



S. 43CA: Tax Implications On Builders And Real Estate Developers

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Finance Act, 2013 has inserted a new section 43CA under the Income Tax Act, 1961 which is applicable from Financial Year 2013-14, introducing the provisions for taxability of transfer of immovable property (land or building or both) held in the nature of stock in trade, on the same lines which are applicable for immovable property held in the nature of "capital asset" under section 50C of the Act.

Sub Section (1) of Sec 43CA provides as under:

"(1) where the consideration received or accruing as a result of the transfer by an assessee of an asset (other than a capital asset), being land or building or both, is less than the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of consideration received or accruing as a result of such transfer."

The provision of section 43CA shall thus be applicable, inter alia, for the real estate developers and builders who are dealing in real estate properties. This section requires that in case land or building or both, is transferred by a trader/ a real estate developer for a value less than the circle rate or a stamp duty value notified by the stamp duty authority, stamp duty value in such a case shall be deemed to be the full value of the sale consideration to such person and he shall be required to compute his taxable business income by substituting the actual sale consideration with the above mentioned deemed sale consideration.

Section 50C of the Income Tax Act, 1961 was introduced by Finance Act, 2002 w.e.f 1.4.2003 which prescribes similar provisions in the case of transfer of land or building or both held in the nature of "capital asset".

In certain cases in the past, the tax authorities tried to extend the applicability of the provision of Section 50C to cover cases of transfer of such immovable property held as stock in trade, i.e. for real estate developers and builders etc. However, Allahabad High Court in the case of **CIT vs. Kan Construction And Colonizers P Ltd. 70 DTR 169 (All)** and Madras High Court in the case of **CIT vs. Thiruvengadam Investments P Ltd. 320 ITR 345 (Mad)** held that Section 50C has limited applicability to capital gains' assessment and can not apply to assessee holding land or building as trader (stock in trade) and assessed for the same under the head "Income from business". As per new section 43CA, it is apparent that the intent of the provision of Section 50C applicable in the case of "capital asset" has been extended to real estate developer/ builder holding land or building as stock in trade.

Special features of the provision of Section 43CA (1) may be noted as under:

1. Provision of Section 43CA is applicable to all categories of assesseees who deal in immovable property being land or building or both. Thus, the provision of this section is applicable to Individual, Firm, HUF, Company or any other category of assesseees.
2. Provision of this section is applicable to all kind of immovable properties being Land or Building or both, held as stock in trade. It may be a residential flat, commercial flat, industrial building or plot, residential plot in a township, agricultural land whether in rural or urban area etc.
3. Provision of Section 43CA shall be applicable in case of transfer of ownership of property by any mode. In case, transfer of immovable property takes place without registration of sale deed but by way of execution of sale agreement / Power of Attorney or by way of transfer with the regulatory authority or in any other manner, provision of Section 43CA shall be applicable.

In case market price of the property is less than stamp duty value-sub section (2) of section 43CA

The sale consideration agreed between the parties at the time of entering into sale agreement is generally higher than the prevailing stamp duty value of the property applicable as on the date of sale agreement but in case of certain genuine cases, where market price is less than the stamp duty value of the property, sub section (2) of Sec 43CA takes care of the situation wherein provision has been made to make representation to the Assessing Officer for referring the matter to the valuation officer to determine the fair market value of the property. **Sub section (2) of section 43CA states as under:-**

(2) The provisions of sub section (2) and sub section (3) of section 50C shall, so far as may be, apply in relation to determination of the value adopted or assessed or assessable under sub section (1)

Since sub section (2) & (3) of section 50C have been incorporated in section 43CA, it would have the effect that in case fair market value of the property determined by the valuation officer is less than stamp duty value of the property, such fair market value shall be considered for the purpose of applicability of the provision of section 43CA.

Stamp duty valuation on the date of sale agreement- sub section (3) & (4) of section 43CA

Sub section (3) and sub section (4) of Section 43CA have further provided to adopt stamp duty value of the property assessable as on the date of entering into sale agreement instead of the value assessed as on the date of transfer of the property. Sub section (3) and sub section (4) of section 43CA read as under:

(3) Where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer of asset are not the same, the value referred to in sub

section (1) may be taken as the value assessable by any authority of a state government for the purpose of payment of stamp duty in respect of such transfer on the date of the agreement.

(4)The provisions of sub section (3) shall apply only in a case where the amount of consideration or a part thereof has been received by any mode other than cash on or before the date of agreement for transfer of the asset.

