PHD & Associates
Chartered Accountants

2 February 2012

ITAT Mumbai rules compensation received by flat owner on redevelopment of housing society is not taxable

Executive Summary

This tax alert summarizes the recent significant ruling of the Mumbai ITAT 'A' Bench (ITAT) in the case of **Kushal Bangia** (the Taxpayer)[1], on an issue whether additional cash compensation received by the Taxpayer consequent to redevelopment of residential building in which he occupied a dwelling unit (flat) is liable to tax.

The Taxpayer, an individual, was a member of a housing society. The Taxpayer received from developer an additional compensation of Rs. 11,75,000 apart from an additional area of 173 sq. feet and displacement compensation @ Rs. 34,000 per month during the period of construction of the new building in the place of the demolished building of the society. The Assessing Officer (AO) brought to tax the additional cash compensation of Rs. 11,75,000 and the estimated value of 173 sq. feet area received by the Taxpayer. On an appeal to the first appellate authority, the income addition on account of estimated value of the additional area was deleted but the income addition in respect of cash compensation amount was sustained. The Taxpayer appealed before the Hon'ble Mumbai ITAT which held that the said cash compensation of Rs. 11,75,000 was a capital receipt not liable to tax.

[1] I.T.A. No. 2349/Mum/2011 (AY 2007-08)

Background

- The housing society and its members entered into an agreement with a developer to reconstruct a new building demolishing the old one owned by the society, utilizing the FSI arising out of the property and by utilizing Transferable Development Rights (TDR) to be procured by the developer at his cost with cooperation from the society and members
- Under the said agreement the Taxpayer received cash compensation of Rs. 11,75,000 being compensation received upon redevelopment of the residential building in which he occupied dwelling unit (flat), apart from a flat with an additional area of 173 sq. feet and displacement compensation @ Rs. 34,000 per month during the period of construction of the new building
- The AO assessed the cash compensation amount as a 'casual income' under the head 'Income from other sources'. Similarly, he also brought to tax the estimated value of the additional area which the Taxpayer was entitled to in the new flat

- The first appellate authority upheld the order of the AO so far as cash compensation was concerned and deleted the additions on account of estimated value of the additional area of the new flat
- Aggrieved by the appellate order, the Taxpayer appealed to the ITAT. However, Revenue did not contest the appellate order that deleted the income additions on account of the estimated value of the additional area of the flat which accrued in favour of the Taxpayer

Tax Authority's contentions

- The cash compensation received by the Taxpayer is his share in profits earned by the developer which are essentially revenue in nature

Taxpayer's contentions

- The receipt, being cash compensation relatable to capital asset (residential flat) is a capital receipt not chargeable to tax in the absence of any specific charging provision in the Income Tax Act (IT Act)

ITAT ruling

- Any capital receipt is not an income chargeable to tax unless it is in the nature of a capital gain chargeable to tax under section 45 of the Act or it is otherwise brought within ambit of taxation by a specific provision of the Act
- Thus, a capital receipt simplicitor, is not liable to tax as such
- Though the phrase 'Income' is wide in its connotation, it cannot obliterate the distinction between capital and revenue receipt
- To test the type of a receipt, its nature in the hands of the recipient is of relevance. The character of the payment in the hands of the payer is not determinative of its nature in the hands of the recipient
- The burden of proving that a receipt is of revenue nature is on the Revenue and once it is established that it is of revenue in character, the burden is on the assessee to establish whether it comes under exemption or not
- Residential flat being a capital asset in the hands of the Taxpayer, the compensation received thereof is a capital receipt
- As agreed by the Taxpayer, the receipt under consideration has the effect of reducing the cost of the flat and hence, the same needs to be taken into account when the occasion for computation of capital gain would arise in future upon sale or transfer of the flat

Our comments

- This ITAT ruling brings clarity on the taxation aspect of the cash compensation received by the flat owners of residential housing societies which goes for redevelopment through developers
- In our view, though the compensation is a capital receipt not liable to tax in the hands of the flat owner, this ruling will not affect deduction of the expenditure in the hands of the developer who is otherwise eligible to claim deduction for the same
- It is pertinent to note that Revenue opted for not challenging the first appellate authority's order to the effect that the estimated value of additional area entitlement in the new flat to the Taxpayer is not a taxable income. It is

not clear from the ruling as to the grounds on which the first appellate authority gave relief to the Taxpayer

- It is also pertinent to note that at the assessment level itself, and rightly so, the displacement compensation during the period of construction of the new building was not considered as taxable income
- The Mumbai ITAT has consistently ruled in past that the co-operative housing society is not liable to tax on account of consideration received from developer when additional FSI through TDR instrument are loaded on the existing or redeveloped building. In one of the recent rulings of Mumbai ITAT in the case of Hemandas J. Pariyani (unreported), it was held that a member of the society is also not liable to tax in respect of the consideration received from the developer directly or through society, consequent upon permission given to the developer to procure TDR and construct additional space or reconstruct the building with additional space
- However, it must be noted that in all the favourable rulings, the underlying fact has been that the original buildings were constructed at the time when Development Control Regulations (DCR) did not contain the concept of TDR (which was introduced in DCR in the year 1991) and the rulings are based on the legal concept that the entitlement of additional FSI by the instrument of TDR had no cost to the society or to the members and therefore, following the principles laid down by the Supreme Court in the case of B. C. Shrinivasa Shetty[2], the consideration received on transfer of such entitlement in favour of the developer does not result into taxable capital gains.

It would be advisable to exercise due care while applying the rulings in the case of redevelopment/ reconstruction of a building which came into existence post amendment to DCR permitting the use of TDR instruments

[2] 128 ITR 294 where the court laid down that capital gain is not chargeable to tax when the capital asset has no cost.

This space is intentionally left blank

PHD
The brains you can trust

Disclaimer

This alert has been prepared for general information to our clients; it may not deal with the subject comprehensively. The application of any law stated herein may need evaluation in specific cases under a professional advice. We accept no responsibility for any action taken or inaction, by recipient of this alert.

© **PHD** & Associates - 2012

At your Service

For any clarification or elucidation in respect of this alert, you may kindly connect to our Direct Tax Team.

We are reachable at:

PHD & Associates
Chartered Accountants
Radha Chambers, Level 3,
Telli Park Lane, Andheri East,
Mumbai - 400 069. India.
Tel : +91 22 26820083
Fax : +91 22 26830824