

# **INCOME-TAX ISSUES ON JOINT DEVELOPMENT AGREEMENTS**

**Awareness Programme – Bangalore Branch of the ICAI**

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# CONTENTS

PARTICULARS	SLIDE REF.
Background	<a href="#">4</a>
Basic framework	<a href="#">6</a>
Legacy approach	<a href="#">7</a>
Section 45(5A) – overview	<a href="#">10</a>
Main section 45(5A) – discussion	<a href="#">14</a>
Proviso to section 45(5A) – discussion	<a href="#">17</a>
'Specified agreement' under section 45(5A)	<a href="#">19</a>
TDS under section 194-IC	<a href="#">20</a>
Points to track	<a href="#">21</a>



# LEGEND

ITA	Income-tax Act, 1961
SC	Supreme Court
HC	High Court
TDS	Tax Deduction at Source

# BACKGROUND (1/2)

- Complex and constantly evolving area in income-tax
- Issues primarily involve:
  - Characterisation of asset – whether subject matter is:
    - Stock in trade, or
    - Capital asset involving ‘land’, ‘building’, or any other right connected with immovable property (such as undivided interest in land)
  - Whether there is ‘transfer’ as per the ITA
  - When has the transfer taken place?
  - What is the sale consideration? Can it be otherwise than the actual ‘sale consideration’? For instance, guidance value (see Karnataka HC in CPC Logistics (134 taxmann.com 197), Sarojini Kushe (135 taxmann.com 365)), cost of construction etc. (see Bangalore ITAT in NS Nagaraj (152 ITD 262))
  - What is the cost of acquisition? Can it be otherwise than the actual ‘cost of acquisition’?



# BACKGROUND (1/2)

- All of the previous discussion points are relevant to determine:
  - Quantum of taxable income (considering the gross income and allowable expense)
  - Tax rate – whether tax rate applicable to business income, or long term capital gains or short term capital gains

**In today's discussion, discussion is restricted only to the implications for the land-owners and not discuss issues relating to developers**



# BASIC FRAMEWORK (1/1)

- Land-owner owning land:
  - Land in urban area
  - Agricultural land
- Developer with capability to construct residential or commercial units on the land
- Characterisation of income in the hands of land-owner
- Characterisation of income in the hands of the developer



# LEGACY APPROACH (1/3)

- Relevant key provisions
  - 'Transfer', in relation to a capital asset, includes:
    - Sale, exchange or relinquishment of the asset ; or
    - Extinguishment of any rights therein ; or
    - Any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; or
    - Any transaction which has the effect of transferring or enabling enjoyment of any immovable property.
  - Explanation 1 : 'Immovable property' shall have the meaning per section 269UA(d).
- Primacy to section 2(47)(v) of ITA (effective AY 1988-89)
  - To plug the loophole that taxpayers used to enter into agreements for developing properties with the builders and under the agreement with the builders, they used to confer privileges of ownership without executing conveyance.



# LEGACY APPROACH (2/3)

- Ruling of SC in Chaturbhuj Dwarkadas Kapadia (260 ITR 491)
  - There should be a contract for consideration;
  - It should be in writing;
  - It should be signed by the transferor;
  - It should pertain to transfer of immovable property;
  - Transferee should have taken possession of the property;
  - Transferee should be ready and willing to perform his part of the contract.
- Followed by Karnataka HC in TK Dayalu (14 taxmann.com 120) where taxpayer sought to offer it to tax in year of completion of construction.
- Ruling of SC in Balbir Singh Maini (398 ITR 531)
  - Section 2(47)(v) does not apply to unregistered JDAs
  - Where possession is granted for a specific purpose with ownership rights retained, section 2(47)(vi) not applicable.





# LEGACY APPROACH (3/3)

- Two-stage taxation of capital gains:
  - 1<sup>st</sup> stage – upon entering into a registered JDA with possessory rights in property for developer
  - Upon sale of flats / units to end-user
- Difficulties with above approach on:
  - Sale consideration on 1<sup>st</sup> stage transfer – whether guidance value or cost of construction
  - Cost of acquisition for 1<sup>st</sup> stage transfer
  - Fund flow to discharge tax liability in first stage transfer
  - Cost of acquisition for 2<sup>nd</sup> stage transfer – whether guidance value or cost of construction
  - What if JDA is terminated before completion of project



# SECTION 45(5A) (1/4)

## Overview

- Introduced by Finance Act 2017 effective FY 2017-18
- Statements in Memorandum:
  - *Extant scheme of taxation:*
    - Execution of JDA between the owner of immovable property and the developer triggers the capital gains tax liability in the hands of the owner in the year in which the possession of immovable property is handed over to the developer for development of a project.
  - *Context of amendment*
    - With a view to minimise genuine hardship which the owner of land may face in paying capital gains tax in the year of transfer
    - For individual or HUF, who enters into a specified agreement for development of a project, the capital gains shall be **chargeable to income-tax as income of the previous year in which the certificate of completion** for the whole or part of the project is issued by the competent authority.



# SECTION 45(5A) (2/4)

## Overview

- **Notwithstanding** anything contained in section 45(1)
- Where the capital gain arises to an assessee,
- Being an individual or a HUF,
- From the transfer of a capital asset,
- Being land or building or both,
- Under a specified agreement,
- Capital gains shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority;
- For the purposes of section 48, the stamp duty value, on the date of issue of the said certificate, of his share, being land or building or both in the project, as increased by the consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset



# SECTION 45(5A) (3/4)

## Overview

- **Provided** that this sub-section shall not apply where,
- Assessee transfers his share in the project on or before the date of issue of the said certificate of completion,
- And the capital gains shall be deemed to be the income of the previous year in which such transfer takes place
- And the provisions of this Act, other than the provisions of this subsection, shall apply for the purpose of determination of full value of consideration received or accruing as a result of such transfer.



