabad).***

13. ***DEFERMENT OF TAX ON CAPITAL GAINS:***

It is to be noted that sections 54 and 54F require the assessee to deposit the amount unutilized till the due date of filing the return of income, to be deposited in the

"capital gains accounts scheme" in order to avail exemption from capital gains provided other conditions under relevant sections are satisfied. The said section also provides that if the amount which has been deposited into the capital gains accounts scheme is not utilized for purchase or construction of house property within the stipulated dates, the capital gains originally exempt will be charged under Section 45 as income of the previous year in which the period of three years from the date of the transfer of the original asset expires. Therefore, if there is expectation of lower tax rates on capital gain arising from sale of immovable property in future, it is better to defer the incidence of tax by not utilizing the amount deposited into "capital gain account scheme".

It is to be noted that the ***ITAT Jodhpur Bench has in the case of Jagan Nath Singh Lodha vs. ITO (2004) 85 TTJ 173*** *held that the assessee can not be denied of an exemption for failing to deposit the amount in the "Capital Gain Account Scheme" or failing to purchase a flat on or before the due date of filing the return u/s 139(1). The principle applied was that as long as he had the intention from the very beginning to purchase a residential house which he had done in the said case within the period of two years from the date of sale of the original capital asset, he cannot be denied the exemption u/s 54F.*

14. ***INVESTMENT IN TWO RESIDENTIAL HOUSES – EXEMPTION U/S 54***

The Bangalore Tribunal 'C' Bench has in the case of ***Anand Basappa Vs. ITO (2004) 91 ITD 53*** *held that exemption will be given to a person who has invested in Two Residential properties from the sale proceeds relating to One Residential property as there is no specific bar in Section 54 unlike a specific bar u/s 54F. This was further confirmed by the Karnataka High Court reported in* ***309 ITR 329(Kar).***

The Madras Tribunal has in the case of ***ITO vs P.C Ramakrishna (HUF)(2007) 107TTJ (Chen) 351*** *which is a recent ruling also concurred with the views of the Bangalore tribunal on the same issue and the Karnataka High Court has further*

followed the decision in ***CIT Vs K G Rukminiamma 195 Taxmann(Part 4) XXIX (Kar)(2010) 8 Tamann.com121(Kar).***

Also Refer-Ratanlal Murarka's Case(ITA No 4485/Mum/1999- reported in BCAJ2003.

P.S Mogre(ITA no 4748/Mum/2001)

CIT Vs Sunita Aggarwal(2006) 284 ITR 20 (Del)

However the Mumbai Tribunal Special Bench 'I' Bench has in its order dated 17th April no ITA No 2865/Mum/2002 in the case of ITO Ward 19(3)-4 Vs Ms.Sushila M Jhaveri held that exemption Us 54 and 54 F will be available only with repect to investment in one house.

15 CAPITAL GAIN IN THE CASE OF SALE OF ENTIRE BUSINESS

(i) *The Madras High Court in the case of* ***ACIT Vs Raka Food Products (2005) 277 ITR 261*** *has held that the transfer of entire business undertaking as a whole including immovable property should be treated as Long Term Capital Gain irrespective of the fact that the immovable property was sold through a separate document. The Court further held that the assessee will be entitled to exemption from capital gain under Section 54E of the Income Tax Act, 1961.*

(ii) *Similarly the Mumbai High Court in the case of* ***Premier Automobiles Ltd. Vs. ITO (2004) 264 ITR 193*** *has held that the sale of an entire unit as a going concern will not be treated as a sale of itemised assets merely because the immovable property was conveyed through a separate document. The entire sale of unit was treated as a Slump Sale.*

16. TRANSFER AS CONTEMPLATED UNDER SECTION 53A OF THE TRANSFER OF PROPERTY ACT 1882 AND SECTION 50C:

Section 2(47) which defines "transfer" in relation to a capital asset includes any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act 1882 (explanation {v} to Section 2{47})

Article 5 (e) (i) of the Schedule to the Karnataka Stamp Act 1957 provides that where the possession of the property is delivered or agreed to be delivered in part performance of the contract in the agreements itself without executing the conveyance relating to the sale of immovable property, the same duty equivalent to the duty payable on a conveyance will have to be paid although such agreement is not compulsorily registerable.

