Taxation and Redevelopment of Property

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TDR

- Background
- Cracking Nuts
- Taxability
Definitions

- TDR is not defined in Income Tax Act, 1961

- Regulation 2(d) of Foreign Exchange Management (Permissible Capital Account Transactions) Regulations 2000 defines the term “TDR”.

- The concept of TDR is explained by Regulation 34 of the Development Control Regulation of Greater Mumbai, 1991
Key Features of TDR

- TDR cannot be used all over Mumbai. It can be used only for designated areas.
- Violation of FSI laws may result in demolition of illegally constructed floors.
- No Stamp duty on transfer of property to the authority.
- Development Rights are granted to owner/s or lessee only for reserved land.
Cracking Nuts under different scenario

- Scenario-1 Where Society transfers additional entitlement (development right) to the Developer for development. Is such transfer of development right liable to tax?
Taxability in Scenario-1

- Development Right is a capital asset as per the Provision of Section 2(14) of the Act.

- For computing Capital gains there should be sale consideration and cost of acquisition along with the cost of improvement thereto.

- Gain on transfer of capital asset whose cost is not ascertainable, no capital gain chargeable to tax under section 45 of the Act- CIT v. B.C. Srinvasa Shetty [1981] 128 ITR 294 (SC)
Taxability in Scenario-1

- If the assessee has not incurred any cost of acquisition on a capital asset, such capital asset does not fall in the category of the capital asset specified under section 55(2) of the Act. Therefore, it is covered by the Judgment of the Supreme Court in case of B.C.Srinvasa shetty (Supra) - M/s New Shailaja CHS Limited [supra].
Taxability in Scenario-1

☐ The rights are acquired by virtue of being owner of the plot in the specified area, but this does not mean that the cost incurred on the plot is the cost of acquiring development right—Jethalal D.Mehta v. Dy. CIT [(2005) 2 SOT 422 (Mumbai)].

☐ Accordingly, transfer of TDR to Builder for development of property does not attract Capital Gain Tax. CIT v. B.C.Srinvasa shetty [supra].
Taxability in Scenario-1

- Cost of the land and building of the existing structure could not be attributable to the additional FSI received by means of the Development Control Regulations,1991.-[M/s New Shailaja CHS Limited [ITA No.512/Mum/2007].

- There is difference in the situation when cost of acquisition is Rs. NiL and where the cost of acquisition cannot be ascertained or no cost has been incurred.-[M/s New Shailaja CHS Limited[supra]
Cracking Nuts under different Scenario

- **Scenario-2** Where Society transfers entitlement (development right) to the Developer for development and does not receive any monetary consideration. However, builder agrees to carry out repairs to the building. Is such transfer liable to tax?
Taxability in Scenario-2

The assignment of the TDR to the developer and in turn the additional floor to be constructed and also repair / renovation of building to be carried out, does not entail accruing of any income in the hands of the assessee society. Accordingly, it does not attract tax liability- *ITO vs. M/s Lotia Court Co-op. Housing Society Ltd.*, [ITA No. 5096/M/05]
Cracking Nuts under different Scenario

- Scenario-3 Whether compensation received by the society or by members for allowing the developer (rightful owner of TDR/FSI) to develop or construct the property is liable to be taxed in the hands of the society or members?
Taxability in Scenario-3:

- Transferable Development Rights were owned or possessed by the builder in terms of the regulations, it was permissible for the builder to utilise the said transferable right in or with respect to the prescribed area including the land. *Om Shanti Cooperative Society [ITA. No. 2550 /Mum/2008]*

- No Capital gain tax on permitting construction of additional floors, whether or not any right is available with the society or its members, as it does not involve any cost of acquisition in the light of decision of the Supreme Court in the case of CIT vs. B.C.Srinivasa Shetty (Supra)- *Om Shanti Cooperative Society [supra]*
Taxability in Scenario-3

- Compensation paid to the Members of the society, not holding any capital asset, will not attract capital gain tax under section 45 of the Act - Deepak S. Shah v. ITO [(2009) 29 SOT 26 (Mumbai)].
Cracking Nuts under different scenario

**Scenario 4** – in case of demolition of old building structure (i.e. flat owner society), who is liable to receive consideration (whether member or society) on transfer of TDR to builder and tax liability?
TAXABILITY UNDER SCENARIO-4

- Under the given circumstance the legal ownership lies with the individual member and therefore individual members are entitled to receive consideration and claim exemption under section 5(1)(iv) of the Wealth Tax.

