

Transfer of development rights and transfer of share of constructed area are separate transactions, liable for capital gains tax at respective points of time

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In brief

The Chennai Income-tax Appellate Tribunal (Tribunal) held that capital gain arising on transfer of development rights is taxable in the year when possession of land is given to the developer. Further, the sale of constructed area (received under the development agreement) is a separate transaction, liable for capital gains tax in the year in which the constructed area is transferred.

In detail

Facts

- The taxpayer, along with other family members, entered into a Joint Development Agreement (JDA) with the developer on 27 June, 2006 for the development of a commercial-cum-residential complex. Under the JDA, the landowners handed over 50% undivided share of the land. The taxpayer received a refundable security deposit of INR 115 million and a share in the constructed area.
- The taxpayer handed over the possession of the land to the developer on 27 June, 2006, on receipt of a substantial amount of the refundable security deposit.
- On 15 December, 2010, the taxpayer and other co-owners entered into an agreement to sell a part of the constructed area.
- During Assessment Year (AY) 2011-12, the taxpayer filed its return of income by offering the income from sale of constructed area as “capital gains.”
- The Tax Officer (TO) recomputed the income in accordance with section 45(2) of the Income-tax Act, 1961 (Act) by treating a portion of the income as “business income.”
- The Commissioner of Income-tax (Appeal) [CIT(A)] held that a portion of the refundable security deposit should be apportioned towards the sale proceeds of the constructed area. The CIT(A) directed the TO to

compute long-term capital gains and rejected the TO’s computation under section 45(2) of the Act.

Issues before the Tribunal

Whether transfer of land (development rights) and transfer of constructed area amounted to a single transaction.

Tribunal’s decision

On transfer of development rights

- The Tribunal held that “Transfer” takes place at the time when the possession of land is handed over to the developer or when the developer is allowed to enter the premises.
- Further, the possession of the developer need not be sole or exclusive. The transferee should be able to

exercise general control over the property and make use of it for the intended purpose. The mere fact that the transferor also has the right to enter the property to oversee the development work or to ensure performance of the terms of the agreement cannot defer the taxation event.

- Even if some part of the consideration remains to be paid, the transaction does not postpone the liability to pay capital gains tax.
- The fact that the legal ownership of the land continued with the taxpayer and other co-owners does not affect the applicability of section 2(47)(v) of the Act.
- Based on the facts of the case, the Tribunal held that the gains arising on transfer of development rights is taxable in AY 2007-08. The Tribunal relied on the decision of the Bombay High Court in the case of Chaturbhuj Dwarkadas Kapadia¹.

On transfer of constructed area

- The transfer of land (development rights) and transfer of constructed area constitute different

transactions. It does not result in the conversion of one capital asset (i.e., land/development rights) into another (i.e., constructed area).

- The sale of constructed area along with undivided share in land constitutes another transaction, giving rise to short-term capital gains or long-term capital gains, depending upon the period for which the same is held.
- The Tribunal held that the capital gains arising on the constructed area can be taxed only on the area actually transferred by the taxpayer. The share in the constructed area retained by the taxpayer cannot be taxed on receipt basis.

The takeaways

This decision reiterates the position that in case of transfer of development rights under a JDA, the capital asset can be regarded to be “transferred” on granting the possession of the land. The receipt of consideration (share of constructed area or share in revenue) in future, does not affect the timing of the taxable event. Further, it emphasises that

“development rights” and “constructed area” received are separate capital assets, liable to capital gains tax at different points of time.

The Finance Act, 2017 has brought an amendment with respect to the payment of taxes in case of transfer of development rights by individuals and Hindu undivided family in certain cases. In case of transfer of development rights for a consideration involving the share of constructed area, with or without payment of cash consideration, the capital gains tax would now be payable on receipt of certificate of completion or transfer of constructed area, whichever is earlier. No tax would be payable by individuals and Hindu undivided family in the year of granting the possession of land.

However, this decision would be relevant for other types of taxpayers (other than individuals and Hindu undivided family) for evaluating the timing of taxable events under a JDA.

Let’s talk

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

¹ *Chaturbhuj Dwarkadas Kapadia v. CIT* [2003] 260 ITR 491 (Bom)

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