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SALIENT FEATURES OF FINANCE BILL, 2017 (AS AMENDED AND PASSED BY THE LOK SABHA ON 22ND MARCH, 2017) DIRECTLY CONCERNING THE REAL ESTATE SECTOR INCLUDING RETROSPECTIVE AMENDMENTS EFFECTIVE FROM THE FINANCIAL YEAR 2016-2017

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**Our Supplement on The Real Estate (Regulation and Development) Act, 2016 and rules framed thereunder to follow.*

SALIENT FEATURES OF FINANCE BILL, 2017 (AS AMENDED AND PASSED BY THE LOK SABHA ON 22ND MARCH, 2017) DIRECTLY CONCERNING THE REAL ESTATE SECTOR

I N D E X

SALIENT FEATURES OF FINANCE BILL, 2017 DIRECTLY CONCERNING THE REAL ESTATE SECTOR AS AMENDED AND PASSED BY THE LOK SABHA ON 22ND MARCH, 2017

I. INTRODUCTION

In line with the expectations, and as a logical consequence to the demonetization exercise, the Union Budget 2017-18 has announced significant incentives for the real estate sector by making major policy announcements, such as according infrastructure status to the affordable housing projects, providing thrust to infrastructure and abolition of Foreign Investment Promotion Board, etc.

Granting of infrastructure status to affordable housing could be a major boost for the real estate developers, since SEBI registered Foreign Venture Capital Investors ("**FVCI**") may now be permitted to invest in companies engaged in affordable housing. However, it would be challenging to implement this considering that most of developers who would be engaged in affordable housing may also be engaged in development of non-affordable housing projects. With the grant of infrastructure status to affordable housing, the developers will have access to cheaper funding by way of debt which would result in reduction of overall cost of homes to the buyer. Furthermore, this would see a likely increase in participation from domestic and foreign players in the affordable housing sector. Whilst significant incentives were announced to the real estate sector, some of the proposed amendments, such as the introduction of thin capitalization norms, are likely to severely impact the interests of foreign private equity investors in the real estate sector.

The Pradhan Mantri Awas Yojana ("**PMAY**"), the central government's flagship programme for providing affordable housing to the poor vis-à-vis Lower Income Group ("**LIG**") and Economically Weaker Section ("**EWS**"), announced by the Prime Minister Mr. Narendra Modi in 2015, primarily aims to ensure that 2 crore houses are built across nation's length and breadth by the year 2022 which means that these 2 crore homes will have to be constructed over a period of 7 years. Under the PMAY, a subsidy is granted to people from LIG and EWS segments of urban population from the Central Government treasury, ranging anywhere between Rs.1 lakh to Rs.2.50 lakhs. Further, the government also offers a subsidized interest rate on loans availed under PMAY at the rate of 6.5% up to a loan amount of Rs. 6 lakhs. This interest subsidy will last for a period of 15 years from the date on which the loan is disbursed to the borrower. The Union Budget 2017-18 has proposed to increase the allocation under PMAY to Rs.29,043 crores from Rs.20,075 crores in the previous year. All these measures taken by the government is expected to increase the market for affordable housing.

The Goods and Services Tax ("GST") Council has arrived at a consensus on key GST issues and the IT preparedness for the GST roll out is also on schedule. The GST is likely to be rolled out from 1st July 2017.

The Finance Bill, 2017 was introduced by the Finance Minister in the Lok Sabha on 1st February, 2017. On 20th March, 2017, the amendments to the Finance Bill have been tabled in the Lok Sabha by notice of amendments. The amended Finance Bill, 2017 has been passed by the Lok Sabha on 22nd March, 2017.

The Finance Bill, 2017 as amended and passed by the Lok Sabha on 22nd March, 2017 ("**Finance Bill**") has proposed several changes with far reaching consequences in respect of the taxation of transactions in immovable properties as compared to other transactions.

Analysis of the proposed amendments made to the Income Tax and Service Tax provisions by the Finance Bill pertaining to the real estate sector and its potential impact are as under :

II. INCOME TAX

Unless otherwise specifically mentioned, the amendments are effective from A. Y. 2018-19 and are therefore applicable with respect to income arising on or after 1st April, 2017. Specific mention is made at the relevant places, when the effective date of the amendment is other than 1st April, 2017. Any reference to the sections, unless otherwise stated, is to the sections of the Income Tax Act, 1961 ("**Act**").

1. IMPORTANT CHANGES TO TAX RATES FOR THE F. Y. 2017-2018 (A.Y. 2018-2019)

With respect to rates of tax, the following changes have been made in the Act :

(a) No Changes in maximum rate of 35.535% and education cess of 3%.

(b) Surcharge @10% is introduced where total taxable income of an individual and HUFs exceeds Rs. 50,00,000/- but does not exceed Rs. 1,00,00,000/-.

(c) Surcharge @ 15% continues where total taxable income of an individual and HUFs exceeds Rs. 1,00,00,000/-.

Earlier, rebate for resident individuals having income less than Rs. 5,00,000/- was Rs. 5,000/- which is proposed to be reduced to Rs. 2,500/- only for individuals whose taxable income is less than Rs. 3,50,000/- to bring it in line with reduced tax rate.

The income tax rates (inclusive of Surcharge, Education Cess and Secondary and Higher Secondary Education Cess) and TDS Rates for the F. Y. 2017-18 is tabulated hereunder for ready reference. These income tax rates are applicable on income earned during the period from 1st April, 2017 to 31st March, 2018.

1.1 EFFECTIVE TAX RATES FOR INDIVIDUALS AND HUFs (INCLUSIVE OF SURCHARGE AND EDUCATION CESS AND SECONDARY AND HIGHER EDUCATION CESS)

Particulars	Tax Rates for F. Y. 2017-18		
	Resident Very Senior Citizens of age 80 Years & above	**Resident Senior Citizens of 60 Years & above but below age of 80 years**	**Resident Men & Women below 60 Years & Non Residents (Men & Women)/ HUF**
Total Income			
Up to Rs. 2,50,000	Nil	Nil	Nil
Rs.2,50,001 – 3,00,000	Nil	Nil	5.15%
Rs.3,00,001 – 5,00,000	Nil	5.15%	5.15%
Rs.5,00,001 – 10,00,000	20.60%	20.60%	20.60%
Rs.10,00,001 – 50,00,000	30.90%	30.90%	30.90%
Rs.50,00,001- 1,00,00,000	33.99%	33.99%	33.99%
Above Rs.1,00,00,000	35.535%	35.535%	35.535%

1.2 NORMAL TAX RATES FOR OTHER ASSESSEES (INCLUSIVE OF SURCHARGE, EDUCATION CESS AND SECONDARY AND HIGHER EDUCATION CESS)

Particulars	Threshold Limit for Surcharge	F. Y. 2017-18		
		Tax Rate without Surcharge	Tax Rate with Surcharge	Rate of Surcharge
Partnership Firm	Rs.1 Crore	30.90%	34.608%	12%
Limited Liability Partnership	Rs.1 Crore	30.90%	34.608%	12%
Domestic Companies (where the total turnover or the gross receipts in F. Y. 2015-16 does not exceed Rs.50 Crores)	Rs.1 Crore	25.75%		Nil
	Rs.1 Crore to Rs.10 Crores		27.5525%	7%
	Rs.10 Crores		28.84%	12%
Other Domestic Companies	Rs.1 Crore	30.90%		Nil
	Rs.1 Crore to Rs.10 Crores		33.063%	7%
	Rs.10 Crores		34.608%	12%
Domestic Companies engaged in manufacture/ production of any article/ thing and set up and registered after March 31, 2016	Rs.1 Crore	25.75%		Nil
	Rs.1 Crore to Rs.10 Crores		27.5525%	7%
	Rs.10 Crores		28.84%	12%
Foreign Companies	Rs.1 Crore	41.20%		Nil
	Rs.1 Crore to Rs.10 Crores		42.024%	2%
	Rs.10 Crores		43.26%	5%
Local Authority	Rs.1 Crore	30.90%		Nil
	Rs.1 Crore		34.608%	2%
Co-operative Society				
Up to Rs.10,000		10.30%		Nil
Rs.10,001 - 20,000		20.60%		Nil
Rs.20,000 - 1,00,00,000/-		30.90%		Nil
Rs.1,00,00,001/- and above			34.608%	12%
Tax on profits distributed by Indian Companies				
(A) Dividend Distribution Tax in respect of dividend declared, distributed or paid by Domestic Companies during the F. Y. 2017-2018			20.358%	12%
(B) Buyback of shares by unlisted Domestic Companies during the F. Y. 2017-2018			23.072%	12%

