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News Alert
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Development Agreement – willingness to perform critical to invoke transfer

In brief

In a recent decision in the case of *M/S. Fibars Infratech Pvt.Ltd.*¹, the Income-tax Appellate Tribunal, Hyderabad (the Tribunal), held that a deemed 'transfer' under section 2(47)(v) of the Income-tax Act, 1961 (the Act), with respect to part performance of a contract, can arise only when all the pre-conditions mentioned under section 53A of the Transfer of Property Act, 1882 (the TOPA), are satisfied. Handing over possession of a property is one of the conditions under section 53A of the TOPA, but is not the sole and isolated condition. The transferee should be '**willing to perform**' its obligation under the Development Agreement to attract section 53A of the TOPA.

This alert summarises the key aspects of the decision

Facts

- M/S. Fibars Infratech Pvt. Ltd. (the taxpayer), entered into a Development Agreement-cum-General Power of Attorney (the DA) with MAK Projects Pvt. Ltd. (the Developer) to undertake development on the land parcel owned by it. The taxpayer treated the land as agricultural land.
- The agreed consideration to be received was in the form of 16 villas to be developed by the Developer. The DA provided for a penal clause to ensure compliance with the obligations and promises made by the Developer.

¹ M/s. Fibars Infratech Pvt. Ltd. v. ITO [ITA No. 477/Hyd/2013] AY 2007-08

- The taxpayer filed its return of income for AY 2007-08 claiming that no capital gain arose since the land, being agricultural land, was not a capital asset.
- After examining the documents and details filed by the taxpayer, the tax officer (TO) rejected the taxpayer's claim and held the land to be non-agricultural land. The TO also held that the DA triggered a transfer under section 2(47)(v) of the Act, and subjected the income to tax as capital gains. The TO referred to the penal clause in the DA and adopted it as a yardstick to estimate the consideration for the purpose of computation of the capital gains.
- The TO alternatively held that the income could be assessed under the head 'Profits and Gains from Business and Profession', on the grounds that the DA was an adventure in the nature of trade.
- The Commissioner of Income-tax (Appeal) [CIT(A)] confirmed the addition by the TO.
- The rights in the property continued to be with the owner, and therefore there was no extinguishment of right or compulsory acquisition;
- Since the consideration was non-existent on the date of the DA, the exchange mode of transfer failed;
- The possession of land given under the DA was a permissive possession, and not a possession as provided under section 2(47)(v) of the Act.

- The consideration to be received, in the form of a constructed area of the project, was non-existent on the date of the DA and was subject to various factors such as the non-sanction of municipal application, disputes, non-availability of men and materials on account of statutory prohibition, escalation of cost, etc. The consideration was uncertain and could not be estimated. Hence, the charging section and the computation provisions failed on the date of execution of DA.

Issues before Tribunal

Whether entering into a DA triggered the 'transfer' event and was subject to capital gains tax?

Taxpayer's contentions

The taxpayer contested and argued as follows:

- An asset which did not fall within the scope of section 2(14) of the Act, would automatically be outside the scope of section 45 of the Act.
- Assuming the land was a capital asset, the event of entering into a DA was not covered under the provisions of section 2(47) of the Act, for the following reasons:
 - There was no monetary consideration and hence sale, as a mode of transfer, failed;

- The taxpayer placed reliance on the decision of the co-ordinate Bench of the Hyderabad Tribunal in the case of *Raghurami Reddy*² in which it was held that, when it is not possible to estimate the consideration with reasonable accuracy on the date of the signing of a development agreement, the year of taxability could only be the assessment year in which the flats were handed over by the builder to the taxpayer, and not the year in which the development agreement was entered into.

- The undivided share in land had not been sold during the AY 2007-08, and hence no income could be assessable under the head 'Profits and Gains from Business and Profession'.

Revenue's contention

- The Revenue contended that according to the terms of the DA, the developer was given unfettered rights over its share of the project, as long as it was willing to perform the contract. Furthermore, the developer had started selling its share of villas from the AY 2007-08 itself, and received advances from

² Raghurami Reddy v. ITO (unquoted) (ITA No. 296/Hyd/2003 dated 30-7-2004)

customers in the same year which showed that the transfer was complete on the date of execution of the DA.

- Reliance was placed on the decision of the Bombay High Court in the case of *Chaturbuj Dwarakadas Kapadia*³, in which it was held that giving irrevocable power of attorney amounted to a transfer and hence the liability to pay capital gains tax arose on the date of execution of such an irrevocable power of attorney. Furthermore, it was held that even arrangements confirming privileges of ownership without a transfer of title could fall under section 2(47)(v) of the Act.
- Based on the information on the constructed area of the project to be received by the taxpayer as the consideration under the DA and the penal clause in the DA, the consideration could be ascertained with reasonable certainty as on the date of the transfer.

Tribunal Ruling

- Based on the facts of the case, the Tribunal held that the land was non-agricultural land.
- The Tribunal held that in the case of *Chaturbuj Dwarakadas Kapadia*³ there was no dispute on the satisfaction of the conditions of section 53A of the TOPA.
- The proposition laid down by the Bombay High Court could be inferred when conditions under section 53A of the TOPA were satisfied and when the taxpayer entered into a contract which was a development agreement in the garb of an agreement for sale. The legal precedent could not support the proposition that all development agreements, in all situations, had to satisfy the conditions of section 53A of the TOPA, which was a *sine qua non* for invoking section 2(47)(v) of the Act.
- The handing over of the possession of the property was only one of the conditions under section 53A of the TOPA, but it was not the sole and isolated

condition. It was necessary to understand whether or not the transferee was 'willing to perform' its obligation under the terms consented to. When the transferee, by its conduct and by its deeds, demonstrated that it was unwilling to perform its obligations under the agreement, the date of agreement ceased to be relevant. In such a situation, it was only the actual performance of the transferee's obligations which could give rise to the situation envisaged in section 53A of the TOPA.

- In the present case, there was no progress in the development work during AY 2007-08, and the sanction of the building plan was granted in March 2006 (i.e. last month of the concerned financial year). Furthermore, no investment was made by the developer in the construction activity.
- Based on the facts of the present case, it was not possible to hold that the transferee was willing to perform its obligations in the AY 2007-08 and hence, the conditions laid down under section 53A of the TOPA were not satisfied during this year.
- The Tribunal also held that the TO would be at liberty to examine the taxability of the capital gain in any other year when a substantial consideration is passed to the assessee with reference to the DA.
- Since the taxpayer had not sold the undivided share in the land and continued to be the owner of the property in AY 2007-08, no income could be assessable under the head 'Profits and Gains from Business and Profession' during that year.

PwC's observations

- The proposition laid down by the Bombay High Court in the case of *Chaturbuj Dwarakadas Kapadia*³, that the date of the development agreement is the basis for deciding the date of transfer of the property, cannot be applied to all development agreements.
- The satisfaction of all conditions of section 53A of the TOPA is a *sine qua non* for invoking section 2(47)(v) of the Act.

³ Chaturbuj Dwarakadas Kapadia v. CIT [2003] 260 ITR 491 (Bombay)

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