SC upholds deletion of capital gains under section 2(47)(v) in absence of registration of JDA; income cannot be taxed on a hypothetical basis

October 9, 2017

In brief

The Supreme Court (SC) in a recent decision[1] deleted the capital gains addition in the hands of the taxpayer-individuals (members of a co-operative society) in the absence of registration of the Joint Development Agreement (JDA) between the co-operative society and developers. The SC ruled that there must be a "contract" that could be enforced in law under section 53A of the Transfer of Property Act, 1882 (TOPA) to qualify as "transfer" of capital asset under section 2(47)(v) of the Income-tax Act, 1961 (Act).

Further, the SC held that profits and gains being in the nature of capital gains, should "arise" from the transfer of a capital asset and income that has not arisen or accrued cannot be taxed on a hypothetical basis.

In detail

Facts

- A JDA was entered into between a co-operative housing society (Society) and two developers (Developers) on 25 February, 2007.
- The said JDA was not a registered agreement.
- *Vide* the JDA, it was agreed that the Developers would undertake to develop the land owned and registered in the name of the Society and the agreed consideration (being money and flats) would be given by the Developers to each individual member (collectively referred to as Members) of the Society.
- The Developers were to make payments in four instalments depending on the milestones as mentioned in the JDA.
- The Developers, in pursuance of the JDA, made payments of two instalments against conveyance of 7.7 acres of land parcel.
- However, the JDA did not take ground for want of approvals; receipt of approvals being the milestone for trigger of the third instalment.
- While the Members offered the two instalments received against the conveyance of a part of the land parcel to capital gains tax, the amounts not received, owing to the cancellation of the JDA, were not offered to tax.
- Registration and Other Related Laws (Amendment) Act, 2001 and TOPA were amended in the year 2001 to the effect that unless the document containing the contract to transfer for consideration, any immovable property (for the purpose of section 53A of TOPA), is registered, it shall not have any effect in law (other than it being received as an evidence in a suit for specific performance or as an

[1] TS -444-SC-2017

evidence of any collateral transaction not required to be effected by a registered instrument).

Issues before the Court

- Whether the transaction envisages a "transfer" taxable under section 2(47)(v) of the Act, read with section 53A of TOPA?
- Whether "possession" as envisaged by section 2(47)(v) of the Act and section 53A of TOPA was delivered and if so, its nature and legal effect?
- Whether the amount yet to be received could be taxed on a hypothetical assumption arising from the amount to be received?

Taxpayer's contentions

- Section 2(47)(v) would not apply in the absence of registration of the JDA.
- The Society had only given a license to develop the property under the JDA, and hence, no possession was ever handed over. The possession delivered, if at all, was as a licensee for development of the property and not in the capacity of a transferee. In addition, the Developers were not ready and willing to perform their part of the JDA (in the absence of receipt of relevant approvals), and hence, the ingredients of section 53A of TOPA were not present in the facts of the case.
- According to section 45 and section 48 of the Act, profits and gains should "arise" from the transfer of a capital asset and as in the said case, there was no income received or accrued, no profits or gains arose to the members.
- In addition, section 2(47)(vi) of the Act would not apply because there was no change in membership.

Revenue's contention

- Since physical and vacant possession of the land had been handed over under the JDA, the same would amount to "transfer" within the meaning of section 2(47)(ii), 2(47)(v) and 2(47)(vi) of the Act, and hence, should have been charged to tax.
- The fact that the agreement was not registered would not impede the applicability of section 2(47)(v), as the words *"of the nature referred to in section 53A of the Transfer of Property Act, 1882"* used in section 2(47)(v) referred to the nature of contract mentioned under section 53A of the TOPA and would in turn not require any registration.
- Section 53A of the TOPA being applicable to the present case, it was squarely covered by section 2(47)(v) of the Act.

Supreme Court's decision

- The position that an agreement of sale, which fulfilled conditions mentioned in section 53A of the TOPA was not required to be registered, was amended *vide* an amendment made in the year 2001.
- As a result, unless such an agreement was registered, it would not have any effect in law (other than being received as evidence in certain cases). That is, in the eyes of law, there would be no contract that could be taken cognisance of for the purpose of section 53A of the TOPA.
- To qualify as a "transfer" under section 2(47)(v), there must be a "contract," that could be enforced in law under section 53A of the TOPA.
- Further, section 2(47)(v) incorporates the words "of the nature referred to in section 53A" since its introduction in the year 1988. Hence, the expression could not be stretched to refer to an amendment that was made years later in 2001.
- Thus, the said expression would be interpreted to mean the ingredients of applicability of section 53A of the TOPA.
- Since registration was one of the ingredients of section 53A, in absence of such a registration, section 2(47)(v) of the Act would not apply.
- Given that in the facts of the case, section 2(47)(v) of the Act was not attracted, the analysis of any factual information with respect to whether or not the possession of the property was handed over, for determining delivery of "possession" as envisaged by section 53A of the TOPA was considered unnecessary.
- Section 2(47)(vi), in the absence of transfer of rights akin to ownership by the members to the Developers, would also not apply.
- Income-tax could not be levied on hypothetical income. Income was said to accrue, when it became due and was accompanied by a corresponding liability of the other party to pay the amount.
- Since in the present case, the members did not acquire any right to receive income, such a right being dependent upon receipt of relevant approvals (which did not come through), the income that the Revenue sought to tax was at best a hypothetical income.
- Since no profits or gains "arose" under section 45 and section 48 of the Act, tax could not be levied on such a hypothetical income.

The takeaways

- The SC decision has made it clear that for section 53A of the TOPA to be applicable to a JDA, transfer of effective possession is necessary and not merely transfer by way of a license to develop.
- Further, for section 2(47)(v) of the Act to be attracted, it is necessary that all ingredients for applicability of section 53A of the TOPA are satisfied (registration being one of such ingredients).
- With regard to the concept of non-taxability of hypothetical income upheld by the SC, 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 your local PwC advisor

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Bengaluru

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Telangana
+91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata – 700 091,
West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR (Gurgaon), Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

Follow us on: