

# ***No tax on consideration agreed under development agreement if not accrued or received; concept of 'real income' relevant while determining income chargeable to tax***

March 16, 2015

## ***In brief***

The Bombay High Court (HC), in the case of Chemosyn Limited (taxpayer), dismissed the appeal filed by the revenue authorities against the decision of the Mumbai Income-tax Appellate Tribunal (Tribunal) in which it was held that in the absence of 'real income', no income on account of a constructed area (to be received under the development agreement) could be subjected to tax.

## ***In detail***

### ***Facts***

- The taxpayer<sup>1</sup> owned two plots of land, plots no. 256 and 257. On 16 June 2006, the taxpayer entered into a development agreement with Dipti Builders (Developer) for development of plot no. 257. As a consideration for provision of the development rights, the taxpayer received INR 161.1 million and construction of 18,000 sq. ft. of built up area to be done free of cost on plot no. 256.
- On 5 July 2007, a tripartite agreement was entered into between the taxpayer,

Developer and a new buyer. Under this agreement, both plots were sold to the new buyer for a consideration of INR 291.1 million.

- The taxpayer filed its return of income for assessment year (AY) 2007-08, offering INR 161.1 million to tax as capital gains.
- In the return of income for AY 2008-09, the taxpayer offered to tax INR 130 million (the difference between INR 291.1 million and INR 161.1 million) as capital gains.
- For AY 2007-08, the Tax Officer (TO) held that capital gains was payable on the market value of the 18,000 sq. ft. of

construction to be carried out by the Developer.

- The Commissioner of Income-tax (Appeals) (CIT(A)) upheld the TO's order. However, it held that the consideration for 18,000 sq. ft. of constructed area required to be arrived at on the basis of cost of construction.

### ***Tribunal's ruling***

- The Tribunal deleted the additions made by the TO and sustained those made by the CIT(A) in computation of capital gains.
- The Tribunal held that the Bombay HC's decision in the case of *Chaturbhuj*

<sup>1</sup> CIT v. Chemosyn Ltd [TS-73-HC-2015(Bombay)]

*Dwarkadas Kapadia*<sup>2</sup> was not applicable, as there was no dispute regarding transfer of property under the development agreement. The dispute was regarding the amount of consideration for computing the capital gains.

- The Tribunal relied upon its decision in the case of *Kalpataru Construction Overseas (P). Limited*<sup>3</sup> and the decision of the Bombay HC in the case of *Shivsagar Estates*<sup>4</sup> to hold that on the basis of the 'real income' theory, since income on account of 18,000 sq. ft. of cost of construction of area had neither accrued nor been received on account of subsequent events, this could not be brought to tax.

#### **High Court's ruling**

- On further appeal by the revenue, on the basis of the factual finding that no income in respect of 18,000 sq.ft. of

constructed area had been accrued or received, the HC held that the Tribunal's findings were not perverse or arbitrary. As a result, no substantial question of law arose warranting interference with the Tribunal's order

- The HC therefore dismissed the appeal filed by the revenue.

#### **The takeaways**

The ruling reinforces the principle that the concept of 'real income' is important while determining taxable income. It emphasises that subsequent events may need to be taken into account in determining the accrual or receipt of income and tax liability for a particular year. However, one would need to examine whether the concept of 'real income' can be applied to defer the taxation of a consideration (for computing capital gains on development agreements) which is contingent upon future events.

#### **Let's talk**

For a deeper discussion of how this issue might affect your business, please contact:

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<sup>2</sup> Chaturbhuj Dwarkadas Kapadia v. CIT [2003] 260 ITR 491 (Bombay)

<sup>3</sup> Kalpataru Construction Overseas Private Limited v. DCIT [2007] 13 SOT 194 (Mumbai-Tribunal)

<sup>4</sup> CIT v. Shivsagar Estates [1993] 204 ITR 1 (Bombay)

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