1.3 AMT RATES FOR NON CORPORATE ASSESSEES AND MAT RATES FOR DOMESTIC COMPANIES AND FOREIGN COMPANIES (INCLUSIVE OF SURCHARGE, EDUCATION CESS AND SECONDARY AND HIGHER EDUCATION CESS)

Particulars	Threshold Limit for Surcharge	F. Y. 2017-18		
		Tax Rate without Surcharge	Tax Rate with Surcharge	Rate of Surcharge
Partnership Firm - Alternate Minimum Tax	Rs.1 Crore	19.05%	21.34%	12%
Limited Liability Partnership – Alternate Minimum Tax	Rs.1 Crore	19.05%	21.34%	12%
Co-operative Society – Alternate Minimum Tax	Rs.1 Crore	19.05%	21.34%	12%
Individuals and HUFs – Alternate Minimum Tax	Rs.50 Lakhs	19.055%		Nil
	Rs.50 Lakhs to Rs.1 Crore		20.96%	10%
	Rs.1 Crore		21.91%	15%
Domestic Companies - Minimum Alternative Tax (MAT)	Rs.1 Crore	19.05%		Nil
	Rs.1 Crore to Rs.10 Crores		20.39%	7%
	Rs.10 Crores		21.34%	12%
Foreign Companies - Minimum Alternative Tax (MAT)	Rs.1 Crore	19.05%		Nil
	Rs.1 Crore to Rs.10 Crores		19.44%	2%
	Rs.10 Crores		20.01%	5%

1.4 TAX ON CAPITAL GAINS (INCLUSIVE OF SURCHARGE, EDUCATION CESS AND SECONDARY AND HIGHER EDUCATION CESS) - SECTIONS 10(38), 111A & 112

Category of Assessee	Long Term Capital Gains			Short Term Capital Gains	
	On all Assets (other than listed securities)	On securities listed on Recognised Stock Exchange		On all Assets (including listed securities where STT is not paid)	On securities listed on Recognised Stock Exchange where STT is paid
		If STT is paid	If STT is not paid		
Resident Individuals/ HUFs having taxable income up to Rs.2.50 lakhs	Nil	Nil	Nil	Nil	Nil

Category of Assessee	Long Term Capital Gains			Short Term Capital Gains	
	On all Assets (other than listed securities)	On securities listed on Recognised Stock Exchange		On all Assets (including listed securities where STT is not paid)	On securities listed on Recognised Stock Exchange where STT is paid
		If STT is paid	If STT is not paid		
Individuals & HUFs having taxable income exceeding Rs.2.50 lakhs	20.60% / £ 22.66%/ * 23.69%	Nil	10.30%/ £ 11.33%/ *11.845% without Indexation or 20.60%/ £ 22.66%/ *23.69% with Indexation	Slab Rates Max – 30.90%/ £ 33.99% / * 35.535%	15.45%/ £16.995%/ * 17.7675%
Partnership Firms/ LLPs	20.60%/ * 23.07%	Nil	10.30%/ *11.54% without Indexation or 20.60%/ *23.07% with Indexation	30.90% / * 34.608%	15.45% / * 17.304%
Companies	20.60%/ # 22.04%/ @ 23.07%	**19.055%/ 20.39%/ 21.34% ($ - MAT)**	10.30%/ #11.02%/ @11.54% without Indexation or 20.60%/ #22.04%/ @23.07% with Indexation	30.90%/ # 33.06%/ @ 34.61%	15.45%/ # 16.53% @ 17.30%
Co-operative Societies	20.60% / * 23.07%	Nil	20.60%/ * 23.07%	30.90% / * 34.61%	15.45%/ * 17.30%

* ***Where the taxable income of assessees other than Companies exceeds Rs.1,00,00,000/-,then the surcharge applicable would be 15% in case of Individuals/ HUFs and the surcharge applicable would be 12% in case of Partnership Firm/ LLP/ Co-operative Society.***

£ ***Where the taxable income of Individuals/ HUFs exceeds Rs.50,00,000/- but does not exceed Rs.1,00,00,000/- the surcharge applicable would be @ 10% with effect from 1st April, 2017.***

 # Applicable rates where the taxable income of Company is between Rs. 1,00,00,001/- to Rs.10,00,00,000/- the surcharge applicable would be @ 7%.

@ Where the taxable income of Company exceeds Rs.10,00,00,000/- the surcharge applicable would be @ 12%.

$ Applicable rate of MAT to be paid on the Book Profits of the Company, determined in accordance with the provisions of Section 115JB. No surcharge if the book profit for the purpose of MAT is less than Rs.1,00,00,000/-. Surcharge applicable @ 7% if the book profit for the purpose of MAT profit is between Rs.1,00,00,001 to Rs.10,00,00,000/-. Surcharge applicable @ 12% if MAT profit exceeds Rs.10,00,00,000/-.

1.5 MAXIMUM MARGINAL RATES OF INCOME TAX (INCLUSIVE OF SURCHARGE, EDUCATION CESS AND HIGHER EDUCATION CESS)

Category of Assessee	Normal Income	Rental Income from House Property (post standard deduction of 30%)
Individuals & HUFs having taxable income exceeding Rs. 1 Crore	35.535%	24.8745%
AOPs / Joint Venture having taxable income exceeding Rs. 1 Crore	35.535%	24.8745%
Partnership Firms/LLPs having taxable income exceeding Rs. 1 Crore	34.608%	24.2256%
Domestic Companies having taxable income exceeding Rs. 10 Crores	34.608%	24.2256%
Co-operative Societies having taxable income exceeding Rs. 1 Crore	34.608%	24.2256%

1.6. RATES OF TDS APPLICABLE FOR THE PERIOD FROM 1ST APRIL, 2017 TO 31ST MARCH 2018 DEPENDING UPON THE CATEGORY OF RECIPIENT WITH RESPECT TO THE IMPORTANT PAYMENTS MADE BY THE BUILDERS / DEVELOPERS

		TDS Rates for different Categories of Recipient		
Main Section	**Nature of payment**	**Resident Individual / HUF/AOP**	**Resident Company**	**Resident Firm / LLP**
193	**Interest on Debenture issued by a Company** Basic exemption Rs. 5000/-, where the payee is a resident individual or HUF **Interest on listed Securities of a Company held in dematerialized form**	10% Nil	10% Nil	10% Nil
194A	**Interest other than interest on securities** i.e Interest on loans etc. (Basic Exemption - Rs.10,000/- where the payer is Banking Company, Co-op. Society engaged in the business of banking and Post Office and Basic Exemption – Rs. 5,000/- for all other payers)	10%	10%	10%
194C	**Payments to Contractors** **(1) In case of Contract/Sub-Contract** **(2) Contractor/Sub-Contractor in Transport Business** **(provided Transporter furnishes his PAN)** (Basic Exemption –Rs.30,000/- per Contract subject to over all limit, of Rs.1,00,000/- per annum per contractor)	1% Nil	2% Nil	2% Nil
194H	**Commission or Brokerage** (Basic Exemption –Rs. 15,000/-)	5%	5%	5%
194I	**<u>Rent to Residents</u>** **-Rent on Plant, Machinery and Equipments** (Basic Exemption-Rs.1,80,000/- per person) **-Rent for Land & Building or Furniture or Fittings** (Basic Exemption-Rs.1,80,000/- per person)	2% 10%	2% 10%	2% 10%

		TDS Rates for different Categories of Recipient		
Main Section	**Nature of payment**	**Resident Individual / HUF/AOP**	**Resident Company**	**Resident Firm / LLP**
194-IA	**Consideration for transfer of immovable property (other than agricultural land)** (Basic exemption - Rs.50 lakhs) Applies to person other than the person referred to in Section194LA	1%	1%	1%
194-IB	**Rent payable by Individuals/ HUFs (other than those covered u/s 44AB) for use of Land or Building in excess of Rs.50,000/- per month or part of the month (Refer amendment - Page 42 - 43)**	5%	5%	5%
194-IC	**Monetary consideration payable by Developer to the Land owner being Individual / HUF under a specified agreement (Joint Development Agreement) referred to in Section 45(5A) (Refer amendment - Page 10 - 14)**	10%	-	-
194J	**Fees for professional or technical services or payment towards Royalty or Non Compete Fees** (Basic Exemption - Rs. 30,000/- per person, per annum.)	10%	10%	10%
194J	**Remuneration (not in the nature of salary), fees or commission to Directors (w.e.f. 1st July, 2012)**	10%	-	-
194LA	**Payment of compensation/ consideration on compulsory acquisition of certain immovable property** (Basic Exemption - Rs. 2,50,000/-)	10%	10%	10%
195	**Payment of consideration exceeding Rs. 1 Crore by any transferee to a non resident transferor towards purchase of any immovable property situated in India :**	**Non-Resident / Non Corporate Person (including surcharge)**	**Foreign Company (including surcharge)**	
	For a period exceeding 3 years	23.69%	21.63%	
	For a period of less than 3 years	35.54%	43.26%	

Notes:

1. **Time of deduction of tax** :

Except in case of salary (wherein tax is to be deducted at the time of payment), tax is to be deducted at the time of payment or credit, whichever is earlier.

