

**Real Estate Summit 2021- Untangling the Complexities**  
**(Jointly by CTC, ACAE, AIFTP (EZ), IDTPF, RIERF & STAR)**

# Revenue Recognition for Real Estate Transactions under Income Tax Act

20 August 2021

Adv. Dharan V. Gandhi

## Agenda

- ✓ Complexities involved in Real Estate Transactions in case of builders/developers
- ✓ Income-tax Act – charging provisions
- ✓ Accounting and Income-tax - Method of accounting – Section 145/ 145A
- ✓ ICDS and section 43CB
- ✓ 43CA
- ✓ Interest on WIP
- ✓ Notional rent
- ✓ Conversion of capital asset into stock in trade and vice versa

## Following issues are not covered

- ✓ Construction contracts
- ✓ Stamp Duty implications
- ✓ GST implications
- ✓ Capital gains implications

# Complexities involved in Real Estate Transactions in case of builders/developers

## Complexities involved in Real Estate Transactions in case of builders/developers

### Nature of transaction:

- Construction of building for onward sale of units to buyers – spread over a period of more than 1 year
  - Income-tax to be paid on yearly basis
- Lot of uncertainties in construction work due to:
  - frequent changes in rules, regulations and law
  - litigation involved in clear title and
  - bureaucratic hurdles etc.
- Uncertainty of revenue because of (as compared to construction contract)
  - market demand and
  - consideration to be received based on various contingencies viz. slab wise payment, on possession etc.

**As a result of the above, difficulty in offering any income to tax for the intermittent years.**

- **Profits earned if flats sold though construction incomplete**
- **But cannot determine the amount of profit**
- **Tax neutral - (2013) 358 ITR 0295 (SC) CIT vs. Excel Industries Ltd.**

# Income-tax Act, 1961 – Charging provisions

## Income-tax Act, 1961 – Charging provisions

- **Charging section** – section 4 r.w.s. section 2(24)

*“(24) "income" includes— (i) profits and gains “*

- ✓ **Real Income theory**

- ✓ **(2013) 358 ITR 0295 (SC) CIT vs. Excel Industries Ltd.**

Three tests laid down by various decisions of this Court, namely,

- ✓ whether the income accrued to the assessee is real or hypothetical;
- ✓ whether there is a corresponding liability of the other party to pay
- ✓ probability or improbability of realisation of the benefits by the assessee considered from a realistic and practical point of view

- ✓ **Section 28 – charging section**

*“28. The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession",—*

*(i) the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year”*

## Head of Income

- ✓ S. 2(13) – business includes any adventure or concern in the nature of trade, commerce or manufacture
- ✓ A single transaction can also be in the nature of business
- ✓ **(1959) 35 ITR 594(SC) G. Venkataswami Naidu & Co. vs. CIT**
  - ✓ If a person invests money in land intending to hold it, enjoys its income for some time, and then sells it at a profit, it would be a clear case of capital accretion and not profit derived from an adventure in the nature of trade.
  - ✓ In deciding the character of such transactions several factors are treated as relevant.
- ✓ Onus on the Department to prove it is business - **(1959) 37 ITR 242 (SC) Saroj Kumar Mazumdar vs. CIT**
- ✓ If at the time of purchase, the intention is to resell, then business income
- ✓ If at the time of purchase, the intention is to invest, then capital gains



# Accounting and Income-tax

## Interplay of accounts and tax

- ✓ Commercial accounting practices were accepted by the Courts. (See **Metal Box Company Of India Ltd. vs. Their Workmen - 73 ITR 53(SC)**]
- ✓ Section 145 allows – cash or mercantile system of accounting
- ✓ Finance Act 1995 - section 145 amended to give power to the Central Government to notify accounting standards
- ✓ Notification No. SO 69(E) dated 25-1-1996 - Government introduced two accounting standards to be followed by all the assessee's following mercantile system of accounting from AY 1997-98. (now superseded by the ICDS)
- ✓ Two accounting standards notified were:
  - AS I – Disclosure of significant accounting policies
  - AS II – Disclosure of prior period and extraordinary item and changes in accounting policies.

