

Taxation of Real Estate Transactions

1. The subject is very wide & litigative & I will only try to navigate through some of the aspects of taxation of real estate transactions.
2. Transactions relating to real estates are affected by multiple state laws & central laws like Transfer of Property Act, Stamp Duty Act, Registration Act, Contracts Act, RERA, Land Ceiling Laws, Town Planning Act, Tenancy Laws, Laws relating to inheritance, law relating to Right to Fair Compensation on Compulsory Acquisition, Income Tax, GST, Benami Law & many others.
3. Advisory services relating to structuring of real estate transactions require basic knowledge about these laws & it is advisable to keep other professionals like Advocates & Architects in loop.
4. Normally, professional services of tax professional are sought at three different levels, in real estate transactions –
 - In planning or structuring the transaction : It is advisable to take conservative view at this stage.
 - After completion of transaction, say at return or assessment stage : One may take conservative or aggressive stand, depending on the facts of case & the approach of client. But it is advisable to present all pros & cons of the transaction & legal provisions to the client & then to proceed as per the instructions from client. Care is needed to be taken in making disclosures &

correspondence with the Department, particularly now under e-assessment regime.

- Litigation level : Here, depending on facts of the case, aggressive stand may be advisable.

5. Historically, up to 1956, only profits or gains made in the business of real estate were taxable. No income tax was leviable on sale of real estate as capital asset. Tax on capital gain made on transfer of capital asset, was for first time came on statute book in 1956.

6. Two aspects of taxation of transactions relating to real estates :

- Taxation of transactions involving income from use of real estate asset i.e. income from renting or leasing &
- Taxation of transactions involving income from transfer of real estate asset.

7. Income from Use of Real Estate Asset :

- Possible heads of income are –
 - Renting of land – Income from Other Sources or Income from Business
 - Renting of Building or Land & Building Both - Income from House Property, Income from Business & Income from Other Sources.
- Long term leases with upfront premium payments are either taxable as business income (MIDC like) or as capital gains. Lump sum advance payment of lease rental is however taxable like renting.
- Renting of Buildings : Income from House Property v/s Income from Business. Both heads have their own

advantages & disadvantages. Business gets deduction of depreciation & other expenses but makes the gain on sale short term (sec 50) whereas House Property head permits 30% standard deduction without necessity to incur such expenses & allows the benefit of long term capital gain on sale of property but does not allow depreciation & other expenses.

- If the primary or the dominant object is to let out property, without involving complex nature of commercial activity, then it is income from House Property (S.C. decision in Raj Dadarkar Associates 394 ITR 0592)
- If the dominant intention of the assessee is to exploit property as commercial asset by carrying on a complex commercial activity, then it is income from Business (Bom H C in Nutan Warehousing Co. P. Ltd 326 ITR 94). Object clause also plays an important role (S.C. decisions in Chennai Properties 373 ITR 673 & Rayala Corporation 386 ITR 500)
- Inseparable renting of house property along with furniture &/or machinery is taxable under the head 'Income from Other Sources' Sec 56(2)(iii) (S.C. decision in Sultan Bros P. Ltd - 51 ITR 353). Therefore, care is needed in structuring such transactions, otherwise standard deduction may be lost, though depreciation & other expenses would be allowable.
- Taxability of temporary letting of unsold flats/shops held as stock in trade by builder. Bom H C in Mangla Homes P. Ltd. (182 Taxman 55) held as under H.P. head.
- This leads to notional taxation of such unsold flats/shops, even if vacant. Guj H C. in Neha Builders P.

Ltd (296 ITR 661) – Not liable. Delhi H.C. in Ansal Housing Finance & Leasing (354 ITR 661) against i.e. liable to tax. Matter is pending before Supreme Court?

➤ Sub Sec (5) added to sec. 23 w.e.f. A.Y. 2018-19 allows tax holiday of one year for such notional taxation. Implication?

