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Finance Act, 2013 – Double Trouble on Certain Real Estate Transactions



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"Finance Act 2013 inserted Section 43CA and amended Section 56(2)(vii)(b) of Income Tax Act, 2013"

"Section 43CA will have direct implications on persons who deal in real estate"

"Section 43CA has its genesis in Section 50C which is applicable in case of transfer of a capital asset and not stock-in trade"

<sup>1</sup> Section 2(14) of the Act

## Finance Act, 2013 – Double Trouble on Certain Real Estate Transactions

- The Finance Act 2013 has amended the Income Tax Act, 1961 (the "**Act**") by introducing new provisions and amending certain existing provisions which may result in far reaching consequences on the real estate sector in India, not only from a taxation perspective but may also have an impact on the sector as whole. The real estate sector has always been under the scanner of the Income Tax Department of India. Considering the absence of complete transparency in transactions in this sector, builders and developers (collectively "**Real Estate Developers**"), brokerage firms and property

dealers who are responsible for consummating or facilitating real estate transactions have been under the scrutiny of the Income Tax Department time and again.

- However, with the introduction of Section 43CA in, and amendment made to Section 56(2)(vii)(b) of, the Act, the Income Tax Department has more reasons to raise objections while scrutinising books of not only the Real Estate Developers and other persons dealing in real estate business, but also the investors and the acquirers of the immovable properties in India.

## Section 43CA-Incidence of Tax under the head of "*Profits and Gains from Business or Profession*"

- Section 43CA has been newly inserted in the Act by the Finance Act 2013 and shall be effective prospectively from April 1, 2014. This section triggers upon transfer of an asset (*other than a <sup>1</sup>capital asset*), being land or building or both, for a consideration which is less than Stamp Value of such asset. Section 43CA has direct implications on persons (*including Real Estate Developers*) who deal in

real estate (*i.e. land or building or both*) and for whom such land or building is stock-in-trade and not capital asset. However, this section has its genesis in Section 50C of the Act, which is applicable in case of transfer of a capital asset, being land or building or both, but not stock-in-trade.

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## Section 50C-Incidence of Tax under the head of "*Capital Gains*"

### Deeming Fiction

"Difference between the Stamp Value and the Actual Sale Consideration is deemed to be a notional income arising in the hands of the transferor"

- For reasons stated above, prior to discussing Section 43CA of the Act, it is pertinent to give a brief background of Section 50C of the Act which was introduced by the Finance Act, 2002 effective from April 1, 2003.
- In terms of Section 50C(1) of the Act, if a capital asset, being land or building or both, is transferred for a consideration ("**Actual Sale Consideration**") that is less than the value adopted or assessed ("**Stamp Value**") by the relevant stamp authority of the State, then for the purposes of computing capital gains under Section 48 of the Act, the Stamp Value is considered to be the total consideration received from transfer of such capital asset..
- For instance, if A sells a flat to B for Rs.90,00,000, being the actual consideration received for such sale by A but the Stamp Value of which is Rs.1,00,00,000, then the sale value of such flat shall (*in terms of Section 50C(1) of the Act, for the purpose of computing capital gains of A in respect of such sale*) be deemed to be Rs.1,00,00,000.
- The above provision is popularly known as the "*Deeming Fiction*". The difference between the Stamp Value and the Actual Sale Consideration is deemed to be a notional income arising in the hands of the transferor (*read seller*) of the capital asset and based on which the Stamp Value (*albeit on a notional basis*) is considered for the purpose of computing capital gains of the transferor. In our view, the legislators have inserted this provision in the Act in the year 2003 to bring about greater transparency in real estate transactions and also to plug a loophole which may have been in vogue prior to 2003 in fixing the actual sale consideration for such transactions. [*In early 1980s, w.e.f. July 1, 1982, the Act was modified and certain changes were incorporated in Chapter XX-A (then colloquially known by the prescribed form 37EE), which Chapter became non-applicable from October 1, 1986, when the Act introduced Chapter XX-C (then colloquially known by the prescribed form 37-I) and finally even this Chapter XX-C became non-applicable on and from July 1, 2002.*]
- The constitutional validity of Section 50C was challenged in K.R. Palanisamy and Ors. vs. Union of India (UOI) and Ors. [2008]306ITR61(Mad). However, the Hon'ble Madras Court upheld the validity of the provision and held that the Section 50C has been introduced by the Ministry of Finance to check the undervaluation of the capital asset thereby evading tax payable to the Government and also to curtail black money.
- Section 50C is applicable to transfer of capital assets only. The definition of the term "*capital asset*" under the Act specifically excludes any "*stock-in-trade, consumable stores or raw*

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*materials held for the purposes of his business or profession*". Although the language of Section 50C explicitly covers within its purview transfer of capital assets only, the Income Tax Department has, on quite a few occasions, extended the ambit of this Section 50C to transfer of land or building by the Real Estate Developers and considered the difference between the Stamp Value and the Actual Sale Consideration arising on such transfer as the "*business income*" of Real Estate Developers.

