

*Development Agreements –  
Area Sharing and Revenue sharing –  
Tax and other implications*

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# 1. Nature of transaction



- i. Owner and Builder/Developer agree to develop the Immovable Property for residential/ commercial/ mixed use.
- ii. Owner and Developer/ Builder agree to share the area developed at a ratio as agreed upon. The area to be shared would be identified post plan sanction and detailed by way of an allocation agreement.
- iii. General Power of Attorney to be executed in favour of the Developers/Builders to do all acts, deeds and things for the purpose of the development.

- iv. The Developer/ Builder is granted the right to enter the Immovable Property as a “Licensee” as understood under Section 52 of the Indian Easement Act, 1882 to commence the construction activity. It is explicitly stated that the legal title, domain, and control of the property continues to be vested with the Owner till its transfer in favour of the ultimate purchasers of apartments.
- v. Developer given the right to mortgage the Developer’s interest in the property for obtaining construction finance.
- vi. Owner to deposit original title deeds with the Financing Institution. The Financing Institution will give a letter of endorsement stating that the Owners share of interest is not secured or charged.
- vii. Clause on date of commencement, date of completion, grace period to be given to the Developer, compensation to Owners for delay subject to conditions force majeure to be included.



- viii. Compensation from prospective buyers to be charged by both the Owner and Developer for delay in receipt of installments to be standardized as this is a RERA requirement also.
- ix. Agreements on price parity i.e. review of minimum price to be fixed periodically to be provided for in the agreement.
- x. Developer to be responsible for all matters relating to construction including adherence to applicable laws, specifications agreed to be provided, quality of construction etc- This is also a RERA requirement.
- xi. Power to the Developer to enter into agreements and collect advances from his/ their share of buyers will be given. However, the power to execute conveyance deeds in respect of their share will be given only on the Developer handing over the Owner's share of super built up area in habitable condition after joint inspection by both the parties or after the OC for the project is obtained – Sec 17 of RERA to be considered.

## 2. Issues arising out of Area Sharing Development Agreement

### **i. Point of incidence of capital gain on the land owner**

- Applicable on date of entering into the joint development agreement, refer decisions below-
- ✓ Charturbuj Dwarakadas Kapadia Vs CIT (2003) 260 ITR 491 (Bom)
- ✓ JCIT (Asst)(Spl Range 6)Vs Dr T.K Dayalu (ITA No 3209 of 2005) dated 20-06-2011, 60 DTR (Kar) 403, 202 taxman 531(Kar)

- ✓ Karnataka High Court has in the case of CIT and Others Vs H B Jairaj in ITA No 20 of 2005 C/W ITA No 21 of 2005 dated 16.09.2011, 60 DTR
- ✓ CIT Vs Ved Prakash Rakhra (2012) 210 Taxman 605 Karnataka: (2013) 256 CTR (Karn) 285
- ✓ Smt. Prameela Krishnan vs. Income Tax Officer, Ward - 1(2) Mysore (2014) 221 Taxmann 418(Kar)
- ✓ Potla Nageswar Rao Vs DCIT IITA 245 of 2014 rendered on 9-4-2014 reported in (2014) 365 ITR 249 (AP), (2014) 269 CTR (Hyd) 325
- ✓ Jasbir Singh Sarkaria (2007) 294ITR 196(AAR)
- ✓ R Kalanidhi Vs ITO (2009) 314 ITR (AT) 266 (Chennai-ITAT)
- ✓ *Basis for the above is the cessation of domain and control of the property and the unbridled right of the Developer to deal with his share.*



- **Applicable on date when builder commences construction activity in carry out the Development.**
- ✓ Ranjith Reddy Vs Dy CIT (Hyd) Circle 6(1) rendered on 7/6/13 reported in 144 ITD 461 (Hyd “A” Trib)
- ✓ Fibars Infratech Pvt. Ltd vs. ITO Ward 1(2) Hyderabad (ITAT Hyderabad), ITA. No. 477/Hyd/2013
- ✓ ABVS Prakash Vs The Asst CIT Hyderabad Central Circle – 1 ITA No 462/Hyd/2013
- ✓ Binjusaria Properties (P) Ltd Vs ACIT (2014) 45 taxmann.com 115 (Hyd Trib).



