Is Section 56(2)(vii) [or 56(2)(x)] a new threat to landlords in a JDA?

The Indian real estate sector has witnessed high growth in recent times with the rise in demand for office as well as residential spaces. Joint development agreement ("JDA"), is currently the most prevalent form of land development. This arrangement is based on the mutual commercial understanding. The arrangements in vogue are area sharing and revenue sharing arrangement. In this article, the author has focused on the 'area sharing arrangement' of a JDA. Read on to know more....

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In an area sharing JDA, a Developer is permitted to enter the property for the purposes of development. A Developer develops the lands by the construction of flats/apartments/building together with common ways, infrastructure, amenities and facilities both for the owners of lands (hereinafter referred to as "landowner") as well as for the prospective buyers

of flats/apartments. The consideration for the sale of the land area going to Developer or his nominees will be flats/apartments built by the Developer (at Developer's cost) for the landowner. On the handover of the flats/apartments to the landowner post construction, obligation of the Developer to the landowner is fully discharged.

When viewed from a landowner's perspective, the aforesaid modus operandi results in parting of portion of land in lieu of which the landowner gets a proportionate share in the superstructure. Parting of land (when held as capital assets) would invariably result in capital gains taxation. Of late, the Department's view has been that the transfer for the purposes of capital gains in such cases will trigger on giving possession to the Developer. The capital gain in such circumstances is calculated by taking the fair market value of land (guidance value) which is deemed as consideration of transfer. Although there are various issues that emerge within the spectrum of capital gains tax, the scope of discussion is limited to Chapter IV-E of the Income-tax Act. Recent developments in the income-tax assessments reveal that a novel school of thought has emerged from the Revenue's side. Landowner who had and is shouldering the capital gains tax levy is now sought to be dragged within the spectrum of Section 56(2)(vii) or Section 56(2)(x) of the Income-tax Act, 1961 ("the Act"). Such thought process is bolstered by the literal reading of Section 56(2)(vii) which is sought to be triggered on getting possession of the built up area. The cost/value of the built-up area handed over to the landlord could be much more than the guidance value of land (on the basis of which the capital gains was paid). The question for consideration is whether on taking possession of flats/apartments (hereinafter referred to as 'building' for brevity) by a landlord under the JDA arrangement, any portion of the value thereof (of building) could be taxable under the provisions of Section 56(2)(vii)? Prior to Finance Act, 2017 this would have been a question relevant only to an individual or Hindu Undivided Family (to whom Section 56(2)(vii) is applicable). With Section 56(2)(x) encompassing every person within its ambit, the issue assumes a larger importance.

Taxability under Section 56

Chapter IV-F of the Act contains provisions relating to *"Income from other sources"*. It comprises of Sections 56 to 59. Section 56 is the charging section.

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Sub-Section (1) to Section 56 provides that the section is triggered when income is chargeable to tax but is not dealt with and covered by the earlier heads of income. Sub-section (2) enlists certain specific incomes to be charged under this head. Clause (vii) deals with receipt of cash, moveable or immoveable property by an individual or a HUF from non-relatives. Relevant extract of clause (vii) reads as under:

"(vii) where an individual or a Hindu undivided family receives, in any previous year, from any person or persons on or after the 1st day of October, 2009
(a)...
(b) any immovable property,—
without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property;
for a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the stamp duty value of such property as exceeds such consideration:
Provided that where the date of the agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of the agreement may be taken for the purposes of this sub-clause:
Provided further that the said proviso shall apply only in a case where the amount of consideration referred to therein, or a part thereof, has been paid by any mode other than cash on or before the date of the agreement for the transfer of such immovable property;"

Under a JDA, a landowner would be handed over the built-up area in *lieu* of parting of Developer's share of land. The question is can taking possession of such built-up area by landowner be considered as a *'receipt of immovable property for inadequate*

In a JDA, there is handing over of building to landlord in *lieu* of land transfer. The building constitutes 'consideration' for transfer of land. The term 'consideration' is not defined in the Income-tax Act. One may therefore take recourse to Indian Contract Act, 1872 which defines consideration in Section 2(d)

consideration' and thereby make such receipt chargeable to tax under Section 56(2)(vii)(b)?