Sale consideration between the seller and the buyer is negotiated at the time of entering into sale agreement and not at the time of transfer of the property. Therefore, sub section (3) has provided that stamp duty valuation of the property applicable as on the date when sale consideration is fixed between the parties by entering into the agreement is to be considered for comparing with the actual sale consideration agreed. Thus, any agreement which is legally enforceable entered between the parties fixing the value of consideration for transfer of the property will be relevant for the purpose of applicability of the provision of Section 43CA. It may be an allotment letter issued by the developer or a buyer's agreement executed, fixing the value of the consideration and agreed to by both the parties. Further, sub section (4) takes care of the situation so as to put check on ingenuine anti-dated agreements.

Complexity Involved In Application of Section 43CA For Real Estate Developer

A Real Estate developer generally holds the immovable property as stock in trade and thus, provision of Section 43CA shall be applicable to a Real Estate Developer. It is accordingly significant to examine as to at what point of time and in what manner, provision of Section 43CA shall be applicable in the case of Real Estate developer in the backdrop of the following methodology of operations usually followed by a Real Estate Developer:-

- Real Estate developer operates, interalia, in a manner where booking of plot/flat is made by way of issue of allotment letter to the buyer or by way of entering into an agreement with the buyer for the plot to be developed or flat to be constructed in future.
- Buyer keeps on making periodical payments in installments linked with the construction or otherwise.
- The property comes into existence after a period of several years, generally 3-4 years.
- Possession of the property is generally handed over by the seller to the buyer after receiving full value of the consideration.
- Registration of the documents transferring the property is executed in favor of the buyer simultaneously at the time of handing over the possession or at a later date, as may be mutually agreed.
- Real estate developer generally recognizes revenue in its financial statements on Percentage of Completion Method (PCM) as prescribed under the Guidance note on Accounting of Real Estate Transactions by Real Estate Developers, and Accounting

Standard 7 on Construction Contracts, issued by the Institute of Chartered accountants of India (ICAI)/ Other Regulatory authorities.

- For the income tax purpose also, income tax computation is made as per revenue recognized by adopting the Percentage of Completion method for preparation of the financial statements.

Therefore in such a case when the accounting treatment and computation of taxable income both are done by a real estate developer by adopting Percentage of Completion Method, following significant questions do emerge relating to practical applicability of the provision of Section 43CA:

- A. In what manner, provision of section 43CA is to be applied in the case of Real Estate Developer adopting Percentage of Completion method for revenue recognition? Whether “deemed sale consideration of property” is to be substituted for the actual sale consideration for the purpose of revenue recognition based on Percentage of Completion method, at each stage and for each year from the beginning of the project, from which revenue is commenced to be recognized?
- B. Whether applicability of the provision of Section 43CA would take place only when the immovable property comes into physical existence and transfer of the property takes place?
- C. Whether allotment letter issued by the Real Estate developer is in the nature of sale agreement for the purpose of sub section (3) of section 43CA?
- D. Whether effect of section 43CA is to be given in the books of accounts?

Manner of Applicability of provision of section 43CA when real estate developer applies Percentage of Completion Method for revenue recognition

In normal case, profits or gains are computed at the time when goods are sold by transferring the ownership. In the case of real estate transaction, the same principle is applied when completed contract method (CCM) is adopted. However, real estate transactions have a peculiar nature for real estate developers who are required to follow percentage of completion method for revenue recognition, as per the Guidance Note on Revenue Recognition for Real Estate Transactions issued by ICAI.

Under percentage of completion method, revenue is required to be recognized and profit or gain from the real estate activity is required to be computed as per stage of completion of project on year to year basis even when the asset is under construction and has not come into existence and even before the asset is transferred by the developer to the buyer.

Section 43CA of the Income Tax Act creates a deeming fiction to substitute stamp duty value of the asset with the actual sale consideration to compute profits or gains arising on **transfer of asset**, when actual sale consideration is less than the stamp duty value. The language of sub

section (1) of section 43CA evidently requires such substitution of sale consideration for the purpose of computing profits and gains accruing as a result of **transfer of the asset**.

It is therefore evident that unless the asset comes into existence and the "transfer" of asset takes place, provision of Section 43CA cannot be applied. Thus, the stamp duty value of the asset is to be considered only at the time of "transfer" of the asset for the purpose of section 43CA. But, when revenue is recognized on the basis of percentage of completion method, the date of "transfer" of asset is a future event dependant upon several contingencies and thus can not be determined. Also, stamp duty value which would be applicable on the future date of transfer of the asset is not determinable. Therefore, deeming fiction of section 43CA can not be applied on year to year basis while recognizing revenue based on percentage of completion method.

However, an argument can be advanced contrary to above proposition that since sub section (3) of section 43CA permits the adoption of stamp duty value as on the date of agreement, the revenue should therefore be recognized based upon such stamp duty value prevalent on the date of agreement, if it exceeds the agreed sale consideration.