- Further, as far as taxability is concerned in respect of consideration received by the members, the case is covered by the Mumbai tribunal decision in case of Deepak S. Shah vs. ITO [2009] 29 SOT 26 (Mumbai).
Cracking Nuts under different scenario

**Scenario 5** Where under an agreement the members transfer the entire development potential consisting of original F.S.I. as well as TDR FSI to the developer with a stipulation that the developer will demolish the existing structure and in exchange of those rights provide to the existing members new flats at his own cost. What is tax implication?
TAXABILITY UNDER SCENARIO-5

- The said transaction is a transfer of entire property. Further, it may become a case of transfer by exchange in which the members exchange their existing flats for the new flats. The gain arising, therefore, may qualify for exemption under section 54 of the Income tax Act. If, however, Assessing Officer holds a view that it is the transfer of TDR rights and not residential house, then applicability of Section 54 will be ruled out and the only available provision will be Section 54F or Section 54EC of Income-tax Act.
Cracking Nuts under different scenario

Scenario-6 Where under an agreement the members retain the FSI required to be consumed for construction of their flats and transfer only the surplus TDR FSI to the developer. The agreement will also provide that the developer will construct flats for the owners as their contractor by utilizing the FSI + TDR retained by members in consideration of developer acquiring surplus TDR FSI. What is the tax Implication on such transaction?
TAXABILITY UNDER SCENARIO-6

☐ In such a case, there being no transfer involved with reference to the construction on retained portion, no capital gain arises on the FSI retained including the residential flats.

☐ The gain arises only from that part of the TDR FSI which is transferred to the developer. The transferred property not being the residential house, will not qualify for exemption under Section 54. The only applicable exemption provisions will be Section 54F or 54EC of the Income-tax Act.
Scenario-7 What will be the position in Scenario 5 & 6 (Supra) if the land belongs to the society and the building is also constructed by it?
TAXABILITY UNDER SCENARIO-7

☐ There is no transfer by the members and hence there will be no capital gain tax liability for members. In such a case capital gain arises to the society only. The society is eligible for exemption under section 54EC and not Section 54 / Section 54F of Income Tax.
Cracking Nuts under different scenario

- **Scenario 8**: Where a Flat Owners society distributes the unutilized FSI among the existing members in proportion to the area occupied by them and gives them the right to develop their share with or without the assistance of a builder, Whether society is liable to tax on such distribution ?, Whether compensation received will be taxable in the hands of the members?, will it be treated as dividend in the hands of the members?
TAXABILITY UNDER SCENARIO-8

☐ Such distribution will not amount to transfer.

☐ when the members transfer their rights to a builder, it may result in short term or long term capital gain. The members may take advantage of Sec. 54-F or 54-EC. (Benefit of Sec.54 may be doubtful as transfer of TDR may not be treated as a transfer of residential house).

☐ As the TDR rights already belonged to the member, though collectively, it should not be taken as distribution of dividend.
TAXABILITY UNDER SCENARIO-8

- A different view is, however, possible in case of plot purchased type society. Allocation of FSI to members may not be taken as distribution of asset held collectively.
Cracking Nuts under different scenario

- **Scenario-9** Where a plot purchased type society enters into a development agreement with a builder giving him the right to demolish and reconstruct the building by utilising the existing FSI and loading TDR so as to compensate the members with additional space (Say 20%) and pay to the society an agreed amount. Whether there will be tax implications for the Society or for the individual members who will get additional space. If yes, how will the gain be determined? Whether in such a case, it is permissible to avail of the benefits of Section 54 of I. T. Act.?
TAXABILITY UNDER SCENARIO-9

- Grant of right to load TDR FSI will accrue to the society and not to the individual members and it is the society which will be subjected to tax on capital gains. *ITO vs. Bhagwandas J. Lakhiani* [ITA No.7054/MUM/2005 dated 30-3-2005].

- the cost incurred by the developer on reconstruction of existing area with additional 20% including the cost of acquisition of TDR space will be the consideration and gain is to be computed by deducting from it the indexed cost of acquisition of the capital asset.
Cracking Nuts under different scenario

 Scenario-10 Where temporary accommodation is provided by the builder or inconvenience/disturbance compensation is paid for finding an alternate accommodation, during period of construction of new building, will such compensation be deemed to be part of the consideration received by the society and taken into account in working out the taxable gains? Can it be offered to tax by the members? Or, no tax liability arises in respect of such income?
TAXABILITY UNDER SCENARIO-10

- Accommodation or compensation given to the member is *not in the nature of income in the hands of the members*.

- In a case decided by ITAT, Mumbai in *Lohtse Co-operative Housing Society Vs. 7th I.T.O. 051 ITD 0608*, it was held that use of TDR injuriously affects the rights of existing occupants and, therefore, what is received is compensation for the injury caused.

- Hence there is no tax liability.
Q & A
Thank You