Section 43CA & Section 56(2) (vii) – A Critical Analysis

The implications of the newly inserted Section 43CA and the amended Section 56(2)(vii)(b), in the Income-tax Act, 1961 (the Act) are discussed in this article. The article explains the evolution and applicability of these sections together with how there is an apparent double taxation/deferred taxation of the same transaction or due to a same transaction, and also how the assessee may plan complex procedures in genuine situations to try and mitigate the tax impact. This Article also discusses the possible legal impact in different scenarios which may be thought of by an assessee to escape from the garb of these sections.

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Section 43CA & Section 56(2) (vii) – A Critical Analysis

Section 43CA inserted in the Act has raised a lot of eyebrows. The Government with an intention to curb black money has resorted to a very strict approach of applying the stamp duty value of an immovable property to respective incomes of persons transacting in it. Nature of their business activities have a serious bearing on the income that is offered to tax, from the point of view of the Revenue.

There were cases (*Kan Constructions–Allahabad HC, Discovery Estates–Del HC*) in which courts held that Section 50C being limitedly applicable to

assessment of capital gains cannot apply to assessee holding land/building as his stock in trade. By this new provision (Section 43CA), all such decisions will be overruled w.e.f *Assessment Year 2014-2015 & the deeming* provisions like Section 50C will be applicable to immovable property held as stock in trade. Previously, Section 56(2)(vii) contained the same amended sub-clause (b) (though there was no Section like 43CA then) which was removed w.e.f. 01-10-2009 by Finance Act 2010. The reason given for such removal in Memorandum explaining Finance Bill, 2010 was that "*there is often a time gap between booking of a property and receipt of such property on registration, which results in taxable differential. It is, therefore, proposed to amend clause (vii) of Section 56(2) so as to provide that it would apply only if the immovable property is received without any consideration and to remove the stipulation regarding transactions involving cases of inadequate consideration in respect of immovable property*". Now that there is a provision to this effect by way of sub-section (3) and (4) to Section 43CA and *proviso* to Section 56(2)(vii), it has been reinserted with much stricter force.

It would be relevant to mention that the Supreme Court had decided in the famous case of *K. P. Varghese vs. ITO 131 ITR 597 (SC)*, in which the decision was delivered by the Bench of *Hon'ble Justice P. N. Bhagwati and Hon'ble Justice E. S. Venkataramiah*, as under:

> "*We must, therefore, hold that sub-section (2) of Section 52 can be invoked only where the consideration for the transfer has been understated by the assessee or, in other words, the consideration actually received by the assessee is more than what is declared or disclosed by him and the burden of proving such an understatement or concealment is on the revenue. This burden may be discharged by the revenue by establishing facts and circumstances from which a reasonable inference can be drawn that the assessee has not correctly declared or disclosed the consideration received by him and there is an understatement or concealment of the consideration in respect of the transfer. Sub-section (2) has no application in the case of an honest and bona fide transaction where the consideration received by the assessee has been correctly declared or disclosed by him, and there is no concealment or suppression of the consideration.*"

Some courts held that Section 50C being limitedly applicable to assessment of capital gains cannot apply to assessee holding land/building as his stock-in-trade. By insertion of new provision (section 43CA), all such decisions will be overruled w.e.f. *Assessment Year 2014-2015*.

This Section 52(2) was omitted from the Act w.e.f. assessment year 1988-89. However, the provisions of deeming income are finding place in various Sections of the Act, which is against the concept of charging tax on real income.

For the purpose of simplicity in understanding, Sections 43CA and 56(2)(viib) are dealt with separately.

General Meaning and Applicability

A. Section 43CA

Section 43CA is applicable to transaction of transfer of immovable property held as Stock-in-trade by the transferor, if the value at which it is sold is less than the stamp duty value. Unlike Section 56(2)(vii)(b), the operation of Section 43CA is not dependable on the difference in actual transaction value and the stamp duty value. It is also provided that where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of Registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer and not as on the date of registration for such transfer. However, this clause shall apply only where amount of consideration or a part thereof for the transfer has been received by any mode other than cash on or before the date of the agreement.