- Redevelopment compensation received by way of hardship allowance is capital receipt not liable to Tax (145 TTJ 37). However, excess reimbursement recd against expenditure on rent is held taxable (161 ITD 269). What about capital gains tax on exchange of new flat against old one?
- Sum received towards amenities, is taxable as H.P. income (53 CCH 0012).
- Subletting of property, taken on lease for more than 12 years, is taxable under H.P. head, as such principal tenant is deemed owner u/s 27(iib) r.w.s. 269UA(f).
- Maintenance charges paid to Society or company is deductible in determining ALV (334 ITR 358 (Del & ITAT decisions in the cases of Sharmila Tagore (93 TTJ 83) & Saif Ali Khan (ITA No. 1653/Mum/2009 decided on 29.06.2004)).
- 194I TDS on rent relating to land or building @ 10%. Not applicable to individuals & HUFs not liable to tax audits.
- W.e.f. 01.06.2017 (for cases other than those covered u/s 194I) sec 194IB provides for 5% TDS on rent payable by Individuals or HUFs @ sum exceeding Rs. 50,000/- p.m. or part of month.

8. Taxation of income on Transfer of Real Estate : Two situations

- If held as stock in trade : Taxable as per regular method of accounting, subject to the provisions of ICDS & guidance note of ICAI. Presently there is no trade specific ICDS available. ICDS IV on revenue recognition applies. ICDS III on construction contracts is not applicable. Draft ICDS is published but not yet notified.
 - Completed Contracts Method/Possession Method (Shree Nirmal Commercial Ltd - 193 ITR 694(Bom))
 - % Completion Method
- If held as capital asset : Liable to tax under Capital Gains head. General Rule : Taxable in the year of transfer of capital asset.

9. Taxation as Capital Gains : Provisions relating to taxation of capital gains relating to real estate are more in the nature of regulatory provisions, tackling the problem of huge involvement of black money in the real estate transactions. Some of important issues in taxation of capital gains of real estate are –

- Capital Asset v/s Stock in trade :
 - Issue of Adventure in the nature of trade.
 - A dealer in real estate can also avail benefit of capital gains for certain real estates acquired with a view to make investment, like the traders in shares & securities (Sunil Bhandari 122/Jodh/2011 dt. 30.11.2012).
- Joint purchase, development & sale of plots. Possibility of assessment as an AOP. Danger of double taxation. Income has to be taxed in correct hands. Therefore, taxing individual members instead of AOP may prove very costly, in such cases (refer Supreme Court decision in Ch. Atchiaiah (218 ITR 239)).

- Development of land held as investment or of ancestral land. Sale of developed plots or building need not necessarily result in business income.
- Important amendment in T.P Act & Registration Act in 2001. W.e.f. 24.09.2001, agreement with possession covered u/s 53A of T.P. Act is compulsorily liable for registration. Development Agreement not registered was held not legal & land owner was exonerated from capital gains tax liability (S.C. in Balbir Singh Maini - 398 ITR 0531). No depreciation allowed on construction in absence of stamped & registered document in favour of assessee (Mother Hospital Pvt. Ltd 392 ITR 628(S C)).
- Conversion of Capital Asset into stock in trade : Consequence of Supreme Court decision in Bai Shiribai K Kooka (46 ITR 86). Now Sec. 2(47)(iv) r.w.s. 45(2) provides for taxation of such conversion. Best part of these provisions is that, tax liability does not arise in the year of conversion but on sale or otherwise transfer of stock in trade. This offers good scope for tax planning. On sale of stock in trade, difference in conversion price & cost is taxed as capital gains & surplus over conversion price as business income. Can be best exploited, where land owner himself decides to develop the land held by him as his capital asset.
 - Care needed to evidence conversion – Notary Declaration, Accounting entries, Reporting in Tax Audit Report
 - Conversion value has to be FMV on the date of conversion.
 - Cir No. 791 dt. -2.06.2000 provides that, time limit of 6 months is to be calculated with reference to the date of sale of stock in trade for reinvestment purposes u/s 54EA, 54EB & 54EC. What about 54, 54B, 54F?
- Conversion of stock in trade to investment : New provisions are incorporated by introducing clause (via) to Sec. 28. Such conversion, w.e.f. 2019-20 will be

taxed as business income @ FMV of such stock items, determined in the prescribed manner. Entire FMV or surplus FMV over cost of converted stock is business income? Subsequent capital gains to be calculated with reference to FMV as cost of acquisition (sec 49(9)) & period of holding with reference to the date of conversion (Clause (ba) of Explanation 1 to sec 2(42A).