2. **Time of deposit of tax** :

All sums deducted shall be deposited with the government within 7 days from the end of the month in which the deduction is made. However, where the amount is credited or paid to the account of the payee in the month of March, the tax is required to be deposited with the government on or before 30 April.

3. **Mode of making payment of Tax** :

For payment of tax, Challan No. INS 281 is to be used. All companies and deductors who are liable to tax audit have to make payment of tax by electronic mode. Others can make payment of tax either physically or by electronic mode.

4. **TDS Return** :

Person deducting tax is required to file quarterly statements for the quarter ending on 30 June, 30 September, 31 December and 31 March in each financial year, in Form 26Q (Form 24Q for Salary) along with Form 27A, on or before 31 July, 31 October, 31 January, and 31 May respectively. Form 26Q and Form 24Q are to be filed electronically while Form 27A is to be filed in physical form.

5. **Certificate for tax deduction in case of non-salary payments** :

TDS Certificate in Form 16A is required to be issued on quarterly basis within 15 days from the due date of furnishing the statement of TDS i.e. on or before 15 August, 15 November, 15 February and 15 June for quarters ended 30 June, 30 September, 31 December and 31 March respectively.

6. **Certificate for tax deduction in case of salary payments** :

TDS Certificate in Form 16 is required to be issued on annual basis by 31 May of the financial year immediately following the financial year in which the income was paid and tax deducted.

7. **Higher TDS rate of 20% for not furnishing PAN** :

In case the payee is not able to furnish his / her / its PAN to the payer, tax shall be deducted w.e.f. 1st April, 2010 at higher of the rates specified in the relevant provisions of the Act or at the rates in force or 20%.

8. **Liability of Individual or HUF to deduct tax at source**

As such individuals or HUFs are not liable to deduct tax at source. However, in case of rent payable for use of land and building, consideration payable for transfer of an immovable property and Salary payments, even individuals or HUFs are liable to deduct tax at source under Section 194-IB, Section 194-IA and Section 192 respectively. However, an individual or HUF, who is liable to tax audit under Section 44AB during the financial year immediately preceding the financial year in which sum is credited or paid, shall be liable to deduct tax under Sections 194A, 194C, 194H, 194I and 194J, as the case may be.

9. **Consequence for delay in deposit of tax at source**

As per the provisions of Section 201(1A), an assessee shall be liable to pay interest @ 1% per month from the date the tax was deductible to the date on which tax is deducted and @ 1.5% per month from the date of tax deduction till the date of tax payment to the Government.

2. AMENDMENTS RELATED TO TRANSACTIONS IN IMMOVABLE PROPERTIES

2.1 Special provisions for computation of capital gains in case of Joint Development Agreement [Sections 45 (5A), 49 & 194-IC]

Background

(a) Under Section 2(47)(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 is deemed to be 'transfer' of a capital asset for the purpose of triggering the capital gains tax liability under Section 45.

(b) Due to the deeming fiction of Section 2(47)(v), in case of Joint Development Agreement ("**JDA**") under which the possession / part possession of the immovable property is handed over by the land owner to the Developer, Courts have held that where, as per the JDA, possession is also handed over to the developer, the immovable property would be deemed to be transferred as on the date of handing over of the possession, irrespective of whether the legal title over the immovable property has been transferred or not. Accordingly, the capital gains liability would arise irrespective of whether the land owner has realized / received any consideration or not. Accordingly, the capital gains tax liability arises on accrual basis even without the land owner getting any consideration upfront.

(c) This position has caused undue hardships to the land owners since they are required to pay capital gains tax even though no income is actually accrued or realized by them under the JDA.

Proposed Amendments

(a) Sub-section (5A) is proposed to be inserted in Section 45 to provide that capital gain arising on transfer of land or building or both, under a **specified agreement**, by an **Individual** or **Hindu Undivided Family** shall be chargeable to tax in the year in which the completion certificate has been issued for the whole or part of the project by the competent authority. It is also provided that, in such a case, stamp duty value of the assessee's share in the land or building or both, on the date of issue of completion certificate, as increased by consideration, if any, received in cash, shall be deemed to be full value of consideration.

'**Specified Agreement'** has been defined in Explanation (ii) to mean a registered agreement in which the owner of land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both, in such project, such share being with or without payment of part of the consideration in cash.

(b) However, in case the assessee transfers his share in the project on or before the date of issue of completion certificate, the provisions of this sub-section shall not apply and the capital gain shall be deemed to be income of the previous year in which such transfer takes place and the provisions of the Act (other than provisions of this sub-section) dealing with determination of full value of consideration shall apply. In other words, where the assessee transfers his share in the project before the date of issuance of the certificate of completion, then the benefit of Section 45(5A) will not be available to the assessee and in such as a case, the capital gains tax liability would arise in the year of transfer of the share itself.

(c) Consequently, Section 49 has also been amended to provide that for the purposes of computing capital gain arising to the assessee on transfer of his share after the date of issuance of the completion certificate, the amount deemed to be full value of consideration at the time of issuance of the completion certificate shall be regarded as cost of acquisition.

(d) Section 194-IC is proposed to be inserted to provide that monetary consideration payable to a resident under such a specified agreement shall be liable to deduction of tax at the rate of 10% of such monetary consideration.

These amendments will be effective from Assessment Year 2018-19 onwards.

<u>Comments</u>

(a) It is a welcome move by the government considering the genuine hardship faced by the land owners in paying tax in the year of transfer, irrespective of receipt of any monetary consideration in the year of transfer. However, the said relaxation has been provided to only individuals and HUF and is not extended to the corporate and other non-corporate entities such as LLPs, partnership firm, etc.

(b) Since the definition of specified agreement restricts its ambit to a joint development agreement, wherein the owner of land or building or both, is entitled to consideration by way of a share in land or building or both, in our view the revenue sharing model of joint development agreement may not be able to take the benefit of Section 45(5A) and normal provisions of taxation may apply to the same.

(c) In our view, the capital gains tax liability would accrue upon the land owner in the year in which the land owner transfers his entire share, right, title and interest in the project, before the date of issuance of the completion certificate **and not on sale of individual premises allocated to the land owner under the joint development arrangement, prior to the date of issuance of the completion certificate.**

(d) The benefit of this amendment would not be available to the land owner where the specified agreement is not registered with the concerned Sub-Registrar of Assurances.

(e) The proposed amendment *inter alia* provides that, in case of specified agreement, the capital gains tax liability would arise in the year in which the project is completed either partly or wholly and a certificate of completion is obtained in respect thereof from the competent authority. The stamp duty value of the land owner's share in the land or building or both, on the date of issuance of completion certificate, as increased by consideration, if any, received in cash, shall be deemed to be full value of consideration. **This provisions would seriously impact those land owners who would under the joint development arrangement intend to retain the constructed premises for personal use as they would be now required to pay tax on the market value of the constructed premises retained by them prevalent at the time of issuance of the completion certificate.**

(f) The amount which is deemed as full value of consideration chargeable to capital gains tax under Section 45(5A) would be regarded as the cost of acquisition of the share of the land owner in developed property. **Accordingly, the amount taxed as capital gains in the year of completion of the project would be allowed as deduction on subsequent transfer of the developed property by the land owner in proportion to the area sold.**

(g) Post receipt of the completion certificate from the competent authority for the project or any part thereof and payment of capital gains tax by the land owner in accordance with the provisions contained in Section 45(5A), if the land owner subsequently sells any premises, then the capital gains on sale of such premises will be chargeable to long term or short term capital gains tax depending upon the holding period of such premises. The holding period of such premises would be computed from the date of issuance of the completion certificate by the competent authority. **Nevertheless, the stamp duty value of such premises on which tax is paid by the land owner in the year of completion of project will be deemed to be the cost of acquisition of such premises and capital gains would be computed and paid accordingly.**

(h) The proposed amendment only overrides the provisions of sub-section (1) of Section 45 which provides that capital gains liability arises in the year of transfer. However, the definition of the term ‘transfer’ as envisaged in Section 2(47)(v) has not been amended so as to defer the tax liability of the land owner at the time of completion of the project.

