Interesting Amendments and Law of Taxation on Transfer of Immovable Property

We all are well aware that prices of property have increased manifold in the last decade. Not only transaction values have gone up, even the number of transactions has increased manifold. Further, there is a high likely element of cash involvement in property transactions. Naturally, the Government has, on a progressive basis, enacted very tight laws to avoid any profit on sale of property getting untaxed. It is therefore important to understand in detail the law on taxation of capital gains. The article primarily intends to discuss and analyse the recent amendments to the capital gain on immovable property viz. implications of deeming provision connected with stamp value under Sections 50C, 43CA and 56(2) (vii) and liability on the transferee of any immovable property to deduct tax at source under Section 194IA. The article also touches upon the overall scheme of capital gain and other Income-tax provisions on sale and purchase of immovable property.

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Capital gain provisions are contained under Sections 45–55A of the Income-tax Act, 1961. The basis of charge is provided by the Section 45(1): *"any profits or gains arising from the transfer of a capital asset shall be chargeable to income tax under the head Capital gains and shall be deemed to be the income of the PY in which such transfer took place unless exempt under the Act"*. The charging Section throws five basic things to study:

1. There must be a capital asset which is owned by an assessee
2. It must be transferred
3. Point of taxation

For calculating the holding period, date of sale is excluded and period must be more than 36/12 months. When a property is sold, period of holding has to be reckoned separately for land and building. Thus, when land and building are sold together, building being depreciable shall be short-term, however land can be long-term.

4. Computation of capital gain and rate of taxation thereon
5. Capital gain should not be exempt under the Act

What is a Capital Asset?

The definition is given in Section 2(14): "Capital asset means property of any kind held by an assessee but does not include" the following three:

(i) Inventory or consumables held for the purpose of his business or profession (as the same shall be chargeable under *income from business or profession*)

(ii) Personal effect is defined as *"moveable property held for personal use by the assessee or any member of his family dependent on him except jewellery, archaeological collections, drawings, paintings, sculpture, any work of art, etc" (drawings, paintings, etc.,* excluded only with effect from AY 08-09).

Jewellery is defined by explanation to Section 2(14) as *"a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing any such precious metal whether or not containing any precious or semi-precious stone and whether or not worked or sewn into any wearing apparel & b) precious or semi precious stones."* In the definition of jewellery, only ornaments made of precious metal are included. Thus, items other than ornaments, made of precious metal can be treated as personal effects provided they are commonly and ordinarily used or intended to be used for personal or household use. The Supreme Court holds that silver coins or bullion are not capital assets as they cannot be personal effects even if used in *puja.* Similarly, though silver utensils can be a personal affect, they can be so only to the extent of reasonable quantity that can be attributed to personal use. So, capital assets that come to mind being in nature of personal effects are car, furniture, clothes, stationery, watch, etc.

(iii) Agricultural land has to satisfy the following three conditions: being used for agricultural purposes; situated in India and not situated in an urban area.

Urban area is any area comprised within the jurisdiction of a local body and which has a population of not less than 10,000, or, any area within such distance from such local body (to be counted aerially) which is 2 km for an area with population 10k–100k, 6 km for an area with population 100k–1,000k and 8 km for the rest. This provision linking distance from local body to population and of measuring such distance aerially (commonly known as crow flight) is a recent one introduced by the Finance Act, 2013 (applicable for AY 14-15); earlier distances were notified by the Government city-wise through notification and there was no clarity on how such distance would be measured. Secondly, the property to be transferred must be a capital asset on the date of transfer; therefore, if a dealer of real estate on closure of business retains the existing stocks as investment, the stock shall become capital asset in his hands from the time of closure. Whether a stock is a business asset or a capital asset, the law is silent and it has to be seen from the facts and circumstances of the case. Points the court have relied upon are intention of assessee at the time of purchase, multiplicity of transactions, length of ownership, etc.

Therefore, it can be seen that the definition of capital asset is of a sweeping nature and covers property of any kind— which may be intangible rights, part ownership, etc.

There are two types of assets:

Long-term: It is a *"capital asset which is not a short-term capital asset".*

Short-term: It is a *"capital asset held by an assessee for not more than 36 months immediately preceding the date of transfer".* Period is not more than 12 months for the following assets:

a) Equity/preference shares held in a company (may be listed or unlisted)
b) Any other security listed in an RSI in India
c) Unit of UTI/MF specified u/s 23(D) (may be a debt fund)
d) Zero-coupon bonds

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When a property is sold, period of holding has to be reckoned separately for land and building. Thus, when land and building are sold together, building being depreciable shall be short-term, however land can be long-term. [*CIT vs. CITI Bank NA* (2003) 261 ITR 570 (Bombay)]. In case of any property acquired under any mode given under Section 49(1), e.g. gift, will, etc., the holding period of previous owner has to be included as well to determine the nature of asset.

