



# Capital Gains Income tax implication on – Real Estate Transactions



**S. Sathiyannarayanan**  
Partner

*Wise & Worth*  
Advocates & Consultants



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# Introduction



# Real Estate Sector

- 2<sup>nd</sup> Largest Employer in the Country
- 2<sup>nd</sup> largest contributor to GDP after Agriculture (>10%)
- Strong growth post COVID19
- Demon has brought the sector in the main stream

# Capital Gain or Business Income ?

- Answer to this question will depend upon the nature of transaction. Even a solitary transaction could result in business income.
- If a person has lived in a house for 20 years and then gives it for development, it is a clear case of capital gains.
- If a builder gives a piece of land held as stock in trade for development it is a clear case of business income.

- Land transfer is transfer of capital asset or Biz asset ?
- Can entering into JDA amounts to carrying on biz by Land Owner ?
- Can change of land use converts land into Biz asset ?
- Can receipt of sale consideration in Kind or linked to revenue recognition by the developer make the land as Biz asset ?

# Tax issues for Land Owner

- Land held as biz asset transferred at the time of JDA
- Whether JDA may be treated in the nature of biz JV
- If JV, separate taxable entity comes into existence – AOP ?
- Year of taxability when land owner transfers as biz asset in consideration of develop constructed area
- In case UDS is transferred directly to the customer by the Land Owner, whether land may be treated as business asset in his hands ?

# Capital Gains

- Concept of Income u/s 2(24)
- Legal friction

# Capital Gain – at glance

- Capital Asset
- Long Term v. Short Term Capital Asset
- Transfer
- Indexation
- Cost to previous owner
- Capital Gain computation
- Exemptions – sec 54A, 54EC, 54F, 54G





# Structured Transactions



## Development Agreement – an illustration

- Total Landarea - 10,000 sq ft.
- Builtup Area – Total Builtup area – 20000 sq ft.
  - Landowner - 50 % i.e. 10,000 sq ft.
  - Developer - 50 % i.e. 10,000 sq ft.
- Date of Development Agreement – 01/01/2018
- Possession hand-over to developer on 30/04/2019  
(with/without GPOA )
- Building completed & Landowner's share hand-over on 10/05/2019

# When is the transfer complete

- Date of transfer to decide the year of accrual of capital gain

## Transfer under the Income Tax Act

- Section 2 (47) (v) of the IT Act reads as under:
- 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 Sec 53A of the Transfer of Property Act, 1882.

## Sec 53A of TP Act – What is part performance

- Where any person contracts in writing to transfer any immovable property, and the transferee has, in part performance of the contract, taken possession of the property and has done some act in furtherance of the contract, and is willing to perform his part of the contract then –

the transferor shall be debarred from enforcing any right in respect of the property, other than a right expressly provided in the agreement.

# S.53A of TP Act

- 'willingness to perform' for the purposes of Section 53A is something more than a statement of intent;
- it is the unqualified and unconditional willingness on the part of the vendee to perform its obligations.
- willing to perform under the contract in the same sequence in which these are to be performed, it cannot be said that the provisions of Section 53A of the TP Act will come into play.

(K. Radhika V. DCIT, Mumbai AIT (2011) 482

# Point of accrual of income

- Date of execution of Development Agreement
- Date of handingover of possession
- Handingover of possession coupled with GPOA in favour of developer
- Date of execution of first sale deed for developer's share
- Date of execution of first sale deed for landowner's share
- Date of handing over of Landowner's builtup area

## Date of execution of Development Agreement

- Transfer would not be complete if the agreement is properly drafted and all clauses are kept out of the purview of Section 2(47) read with Section 53A of the Transfer of Property Act.



## Date of handing over of possession of land

- Capital gain will not accrue provided possession is handed over to developer purely as a licensee – See R Vijayalakshmi Vs Appu Hotels Ltd ( 2002) 257 ITR 4 – though given in the context of Chapter XXC.

