

Development agreement without passing of possession does not result in transfer liable to capital gains tax

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In brief

In a recent case¹, the Mumbai bench of the Income-tax Appellate Tribunal (Tribunal) held that the development agreement entered between the owner of land and the developer without passing of possession did not result in transfer of land under section 2(47)(v) of the Income-tax Act, 1961 (the Act), and therefore was not liable to capital gains tax.

In detail

Facts

- The taxpayers¹ had purchased two pieces of land in 1994. The lands were fully occupied by slum dwellers and were declared as slums under section 4(1) of Maharashtra Slum Areas (Improvement, Clearance and Redevelopment) Act.
- On 7 November 2007, the taxpayer entered into an development agreement (the Agreement) with the developer. As per the Agreement, the developer was required to:
 - obtain Letter of Intent from the Slum Rehabilitation Authority (SRA);
 - make arrangements with the slum dwellers for their re-location, and to construct separate buildings for rehabilitating the slum dwellers; and
 - develop other separate residential or commercial buildings which were permitted to be freely sold, by consuming the Floor Space Index (FSI) or by loading outside Transferable Development Rights (TDR).
- The taxpayers owned two physically separate lands, and the land parcels between the two lands belonged to others. The developer had entered into agreements with other land owners also. Under the Agreement, the taxpayer was entitled to receive 1,30,000 sq. ft. of FSI out of the total FSI, and the developer was free to use remaining land.
- The land could be used by any person only after statutory permission was issued by SRA with respect to development of land and its free use. No such permission has been issued by SRA during the year under consideration.
- The Agreement provided that the taxpayer would be deemed to be in physical and exclusive possession of the said property until the permission was received from SRA.
- No registered conveyance deed was executed during the year under consideration.
- The cost of construction of 1,30,000 sq. ft. was estimated to be INR 0.26 billion. The developer would either incur such cost or provide the funds to the taxpayer for construction.

¹ TS-551-ITAT-2016(Mum)

- During the relevant year, the taxpayer received INR 0.1 billion from the developer and recorded it as an advance.
- The Tax Officer (TO) considered that the Agreement gave rise to a transfer of the land, and computed capital gain on the sale consideration at INR 0.26 billion, and levied tax thereon
- The Commissioner of Income-tax (Appeals) held that the Agreement did not give rise to transfer, and was thus not liable to capital gain tax.

Issue before the Tribunal

Did the development Agreement give rise to transfer in terms of section 2(47)(v) or any other provision of the Act?

Revenue's contentions

- The Agreement provided various rights to the developer to approach various authorities and to execute development of land. The taxpayers also executed Power of Attorney (PoA) in favour of the developer to enable it to obtain Letter of Intent in respect of the land in the developer's name. Thus, for all practical purposes, the land was in the developer's control.
- The capital gain would be chargeable to tax in the year of entering into Agreement and hand over of possession, whether any conveyance deed was registered or not².
- For transfer under section 2(47), exclusive physical possession was not necessary. Pursuant to the Agreement, the entire development rights were transferred, and the developer was free to execute the same in any manner which brought out the intent of giving possession to the developer.

- All the ingredients specified under section 2(47)(v) were present, and therefore there was transfer of land which was liable to tax under section 45 of the Act.

Taxpayer's contentions

- Various clauses of the Agreement clearly suggested that possession had not been given to the developer.
- As physical possession of land was not given to the developer, section 2(47)(v) was not applicable.³
- There were fetters on the legal rights of the taxpayer and the developer on making free use of the land, as the land could not be used for development without permission from the SRA, and no such permission was received during the year under consideration.
- The Agreement was not registered under the provisions of Registration Act, 1908. Section 17(1A) of the Registration Act provides for mandatory registration of any document contemplating the transfer of immovable property for the purposes of section 53A of Transfer of Property Act, 1882. Thus, in the absence of registration, the Agreement could not give rise to valid transfer under section 2(47) (v) of the Act.⁴

Tribunal's ruling

- Possession of land along with other legal rights entitling the developer to full use and enjoyment of the property and further sale of the developed units at its sole discretion, result into 'transfer'.
- The Agreement provided that the taxpayer would be deemed to be in physical and exclusive

possession of land until the SRA permission was received.

- As the possession could be given only post SRA permission, the SRA permission had not been received, and the revenue had not produced evidence contradicting the above findings, it was held that the taxpayer had not parted with possession.
- As physical possession of land was held by the slum dwellers and there was nothing to show that the taxpayer could have given physical possession, it was held that possession of land was not given to the developer.
- Without transfer of physical possession, the applicability of section 2(47)(v) of the Act became doubtful.³
- The effect of non-registration of the agreement could lead to holding that there was no transfer under section 2(47)(v).
- Therefore, it was held that no transfer of the impugned land had taken place during the year under consideration. The Revenue's Appeal was therefore dismissed.

The takeaways

This decision reiterates the principle that for a transaction to be regarded as 'transfer' under section 2(47)(v) of the Act, all the conditions of section 53A of Transfer of Property Act, 1882 should be satisfied and possession of the property should be obtained by the transferee in part performance of the contract.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

² Chaturbhuj Dwarkadas Kapadia v. CIT [2003] 260 ITR 491 (Bom)

³ Ajay Kumar Shah Jagati v. CIT [2008] 168 Taxman 53 (SC)

⁴ C.S. Atwal v. CIT [2015] 378 ITR 244(P&H)

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