Right to acquire any house property: 'Right to acquire a flat' from a builder is a capital asset separate from the flat itself. Therefore, if such right is acquired more than 36 months back, it becomes a long-term asset. However, when the possession of the flat is taken, the small 'right to acquire a flat' gets merged into larger right and loses its existence. Thus, the period of holding would once again commence for the purpose of counting possession of flat.

What Constitutes a Transfer?

Section 2(47) provides an *inclusive definition of transfer. It includes "sale, exchange, relinquishment, extinguishment of any right, compulsory acquisition, conversion from capital asset to stock in trade, any transaction which has the effect of transferring or enabling the enjoyment of any immovable property".*

Section 47: Transactions not Regarded as Transfer

- Transfer under gift, will or irrevocable trust.
- Distribution of assets of a company to its shareholders on liquidation will not be a transfer in the hands of the company, while the receipt in the hands of shareholder is taxable as reduced by the amount assessed as deemed dividend [Section 2(22)(e)].
- Distribution of assets on total partition of HUF.
- Amalgamation/demerger of companies.
- Conversion of bonds or debentures of a company into shares or debentures of that company (including FCCB).
- Any transfer of a capital asset by an Indian company to its 100% subsidiary or *vice versa.*
- Succession of firm or sole proprietorship by a company.
- Succession of a private limited company by an LLP.

Family settlement is held not to be a transfer as it is merely a realignment of assets.

Transfer in case of Immovable Property: Generally, transfer happens on the date of registry of the property. However, Section 2(47) (v) reads with Section 53A of the Transfer of Property Act, if

a) Possession is given,
b) Consideration has been paid, and
c) There is either power of attorney, agreement to sell or will;

Then even if sale deed is not executed, transfer will be deemed to have taken place.

Point of Taxation

Charging section itself provides that taxation shall be in the year of transfer, i.e. accrual basis. However there are three exceptions:

1. *Conversion of capital asset into stock-in-trade:* Here sale consideration is FMV on date of conversion but tax postponed till year of actual sale/transfer.
2. *Compulsory acquisition of asset:* Point of taxation is postponed till year of actual receipt of compensation.
3. *Damage or destruction of any asset by fire or other calamities:* Point of taxation is postponed till year of actual receipt of insurance.

However in all the above three cases, indexation shall be done only up to the year of transfer.

Section 48: Computation of Capital Gain

Capital gain is computed as full value of consideration, less expenditure incurred wholly and exclusively in connection with such transfer, less cost of acquisition/ indexed in case of long-term capital gain, less cost of improvement/indexed in case of long-term capital gain.

Deemed Value of Consideration:

- *Conversion* of capital asset to stock-in-trade: FMV on date of conversion
- Introduction of capital in kind into firm/AOP/ BOI by partner/member: amount recorded in the books of accounts of firm/AOP/BOI as capital contribution.

Earlier, Section 50C was not applicable, if property is not being actually registered, e.g. sale explained under the Section 53A of the Transfer of Property Act. But with addition of word 'assessable', the Section 50C has been made applicable even to such cases.

- Distribution of assets in kind on dissolution of firm/AOP/BOI: FMV on that date
- Section 50C: Introduced with effect from AY 2003-04. As per this section valuation adopted/assessed/ assessable (inserted by the Finance Act, 2009) by the stamp valuation authorities shall be treated as the consideration for such transfer of land and/or building ignoring the actual consideration, if the same is lesser than the value so adopted.

Section 50C is very draconian with respect to disputed properties or odd-location ones. The law provides an assessee the following two options if he thinks that the stamp value is not FMV:

i) Assessee may claim that the stamp valuation exceeds FMV—in this case the AO may refer the valuation to a valuation officer ('may' here has to be read as 'shall'). Valuation officer is as per Section 16A of WT Act. These are Govt officials of CPWD. If value > 3 crore, then valuation is referred to District Valuation Officer, DVO.
ii) Dispute the fairness of the valuation with stamp valuation authority or in any court. For this purpose, Section 155 says that the period of four years for the purpose of carrying out rectification shall be reckoned from the end of the previous year in which the order revising the value was passed here.