# Handingover possession with GPOA

- Transfer for IT purposes = date when irrevocable GPOA is given
- What happens if GPOA is given but possession is not handedover or it is linked to some other event like permission from municipal authorities?  
?

# Chaturbhuj Dwarkadas's case

## 260 ITR 491

- ❑ Original Agreement dated 18/08/1994
- ❑ This was a sale agreement with a consideration of Rs 1.86 cr. Court held that this was a development agreement.
- ❑ Almost entire consideration paid by 31/3/96
- ❑ Possession given on 1/4/96
- ❑ GPA given on 12/3/99
- ❑ Capital gains tax paid for AY 1999-2000
- ❑ Dept. said capital gain in A Y 1996-97
- ❑ Court held that capital gain arose on 18/8/94 itself.

# Potla Nageswara Rao v. DCIT (APHC)

- In AY 2003-04, the assessee entered into an agreement with Bhavya Constructions pursuant to which he agreed to transfer the land in consideration of the developer giving him four flats in the developed area. The assessee received a token advance and handed over possession of the land. The developer obtained the approval of the municipality to the plan for construction on the property.

# Potla Nageswara Rao v. DCIT

- The AO held that the capital gains in AY 2003-04
- Assessee = AY 2004-05 when the consideration was received.
- The CIT(A) upheld the claim of the AO. The Tribunal (included in file), relying on Chaturbhuj Dwarkaddas Kapadia 260 ITR 491 (Bom), Dr.T. K. Dayalu 202 Taxman 531 (Kar) & Maya Shenoy 124 TTJ (Hyd) 692, held that as the assessee had handed over possession of the property to the developer, it was a clear case of transfer by exchange

# Potla Nageswara Rao v. DCIT

- It was held that the fact that the consideration was received in a later year was not relevant. On appeal by the assessee to the High Court dismissed the appeal:
- APHC:: The element of factual possession and agreement are contemplated as transfer within the meaning of the aforesaid section.

# Potla Nageswara Rao v. DCIT

- APHC :: When the transfer is complete, automatically, consideration mentioned in the agreement for sale has to be taken into consideration for the purpose of assessment of income for the AY when the agreement was entered into and possession was given. Both the aforesaid aspects took place in the previous year relevant to the assessment year 2003-04.

# ***CIT v. Balbir Singh Maini – SC***

Civil Appeal No. 15619 of 2017.

- Issue - whether giving of possession of land for purposes of development under an unregistered joint development agreement could be regarded as giving rise to capital gains
- SC after referring to the 2001 amendment to the Registration Act, 1908, have categorically held that an unregistered agreement was not covered by section 53A of the Transfer of Property Act, 1908.
- Issue - whether the signing of the JDA or giving of possession could be said to be a transaction, which had the effect of transferring or enabling the enjoyment of the immovable property, which could also give rise to capital gains.



# *CIT v. Balbir Singh Maini – SC*

- According to the SC, the purpose of this provision was to bring those transactions within the tax net, where, though title of the property was not transferred in law, there was, in substance, a transfer of title in fact.
- On a reading of the JDA, the Apex Court noted that the owner had continued to be the owner of the property throughout the development of the property, and had at no stage sought to transfer rights similar to ownership to the developer. At the most, only possession was given under the agreement and that too, for the limited purpose of development.

# *CIT v. Balbir Singh Maini – SC*

- The Hon'ble Apex Court, therefore, held that this clause also did not apply to the transaction, and that there was no transfer giving rise to capital gains.
- Therefore, the principal ratio which emerged out of the above judgement of the Hon'ble Apex Court is that part performance of such an unregistered agreement (JDA) by the landowner, by giving possession of the property for the limited purpose of development, would not amount to a transfer, and hence did not give rise to capital gains.



