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Flash news

No ‘transfer’ results for capital gains taxation if joint development agreement is not registered; income cannot be taxed on a hypothetical basis – Supreme Court

Background

The Supreme Court in the case Balbir Singh Maini[1] (the taxpayer) held that the provisions of ‘transfer’ under Section 2(47)(v) of the Income-tax Act, 1961 (the Act) are not applicable since Joint Development Agreement (JDA) entered into by the taxpayer with developers is not registered. In order to qualify as a ‘transfer’ of a capital asset under Section 2(47)(v) of the Act, there must be a ‘contract’ which can be enforced in law under Section 53A of the Transfer of Property Act, 1882 (TOPA). There is no contract which can be taken cognisance of, for the purpose specified in Section 53A of the TOPA after the amendment in 2001 unless the said contract is registered. Since JDA was never registered, the JDA has no efficacy in the eye of law, therefore, no ‘transfer’ can be said to have taken place.

The Supreme Court also observed that the income from the capital gain on a transaction has never materialised and it is a hypothetical income. There is no profit or gain which arises from the transfer of a capital asset. The taxpayer did not acquire any right to receive income, in as much as such alleged right was dependent upon the necessary permissions being obtained. There was no debt owed to the taxpayers by the developers, and therefore, the taxpayers have not acquired any right to receive income under the JDA. Therefore, no profits or gains ‘arose' from the transfer of a capital asset so as to attract Sections 45 and 48 of the Act.

Facts of the case

- The taxpayers are members of the Punjabi Co-operative Housing Building Society Ltd. The society consisted of 95 members and was the owner of 21.2 acres, of which 500 square yards plots were held by 65 members, 1000 square yards plots by 30 members and the remaining 4 plots of 500 square yards each were being retained by it.
- The owners entered into a tripartite JDA dated 25 February 2007 for development of 21.2 acres of land in the village Kansal. This JDA was entered into between the owner, i.e., Punjabi Cooperative Housing Building Society Ltd., Hash Builders Pvt. Ltd., Chandigarh (HASH) and Tata Housing Development Company Ltd. (THDC).
- Under the JDA, it was agreed that HASH and THDC, will undertake to develop 21.2 acres of land owned and registered in the name of the society. The agreed consideration was to be disbursed by THDC through HASH to each individual member of the society, and different amounts and flats were payable and allotable to members having different plot sizes.
- The developers were to make payments in four instalments. A sum of INR38.7 million was paid on execution of the JDA. Further, INR154.8 million was to be paid against a registered sale deed for land of an equivalent value of 3.08 acres, earmarked on the demarcation plan annexed to the JDA, which was effected by a registered conveyance dated 2 March 2007.

[1] CIT v. Balbir Singh Maini (Civil Appeal No. 15619 of 2017) – Taxsutra.com

- The second instalment payment, being INR232.2 million, was for the land of an equivalent value of 4.62 acres, also earmarked on the demarcation plan, which was effected by a registered deed of conveyance dated 25 April 2007.
- The third instalment payment of INR319.275 million was to be made within six months from the date of execution of the agreement or within two months from the date of approval of plans/design and drawings and grant of the final license to develop, whichever was later. This was to be for the land of an equivalent value of 6.36 acres, also earmarked on the demarcation plan.
- The balance payment of INR319.275 million was to be made within two months from the date of the last payment, towards full and final settlement of the entire payment of INR1064.25 million, for which a registered sale deed for land of an equivalent value being 7.14 acres, also earmarked on the demarcation plan, was to be conveyed.
- The developers made payments up to the second instalment, and the taxpayer paid capital gains tax on the same for Assessment Year (AY) 2007-09 and 2008-09. For the subsequent AYs proceedings were pending before the Punjab and Haryana High Court and thereafter before the Delhi High Court. The necessary permissions for development were not granted, as a result of which the JDA did not take off the ground. The Assessing Officer (AO) held that since physical and vacant possession had been handed over under the JDA, the same would tantamount to 'transfer' within the meaning of Sections 2(47)(ii)[2], (v) and (vi) of the Income-tax Act, 1961 (the Act). Accordingly, the entire amount was taxable in the year in which JDA was executed.