- Finalisation of accounts for F.Y. 2017-18 & suitable declaration, in case of any such conversion.
- Capital Gains on transfer of Agricultural Lands :
 - What is agricultural land?

The Gujarat High Court in CIT vs. Siddharth J. Desai (139 ITR 628) evolved following 13 factors/ indicators applying which the question has to be answered. The 13 factors are the following :

(1) Whether the land was classified in the revenue records as agricultural and whether it was subject to the payment of land revenue ?

(2) Whether the land was actually or ordinarily used for agricultural purposes at or about the relevant time ?

(3) Whether such user of the land was for a long period or whether it was of a temporary character or by way of a stop-gap arrangement ?

(4) Whether the income derived from the agricultural operations carried on in the land bore any rational proportion to the investment made in purchasing the land ?

(5) Whether the permission under s. 65 of the Bombay Land Revenue Code was obtained for the non-agricultural use of the land ? If so, when and

by whom (the vendor or the vendee) ? Whether such permission was in respect of the whole or a portion of the land ? If the permission was in respect of a portion of the land and if it was obtained in the past, what was the nature of the user of the said portion of the land on the material date ?

(6) Whether the land, on the relevant date, had ceased to be put to agricultural use? If so, whether it was put to an alternative use ? Whether such cesser and/or alternative user was of a permanent or temporary nature ?

(7) Whether the land, though entered in revenue records, had never been actually used for agriculture, that is, it had never been ploughed or tilled ? Whether the owner meant or intended to use it for agricultural purposes ?

(8) Whether the land was situate in a developed area? Whether its physical characteristics, surrounding situation and use of the lands in the adjoining area were such as would indicate that the land was agricultural?

(9) Whether the land itself was developed by plotting and providing roads and other facilities?

(10) Whether there were any previous sales of portions of the land for non-agricultural use?

(11) Whether permission under s. 63 of the Bombay Tenancy & Agricultural Lands Act, 1948, was obtained because the sale or intended sale was in favour of a non-agriculturist was for non-agricultural or agricultural user ?

(12) Whether the land was sold on yardage or on acreage basis ?

(13) Whether an agriculturist would purchase the land for agricultural purposes at the price at which the land was sold and whether the owner would have ever sold the land valuing it as a property yielding agricultural produce on the basis of its yield ?

Not all of these factors would be present or absent in any case and that in each case one or more of those factors may make appearance and that the ultimate decision will have to be reached on a balanced consideration of the totality of circumstances.

The above conditions laid down by the Gujrat High Court are approved by the Supreme Court in *Sarifabibi Mohamed Ibrahim* (204 ITR 631) & applied by the Bombay High Court in *Minguel Chandra Pais & Anr* (282 ITR 0618)

- References to non cultivability or barren nature of land in sale deed prove fatal for claim as agricultural land.
- Even if no agricultural income is declared in ROI, use of land for agriculture cannot be denied (*Bom H. C. in Debbie Alemao* 331 ITR 59)
- Annual agricultural income below Rs. 5,000/- is not required to be aggregated for tax purposes.
- Two types of Agricultural lands –
 - Urban agricultural lands : Covered by the definition of Capital Asset & so liable to Capital Gain tax. Following are urban agricultural lands
 - ✓ Within municipal limits of municipalities, municipal corporations, notified area

committee, town area committee, town committee with population not less than 10,000.