- ✓ Dilip Anand Vazirani Vs ITO (2015) 57 taxmann.com 142 (Mum Trib)
- ✓ CIT V/s Eastern Ceramics Ltd (2013), 219 Taxmann.com 68/219 Taxmann 66 (Mag) (Bom)
- ✓ ACIT v. Geeta Devi Pasari (2017) 17 DIR 280(Bom).
- ✓ Sumeru Soft (p) Ltd Vs. ITO (2017) 1 (2017) 165 ITD 48 (Chenn-Trib).
- ✓ The CIT-111, Pune Vs. Dr. Arvind S. Palke (2017) - ITAAppeal No. 139 of 2015 (Bom.)- Rendered on 20-11-2017.
- ✓ Smt.Lakshmi Swarupa vs. Income Tax Officer , Ward 4(4), Bangalore- ITAT Blore – rendered on 12/10/2018
- ✓ *Can be used to postpone taxable event wherever advantageous*



- **At a point when Owner receives his share of super built up area**
- ✓ CIT Vs Attam Prakash & Sons (Del HC) IT Reference Nos 250-251 Of 1988 – delivered on August 8, 2008- (2008) 175 Taxman 499 (Del)
- ✓ CIT-I vs Naju Daru Deboo (2013) 38 taxmann.com 258(All), 218 Taxmann 473(All) rendered 16-9-2013.
- ✓ CIT Karnataka (Central) Bangalore v Shri Sadia Shaikh (Tax Appeal No. 11 & 12 of 2013) rendered on 2nd December 2013 reported in (2014) 56(I) ITCL 147 (Bom HC ) (High Court of Bombay at Goa
- ✓ Giridhar G Yadalam vs CWT and Others (2016) 237 taxman 392 (SC) - affirming decision of Kar HC in (2010)325 ITR 223.

- ✓ Refer wordings of Section 53A and 54 of the Transfer of Property Act, 1882.
- ✓ Section 54- Contract of Sale Vs Contract for Sale.
- ✓ Observations in the case of Govind Saran Ganga Saran v/s Commissioner of Sales Tax and Others (1985) 155 ITR 145 (SC)
- ✓ Observations in the case of Ishikawajima – Harima Heavy Industries Ltd. Vs DCIT, Mumbai (2007)(SC) 288 ITR 408





- *NOTE- To avoid incidence of capital gains at the stage of signing the Development Agreement or at the point when the construction activity commences, it is advisable for the Owners to convert the immovable property into stock in trade either in the books of the proprietary concern of the Owner or by introducing the said immovable property into a partnership firm as capital contribution*
- R Gopinath (HUF) v. ACIT (2010) 5 Taxmann.com ITA Nos. 29 & 30/ MDS/2008 rendered by the ITAT Chennai 'A' Bench on 24th July, 2009 also reported in 133 TTJ (Chennai) 595.
- Ramesh Abaji Walavalkar v. Addln CIT 150 TTJ 725 Mum Trib. (D Bench)
- Vidyavihar Containers Ltd v. Dy. CIT (2011) 133 ITD 363 (Mum. Trib)
- DCIT vs Crest Hotels Ltd (2001) 78 ITD 231 (Chennai Bench).
- Fardeen Khan Vs ACIT 11(1) Mumbai- ITA No 1588/1589 of 2013 rendered on 25-2-2015, 169 TTJ 398 ( ITAT F Bench Mumbai) [*Pr.CIT vs Fardeen Khan ITA No. 162 of 2016 rendered on 25.07.2018 ( Bombay – HC)*]
- Wipro Ltd Vs CIT (2016) 382 ITR 179( Kar).
- Dheeraj Amin Propreitor J V Builders v. ACIT Circle 2(1) Mangalore ITAT NO 1709/Bang/ 2013 rendered on 30-6-2015- (2015)172 TTJ 228-( Blore Trib)

## ii. Consideration for the purpose of transfer -

- ✓ *Adopt estimated construction cost of Owner's share of super built up area plus non-refundable deposit.*
- ITO v. N S Nagaraj ITA (2015) 152 ITD262 , 52 Taxmann.com 511.
- CIT Mysore vs. Khivraj Motors (2015) 62 Taxmann.com 305 , 380 ITR 215 (Kar).
- CIT Vs Ved Prakash Rakhra (2012) 210 Taxman 605 Karnataka: (2013) 256 CTR (Karn) 285
- Essae Teraoka Ltd vs Dy.CIT (2016) 157 ITD 728 (Bang-Trib)
- Smt. Pratima Reddy vs. ITO, ward-6(4) (2012) 25 Taxmann.com 264 (Hyd)
- IT v. Vasavi Pratap Chand and Sidharth P Chand (2017) 398 ITR 316 (Delhi)
- Udai Hospitals Pvt Ltd vs ITO. Ward 17(3), Hyd, (ITAT "B" Bench) ITA No. 1755/Hyd/2017 rendered on 28/09/2018.