Supreme Court's decision

Analysis of JDA and applicability 'transfer' definition under the Act read with Transfer of Property Act 1882

- On a perusal of the JDA, it indicates that it is essentially an agreement to facilitate the development of 21.2 acres so that the developers build at their own cost, after obtaining necessary approvals, flats of a given size, some of which were then to be handed over to the members of the society. Payments were also to be made by the developer to each member in addition to giving each member a certain number of flats depending upon the size of the member's plot that was handed over.
- The payments under the third instalment were only to be made after the grant of approvals and not otherwise, and it is an admitted position that this was never done because no approvals could be obtained as the High Court ultimately interdicted[3] the project.
- On reference to the termination clause of JDA, it indicates that in the event of the JDA being terminated, whatever parcels of land have already been conveyed, will stand conveyed, but that no other conveyances of the remaining land would take place.
- The Supreme Court in the case of Shrimant Shamrao Suryavanshi & Anr.[4] observed that there are certain conditions which are required to be fulfilled if a transferee wants to defend or protect his possession under Section 53-A of the Act.
- The Supreme Court referred the decision of Rambhau Namdeo Gajre[5]. It was observed that an agreement of sale which fulfilled the ingredients of Section 53A of the Transfer of Property Act, 1882 was not required to be executed through a registered instrument. However, this position was changed by the Registration and Other Related Laws (Amendment) Act, 2001. Amendments were made simultaneously in Section 53A of the Transfer of Property Act and Sections 17 and 49 of the Indian Registration Act.
- By the aforesaid amendment, the words 'the contract, though required to be registered, has not been registered, or' in Section 53A of the Transfer of Property Act, 1882 have been omitted. Simultaneously, Sections 17 and 49 of the Indian Registration Act 1908 Act have been amended, clarifying that unless the document containing the contract to transfer for consideration any immovable property is registered, it shall not have any effect in law, other than being received as evidence of a contract in a suit for specific performance or as evidence of any collateral transaction not required to be effected by a registered instrument.

[2] Transfer in relation to a capital asset includes the extinguishment of any rights therein

[3] Prohibited

[4] Shrimant Shamrao Suryavanshi & Anr. v. Pralhad Bhairoba Suryavanshi (D) by LRs. & Ors., (2002) 3 SCC 676 at 68

[5] Rambhau Namdeo Gajre v. Narayan Bapuji Dhgotra (Dead) through LRs. (2004) 8 SCC 614 at 619, para 10

- Accordingly, on and after the commencement of the Amendment Act of 2001, if an agreement, like the JDA in the present case, is not registered, then it shall have no effect in law for the purposes of Section 53A of the Act. The Supreme Court observed that the High Court was right in stating that in order to qualify as a 'transfer' of a capital asset under Section 2(47)(v) of the Act, there must be a 'contract' which can be enforced in law under Section 53A of the Transfer of Property Act.

- There is no contract in the eye of law in force under Section 53A after 2001 unless the said contract is registered. It is clear that the said JDA was never registered since the JDA has no efficacy in the eye of law, obviously, no 'transfer' can be said to have taken place under the aforesaid document. Accordingly, it has been held that the provisions of transfer provided under Section 2(47)(v)[6] of the Act is not attracted on the facts of the present case.

Effect of JDA under Section 2(47)(vi) of the Act for extended definition of transfer under the Act

- The object of Section 2(47)(vi) of the Act appears to be to bring within the tax net a de facto transfer of any immovable property. The expression 'enabling the enjoyment of' takes colour from the earlier expression 'transferring', so it is clear that any transaction which enables the enjoyment of immovable property must be enjoyment as a purported owner thereof[7]. The idea is to bring within the tax net, transactions, where, though the title may not be transferred in law, there is, in substance, a transfer of title in fact.