(i) The provisions of Section 45(5A) would not have any impact on the tax liability arising from joint development arrangements entered into by individuals and HUFs where the immovable property is held by them as stock-in-trade.

(j) Although the monetary consideration payable to the resident land owner under the specified agreement is chargeable to tax at the time of completion of the project, the TDS on such monetary consideration is deductible at the time of credit or at the time of payment thereof, whichever is earlier. In the consequence, the issue would arise as to how will the land owner claim a credit of such TDS in the year of deduction, without there being any corresponding income offered to tax. Thus, there will be a mismatch vis-à-vis the year of deduction of tax at source and the year of taxability of the income in hands of the land owner.

2.2 Shifting base year from 1981 to 2001 for the purpose of computation of capital gains [Section 55]

Background

(a) Section 55 of the Act provides the meaning of terms “cost of any improvement” and “cost of acquisition” for the purpose of computation of income under the head ‘Capital Gains’.

(b) Presently, the cost of acquisition of a capital asset acquired before 1st April, 1981 is taken to be the fair market value of the capital asset as on 1st April, 1981 or the actual cost of acquisition, at the option of the assessee. Furthermore, the cost of improvement incurred by the assessee before 1st April, 1981 is not allowed as deduction for computing capital gains.

Proposed Amendments

(a) Section 55 is proposed to be amended with effect from A. Y. 2018-19 to provide that the cost of acquisition of the assets acquired before 1st April, 2001 shall be its fair market value as on 1st April, 2001 or the actual cost of acquisition, at the option of assessee. Furthermore, amendment is also proposed to provide that the cost of improvement incurred prior to 1st April, 2001 shall not be allowed as deduction while computing the capital gains. Consequently, the cost of improvement shall be restricted to capital expenses which are incurred on and after 1st April, 2001.

(b) Consequential amendment is also proposed in Explanation (iii) to Section 48 to provide that the base year for the purpose of computing the indexed cost of acquisition shall be the first year in which the asset was held by the assessee or the year beginning on 1st April, 2001, whichever is later.

These amendments will be effective from AY 2018-19 onwards.

Comments

(a) As the current base year (i.e. 1981-82) for computation of capital gains has become more than three decades old, and as computation of the capital gains in respect of a capital asset especially immovable property acquired before 1st April, 1981 becomes difficult due to non-availability of relevant information for computation of fair market value of such asset as on 1st April, 1981, it is proposed to shift the base year from 1st April, 1981 to 1st April, 2001.

(b) For determining the capital gain tax liability, the notified cost inflation index for the F.Y. 1981-82 is 100, for the F.Y. 2001-2002 is 426 and for the F.Y.2016-17 is 1125. Accordingly, if the immovable property held by an assessee as capital asset was acquired prior to 1st April, 2001, then the fair market value of such immovable property will be further increased by applying the multiplying factor of 2.64 (1125 / 426) to the fair market value of such immovable property.

The market value of the properties in Mumbai from 1981 to 2001 have appreciated by almost 10 times as can be evidenced from the fact that the market value of a flat at Malabar Hill, Cumballa Hill Division, which was Rs.1,000/- per sq. ft. in 1981 has arisen to Rs.10,000/- per sq. ft. in the year 2001. Thus if an apartment in Malabar Hill, acquired prior to 1st April, 1981 is now sold, then the indexed cost of acquisition for the purposes of computing capital gains would be Rs. 26,400/- per sq. ft. (Rs. 10,000/- per sq. ft. x 1125 / 426) as against Rs. 11,250/- per sq. ft. (Rs. 1,000/- per sq. ft. x 1125 / 100). In the premises, there will be substantial benefit to the assessee in terms of deduction of higher indexed cost of acquisition for the purposes of computing capital gains, as is evident from the above illustration, **wherein the indexed cost of acquisition is likely to be more than double.**

(c) Disputes may arise between the assessee and the tax department, where the actual fair market value of an immovable property is different from stamp duty ready reckoner value of such immovable property.

2.3 Holding period of immovable property being land or building or both held as capital assets [Section 2(42A)]

Background

Section 2(42A) defines a “short-term capital asset” to mean a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer.

Presently the third proviso thereto provides that in the case of a share of a company (not being a share listed in a recognised stock exchange in India) or in other words unlisted shares, the provisions of this clause shall have effect as if for the words “thirty-six months’, the words “twenty-four months” had been substituted.

Accordingly at present, an immovable property, being land or building or both is regarded as a long-term capital asset, where it is held for more than 36 months.

Proposed Amendment

The proviso to Section 2(42A) is proposed to be amended with effect from F. Y. 2017-18 to provide that, where the capital asset being land or building or both is held for a period of not more than 24 months, immediately preceding the date of transfer, then it shall be treated as short term capital asset. In the consequence, land or building or both held for a a period of more than 24 months immediately preceding the date of transfer will be regarded as long term capital asset.

Comments

(a) With the view to furthering investments in real estate, effective from 1st April, 2017, the holding period for capital gains arising from immovable property has been reduced from 36 months to 24 months. Further, the base year for indexation benefits has also been prescribed to be 1st April, 2001 from 1st April, 1981 earlier. These measures should allow for greater mobility of assets in the real estate sector and enhance liquidity for investments in the sector. The aforesaid proposals will significantly reduce the capital gains tax liability on both counts viz. the reduction of holding period and also shifting of base from 1981 to 2001. These amendments are proposed with a view to provide an incentive towards investment in immovable property and promote real estate sector and to compete with other financial instruments.

(b) With effect from 1st April, 2017, an immovable property, being land or building or both, held as a capital asset for a period of more than 24 months would be subjected to tax at the concessional rate of tax of 20% (plus applicable surcharge and cess).

(c) The proposed amendment would also apply to transfers of immovable properties being :

(i) Allotment rights in an under-constructed property;

(ii) Rights in an immovable property by virtue of holding shares in a co-operative society;

(iii) Transfer of shares having occupancy rights in a flat or an office premises;

(iv) Leasehold or tenancy rights in an immovable property; and

(v) Rights of a land owner under a development agreement.

This amendment will be effective from Assessment Year 2018-19 onwards.

2.4 Notional Income in respect of House Property held as Stock-in-Trade [Section 23(5)]

Background

(a) Section 22 of the Act is the charging section which provides that the annual value of property consisting of buildings or lands appurtenant thereto of which the assessee is the owner (other than the 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), would be chargeable to tax under the head 'Income from House Property'.

(b) Thus, the charging section for "Income from House Property" excludes from its ambit property occupied by an assessee for the purpose of business.

(c) Accordingly, there exists a view that the unsold premises which are held by a developer as stock-in-trade cannot be deemed to be let out and be subject to tax on notional rent. In this regard, attention is invited to the decision of the Gujarat High Court in the case of CIT Vs. Neha Builders (P.) Ltd., [2007] 296 ITR 661, wherein the High Court has held as under :

"*1f the business of the assessee is to construct the property and sell it or to construct and let out the same, then that would be 'business' and the business stocks, which may include movable and immovable, would be taken to be* *'stock-in-trade', and <u>any income derived from such stocks cannot be termed as 'income from property</u>"*

(d) However, the Delhi High Court in the case of CIT Vs. Ansal Housing and Construction, [2016] 389 ITR 373 and the Bombay High Court in the case of CIT v. Sane & Doshi Enterprises, 377 ITR 165, has taken a contrary view to the above decision of the Gujarat High Court and has held that the provisions of Sections 22 and 23 are applicable even to an assessee engaged in business of construction of house property, and therefore, are liable to pay tax on the annual letting value of the unsold premises as income from house property. The assessee, Ansal Housing, has filed a Special Leave Petition against the said decision of the Delhi High Court, which has already been accepted by the Hon'ble Supreme Court.

(e) To resolve the conflicting judicial decisions on the foregoing issue, the Finance Bill has proposed amendment to Section 23(5) of the Act.

<u>Proposed Amendment</u>

Section 23 has now been amended to provide that :

(i) where property consisting of buildings or lands appurtenant is held as stock-in-trade; and

(ii) such property or any part thereof is not let out during the whole or any part of the previous year,

then its annual value will be NIL for a period up to 1 year from the end of the financial year in which the completion certificate has been obtained from the Competent Authority. The term 'Competent Authority' is not defined for the purpose of this Section.

This amendment will be effective from Assessment Year 2018-19 onwards.

Comments

(a) This proposal of the government will have a far reaching impact on real estate developers who own and hold finished inventories as a stock in trade. There will be significant pressure on real estate developers to sell or lease out the finished inventories within the stipulated time period in order to avoid tax on the notional rental income without actually earning it. Correspondingly, it could result into rationalisation of the real estate prices and reduce unsold inventory levels.

