

# CAPITAL GAINS

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# Understatement of consideration

- What is the recourse available with the AO ?
- Can AO refer to the Valuation Officer for ascertaining FMV of the transferred capital asset ?
- What are the consequences if the Valuation Officer arrives at a value higher than the stated consideration ?

# Reference to Valuation Officer

- Section 55A of the Income tax Act, 1961
- Specific powers to the AO for referring to the Valuation Officer if in the opinion of AO the value of the asset as claimed by the assessee is less than the FMV of the asset.
- Reference only for the purpose of ascertaining FMV for the purpose of Chapter IV of the Act

# Reference to Valuation Officer

- Reference in the case of property purchased or constructed, etc
- Addition by the AO u/s 69, 69B, 69A of the Act which fall in Chapter VI which is outside the purview of section 55A
- *Amiya Bala Paul 262 ITR 407 (SC)*
- Section 142A introduced by The Finance (No. 2) Act, 2004 w.r.e.f. 15-11-1972

# Section 142A

- To estimate the value of any investment referred to in section 69, 69B, 69A of the Act
- Introduced by The Finance (No. 2) Act, 2004 but made effective from 15-11-1972
- Proviso to the effect that section not to apply to assessments which have become final & conclusive before 30<sup>th</sup> day of September, 2004
- *ACIT v. Shakti Bldrs (2005) 93 ITD269(ITAT-DEL)*



# Questions

- Whether AO can refer a capital asset to the Valuation Officer for ascertaining the FMV of the asset ?
- What are the consequences in case the Valuation Officer arrives at a FMV higher than the stated consideration ?

# Understatement of consideration

- Section 52(2):  
FMV of the asset transferred exceeds the stated consideration by 15% than FMV be taken as the full value of consideration for the transfer.
- K.P. Verghese V. ITO.(1981) 131 ITR 597 (SC)  
Onus on the revenue to show that the FMV of the asset exceeds the stated consideration but also that the consideration had been understated and the assessee had actually received more than what was declared by him.
- Section 52 deleted from the statute by The Finance Act, 1987

## Section 142A(3)

On receipt of the report from the Valuation Officer, the Assessing Officer may, after giving the assessee an opportunity of being heard, take into account such report in making such assessment or reassessment



# Understatement of consideration

- Whether valuation report is an evidence sufficient for making addition ?
- Whether addition on the basis of valuation report can be made in the hands of buyer or seller ?

# Consequences

- K.P. Verghese v. ITO (1981) 131 ITR 597 (SC)
- CIT v. George Handerson & Co. Ltd (1967) 66 ITR 622 (SC)
- CIT v. Gillander Arbuthnot & Co ( 1973) 87 ITR 407 (SC)
- CIT v. Rakesh Kumar, SLP (civil) No. 3330 / 1982 (1988) 171 ITR (ST) 47 (SC)

# Understatement of consideration

- Expert valuer confirming the valuation as per the sale deed
- Valuation officer of the department arrived at a higher value
- Lordships Sabyasachi Mukherji and S.Ranganathan JJ. Dismissed departments special leave petition against the orders of the Delhi High Court holding that no understatement of value was proved
- *CIT v. Rakesh Kumar 171 ITR (ST) 47 (SC)*
- *ACIT v. Shakti Bldrs (2005) 93 ITD269(ITAT-DEL)*

# Understatement of consideration

- Agreement as well as other documents seized during the course of search stating amounts more than the sale consideration as per the sale deed
- Held; The court cannot come to the conclusion that the price mentioned in the sale deed is not correct unless it is proved that the amount stated in the agreement was paid

**CIT v. K.C. Agnes and others**

**(2003) 262 ITR 354 (Ker)**

# Understatement of consideration

- AO can substitute actual sale consideration in place of stated consideration, if there is evidence to show that the assessee had indeed received higher amount
- **Inderpal Singh Ahuja v. CIT**  
**(2006) 103 ITD 271 (ITAT-Asr)**



# Valuation for Stamp Duty

- Actual consideration < Value for Stamp Duty
- Actual consideration that passed between the parties is a question of fact to be determined in each case having regard to the facts & circumstances of the case.  
*Dinesh Kr Mittal v. ITO (1992) 193 ITR 770 (All)*
- Section 50C introduced by The Finance Act, 2002 w.e.f. 1-4-2003

# Section 50C

- Value for the purpose of stamp duty, deemed to be the full value of the consideration from transfer of the capital asset for calculating capital gains
- In case the value is disputed before the AO and the stamp duty valuation has not been disputed; the AO may refer to a Valuation Officer for ascertaining FMV

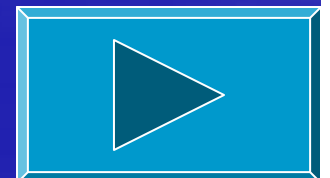
# Issues in section 50C

- Consequences in case value arrived at by the Valuation Officer is:
  - less than stamp duty valuation
  - more than the stamp duty valuation
- In case the stamp duty valuation is disputed before the concerned authority; Section 155(15)
- Harsh only to the seller
- How the seller can avail benefit u/s 54/ 54EC
- Finality as regards consequences of variation if any in the valuations
- Provision yet to be tested in the light of decision in the case of K.P. Verghese V. ITO.(1981) 131 ITR 597 (SC)

# Capital Gains deemed to be Income

## Section 45(1)

Any Profit or gains arising  
from transfer of a Capital Asset  
— shall be chargeable to tax  
as Capital Gains  
and shall deemed to be income  
of the previous year  
in which transfer took place.



# Insurance claim

- Capital asset destroyed in fire
- Insurance claim received against the destruction of the said asset
- Whether insurance claim liable to tax as capital gains ?
- *Vania Silk Mills (1991) 191 ITR 647 (SC)*
- Section 45(1A) inserted wef 1-4-2000



# Insurance Claim

## Section 45(1A)

Profit or gains arising from receipt of money or other asset from an insurer on account of damage or destruction of Capital Asset shall be deemed to be income & chargeable to tax under the head Capital Gains.

Money received or Fair Market Value of the asset received shall be treated as the Full Value of consideration in the year of receipt.