However if the possession is not delivered or agreed to be delivered in the agreement itself, the agreement can be registered by paying a nominal stamp duty of 1% of the market value equal to the amount of consideration subject to a maximum of Rs 20,000/- and a minimum of Rs. 500/- as per Article 5 (e)(ii) of the Schedule to the Karnataka Stamp Act, 1957.

On a combined reading of the aforesaid provisions it is to be highlighted as follows:-

Where an assessee has entered into an agreement for sale and has also delivered possession of the immovable property in part performance of the contract of the nature referred to in Section 53A of the Transfer of Property Act 1882, the transfer takes place immediately and the assessee is liable for capital gains.

If the value mentioned in the agreement for sale is less than the value adopted by the Stamp Valuation Authority for the purpose of payment of stamp duty in respect of such transfer, the assessing officer can deem the value adopted by the stamp valuation authority as the full value of consideration received or accruing as a result of such transfer by invoking the provisions of Section 50 C .

It is to be noted that the document containing contracts to transfer for consideration any immovable property for the purpose of Section 53-A of the Transfer of Property Act, 1882 (4 of 1882) shall be registered if they have been executed on or after the commencement of the Registration and Other Related Laws (Amendment) Act, 2001 and if such documents are not registered on or after such commencement, then, they shall have no effect for the purposes of the said Section 53-A. As a result of the said amendment it is now mandatory to register the agreement for sale and pay the Stamp duty as stipulated under Article 5(e) of the Schedule to the Karnataka Stamp Act as if the same is not done, there will be no "transfer "of the nature referred to in Section 53-A of the Transfer of Property Act so as to invoke the provisions of Section 2 (47)(v) of the Income Tax Act.

17. *SALE OF AGRICULTURAL LAND:*

Agricultural land is not a capital asset as defined under Section 2(14) of the Income Tax Act, if,

a) *it is situated in an area which is comprised within the jurisdiction of a municipality or a cantonment board having a population of less than 10000 (ten thousand) or;*

b) *it is situated within eight kilometers from the local limits of the municipality or cantonment board and is in an area which is not notified by the Central Government in the official gazette having regard to the extent of and scope for urbanization of that area. It is to be noted that only 23 cities and towns have been notified in Karnataka. Therefore, for eg. agricultural land which is situated outside the municipal limits of Devanahalli and which is more than 8 kms away from the municipal limits of Bangalore will not be considered as a capital asset under Section 2 (14) of the Income Tax Act.*

Similarly, the income from the transfer of agricultural land situated within the jurisdiction of municipality or within eight kms from the municipal limit will not be chargeable to tax on capital gains provided the transfer is due to compulsory acquisition under any law and also provided that the land was used for agricultural purpose by the individual or Hindu Undivided Family or their parents during the period of two years immediately preceding the date of transfer. This exemption arises due to the specific provisions of Section 10(37) of the Income Tax Act with effect from 01/04/2005 ie., assessment year 2005-06.

It is to be noted that the Supreme Court in the case of ***Union of India Vs Muthyam Reddy 240 ITR 341*** *held that sale of Agricultural Land will not be considered as agricultural income and therefore will not be exempt from Tax.*

IV. TAX INCIDENCE IN THE CASE OF DEVELOPMENT AGREEMENTS

A. BROAD FEATURES OF DEVELOPMENT AGREEMENTS:-

i. OWNER OF LANDS:-

A single owner or a group of co-owners own certain lands.

ii. CONVERSION:-

Such lands may be agricultural in nature and they get 'converted' by suitable orders of the competent statutory authorities for use for non agricultural purposes ie., for the development of sites, flats, apartments, townships etc.

iii. OFFER OF DEVELOPER:-

A property developer approaches the owners and offers the following:-

a. To construct for the owners certain specified extent of built up area of flats / apartments together with the right to use certain common areas, facilities and amenities.