(b) This proposal would also raise a fundamental question relating to characterisation of rental income as income from house property or income from business and profession in the hands of real estate developers. From literal interpretation of Section 23(5), it appears that after the period of 1 year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, the annual value of such property will become taxable in the hands of the Developer under the head 'Income from House Property' on notional basis or on actual basis, as the case may be.

(c) It may be noted that as per Section 24(a) of the Act, standard deduction equal to 30% of the annual value of the property is allowable as deduction in computing the income under the head 'Income from House Property'. This standard deduction would also be available while computing notional income from unsold inventory held as stock-in-trade and accordingly the effective tax rate on the **notional annual value of unsold inventory held as stock-in-trade would be about 24%.**

(d) The applicability of the proposed amendment to Section 23(5) is explained by way of an illustration hereunder:

No.	Particulars	Date
1.	Date of receipt of Completion Certificate from the Competent Authority	1st June 2016
2.	**Tax Free Period**	**Up to 31st March 2018**
3.	**Taxable Period**	**Begins from 1st April, 2018**

2.5 Restriction on set-off of loss from House Property against any other head of income to Rs.2,00,000/- [Section 71 (3A)]

Background

Presently, under Section 71 of the Act, inter-head set-off is allowed in a particular assessment year in respect of net loss under the head "Income from House Property" without any limit. Furthermore, under Section 71B of the Act any unabsorbed net losses under the head "Income from House Property" is allowed to be carried forward up to 8 assessment years, which can be set off only against income under the head 'Income from House Property'.

Proposed Amendments

(a) A new Section 71(3A) is proposed to be inserted in the Act with effect from A. Y. 2018-19 so as to limit the inter-head set off of losses under the head "Income from House Property' in a particular assessment year only to Rs.2 lakhs. Thus, losses under the head "Income from House Property' in excess of Rs.2 lakhs shall not be allowed to be set off against income chargeable under any other head of income.

(b) It may be noted that the proposed amendment applies only in respect of inter-head set-off of losses under the head "Income from House Property" and not to carry forward of the said loss to subsequent years for the purpose of set-off against the head 'Income from House Property' in subsequent years. Thus, the unabsorbed losses under the head 'Income from House Property' (i.e., losses in excess of Rs. 2 lakhs) can be carried forward and set off against the house property income for the 8 subsequent assessment years.

This amendment will be effective from Assessment year 2018-19 onwards.

Comments

(a) Under the existing provisions for computation of income under the head 'Income from House Property', interest payable on capital borrowed for the purpose of acquisition, construction, repair, renovation or reconstruction of the house property is allowed as deduction. There is no limit for deduction of such interest expense in case of a let out property or a deemed let out property.

However, in case of a self-occupied property, such deduction is restricted to maximum of Rs. 2 lakhs per year, per assessee.

(b) Since housing was also considered as an investment asset, a large population was acquiring multiple housing assets backed with the support of tax incentives on purchase of second house and thereafter. The Finance Bill provides that a loss under the head 'house property', in excess of Rs. 2,00,000/- can not be set off against income from any other head.

(c) This amendment will seriously impact the pre-leased market of commercial asset, where the investors used to invest in pre-leased assets, based on the existing and future rentals of such pre-leased assets. Impact also would be seen in transactions where the investors borrow funds on security of pre-lease assets to use the same to acquire another residential / commercial premises, for the purpose of letting it out.

(c) The foregoing amendment may have been proposed in order to bring parity between the losses allowable in case of self-occupied property vis-à-vis losses allowable in case of let out property / deemed let out property. However, the foregoing proposed amendment which restricts the set-off of loss under head 'Income from House Property' is inconsistent with policy of the government to incentivise housing sector.

(d) The impact of the proposed amendment as compared to the existing provisions is tabulated hereunder :

Particulars	**Existing Provisions**	**Proposed Provisions**
Rental Income	3,50,000	3,50,000
Less : Property Tax	(50,000)	(50,000)
	3,00,000	**3,00,000**
Less: Standard Deduction @ 30%	(90,000)	(90,000)
Less: Interest on House Property	(6,00,000)	(6,00,000)
Loss on House Property	**(3,90,000)**	**(3,90,000)**
Loss to be set off against income under any other head in same year	(3,90,000)	(2,00,000)
Amount to be carried forward and set off only against "Income from House property" (up to next 8 years)	Nil	(1,90,000)

2.6 Widening the scope of deemed gifts to all assessees besides individual and HUF [Section 56(2)(x) & 49]

Background

(a) Under the existing scope of section 56(2)(vii) of the Act, where an individual or a HUF receives any of the following, the same shall be taxable under the head "Income from Other Sources".

- any sum of money without consideration, exceeding Rs. 50,000/- in aggregate, the whole of the aggregate value shall be taxable.

- any immovable property without consideration, the stamp duty value of which exceeds Rs. 50,000/-, or for a consideration which is less than the stamp duty value of the property by an amount exceeding Rs. 50,000/-, the stamp duty value of such property as exceeds any consideration paid shall be taxable

- any property other than the immovable property without consideration, the aggregate fair market value of which exceeds Rs. 50,000/- or for a consideration which is less than the fair market value by an amount exceeding Rs. 50,000/-, the fair market value of such property as exceeds any consideration paid shall be taxable.

(b) Similarly, Section 56(2)(viia) of the Act provides that, where a firm or a company not being a company in which the public are substantially interested, receives any property being shares of company not being a company in which the public are substantially interested without consideration, the aggregate fair market value of which exceeds Rs. 50,000/- or for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50,000/- than the aggregate fair market value of such property as exceeds any consideration shall be taxable as Income from Other sources.

(c) Both the aforesaid sections have certain exemptions. Section 56(2)(vii) is currently applicable only to an individual and HUF whereas Section 56(2)(viia) is applicable only to a firm or a company which is not a company in which the public are substantially interested. Thus, if any other tax payer other than those mentioned above receive any property without consideration or for inadequate consideration than as per the current provisions the said entities are not taxable under the Act.

(d) Section 49(4) provides that the cost of acquisition of a capital asset, the value of which has been subject to tax under Section 56(2)(vii) and Section 56(2)(viia), shall be the value which has been taken into account for the purpose of Section 56(2)(vii) and Section 56(2)(viia).

<u>Proposed Amendments</u>

(a) Hitherto Section 56(2)(vii) was applicable only to an **Individual or an HUF** and Section 56(2)(viia) was applicable only to a firm or company which is not a company in which the public are substantially interested. With effect from 1st April, 2017, the provisions of Section 56(2)(vii) and Section 56(2)(viia) shall be subsumed in the proposed new Section 56(2)(x) and will become applicable to all the assessees.

(b) The proposed new Section 56(2)(x) provides that the receipt of sum of money or any immovable property or any property (other than immovable property) such as shares and securities **by any person**, without consideration or for inadequate consideration in excess of Rs. 50,000/- shall be chargeable to tax in the hands of the recipient as "Income from Other Sources". **The amended Finance Bill has further proposed to amend the definition of the term "income" under Section 2(24) of the Act to include within its ambit receipt of sum of money or value of property, without consideration or for inadequate consideration under Section 56(2)(x) of the Act.**

(c) With respect to transactions in immovable properties, the proposed Section 56(2)(x) of the Act provides that where the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, the stamp duty value as on the date of the agreement may be taken for the purposes of computing the income under the head 'Income from Other Sources' instead of and in place of the date of registration, provided the amount of consideration, or a part thereof, has been paid by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account on or before the date of the agreement fixing the amount of consideration for the transfer of such immovable property.

It further provides that if the stamp duty value of immovable property, being higher than the agreement value, is disputed by the assessee, the Assessing Officer may refer the valuation of such property to a Valuation Officer. In such cases, the provisions of existing Section 50C (treating stamp duty value as sale consideration) and sub-section (15) of Section 155 (value adopted as per section 50C subsequently revised in an appeal or revision or reference) of the Act shall, as far as may be, apply for determining the value of gift.

(d) This proposed amendment would not apply to any sum of money or any property received :

(i) from any relative; or

(ii) on the occasion of the marriage of the individual; or

(iii) under a will or by way of inheritance; or

(iv) in contemplation of death of the payer or donor, as the case may be; or

(v) from any local authority as defined in the Explanation to clause (20) of Section 10; or

(vi) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to Section 10(23G); or

(vii) from or by any trust or institution registered under Section 12AA; or

(viii) by any fund or trust or institution or any university or other educational institution or an hospital or other medical institution referred to in sub-clause (iv) or sub clause (v) or sub clause (vi) or sub-clause (via) of Section 10(23C); or

(ix) by way of certain transaction not regarded as transfer under the provisions of Section 47 viz.

