Mere handing over physical possession of property for development not "transfer" under section 2(47)(v) of the Act

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In brief

In a recent decision[1] the Calcutta High Court (HC) held that merely entering into a development agreement for undertaking construction activity on an immoveable property would not be construed as "transfer" under section 2(47)(v) of the Income-tax Act, 1961 (the Act). Furthermore, the developer would only be in *de facto* possession of the property while the landowner continues to be in the lawful possession of such property until the parties meet the obligations under the agreement.

In detail

Facts

- The taxpayer company (landowner) entered into a development agreement (Agreement) on 07 February, 2007 with an Indian company (Developer) for developing an Information Technology (IT) Park.
- The Developer agreed to incur all the development costs envisaged in the Agreement, with an understanding to share the total built up area along with the underlying land between the Developer and the taxpayer company in the ratio of 61:39.
- The taxpayer argued that there was no capital gain tax payable in the year of entering into the Agreement and that taxability could be determined only when the consideration was actually delivered by the Developer.
- The Tax Officer (TO) accepted the contentions of the taxpayer company and passed an assessment order under section 143(3) of the Act, without making any capital gains adjustment.
- The taxpayer company received a part of the consideration (developed area) during Financial Year (FY) 2010-11 and the balance during FY 2011-12, which was offered to tax in the respective years.
- Subsequently, the Commissioner of Income Tax (CIT) invoked revisionary powers under section 263 of the Act and set aside the TO's order on the grounds that the execution of Agreement between the parties gave rise to capital gains liable to tax in FY 2006-07.
- Aggrieved by the order of the CIT, the taxpayer company filed an appeal before the Kolkata Income Tax Appellate Tribunal (Tribunal).

  The Tribunal[2] held that the capital gain was assessable only with reference to the consideration actually received by the taxpayer. In other words, it can be taxed only in the year in which the consideration was actually received. Accordingly, the Tribunal dismissed the Revenue's contention.
- The Revenue Authorities filed an appeal against the

[1] TS 404 HC 2018(Cal)
[2] ITA No. 413 and 414/ Kol/ 2015

order of the Tribunal before the HC.

Issue before the High Court

Whether entering into an Agreement for undertaking construction activity be construed as transfer under section 2(47)(v) of the Act.

Revenue's contention

- The Revenue referred to section 2(47)(v) of the Act to suggest that the transfer between the taxpayer and the Developer was deemed to have taken place upon execution of the agreement and handing over of possession of the land by the taxpayer to the Developer.
- Section 45 of the Act implies that capital gain tax was payable at the time of transfer and not at a later date when the consideration is received.

High Court's decision

- To construe that a transfer has taken place within the meaning of section 2(47)(v) of the Act, the possession sought to be transferred in part performance of a contract needs to be the kind of possession protected under section 53A of the Transfer of Property Act, 1882 (TOPA).
- While elaborating the provisions of section 53A of the TOPA, the HC observed that the person in possession of the property (without having a valid conveyance) should have the right to retain the possession of the property by paying the balance amount due, although the conveyance of the property has not been made.
- The *de facto* possession of the land made over to the Developer for the purpose of construction thereon will not imply that the possession was made over to the developer for enjoyment of the property. The developer would be in *de facto* possession under the *de jure* possession (lawful possession) of the owner for undertaking construction activity.
- In the absence of formal conveyance pertaining to the Developer's entitlement, section 53A of the TOPA could be invoked to resist dispossession only when the Developer has discharged its obligation under the agreement of delivering the agreed share in the construction to the landowner.
- Until the construction was completed and 39% (landowner's share) of the constructed area was made over to the taxpayer, it could not have been said that the possession of the balance land (i.e. 61%) was transferred to the Developer as per the expression of section 2(47)(v) of the Act.
- It was only after the apportionment of the area upon the construction being completed that the Developer could have rightfully retained the possession over the land attributable to him.
- When the landowner enters into an agreement with the developer, the terms of the contract would indicate when the transfer would take place.
- Thus, the HC concurred with the view of the Tribunal and held that the taxpayer had rightfully discharged capital gains tax in the year of actually receiving the consideration.

The takeaways

- The HC decision presents a view that transfer in case of development agreements shall take place only when the construction activity is completed and the consideration in terms of share in the total built up area is delivered to the landowner.
- However, it is imperative to note that the HC has not delved into the specific rights emanating to the Developer under the Agreement, which may be essential in determining whether the land has been actually transferred to the Developer pursuant the Agreement or not.
- Practically, most development agreements allow developers to raise construction finance by mortgaging the land. Such a right given by the landowner to the Developer can be the decisive factor in the transfer being effected immediately on execution of the Agreement.
- A plain development agreement that only permits the developer to enter the land and undertake construction activity may partake the character of a license arrangement, and may not be *per se* treated as transfer under section 2(47)(v) of the Act.
- A case-specific analysis is required to factually assess if the provisions of section 53A of the TOPA are invoked, and consequently, trigger capital gains tax on entering into a development agreement.
- The Finance Act, 2018 has been amended to defer taxation for landowners who are individuals and Hindu undivided families to the year in which the construction is completed. All other taxpayers will need to critically assess the terms of the development agreement to determine taxability at the time of entering into the development agreement

Let's talk

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

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