6. *In return for the same, the owner agrees to sell a specified share / percentage of undivided interest in the land to the prospective buyers nominated by the developer.*

iv. ***ACCEPTANCE AND EXECUTION OF DEVELOPMENT AGREEMENT:-***

The aforesaid terms are accepted by the owners and in pursuance thereof the development agreements are entered into between the owners and the developers. Under these agreements the developer by himself does not purchase any immovable property from the owner and it is the prospective buyer who buys a specified share of undivided interest in the land from the owner. Therefore these agreements between the owners and the developer are purely contractual and commercial in nature and hence the provisions of Section 53-A of the Transfer of Property Act 1882 has no application since the developer by himself is not a transferee / purchaser of any immovable property.

v. ***POPULARLY KNOWN AS JOINT DEVELOPMENT:-***

Even though it is the developer who develops the property and constructs the buildings, the above arrangement is popularly known as "Joint Development"

vi. ***DEVELOPER TO NOMINATE BUYERS:-***

The developer is authorized to exclusively nominate the prospective buyers and enter into agreements with them fixing the sale prices and considerations payable by them.

vii. ***G.P.A TO DEVELOPER:-***

The developer is empowered through a General Power of Attorney (GPA) by the owner to act on owner's behalf and agree to sell certain specified shares of undivided interests in the land to the prospective buyers at the aforesaid prices fixed for this purpose.

A General Power of Attorney given by the Owner to a Developer constitutes only an authority given to a Developer to act for and on behalf of and in the name of the

Owner. No right or interest in the immovable property or right to have possession of the property is conferred on the Developer in any manner whatsoever.

viii. NO POWER GIVEN TO DEVELOPER TO EXECUTE SALE DEEDS AND POSSESSION TO PROSPECTIVE BUYERS BEFORE SALE:-

However the developer is not given any power to execute sale deeds in favour of the prospective buyers. Only on the developer completing the construction of the specified built up area of flats / apartments for the owner as per the agreed specifications and dimensions, and on handing over the same to the owner with 'occupancy' rights (being granted by the competent statutory authorities), the sale deeds are executed by the owner himself in favour of the prospective buyers. In the alternative, only at that stage the owner gives a separate General Power of Attorney to the developer to execute and register the sale deeds on owner's behalf to and in favour of the prospective buyers. At no stage before the actual sales are effected, the prospective buyers are put in possession of the flats / apartments sold to them.

ix. DEVELOPER'S RIGHT TO ENTRY IS ONLY 'LICENCE' – NOT POSSESSION:-

It will be specifically provided that the development and construction and such right of entry is only a Licence coming within the purview of the provisions of Section 52 of the Indian Easements Act 1882. It will be clearly provided and recorded that the legal and physical possession of the property shall only be with the owner till the same or parts thereof are sold to the prospective buyers.

The Developer is only permitted to enter the property for the purpose of development. The Developer not being the purchaser or a transferee, the provisions of Section 53-A of the Transfer of Property Act 1882 have no application and the aforesaid right of entry to the Developer constitutes only a 'Licence' coming within the meaning of the term under the aforesaid Section 52 of the Indian Easements Act 1882.

x. SEPARATE AGREEMENTS FOR FLATS / APARTMENTS:-

The developer enters into separate agreements with the prospective buyers for the construction and sale of flats / apartments to them fixing the consideration payable by them for the same. These agreements are entered into by the developer on his own and not as a G.P.A holder for the owner.

xi. REGISTRATION OF AGREEMENTS – BENEFITS AVAILABLE

The development agreements entered into by the Owners with the Developers can be registered with the appropriate registration authorities of the State Government under the Registration Act 1908, and they will get the benefit of entry into Book-I maintained in the Registrar's Office. Such entry will ensure that there is 'public notice' to these documents and their contents. Whenever any encumbrance certificates are obtained on the concerned immovable properties, there will be entries recording the execution of the development agreement. The General Power of Attorney (GPA) given to a developer by the owner can also be registered in the same manner and the same will be entered in Book IV maintained at the Sub Registrar's office. When the fact of this G.P.A is recorded in the development agreements, there will be 'public notice' to the G.P.A also.. As the G.P.As are given to the developer for 'consideration', these G.P.As will become irrevocable as it will be treated as creating an agency coupled with interest to come within the purview of the provisions of Section 202 of the Indian Contract Act 1872. There will be a suitable clause in the G.P.A to indicate that the same is irrevocable. The total cost of stamp duty and registration fee payable on these documents is very nominal in all the States of India.

