

Deeming Fiction for Real Estate: Is It beyond Reality?

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“Roti, Kapda aur Makan”, are 3 basic needs of a common man, out of which buying a Makan is one of the common dreams of every Indian. Time and again various representations have been made to the government to regularize the Real Estate Sector to make it affordable for the common people.

So far as Income Tax Regulations are concerned, since last two decades, which is also the period of major economic growth of the country, Finance Ministers had given due weightage to systemize the taxing provisions, specially related to Real Estate Sector.

Why Real Estate Sector is Special?

Before moving into the topic, an interesting question pops up in my mind, regarding reason for affection of the taxing authorities with the Real Estate Sector and the answer may be hidden in the given statistics.

Real estate sector in India has come a long way by becoming one of the fastest growing markets in the world. The growth of the industry is attributed mainly to large population base, rising income level and rapid urbanization. Currently, the Indian Real Estate Market has a market size of approx USD 70 billion [INR 3.8 lakh crore] and is expected to touch the market size of USD 180 billion [INR 10 lakh crore] by the year 2020. The Real Estate sector contributes approx 5% of the national GDP. As per the recent global survey, India Ranked 20th among the top 20 Real Estate Investment markets globally with investment volume of USD 3.5 billion [INR 19000 crore] recorded in FY 2012-13 alone. Further, there is a huge demand – supply mismatch in the Indian Real Estate industry. As per an estimate Indian cities have faced a shortage of approx 15 - 20 million residential units by the end of FY 2012-13.

It is a known fact that number of property transactions in India is not recorded as per their actual market price. Due to these reasons, the taxing authorities are now giving “much needed special attention” to the Real Estate Industry”

Introduction of Deeming Fiction in Real Estate :

One of the most controversial provisions, which had a huge impact on the taxation of Real Estate Transactions, was the introduction of concept of “**Deeming Fiction**” through Section 50C.

Section 50C was introduced by the Finance Act 2002 with lots of hue and cry by the Industry. As per this section, when immovable property, being land or building or both held as **Capital Asset**, is transferred, at the value which is *less than* value adopted, assessed or assessable for the *purpose of stamp duty*, then the stamp duty value will be taken as *Deemed Sale Consideration* for computing capital gains.

Deeming Fiction is constitutionally valid:

The constitutional validity of Section 50C was challenged in the Madras High Court [Palaniamy vs. UOI 306 ITR 61] on the ground that an income based upon the guidelines (stamp duty value) is fanciful and imaginary and that the provision lacked legislative competence. It was also contended that the provision is discriminatory as between those assessee in whose case stamp duty value was more or less than actual consideration. The arbitrary manner in which the stamp duty value was fixed by the state authorities is evident from the variation in values within the same area under common guidelines. It was claimed that the procedure to challenge the guidelines before the state authorities, was unworkable and placed an undue burden on the taxpayer.

High Court found that any arbitrary result on application of Section 50C against the taxpayer can be avoided by the protection offered by resources to remedies available in the section itself. The court was also not inclined to accept that the guidelines valuation was an arbitrary yardstick. They are fixed after following the prescribed procedure under the Stamp Act and they are also justifiable. Accordingly, Constitutional validity of the section 50C had been upheld by the High Court.

Amendments made by Finance Act 2013 (Introduction of Section 43CA):

After a gap of 4 years, Mr. P Chidambaram had taken the charge of Finance Ministry in August 2012. Prevalent tax loopholes were in his mind while presenting the Finance Bill 2013. In his budget speech Mr. Chidambaram had said *"Some tax avoidance arrangements have come to notice, and I propose to plug the loopholes"*.