B. Section 56(2)(viii)(b)

Where any immovable property has been transferred for a consideration which is less than its stamp duty value by an amount exceeding ₹50,000/, the stamp duty value as exceeds the amount of consideration shall be charged as gift in the hands of the purchaser. The clause regarding applicability of value in case of difference between date of initial sale agreement and the date of registered agreement is similar as in case of Section 43CA, which is given by way of a *proviso* to this section.

Impact and Consequences

A. Double Taxation

There is an apparent double taxation where the above provisions come into play. Where a property whose stamp duty value is ₹50 lakh, is sold for ₹40 lakh by the builder, these ₹40 lakh will constitute his part of earnings from sale along with the excess ₹10 lakh which is the difference between the sale price and the stamp duty value. Thus the whole ₹50 lakh will be offered as earnings (gross) in the hands of the Builder. Though here the whole amount of transaction of a certain property has been offered to government as earnings to be taxed, the same ₹10 lakh (difference) is again taxed as gift under Section 56(2)(viib) in the hands of the purchaser, effectively taxing the net income on the difference of same ₹10 lakh.

B. Cost of Acquisition

Section 49(4) of the Act deals with Cost of acquisition of an Immovable property which has been subjected to tax under Section 56(2)(vii)/(viia). As per this section when any person, for whom the immovable property in question is a capital asset subjected to Income tax under Section 56(2)(vii)/(viia), sells his property, then the cost of acquisition of such property for the purpose of calculating the resultant capital gain shall be the **value** which has been taken into account whilst that Section 56(2)(vii)/(viia). *Thus, post amendment in sub-clause (b) of Section 56(2)(vii), it can be* ***either*** *said that the Government is kind enough and logical to at least allow the extra amount taxed in the hands of the purchaser (for whom the immovable property is not his stock-in-trade) as his Cost of Acquisition on further sale of this immovable property* ***or*** *is just hoping to save and earn its revenue by assessing the probability that the purchaser will not sale the immovable property further!*

Further to the above discussion, it is quite evident that the position with respect to the Cost of acquisition will be totally different *when the Re-seller of the Immovable property is the person who treats such properties as his stock-in-trade*. As the above section of cost of acquisition is only applicable in case of capital assets and comes under the purview of the Chapter IV – E of the Act (*capital gains*), the benefit of deduction of extra amount treated as *'Income from other sources'* in the hands of purchaser earlier, is not available to such person being a trader in immovable properties. Thus there is an absolute double taxation when it comes to a situation where both the seller and the buyer are the persons who treat the property as stock-in-trade.

Section 43CA is applicable to transaction of transfer of immovable property held as Stock-in-trade by the transferor, if the value at which it is sold is less than the stamp duty value.

C. Non-Applicability of Provisions

1. Section 43CA is made specifically applicable to assets (not being capital assets) being Land or building or both. Therefore from the bare language of the section it *doesn't apply to assets being specific rights* in a land or building, unlike provided specifically in Section 55(2) relating to cost of acquisition for capital assets. Therefore there can be situation in which there is a joint ownership (managed by a firm or a company) in an immovable property (e.g Name of the assessee in 'other right holders' on 7/12 of a plot, or assessee being joint owner in a property say 30% stake-owner in private company having business of dealing in real estate) and the assessee being such a proportionate owner sells his rights and stake valued in that concern (valued as per valuation of the property) to a third party for a consideration. For the sake of argument, this scenario may not be covered under Section 43CA as the rights or stake in the concern is sold and not Land or building as such. Thus Assessee might be successful in evading the purpose of Section 43CA along with Section 56(2)(vii), asset not being an immovable property as such. Though illegal along with being unethical, one may also think about a *Single Shareholder Company (OPC – One person company)* and act in above manner to escape from the garb of Sections 43CA and 56(2)(vii).
2. Strictly speaking, Section 2(47) relating to transfer of asset doesn't apply in case of transfers covered under Section 43CA since it is applicable only for transfer of capital assets. [Section 2(47): *"transfer" in relation to capital asset, includes*,-……]. Thus, as there is a corresponding Section - 2(47) with regard to operation of transfer of capital asset [deeming under Section 50C], there is no such corresponding Section with regard to operation of transfer of current asset (Section 43CA for stock-in-trade).