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Where the value of Valuation officer > stamp value: then stamp value applicable

Earlier the Section 50C was not applicable, if property is not being actually registered, e.g. sale explained under the Section 53A of the Transfer of Property Act. But with addition of word 'assessable', the Section 50C has been made applicable even to such cases. Still the question remains whether the stamp value is applicable on the date of agreement to sell or on the date of registration. Section 50C is silent in this regard. However, Section 43 CA inserted by the Finance Act, 2013, which is a replica of the Section 50C but for land and building that are held as stock in trade. It provides that *"where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer are not the same and in a case where the amount of consideration or part thereof has been received by any mode other than cash on or before the date of agreement for transfer of the asset, then stamp value assessable on the date of agreement shall be taken as full value of consideration."*

...if an Individual or HUF being in the business of real estate, buys the land or building at less than stamp duty value and therefore being subject to rigour of newly inserted clause (b) of Section 56(2) (vii), pays tax on the difference of stamp duty value and the actual consideration yet such individual or HUF would not be able to take advantage of the deemed enhanced cost and in a way results in double taxation.

However, it is interesting to note that if stamp duty on transfer is paid by seller—it would be reduced from the corresponding stamp value for determining the value of capital gain.

Transfer of Property without consideration/ inadequate consideration [Section 56(2) (vii)]: Any immovable property received by an individual or HUF without any consideration is chargeable to tax as income under the head income from other sources, if the stamp duty value of such property (or properties) exceeds ₹50,000. Finance Act, 2013 further adds: *"where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding ₹50,000, the stamp duty as exceeds such consideration shall be chargeable to tax in the hands of the individual or HUF as income from other sources"*. Section 43CA provision of stamp value on date of agreement provided here as well.

Exclusions as below: (i) Receipts on occasion of marriage of the individual; (ii) Receipts under a will or inheritance, (iii) Receipts received from a relative.

Relatives are defined by the following relationships of the individual:

1. Parents, parents siblings and their spouse
2. Siblings, spouse of siblings
3. Daughter and son, spouse of daughter and son
4. Spouse, spouse's parents
5. Spouse's siblings and their respective spouse.

Also note that clubbing provision shall apply if any asset is transferred without adequate consideration to wife, son's wife or by a member to its HUF. It is important to note that provision of the Section 56(2) (vii) applicable only in case of transferee being individual or HUF, whereas provisions of the Section 50C/43CA are applicable to all assessees.

The legislature has provided 49(4) which states *"where the capital gain arises from the transfer of a property, the value of which has been subject to income tax under section 56 (2) (vii), the cost of acquisition of such property shall be deemed to be the value which has been taken into account for the purposes of the said clause (vii)."*

However, in case where an individual or HUF acquired such property as a trading asset, the enhanced value of such asset cannot be taken as its cost of acquisition, as no provision equivalent to the Section 49(4) is provided under *profit & gains of business or profession*. In other words, if an Individual or HUF being in the business of real estate, buys the land or building at less than stamp duty value and therefore being subject to rigour of newly inserted clause (b) of Section 56(2) (vii), pays tax on the difference of stamp duty value and the actual consideration yet such individual or HUF would not be able to take advantage of the deemed enhanced cost and in a way results in double taxation.

Gift to relative is allowed. It is exempted for seller being out of definition of transfer (Section 47) as well as exempted for buyer [Section 56(2)]. However, as per general definition, *gift* is meant to be free and therefore there cannot be part gift. Where the sale deed is executed at a lower apparent consideration in favour of some close relative, it may be specifically mentioned in the sale deed that either land or superstructure is gifted and the sale proceeds are received only for the remaining asset, in that case the gifted land or building shall not be regarded as transfer and, therefore, Section 50C shall not be applicable.

Cost of Acquisition: Where acquisition is before 01-04-1981, assessee has the option to take either cost of acquisition or FMV as on 01-04-1981 as cost of acquisition. Further, cost of acquisition shall cover all other charges paid to builders like for power, club, etc., if capital asset is acquired through borrowed money, then the interest incurred before the asset is put to use will be included in cost of asset provided the same has not be claimed as deduction elsewhere under the Act.

Deemed Cost of Acquisition: Section 49(1): Cost to the previous owner in certain cases like gift, will, partition of HUF, transfer to a trust, conversion of a self-acquired property to HUF property, amalgamation, etc.