- ✓ Adopt guideline value of the land to be transferred to the Developer and/or his/its nominees as per provisions of Section 50 D
- ACIT vs M/s Shankar Vittal Motor Co. Ltd. ITA No.35/Bang/2015 rendered on 18/03/2016
- B V Narayana Reddy vs Asst. CIT (2015) TaxPub (DT) 4553 (Hyd "B"- Trib)
- Circular F.No. 225/58/2016/ITA.II dated 29/02/2016 issued by CBDT





# Implications of Section 45(5A)



- Inserted by Finance Act 2017 and applicable to development agreements executed on or after 01/04/2017.
- Section inserted to mitigate hardship of land owners from paying Capital Gains Tax at the point of entering into the Agreement.
- Applies only to Individuals and HUF and only for transfer of a Capital Asset being land or building or both.
- The term “specified agreement” defined under the said Section applies to an area sharing agreement and not to a revenue sharing arrangement.
- This Section is only prospective- Adinarayana Reddy Kummata vs ACIT Circle-11(1), Hyderabad [2018] 91 taxmann.com 360 [Hyderabad-Trib.]

- The wordings indicate that there is a transfer of Capital Asset on the date of entering into a development agreement on Land pertaining to the Developer's Share and only the payment of Capital Gains is postponed.
- The Owners of Land/Building which is subject to development under a development agreement should therefore invest in bonds u/s 54EC or in a House Property u/s 54/54F within the stipulated dates which commence from the date of the agreement and not from the date of payment of Capital Gains
- Capital Gains to be levied on the deemed value (Guideline Value) of Building which will be received at the point of completion of the project and therefore the option of declaring Capital Gains on the deemed value (Guideline Value) of Land as per the Section 50D cannot be adopted henceforth
- TDS u/s 194 IC @ 10% introduced on the consideration paid at time of entering into the Agreement i.e., 10% on non refundable deposit. TDS Credit to be carried forward and postponed till the year in which corresponding income is offered to tax- Section 199 r/w Rule 37 BA.

# iii. Tax incidence on sale of Owner's share of apartments

In most cases-

- Long term for land
- Short term for super built up area



## Whether the income from sale of super built-up area along with UDI in land representing the Owner's Share can be taxed as Income from Business holding that it is an adventure in the nature of trade

- Direct decision on the matter in the case of JD
  - Rungta Properties (P.) Ltd vs Pr.CIT (2017) 83 taxmann.com 106 (Calcutta)
- Conversion of agricultural land into plots and subsequent sale taxed as income from Capital Gains in the case of;
  - M.V. Chandrashekar vs Dy.CIT (2004) 91 ITD 543 (Bang – Trib) – upheld by Karnataka High Court in ITA No. 209/2003 rendered on 02/01/2008

## iv. Service Tax , VAT , GST on the Owner's share of Super Built Up Area

- ✓ Refer Circular No. 12 dated 07/12/2009 issued by Commissioner of Commercial Taxes
- ✓ Refer Circular No. 151/2/2002-ST dated 10/02/2012 issued by CBE & C under Section 65 (105) (zzq) of the Finance Act, 1994 relating to commercial or industrial construction service.
- ✓ Mad HC decision in the case N Bala Baskar vs UOI (2016) WP no 10515 ( Mad)- SLP dismissed by SC- Validity of above circular of CBE&C upheld.
- ✓ Refer Circular No. 108/02/2009-ST dated 29/01/2009 on service tax leviable on Builders and Developer prior to 01/07/2010 r/w the decision of Magus Construction Pvt Ltd and Anr v. UOI and Anr (2008) 22 (I) ITPJ 343 or STR 2008 (II) STR 225 (Gou HC)

### Opposite view -

- AAR- Ruling in Harikrishna Developers (2008) 10 STR 341 (AAR)







# GST on Owners Share:

- GST payable on the Land Owner's share of Super Built Up Area by the Developer – Refer FAQs and earlier Circular under Service Tax.
- Refer FAQ under GST – at [icegate.gov.in](http://icegate.gov.in) - issued on 09-10-2017 titled “FAQ on GST in respect of Construction of Residential Complex by Builders/Developers” - Point of levy.
- The Developer in turn to levy GST on Land Owner by raising monthly invoices under Entry 5(b) of Schedule II r/w Section 7 of the CGST Act.
- The Developer shall pay the GST on the Owners share and debit the account of the Owner in its books which shall be treated as a constructive payment by the Owner.
- The effect of occupation of land under an easement or an license in Para 2(a) of Schedule II of the CGST Act- effect of clause to be evaluated.
- GST will be levied on the Land Owner @ 18% on a value which shall be determined as per the Circular issued under Service Tax which has been more or less adopted under GST.