# Conversion of capital asset into stock in trade

- Shares purchased in 1985 held as investments.
- In 1998 the assessee started business in shares and treated the aforesaid shares as stock in trade.
- Shares sold in the year 2000.
- Taxability ?

*CIT v. Shirinbai K. Kooka 46 ITR 86 (SC)*

- Section 45(2) inserted wef 1/4/1985

# Conversion of capital asset into stock in trade

## Section 45(2)

Fair Market Value of the asset  
on the date of conversion  
to be deemed to be  
full value of consideration.

Capital Gains deemed to be income of the  
year in which such stock in trade is sold.

# Conversion of stock in trade into a capital asset

- How capital gains to be ascertained ?
- How the period for which asset is held to be calculated ?
- Date on which asset was acquired will be the date of purchase of the asset
- Kalyani Exports & Investments Pvt Ltd v. CIT (2001) 78 ITD 95 (Pune)

# Partnership firm

- Admission of a partner
- Retirement of a partner
- Dissolution of firm
- Transfer of capital asset
  - By partner to firm
  - By firm to partner



# Transfer of capital asset

- By partner to firm
- By firm to partner
- *Sunil Sidharthbhai v. CIT (1985) 156 ITR 509 (SC)*  
*CIT v. B.C.Srinivasa Setty 128 ITR 294 (SC)*
- Section 45(3) & 45(4) brought into the statute by Finance Act, 1987 wef 1/4/1988

# Transfer by Partner to the Firm

## Section 45(3)

Transfer of capital assets

by partner to the firm

as capital contribution or otherwise.

Amount recorded in the books of accounts of the firm to be treated as full value of the consideration.

Capital Gains taxable accordingly.

# Transfer by Firm to the Partner

## Section 45(4)

Transfer by firm to the partner

by way of distribution of capital asset on  
dissolution of firm or otherwise

shall be chargeable to tax in the hands of  
the firm.

Fair Market Value of the asset to be  
deemed to be the full value of  
consideration.

# Issues in section 45(3) & (4)

- Transfer of capital asset by the partner to firm & vice-versa
- In case of partner to firm: Value recorded in the books of the firm
- In case of firm to partner: FMV of the capital asset
- Whether section 45(4) applies to retirement as well ?
- Whether section 45(4) operative without amendment in definition of transfer in section 2(47)

# Admission of a partner

- Partner transfer a capital asset to the firm
- A new partner is admitted who brings in his capital asset into the firm
- Proprietorship converted into partnership
- New partner admitted in an existing firm wherein firm possesses capital asset



# Admission of a new partner

- Firm possessing capital asset
- A new partner is admitted
- Whether there is any capital gain
- Held, yes
- *CIT v. Bhanodya Ind. (2002) 253 ITR 350 (AP)*

# Admission after revaluation

- Revaluation of assets & liabilities of the firm
- A new partner is admitted into the firm
- Subsequently old partners retire
- Whether any liability of capital gains
- Held, No
- *CIT v. Kunnamkulam Mill Board (2002) 257 ITR 544 (Ker)*

# Two school of thoughts

- Firm a separate entity
- Firm not a separate entity
- Section 4 of The Partnership Act, 1932

*“partnership is a relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all”*

# Retirement of partner from firm

- Applicability of section 45(4)
- Partnership firm is not a separate legal entity
- Status prior to amendment by the Finance Act, 1987
  - *CIT v. Banke Lal Vaidya* (1971) 79 ITR 594 (SC)
  - *CIT v. Diwan Cine Corp.* ( 1968) 68 ITR 240 (SC)
  - *Malabar Fisheries v. CIT* (1979) 120 ITR 49 (SC)

## Section 45 (4)

- Whether transfer ?
- Whether retirement of a partner covered ?
- *Held, Yes,*
- *CIT v. A.N. Naik Associates (2004) 265 ITR 346 (Bom.)*
- *Similar circumstances: Held, No*
- *CIT v. Machines & Mopeds (2005) 281 ITR 52 (M.P.)*



# Retirement of partner from firm

- Amount received in excess of capital balance on retirement from the firm.
- Status prior to amendment:
- Held, not taxable as it is realisation of the pre existing right
- *CIT v. Sheshagiri Rao (1995) 213 ITR 304 (AP)*
- *CIT v. Anant Narhar Ninkar (HUF) (1997) 224 ITR 221 (Guj)*
- Held, taxable as resulting in transfer & retirement is different form dissolution of the firm.
- *Bishan Lal Kanodia v. CIT (2002) 257 ITR 449 Del*

# Partnership firm

- Retirement of a partner
  - Capital asset taken over by the retiring partner
  - Resulting in conversion into proprietorship
  - Capital asset owned by the firm continuing with remaining partner
  - Retiring partner getting more than cr in his capital a/c
  - Retiring partner given proportionate share in the capital asset
- Dissolution of firm
- Transfer of capital asset
  - By partner to firm
  - By firm to partner

# Family arrangements

- Whether transfer of property in family settlement is chargeable to capital gains tax?
- Family arrangements made voluntarily to resolve the disputes among members of a family did not amount to transfer.
- No capital gain arises from the transaction
- *CIT vs AL Ramanathan 245 ITR 494 (Madras)*

# Family Arrangements

- Cost of acquisition in the hands of the member receiving the asset after the settlement
- Cost to the previous owner and not the amount mentioned in the family settlement deed

**CIT v. Shanti Chandran (2003) 127 Taxman 475 (Mad)**

# Mode of Computation of Capital Gains

## Section 48

Full value of the consideration received or accruing as a result of transfer of capital asset less.