- In light of a recent ITAT (*Mumbai bench*) ruling in Neelkamal Realtors and Erectors India

## Analysis of Section 43CA

- To counter the aforesaid settled position on applicability of Section 50C of the Act to Real Estate Developers and considering that the definitions of "*capital assets*" under the Act specifically excludes stock-in trade held for the purposes of business or profession, Section 43CA was introduced by the Finance Act 2013 to cover within its ambit, transactions of land or building which are held as stock-in trade by the Real Estate Developers.
- In terms of Section 43CA(1), on and from April 1, 2014, if in case of transfer of an asset (*other than a capital asset*), being

Private Limited vs the Deputy Commissioner of Income Tax [ITA No.1143/Mum/2013] and a judgment of the Allahabad High Court in Commissioner of Income Tax vs Kan Constructions and Colonizers Pvt. Ltd. [TS 252 HC-2012(ALL)], it is now a settled position that Real Estate Developers in whose books an asset, being land or building, is reflected as "*stock-in trade*", profits arising from sale of such assets will be liable to be taxed under the head of "*Profits and Gains from Business or Profession*" and not "*Capital Gains*". In view thereof, Section 50C cannot be made applicable to transfer of an asset which is "*stock-in trade*".

land or building or both, the Actual Sale Consideration of such asset is less than the Stamp Value, then the Stamp Value shall deemed to be the total consideration received for the purpose of computing profits and gains arising from the transfer of such asset

- For instance, if a developer sells a flat to a buyer for Rs.90,00,000, the Stamp Value of which flat is Rs.1,00,00,000, then for the purpose of computing business income of the developer under the head of "*Profits and Gains from Business or Profession*" under the Act, the Stamp Value is considered to be the total consideration received from transfer of such capital asset..

"Section 43CA was introduced by the Finance Act 2013 to cover within its ambit, transactions of land or building which are held as stock-in trade by the Real Estate Developers"

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"Section 43CA is prospectively applicable from April 1, 2014 and will not be applicable to real estate transactions consummated prior to April 1, 2014"

- It is significant to note that the applicability of Section 43CA to transfers contemplated thereunder is prospective in nature and will not be applicable to real estate transactions consummated prior to April 1, 2014.

### Section 56(2)(vii)(b)–Incidence of Tax under the head of "*Income from Other Sources*"

"Applicability of Section 56(2)(vii)(b) has been extended to acquisition of immovable property in addition to gift"

- Section 56(2)(vii)(b) of the Act has been amended by the Finance Act 2013. In view thereof, while earlier Section 56(2)(vii)(b) covered within its ambit, gift of immovable property, the amended provision now also extends to acquisition of immovable property, which is for a consideration less than the Stamp Value of such immovable property by an amount exceeding Rs.50,000.
- As a consequence of such amendment, the difference between the Stamp Value of the property being acquired and the actual consideration paid for purchase shall be deemed to be income in hands of the buyer and shall be subject to tax under the head of "*Income from other Sources*" for the purposes of Section 56 of the Act.
- Section 56(2)(vii)(b) is applicable only if such buyer or transferee is an individual or HUF.
- Going by the earlier illustration, if a developer sells a flat to a buyer for Rs.90,00,000, the Stamp Value of which flat is Rs.1,00,00,000, the differential amount of Rs.10,00,000 (*to the extent it exceeds Rs.50,000, i.e. Rs.9,50,000*) will be considered as deemed income in the hands of the buyer under Section 56(2)(vii)(b) and will be subject to tax under the head of "*Income from Other Sources*"

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If you would like to know more about the subject covered in this publication or our services, please do contact us on [prem@rajaniassociates.net](mailto:prem@rajaniassociates.net) and [poorvi@rajaniassociates.net](mailto:poorvi@rajaniassociates.net)  
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## OUR VIEW

1. Incidence of tax under Section 43CA will, from April 1, 2014 (*Assessment Year 2014-2015*), arise in the hands of the Real Estate Developers or other persons dealing in real estate (*who hold land or building in their books as stock-in trade*), upon transfer of land or building or both, on the difference between the Stamp Value and Actual Sale Consideration and shall be subject to tax under the head of "*Profits and Gains from Business or Profession*";
2. No exception has been carved out to exclude genuine transactions consummated by the Real Estate Developers or other persons dealing in real estate. For instance, if a Real Estate Developer has, due to depressed market conditions or bulk booking by a proposed buyer (*or group of buyers, all of whom are individuals*), agreed to sell a residential flat at a price which is less than the Stamp Value of such flat, then on one hand the Real Estate Developer will be subject to tax on the notional income (*being difference between the Stamp Value and actual sale price*) in terms of Section 43CA and on the other hand the (individual/ HUF) buyer will be subject to tax on the notional income (*being difference between the Stamp Value and actual purchase price as reduced by Rs.50,000*) in terms of Section 56(2)(vii)(b);
3. The combined reading of these 2 sections could result dual tax implication on the same amount arising from the same transaction albeit in the hands of two different persons. For instance, if a developer sells a flat to an individual buyer for Rs.90,00,000, the Stamp Value of which flat is Rs.1,00,00,000, the differential amount of Rs.10,00,000 will be considered as deemed income (i) in the hands of the developer under Section 43CA, as well as (ii) in the hands of the buyer under Section 56(2)(vii)(b). In view thereof, at a rate of 30% (*for the moment, not considering the surcharge charge*) on the aforesaid deemed income, while the developer will be required to pay tax of Rs.3,00,000 (*30% of Rs.10,00,000*), the buyer too will be required to pay tax of Rs.2,85,000 (*30% of Rs.9,50,000, being the excess of Rs.10,00,000 over Rs.50,000*). Interestingly, the Revenue stands to receive/ collect Rs.5,85,000 (*plus surcharge*) on a transaction, which would otherwise be genuine and on arms-length basis, but the price being driven down due to market forces. Not to forget the additional stamp duty that the buyer will have to pay on the Stamp Value (*which in the State of Maharashtra would be Rs.50,000 – being 5% on the differential amount of Rs.10,00,000*).



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