- Point of levy of GST on the Owners Share is a contentious issue-
- Revenue is taking a contention that the liability to pay central tax on supply of said services shall arise at the time when the said developer, builder, construction company or any other registered person, as the case may be, transfers possession or the right in the **constructed** complex, building or civil structure, to the person supplying the development rights by entering into a conveyance deed or similar instrument (for example allotment letter)- Notification No 4/2018 dated 25/1/2018 issued by Dept of Revenue MOF GOI i.e at the point of entering into the area sharing/allocation agreement
- Our contention is that the point of taxation should either be at the point when the Owners share of SBA is being handed over by the Developer or on a monthly basis based on the progress of construction.
- The value on which GST is to be charged on the Owners share is also a highly subjective and contentious issue with various methods being adopted by the Developers.

v. **Stamp duty under Article 5(f) of the Schedule to the Karnataka Stamp Act, 1957 r/w Article 41 (ea) of the said Schedule - 2% of market value of Owner's super built up area or 2% of the market value of land being transferred to Developer or their nominees, whichever is higher plus consideration by way of refundable or non refundable deposit. Market Value taken is the guideline value.**



# II. Development Agreement on Revenue Sharing Basis



## 1. Nature of agreement, arrangement-

- i. Owner and Builder/Developer agree to develop the Immovable Property for residential/ commercial/ mixed use.
- ii. Owner and Builder/Developer agree to share the revenue at a ratio as may be decided between the parties.
- iii. Various terms for sharing of revenue such as 'distributable revenue' etc will be detailed in the agreement.
- iv. Agreement will be styled keeping the dual ownership concept in mind i.e., Owner will transfer undivided right, title and interest in land and Developer will transfer super built up area in favour of the ultimate purchasers of the apartments.
- v. Nature of consideration to be received by Land Owner and the Developer to be specified.

- v. Modality of sharing revenue such as opening and operating of bank accounts, distribution of revenue etc., will be detailed.
- vi. Clause on date of commencement, date of completion, grace period to be given to the Developer, compensation to Owners for delay subject to conditions force majeure etc is included.
- vii. Compensation from prospective buyers to be charged by both the Owner and Developer for delay in receipt of installments to be standardized.

- viii. Agreement on pricing i.e. periodical fixation of minimum price to be adopted for sale for a specified period
- ix. Developer to be responsible for all matters relating to construction including the adherence to applicable laws, specifications to be provided, quality of construction etc.
- x. General Power of Attorney will be given to the Developer for the entire area to enter into agreements and sell undivided interest in land and Developer to transfer super built up area in favour of the ultimate purchasers of the apartments.





## 2. Issues arising out of Revenue Sharing Agreement

i. Point of incidence of tax on the owners.

AS 9 r/w Section 145

ii. Point of incidence of tax on the Developers who are not contractors

AS 7 r/w Section 145- Tax Accounting Standards

- S N Builders and Developers Vs ACIT 4(1) Bangalore ITA No 487/Bang/2013 rendered on 11-4-2014.
- Prestige Estate Projects Ltd V DCIT ITA 218/Bang/2009 (ITAT Bangalore)
- CIT Vs Rema Country Holdings Pvt Ltd ITA No 1041 and 1042/2006 order dated 29-9-2011 (Kar HC)

- ACIT v Layer Exports (P) Ltd (2017) 53 TR 416 (Mumbai- Trib)
- Shivalik Buildwell (P) Ltd v CIT (2013) 40 taxman.com 219 (Gujarat)
- Paras Buildtech India (P) Ltd v CIT (2016) 382 ITR 630 (Delhi)
- CIT v Excel Industries Ltd (2013) 358 ITR 295 (SC)

iii. Applicability of Section 50 D

iv. Service Tax and VAT on the owner's revenue share whether applicable?

v. *Stamp duty under Article 5(f) of the Schedule to the Karnataka Stamp Act, 1957 r/w Article 41 (ea) of the Schedule.- 2% of market value of Owner's super built up area or 2% of the market value of land being transferred to Developer or their nominees, whichever is higher plus consideration by way of refundable or non refundable deposit. Market Value taken is the guideline value.*

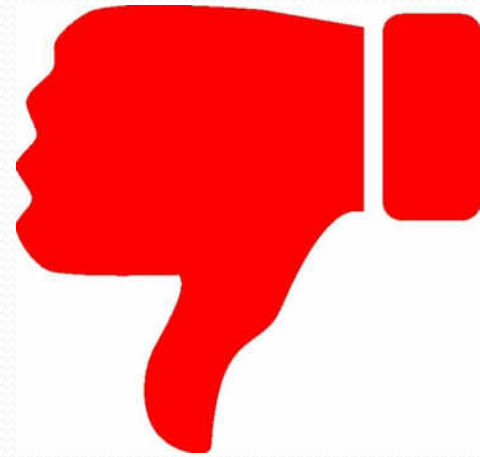
# Advantages

- a) Postponement of tax for land owner.
- b) No GST on owner's share
- c) Provisions of Section 50 D not applicable on date of entering into revenue sharing agreement.