- (i) expenditure incurred **wholly & exclusively in connection with such transfer.**
- (ii) the **cost of acquisition of the asset & the cost of improvement there to.**



# Expenditure in connection with transfer

- Expenditure which is necessary to effect the transfer
- Every expenditure which has nexus with the transfer does not qualify for deduction

*Sita Nanda v. CIT 119 Taxman 227 (Delhi)*

- Amount paid to tenant to get the property vacated

*CIT v. A. Venkataraman (1982) 137 ITR 846 (Mad.)*

# Discharge of mortgage

- Repayment of loan taken by the assessee / discharge of mortgage created by the assessee cannot be regarded as expenditure in connection with the transfer

*CIT v. SRV publications pvt ltd 107 Taxman 458 (Ker)*

*CIT v. Attili N Rao 119 Taxman 1030 (SC)*

*CIT v. Roshanbabu M.H. Merchant 144 Taxman 720 (Bom.)*

- Mortgage created by the previous owner, property inherited/ acquired subject to mortgage. Amount paid to clear the mortgage is a part of cost of acquisition.

*VSMR Jagdish Chandran v. CIT 93 Taxman 389 (SC)*

# Interest on borrowings

- Revenue expenditure
- Allowable u/s 57 or u/s 24 of the Act
- Balance interest can be taken as allowable deduction for calculation of capital gains
- *CIT v. Mithlesh Kumari (1973) 92 ITR 9 (Del)*  
*Addl CIT v. K.S.Gupta (1979) 119 ITR 372*  
*CIT v. Mithreyi Rai (1989) 152 ITR 247 (Ker)*  
*Vasanji Sons & co Pvt Ltd (1975) 99 ITR 148 (Del)*

# Short term / Long term

- Long term capital asset: section 2(29A)
  - Cost of acquisition to be indexed as per second proviso to section 48
  - Flat rate of tax u/s 112
  - Various exemptions
- Short term capital asset: section 2(42A)
  - No indexation
  - Flat rate of tax u/s 111A only on equity shares transfer of which is subject to STT
  - Exemption only u/s 54B, 54D & 54G

# Depreciable Assets

## Section 50

- Not with standing section 2(42A)
- Capital assets forming part of block of assets
- Depreciation has been allowed
- Mode of computation
  1. Full value of consideration on transfer of asset
    - Less - expense incurred wholly & exclusively on such transfer.
      - WDV of the block
      - Addition to the block during the previous year
    - Excess deemed to be short term capital gain
  2. Income from transfer of assets of a block
    - Less - WDV
      - Addition during the year
    - Deemed to be short term capital gains



# Consequences

- Capital gains/ loss is always short term.
- Indexation whether available ?
- Whether FMV as on 1-4-1981 can be adopted?
- Whether benefit u/s 54F \ 54EC available ?
- Depreciable asset can be treated as long term or short term depending on the period of holding
- *Assam Petroleum Industries Pvt Ltd 262 ITR 587 (Guwhati)*  
*CIT vs Ace Builders Pvt Ltd 144 Taxmann 855 (Bombay)*
- Set off of b/f loss u/s 72
- Unabsorbed depreciation?
- Taxability u/s 115JB

# Treatment of Land & Building

- Land separate from building for calculating capital gains
- Land on which building constructed is long term capital asset even if building is a depreciable asset as per section 50
- *CIT vs Citibank N.A. 261 ITR 570 (Bombay)*

# Forfeiture of earnest money

- Capital asset acquired in FY 1995-96 for Rs.10 Lacs
- Advance of Rs.3 lacs received during FY 2005-06 against sale of the said property for Rs.25 lacs
- Buyer could not make the payment of balance amount and the earnest money is forfeited.
- Treatment ?

# Advance money received

## Section 51

- Advance money received & retained
- To be deducted from the cost or FMV in computing cost of acquisition

# Issue

- Whether advance money received & retained is to be deducted from cost of acquisition or indexed cost of acquisition
- Section 48 amended wef 1-4-1993 consequential amendment to section 51 not done
- Advance received more than cost of acquisition



# Treatment of advance

- Cost of acquisition : Rs.5 lacs
- Advance forfeited : Rs.25 lacs
- Treatment ?
- Excess over cost of acquisition is a capital receipt
- *Travancore Rubber & Tea Co. Ltd. 243 ITR 158 (SC)*
- Subsequent sale whether cost of acquisition to be NIL or negative figure?
- *Held: NIL Smt Sunita N. Shah (2005) 94 ITD 492 (Mum)*

# Profit on sale of property used for Residence

## Section 54

### Basic Conditions

- Individual or HUF
- Transfer of long term capital asset
- buildings or lands appurtenant thereto
- Residential house
- The income of which is chargeable under the head “income from house property”

### Compliance for exemption

- Purchase a residential house
  - one year before
  - two year afterthe date of transfer
- constructed a residential house
  - with in period of 3 yearafter the date of transfer
- Restriction on transfer of new asset

# New Asset

- Not to be transferred within a period of 3 years of its purchase or construction as the case may be

- In case transferred:

Gain to be short term capital gain

Cost of acquisition depends upon extent of exemption availed at the time of its acquisition

- if fully exhausted - Nil
- Otherwise - Balance

# Exemption U/s 54

Capital Gains  $>$  Cost of the new residential house

- diff liable to tax u/s 45.

Capital Gains  $\leq$  Cost of the new residential house

- No taxability u/s 45.

# Profit on sale of capital asset other than residential house

## Section 54F

### Basic Conditions

- Individual or HUF
- Transfer of long term capital asset
- Other than residential house

### Compliance for exemption

- Purchase a residential house
  - one year before or
  - two year afterthe date of transfer or
- constructed a residential house
  - within period of 3 yearafter the date of transfer
- Eligibility as well as other conditions to be fulfilled



# Conditions for section 54F

- Assessee should not own more than one residential house other than the new asset on the date of transfer of the original asset
- Should not purchase/ construct any other residential house within two years / three years respectively of the transfer of the original asset
- New asset not to be transferred before three years from the date of its purchase/ construction, in case transferred LTCG exempted earlier to be taxed in the year of sale

# Exemption U/s 54F

Net consideration > Cost of the new residential house

- diff liable to tax u/s 45.

Net consideration < Cost of the new residential house

- No taxability u/s 45.