- A reading of the JDA in the present case indicates that the owner continues to be the owner throughout the agreement, and has at no stage purported to transfer rights akin to ownership to the developer. At the highest, possession alone is given under the agreement, and that too for a specific purpose. The purpose being to develop the property, as envisaged by all the parties. Therefore, it has been observed that Section 2(47)(vi) of the Act will also not rope in the present transaction.

[6] Transfer in relation to a capital asset includes any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of nature referred to Section 53A of the Transfer of Property Act, 1882

[7] The maxim 'noscitur a sociis' has been repeatedly applied by this Court. A recent application of the maxim is contained in Coastal Paper Limited v. Commissioner of Central Excise, Visakhapatnam, (2015) 10 SCC 664 at 677, para 25. This maxim is best explained as birds of a feather flocking together. The maxim only means that a word is to be judged by the company it keeps.

No capital gain accrues or arises

- The taxpayer is right when he has referred to Sections 45 and 48 of the Act and has then argued that some real income must 'arise' on the assumption that there is a transfer of a capital asset. This income must have been received or have 'accrued' under Section 48 of the Act as a result of the transfer of the capital asset.

- The Supreme Court referred the decision of E.D. Sassoon & Co. Ltd.[8] on the issue of accrual concept. Similarly, the Supreme Court in the case of Excel Industries[9] referred to various decisions on the expression 'accrual', and held that income-tax cannot be levied on hypothetical income.

- In the facts of the present case, it is clear that the income from the capital gain on a transaction which never materialised is, at best, a hypothetical income. It is admitted that, for want of permissions, the entire transaction of development envisaged in the JDA fell through. The income did not result at all for the aforesaid reason. It is clear that there is no profit or gain which arises from the transfer of a capital asset, which could be brought to tax under Section 45 read with Section 48 of the Act.

- In the present case, the taxpayer did not acquire any right to receive income, in as much as such alleged right was dependent upon the necessary permissions being obtained. There was no debt owed to the taxpayers by the developers, and therefore, the taxpayers have not acquired any right to receive income under the JDA. This being so, no profits or gains 'arose' from the transfer of a capital asset so as to attract Sections 45 and 48 of the Act.

Our analysis

Registration of JDA

Due to the Registration and Other Related Laws (Amendment) Act, 2001, amendments were made in Section 53A of the TOPA and Sections 17 and 49 of the Indian Registration Act. It was provided that unless the document containing the contract to transfer of any immovable property is registered, it shall not have any effect in law, other than being received as evidence of a

[8] E.D. Sassoon & Co. Ltd. v. CIT [1955] 1 SCR 313 at 343

[9] CIT v. Excel Industries (2014) 13 SCC 459 at 463-464

the contract in a suit for specific performance or as evidence of any collateral transaction not required to be effected by a registered instrument. Accordingly, 2001 onwards, registration of the document of transfer is a precondition to recognise the transfer within the meaning of Section 2(47)(v) of the Act.

The Punjab and Haryana High Court[10] held that since the JDA was not registered (one of the requirements for the grant of possession under the JDA), possession of land could not be said to have been given under the JDA. Therefore, the transaction could not be said to be a 'transfer' as per Section 2(47)(v) of the Act read with section 53A of TOPA. However, in some of the cases[11] it was held that since the taxpayer acted upon the agreement and accepted the payment, all conditions under Section 2(47)(v) of the Act were satisfied and the transfer took place even though sale deeds in respect of flats were not registered.

The Supreme Court in the instant case has held that provisions of 'transfer' under Section 2(47)(v) of the Act are not applicable since JDA entered into by the taxpayer with developers is not registered. In order to qualify as a 'transfer' of a capital asset under Section 2(47)(v) of the Act, there must be a 'contract' which can be enforced in law under Section 53A of the TOPA.

The Supreme Court decision settled the prolonged litigation and provided the clarity on the issue. The decision will have considerable impact on transactions of immovable properties as to consider it as a transfer, registration of the agreement will be compulsory.

