Capital gains tax liability arises in the year of execution of the Joint Development Agreement, which grants possession over the land through irrevocable license. The cost of the constructed area received by the taxpayer in lieu of the land transferred is the full value of sale consideration.

12 December 2014

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Sri N.S. Nagaraj¹ (the taxpayer) held that the moment the owners of land hand over the possession to the developer under a Joint Development Agreement (JDA), a right to receive the developed area would accrue to the owners and would result in capital gains tax liability in the hands of the owners.

Further, the full value of consideration is the cost of construction incurred by the Developer on the taxpayer's share of constructed area, because the taxpayer would receive the constructed area in lieu of the land given to the Developer.

Facts of the case

- The taxpayer, an individual, had filed his return of income for the relevant year which was selected for scrutiny assessment.

- On scrutiny of the accounts, the Assessing Officer (AO) noticed that the taxpayer along with his brother Mr. Nandish Reddy were the Owners (the Owners) and in possession of certain land.

- The Owners entered into a JDA with Akme Project Ltd (the Developer). As per the JDA, the Owners jointly received refundable deposit of INR 10 million for allowing the development on their land.

- On scrutiny of the accounts, the Assessing Officer (AO) noticed that the taxpayer along with his brother Mr. Nandish Reddy were the Owners (the Owners) and in possession of certain land.

- The Owners entered into a JDA with Akme Project Ltd (the Developer). As per the JDA, the Owner jointly received refundable deposit of INR 10 million for allowing the development on their land.

- Further, the Developer would construct a saleable area of 300 thousand square feet (TSF) at its own cost and the Owners are entitled for 50 per cent of the built-up area i.e. 150 TSF minimum.

- The Owners had given an irrevocable license to the Developer to enter and develop the property. The Owners have also executed a Power of Attorney (POA) in favour of the Developer, to enable the Developer to get sanction of site plans, license and other approvals for the development of entire scheduled property. Also, the Developer was authorised to avail loans and financial facilities from the financial institutions.

• The AO was of the view that the Owners have surrendered their rights to the extent of 50 per cent in the land in lieu of 50 per cent constructed area (i.e. 150 TSF) whose cost was to be borne by the Developer.

• Accordingly, the AO held that the transfer of the land had taken place within the meaning of Section 2(47)(v) of the Income-tax Act, 1961 (the Act) and the Owners were assessable for long term capital gain. The AO adopted the consideration of the land at INR 800 per sq. ft., because this was the expenditure which the Developer will incur for constructing the area.

Tribunal’s ruling

Determination of the year of chargeability of capital gains

• Bare reading of Section 2(47)(v) of the Act reveals that in order to determine the capital gain as arisen to the taxpayer, there are three ingredients:
  - There must be a capital asset,
  - It must have been transferred during the relevant year and
  - Capital gain must have arisen to the taxpayer of such an asset.

• The JDA provided that the Owners would get 50 per cent of the share in the total constructed area.

• Further JDA also suggested that the Owners have executed an irrevocable license in favour of the Developer to enter into the scheduled property and develop the same, by putting up the construction. The Owners have also executed the POA and authorized the Developers to sell and transfer its constructed area to their clients.

• In the case of T.V.Sundram Iyengar & Sons, the Madras High Court held that the right to receive the price had accrued to the taxpayer in the year of sale though the price was to be paid at future time. The taxpayer had obtained a right to receive price in that year and therefore, capital gains had arisen in that year.

• In the case of G.M. Omarkhan, the Andhra Pradesh High Court considered the case of T.V.Sundram Iyengar & Sons and also the case of the Supreme Court in the case of Alapati Venkataramiah. The Andhra Pradesh High Court observed that to attract the capital gains tax liability, it is sufficient if in the accounting year, the taxpayer had a right to receive the profit and actual receipt of profit is not a relevant consideration.

• In the present case, the contention of the taxpayer was that it was an exchange of asset and transfer would materialise when the taxpayer would receive the constructed portion.

• Further, the profits would be business income in the hands of AOP. However, that was not the situation in the present case. The Owners had neither agreed for jointly doing the business nor the Developer shown such an intention. The taxpayer had relinquished his rights in the land upon which the Developer had incurred cost of construction and developed the property.

• In lieu of the relinquishment of rights in the land which ultimately would vest in the Developer, the Owners would receive 150 TSF of the constructed area. The year in which the area would be given to the taxpayer was immaterial.

• The moment the Owners have handed over the possession to the Developer, a right to receive the developed area would accrue to the Owners. It is a consideration in kind, which has a value and it can be worked out.

Determination of full value of consideration

• The taxpayer pleaded that market value of the land transferred to the Developer as on the date of the JDA should be adopted as a consideration.

• Section 48 of the Act, dealing with the mode of computation of capital gains, nowhere talks of fair market value but it talks of full consideration.

• Full consideration in this case was the cost of construction incurred by the Developer on the taxpayer’s share of constructed area, because the taxpayer would receive constructed area in lieu of the land share.

• The AO has estimated this consideration at INR 800 per sq. ft. which was the minimum rate adopted by him on the basis of the expenditure accounted by the Developer and therefore, the computation of capital gain made by the AO was appropriate.

Our comments

The above ruling is in line with the principle laid down by various judicial precedents which have held that the capital gains (on land held as capital asset) are taxable in the year when the JDA is entered into with a developer for development of the land and the possession is granted to the developer.

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2 T.V.Sundram Iyengar & Sons v. CIT (1959) 37 ITR 26 (Mad)
3 ACIT v. G.M. Omarkhan (1979) 116 ITR 950 (AP)
4 Alapati Venkataramiah v. CIT (1965) 57 ITR 185 (SC)
The Bangalore Tribunal in the present case has held that the taxpayer had relinquished his rights in the land on the execution of the JDA and grant of possession over the land through irrevocable license. In lieu of relinquishment of the rights in the land, the taxpayer got the right to receive the developed area, and therefore, the capital gains tax liability gets fastened on the taxpayer in the year of such transfer.

It is pertinent to note that the Chandigarh Tribunal in the case of Charanjit Singh Atwal5 while dealing with the aforesaid issue adopted the fair market value of flats provided by the developer as full value of consideration to determine capital gains tax liability. However, in the present case, the Bangalore Tribunal has held the cost of construction incurred by the developer as the full value of consideration in lieu of the relinquishment of the rights in the land, and not the fair market value of the land on the date of transfer.

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5 Charanjit Singh Atwal v. ITO [2013] 144 ITD 528 (Chd)
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