# Diff between 54 & 54F

- Transfer of residential house ; any other capital asset
- Restriction on ownership of one residential house at the time of transfer u/s 54F
- Net sale consideration to be invested for exemption u/s 54F
- Restriction on purchase within 2yrs / construction within 3yrs of any other residential house u/s 54F
- In case sale of new asset within 3 yrs:
  - Section 54: Cost of acquisition of the asset to be adjusted with the amount of exemption availed
  - Section 54F: LTCG taxable in the year of sale of the new asset

# Cost of plot

- Whether cost of plot for the purpose of construction of residential house is considered for benefit u/s 54/ 54F ?
- Cost of land is the integral part of the cost of residential house
- *Circular No. 667 dt 18/10/1993*

# Issues in section 54/ 54F

- Benefit restricted for either purchase or construction of a residential house or both can be considered jointly ?
- Benefit available for both jointly
- *BB Sarkar v. CIT 132 ITR 150 (cal)*



# Purchase of more than one house

- Whether benefit u/s 54 is available for purchase of more than one house ?
- Section 54/54F : “a residential house”
- Whether “a” here denotes “one”

# Purchase of more than one house

- *Benefit restricted to only one house*  
*KC Kaushik v. ITO (1990) 185 ITR 499 (Bom)*
- *KG vyas v. ITO 16 ITD 195 ( ITAT- Mum)*
- The controversy and the judicial precedents above was on section as it stood before amendment by The Finance Act, 1982 where benefit was restricted to “a house property for the purpose of his own residence”

# Purchase of more than one house

- The General Clauses Act, 1897:  
Section 13(2): “words in the singular shall include the plural, and *vice versa*”
- The article “a” is not necessarily a singular term. It is often used in the sense of any, and when so used it may be applied to more than one individual object- National Union Bank v. Copeland 4NE 794
- *Two adjacent flats; Held allowable; D. Anand Basappa v. ITO (2004) 91 ITD 53 (Bang.)*
- *Held allowed only for one flat; Gubhanbanoo R. Mukhi v. JCIT (2002) 83 ITD 649 (ITAT- Mum)*

# Land & building

- Land purchased in 1991
- Residential house constructed thereon in 1995
- Sold in 1996
- Whether gain is short term or long term
- *CIT v. lakshmi b Menon (2003) 184 CTR 52 (Ker)*
- *Capital gains to be determined seperately*

# Execution of sale deed

- Payment made but sale deed could not be executed within 2 yrs; whether assessee is entitled to benefit u/s 54 ?
- Legal transfer not mandatory, payment of consideration coupled with taking over of possession is more important
- *CIT v. Dr Laxmichand (1995) 211 ITR 804 (Bom)*
- *CIT v. Shahzada Begum (1988) 175 ITR 397 (AP)*



# New house in wife's name

- Capital gains from sale of residential house property in the name of husband
- New residential house purchased in the name of wife
- Exemption u/s 54 allowable

*CIT v. Natrajan (2006) 287 ITR 271 (Mad)*

# Section 54F

- Pre condition that assessee should not own more than 1 residential house
- Share in a joint property is 'owned wholly or partly' whereas in section 54F the word is 'owned'
- For denial of exemption u/s 54F the assessee should own a complete residential house and does not include shared interest in a residential house
- *ITO vs Rasik Lal N Satra (2006) 98 ITD 335 (Mum)*

# Acquisition of share in property

- Assessee purchases 15% share in the residential house property in which he was already staying
- Exemption u/s 54 cannot be denied
- *CIT vs Chandan ben Magan Lal (2000) 245 ITR 182 (Guj)*  
*CIT vs TN Arvinda Reddy (1979) 120 ITR 46 (SC)*

# Non residential use of house

- House purchased / sold u/s 54 / 54F although being a residential house is being utilized for non-residential purposes
- Mere non-residential use of residential house would not render property ineligible for benefit u/s 54/ 54F
- *Mahavir Prasad Gupta (2006) 5 SOT 353 (Del)*
- *Amit Gupta v. DCIT (2006) 6 SOT 403 (Delhi)*

# Purchase of residential house outside India

- Whether assessee entitled to exemption u/s 54/ 54F
- Held: No, Income Tax Act, 1961 applies only to India
- *Leena J Shah v. ACIT (2006) 6 SOT 721 (Ahd)*
- Held: Yes, section 54 does not impose any bar on acquisition outside India
- *Prema P Shah v. ITO 282 ITR (ITAT) (Mum.)*



# Collaboration agreement

- Whether repurchase of a part of the property sold will entitle assessee to claim benefit u/s 54
- Held, yes
- *CIT v. Phiroze H. Patel (1994) 205 ITR 377 (Bom)*

# Construction whether before or after the date of transfer

- Whether construction of house property can be completed before the date of transfer of the original asset
- Held, No
- *Smt Shantaben P. Gandhi (1981) 129 ITR 218 (Guj)*
- *CIT v. JR Subramanya Bhat (1987) 165 ITR 571*
- Whether it can be started before the date of transfer
- Held, Yes
- *CIT v. HK Kapoor (1998) 150 CTR 128 (All)*

# Construction with in 3 years

- Assessee has made payments out of the capital gains with in the stipulated time
- Builder failed to hand over the property with in the prescribed time
- Exemption u/s 54/ 54F cannot be denied
- *CIT vs RC Sood (2000) 108 Taxman 227 (Del)*  
*CIT vs Ms Hille JB Wadia (1995) 216 ITR*

# Payment for SFS/ CGHS flat

- Whether to be taken as construction or purchase of residential house
- To qualify for construction
- *Circular No. 471 dt 19-10-1986*
- *Circular No. 672 dt 16-12-1993*

# Purchase/ construction

- Property being developed by the builder under collaboration agreement
- Assessee to get some portion of the dwelling unit
- Whether time limit of 2 yrs or 3 yrs would apply ?
- The case would fall under purchase of property by way of construction
- *ITO v. Abbas Ali Shiraz (2006) 5 SOT 422 (Bang.)*
- Construction may be by a third party
- *CIT v. Uma Budhia (2004) 141 Taxman 39 (Kol.)*



# Incomplete house

- Capital gains invested in construction of residential house within the stipulated time
- More funds required to complete the construction in a particular manner
- Assessee entitled to exemption as the utilization of the capital gains is complete
- **Ajay Goyal v. ITO (ITA No 493 of 2004 dt 9-5-2005)**