# Disadvantages

- a) Owners cannot hold on to their stock and have the benefit of increase in sale price
- b) No recourse available to Owner if Developer delays completion, except invoking specific performance and claiming compensation
- c) Developers could have an issue if Owner/s has/have not paid his/their tax on his revenue share and Department takes coercive steps to recover tax dues by attaching the unsold apartments.
- d) Owner could also be deemed to have entered into an activity which could be construed "as an adventure in the nature of trade" and therefore his revenue share will be taxed as business income.
- e) Department could take a contention that it is an AOP.



## Structure to be evolved

### Formation of an LLP between the land Owner and the Developer.

- Land owner to contribute immovable property as capital contribution into the LLP as per provisions of Section 32(1) of the LLP Act.
- LLP to pay 1% Registration Fee and .1% stamp duty under Article 40A.A of the schedule to the KSA to enable entry into Book I
- Developer will become partner in the LLP by making initial capital contribution.

- The profit sharing and drawings clause in the deed would be suitably worded.
- Owner will draw as profits a % of gross revenue less cost of land contributed less proportionate income tax.
- Developer to draw as profits a % of gross revenue less cost of construction, selling cost, finance cost etc. less proportionate income tax. Or
- A profit sharing ratio will be arrived at based on the net revenue to be earned by the Owners and Developers.
- GST and deposits for facilities would be charged by the LLP and paid accordingly.
- Owners share of drawings will be transferred to a separate bank account.
- Dissolution clause in Deed to be drafted suitably



**The LLP will convert or treat the immovable property as stock in trade on the happening of certain events**

**Advantages:**

- 1) No need of POA to developer as he can be empowered to do various acts, deeds and things for the purpose of development in the LLP deed itself.
- 2) Question of giving a possession to the builder as a licensee or prospective buyer does not arise
- 3) Incidence of Income tax postponed to the year of sale or transfer of stock in trade
- 4) Recent judicial judgments on development agreements will not apply.
- 5) RERA and GST regn will be taken by the firm.
- 6) LLP is a distinct legal entity registered under the LLP Act, 2008 but is treated as a “firm” U/s 2(23) of the IT Act.

**Disadvantages:**

Property would be stuck in the firm in the event the development is abandoned mid way and hence dissolution clause to be suitably worded.

The Partners to pay capital gains tax on the introduction of the immovable property into the LLP as their capital contribution

## Developer to be treated as a Contractor

- ~ Owner to retain legal title and possession of land till it is transferred to the ultimate buyer.
- ~ Construction Contract to be given to the builder for the entire super built area allowed as per FSI.
- ~ Builder to recover contractors fee by being entitled to sell specified percentage of UDI in land and SBA.
- ~ POA to be suitable worded to indicate agency coupled with interest.
- ~ GST to be charged and collected in the name of the Owner.
- ~ Set off available on GST charged by the Builder on the Owner – GST will be at 18%.
- ~ Entire sales revenue minus contractor fee = Owners share of revenue
- ~ Contractors fee minus cost of construction = Developers share of revenue



# Implications of RERA

- “Promoter” – Section 2(zk) – **A person who constructs or causes to be constructed** an independent building or a building consisting of apartments, or converts an existing building or a part thereof into apartments, for the purpose of selling all or some of the apartments to other persons and includes his assignees ; **any other person who acts himself as a builder, coloniser, contractor, developer, estate developer or by any other name** or claims to be acting as the holder of a Power of Attorney from the owner of the land on which the building or apartment is constructed or plot is developed for sale ; such other person who constructs any building or apartment for sale to general public.
- Maha RERA has clarified vide office order dated 11/05/2017 and notifications dated 4/12/2017 that a Land Owner is a Co-Promoter for the purpose of RERA
- The Land Owner shall be liable for defects with respect to Title of the Land and the Developer shall be liable for defects in construction and a cross indemnity between them has to be provided for in the agreement.
- Deposit of 70% of the amount received from Allottees in a designated bank account to be adhered to both by the Developer and Land Owner.



*Thank You*

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