# Section 45(5A)

- Capital gain arises at the instance of transfer of the capital asset.
- Deviation from this general rule was provided by the Finance Act, 2017, by inserting a new sub section (5A) to section 45, with effect from 01.04.2018, i.e. Assessment Year 2018-19.
- Section 45(5A) defers the point of taxability from the point of transfer, in cases of Joint Development Agreements (JDAs), which are referred to in the provision as ‘specified agreements’.

# Memorandum of explanation to Finance Bill, 2017

- *“With a view to minimise the genuine hardship which the owner of land may face in paying capital gains tax in the year of transfer, it is proposed to insert a new sub-section (5A) in section 45 so as to provide that in case of an assessee being individual or Hindu undivided family, who enters into a specified agreement for development of a project, 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.”*

# Section 45 (5A)

*“(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 the 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 the Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.”

# DATE OF TRANSFER IS FROZEN

- As section 45(5A) deals only with the capital assets being in the nature of land or building.
- As the transfer is so well defined under the Act and no diversion is provided even under section 45(5A), the date of transfer has been made rigid by the instance of transfer as per this provision. Only the instance of taxability has been deferred by it.



# Another instance

- where a capital asset is converted into stock in trade
  - ▣ capital gain is though taken to have arisen on the date of such conversion,
  - ▣ the taxability arises only at the time of sale of the stock, which came into existence on conversion of the capital asset.
- The intention is clearly to tax the person at the time the consideration is realised, as on the date of conversion only the nature of asset changes from investment to inventory and nothing actually realises on that day. The similar intention is there in section 45(5A), as on the date of transfer nothing would have actually realised.
- In such a situation the property actually gets transferred on a date preceding the chargeability of tax.

# Issues – Section 45(5A)

# Holding Period - Issue

- In case of section 45(5A), though the provision calls for deferment of tax from the date of actual transfer, still no such specific provision is provided to clarify how the period of holding is to be computed. In such a situation normal provisions of the Act will prevail.
- Section 2(42A) -- term 'short term capital asset' reads as under:
- *"short-term capital asset" means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of **its transfer**."*
- Third Proviso to section 2(42A), inserted by Finance Act, 2017, w.e.f. 01.04.2018, -- in case of immovable property being land, building or both the period of holding for this purpose is taken to be 24 months immediately preceding the date of transfer.

# Case Study

- An assessee transfers a property under JDA to the developer for development after only a period of six months of its acquisition, the completion certificate is issued, say, after five years of such transfer.
- The capital gain would be taxable after a period of more than five years from the acquisition, however only as short term capital gain, since the period of holding between acquisition and transfer is only six months.

# Indexation Issue

- Section 48 provides for the mode of computation of capital gains. The second Proviso to this section also provides for indexation of cost of acquisition in cases of transfer of long term capital asset. Clause (iii) of Explanation under this section defines the term 'indexed cost of acquisition' as under;
- *“(iii) "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, 2001 , whichever is later;”*
- The law is very clear that the indexation benefit will be given to the extent of cost inflation index till the year of transfer.

# Karnataka High Court in CIT Vs. Rudra Industrial Commercial Corporation

- In the context of section 45(2) of the Act. The High Court, observed as under:
- *“Explanation (iii) to s. 48 defines indexed cost of acquisition which 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.*
- *12. A harmonious interpretation of these two provisions makes it clear as to how the capital gains is to be taken into consideration. First we have to find out what is the fair market value of the asset on the date of conversion, then to find out what is the market value of the property on the date of transfer. So, in order to compute the capital gains payable, it is the market value on the date of transfer that is relevant and in arriving at that market value the index cost of acquisition as prescribed on the date of transfer is to be taken into consideration and not the date of conversion. In the instant case, the index cost of acquisition was 223 on the date of transfer in the year ending 1993 and the index cost of acquisition on the date of conversion is 161. Therefore, the AO committed a serious error in taking 161 as the index. The appellate authorities have rightly interfered with the said assessment and have taken 223 as correct index cost of acquisition. Therefore, when the impugned order passed by the appellate authorities is in accordance with the aforesaid statutory provisions, the said substantial questions of law have to be answered in favour of the assessee and against the Revenue.”*

- the basic difference between the situation perceived under section 45(2) and 45(5A) --
- In case of conversion of capital asset/investment in the stock in trade, there is no actual transfer of the asset. At this point of time, it is only the nature of the property that has changed, the asset itself remains with the owner, there is no actual transfer.
- While in cases referred under section 45(5A), there is actual transfer of asset in JDA.