Accrual of income

The Supreme Court in the case of E D Sassoon & Co Ltd.[12] held that income may accrue to the taxpayer without the actual receipt of the same. If the taxpayer acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. Unless and until there is created in favour of the taxpayer a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him.

There is a lot of ambiguity with respect to accrual of income in the JDA transaction. The Chandigarh Tribunal in the case of Charanjit Singh Atwal and Others[13] held that income accrued to the taxpayer on entering into the JDA. Upon execution of the JDA, vested right came to such members to receive such flats. Once this vested right arises, it can be said that income has also accrued to the taxpayer attracting taxation under Section 45 of the Act.

The AAR in the case of Jasbir Singh Sarkaria[14] observed that as long as the transferee is, by virtue of the possession given, enabled to exercise control over the property and to make use of it for the intended purpose, the mere fact that the owner has also the right to enter the property to oversee the development work or to ensure performance of the terms of agreement does not introduce any incompatibility. There is no warrant to postpone the operation of Section 2(47)(v) and the resultant accrual of capital gain to a point of time when the concurrent possession will become exclusive possession of developer/transferee after he pays full consideration.

However, Punjab and Haryana High Court in the case of C S Atwal while dealing the taxability of income from JDA observed that there was termination of JDA and the developers could not make the remaining payments. The High Court held that it cannot be said that any income chargeable to capital gains tax had accrued or arisen to the taxpayer.

The Supreme Court in the present case has held that the taxpayer did not acquire any right to receive income as the said right was dependent upon approval of plans which never got through. There was thus no debt owed to the taxpayer by developers, and consequently, the taxpayer had not acquired any right to receive income under JDA.

Real income theory

The Supreme Court in the case of Shoorji Vallabhdas and Co.[15] held that income-tax is a levy on income. No doubt, the Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping,

[10] C S Atwal v. CIT [2015] 59 taxmann.com 359 (P&H), Pr. CIT v. Charanjit Singh [2017] 85 taxmann.com 144 (P&H)
[11] Dnyaneshwar Mulik v. ACIT [2005] 98 TTJ 179 (Pune)
[12] E D Sassoon & Co Ltd. v. CIT [1954] 26 ITR 27 (SC)
[13] Charanjit Singh Atwal and Others (ITA 448/Chd/2011)
[14] Jasbir Singh Sarkaria [2007] 294 ITR 196 (AAR)
[15] CIT v. Shoorji Vallabhdas and Co. [1962] 46 ITR 144 (SC)

an entry is made about a 'hypothetical income', which does not materialise. Where the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account. The Supreme Court in the case of Excel Industries[16] held that income-tax cannot be levied on hypothetical income.

The Mumbai Tribunal in the case of Chemosyn Ltd.[17] applying the doctrine of real income theory held that as a result of subsequent events (i.e. cancellation of the agreement) the consideration in the form of constructed area to be received as per the JDA never accrued to the taxpayer and hence, should not be taxed in the hands of taxpayer. The Supreme Court held that it is clear that the income from the capital gain on a transaction which never materialised is, at best, a hypothetical income. For want of permissions, the entire transaction of development envisaged in the JDA fell through, and therefore the income did not result at all. It is clear that there is no profit or gain which arises from the transfer of a capital asset, which could be brought to tax under Section 45 read with Section 48 of the Act.

Amendment in the Finance Act 2017

Under the existing provisions of Section 45 of the Act, capital gains are chargeable in the year in which transfer takes place except in certain cases as provided in Section 45.

The Finance Act, 2017 amended[18] Section 45 to provide that where the capital gains arises to the taxpayer being an individual or Hindu undivided family, from the transfer of a capital asset, being land or building or both, under a specified agreement, 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.

[16] Commissioner of Income Tax v. Excel Industries [(2014) 13 SCC 459]
[17] Chemosyn Ltd. v. ACIT [2012] 139 ITD 68 (Mum)
[18] With effect from assessment year 2017-18

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