## Judicial Precedents on Accounts and Tax

- **98 ITR 167 (SC) Challapalli Sugars Ltd. vs. CIT**

*“For this purpose it would be necessary to ascertain the connotation of the above expression in accordance with the normal rules of accountancy prevailing in commerce and industry. The above rule of accountancy should be adopted for determining the actual cost of the assets in the absence of any statutory definition or other indication to the contrary.”*

- **225 ITR 703 (SC) CIT vs. U.P. State Industrial Development Corpn.**

*“It is a well-accepted proposition that for the purposes of ascertaining profits and gains the ordinary principles of commercial accounting should be applied, so long as they do not conflict with any express provision of the relevant statute.”*

- **404 ITR 409 (SC) CIT vs. Virtual Soft Systems Ltd**

*“Hence, there is no force in the contentions of the revenue that the accounting standards prescribed by the Guidance Note cannot be used to bifurcate the lease rental to reach the real income for the purpose of tax under the IT Act..”*

- **227 ITR 172 (SC) Tuticorin Alkali Chemicals & Fertilizers Ltd. V. CIT**

*“It is true that the Supreme Court has very often referred to accounting practice for ascertainment of profit made by a company or value of the assets of a company. But when the question is whether a receipt of money is taxable or not or whether certain deductions from that receipt are permissible in law or not, the question has to be decided according to the principles of law and not in accordance with accountancy practice”*

*Also see 400 ITR 178 (Del) CTC vs. UOI*

# Method of accounting – Section 145/ 145A

## Section 145

### Parent Section - Section 145 (Method of accounting)

145(1) - Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, ***subject to the provisions of sub-section (2)***, be computed in accordance with either **cash or mercantile system of accounting** regularly employed by the assessee.

145(2) – The Central Government may notify in the Official Gazette from time to time ***income computation and disclosure standards*** to be followed by any class of assessee or in respect of any class of income.

145(3) – Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) has not been regularly followed by the assessee, or income has not been computed in accordance with the standards notified under sub-section (2), the Assessing Officer may make an assessment in the manner provided in section 144. – ***Best judgment assessment***

## Section 145 vs. 5

### Section 145 vs. Section 5

- **119 ITR 573 (Mad.) CIT v. Standard Triumph Motor Co. Ltd.**

*“But, it must be remembered that section 145 is only a machinery provision and cannot qualify the charging section so as to make the latter otiose”*

- **130 ITR 145 (Madras) M. Velayutham vs. CIT**

*“In other words, as pointed out by Kanga, the charge on income accruing or received in India imposed by section 5 cannot be avoided by any method of accounting.”*

- **127 ITR 572 (Madras) CIT vs. Motor Credit Co. (P.) Ltd.**

*“Regular mode of accounting only determines the mode of computing taxable income and point of time at which the tax liability is attracted. It cannot be relied on to determine whether income has, in fact, resulted or materialised in the assessee's favour, nor can it affect the range of taxable income or the ambit of taxation”*

## Method of Accounting – PCM vs. POCM

**Section 145 of the Act – project completion method and percentage completion method are valid method of accounting – cannot reject one of the method**

- CIT V. Bilhari Investment Private Ltd. (2008) 299 ITR 1 (SC)
- CIT V. Realest Builders & Services Ltd. 216 CTR (SC) 345
- Paras Buildtech India Pvt. Ltd. Vs CIT (2016) 382 ITR 0630 (Delhi)
- CIT V. Manish Buildwell Pvt. Ltd. (2011) 245 CTR 0397 (Del)
- CIT vs. Shivalik Buildwell (P.) Ltd. - 40 taxmann.com 219(Gujarat)
- ITA No. 853 of 2015(Bom) CIT vs. Millennium Estates Private Ltd.
- CIT vs. Aditya Builders - 378 ITR 75(Bom)
- Bakshi Vikram Vikas Construction Co. P. Ltd. V. DCIT - 158 Taxman 61 (Del.)
- CIT v. V. S. Dempo & Co. Pvt. Ltd. (131 CTR 203)(Bom)
- ACIT v. Rajesh Builders (2004-TIOL-88-ITAT-MUM)
- Maitri Developers v. ITO (2011-TIOL-472-ITAT-Mum)

## Method of Accounting – PCM vs. POCM

### **TDS issues - Section 194IA and Section 199**

- Vis-à-vis POCM
- Vis-à-vis PCM
- **Rule 37BA(3)**

(3)

*(i) Credit for tax deducted at source and paid to the Central Government, shall be given for the assessment year for which such income is assessable.*

*(ii) Where tax has been deducted at source and paid to the Central Government and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax.*



# ICDS

## History of ICDS and Accounting Standards

- ✓ In December 2010 –CBDT constituted committee for Tax Accounting Standards
- ✓ In August 2012 –Formulation of 14 Tax Accounting Standards
- ✓ In July 2014 – Nomenclature changed from TAS to ICDS
- ✓ In January 2015 –released 12 draft ICDS
- ✓ Notification No. 32/2015 dated 31-3-2015, the Central Government notified 10 ICDS and the ICDS were made applicable w.e.f. AY 2016-17
- ✓ Implementation of ICDS postponed by one year due to practical difficulty – Notification No. 86/2016 dated 29.9.2016
- ✓ Vide Notification No. 87/2016 dated 29.9.2016, new ICDS notified and made applicable w.e.f. AY 2017-18.

