Transaction of unregistered development agreement not regarded as a 'transfer' under 2(47)(v); on subsequent cancellation of development agreement, expected income cannot be taxed on hypothetical basis

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In brief

The Punjab and Haryana High Court (HC), in the taxpayer's case, held that since the Joint Development Agreement (JDA) was not registered (one of the requirements for grant of possession under the JDA), possession of land could not be said to have been given under the JDA. Therefore, the transaction could not be said to be a 'transfer' as per section 2(47)(v) of the Income-tax Act, 1961 (Act) read with section 53A of Transfer of Property Act, 1882 (TOPA). Further, in view of the cancellation of the JDA, no further money was received by the taxpayer and no further actions were taken. Therefore, no income tax could be levied on any hypothetical income from the deal.

In detail

Facts

- The taxpayer[1] was one of the 95 members of the Punjab Cooperative Housing Society Limited (the Society)which owned 21.2 acres of land.
- On 25 February 2007, the Society entered into a tripartite JDA with Hash Builders Private Limited (Hash) and Tata Housing Development Company Limited (THDC). Under the JDA, it was agreed that Hash and THDC (the Developers) would undertake development of the entire land parcel. In consideration of giving the development rights, the Developers would pay the members a consideration comprising a sum of money and a share in the finished property.
- An irrevocable Power of Attorney (PoA) granting substantial rights to the Developers was executed and registered on February 26, 2007.
- The Developers had made part payment of the agreed monetary share to the members.
- In view of the legal dispute, the HC (under a Public Interest Litigation) restrained the Developers from starting construction. On the failure of the Developers to pay the next instalment, the Society terminated the JDA.
- In the return of income filed by the taxpayer, the income received in each years were offered to tax as capital gains for the assessment years (AYs) 2007-08 and 2008-09.
- The tax officer (TO) held that since various rights in the property had been

[1] TS-414-HC-2015 (P&H)

granted and assigned by the taxpayer to THDC, and physical and vacant possession of the land had been handed over, the deal was tantamount to a 'transfer' under section 2(47)(v) of the Act. The TO sought to tax the entire consideration in the AY 2007-08. The consideration was based on:

  - Total monetary consideration receivable (though only a part was received during the year); and
  - Fair market value of the finished property to be received in the future.

- The Commissioner of Income-tax (Appeals) (CIT (A)) and the Tribunal upheld the TO's order.

High Court's ruling

- The HC observed that as per the JDA, possession of the property was to be handed over simultaneously with the *execution* and *registration* of the agreement. The JDA was never registered, and therefore the delivery of possession to the Developers could not be presumed. Delivery of title deeds did not necessarily raise the presumption of delivery of possession.

- The HC held that neither the Society nor its members had parted with possession of the property. The Developer was given the power to raise finance by mortgaging the property and registering as the mortgagor. However, such possession should be regarded as that of licensee only, and not of a transferee.

- To be covered under section 53A of TOPA, for the purposes of enforcing civil law rights, the JDA was required to be a registered instrument. Once section 53A of TOPA was embodied in section 2(47)(v) of the Act by incorporation, all legal requirements of section 53A of TOPA had to be complied with. Without registration, the JDA was not enforceable. Accordingly, the transaction could not be regarded as a 'transfer' for the purpose of section 2(47)(v) of the Act.

- Willingness to perform their part of the contract was absent on the part of the Developers – one of the conditions precedent for applying section 53A of TOPA. Accordingly, capital gains tax should not have been triggered.

- Furthermore, in relation to the taxation of hypothetical income, the HC relied on the decisions of the Supreme Court in the cases of *Messrs Shoorji Vallabhdas* & Co[2], *Godhra Electricity Co. Limited*[3], *Excel Industries Limited*[4], and the decision of Calcutta HC in *Balarampur Commercial Enterprises Ltd*[5]. In view of the cancellation of the JDA, no further amount was received, and no action was taken. The HC agreed with the taxpayer's stance that as and when any amount of income was received from the deal, it would be liable for capital gains tax.

The takeaways

With regard to the taxability of hypothetical income (due to the termination of JDA), the principles laid down by the HC are similar to the principles laid down by the Bombay HC in the case of Chemosyn Limited (refer to our news alert dated 16 March 2015), though the HC has not referred to or relied on the Bombay HC decision.

However, one would need to examine whether, in principle, the concept of 'real income' can be applied to defer taxation of a consideration (for the purpose of 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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[2] CIT *v.* Messrs Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC)
[3] Godhra Electricity Co. Limited *v.* CIT [1997] 225 ITR 746 (SC)
[4] CIT *v.* Excel Industries Limited [2013] 358 ITR 295 (SC)
[5] CIT *v.* Balarampur Commercial Enterprises Limited [2003] 262 ITR 439 (Cal)

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