Indexed Cost of Acquisition: Cost of acquisition * CII in which asset is transferred/CII in which assets was held by assessee or 01-04-1981 whichever is later. Indexation is not allowed in certain cases:

(i) Transfer of bonds & debentures (being interest bearing)
(ii) Transfer of shares/debentures acquired by a non-resident in foreign currency in an Indian company
(iii) Slump sales
(iv) Transfer of securities by an FII

Academically, in the cases of acquisition of property by inheritance or will, CII for the year in which the transmission/inheritance of property takes place is to be made the denominator holding the same to the CII for the first year in which the asset was held by the assessee but there are decisions of the ITAT in which it has been held that CII of the year in which the property was acquired by the previous owner, or, 01-04-1981 whichever is later has to be taken as CII of the year of acquisition

i) Mrs. Pushpa Sofa vs. ITO 89 TTJ (Chandigarh) 499
ii) Kamala Mishap vs. ITO (2008) 19 SOT 251 (Delhi)
iii) Smt Mina Degum vs. ITO (2008) 117 TTJ (Kolkata) 121

Section 50 Depreciable Assets: Profit arising on transfer of depreciable assets is regarded as short-term gain once written down value in block of asset is exhausted and there is no indexation. However held in Assam Petroleum 262 ITR 587 Guwahati that *Section 54E (now 54EC)* is an independent provision which is not controlled by the Section 50. Section 50 only provides that if depreciation has been allowed under the Act on the capital asset, the assessee computation of capital gain would not be under Section 48 and under Section 49 of the Act and it would be with modification as provided under Section 50.

Section 51 Advance Money Received: "Where any capital asset was on any previous occasion the subject of negotiations for transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost (or wdv or FMV as the case may be) of the asset." Even if advance money forfeited is more than cost of acquisition, it will be a capital receipt not taxable (*Travancore Rubber Tea Co. Ltd. vs. CIT (2000) 243 ITR 158 SC*)

Cost of Improvement:

- Expenditure incurred by the assessee or the previous owner before 01-04-1981 is to be completely ignored, whether the assessee opts for the market value as on 01-04-1981 or not.

- Assets acquired after 01-04-81: all capital expenditure incurred in making any addition/ alteration to the capital asset.

(Routine expenses on repairs and maintenance of not form part of cost of improvement).

Indexed Cost of Improvement: Cost of improvement * CII in which asset is transferred/CII in which improvement was made by the assessee or previous owner.

Exemptions from Capital Gains Tax

Various exemptions provided under the Act are:

Section 10(37): "Exempts capital gain arising to individual/HUF from transfer of agricultural land by way of compulsory acquisition provided such land has been used for agricultural purposes during the preceding 2 years by such individual or a parent of such individual or HUF."

Section 10(38): Exempts long-term capital gain arising either from equity shares or units of an equity-oriented mutual fund provided such shares are sold through a recognised stock exchange and mutual funds are sold either through a recognised mutual fund or back to the mutual fund house and such transaction is charged to STT. Therefore, exemption is not available in case of buyback of shares, off-stock exchange transfer. The entities and the specific assesses, whose income are exempt under specific provisions of Section 10, the capital gains arising in their hands are also exempt. In the case of religious trusts or institutions, the capital gains are exempt subject to satisfaction of certain conditions provided therein.

Section 54 to 54F: relate to the exemptions of capital gains with reference to investment thereof in the specified assets as provided in the said sections. We shall discuss a few provisions below:

Section 54: "any long term capital gain arising to an individual or HUF, from the transfer of a residential house shall be exempt to the extent such capital gain is invested in the purchase of another residential house within a period of 1 year before or 2 years from the date of transfer or construction of a residential house within a period of 3 years from the date of transfer" (construction could have started before sale). The important issues under this section are:

i) In case the new asset is transferred within a period of three years from the date of its acquisition, for the purpose of computing short-term capital gain on such transfer, the long-term capital gain exempt earlier shall be reduced from the cost of acquisition of the new asset.
ii) It is not necessary that only the same funds used for acquiring the new asset should be invested.
iii) If agreement to sell has been made and consideration made and thereafter if builder delays in making the possession available: In view of the author, assessee should not be penalised in such cases.

Section 54 to 54F relate to the exemptions of capital gains with reference to investment thereof in the specified assets as provided in the said sections.