The insertion of Section 43CA with amendment in Section 56(2)(vii)(b) might pose as a hardship for persons who have a genuine cases of transfer of property at low rate than Ready-Reckoner rate due to some reasons.

3. There are situations where *agreement to sell* is effected at a particular period of time after accepting part or full consideration and the final agreement is registered much later. (Say agreement to sell is prepared on 100 rupee stamp paper before March 2013 which is finally registered with the Sub-registrar afterwards[1]). In such a situation, it is important to ascertain the event of occurrence of *'transfer'* of Immovable property. It is pertinent to note that subsection (3) and (4) of Section 43CA which talk about difference in date of *agreement fixing value of consideration* **&** *date of registration of final agreement*, are only useful for fixing the value of stamp duty as of that date, and not for deciding the occurrence of transfer. Thus there is still an ambiguity about how the date of transfer will be decided as per the Act, or it is the *'Transfer of Property Act, 1882'* which will come into play here.

D. Some Practical Scenarios

1. Plot of land owned by a person who treats it as Stock-in-trade

Often, it is the practice that a person dealing in plots of land purchases a Land and plans its layout into number of proportionate small plots. After such layout is sanctioned by concerned Municipal authorities, he sells it. Now, can there be a situation that owner of whole plot enters into agreement to sell with a prospective buyer vide which he has even accepted some token amount out of mentioned full amount and agreed in writing that he has sold all rights, title and interest in a specific plot of land as per layout and will receive balance consideration after layout has been sanctioned. Now, if the proposal for sanction of layout was submitted in March 2013 and sanction was approved after 01-04-13, can the seller escape 43CA by contending that occurrence of transfer of property was before 01-04-13 when Section 43CA became effective?

➔ Referring to the principle laid down in the case of *Vania Silk Mills (P.) Ltd. vs. CIT [1991] 59 Taxman 3/191 ITR 647 (SC)/Marybong & Kyel Tea Industries Ltd. vs. CIT [1997] 91 Taxman 11/224 ITR 589 (SC) that "Whatever the mode by which transfer is brought about, the existence of the asset during the process of transfer is a pre-condition. Unless the asset exists in fact, there cannot be a transfer of it".*, the Income Tax department may contend that since the layout was not sanctioned and that possibility of rejecting such layout cannot be ruled out, the asset (specific plot of land) comes into existence only when the layout is sanctioned. Since at the date which is sought to be transfer date by Assessee, the asset had not come into existence, the transfer cannot be effected. The Income Tax authorities may further rely principally upon some judgments which say that *"In the case of sale of immovable properties, the sale can be said to have taken place on the date of execution of the sale deed and not on the date of the agreement to sell" - Hall & Anderson (P.) Ltd. vs. CIT [1963] 47 ITR 790 (Cal.)/CIT vs. F.X. Periera & Sons (Travancore) (P.) Ltd. [1990] 184 ITR 461 (Ker.) /CIT vs. Ghaziabad Engg. Co. Ltd. [2001] 116 Taxman 268 (Delhi).*

2. There are some flats ready for sale by the builder. The builder already possesses back-dated blank stamp-papers and has also accepted advance/token amount from some buyers. Now if the builder designs an *Agreement to sell* which talks about transfer of possession and rights in the flat, before 31-03-2013 and offers the balance consideration to tax as sale amount receivable, will he be successful in escaping the provisions of Section 43CA since it has come into effect prospectively from 01-04-2013?

It is a normal practice for black money holders to purchase immovable properties by paying say 20% to 70% of stamp value *via* banking channels and rest all in cash. After operation of amended Section 56(2)(vii) such balance consideration though paid in cash will be treated as Income in their hands which will be taxed as per normal slab rates say 30%.