## History of ICDS and Accounting Standards (contd.)

- ✓ Circular No. 10/2017 dated 23.3.2017 issued giving certain clarifications in respect of ICDS.
- ✓ Hon'ble Delhi High Court in case of **Chamber of Tax Consultants vs. UOI (400 ITR 178)** vide order dated 8.11.2017, quashed certain ICDS and certain portion of other ICDS and read down the powers of the Government u/s 145(2).
- ✓ Amendments brought out by Finance Act, 2018 w.r.e.f. AY 2017-18 to over rule the judgment of the Hon'ble Delhi High Court.

# Introduction to ICDS

## Essential features:

- Applicable to all assesseees following mercantile system of accounting (Cash system not governed by ICDS)
- except individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB of the said Act (*Only if Tax audit applicable in a previous year, then ICDS applicable*).
- For computing income under the head 'PGBP' and 'IFOS'
- Effective from AY 2017-18
- Not for the purpose of maintenance of books but only for computation of income (*Q. 1 of circular No. 10*)
- In case of conflict between the provisions of Act/ Rules and the ICDS, the ACT/ Rules shall prevail.
- Not applicable for computation of book profit u/s 115JB (*Q. 6 of Circular No. 10*)

# Findings and implications of Delhi High Court ruling.

## What did the Delhi High Court hold?

A. The Court held that the following are **essential legislative functions**:

- changing the basic principles of accounting that have been recognized in the various provisions of the Act for computation of income
- changing the method of accounting for computation of taxable income
- alteration of system of accounting, or according accounting or taxing treatment to a particular transaction
- To make a validation law to override judicial precedents and that too by actually removing the defect pointed out by such precedent

B. The Court further held that:

- After considering Q.2 of Circular 10, it is unmistakable that the ICDS is intended to prevail over judicial precedents which may be to the contrary.
- ICDS notified under Section 145 (2) of the Act has the effect of modifying the basis for computation of taxable income as recognised by the Act and as interpreted by the Court.

## Findings of the Court - On the issue of Delegation of essential legislative function and Excessive Delegation:

- C. After considering the judgment of the SC in case of **Tuticorin Alkali Chemicals and Fertilizers Limited v. Commissioner of Income Tax (1997) 227 ITR 172**, the Court held that AS has hardly any role to play in the principles governing determination of income, which has been well settled by the provisions of the Act as well as by judicial precedents

**The Court, in order to preserve its constitutionality, read down section 145 (2) of the Act as amended to restrict power of the Central Government to notify ICDS that do not seek to override binding judicial proceedings or provisions of the Act.**

**Thus, the Court held that:**

The Central Government by way of a Notification cannot:

- 1. Override any judicial precedents (High Court and Supreme Court)**
- 2. Cannot amend or alter any basic principles of computation of income.**

## Findings of the Court - On the issue of overruling judgments:

The Court has specifically dealt with cases where the judgments are getting overruled and to that extent held the provisions of ICDS to be not valid. However, where the Court has not dealt with any particular judgments which are side tracked by the ICDS, the Court has given a very relevant finding in para 102(ii)

**“The ICDS is not meant to overrule the provisions of the Act, the Rules thereunder and the judicial precedents applicable thereto as they stand.”**

**Accordingly, Q. 2 of the Circular is rendered invalid.**

*Q.2: Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?*

*Ans. The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years*



## Some other important issues arising out of the Delhi High Court Judgment

### Issues:

- ✓ Whether the ruling of the Delhi High Court has pan Indian application?
- ✓ What about the other issues where the ICDS run contrary to the rulings and not dealt with by the Delhi High Court?
- ✓ What if there is a SC or HC judgment subsequent to the notification of the ICDS? Can still the judgments be preferred over the ICDS?