Section 54EC: The assessee has to invest capital gains in the specified bonds of RECL or NHAI within a period of six months from the date of transfer of long-term asset. The investment in such bonds by an assessee should not exceed ₹50 lakh during any financial year. Thus, with respect to a sale of asset: if there are joint owners, both can invest up to ₹50 lakh. Further, the investment can be staggered over two financial years (for this it is important that asset is sold in second half of the year): *Smt. Siam Indaba vs. ITO* (2013) 32 Taxman 118 (Chennai – Trib.)

Section 54F: Exempts capital gain on transfer of any long-term capital asset other than residential house if the net consideration is used for purchase/ construction of a residential house (time period same as Section 54). Difference in 54F as compared to 54: (i) Transfer of any property other than residential house property here. (ii) Net consideration needs to be invested here. (iii) Assessee should not own more than one house on the date of transfer of the original asset. (iv) Assessee should not purchase any residential house other than the new asset within a period of 2 years after the date of transfer of original asset or should not construct any other residential house other than the new house within a period 3 years from the date of transfer.

In all the cases of exemptions, except the Section 54EC, if the amount of capital gains is not invested or utilised for the purposes of new asset before furnishing of return of income under Section 139, the amount which is not utilised for the purposes of new asset before furnishing of return of income the amount which is not utilised shall be deposited in bank account opened in accordance with the capital gain account scheme, 1988 and proof of deposit has to be enclosed with the return of income. But if the amount is neither appropriated before the due date of filing nor deposited in the capital gain account, it can be appropriated for the purchase of new asset before filing return of income under Section 139(4) and the benefit of the said section has to be allowed. See following case laws: *Nipun Malhotra vs. ACIT* (2008) 110 ITD 520 (Bangalore) and *CIT vs. Rajesh Kumar Jallan* (2006) 286 ITR 274 (Guwahati).

Rate of Tax

Short-Term: Normally, short-term capital gain forms part of regular income of the assessee and is taxable at normal rate applicable subject to special rate under Section 111A for charging tax on short-term capital gain arising from transfer of equity shares in a company or a unit of an equity-oriented fund if such transactions are chargeable to STT.

- Rate of tax shall be 15%.
- No chapter VI A deductions on such short-term capital gain.
- Provided in case of a resident individual or HUF, where total income as reduced by such short-term capital gain is below the maximum amount not chargeable to tax, then shortfall shall be reduced from such short-term capital gain and balance taxable at 15%.

Long-Term: Normally long-term capital gain is chargeable @ 20%. No chapter VIA deductions available here and, in case of a resident individual or HUF, where total income as reduced by such long-term capital gain is below the maximum amount not chargeable to tax, then shortfall shall be reduced from such short-term capital gain and balance taxable at 20% (Section 112). Provided that where the tax payable in respect of any income arising from the transfer of a long-term capital asset, being listed securities or units exceeds 10% of the amount of capital gain before indexation then excess shall be ignored.

Set Off & Carry Forward: Section 74

- Capital loss can be set off only from capital gain. However, short term capital loss can be set off either from short term or long term capital gain. Capital loss arising from a long term capital asset can be set off only against long term capital gain.
- Remaining loss can be carried forward for not more than 8 years immediately succeeding the AY for which loss was first computed.

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TDS on Purchase of Property (Section 194IA)

Finance Act, 2013 has introduced TDS liability in case of transfer of immovable property. It enacts: *"any person being a transferee responsible for paying to a resident transferor any sum by way of consideration for transfer of any immovable property other than a) agricultural land or b) where consideration for such transfer is less than ₹50 lacs shall deduct tax @ 1%."*

Key features are:

(i) Even individuals/HUF, who are not covered by provisions of Section 44AB have TDS liability here.
(ii) Tax to be deducted at the time of payment or credit whichever is earlier.
(iii) Tax to be deducted @ 20% if PAN is not quoted by the seller.
(iv) The only relaxation provided considering the one-time nature of such transaction in many cases is that the deductor is not required to obtain TAN number.

Conclusion

Finance Act, 2013 has more or less settled the legislative intent of deeming the stamp valuation as the consideration price in case of immovable properties for all assessees. The deemed consideration is applicable for purpose of calculating capital gain in the hands of a seller of capital asset (Section 50C). The stamp valuation is also applicable for the purpose of calculating business income in the hands of a seller of trading asset (Section 43CA). The deemed consideration would be assumed to have been paid even in the hands of the purchaser under Section 56(2) (viii). Further, the introduction of TDS, wherein the registrar of properties shall not register a covered property till proof of deposit of TDS is produced by the buyer shall go a long way in bringing all property transactions under the tax net.■