# SECTION 45(5A) (4/4)

## Overview

- **3 Explanations:**
- 'Competent authority' means the authority empowered to approve the building plan by or under any law for the time being in force
- 'Specified agreement' means:
  - A registered agreement
  - In which a person owning land or building or both,
  - Agrees to allow another person to develop a real estate project on such land or building or both,
  - In consideration of a share, being land or building or both in such project,
  - Whether with or without payment of part of the consideration in cash;
- 'Stamp duty value' means the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.



# MAIN SECTION 45(5A) (1/3)

## Discussion

- Fairly beneficial section for a taxpayer, if not for the issue of 'stamp duty value' being considered as 'full value of consideration' (discussed subsequently).
- Mandatory provision and not optional for the taxpayer once the conditions therein are satisfied.
- Provision specifically held to be prospective and not retrospective – see Bangalore ITAT in NA Haris (188 ITD 517), Hyderabad ITAT in K Vijaya Lakshmi (91 taxmann.com 253) and Adinarayana Reddy Kummata (91 taxmann.com 360); Pune ITAT in Amit Vishnu Pashankar (131 taxmann.com 118);
- Applies only to individuals and HUFs; not to other taxpayers
- Applies whether the individuals / HUFs are resident or non-resident
- Transfer of land or building or both can be under any forms under section 2(47) and not only section 2(47)(v) or 2(47)(vi)
- Important that section 2(47) is triggered; else there will be no capital gains (see principles from Balbir Singh Maini (supra) and Seshasayee Steels (421 ITR 46))



# MAIN SECTION 45(5A) (2/3)

## Discussion

- Year of transfer to be determined per section 2(47) not per section 45(5A)
- Only land and building is covered; not the whole gamut of immoveable property per section 269UA
- Relevant year of taxation is year of issue of completion certificate
  - To distinguish between date of actual completion, date of application for completion certificate, date of completion certificate itself
  - Can certificate of completion be issued for part of the project? If yes, would this scheme apply to only part of the project proportionately?
- Full value of consideration – not with reference to asset transferred, but asset received
- Where full value of consideration is received only in cash provision would not apply
- Full value of consideration = stamp duty value on date of issue of completion certificate + any cash consideration
  - Can we rely on guidance in section 50C on understanding 'stamp duty value' and limitations thereon?



# MAIN SECTION 45(5A) (3/3)

## Discussion

- Indexation and difficulty therein
- Indexation whether to be applied till date of issue of completion certificate? Or till year of transfer under section 2(47)?
  - Strict reading (Chennai ITAT ruling in Best & Crompton (30 ITR (Trib) 688) the context of conversion of asset into stock-in-trade – whether year of conversion or year of taxation)
  - Purpose of indexation
- Relief under sections 54EC, 54 and 54F – from when to be computed?





# PROVISO TO SECTION 45(5A) (1/N)

## Discussion

- Transfer of 'share in project' on or before date of 'issue of completion certificate'
  - Would 'share' require identification or mere 'proportion' per JDA suffice?
  - Would 'share in project' need to be fully transferred?
  - What if it is partly transferred?
  - Situation where both section 45(1) and section 45(5A) would apply
- Capital gain in the year of transfer of the share (not year of original transfer)
  - Capital gain applies per section 45(1) in that year
  - What will be the period up to which indexation would be considered?
  - What will be the period for computation of relief under sections 54, 54EC and 54F?
- In such scenario, full value of consideration would be actual consideration, read with sections 50C and 50D as applicable.
- To be noted – capital gain payable on 'original transfer' and 'transfer of share in project' – 2 transactions



# PROVISO TO SECTION 45(5A) (2/2)

## Discussion

- Capital gain computation of 'share in project' distinct exercise
  - How to identify 'cost of acquisition' for share of project? Per existing guidance on sections 48 and 50D (not section 50C since subject matter of transfer is 'share in project' and not 'land or building or both')
  - BC Srinivasa Setty (128 ITR 294) to the rescue?



# 'SPECIFIED AGREEMENT' (1/1)

## Discussion

- Registered agreement
  - Unregistered agreement – outside the ambit of income-tax itself ?
- Land or building or both – no other asset or 'immoveable property' per section 269UA
- Agrees to allow other person to develop a 'real estate project'
  - Other person need not be individual / HUF
  - Real estate project not defined
  - Residential or commercial
  - Plot development (not really development of fully built commercial or residential units)
- Consideration 'of a share' = land or building or both whether with or without payment of consideration in cash
  - Section 45(5A) not applicable if payment only in cash ?
  - Would the ratio of cash to land / building / both be relevant ?



# TDS UNDER SECTION 194-IC (1/1)

## Discussion

- Applies to consideration in cash under the 'specified agreement' per section 45(5A)
- Applicable at 10%
- Applies when payment is made to resident
  - For non-residents, per section 195, TDS applies on entire 'income chargeable to tax'
- If proviso to section 45(5A) applies, then can 194-IC still apply or should section 194-IA apply?
  - Is this section de hors section 45(5A) only to the extent of payment being made under specified agreement?



# Points to track

- Whether taxation triggered considering principles in Balbir Singh Maini and Seshasayee Steels
- Whether taxation triggers per section 45(5A) or per section 45(1); does proviso to section 45(5A) trigger?
- Whether completion certificate would be issued party or wholly for the project
- Stamp duty value on the date of JDA and date of issue of completion certificate



**THANK YOU**