On a first blush, the proposition appears convincing enough to fuel a judicial battle. However, on various occasions the judiciary has gone beyond the words; appreciated the intent; weighed the ramifications and adjudged in favour of justice. On the same path, this write-up focuses on the possible leads or merits to argue that legislature never intended to bring the acquisition of superstructure under JDA arrangement within Section 56(2)(vii):

Nature of transaction

From a landowner's standpoint, there is a transfer of land (held as capital asset) in *lieu* of building. Any gain arising from transfer of capital asset should necessarily be chargeable to tax under the head 'Capital gains'. The capital asset transferred is the land (Developer's portion) and for which the landowner pays capital gains on the basis of guidance value of land. Thereafter, in terms of the contract/agreement, the Developer completes the built-up area and hands over the same to land owner. The building is on the land owned by the landlord. The moot question would be that on taking delivery of built-up area by the landlord, is there (i) any 'receipt' as such of any immovable property; and (ii) even if there be a 'receipt', can it be said that the 'receipt' is 'without consideration' or at best for 'inadequate consideration'?

The question is *qua* the landowner. The contract should therefore be viewed from his perspective. In a JDA, there is handing over of building to landlord in *lieu* of land transfer. The building constitutes 'consideration' for transfer of land. The term 'consideration' is not defined in the Income-tax Act. One may therefore take recourse to Indian Contract Act, 1872 which defines consideration in Section 2(d) therein to *inter-alia* mean *"when, at the desire of the promisor, the promisee or any other person has done or does or promises to do something, such act or promise is called a consideration for the promise"*. In the present context, at the desire of landowner (promisor), the Developer (promisee) promises to construct super-structure (do something), such act (construction) is called consideration.

Thus, there is parting of land by the landowner. In consideration of such parting (of land), there is handing over of building. It is thus not a receipt of immovable property (building in the present case) for consideration. It is the receipt of consideration for transfer of capital asset (being land). The phrase 'of consideration' is also seen in the proposed Section 194-IC (vide Finance Act, 2017) wherein payment of any sum other than in kind by way of consideration under Section 45(5A) is subject to tax deduction at source. The language employed herein supports the proposition that the landowner is in receipt (if at all any) of consideration (and not for consideration). Conceptually therefore, the transaction does not fit into the scheme of Section 56(2).

The question is, can Chapter IV-E be invoked at all in such transactions? The Bombay High Court in *Chaturbhuj Dwarkadas Kapadia vs. CIT* (2003) 260 ITR 491 (Bombay) held that a developer's possession pursuant to a JDA amounts to deemed transfer under Section 2(47)(v) of the Act. The Karnataka High Court in *CIT vs. Dr. T. K. Dayalu* (2011) 14 taxmann.com 120 (Kar) after referring to the decision of the Bombay High Court in the above case held that the transfer in case of a JDA gets effected on the day when possession is handed over to the developer. The Karnataka High Court reiterated the same view in *CIT vs. H.B. Jairaj* ITA No 21/2005. Although one may dispute on the 'time/point' of taxation in a JDA arrangement, the head of income has been repeatedly confirmed to be 'Capital gains'. This being the case, it is not open to the Revenue authorities to dispute the head of income to be *'Income from other sources'*.

There is another fallout from these judgements. The date of possession has been held to be the date of transfer in these cases (which is generally the date of entering into JDA). Although there are contrary views on this matter, this is the accepted and majority view of the Courts [more so, in Karnataka]. First proviso to Section 56(2)(vii) provides that if the date of agreement fixing the consideration and the date of registration of immovable property are not the same, the stamp duty value as on the date of agreement shall be taken for the purposes of Section 56(2)(vii). Primacy is thus given to the date of agreement from

the recipient standpoint. Thus, both from a transfer [Section 47] and receipt [Section 56] standpoint, the statute focuses on the agreement stage. One could argue that transfer (of land) at the agreement stage, is by inference receipt (of superstructure) by the landowner. Both the actions of transfer and receipt occur simultaneously. If this proposition were to be accepted, the receipt of superstructure (although may be a constructive receipt) is concluded on the date of executing JDA. This being the case, there cannot be 'second' receipt in the hands of transferee/landowner on actual possession of building. Any attempt to tax the landowner on possession under the head 'Income from other sources' will result in an absurd situation of 'two' receipts (one on JDA execution and another on possession) for 'one' transfer. This could not be the intent of law.

Guidance from Finance Act, 2017

Finance Act, 2017 inserted sub-Section (5A) into Section 45 to clarify taxation of JDA. There is no dispute on this being a prospective amendment. However, the memorandum to Finance Bill, 2017 which details the objective of this provision clarifies that Section 45(5A) is introduced to bring clarity in capital gains taxation of landowners in a JDA arrangement. The memorandum acknowledges the hardship in paying 'capital gains tax'. Thus, the legislature recognises the income to be chargeable to tax under capital gains tax even under the existing regime.