## Some other important issues arising out of the Delhi High Court Judgment

### Issues:

- ✓ The Delhi High Court in some cases has struck down the entire ICDS and in some cases, some parts of the ICDS. In the amendments, the Legislature has referred to the ICDS notified u/s 145(2) but no new notification has yet been issued.
- ✓ Can one say that in so far as the status of said notification No. 87 is concerned, the Delhi High Court ruling would still prevail till the time the same is reversed by the Supreme Court and the Government is supposed to notify new ICDS? Or has the Notification No. 87 or 88/2017 come to life automatically because of the retrospective amendment?
- ✓ If the notifications have come to life then to what extent?

## Amendments brought in Finance Act, 2018

Explanatory Memorandum to Finance Bill 2018:

- In order to bring **certainty in the wake of recent judicial pronouncements** on the issue of applicability of ICDS,
- Recent judicial pronouncements have raised doubts on the legitimacy of the notified ICDS. However, a large number of taxpayers have already complied with the provisions of ICDS for computing income for assessment year 2017-18. In order to **regularise the compliance with the notified ICDS by a large number taxpayers** so as to **prevent any further inconvenience to them**, it is proposed to bring the amendments retrospectively with effect from 1st April, 2017 i.e the date on which the ICDS was made effective and will, accordingly, apply in relation to assessment year 2017-18 and subsequent assessment years

# ICDS 3 and S. 43CB

## Finding of High Court on ICDS 3

- ❑ The treatment to retention money under Paragraph 10 (a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income. By deploying ICDS-III in a manner that seeks to bring to tax the retention money the receipt of which is uncertain/ conditional, at the earliest possible stage, the Government would be acting contrary to the settled position in law.
- ❑ Para 12 of ICDS III read with para 5 of ICDS IX, dealing with borrowing costs, which makes it clear that no incidental income can be reduced from borrowing cost is contrary to the decision of the Supreme Court in **CIT v. Bokaro Steel Limited (1999) 236 ITR 315**.
- ❑ para 6 of ICDS-IV permits only one of the methods, i.e., proportionate completion method for recognising revenue from service contracts and is contrary to the **CIT v. Bilhari Investment Pvt. Ltd. (2008) 299 ITR 1 (SC)**, **CIT v. Manish Buildwell Pvt. Ltd. (2011) 245 CTR 397 (Del)** and **Paras Buildtech India Pvt. Ltd. V. CIT (2016) 382 ITR 630 (Del)**. – Should apply equally to ICDS III

**Held: ICDS III is held to be ultra vires to the extent as stated above and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

## Amendment brought in by Finance Act 2018

### Computation of income from construction and service contracts.

**43CB.** (1) *The profits and gains arising from a **construction contract or a contract for providing services** shall be determined on the basis of percentage of completion method **in accordance with** the income computation and disclosure standards notified under sub-section (2) of section 145:*

**Provided** that profits and gains arising from a contract for providing services,—

- (i) *with duration of **not more than ninety days** shall be determined on the basis of **project completion method**;*
- (ii) *involving **indeterminate number of acts over a specific period of time** shall be determined on the basis of **straight line method**.*

(2) *For the purposes of percentage of completion method, project completion method or straight line method referred to in sub-section (1)—*

- (i) *the **contract revenue shall include retention money**;*
- (ii) *the **contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains**.*

## Issues in ICDS 3

✓ What do you mean by construction contract u/s 43CB? Will it include real estate construction?

✓ See definition of construction contract under para 2(1)(a) of the ICDS III - *Construction contract* " is a contract specifically negotiated for the construction of an asset or a combination of assets"

✓ See Q.12 of Circular 10/2017

***Question 12 : Since there is no specific scope exclusion for real estate developers and Build -Operate-Transfer (BOT) projects from ICDS-IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.***

*Answer : At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.*

✓ Draft ICDS on Real Estate

✓ Assuming 43CB apply – there is no ICDS to provide for computation mechanism.

# Section 43CA



## 43CA

- ✓ W.e.f. AY 14-15
- ✓ SDV shall be deemed to be consideration received if consideration less than SDV
- ✓ Safe harbour limit – 10% increased to 20% upto 30.06.2021 on fulfilment of certain conditions
  - ✓ Retrospective? **ITA NO.5752/Mum/2019 Stalwart Impex Pvt. Ltd. vs. ITO**
- ✓ 43CA to apply in year of transfer or in year of recognition of income as per method of accounting?
- ✓ Objection and reference to DVO
- ✓ Date of agreement different from date of registration, then SDV as on date of agreement
- ✓ Rights in land or building
  - ✓ **(2016) 389 ITR 0068 (Bom) CIT vs. Greenfield Hotels & Estates Pvt. Ltd.**
  - ✓ **ITA No. 1821 OF 2013(Bom)(HC) CIT vs. Mr. Abdul Aziz Abdul Kadar**
  - ✓ **(2016) 161 ITD 0199 (Mumbai) VOLTAS LTD. vs. ITO – favour;**