# Transformation of an asset

- Assessee books a flat with DDA/ becomes member of a CGHS in 2001
- Possession of the flat is given to the assessee in 2003
- Flat sold in 2005
- Capital gain; whether long term or short term
- *Flat is only an incidental right flowing from the shareholding in the CGHS*
- *CIT vs Jindas Parchand Gandhi (2005) 279 ITR 552 (Guj)*

# Link capital gain & investment

- Capital asset sold resulting in long term capital gains and sale proceeds utilized for business.
- New residential house property purchased after getting the same financed from bank
- Other stipulations for exemption complied
- Whether assessee entitled to deduction u/s 54
- **Ajit Vaswani v. (2001) CIT 117 Taxman 123 (Delhi) (Mag.)**

# Death of the assessee

- Legal heirs entitled to exemption if conditions satisfied
- *CV Ramanathan (1980) 155 ITR 191 (Madras)*  
*Mir Ghulam Ali Khan (1987) 165 ITR 228 (AP)*
- Deposit in Capital Gains Scheme A/C inherited by the legal heirs
- No obligation to utilize the same for purchase or construction of the residential house because the same is not income but estate devolving upon the legal heirs.
- *Circular No. 743, dt 13-7-1989*

# Benefit u/s 54/ 54F

- Benefit only for new construction or for remodeling & renovation also covered
- Benefit not restricted to new construction alone
- *CIT v. ar Mathavan pillai (1996) 219 ITR 696 (Ker)*
- *CIT v. Narsimhan PV (1990) 181 ITR 101(Mad)*
- Mere extension of old existing house would not mean construction. The construction must be real one and not a symbolic construction.
- *CIT v. Pradeep Kumar (2006) 153 Taxman 138 (Madras)*



# Farm House

- Whether a farm house can be considered as a residential house for the purposes of section 54/ 54F
- Land appurtenant to a building is a question of fact
- Land appurtenant thereto implies lands which are necessary for the effective enjoyment of the building as a residential house
- Tests as per judicial precedents
- *S Radha Krishnan vs CIT (1984) 145 ITR 170 (Madras)*  
*CIT vs M Kalpagam (1997) 227 ITR 733 (Madras)*  
*CIT vs Zaibunisa Begum (1985) 151 ITR 320 (AP)*  
*L & T vs Trustees (1988) 4 SCC 260*

# Indexation

- Father purchased house property for Rs1.16 lac in the year 1983.
- Father died in the year 2004 and son Mr. X inherits the property.
- Mr. X sells the property in Nov,05 for Rs5.00 lacs.
- Cost Inflation Index:
  - 1983-84: 116
  - 2004-05: 480
  - 2005-06: 497
- Taxability under the head capital gains:
  - Short term/ long term
  - Cost of acquisition
  - indexation

# Capital asset acquired u/s 49

- Explanation (iii) to Section 48:

Indexed cost of acquisition means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1-4-81 which ever is later.

- Whether benefit of indexation available ?

# Capital Gains Tax Scheme

## Section 54(2)

- unutilized amount of capital gains
- Deposit in an account
- With any specified bank or institution
- Scheme notified in official gazette by Central Government
- Before the date of furnishing ITR u/s 139(1)
- Proof of such deposit to be furnished alongwith the ITR.
- Withdrawal for purchase/construction of new house.
- Unutilized amount chargeable to tax as the income of the previous year in which the period of three years expires.

# Capital Gains Scheme

- Funds given as advance instead of depositing in the Capital Gains Scheme
- Later received back
- Property purchased during the stipulated time
- Whether benefit u/s 54 or 54F will be available to the assessee
- ***“Deminimus non curat lex”***  
*Rupali R Desai v. ACIT (2005) 273 ITR 109 (ITAT- MUM)*
- ***Exemption u/s 54F not available***  
*Taranbir Singh Sahni v DCIT(2006)5 SOT 417 (Delhi)*



# Section 54EC

- Long term capital gains not to be charged on investment in certain bonds at any time within a period of 6 months from the date of transfer
- Specified asset wef 1/4/2006:
  - National Highway Authority of India
  - Rural Electrification Corporation Limited
- Advance invested in specified bonds, while transfer takes place subsequently
  - Whether assessee entitled to benefit u/s 54EC
  - ***Circular No. 359 dt 10-5-1983***
- Bonds transferred / security for loan with in 3 yrs

# Section 54GA

- Shifting from urban area to any SEZ
- Capital gains arising from transfer of land & building, plant & machinery exempt from tax in case utilised for establishment of undertaking in SEZ
- The capital gains to be utilised within 1 yr before or 3 yrs after the date of transfer for:
  - Purchased plant & machinery
  - Land & building
  - Other expenses as may be specified by the CG
- SEZ may be in an urban area or any other area

# SEZ

- Section 54GA inserted by the Special Economic Zones Act, 2005 wef 10/2/2006
- Unprecedented privileges:
  - Section 10AA
  - Section 115JB(6)
  - Section 115-O
- Section 10AA amended wref 10/2/2006 by substituting sub-section 4 by Finance Act, 2007

# Agricultural Land

- What is agricultural land?
  - Whether agricultural or not is essentially one of fact & circumstances of each case; Sarifabib Mohamed Ibrahim v. CIT (1993) 204 ITR 631 (SC)
  - Determining factors; CIT v. Siddharth J. Desai (1983) 139 ITR 628 (Guj)
  - Forest land; Kalpetta Estates Ltd v. CIT (1990) 185 ITR 318 (Ker)

# Agricultural Land

- Capital asset (Section 2 (14))
  - Municipality having population of 10k or more
  - Within the notified area (not being more than 8 KM from local limits)
- Notification No. SO 10(E) dt 6/1/1994 as amended by Notification No. SO 1302 dt 28/12/1999



# Agricultural land

- Rural agricultural land not a capital asset u/s 2(14)
- Compulsory acquisition not liable to tax u/s 10(37)
- Exemption of capital gains from sale of land in case other agricultural land purchased within 2 yrs