Operating portion of Section 56

Section 56(1) creates a charge on income which is chargeable to tax but is not dealt with and covered by the earlier heads of income. Thus, if an income is chargeable to tax under the head 'Capital gains', the charge under Section 56 fails at threshold. Transfer of land under a JDA is chargeable to tax under Capital gains and cannot be enveloped within Section 56. It is a settled law that if a transaction is to be charged under one head of income, it is impossible to hop to the next head in the event of failure in the former head of income. Judicial precedents such as *ACIT vs. Smt. Farida Begum Tazudeen* (1997) 63 ITD 298 (Mad); *Nalinikant Ambalal Mody vs. CIT* (1966) 61 ITR 428 (SC); and others confirm this proposition.

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Thus, a transaction such as the JDA cannot be brought under the regime of Section 56 purely because it was not possible to tax under the head 'Capital gains' merely on receipt basis. It is not an alternate head of taxation. Transfer under JDA is ring fenced within the contours of Section 45 and cannot trespass into 'Income from other sources'. The charge of capital gains tax cannot be by-passed. An attempt to fix a charge under Section 56 would result in double taxation.

There is no 'receipt' in the hands of landlord

The opening portion of clause (vii) to Section 56(2) states that there should be 'receipt' [of cash, movable or immovable property] from any person(s). The term 'receipt' is not defined in the Act. It is not a term of art and must receive colour from the context in which it is used [*CIT vs. Dharamdas Hargovandas* (1961) 42 ITR 427 (SC)].

In the present context, the receipt of building is a pre-requisite for taxing landowner under Section 56(2)(vii). A receipt of building presupposes a giver to whom it belongs prior to such receipt. Thus, receipt of building in JDA should be the property of the person from whom it is received. However, the landowner's share of building was always belonging to the landowner pursuant to JDA. The landowner has such right in the building since inception [or date of JDA]. To this extent, the building cannot be regarded as Developer's property. The qualifying attribute of the asset moving being a property of the giver would not be satisfied. The giver should have held such building as assets (reflected in its Balance Sheet either as investments or as stock-in-trade). In the context of JDA, the building pertaining to Developer's share would only be reflected as its stock-in-trade. To the extent of landowner's share in the building, the superstructure is constructed or developed by the Developer on behalf of landowner. Accordingly, there is no 'giver' of building to the landowner in the context of JDA. Consequentially, there is no occasion to 'receive' the building. Thereby, the primary condition of triggering Section 56(2)(vii) fails.

Clause (vii) to Section 56(2) is an anti-abuse provision

Section 56(2)(vii) was inserted by Finance Act, 2009. It is an anti-abuse provision inserted to *inter-alia* plug the 'transfer' of immovable property at inadequate or no consideration [Circular 5 of 2010 dated 3.6.2010]. Such provision should not be used as a tool to levy double taxation. The same transaction (JDA in the present case) cannot be taxed both under the heads - Income from other sources and capital gains.

If the said proposition were to be accepted, there could be absurd tax consequences that emerge on purchase of immovable properties although unintended. For instance, Mr. X sells land (held as capital asset) for an agreed 'cash' consideration. The said sale would be subject to capital gains tax in the hands of Mr. X. The question is can receipt of 'cash' [received in consideration for sale of land] be taxed under the head 'Income from other sources' under Section 56(2)(vii)? It is obvious that 'parting of land' and 'receipt of cash', being two facets of the same transaction, cannot be subject to tax under two different heads. Extending the same analogy in the present context, 'parting of land' and 'receipt of building' cannot be subject to tax in the hands of landowner.

Concluding thoughts: Real estate is the second largest employer after agriculture. The financial stakes in this segment are huge. With the growth of this segment, one has seen the increasing legal disputes in the area. Clarity in taxing real estate transactions is of utmost importance. JDA has been one of the most preferred *modus operandi* of property development. Players in this arrangement deserve and have been yearning for clarity on the income/gain made from such arrangement. While the mysteries in capital gains tax still remain unsolved [inspite of fair attempt through Section 45(5A)], this new twist in taxing the landowner will only be discouraging. ■

Success is not the key to happiness. Happiness is the key to success. If you love what you are doing, you will be successful. - Albert Schweitzer