# Interest on WIP

## 36(1)(iii)

### ✓ Section 36(1)(iii)

*“the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :*

*Provided that any amount of the interest paid, in respect of capital borrowed **for acquisition** of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.”*

*“Explanation 8. to S. 43(1)—For the removal of doubts, it is hereby declared that where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such asset.”*

✓ No delegation u/s 36(1)(iii) – therefore, ICDS 9 is a piece of backdoor legislation

## ICDS 9

### ☐ Scope

- ✓ This ICDS deals with treatment of borrowing cost

### ☐ Definition

- ✓ “Qualifying asset” means:

- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- **inventories that require a period of twelve months or more to bring them to a saleable condition.**

### ☐ Recognition

- ✓ Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.
- ✓ **“capitalisation” in the context of inventory means addition of borrowing cost to the cost of inventory**

## ICDS 9

✓ Inventories that require 12 months or more to put them to saleable condition [All inventories including real estate covered] - No such condition in 36(1)(iii)? Conflicting with the Act?

✓ ***Lokhandwala Construction Inds. Ltd. 260 ITR 579 (Bombay HC)***

✓ ***CIT vs. Cellice Developers (P.) Ltd. (231 Taxman 255)(Cal)***

✓ ***DCIT vs. Core Health Care Ltd - 298 ITR 194(SC)***

*“36(1)(iii) is attracted when the assessee borrows the capital for the purpose of his business. It does not matter whether the capital is borrowed in order to acquire a revenue asset or a capital asset, because of that the section requires is that the assessee must borrow the capital for the purpose of his business. “*

✓ ***SLP no. 18736 of 2018 (SC) PCT vs. Aditya Propcon P Ltd.***

✓ ***Raj HC – DBITA No. 309 of 2017 Jaipur bench***

✓ ***Against***

✓ (2006) 101 ITD 0156 (SB) Wall Street Construction Ltd.

✓ In Wall street construction (Mum)(SB) the court has relied upon the judgment of Bombay HC in case of Taparia tools which has now been reversed by Apex Court.

# Notional Rent

## Section 22, 23

- Section 22 –

*annual value of property of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax*

- Business of construction and development of properties.
  - properties developed becomes the stock in trade
  - income from such stock in trade, should be considered as the business income and should be charged to tax under Chapter IV – D
  - income from the trading assets would not be chargeable to tax u/s 22 and accordingly, section 23 would have no application.
- Intention of the Act to penalise the builders who are not able to sell the shops/ flats by taxing them with notional rent on such unsold stock
  - Forcing the assessee to let out the properties
  - Have to keep the flats vacant because the same is used to show them to the prospective buyers therefore used for the purpose of business. Thus, it is kept vacant for the purpose of business.

## Section 22, 23

- Object clause includes letting out of property - 373 ITR 673(SC) Chennai Properties & Investment Ltd. vs. CIT
- **Income from stock in trade to be taxed under the head business income**
  - ITXA No. 1216 of 2016 (Bom)(High Court) PCIT vs. M/s. Classique Associates Ltd
  - 281 CTR 458 (Cal) SHYAM BURLAP COMPANY LTD vs. CIT
  - 296 ITR 661 (Guj) CIT vs. Neha Builders Pvt. Ltd.
  - **352 ITR 82(Cal) AZIMGANJ ESTATE PVT LTD vs. CIT - Against**
- **Notional rent cannot be taxed in case of builder**
- 184 ITR 484(Cal) Madgul Udyog vs. CIT
- ITA No. 6037/Mum/2016 - ITO vs. M/s Arihant Estates Pvt. Ltd.
- ITA No. 5408 & 5409/Mum/2016 - M/s. Runwal Constructions vs. ACIT
- ITA No. 4360/Mum/2018 -Dream Enterprises vs. DCIT CC
- ITA No. 5620/Mum/2016 -M/s Sarang Property Developers Pvt. Ltd. Vs. ACIT
- ITA 282- 283/Mum/2018 - Haware Engineers & Builders Pvt. Ltd. vs. ACIT
- ITA No.4420/Mum/2017 -M/s. Saranga Estates Pvt. Ltd vs. DCIT
- **CIT vs. Ansal Housing Finance and Leasing Co. Ltd. (2013) 354 ITR 180 (Del) (Against)**



## Section 22, 23

### 23(5)

- *Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period up to two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be nil.*
- W.e.f AY 18-19
- Only if section 22 triggers – then 23(5) can apply – 23 is a machinery provision
- Constitutional validity?