# Cost of Improvement - Issue

- Clause (iv) to the Proviso to section 48, defines ‘indexed cost of improvement’ as follows:
- *“(iv) "indexed cost of any improvement" means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place;”*
- The cost of improvement incurred by an assessee on the capital asset, transferred is recognized only till the date of transfer.
- If there is an obligation under JDA on the Landowner to incur costs, such costs may not qualify.



# Section 50-C

- Sec. 45(5A) provide a deeming fiction by prescribing the method of determination of the value of consideration to be received in kind.
- Under Sec. 45(5A) there is no provision which states to substitute fair market value as a sale consideration if the FMV is less than Stamp duty Value.
- Provisions of sec. 50C(2) are applicable on the ground of principle of parity and natural justice.
- provisions of sec. 50C are not applicable to the provisions of Sec. 45(5A) of the Act

# Section 50-C

- Section 45(5A) and Section 50C are deeming provisions;
- Specific provision over-rules general provision of law
- Section 45(5A) being deeming provision needs strict interpretation
- Supreme Court in CIT vs. Moonmill Ltd. 59 ITR 574
- where in it held that one deeming section cannot be extended by importing another deeming section

# Exemption – Sec 54 / 54F

- Investment in new asset
- Benefit of CBDT cir NO. 672 dated 16.12.1993 (flats by coops) refers to CBDT Cir No. 471 dated 15.10.1986
- Followed in Sashi Varma Vs. CIT (1997) 224 ITR 106 (MP)
- CIT vs RL Sood (2000) 245 ITR 727 (Del)
  
- Even if hand over is delayed beyond 3 years !!

# Displacement Allowance / Rental

- Compensation such as rent, for alternate accommodation, shifting expenses, inconvenience allowance, hardship allowance etc.
- **Such compensation is Capital Receipt** – Not taxable
- *Smt. Delilah Raj Mansukhani vs. ITO (ITAT Mumbai), ITA No. 3526/Mum/2017*
- *Kushal K. Bangia vs. ITO in ITA No.2349/Mum/2011*
- *Shri Devshi LakhamshiDedhia vs. ACIT in ITA No.5350/Mum/2012, and*
- *Lawrence Rebello vs. ITO (ITAT Indore) in ITA No. 132/Ind/2020.*

# Displacement Allowance / Rental

- ***Allowance/Compensation is Part of Capital Gain***
- *ITO vs. Harsha Jitendra Sanghvi [ITA No 6732/Mum/2012 and MA No 15/Mum/2017].*
- *Pradyot Borkar vs. ACIT: ITA No 4070/Mum/2016.*
  
- ***Allowance/Compensation is “Income from Other Sources”***
- *Section 56(2)(x)*
- *Jatinder Kumar vs ITO: 21 taxmann.com 316 (Mum-Trib).*

# Sec 194-IC

- in case any monetary consideration is payable under the specified agreement, tax at the rate of **ten percent** shall be deductible from such payment.

# Queries ?



# Thank U

[ssn@wiseandworth.com](mailto:ssn@wiseandworth.com)

[srinisathiya@gmail.com](mailto:srinisathiya@gmail.com)

*Wise & Worth*  
Advocates & Consultants

Chennai, Madurai, Bangalore, Cochin





# Scenarios



- Transfer after issuance of Completion Certificate
  
- Transfer before issuance of Completion Certificate