As per the provisions of Article 5(f) of the Schedule to the Karnataka Stamp Act, 1957 the stamp duty payable in respect of an Agreement or Memorandum of an Agreement if relating to giving authority or power to a promoter or developer by whatever name called, for construction or, development of or sale or transfer (in any manner whatsoever) of any immovable property situated in Karnataka State is as follows-

Where the Market Value of the Property

(1) Does not exceed Rupees one crore	*Rs.10,000*
(2) Exceeds one crore and does not exceed two crores	*Rs.20,000*
(3) Exceeds two crores and does not exceed five crores	*Rs.50,000*
(4) Exceeds five crores and does not exceed ten crores	*Rs.1,00,000*
(5) Exceeds ten crores	*Rs.1,50,000*

Further As per the provisions of Article 41(ea) of the Schedule to the Karnataka Stamp Act, 1957 the stamp duty payable where a Power of Attorney is given to a promoter or developer by whatever name called, for construction, development on, or sale, or transfer (in any manner whatsoever) of, any immovable property situated in Karnataka State is as follows-

Where the Market Value of the Property

(1) Does not exceed Rupees one crore	*Rs.10,000*
(2) Exceeds one crore and does not exceed two crores	*Rs.20,000*
(3) Exceeds two crores and does not exceed five crores	*Rs.50,000*
(4) Exceeds five crores and does not exceed ten crores	*Rs.1,00,000*
(5) Exceeds ten crores	*Rs.1,50,000*

B. MAIN POINTS RELATING TO TAXATION HIGHLIGHTED:-

i. *The Developer is not a Transferee / Purchaser coming within the purview of Section 53-A of the Transfer of Property Act 1882.*

ii. *The Developer does not buy any land or property from the owners.*

iii. *The right to develop the property granted to a developer as provided in the development agreement does not constitute a contract to a transfer of any immovable property as between the owner and the developer, to attract the provisions of Section 53-A of the Transfer of Property Act 1882 between them.*

iv. *The developer only nominates the prospective buyers.*

v. *The Developer enters the property only for the purposes of development of the property and not as a purchaser / transferee.*

vi. *The G.P.A given to a developer is only to enter into agreements with the prospective buyers for and on behalf of the owner and not for executing the sale deeds. There will be a restrictive clause in the G.P.A to this effect.*

vii. *Only the prospective buyers are the purchasers / transferees in respect of the flats / apartments purchased by them together with the corresponding shares of undivided interests, rights and titles in the land.*

viii. *The prospective buyers of flats / apartments are never put into possession of them before the sale deeds are executed and registered in their favour and hence there is no scope for invoking the provisions of Section 2(47)(v) read with Section 45 of the Income tax Act 1961 and the provisions of Section 53-A of the Transfer of Property Act 1882.*

ix. *It is only the developer who develops the lands by the construction of flats / apartments together with common ways, infrastructure, amenities and facilities both for the owners of lands as well as for the prospective buyers of flats / apartments and his profit margins are assessable as business income.*

x. *In the hands of the owners, the chargeability to tax the gains made by them will be treated as follows:-*

a. *Only as and when the flats / apartments constructed by the developer on the developers share of land are sold/transferred to the prospective buyers, the*

chargeability to tax on capital gains will arise on the owners in the years in which such sale/transfer takes place. The consideration for the sale of the developers share of land will be equal to the cost of the flats / apartments built by the developer for the owners. On the occupancy of these flats / apartments being given to the owners after the completion of the construction of the same as per the specifications and dimensions mutually agreed to between the owners and the developer, the consideration to be given to the owners becomes fully discharged.

b. *When the owners get more flats / apartments than what they can personally use and occupy, they effect sales of such additional flats / apartments. When such sales are made the following position will emerge.*

c. *If the sales are made within three years from the date when occupancy was given to the owners, the further gains made by them on sale of the super built up area will be treated as short term capital gains and if the sale of the super built up area is effected after a period of three years after taking possession, the gains will be treated as long term capital gains. However, it is to be noted that the consideration for the sale of undivided share of land relating to the owners share of apartments will be taxed as long-term capital gains only as the same were always held by the owners and transferred at any time to the developer or his nominees.*

Where the owners retain one flat each out of the total number of apartments allotted to them towards their share, each of them will be entitled to claim exemption under Section 54F of the Income tax Act on the cost of construction of such retained apartment, subject however to other conditions under Section 54F being fulfilled by them.

