

Capital gains on transfer of development rights is to be computed by considering market value of land as per municipal records as the full value of consideration; cost of construction of share of built-up area is not relevant

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In brief

The Bangalore Income-tax Appellate Tribunal (Tribunal), in the case of taxpayer held that, in the case of transfer of development rights (where the land owner is entitled to receive a share in the built up area), the market value of the land should be taken as full value of consideration for computing capital gains; the cost of construction of the built up area should not be considered.

In detail

Facts

- The taxpayer¹, a company engaged in the business of transport operators, executed a Development Agreement (DA) on 2 February, 2009. Under the DA, the taxpayer was to receive a share in the built-up area for transferring the development rights.
- For the assessment year 2010–2011, in response to a notice under section 148 of the Income-Tax Act, 1961 (Act), the taxpayer filed a revised return of income, in which long term capital loss was computed based on the guidance value of the land.

- The tax officer (TO) finalised the assessment computing the capital gains based on the cost of construction of the built-up area to be received by the taxpayer.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that capital gains should be computed based on the market value of the land as per municipal records. While deciding, the CIT(A) opined that:
 - The decision of the Karnataka High Court (HC) in the case of *Dr. T. K. Dayalu*², relied on by the TO, could be distinguished from the taxpayer's case. The HC had decided only on the year of taxability of capital gains. There was no finding regarding the working of capital gains.
 - DA was a kind of contract agreement wherein the taxpayer would get his share of the constructed property after completion of the project. Whether the project could be completed, and whether the developer would honour his commitment, was uncertain till the project was completed. Hence, estimating the value of the property even before the taxpayer received it was not realistic.

¹ TS-148-ITAT-2016(Bangalore-Tribunal)

² CIT v. Dr. T. K. Dayalu [2011] 14 taxmann.com 120 (Karnataka)

- On the date of the DA, the taxpayer had received only the right to receive a particular constructed area of the constructed building, and not the building itself. The value of the constructed building could vary from time to time.
- The right to receive the constructed area could at best be equated with market value of the property handed over to the developer.
- The CIT(A) also observed that the market value of the property (taxed on transfer of development rights) should be treated as include the cost of acquisition for the built up area when received from the developer or the value of the right to receive the built up area. Income would be taxed as and when the built up area or the right to receive the area was sold in subsequent years.

Issue before the Tribunal

Would the capital gains arising on transfer of development rights be calculated based on the market value of the land or on the cost of construction of the built up area to be received?

Taxpayer's contentions

Reasons mentioned in the order

passed by the CIT(A) were relied upon.

Revenue's contentions

- The portion of the constructed apartment to be assigned to the taxpayer was already decided and crystallised. Hence, the value of such apartments should be taken as the sale consideration.
- Since the taxpayer was only receiving the apartment and was not selling it, the cost of construction should be considered as the sale consideration. The true value of the asset was the money actually spent in bringing the asset to life.
- Reliance was placed on the decision of the Hyderabad Tribunal in the case of Smt. Pratibha Reddy³.

Tribunal's ruling

- The determination of value was not in dispute.
- The Tribunal upheld the CIT(A)'s order.

The takeaways

In multiple decisions involving transfer of development rights, Tribunals/ HCs have decided on the year of taxability of capital gains. However, the manner of computation of capital gains has not been addressed by most of the

appellate authorities. The Bangalore Tribunal's decision gives some guidance on the computation of capital gains. However, there could be alternative mechanisms of computing the full value of consideration (i.e. fair value of the share of the built-up area). Hence, the view adopted by the Bangalore Tribunal may be subject to litigation.

Reference can also be made to section 50D of the Act, as inserted by Finance Act 2012, which provides that if the consideration received or accruing is not ascertainable or cannot be determined, the fair market value of the asset transferred should be deemed as the full value of the consideration. However, one would also have to examine the implications under section 50C of the Act.

Further, the value considered as the full value of consideration may also have an impact on the service tax liability, if any, on the development agreements.

Let's talk

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

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³ Smt Pratibha Reddy v. ITO [2012] 25 Taxmann.com 264 (Hyderabad)

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