# Agricultural land

## Section 10(37)

- Compulsory acquisition under any law **or**
- The consideration for transfer is determined/ approved by C.Govt./ RBI
- Agricultural land belongs to Indvl/ HUF
- Land used for agriculture for the past 2 yrs by the assessee or his parents
- Consideration / compensation is received on or after 1/4/2004
- Asset may be short term or long term capital asset

# Exemption of capital gains on land used for Agricultural purposes

## Section 54B

1. Land used for agricultural purposes for the last 2 years by assessee or his parents.
2. Land purchased for agricultural purposes within a period of 2 years from transfer.
3. Capital gains to the extent utilized for the new asset exempt.
4. New asset not to be transferred for a period of 3 years
5. In case transferred cost of acquisition to be after adjusting capital gains exemption availed
6. Unutilized amount to be deposited in the capital gains scheme a/c

# Issues

## Section 54B

- Exemption only to individual
- The asset may be short term or long term
- Land may be in urban area

# Shares

- Whether business income or capital gains
- Period of holding
- Exemptions
- Rates of taxes
- Special provisions



# Circular No.4/ 2007

- Associated Industrial Development Company 82 ITR 586 (SC)

Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the shares and it should, in normal circumstances, be in a position to produce evidence from its records as to whether it has maintained any distinction between those shares which are its stock-in-trade and those which are held by way of investment.

- H.Holck Larsen 160 ITR 67 (SC)
- Fidelity Northstar Fund and Others  
288 ITR 641 (AAR)

# Authority for Advanced Rulings

- Fidelity Northstar Fund and Others  
288 ITR 641 (AAR)
- 3 principles:
  - How shares valued/ held in the books
  - Magnitude, etc; finding ratio between purchase & sales
  - Intention to derive income by way of dividends

# Supreme Court

- G.Venkataswamy Naidu & Co v. CIT (1959) 35 ITR 594 (SC)

Criteria to ascertain nature of income:

- Purchase/Sale allied to or incidental to his usual trade.
- Nature & quantity of purchase and sales
- Repetition of the transaction
- Test of intention;-only for resale
  - no intentions for holding the property for himself or enjoying or using it.
- Total effect of all the relevant factors & circumstances

# Draft Instructions dt 16/5/2006

- Whether the purchase and sale of securities was allied to his usual trade or business/was incidental to it or was an occasional independent activity.
- Whether the purchase is solely with the intention of resale at a profit or for long term appreciation and/or for earning dividends and interest.
- Whether scale of activity is substantial.
- Whether transactions were entered into continuously and regularly during the assessment year.
- Whether purchases are made out of own funds or borrowings.
- The stated objects in the Memorandum and Articles of Association in the case of a corporate assessee.
- Typical holding period for securities bought and sold.

# Draft Instructions dt 16/5/2006

- Ratio of sales to purchases and holding.
- The time devoted to the activity and the extent to which it is the means of livelihood.
- The characterization of securities in the books of account and in the balance sheet as stock in trade or investments.
- Whether the securities purchased or sold are listed or unlisted.
- Whether investment is in sister/related concerns or independent companies.
- Whether transaction is by promoters of the company.
- Total number of stocks dealt in.
- Whether money has been paid or received or whether these are only book entries.



# Principle of Consistency

- Janak S. Rangamala v. ACIT  
(2007) 11 SOT 627 (Mum)
  - Magnitude of transactions alone not relevant
  - Determination on the basis of books of accounts
  - Intention to be the decisive factor
  - Unless material change; principle of consistency to be applied
- Tribunal cannot give different decisions for different years  
Arihant Builders & Developers 277 ITR 239 (MP)
- Revenue did not challenge decisions in earlier years  
CIT v. Vikas Chemicals (India) 196 CTR 12 (P&H)

# Final outcome

- Circular does not come up with any thing substantial except a categorical assertion that a taxpayer can have two portfolios  
**CIT v. NSS Investment 158 Taxman 13 (Mad)**
- Intention and the treatment in accounts are two important factors for determining the nature of income
- Principle of consistency
- No single criterion is decisive, total effect of the facts and circumstances of each case to be considered to determine the nature of income.

# Long term capital asset

- Held for more than 12 months in the case of:
  - Shares held in a company
  - Securities listed in a recognised stock exchange in India
  - Units of UTI
  - Units of a mutual fund specified u/s 10(23D)
  - Zero coupon bonds
- Period to be considered from date of allotment for:
  - Shares
  - Rights issue
  - Bonus shares
- For right to subscribe from the date of offer

# Equity shares

## Section 10 (36)

- BSE 500 index
- Shares acquired between 1-3-2003 & 29-2-2004
- Transferred after 12 months through a recognised stock exchange
- Capital gains not chargeable to tax
- Exemption has become redundant after introduction of section 10 (38)

# Equity shares

- Long term capital gains arising from:
  - Equity shares in a company
  - Units of an equity oriented fund
- Exempt from tax u/s 10(38), provided transaction of sale is entered into after the date of application of chapter VII. (1-10-2004)
- STT has been paid on the said transaction
- Exemption available to all assessee
- Long term capital asset
- Similar conditions for short term capital assets for reduced rate of tax of 10% u/s 111A



# Capital gains exempt from tax

- Capital gains not chargeable to tax by virtue of section 10 of the Act. In case assets are transferred at a loss?