# Conversion of capital asset into stock in trade and vice versa

## 45(2) – conversion into stock-in-trade

### **S. 2(47)(iv) and S. 45(1A)**

- Conversion into stock is a transfer
- chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred
- Logic - the difference between the fair market value of the asset and the original cost went untaxed – **(1962) 46 ITR 86(SC) CIT vs. BaiShirinbai K. Kooka; (1979) 116 ITR 125(SC) CIT vs. Groz Beckert Saboo Ltd.**

### **Development agreement –**

- land owner, who is not a developer/ builder, may think of getting actively involved in the activity of redevelopment either independently or along with an experienced developer. He may undertake following activities
  - Conversion of agricultural land into a Non-agricultural plot
  - Getting some permissions or
  - Take the risk of selling some constructed area in the new property and earn profits.

### **When is the stock transferred?**

- When the development rights are given to builder?
- When the flats which are received are transferred?
- As per method of accounting (percentage completion or project completion)
- 78 ITD 213(Mum) DCIT vs. Crest Hotels Ltd.
- (2017) 51 CCH 0277 MumTrib BOMBAY DYEING & MFG. CO. LTD. vs. DCIT

## 45(2) – conversion into stock-in-trade

### **(2011) 133 ITD 363(Mum) Vidhyavihar Containers Ltd. vs. DCIT**

- Passing a special resolution in the meeting of shareholders authorizing commencement of new business of real estate development
- Filed resolution with ROC
- Permission sought for use of land for development purposes
- Proposal/scheme filed with authority for the redevelopment of the property
- Permission from Labour department for issue of NOC
- Resolution passed in the meeting of BOD converting the land owned by it into stock-in-trade
- Entering into JDA

### **(2012) 150 TTJ 725(Mum) Ramesh Abaji Walavalkar vs.Addl. CIT**

- necessary approval of authority for the proposed development of the property
- NOC as well as commencement certificate issued by authority
- an Affidavit-cum-Declaration was made by the assessee before a Notary evidencing the conversion of land into stock in trade.

# Conversion of stock in trade into Capital Asset

## 28(via) – conversion of stock-in-trade into capital asset

*28. The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession",—*

*(via) the fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset determined in the prescribed manner*

- W.e.f. AY 2019-20
- Chargeability in which year? – year of conversion or year of transfer?
- Explanatory memorandum - *"In order to provide symmetrical treatment and discourage the practice of deferring the tax payment by converting the inventory into capital asset"*
  
- Violation of principles of mutuality
- No real income
- Mere book entry
- Impossibility of performance
- Constitutional Validity?
  
- Rule 11UAB – SDV as on the date of conversion
- Cost while computing capital gain – section 49(9) – SDV
- Period of Holding – from date of conversion
- Properties capitalised and depreciation claimed? Expl. 1A to 43(1)

# **Taxpayers' Charter**

## **THE INCOME TAX DEPARTMENT**

### **is committed to**

1. provide fair, courteous, and reasonable treatment
2. treat taxpayer as honest
3. provide mechanism for appeal and review
4. provide complete and accurate information
5. provide timely decisions
6. collect the correct amount of tax
7. respect privacy of taxpayer
8. maintain confidentiality
9. hold its authorities accountable
10. enable representative of choice
11. provide mechanism to lodge complaint
12. provide a fair & just system
13. publish service standards and report periodically
14. reduce cost of compliance

### **and expects taxpayers to**

1. be honest and compliant
2. be informed
3. keep accurate records
4. know what the representative does on his behalf
5. respond in time
6. pay in time

Apex Court in case of **CIT vs. J.H. Gotla [(1985) 156 ITR 323 (SC)]** has held that *“Though equity and taxation are often strangers, attempts should be made that these do not remain always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction.”*

## QUESTIONS, IF ANY?

THANK YOU

**Dharan V. Gandhi**

(B.Com, CA, LL.B.)

Advocate, Bombay High Court

709, Sharda Chambers, New Marine Lines,  
Behind Aaykar Bhavan, Mumbai – 400020.  
Tel : +91 22 79692153 Cell: +91 9820068466  
Email: adv.dharangandhi@outlook.com