- Distribution of assets on total/ partial partition of HUF;

- Transfer in the scheme of amalgamation of a capital asset by amalgamating company to amalgamated company u/s.47(vi)/ (via)/ (vii);

- Transfer in a scheme of amalgamation of a banking company u/s.47(viaa);

- Transfer in a scheme of demerger u/s.47(vib)/ (vic)/ (vid);

- Transfer in a business re-organisation by co-operative banks 47(vica)/(vicb).

The amended Finance Bill has further proposed to expand the exclusion list given above under Section 56(2)(x) to provide that the provisions of Section 56(2)(x) will not apply to the sum of money or property received from an individual by a trust created or established solely for the benefit of a relative of the individual.

(e) Consequential amendment is proposed to be made in Section 49(4) of the Act to step up the cost of acquisition of the concerned property by adding the amount which has been considered as income of the transferee, pursuant to the provisions of Section 56(2) (x).

This amendment will take retrospective effect from 1st April, 2016 and will, accordingly, apply in relation to the A. Y. 2017-18 and subsequent years.

<u>Comments</u>

(a) **The proposed amendment shall be applicable retrospectively for the capital assets received by any person on or after 1st April, 2016 and would therefore be applicable to all the transactions contemplated in Section 56(2)(x) undertaken by any person during the F. Y. 2016-17. Accordingly,**

firms / LLPs / companies who have received any property or immovable property during the F. Y. 2016-17, otherwise than by way stock in trade, at a value less than the fair market value of the property / stamp duty value of the immovable property, as the case may be, will have to pay tax under Section 56(2)(x) on the difference between the fair market value of the property / stamp duty value of such immovable property and the consideration paid.

(b) The proposed provisions in Section 56(2)(x) of the Act has been inserted in order to widen the tax bracket and prevent the practice of receiving sum of money or property without consideration or inadequate consideration. Under the proposed provisions, the following tax consequence shall arise in the hands of the Transferee / Recipient of an immovable property held by him as capital asset :

TRANSFER OF ASSET	CHARGEABLE AMOUNT
Immovable Property received without consideration	Stamp Duty Value of the Property
Immovable Property received for a consideration, which is less than the Stamp Duty Valuation	Difference between Stamp Duty Valuation and Consideration paid

(c) The proposed provisions of Section 56(2)(x) applies only to receipt of an immovable properties by **any person** for NIL / inadequate consideration **and held by him as capital asset**. Thus if an immovable property is acquired by any person in his ordinary business, as his Stock-in-trade, then the provisions of 56(2)(x) would not apply.

(d) The gift of any property or immovable property received without consideration or for inadequate consideration shall not be taxable if received from relatives, at the time of marriage, under will or by way of inheritance, in contemplation of death of the donor, from local authority or from approved association or institution. The term relative is defined to mean:

(i) Spouse of the individual

(ii) Brother or Sister of the Individual

(iii) Brother or Sister of the spouse of the individual

(iv) Brother or Sister of either of the parents of the individual

(v) Any Lineal ascendant or descendent of the individual

(vi) Any Lineal ascendant or descendant of the spouse of the individual

(vii) Spouse of the person referred to in clause (ii) to (vi)

Although the list of Relative is quite exhaustive, cousin brothers / sisters, nephew and niece and their respective spouse/children are not covered and therefore the gifts received from such persons, although from the same family, would be taxable as income under the proposed amendment. The gift of any property or immovable property received by an individual from his/her maternal grandfather and grandmother will be considered as gift received from his/her lineal ascendant and would therefore be not chargeable to tax.

(e) The proposed amended Section 49(4) of the Act relating to determination of the cost of acquisition of any property or immovable property received by any person without consideration or for inadequate consideration provides that **the cost of acquisition to be taken into consideration at the time of transfer of such property by the recipient shall be the** value which has been taken into consideration for the purpose of computing the income taxable under Section 56(2)(x) of the Act i.e. the cost of acquisition to be taken at the time of re-transfer of such property would be **the actual cost plus the differential amount, which is charged to tax.** This amendment provides relief to the person receiving the property for NIL / inadequate consideration for the purpose of computing capital gains on subsequent transfer of such property, since the cost of acquisition shall be increased by the value taxed under the head 'income from other sources'. The aforesaid provisions has been made to bring in consistency in determining the cost of acquisition of asset which has been taxed in earlier years.

(f) The purchaser of immovable property for inadequate consideration who pays the tax on the differential value as per the proposed provision will be in the position to claim the stamp duty ready reckoner value as his cost at the time of the subsequent sale of such immovable property effected by him.

(g) What is now sought to be included is receipt of "any immovable property" as well as receipt of "any property, other than immovable property". Both the types of receipts are governed by separate and distinct sub-clauses, namely, sub-clause (b) and sub-clause (c) respectively of Section 56(2)(x). Now, as far as sub-clause (b) is concerned, which seeks to rope in "any immovable property". In any case, it will certainly include land or building or both, apart from other types of rights attached to immovable property which may be regarded as immovable property under general law such as FSI, TDR-FSI, Shares with Occupancy rights, etc.

Interestingly, so far as sub-clause (c) is concerned, the term "property" is defined separately, according to which it means, among other, "immovable property being land or building or both". Therefore, what is sought to be included in sub-clause (b) is an immovable property, without any qualification which would include any rights attached to immovable property, while what is sought to be first included in sub- clause (c) is only an immovable property which is in the nature of land and building.

(h) With regard to sub clause (b) of Section 56(2)(x) concerning "any immovable property", as discussed herein before, in absence of any definition of this term, the definition as given in the General Clauses Act, 1897 may prevail. Section 3(26) of General Clauses Act, 1897 defines the term immovable property" as under :

"immovable property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth"

As such under this definition the term "immovable property" also includes benefits to arise out of land and things attached to the earth or permanently fastened to anything attached to the earth, In our view the term immovable property contemplated in Section 56(2)(x) would also include FSI, Development Rights, Leasehold Rights, TDR / FSI , Residential / Office Premises in a Co-operative Society, tenancy rights etc.

(i) In absence of any clear indication, it seems that the new provisions will cover all cases of receipt of immovable property, irrespective of the motive, occasion or the character of the transaction. **The transaction may be purely commercial or simply a gratuitous transaction.** In other words, it may not be a gift as per commercial parlance.

(j) An issue may arise as regards **double taxation**. A person may purchase an immovable property and, for various reasons, he may be able to bargain a better price and get the property at a value which may be less than the stamp duty value. If such property is transferred for a consideration which is less than the stamp duty valuation, tax is recovered from the seller on difference u/s. 50C of the Act. Now, the very same difference is again sought to be taxed in the hands of the buyer as per the proposed provisions. Therefore, it may lead to double taxation at the first stage. However, at the second stage the buyer would be entitled to enhance the cost of the Immovable Property, at the time when sells the acquired property, by the amount of the difference on which the additional tax was paid at the time of its acquisition.

(k) The following genuine transactions may be adversely affected on account of this proposed provisions:

- Receipt of immovable property under court auction sale / auction sale through debt recovery tribunal /distress sale.
- Receipt of immovable property which is under dispute / litigation.
- Exchange / allotment of immovable properties under family arrangement between "relatives' not covered by the definition given in Section 56(2)(x).

- Receipt of immovable property at discount on account of incentive schemes, other valid commercial considerations, distress sale, etc.

- Additional Area allotted to the Society Members / Tenants at concessional rate by the Developers under the scheme of Re-development.

(l) In the case of minors who receives gift of immovable property, such addition shall be clubbed with the income of his parent.

(m) The whole concept of taxing the artificial income in the hands of the recipient will lead to revisit of the decision delivered by the Supreme Court in the case of K. P. Varghese Vs. ITO (1981) 131 ITR 597 which eventually resulted in deletion of similar provision contained in Section 52(2) and also revisit of decision delivered by the Supreme Court in the case of C.B. Gautam Vs. Union of India (1992) 199 ITR 530, wherein marginal error of 15% in valuation was allowed in genuine transactions relating to immovable property.

(n) The provisions contained in Section 56(2)(x) are nothing but a back door entry of gift tax, in the form of donee based gift tax. The effect of these provisions with reference to transactions in immovable properties will be very harsh on bonafide and genuine transactions undertaken by any person. The transaction documents involving transfer of immovable properties under an auction sale / distress sale / disputed sale / sale with encumbrances or transfer of immovable properties between the distant relatives (not covered within the definition of relative) should be carefully drafted highlighting all the circumstances under which the transaction has taken place, the negative factors such as encumbrances, disputes / litigations, distress sale, etc. which are always overlooked by the stamp valuation authorities, but which have to be considered by the Valuation Officer appointed by the Income Tax Authorities in the course of Income Tax Proceedings. People may now try to circumvent this proposed provisions by artificially jacking up the transaction value, so as to bring it at par with the Stamp Duty valuation.