[1] *As per the Registration Act 1908, a document may be presented for registration within four months from the date of execution (signature). After four months, the document may be presented within another four months with penalty subject to maximum of ten times the registration fees if the District Registrar grants permission. But the document may be presented before Sub Registrar within eight months.*

➔ As discussed above, the Income tax department may contend, based on some legal precedents, that *in the case of sale of immovable properties, the sale can be said to have taken place on the date of execution of the sale deed and not on the date of the agreement to sell*. Further if Section 2(47) is only applicable to transfer of capital assets and not those assets covered under Section 43CA, then the Section 54 of Transfer of Property Act comes into play, which reads as follows: "*[Such transfer, in the case of tangible immovable property of the value of one hundred rupees and upwards, or in the case of a reversion or other intangible thing, can be made only by a registered instrument]. [In the case of tangible immovable property of a value less than one hundred rupees, such transfer may be made either by a registered instrument or by delivery of the property. Delivery of tangible immoveable property takes place when the seller places the buyer, or such person as he directs, in possession of the property……"]*. Therefore, as per Transfer of Property Act, only when agreement is registered is the immovable property sold/transferred, and hence the assessee may not escape from Section 43CA by resorting to this route too.

E. Hypothetical Situation for Genuine Taxpayers

The insertion of Section 43CA with amendment in Section 56(2)(vii)(b) might pose as a hardship for persons who have a genuine case of transfer of property at low rate than Ready-Reckoner rate due to some reasons (Distress sale due to many possible reasons). So, is litigation the only way for an assessee to prove his genuineness? And then what is the probability of courts deciding in favour of assessee going against bare interpretation of the act?

For example, a person wishes to buy a flat from a builder based on some agreed terms and conditions and the stamp duty value of the same is ₹50 lakh. Now both the builder (seller) and the purchaser in good faith execute the transaction at stamp duty value, i.e ₹50 lakh payable in installments. Now the gross earnings for the seller is ₹50 lakh and for the purchaser is none as the value of transaction is the same as stamp value. Further, in future the seller does not adhere to the agreed terms at which point the purchaser has only paid say ₹40 lakh out of total ₹50 lakh. Due to such disagreement between builder and purchaser, the balance ₹10 lakh, being reflected in balance sheet of builder as debtor and same amount reflected as liability in purchaser's balance sheet, was not agreed to be paid and so was written off. Such writing-off will finally result in deduction of ₹10 lakh for the builder and reduction in asset value and corresponding capital value and for the purchaser, finally resulting into taxation of property at ₹40 lakh.

The government seems successful in inserting Section 43CA with amended Section 56(2)(vii) and we may just hope that the position will be further clarified when questions in this regard are answered by adjudicating forums.

F. Technical Way - Out

As already known, Section 56(2)(vii) applies only to individuals and HUF and not to other persons. Taking advantage of this situation, an assessee who is planning to purchase a property can either form a tightly-held partnership firm or a company with customised deed/MOA in such a way that immovable property will be a capital asset for it. In such a manner property having stamp value of ₹50 lakh may be purchased, at such proportionate price in cheque and cash as may be planned, by that firm/company. For the seller, taxation will be on Net earnings from such gross sale of ₹50 lakh (stamp duty) and for the purchaser it will be none, Section 56(2)(vii) being not applicable to its status.

G. Impasse for Black Money Holders?

It is a normal practice for black money holders to purchase immovable properties by paying say 20% to 70% of stamp value *via* banking channels and rest all in cash. After operation of amended Section 56(2)(vii) such balance consideration though paid in cash will be treated as Income in their hands which will be taxed as per normal slab rates say 30%. Thus to avoid a situation in which tax payable will workout almost equivalent to the returned income or the accounting ratios show an unreasonable picture, there will surely be a curb over Cash spending and in-turn over generation of black money in the long run, at least *via* this route!

Thus finally with some ambiguities, confusions and controversies the government seems successful in inserting Section 43CA with amended Section 56(2)(vii) and we may just hope that the position will be further clarified when questions in this regard are answered by adjudicating forums which they will surely be needed to, considering the desperation of assessees to somehow escape these provisions. ■