Before jumping into the fine print of the Amendment, it will be interesting to take a look on a few judicial pronouncements (now overruled), which was a major cause for amendment of so called avoidance arrangements:

a) Indralok Hotels (p) Ltd. (122 TTJ 145) Mumbai

In this case, the assessee company, a real estate developer, had sold two residential flats for a consideration of INR 60 lakh & INR 40 lakh respectively. The Stamp duty of these flats was INR 78 lakh and INR 72 lakh. The Assessing Officer (AO), in the scrutiny proceedings, by applying the provisions of section 50C, had taken stamp duty value of these two flats i.e. INR 150 lakh as deemed sale consideration instead of actual sale consideration i.e. INR 100 Lakh and added the differential amount as Deemed Business Income. The matter ultimately travelled to ITAT.

Hon'ble ITAT held that section 50C w.r.t. concept of deemed sale consideration shall be applicable only for transfer of 'Capital Assets' for calculating capital gains. In the given case the residential flats are shown as 'Stock in Trade' and income thereof is taxable under Business Income and accordingly deleted the addition made by the AO.

b) Kan Construction & colonizers (p) Ltd. (70 DTR 169) Allahabad HC:

Assessee Company, a Real Estate Developer, had some plot of land which was shown as stock in trade. During the previous year assessee sold some plot of land for a consideration of INR 80 lakh and offered the income under Business Head. The AO had treated the said plot of land as capital assets and thereby applying the provisions of section 50C, had taken stamp duty value as sale consideration for calculating capital gains. Appellate authorities had deleted the addition made by the AO, against the department preferred an appeal before High Court.

Hon'ble High Court held that if the asset is held as stock in trade, the profits and gains from the sales is liable to be taxed as profits and gains from business and not as capital gains. Section 50C has no application where transfer of immovable property is on account of sale of stock.

c) CIT vs. Mukesh & Kishore 33 Taxmann.com 87 (Gujarat HC):

In this case the assessee had sold a plot of land, which was held by them as stock in trade. The Stamp duty value of the land was 2.2 times more than the stamp duty value. AO had made the assessment based on stamp duty value. Matter ultimately travelled to High Court. High Court had held that as the land was held as stock in trade & the profit is taxable under business head, section 50C will not be applicable as the same was applicable only in case of transfer of capital assets.

Amendment made by the Finance Act 2013 to counter [overrule / nullify] the above judgments, as is clear from the Memorandum Explaining the Finance Bill 2013 read as under:

“Currently, when a capital asset, being immovable property, is transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, then such value (stamp duty value) is taken as full value of consideration under section 50C of the Income-tax Act. These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade.

It is proposed to provide by inserting a new section 43CA that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration for the purposes of computing income under the head “Profits and gains of business or profession”.

Presently when a capital asset (other than stock in trade) is sold for a consideration, which is lower than the stamp duty value, then the stamp duty value is considered as deemed sale consideration for the purpose of computing capital gains. From the definition of capital assets, as given in section 2(14), ‘Stock in Trade’ is specifically excluded.

Finance Act 2013, vide insertion of section 43CA, has adopted concept of deemed sales consideration being stamp duty value, on the transactions of land or building or both, held as ‘stock in trade’, transferred by builders / real estate developers. Sub section (1) says that where the consideration for transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, then the stamp duty value shall be the deemed sale consideration for calculating income under the head “Profits & gains of business or profession”. Sub section (2) states that for calculating stamp duty value under this section, provisions of sub section (2) & (3) of section 50C will be applicable. Sub section (3) states that where the date of sale agreement (for fixing final consideration) and the Registration date are not the same, then the value may be taken as value for payment of stamp duty, on the date of the agreement, provided the seller has received, on or before the agreement date, full or partial consideration from the buyer, other than cash. **This Section is introduced w.e.f. 1 April 2013** and will apply to all transactions effected on or after this date.

Amendments made by Finance Act 2013 in Section 56(2)(vii):

Earlier, when any immovable property is received by an individual or HUF **without consideration**, the stamp duty value of which exceeds INR 50,000, then the stamp duty value is chargeable to tax in the hands of the individual or HUF as Income from Other Sources.