(o) Another very disturbing aspect of this system is to regard the stamp duty valuation as sacrosanct with respect to all transactions of immovable property. The most serious objection is against the approach of the government to mechanically and blindly apply the notional value calculated by the stamp valuation authorities for determining the market value of the immovable property and, that too, arrived at by applying adhoc formula without having any regard or concern with the location or facts and circumstances surrounding the transfer of such property. The applicability of these provisions is universal and all pervasive, the levy is automatic and there is no discretion, except for certain exceptions provided therein.

2.7 Thin Capitalization Norms Introduced - Limitation of interest deduction in certain cases [Section 94B]

Background

The different routes for foreign investment in real estate companies have been substantially liberalised. Almost all sectoral restrictions for foreign direct investments have been relaxed. Substantial relaxations for raising foreign debt have also been provided for Indian real estate companies that hesitated listing their securities can now raise foreign debt by issuing Non Convertible Debentures ("**NCDs**") to Foreign Portfolio Investors ("**FPIs**"). Offshore funds get tax optimised redeemable instruments with security interests without any coupon restrictions.

Under Schedule V of the amended Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 read with the provisions of the SEBI (Foreign Portfolio Investment) Regulation 2014, FPIs are permitted to invest in, *inter alia*, listed or unlisted Non Convertible Debentures ("**NCDs**") issued by an Indian company in the dematerialized form. Based on the foregoing regulations, more than 70% of the foreign funding in real estate is received in the form of structured debt. Most particularly, NCDs were the most popular source of receiving foreign funds hitherto. Legitimate tax optimization of cash up-streaming in cash accretive real estate assets is the cornerstone of any investment in these sectors globally.

The Union Budget, 2017 has now borrowed from Base Erosion and Profit Shifting (BEPS) Action Plan 4 and has introduced thin capitalization norms for '**Associated Enterprises**' in an attempt to prevent excessive interest deductions being claimed by Indian companies. These thin capitalization norms will have a huge implications on the foreign debt being raised by real estate companies by issuing **NCDs** to Foreign Portfolio Investors.

<u>Proposed Amendment</u>

(a) Section 94B is proposed to be inserted with effect from 1st April, 2017 to restrict the deduction for interest or similar consideration paid / payable by Indian companies or Permanent Establishment ("**PE**") of foreign companies on debts given / guaranteed by its non-resident '**associated enterprise**' to 30% of the Earnings Before Interest, Taxes, Depreciation and Amortization ("**EBITDA**") of the borrower. Further, a threshold of Rs.1 Crore is provided for the applicability of the proposed new section. The Finance Bill as amended and passed by the Lok Sabha on 22nd March, 2017 has amended the aforesaid provision to provide that the Indian Companies or PE of foreign companies, being borrower, **incurs** an expenditure by way of interest or of a similar nature, exceeding Rs. 1 Crore, it shall be limited to 30% of EBITDA or interest or similar consideration paid / payable to associated enterprise, whichever is less. Accordingly, the thin capitalization provisions have been linked to incurrence of expenditure by way of interest or similar nature of expenditure.

(b) Where the debt is issued by party other than the associated enterprise, the debt shall be deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender or deposits a corresponding and matching amount of funds with the lender.

(c) To the extent of interest which is not wholly deductible against the income under the head "Profits and gains of business or profession", such interest shall be carried forward for allowing in the following assessment years up to a maximum period of 8 assessment years immediately succeeding the assessment year in which the disallowance was first made. The deduction of such brought forward interest shall be allowed only to the extent of maximum allowable interest expenditure of 30% of EBITDA for that year.

This amendment will be effective from Assessment Year 2018-19 onwards.

Comments

(a) An Indian company may not be eligible to claim deductions for interest payments to associated enterprises that exceeds 30% of Earnings Before Interest, Taxes, Depreciation and Amortization ("**EBITDA**") of the borrowing company in the year of the payment of the interest. Interest payments of amounts lower than Rs. 1 crore per annum are exempt from the above requirement.

(b) The ambit of '**associated enterprises'** under the provisions of Act is extremely wide, and includes any person who lends an amount in excess of 50% of the book value of the assets of the borrowing company. For instance, a special purpose vehicle of real estate developer set up may be funded by an offshore PE fund largely in the form of nominal equity and large debt in the form of fully compulsorily convertible debentures or a special purpose vehicle of real estate developer may be solely funded by a Foreign Portfolio Investor by subscribing to the NCDs of such SPV. In both the situations, the offshore private equity investor or the Foreign Portfolio Investor will also qualify as an '**associated enterprise**'.

(c) This interest deduction cap has been made applicable to 'associated enterprises' as defined under the Act without application of mind, since it goes much beyond the group or parent subsidiary relationship.

(d) Even though interest paid in excess of this 30%, is permitted to be carried forward for a period of 8 years, the carry forward may not be of much use since interest costs are likely to remain constant in light of long term borrowings.

(e) The thin capitalization norms, as proposed, shall be applicable to interest payments made from F. Y. 2017-18, and, hence, will cover even interest payments on debt taken prior to such period. For instance, a real estate company has borrowed Rs. 100 Crores at an interest of 15% per annum from a Foreign Portfolio Investors by issuance of NCDs. If there is an EBITDA of Rs. 30 Crores, the borrower real estate company can claim deductions only up to Rs. 9 Crores instead of its requirement to pay Rs. 15 Crores to the Foreign Portfolio Investors. Thus, while an amount higher than Rs. 9 Crores may be payable, the interest expense over and above Rs. 9 Crores is not a deductible expense for the borrowing real estate company. The main purpose of high leveraging is to maximize profits and by introduction of the thin capitalization norms this objective is defeated and the whole exercise of availing investment through debt route is made futile. Nevertheless, the interest expense over and above Rs. 9 Crores would be allowed to be carried forward up to a maximum period of 8 assessment years immediately succeeding the assessment year in which the disallowance was first made.

(e) Considering the fact that the real estate sector is a highly capital intensive industry and generally overseas investors infuse funds in the form of debentures (i.e. NCDs / FCCDs), the restriction of interest deductibility will have an adverse impact on raising low cost funds by the real estate developers from overseas investors at a juncture when currently the real estate industry is facing a financial crunch.

(f) The provisions pertaining to thin capitalization norms would apply only where debt is availed from foreign entities but will not apply to borrowings made from Nationalised Banks and Financial Institutions in India.

2.8 Preventing abuse of tax provisions by deeming fair market value of unquoted shares as full value of consideration for the purpose of determining capital gains on transfer of such unquoted shares [Section 50CA]

Background

(a) Under the existing provisions of the Act, income chargeable under the head "Capital Gains" is computed by taking into account full value of consideration received or accrued on transfer of a capital asset. In order to ensure that the full value of consideration is not understated, the Act also contains provision under Section 50C of the Act for deeming stamp duty value as full value of consideration.

(b) The provisions of Section 50C applies only to a capital asset being land or building or both. It does not apply to transfer of any other capital asset, e.g. transfer of shares of an unlisted company.

(c) Section 56(2) of the Act provides for additional tax liability in the hands of the transferee / recipient of unquoted shares where the same are acquired / received at a price below its fair market value. However, as per Rule 11UA of the Income Tax Rules, 1962, the fair market value of such unquoted shares of a company for the purpose of Section 56(2) of the Act is taken at its book value. Also presently, there is no provision under the Act to provide for a tax liability in the hands of the transferor, where the unquoted shares of a company are sold at a price below its fair market value. Hence, there is a prevalent practice to transfer an immovable properties owned by a real estate company by transferring the shares of the such company at a price equivalent to its book value, thereby avoiding payment of stamp duty and income tax on the actual transaction value. To plug this loophole, Section 50CA is proposed to be introduced with effect from 1st April, 2017.

Proposed Amendments

(a) Section 50CA is proposed to be inserted with effect from 1st April, 2017 to provide that where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share **determined in such manner as may be prescribed**, the value so determined shall, for the purposes of Section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer. **In other words, capital gains in case of transfer of any capital asset, being an unquoted share, is to be computed with reference to the fair market value of such share.**

(b) Explanation to Section 50CA defines the term "quoted share" to mean the share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Comments

(a) Perusal of the explanatory memorandum to the Finance Bill, it seems that for the purposes of computing the capital gains under Section 50CA, **the fair market value of unquoted shares of a company may be determined after taking in to consideration the fair market value of the underlying immovable property held by such company as against the book value of unquoted shares presently provided for in Rule 11UA of the Income Tax Rules, 1962.**

(b) **Further, Section 50CA is proposed to come into effect from 1st April, 2017. Hence, any transfer of unquoted shares of a company (owning a valuable immovable property) prior to 1st April, 2017 will be outside the scope of Section 50CA and may be transferred at its book value.**

2.9 Promotion of affordable housing projects [Section 80-IBA]

Background

(a) With a view to incentivise affordable housing sector, Section 80-IBA was introduced by the Finance Act, 2016 with effect from 1st April, 2016.

