
Compensation received in lieu of flat given to developer under development agreement taxed as “capital gains” and not “income from other sources”

January 31, 2020

In brief

Recently, the Mumbai bench of the Income-tax Appellate Tribunal (Tribunal) pronounced that compensation received by the taxpayer for handing over the old flat under a development agreement, is integrally connected with the transfer of the old flat to the developer for development. Hence, it is to be taxed as income under the head “capital gains” instead of “income from other sources.”

In detail

Facts

- The taxpayer¹ was an individual who owned a flat in a housing society that entered into a development agreement.
- As per the terms of the development agreement between the housing society and its members, each member was entitled to receive a pre-agreed amount in addition to a new residential flat in the redeveloped building.
- The pre-agreed amount comprised of an amount towards:
 - compensation for non-adherence by the redeveloper to earlier agreed terms and for vacating the old flat;
 - beneficial right and interest in corpus and income of the society and for hardship suffered by the member; and
 - for moving or shifting cost.
- The taxpayer, in his return of income for the subject year, offered the gain from transfer of the residential flat as a long-term capital gain and claimed a deduction under section 54 of the Income-tax Act, 1961 (Act).
- During the assessment proceedings, the Tax Officer (TO), after examining the details and explanations received from the taxpayer,

was of the view that the amount paid under the development agreement was towards compensation and not in relation to transfer of the capital asset. Accordingly, the TO taxed the total amount received by the taxpayer under the head “income from other sources” which was further confirmed by the Commissioner of Income-tax (Appeals) [CIT(A)].

Issues before the Tribunal

- Should the compensation received by the taxpayer be taxed under the head “capital gain” or “income from other sources”?
- Alternatively, is the amount received by the taxpayer a capital receipt, and hence, not chargeable to tax?

¹ ITA No.4070/ Mum/2016

Taxpayer's contentions

- The taxpayer's contention was that the payment received was in connection with the handing over of the old flat for redevelopment in lieu of the new flat, and hence, connected to the transfer of capital asset.
- As an alternate plea, the taxpayer relied on recent judicial precedents,² and contended that if the amount received by him is to be treated as compensation, it should be treated as a capital receipt and not chargeable to tax. Such compensation should also be deductible from the cost of the new flat.

Revenue's contentions

- The Department Representative (DR), placing reliance on the observations of TO and CIT(A), argued that the development agreement was between the society and the developer, and any gains accruing as a result of the redevelopment should be assessed in the hands of

the society.

- Further, the DR stated that the amount received by the taxpayer is not connected with the transfer of a capital asset and is a distinct payment due to other factors.

Tribunal's ruling

- The Tribunal agreed with the taxpayer's contention that the amount he received under the development agreement was in connection with handing over his old flat for redevelopment, and therefore, integrally connected with the transfer.
- Hence, relying on co-ordinate bench ruling,³ the Tribunal held that payment received by the taxpayer was to be treated as income under the head "capital gain."
- The Tribunal did not deliberate on the taxpayer's alternate plea as his main plea was accepted.

The takeaways

- This decision reemphasises the

principle that compensation received by flat owners in exchange for a new flat under the scheme of redevelopment should be taxable under the head "capital gains" and not as "income from other sources."

- In this case, given that the compensation paid by the developer is treated as an amount paid in connection with the transfer of the old flat, one may need to evaluate the withholding tax implications under section 194-IA of the Act, in the hands of the developer.
- However, the Tribunal is silent on whether the compensation received towards hardship or displacement should be treated as capital receipt, given that the co-ordinate bench has also confirmed this view in the past.

Let's talk

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

² Kaushal K. Bangia v. ITO [2012] 50 SOT 1 (Mumbai) and Jitendra Kumar Soneja v. ITO [2016] 161 ITD 269 (Mumbai)

³ Rajnikant D. Shroff v. ACIT [ITA No. 4424/Mum/2014]

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 23579101/
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
pwctr.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 over 276,000 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, Bhopal, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai, Pune and Raipur. For more information about PwC India's service offerings, visit www.pwc.in

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

© 2020 PwC. All rights reserved

Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2020 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.