❖ Agricultural land situated in Grampanchayat area with population of or more than 10,000 is not hit (P. Venkatramana 46 TTJ 706)

- ✓ Within the aerial distance of two kms, if population of concerned municipality is more than 10,000 but not exceeding 1 lakh
- ✓ Within the aerial distance of six kms, if population of concerned municipality is more than 1lakh but not exceeding 10 lakhs
- ✓ Within the aerial distance of eight kms, if population of concerned municipality is more than 10 lakhs.
- Rural Agricultural Lands : Other than urban agricultural lands. These are excluded from the definition of Capital Asset & therefore not liable to Capital Gain Tax.
- Sec 54B : If reinvestment is in rural agricultural land, then even if such new rural land is sold no capital gain tax is attracted.

- Sec. 50C :

- Deems full value of consideration with reference to SDV of the property, if consideration is less than SDV.
- Constitutional validity upheld by Bom H.C. in Bhatia Nagar Premises Co-op Soc (334 ITR 145)
- Provisions apply only to capital asset **being land or building or both**
- Applicable for both LTCG & STCG calculations

- Mechanism specifically provided w.e.f. A.Y. 2017-18, if agreement for sale precedes registered Conveyance, then SDV on the date of agreement, provided amount paid is through prescribed banking channel. (Held curative i.e. applicable since beginning : Dharamshibhai Sonani 161 ITD 627).
- S.C. in T. Jayachandran – 302 CTR 95 - held that agreement can be oral & in Sanjeev Lal & Others - 365 ITR 389 – that Agreement to sale is binding on parties)
- Now safe harbour rule of 5% of consideration is provided w.e.f. 2019-20. Earlier ITAT decision permitted such variation up to 10%.(Sita Bai Khetan - ITA No. 826/JP/2013 dt. 27.07.2016)
- For genuine cases of FMV lower than SDV, mechanism of reference to DVO is provided. If DVO values FMV more than SDV, then SDV to be adopted else DVO value.
- Care : Make specific claim before A.O. for DVO valuation. However, in ITA No. 3061/Ahd/2015 dt. 29.12.2017 : A.O. to compulsorily refer to DVO before invoking 50C.
- **Advisable if matters affecting FMV of property are mentioned in the sale document & in the correspondence with the A.O. & DVO, along with evidences.**
- Land & Building introduced in firm by partner. Interplay between two deeming fictions - Sec 45(3) v/s 50C. In Carlton Hotels Pvt Ltd (122 TTJ 515) held that 50C would prevail. In Amartara Pvt. Ltd. (ITA No. 6050/Mum/2016 dt. 29.12.2017 held that sec. 45(3) would prevail.
- Not applicable for transfer of rights in land/building (Anil Jain 3777/Del/2013 dt. 16.01.2018.
- Not applicable for transfer of lease rights in MIDC land (Farid Gulmohamed - 46 CCH 300)

- Distress sale aspect must be considered in determining FMV by DVO (Appadurai Vijayraghavan - 369 ITR 486 – Mad). **Advisable to make reference in sale deed of reasons leading to distress sale.**
 - No reference to DVO, before addition u/s 50C, is fatal for assessment (Aditya Narain Varma (HUF) 4166/Del/2013 dt. 07.06.2017)
 - Deduction u/s 54EC/54F allowable with reference to actual consideration & not SDV (Nikhilesh Sadhukhan 925/Kol/2013 dt. 07.06.2017 & Raj Babbar 6497/Mum/2011 dt. 02.01.2013 Contra Gauuli Mahadevappa 49 DTR 207 (Bang))
 - Not applicable for land & building held through company (Irfan Abdul Kader Fazlani – 8831/Mum/2011 dt. 02.01.2013)
 - 271(1)(c) Penalty for addition u/s 50C cancelled (Bom H C in Fortune Hotels & Estates P. Ltd – ITA 1164 of 2012 dt. 26.09.2014)
 - Not applicable for TDR transfer (Prem Rattan Gupta 5803/Mum/2009 dt. 28.03.2012). TDR is held as immovable property by Bom H. C. in Sadodaya Builders Pvt. Ltd. v/s Jt Charity Commissioner – Writ Petition No. 4543 of 2010 decided on 23.06.2011.
 - Not applicable for transfer of tenancy rights (Kishori Sharad Gaitonde – 1561/Mum/09 dt. 27.11.2009.
 - Applicability with reference to block of assets.
 - 5% safe harbor difference + expenses on stamp, registration, advocate fees, society charges, brokerage, etc on Vendor's account.
 - Part sale part gift : caution sec 56(2)(x)
- Sec 43CA : Almost identical provisions applicable for business income
 - Applicable w.e.f. A.Y. 2014-15