Earlier Immovable received for **Inadequate Consideration** was not covered in the section, which is now taken into consideration by the Amendment. Memorandum explaining finance bill 2013 clears the intention of the statute, which reads as under:

The existing provision does not cover a situation where the immovable property has been received by an individual or HUF for inadequate consideration. It is proposed to amend the provisions of clause (vii) of sub-section (2) of section 56 so as to provide that where any immovable property is received 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, shall be chargeable to tax in the hands of the individual or HUF as income from other sources.

Considering the fact that there may be a time gap between the date of agreement and the date of registration, it is proposed to provide that where the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, the stamp duty value may be taken as on the date of the agreement, instead of that on the date of registration. This exception shall, however, apply only in a case where the amount of consideration, or a part thereof, has been paid by any mode other than cash on or before the date of the agreement fixing the amount of consideration for the transfer of such immovable property.

As per the amended provision, immovable property received for a consideration, by an Individual or HUF, which is less than the stamp duty value by INR 50,000; then the difference between the stamp duty value and such consideration, shall be taxed as income from other sources in the hands of recipient individual or HUF.

Areas of Concern / Controversial Issues:

- a) Now deeming fiction will be applicable even if the land / building is not registered with the concerned Government authorities as the transfer takes place on the basis of the mere agreement for sale.
- b) The deeming fiction will make an adverse impact on genuine real estate transactions. Many a times the assessee is required to sell the property for a price much lower than the stamp duty value due to certain urgencies. There is no provision in the act to cover situations like distress sale.

Recently **Chennai ITAT** in case of **ACIT vs. MIL Industries Ltd** [33 Taxmann.com 120] had held that misfortunes happened to the assessee or difficulties faced by the assessee or matters of distress sale etc. shall not be considered for exclusion of application of section 50C and stamp duty value only shall be taken for calculating capital gains.

- c) Law has not provided any tolerance band for non applicability of deeming fiction. **Kolkata ITAT** in a recent Judgement of **Heilgers Development & Constructions co. (p) ltd vs. DCIT** [32 Taxmann.com 147] had held that even if there is a marginal difference between the actual sale consideration and the stamp duty value due to gap between the agreement date and the registration date, then also the stamp duty value will be taken for calculating capital gains.

- d) The Amendment will lead to **Double Taxation** in certain cases. For e.g. If a property sold by Real Estate Developer (say for INR 40 lakh) is less than the stamp duty value (say INR 50 lakh), then INR 10 lakh will be taxed as business income in the hands of developers.

Consequently, buyer is getting property for INR 40 lakh, which is less by INR 10 lakh from stamp duty value and accordingly INR 10 lakh will be taxed in the hands of buyer u/s 56(2)(vii) as income from other sources.

- e) Normally there is a time gap [3 – 5 years or more] between the launch of a particular project and completion of the project. Real Estate Developers sell the product throughout the construction period and receive the payment progressively. As per section 43CA stamp duty value [if it is higher] shall be considered as deemed sale consideration. The sale consideration, accordingly, will vary drastically and financials of the company will not reflect the true position of its profitability.
- f) There will be an uphill task for Real Estate Developers to prepare their books of accounts by considering the new provision. Normally Real Estate Developers are following either percentage completion method or project completion method for accounting of revenue. In case of project completion method, income is offered for taxation only when the project is completed. In case of percentage completion method, the income is offered based on % completion of the project. Once the income is calculated on the basis of stamp duty value, can they defer the income by applying percentage completion method? There is no clarity on the same.

In case of transaction below stamp duty value, are they required to record the transaction at stamp duty value or on actual value? If they record the transaction at actual value then for income tax purpose they have to prepare a separate set of accounts incorporating deeming values.

In metro cities, Real Estate Developers are selling the flats / inventory on basis of letter of allotment [mainly in cases where the buyer is purely an investor]. The agreement for sale and final registration is done only after possession or at the time of subsequent sale. As per section 43CA, it will result into a higher profitability in the hands of the Developers as well as Investors.

