Contribution of land to AOP for joint development is not transfer of capital asset and therefore not taxable as capital gain

Background

The Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Ashok Gordhandas Kirpalani1 (the taxpayer) held that contribution of land to Association of Person (AOP) formed for joint development of property is not transfer of capital asset under Section 45(3) of the Income-tax Act, 1961 (the Act) but is the case of joint pooling of resources by different parties. Therefore, security deposits received against the contribution made by the taxpayer is not taxable as capital gain.

Facts of the case

- The taxpayer had furnished a return of income declaring total income of INR0.3 million. The Assessing Officer (AO) noted that the taxpayer had shown a liability of INR2.5 million in the balance sheet. The taxpayer furnished the explanation along with a copy of joint venture agreement with M/s. Shriram Constructions.

- The AO noted that five persons had entered into a development agreement with different land owners and all the five parties had further transferred and assigned development rights in taxpayer’s and his family's favour and they had started development of the said properties with M/s. Estate Enterprises and M/s. Shriram Constructions and had formed the AOP in the name and style M/s. Gajanan Associates by deed of joint venture on 26 May 2008.

- The said Joint Venture was entered into with M/s. Estate Enterprises, Kriplani Brothers (taxpayer) and M/s. Shriram Constructions. The first two parties were to make available the land for joint development and the third party was to bring in the capital required for the construction of project.

- The said joint venture was for efficient pooling of resources and it was undertaken that neither party was transferring to other, any kind of right or interest, etc. in the said properties and as such, the documents were exempted from registration.

- The taxpayer stated that it had taken sum of INR2.5 million as a security deposit to avoid any losses and the same does not become part of sale consideration.

- The AO held that the interest-free deposit received from M/s Shriram Construction was nothing but assignment of development rights to the AOP through M/s Shriram Construction. The taxpayer is getting profit from the AOP formed under the name and M/s Gajanan Associates as per agreement. The taxpayer has acquired the development rights for INR1.8 million and assigned the rights to M/s Shriram Construction for INR2.5 million. The difference between the deposits and the development rights acquired in the above properties is to be taxed as a capital gains and added to the total income.

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1 Ashok Gordhandas Kirpalani v. ITO (ITA No.1647/PN/2014) (Pune) - Taxsutra.com
**Tribunal’s ruling**

- The perusal of joint venture agreement entered into between the taxpayer and others reflected that M/s Estate Enterprises had contributed certain lands and also TDR rights and the taxpayer had contributed the land to the AOP for development only.

- It was not the case of transfer of land to the AOP, but was the case of joint pooling of resources by three different parties.

- In such scenario where the asset held by the taxpayer has not been transferred to the AOP, there is no question of charging any income from capital gains in the hands of the taxpayer in this regard under section 45(3) of the Act.

- The security deposit received by the taxpayer is not chargeable to tax. Even otherwise, the said security deposit has been refunded by the taxpayer to M/s. Shriram Constructions. The taxpayer has also placed the copy of bank account on record, wherein there is debit INR2.5 million.

- The assessment of Parmanand A. Kirpalani (Kriplani Brother), who had received 16.67 per cent as against 8.33 per cent received by the taxpayer, was completed by the AO vide order passed under section 143(3) of the Act and though during the course of assessment proceedings, submissions were made with regard to the purchase of property and the joint venture agreement, no addition was made in this regard.

- Where the transaction as such has been accepted in the hands of one of the co-owners, no adverse view could be taken in the hands of other person.

**Our comments**

The Supreme Court in the case of Sunil Siddharthbhai\(^2\) held that when the taxpayer transferred his shares to the partnership firm by way of capital contribution, he has not received any consideration within the meaning of Section 48 of the Act nor did any profit or gain accrue to him for the purpose of Section 45 of the Act. Subsequently, the Finance Act, 1987 introduced Section 45(3) in the Act to tax the profits and gains arising from the transfer of a capital asset by a partner or by a member to partnership or AOP or body of individuals, as the case may be. The provisions have been introduced with a view to prevent misuse of entities such as partnership firms, AOP, etc.

Though the Tribunal does not refer to the Supreme Court decision in the case of Sunil Siddharthbhai, in the present case it observed that the taxpayer’s case was not of transfer of land to the AOP, but was the case of joint pooling of resources by different parties and therefore contribution of land to AOP is not taxable as capital gains because it is not a case of transfer of capital asset under Section 45(3) of the Act.

This decision has been rendered on the basis of peculiar facts of the case. In this case the members themselves have registered their AOP whereas, normally, in a joint development scenario, the members ensure that they do not form an AOP. Further in this case the members have agreed to share the gross sales proceeds as against a normal industry practice of sharing profits on net basis. However, it seems that the Tribunal has not emphasised on such peculiarities while dealing with the present case.

\(^2\) Sunil Siddharthbhai v. CIT [1985] 156 ITR 509 (SC)
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