- What about registered agreements before 01.04.2013, for value at less than then applicable SDV? (S.C. in Sanjiv Lal – 365 ITR 389 – Agreement to sale is binding. Therefore, FMV is the agreement value, as specific performance can be demanded by purchaser)
- Sec 56(2)(x)(b) : W.e.f. AY 2017-18. Almost identical provisions treating excess of SDV over consideration as income in the hands of Purchaser. Earlier clause (vii) covered only Individuals & HUF. Now Cl. (x) covers all assesses.
- Sec. 50D : Deems FMV of capital asset under transfer as full value of consideration, where consideration received or accruing as a result of transfer is not ascertainable or cannot be determined. For Ex : In the Development Agreement consideration agreed is by way of revenue sharing between land owner & developer, then FMV is to be calculated on the date of handing over of possession of land & accordingly, capital gains are to be paid. What if in actual, revenue share received is more than the FMV. Will it not attract tax?
- 269SS & 269T : Now covers advance payments & refund thereof, otherwise than through prescribed banking mode & violation exposes to penalty u/s 271D/271E. Advance against sale of movable property like car, gold, etc not covered. Caution : Provisions of sec. 269 ST for transactions of Rs. 2 lakhs & more.
- W.e.f. A.Y. 2018-19 : Period of holding with respect to land &/or building, to be long term capital asset, is reduced to 24 months from 36 months.

- Sec 56(2)(ix) : Forfeited amount of advance received in relation to sale of capital asset is deemed as income. What if the forfeiture is not in relation to sale of capital asset, say rural agricultural land? Is it still outside taxability?
- 194IA TDS :
 - 1% of consideration for transfer of land (other than rural agricultural land) or building or part of building. What if transfer involves both land & building?
 - Deduction at the time of credit or payment by cash or cheque or draft or by any other mode. What if consideration is paid in kind & land owner's account is never credited for consideration. As per interpretation rules of 'ejusdem generis' & 'noscitur sociis' , 'any other mode' can be like payment by NEFT or by negotiable instrument. It cannot cover cases of in kind payments. Then no TDS, if in JDA only area sharing is involved? For safer side TDS on SDV? Risk exposure to 40(a)(ia) disallowance.
- Taxation of land owners with respect to Development Agreements/Joint Development Agreements/Joint Ventures
 - Largely depend on the specific terms & conditions of such Agreements.
 - Various types of Development Agreements. In fact each development agreement is normally unique.
 - Development Agreements, where cash consideration is the only consideration & substantial control is transferred to Developer like giving of Power of Attorney, capital gains, with respect to land, arise on execution of Development Agreement (Bom H. C. in Chaturbhuj

Dwarkadas Kapadia - 260 ITR 491) even if possession or licence is not allowed, under clause (v) to sec 2(47). In Balbir Singh Maini's case Supreme Court has held that, Clause (v) to sec. 2(47) stand complied where, though title may not be transferred in law, there was, in substance, a transfer of title in fact.

- Development in Joint Venture : In the case under Consumer Protection Act, Supreme Court, in the case of Faqir Chand Gulati v/s Uppal Agencies Pvt. Ltd. (Civil Appeal No. 3302 of 2005 decided on 10.07.2008) has held that development in joint venture involves community of interest or common/joint control in the management, each joint venturer acting as principal & agent of other joint venturer & sharing of profits and losses. Thus, basically, development under joint venture results into coming into existence of AOP. In such AOP if land is brought by any member, then u/s 45(3) capital gains become payable in the year of introducing land in J.V. for development @ value entered in books. Thus, upfront payment of capital gains tax is invited. Further, applicability of Sec. 50C is again a grey area.
- Joint Development Agreement : Takes three forms
 - Revenue sharing, area sharing & hybrid, involving part cash consideration & part area sharing.
 - ✓ Revenue sharing involves transfer of development rights in land against share in sale proceeds of developed plots/flats/shops. Normally, substantial control is given to Developer & since the amount of consideration is not ascertained or determined, provisions of sec. 50D are attracted. FMV of land, on the date of execution of JDA, is to be deemed as full consideration & taxed to capital gains