- g) No corresponding amendment has been proposed in section 50C where there is a time gap between the agreement date and the registration date.
- h) Consider a situation where assessee had earlier converted the land [held as capital assets] into stock in trade and the sale is made after 1 April 2013. As per the new provision the assessee has to calculate the business profit based on stamp duty value, which will impact the taxability. Similar kind of situation will be faced by assessee who had converted the properties / flats purchased before the introduction of section 43CA as stock in trade. They have to pay much higher tax on the final profit.
- i) The Stamp duty value as on the date of the agreement shall be taken for calculating profit, only if the **amount of consideration or part thereof** [other than cash] has been received on or before the date of agreement of sale. There is an ambiguity regarding the taxability of certain individual buyers who had already booked their flats and are waiting for completion of the construction so they can get the registration and possession. Further '*part consideration*' has not been defined which leads to confusion.

For e.g. Mr. A had bought a flat which is under construction and registration is pending. Possession of the flat will be given by 30 Sept 2013. As per agreement for sale dated 1 Jan 2011, the consideration for sale is INR 75 lakh; however the stamp duty value at the time of registration is INR 2 crore. Till 1 Jan 2011, the assessee had paid an amount of INR 5 lakh to the developer and further INR 40 lakh had been paid till 31 Mar 2013. As per the plain language of the section, the stamp duty value as on 1 Jan 2011 shall be taken as deemed sale consideration as the assessee had made *part payment*. The said interpretation is highly litigation prone.

- j) The word “other than cash” may be interpreted in a different manner. Any payment by way of book entry can be considered as valid payment under this section. Further payment through bearer cheque can be a sufficient compliance. Clarification on these issues is necessary to prevent dispute.
- k) Let’s take the case of transfer of business undertaking on slump sale basis, where no separate consideration is paid for land or building. Can deeming fiction be invoked? Prima facie the answer is no due to non identifiable consideration for land or building. However, the same may be disputed by the department.
- l) In case of contribution of stock in trade in to the partnership business, provisions of section 43CA may not be invoked as the consideration for transfer is indeterminable. The same principle is given by SC in **Sunil Siddharthbhai vs. CIT** 156 ITR 509. It will be interesting to see that how the department will take up this issue.
- m) Can transfer of leasehold rights will be covered under the mischief of the deeming fiction. As per plain language of the section, it is clear that it will be applicable only in case of transfer of assets being land or building or both. **Kolkata ITAT** in **DCIT vs. Tejinder Singh [ITA/1459/Kol/2011]** had held that section 50C does not apply to transfer of tenancy / leasehold rights. Still the issue is litigation prone.
- n) Is the deeming fiction applicable on the Transferable Development Rights (TDR) ? Mumbai ITAT in **ITO vs. Prem Ratan Gupta** had held that section 50C does not apply to transfer of FSI and TDR. However after the introduction of 43CA, the issue may be subject to litigation.

Can assessee challenge the Stamp duty value?

In case of transactions covered u/s 50C & 43CA, statute provides an option to the assessee to challenge the stamp duty value as deemed sale consideration and ask for a reference to the Departmental Valuation Officer [DVO]. When requested, the AO is duty bound to make a reference to DVO. In case the value adopted by the DVO is higher than the stamp duty value then the Stamp duty value will be the full value of consideration. A question arises here is whether the AO is duty bound to wait for the report of the DVO? The answer is no. In case of time barring assessments, they generally pass the order without waiting for DVO’s report.

In case of transaction covered u/s 56(2)(vii), **assessee cannot challenge the stamp duty value**. This will cause great hardships to the assessee.

Conclusion:

The intention of the statute for introduction of the concept of deeming fiction is that the people dealing in Real Estate should report the transaction honestly. After the introduction of Section 50C, the said object had been achieved to a certain extent. However, many a times, due to unavoidable circumstances, genuine transactions fall under the purview of this section. Law has not provided any safeguard to the genuine assessee. Extension of Deeming concept on Real Estate Developers has made their life more difficult for common man. Real Estate Developers may pass on the cost of additional Tax / compliance burden on to the buyers. VAT, Service Tax, Stamp Duty & now this Deemed tax, is effectively pinching the common man for buying his dream home.

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