The incidence of tax on joint development agreement have been dealt with in the decision of ***Vasavi Pratap Chand vs. DCIT (2004) 89 ITD 73 (Delhi Trib)*** *which can be referred to.*

Reference can also be made to the decisions of the Bangalore Tribunal in the cases of ***D.L.Nandagopal Reddy Vs ITO Ward 7(2) dated 28th June 2006 and***

JCIT(Asst)(Spl Range 6)Vs Dr T.K Dayalu (ITA No 610 /Bang/2001 dated 23-6-05)
DNYANESHWAR N MULIK vs ACIT (ITAT Pune) (2005) 98TTJ (Pune) 179

C. OWNERS CAN CONVERT THE LANDS INTO STOCK-IN-TRADE:-

i. It is possible for the owners to treat their lands as stock-in-trade of a business in property transactions carried on by the owners before they enter into development agreements with the developers. Such conversion of their capital assets (lands) into stock-in-trade can be evidenced by suitable entries in the books of accounts of the owners supported by other contemporaneous documents executed like sworn affidavits etc. It will only be a natural course of action to be adopted by the owners as the owners will invariably be left with such surplus flats / apartments as mentioned above and sales of the same have to be made on commercial basis only.

ii. In such cases only the provisions of Section2(47)(iv) read with Section 45(2) come into operation and there is no scope for invoking provisions of Section 2(47)(v) and (vi) or any reference being made to Section 53-A of the Transfer of Property Act 1882 through Section 2(47)(v). The profits and gains arising out of such conversion into stock-in-trade will be governed by the provisions of Section 45(2). This would mean that the capital gains arising to the owners on the date of such conversion to stock-in-trade will get quantified at that stage itself but its chargeability to tax will arise only when sales or transfers otherwise of such stock-in-trade take place subsequently. It should be clearly noted that such subsequent sales or transfers otherwise will be of stock-in-trade only and provisions of Section 2(47) cannot be invoked for such subsequent sales or transfers of stock-in-trade.

iii. The profits and gains earned on subsequent sales effected by the owners of their surplus flats / apartments (other than what are kept for their own use) will be taxed as business income only. In the normal course, these sales would have been made

within a period of three years from the date of completion of the project and they would have been subjected to tax as "short term capital gains" only and the tax incidence would have been the same on the owners.

It is to be noted that the above treatment of lands of the owners as stock-in-trade will avoid all the risks and problems arising out of such interpretations that an agreement to sell by itself constitutes a 'transfer' within the meaning of Section 2(47)(v) read with Section 45 of the Income tax Act 1961 as held by the Bombay High Court in the case of ***Charturbuj Dwarakadas Kapadia Vs CIT (2003) 260 ITR 491 (Bom).*** *There will be no scope for invoking the provisions of Section 2(47)(v) and (vi) in such cases as they will be governed by the provisions of Section 2(47)(iv) read with Section 45(2) only.*

Further Case laws to be referred to pertaining to the taxation issues relating to Joint Development Agreements are as follows-

CIT V G Saroja(2008)22(i) ITCL 328, 301 ITR 124(Mad)*-No registration or possession given-Taxable event does not happen till such time*

CIT Vs Attam Prakash & Sons (Del Trib) IT Reference Nos 250-251 Of 1988 *– Mere grant of permissive right to Builder does not amount to "Transfer"*

Jasbir Singh Sarkaria (2007) 294ITR 196(AAR)*- Date of entering into JD agreement is the date for the purpose of "Transfer".*

V. CONCLUSION:

This article attempts to bring about various issues with regard to 'Income from Capital Gains on Transfer of Immovable Properties' and tax planning measures which can be used to ensure least tax incidence. The same could be achieved through systematic planning, proper documentations and executions based on the facts of each case.

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