*CIT v. S.S. Thiagarjan 129 ITR 115 (Mad.)*

*Ramjilal Rais v. CIT 58 ITR 181 (All.)*

# Rate of tax on LTCG

## Section 112

- Tax @ 20%
- Proviso for tax to be restricted to 10% without indexation benefit in case of listed securities, etc
- Unutilised exemption limit can be availed
- No deduction under Chapter VIA
- No rebate u/s 88
- Rebate u/s 88B & 88C are allowed from the tax

# Tax on short term capital gains from shares, etc

## Section 111A

- Tax @ 10% on short term capital gains of:
  - Equity shares
  - Units of an equity oriented funds
- Reduced rate only in case STT paid on the trf of such shares
- Unutilised basic exemption limit can be availed
- No deduction under Chapter VIA
- No rebate u/s 88
- Rebate u/s 88B & 88C are allowed from the tax

# Special provisions

- Cost of acquisition of shares:
  - Rights issue
  - Bonus shares
  - Rights renounced
- Provisions to curb tax avoidance
  - Securities sold and then repurchased
  - Beneficial interest transferred during the yr
  - Loss not allowed in dividend stripping cases
  - Loss not allowed to be set off in case of bonus shares cases.
- Whether business or capital gains

# Implication

- 1000 Shares purchased @ Rs 30 each for Rs 30,000/= in Feb, 2005.
- In April, 2006 company issues bonus shares in the ratio of 1:1
- In June, 2006 the entire 2000 shares are sold @ Rs 15 each for Rs 30,000
- Calculation of capital gain/ loss:
  - Long term capital loss : Rs 15,000/=
  - Short term capital gain : Rs 15,000/=



# Short term capital gains

- The assessee sells a plot of land for Rs 1.4 Cr which was acquired for Rs 1.0 Cr resulting in short term capital gains from sale of property Rs 40 lacs.
- 1 lac shares of Rs 10 each subscribed in a pvt ltd company at a premium of Rs 50 each
- The said pvt ltd company issues bonus shares 1:5
- Original 1 lac shares are now sold for Rs 10 each resulting in short term capital loss of Rs 50 lacs
- Whether gain of Rs 40 lacs above be offset against loss of Rs 50 lacs
- Ensure to be out of section 94(8)

*Thank you*

# **Exemption from capital gains from compulsory acquisition of land & building forming part of an industrial undertaking**

## **Section 54D**

1. Transfer by way of compulsory acquisition
2. Capital asset being land & building
3. For the last 2 years being used for the purposes of and forming part of industrial undertaking
4. Capital gains exempt if utilized for purchase of any other land or building or construction of building within 3 years.
5. For the purpose of shifting or re-establishing or setting up industrial undertaking.
6. Capital gains to be extent utilised for the new asset exempt.
7. New asset not to be transferred for a period of 3 years
8. In case transferred cost of acquisition to be after adjuring capital gains exemption availed
9. Unutilised amount to be deposited in the capital gains scheme A/c

# issues

## Section 54D

- All assessee
- Exemption even for short term capital assets
- Applicable only for compulsory acquisition
- New asset- land building for industrial purpose

# Taxability of goodwill/ tenancy rights

- Whether taxable if self generated?
- What is the cost of acquisition?
- *CIT v. B.C.Srinivasa Setty 128 ITR 294 (SC)*
- *Assessee did not incur any cost to acquire the rights and that if at all any cost has been incurred it was incapable of being ascertained. As capital gains cannot be calculated, the same was not exigible to tax.*
- Section 55(2) amended to define cost of acquisition of various intangible assets by Finance Act, 1994 and various other subsequent amendments



# Section 55(2)

- Cost of acquisition in relation to a capital asset being:
  - Goodwill
  - Trade mark/ brand name
  - Tenancy rights, etc
    - Acquired from outside: **Purchase price**
    - Self developed : **Nil**
- Capital asset became property of the assessee before 1-4-1981
  - Actual cost or FMV as on 1-4-1981
  - Option not available on depreciable assets
  - Bonus shares allotted prior to 1-4-1981

# What is Transfer

“transfer”, in relation to a capital asset, includes,-

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein; or
- (iii) the compulsory acquisition thereof under any law; or
- (iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or
- (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or
- (vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

# Transfer

- Conversion of preference shares into ordinary shares is a transaction of the nature of “exchange”  
*CIT v. Trustees of H.E.H. the Nizam Trust*  
*(1976) 102 ITR 248 (AP)*
- Redemption of preference shares by the company comes under relinquishment of asset.  
*Anarkali Sarabhai v. CIT 90 Taxman 509 (SC)*
- Reduction of share capital is chargeable in the hands of shareholders.  
*Kartikeya V. Sarabhai v. CIT 94 Taxman 164 (SC)*  
*CIT v. G. Narsimhan (1999) 102 Taxman 66 (SC)*

# Capital Gains

- Tenancy rights  
*A. Gasper v. CIT (1979) 117 ITR 581 (Cal.)*
- Advance paid for purchase of property, compensation received on cancellation.  
*K.R. Srinath v. CIT (2002) 80 ITD 193 (Mad.)*
- Amount paid as earnest money subsequently right surrendered in a tripartite agreement. Held to be capital gains  
*CIT v. Tata Services Ltd 122 ITR 594 (Bom.)*
- Realignment of interest in property by effecting family arrangements.  
*CIT v. Al. Ramanathan (2000) 245 ITR 494 (Mad.)*



# Transactions not regarded as transfer

## Section 47

- (i) total or partial partition of HUF
  - (iii) Gift, will or an irrecoverable trust  
except - ESOP
  - (iv) transfer to a subsidiary company
    - whole of the share capital
    - subsidiary company to be Indian company
  - (v) transfer to a holding company
    - wholly held share capital
    - Holding company is a Indian company
    - clause (iv) & (v) not applicable to
- Provisio -> transfer of capital asset after 29/2/1998  
-> as stock in trade



## Transactions not regarded as transfer

- (vi) Amalgamating company to amalgamated company
  - Amalgamated company is an Indian company
- (via) Transfer of shares in a Indian company in a scheme of amalgamation of foreign companies
  - at least 25% of share holding of amalgamated foreign company renew share holders of amalgamated foreign company.
  - transfer does not attract tax on capital gains in the country of incorporation of amalgamating company.