accordingly. Any revenue share exceeding such FMV is not taxable?

- ✓ Taxation on Joint Development Agreement involving area sharing & hybrid model, with respect to other than individuals & HUFs, is also governed by the provisions of sec 50D & FMV of land on execution of JDA is deemed as full value of consideration. Subsequent sale of plots/flats/shops will attract ST/LT Cap Gains or business income taxation, depending on facts, on the surplus over & above FMV.
- ✓ Taxation on Joint Development Agreement involving area sharing & hybrid model, with respect to individuals & HUFs, are now w.e.f. A.Y. 2018-19, taxable under newly introduced Clause (5A) to sec 45. Accordingly, year of taxation is shifted to the year of issue of part or final completion certificate & full value of consideration is to be deemed at SDV of area to be received by the land owner, on the date of issue of such completion certificate plus the agreed cash consideration. However, if the land owner transfers his share in project before issue of Completion Certificate, then the capital gains shall be deemed to arise in such year of transfer & the capital gains will be taxed as per otherwise applicable provisions, say u/s 50D, on FMV of land as on the date of JDA? Can in this way, the tax payment be deferred?
- ✓ JDA, where role of land owner is involved in execution or in relation to execution & management of the project, which is otherwise eligible for deduction u/s 80IB(10), then land owner also can claim deduction u/s 80IB(10), with respect to

business income component, subject to the condition that before entering into JDA the capital asset is converted into stock in trade & systematic business activity is undertaken by land owner with respect to the housing project (Pune ITAT decision in Deccan Paper Mills Co. Ltd – 51 CCH 446).

- Compensation on compulsory acquisition is more or less taxable on receipt basis u/s 45(5), if it is capital gain. Under business head method of accounting & principal accrual will prevail.
 - Compensation & enhanced compensation both are taxable in the year of receipt of such compensation. Cost allowed with reference to enhanced compensation is NIL.
 - However, enhanced compensation received under interim order of any court/tribunal is taxable on passing of final order.
 - Recomputation is permitted in case of subsequent reduction in compensation amount, by passing rectification order within four years from the end of the previous year in which reduction order is passed (sec. 155(16)).
 - Interest on original compensation is also taxable in the year of receipt u/s 56(2)(viii). However, interest on enhanced compensation is taxable in the year in which it attains finality, in case of sub judice dispute regarding enhanced compensation.
 - Deduction of 50% of interest income is allowed u/s 57(iv).
- Compensation received against compulsory acquisition of property under Right to Fair Compensation & Transparency Act, 2013 (RFC Act) is exempt u/s 96 of it. CBDT has also issued circular in this respect under No. 36/2016 dt. 25.10.2016, recognizing such exemption.

- Such exemption is available to both i.e. to acquisition of property held as capital asset as well as stock in trade.
 - Compensation received under award as well as under agreement, both are eligible for exemption.
 - Compensation given by Municipal Corporations for acquisition of Reserved Lands, when such compensation is calculated under the provisions of RFC Act – Gray Area?
 - Compensation received in the form of TDR. At what value capital gains to be calculated, FMV of land or FMV of TDR? 50C Applicability? Accounting of TDR?
- Sec 10(37) : Exemption to individuals & HUFs for compensation received on compulsory acquisition of urban agricultural land, used for agricultural purposes by assessee or his parents, in the two immediately preceding years & where such compensation is received on or after 01.04.2004 for compulsory acquisition under any law or where the amount of compensation is determined or approved by the Central Govt or RBI.