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News Alert
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Execution of a development agreement by itself does not give rise to transfer under the Income-tax Act; all conditions laid down in section 2(47)(v) of the Income-tax Act read with section 53A of the Transfer of Property Act need to be fulfilled

In brief

In a recent decision in the case of Sri S. Ranjith Reddy¹ (the assessee), the Income-tax Appellate Tribunal, Hyderabad (the Tribunal), held that for a development agreement to give rise to a transfer as defined in section 2(47)(v) of the Income-tax Act, 1961 (the Act), the conditions stipulated in section 53A of the Transfer of Property Act, 1882 (TOPA) need to be satisfied.

This case was distinguished on facts from the decision of Chaturbhuj Dwarakadas Kapadia² of the Bombay High Court, which is generally relied upon by the Revenue to argue that a taxable event emanates from the execution of a development agreement.

This alert summarises the key aspects of the decision that are relevant to this conclusion.

¹ Sri S. Ranjith Reddy & Anr v. Dy. CIT [TS-254-ITAT-2013(HYD)]

² Chaturbhuj Dwarakadas Kapadia v. CIT [2003] 260 ITR 491 (Bom)

Facts

- The assessee, along with his family members, owned a land parcel. During financial year (FY) 2005-06, the assessee entered into an agreement, on 28 February 2006 (the agreement) with Lumbini Constructions Ltd. (Lumbini / the developer) for construction of a residential township.
- Some family members of the assessee were shareholders of Lumbini. Lumbini also owned a certain portion of the land which was used for construction of the township.
- As per the agreement, Lumbini was under an obligation to develop the township at its own cost. Of the total houses constructed, the assessee and his family members were entitled to a certain number of houses. The agreement did not provide for grant of possession of the land to Lumbini.
- No consideration had passed between the parties as on the date of signing the agreement.
- No construction had taken place during the FY 2005-06, nor was there a general power of attorney given by the assessee to Lumbini.
- The Revenue was of the opinion that the execution of a development agreement gives rise to a transfer³ as it is akin to an agreement for sale of land. Thus, the value of the residential houses to be received by the assessee (after deduction of certain costs) should be taxed as the income of the year in which the development agreement is executed. The Revenue referred to the Bombay High Court decision in Chaturbhuj Dwarakadas Kapadia² wherein it was held that the date of transfer for the purpose of calculating capital gains is the date of handing over the possession.

Issues before the Tribunal

- Should execution of the development agreement be considered as transfer for the purpose of the Act?

Assessee's contentions

- The agreement entered into by the assessee with the developer is in fact an agreement for settlement of rights among the family members and not a development agreement.
- The agreement did not contemplate an exchange of properties and therefore, the execution of the agreement by itself does not constitute transfer³.
- The rights under the agreement were inchoate till the construction of the residential township by the developer and the handing over of the share in property to the assessee. Until such event occurred, no income accrued to the assessee.

Revenue's contentions

- The agreement entered into by the assessee had as its expressed objective the construction of a residential township. The fact that some of the family members of the assessee were shareholders in Lumbini did not prove that the agreement was a family settlement, as Lumbini was a separate corporate entity.
- The agreement entered into by the assessee was nothing but a development agreement whereby-
 - The assessee was to receive constructed houses in lieu of assigning the land in favour of Lumbini.
 - There was extinguishment of right over a portion of the land.

³ Under section 2(47)(v) of the Act

- Lumbini, as a part of its obligation, obtained the necessary building plan approvals as well as township development sanctions and carried out the construction of the houses.
- Given the above-mentioned features of the agreement, there was a transfer of land by the assessee and other family members, since all the ingredients of the transfer as embedded in section 2(47)(v) of the Act were very much visible in the transaction entered into by the assessee.

Tribunal Ruling

- The assessee had not transferred any right or property to Lumbini by virtue of execution of the agreement.
- It is not the act of entering into an agreement/contract that matters but the event of allowing the transferee to enter into possession of the land that matters.
- The assessee had assigned its landed property in favour of Lumbini *vide* the agreement between them. There was no sale of property by the assessee by virtue of this agreement.
- The extinguishment of assessee's rights over the land was compensated by its right in the built-up area. Even if this were to be considered an exchange, nothing had culminated in the FY 2005-06. All these events would have occurred in future.
- The project was a proposed one, while transfer is contemplated only in the case of an existing property. The execution of the agreement did not bring into existence any tangible asset that could be transferred between the parties.

- In order that a contract be construed as being 'of the nature referred to in section 53A of TOPA' it is one of the preconditions that the transferee should have performed, or be willing to perform, his part of the contract. Unless the party has performed or is willing to perform its obligations under the contract, it cannot be said that the provisions of section 53A of the TOPA will come into play. No construction took place during the FY 2005-06 nor was there a general power of attorney given by the assessee to Lumbini. In such a situation, only the actual performance of Lumbini's obligations could have given rise to the situation envisaged in section 53A of TOPA.
- Since it was not possible to hold that Lumbini had performed its obligation during the period FY 2005-06, the condition laid down under section 53A of the TOPA was not satisfied during this period. Hence, it cannot be said that there was a transfer³ so as to levy capital gains tax.

Conclusion

- Mere execution of a development agreement cannot be construed to give rise to a transfer³ unless the conditions of section 53A of TOPA are satisfied. The Tribunal distinguished the present case from the decision of the Bombay High Court in the case of Chaturbhuj Dwarakadas Kapadia² on the premise that in the latter case, all conditions of section 53A of the TOPA were satisfied.
- The decision emphasises the principle that the terms of each development agreement and the conduct of parties would have to be examined on a case-by-case basis to evaluate whether a transfer has occurred within the meaning of section 2(47)(v) of the Act.

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Our offices

Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	Bangalore 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	Chennai 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006, India Phone +91 44 4228 5000	Hyderabad #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600	Kolkata 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-033 - 2357 9101/4400 1111 Fax: (91) 033 - 2357 2754
Mumbai PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	Gurgaon Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	Pune GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, <pwctr.knowledgemanagement@in.pwc.com< p=""> </pwctr.knowledgemanagement@in.pwc.com<>	

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