# Transactions not regarded as transfer

- (vib) Demerger -> resulting company is an Indian company
- (vic) transfer of shares in a Indian company in a scheme of demerger where demerged & resulting companies are foreign companies.
  - 1/3<sup>rd</sup> share holding of demerged foreign company are shareholders in the resulting foreign company.
  - No tax on capital gains in the country of incorporation of demerged company.
- (vid) Issue of shares by the resulting company to the share holders of demerged company in a scheme of demerger.
- (vii) Transfer of shares by a shareholder in a scheme of amalgamation
  - consideration -> shares in amalgamated company
  - the amalgamated company is an Indian company

# Transactions not regarded as transfer

- (vii) Bonds or shares referred to in section 115AC(1) made outside India by a NRI to another NRI.
- (viii) Transfer of agricultural land in India before 1/3/1970.
- (ix) Transfer of work of art, archaeological, scientific or other collection book, drawing, painting, photograph, etc. to Government, National Museum, etc.
- (x) Conversion of bonds/ debentures into shares
- (xi) Membership of recognised stock exchange to company before 31/12/1998.
- (xii) Land of sick industrial company being managed by its workers co-operative -> conditions.

# Transactions not regarded as transfer

(xiii) Firm succeeded by a a company

- all business assets & liabilities of the firm immediately before the succession become the assets & liabilities of the company.
- all partners of the firm immediately before the succession become shareholders in the same proportion.
- No other consideration & benefit to the firm or partners except allotment of shares.
- Aggregate shareholding of erstwhile partners is not less than 50% of the total voting power which should continue for a period of 5 years from the date of succession.
- Capitalization of recognised stock exchange is as approved by SEBI.



## Transactions not regarded as transfer

(xiv) Sole proprietary concern succeeded by a company

- all the business assets & liabilities immediately before succession become assets & liabilities of the company.
- share holding of the sole proprietor is not less than → 50% of the total voting power for a period of 5 years.
- Sole proprietor does not receive any consideration & benefit except allotment of shares.

(xv) Any lending of securities per guidelines of SEBI



# Full value of consideration

## Received in instalments

- Compensation for compulsory acquisition taxable u/s 45 (5)
- Year of chargeability/ time limits for availing various exemptions ?
- Year of transfer

# Company in liquidation

## Section 46

- Distribution of assets by the company not regarded as transfer for the purpose of section 45
- Receipt of money or other assets by the shareholder as reduced by amount assessed as dividend u/s 2(22)(c) deemed to be full value of consideration

# Industrial undertaking shifting from urban area to rural area

## Section 54G

- Transfer of land, building, plant & machinery or any rights in building or land used for the purpose of business of industrial undertaking

# Industrial undertaking shifting from urban area to SEZ

Section 54 GA

# Capital asset

- Whether right to claim specific performance of an agreement is a capital asset ?
- Whether its relinquishment attracts capital gains tax
- **K.R. Srinath v. ACIT (2004) 268 ITR 436 (Mad.)**
- **Alternate view- Whether it is a personal right**



# Cost of Acquisition

## Section

- 55(2)(a) Goodwill, Trademark, Brand name, Tenancy right, etc.
- 55(2)(aa) Bonus/rights issue
- 55(2)(ab) Shares in lieu of membership of a recognised stock exchange.
- 55(2)(b)
  - (i) Asset acquired prior to 01.04.1981
  - (ii) Asset acquired by the previous owner prior to 01.04.1981, becoming property of the assessee by mode specified u/s 49(1)
  - (iii) Distribution of Capital Asset by the Company on its liquidation.
  - (v) consolidation/Conversion/Division of Share Capital.
- 55(3) FMV on the date of acquisition, if cost to the previous owner cannot be ascertained.

# Cost of acquisition

## Section 55 (2)(a)

- Goodwill of the business
- trade mark or a brand name
- right to manufacture, produce or process any article or thing
- tenancy right
- stage carriage permit
  - (i) if purchased -> Purchase price
  - (ii) otherwise -> Nil

# Cost of acquisition

## Section 55(2)(aa) : Bonus/Rights Issue

By virtue of holding a capital assets

- (A) Subscription to financial asset
  - (B) Addl financial asset without any payment
- 
- (i) Original financial asset -> Actual Cost
  - (ii) Right renounced -> Nil
  - (iii) Cost of Right -> Amount Paid
  - (iv) Bonus Shares -> Nil
  - (v) Cost to the renouncee -> Total Amount Paid

# Cost of acquisition

## Section 55(2)(ab)

Cost of acquisition of original membership of stock exchange to be the cost of share allotted under scheme of corporatisation.

# FMV as on 01.04.1981

## Section 55(2)(b)

- (i) Capital Asset acquired prior to 01.04.1981 FMV as on 01.04.1981 may at the option of assessee be deemed to be Cost of Acquisition.
- (ii) Asset becoming property of the assessee by any of the modes specified u/s 49(1) and the previous owner acquired the Capital Asset prior to 01.04.1981. Assessee has option to replace FMV as on 01.04.1981 in place of cost to the previous owner.



# Cost of improvement

## Section 55(1)(b)

- (1) Goodwill or right to manufacture, produce or process any article - Nil
- (2) Other capital asset
  - (i) capital asset before 1/4/1981
  - (ii) any other case

# Cost with reference to certain modes of acquisition

## Section 49 (1)

Cost of acquisition to be  
Cost + Cost of improvement  
to the previous owner.

- (i) Total or partial partition of HUF.
- (ii) Gift or will.
- (iii) (a) by succession, inheritance or devolution  
(b) distribution of assets by firm (upto 1/4/87 )  
(c) distribution of assets on liquidation of company.  
(d) transfer to a trust.  
(e) transfer referred to in clause (iv) to (via) of  
section 47.
- (iv) In the case of an HUF by mode referred to in  
section 64(2) at any time after 31/12/1969.

# Distribution of assets by company in liquidation

## Section 46

1.
  - Assets distributed by the company
  - At the time of liquidation
  - To the shareholders of the company
  
2.
  - Money or Market Value of Assets
  - Less dividend u/s 2(22)(c)
  - Resultant full value of consideration for the purpose of section 48.

2(22)(c) Accumulated profits

# Slump Sale

## Section 50B

- Sales of one or more undertaking or unit
- Owning & holding undertaking to ascertain short/ long term gains
- Net worth of the division to be cost of acquisition/ improvement
- No indexation for long term capital asset.
- Depreciable assets-WDV; otherwise book values
- Revaluation to be ignored

# Section 53 of the Transfer of Property Act



# Buy back of shares

- Capital gains chargeable to tax u/s 46A