

INCOME FROM OTHER SOURCES

AMENDMENT BY THE FINANCE (No.2) ACT, 2014

Advance forfeited due to failure of negotiations for transfer of a capital asset to be taxable as "Income from other sources" [Section 56(2)]

Related amendment in sections: 2(24) & 51

Effective from: A.Y.2015-16

- (i) Under section 51, any advance retained or received in respect of a negotiation for transfer which failed to materialise shall be reduced from the cost of acquisition of the asset or the written down value or the fair market value of the asset, at the time of its transfer to compute the capital gains arising therefrom. In case the asset transferred is a long-term capital asset, indexation benefit would be on the cost so reduced.
- (ii) Section 56(2) provides for the specific category of incomes that shall be chargeable to income-tax under the head "Income from other sources".
- (iii) New clause (ix) has been inserted in section 56(2) to provide for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset.
- (iv) Such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited and the negotiations do not result in transfer of such capital asset.
- (v) Consequently, section 2(24), defining income, has been amended to include such sum forfeited within its scope.
- (vi) In order to avoid double taxation of the advance received and retained, section 51 has been amended to provide that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, has been included in the total income of the assessee for any previous year, in accordance with section 56(2)(ix), such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

Example

Mr. H has acquired a residential house property in Delhi on 1st April, 2001 for ₹ 22,00,000 and decided to sell the same on 3rd May, 2004 to Mrs.P and an advance of ₹ 70,000 was taken

from her. The balance money was not paid by Mrs. P and hence, Mr. H has forfeited the entire advance sum. In April, 2014, he once again entered into negotiations for sale of the said property to Mr. Y, and received ₹ 2 lakh as advance, but the transfer did not materialize and hence, the advance was forfeited. On 3rd March, 2015, he finally sold this house to Mr. S for ₹ 95,00,000. In the meantime, on 4th February, 2015, he had purchased a residential house in Faridabad for ₹ 28,00,000 and made full payment for the same. However, Mr.H does not possess any legal title till 31st March, 2015, as such transfer was not registered with the registration authority.

Mr.H had purchased another old house in Madurai on 14th October, 2014 from Mr. X, an Indian resident, by paying ₹ 25,00,000 and the purchase was registered with the appropriate authority.

Determine the taxable capital gain arising from above transactions in the hands of Mr.H for Assessment Year 2015-16.

Cost Inflation Index - 2001-02: 426; 2004-05: 480; 2013-14: 939; 2014-15: 1024.

Answer

Computation of taxable capital gain of Mr. H for the A.Y.2015-16

Particulars	₹
Sale proceeds	95,00,000
Less: Indexed cost of acquisition (See Notes 1 & 2)	51,20,000
Long Term Capital Gain	43,80,000
Less: Exemption under section 54 in respect of investment in house at Faridabad (See Notes 3 & 4)	28,00,000
Taxable long-term capital gain	15,80,000

Notes:

1. Computation of indexed cost of acquisition

Particulars	₹
Cost of acquisition	22,00,000
Less: Advance taken in the previous year 2004-05 and forfeited	70,000
Cost for the purpose of Indexation	21,30,000
Indexed cost of acquisition (₹ 21,30,000 x 1024/426)	51,20,000

2. Advance of ₹ 2 lakh taken by Mr. H in April, 2014, which was forfeited due to the transaction not materializing, is taxable under section 56(2)(ix). Hence, such amount would not be reduced to compute the indexed cost of acquisition while computing capital gains on sale of the property in March, 2015.

3. In order to avail exemption of capital gains under section 54, one residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Mr.H has purchased the residential house in Faridabad within one year before the date of transfer

and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2015 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in *Balraj v. CIT*(2002) 254 ITR 22 (Del.) and *CIT v. Shahzada Begum* (1988) 173 ITR 397 (A.P.).

4. The Finance (No.2) Act, 2014 has clarified that exemption under section 54 can be availed only in respect of one residential house. It would be more beneficial for Mr. H to claim exemption in respect of the Faridabad house since the cost of the same is higher than the cost of the Madurai house.