But, in our opinion revenue can not be recognized on percentage completion method based upon the stamp duty value prevalent on the date of sale agreement, because the basic condition of sub section (1) of section 43CA has to be given full effect to which requires the taxability of the difference at the time of **transfer of the asset**. This is also for the reason that sub section (3) is merely an enabling provision which may not be applicable in all cases e.g. when payment is made in cash at the time of agreement or when stamp duty value as on the date of the transfer of the asset is less than the stamp duty value as on the date of the sale agreement.

It is also well settled principle of interpretation of tax statute that a deeming provision has to be interpreted strictly in terms of the language employed. When the section requires provision to be applicable on "**transfer**" of asset, it cannot be applied prior to that, merely for the reason that revenue with respect to such asset is being recognized from an earlier stage for preparation of the financial statement due to applicability of the Guidance Note and Accounting Standards issued by the Institute of Chartered Accountants of India or Other Regulatory Authority as part of Generally Accepted Accounting Principles (GAAP). In fact, percentage of completion method is also creating an accounting deeming fiction of revenue recognition for real estate developers. The underlying principle of revenue recognition under percentage of completion method is that risks and rewards of ownership are substantially transferred along with entering into legally binding sale agreement and after entering into such sale agreement, real estate developer acts on behalf of the buyer as contractor. But nevertheless, in spite of transfer of substantial risks and rewards of ownership, the situation cannot be equated with the actual "transfer" of ownership, particularly for the purpose of applicability of deeming provision of section 43CA of the Income Tax Act where "transfer" of property is the basic requirement. It is also a cardinal principle of interpretation of taxing statute that a deeming fiction over a deeming fiction cannot be applied.

There is one more rationale for the above proposition which can be advanced in this regard. By entering into binding sale agreement with the real estate developer, the buyer of the property gets merely a right to purchase property which can not be equated with the ownership of the property. The right to purchase property is itself a distinct and transferable intangible asset. Unless the property is constructed and comes into existence and possession is handed over by the developer to the buyer, it cannot be said that "transfer" of property has taken place.

It may further be observed that revenue recognition under percentage of completion method is full of contingencies based upon reliability of outcome of the project or uncertainty creeping in ultimate collection of revenue from the customer. There may be situation where under the percentage of completion method, revenue recognized in earlier year(s) may be required to be reversed in subsequent years depending upon such contingency or uncertainty taking place during the development of the project at a later date. In case effect of provision of section 43CA is given in the computation of income on year to year basis along with recognition of revenue as per the percentage of completion method, the effect of reversal of taxable income in the return of income of the later year would give rise to insurmountable difficulties when revenue earlier recognized under percentage of completion method is reversed in the books of accounts.

In view of the above, it can be stated that provisions of Section 43CA cannot be made applicable on year to year basis while recognizing revenue on percentage of completion method as per Guidance note before the "transfer" of property takes place.

At which point of time transfer of property takes place for applicability of Section 43CA?

A further question may arise as to at which point of time, transfer of property takes place for the purpose of applicability of the provisions of Section 43CA.

The definition of the term 'transfer' has been given u/s 2(47) of the Income Tax Act, 1961 which recognizes transfer of asset in many ways and not only when document transferring the property is registered. Section 2(47) of the Act recognizes transfer of asset *inter alia* to include the sale, exchange or relinquishment of the asset or extinguishment of any rights therein or transfer of property by handing over the possession in part performance of the contract as per Section 53A of Transfer of property Act. But, definition of the term "transfer" under section 2(47) is in relation to transfer of a "capital asset" whereas Section 43CA deals with property held in the nature of stock in trade. Therefore, for the purpose of Section 43CA, definition of the term "transfer" given u/s 2 (47) cannot be applied. It follows that for the purpose of applicability of Section 43CA, the date of transfer of property has to be construed in accordance with the provisions of the Transfer of Property Act, 1882 when transfer of ownership of property is recognized.

Whether effect of section 43CA is to be given in the books of accounts?

Since section 43CA creates a deeming fiction for substituting the sale consideration with no corresponding receivable to come into existence, any effect on taxable income due to applicability of the provision of Section 43CA is to be given in the return of income only in the

year in which transfer of property takes place. No accounting treatment in the books of accounts is thus required to be given and, provisions of Section 43CA will not affect revenue recognition process in the books of accounts.

Conclusion

In view of the above analysis of the provision of Section 43CA, it may be stated that the harshness of the provision of section 43CA for real estate developers as was apprehended at the first instance is mitigated to a large extent, as discussed above. There are sufficient safeguards with in the provisions of section 43CA so as not to create any hardships for the genuine transactions.

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