(b) Section 80-IBA provides for 100% deduction in respect of profits and gains derived from developing and building certain housing projects, subject to fulfillment of following conditions :

   (a) The project should be approved by the competent authority after 1st June , 2016 but on or before 31st March, 2019;

(b) The project should be **completed within a period of 3 years** from the date of approval by the competent authority. **Provided** that, -

(i) where the approval in respect of a housing project is obtained more than once, the project shall be deemed to have been approved on the date on which the building plan of such housing project was first approved by the competent authority; and

(ii) the project shall be deemed to have been completed when a certificate of completion of project as a whole is obtained in writing from the competent authority;

(c) the **built-up area** of the shops and other commercial establishments included in the housing project does not exceed 3% of the aggregate built-up area;

(d) the project is on a plot of land measuring not less than :

(i) 1,000 square metres, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai or within the distance, measured aerially, of 25 kilometres from the municipal limits of these cities; or

(ii) 2,000 square metres, where the project is located in any other place;

(e) the project is the only housing project on the plot of land as specified in clause (*d*);

(f) the **built-up area** of the residential unit comprised in the housing project does not exceed :

(i) **30 square metres**, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai **or within the distance, measured aerially, of twenty-five kilometres from the municipal limits of these cities**; or

(ii) **sixty square metres**, where the project is located in any other place;

(f) where a residential unit in the housing project is allotted to an individual, no other residential unit in the housing project shall be allotted to the individual or the spouse or the minor children of such individual;

(g) the project utilizes :

(i) not less than 90% of the floor area ratio permissible in respect of the plot of land under the rules to be made by the Central Government or the State Government or the local authority, as the case may be, where the project is located within the cities of Chennai, Delhi, Kolkata or Mumbai or within the distance, measured aerially, of 25 kilometres from the municipal limits of these cities, or

(ii) not less than 80% per cent of such floor area ratio where such project is located in any place other, than the place referred to in sub-clause (*i*); and

(h) the assessee maintains separate books of account in respect of the housing project.

(c) The provisions of Section 80-IBA of the Act are not applicable to any assessee who executes the housing project as a works contract awarded by any person.

<u>Proposed Amendment</u>

With a view to extend the benefit of deduction under Section 80-IBA, the following beneficial amendments are proposed to Section 80-IBA with effect from F. Y. 2017-18 :

(a) The size of residential unit shall be measured by taking into account the "carpet area" as defined in the Real Estate (Regulation and Development) Act, 2016 and not the "built-up area".

As per Section 2(k) of the Real Estate (Regulation and Development) Act, 2016, the expression “carpet area” means the net usable area of an apartment, excluding the area covered by the external walls, areas under services shafts, exclusive balcony or verandah area and exclusive open terrace area, but includes the area covered by the internal partition walls of the apartment.

Explanation to Section 2(k) of the Real Estate (Regulation and Development) Act, 2016 defines the expression “exclusive balcony or verandah area” to mean the area of the balcony or verandah, as the case may be, which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee; and “exclusive open terrace area” means the area of open terrace which is appurtenant to the net usable area of an apartment, meant for exclusive use of the allottee.

(b) The restriction of 30 square meters on the size of residential units shall not apply to the place located within a distance of 25 kms from the municipal limits of the Chennai, Delhi, Kolkata or Mumbai.

In other words, where the housing project is located within the cities of Chennai, Delhi, Kolkata or Mumbai, the carpet area of the residential unit should not exceed 30 square metres and 60 square metres where the project is located at any other place, say, in Thane or Navi Mumbai (although within 25 kms from Mumbai city).

(c) The condition of period of completion of project for claiming deduction under Section 80-IBA is increased from the existing 3 years to 5 years.

These amendments will take effect from April 1, 2018 and will, accordingly, apply in relation to the A. Y. 2018-19 and subsequent years.

Comments

(a) The Finance Bill has provided further impetus to affordable housing projects being undertaken by developers. The Government has proposed expanded size of the units required to be eligible for 'affordable housing' units: (i) by increasing the limit of 30 square meters in the non-metropolitan cities to 60 square meters for each residential unit; and (ii) by increasing the size of units in a non-metropolitan region and in a metropolitan region from a '*built-up*' area of 30 square metres, and 60 square metres, respectively to a '*carpet area*' of 30 square metres and 60 square metres respectively.

(b) The project was earlier required to be completed within a period of 3 years from the date of approval by the competent authority. The approval from the competent authority is defined to mean building plan and layout plan approvals. However, a building would require a large number of other approvals, including Fire NOC, approvals for height, environmental clearance, etc., which would be time consuming. Accordingly, it may be difficult for developers to complete projects within 3 years from date of receipt of the building / layout plan approvals. This will give sufficient time to the developer to complete the project in 5 years.

(c) However, there has been no reduction to the Minimum Alternate Tax ("**MAT'**) or Alternate Minimum Tax ("**AMT**") rates payable by the developers undertaking affordable housing projects and therefore **although Section 80-IBA provides for 100% deduction in respect of profits and gains derived from developing and building affordable housing projects, the developers will still have to pay MAT and AMT on their book profits @ 21.346%.** Furthermore, although credit for MAT and AMT paid by the developers is permitted to be carried forward for a period of 15 years for being set off against future tax liability, as per the provisions of Section 115JAA, the set off of the brought forward MAT and AMT credit is restricted to difference between the normal tax payable and MAT payable for the year in which MAT / AMT credit is proposed to be set off. The developer may not be able to claim the set off of MAT / AMT credit in respect of an affordable housing project undertaken in an SPV, unless he takes up another non-affordable housing project in the same SPV.

2.10 Deduction of tax at source on rent payments made by Individuals and HUFs for use of land or building or both [Section 194-IB]

Presently, an Individual and HUF, being a payer (other than those liable for tax audit) of rent for use of land or building or both are out of the scope of Section 194-I of the Act.

The Finance Bill proposes to insert a new Section 194-IB to provide that Individuals or a HUF (other than those liable for tax audit under Section 44AB of the Act) responsible for paying to a resident any income by way of rent exceeding Rs.50,000/- for a month or part of month during the previous year, shall deduct an amount equal to 5% of such income as income-tax thereon.

Explanation to Section 194-IB provides that for the purposes of this section, "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or building or both.

The salient features of the new proposed Section 194-IB are as under :

Parameters	Remarks
Basic exemption from levy of tax deduction at source	< Rs.50,000/- per month/part of month
Rate of tax deduction at source	5%
Point at which tax is required to be deducted	- At the time of credit of rent, for the last month of the previous year; or - The last month of tenancy if the property is vacated during the year, as the case may be, to the account of the payee; - At the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earier;
Whether TAN is required by the deductor	The provisions of Section 203A shall not apply to a person required to deduct tax in accordance with the provisions of this Section.
Others	It is also proposed to provide that where the tax is required to be deducted as per the provisions of Section 206AA, such deduction shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy, as the case may be.

This amendment will take effect from 1st June, 2017

Comments

(a) In order to widen the scope of tax deduction at source, so as to cover individual & HUF other than those liable for Tax Audit under Section 44AB, this new Section 194-IB has been inserted.

(b) It is pertinent to note that the provisions of Section 194-I and Section 194-IB will not be applicable where the rent is paid by the Developer to a society member or a tenant for procuring temporary alternate accommodation in a redevelopment project, since rent is not paid by the Developer to the society member or a tenant, for use of any land or building or both. However, when such society member or tenant pays rent directly to the owner for use of temporary alternate accommodation, then he shall liable to deduct tax at source under Section 194-IB, provided the monthly rental exceeds Rs.50,000/-

(c) To reduce the compliance burden on the Individuals/ HUFs, the requirement to obtain TAN is eliminated and it is provided that the amount of TDS shall not exceed the amount of rent payable / paid for last month.

2.11 Restricting the scope of applicability of Domestic Transfer Pricing Provisions [Section 92BA & 40A]

Background

(a) The Finance Act, 2012 made amendments to Chapter X to extend the applicability of transfer pricing provisions to "Specified Domestic Transaction" ("**SDT**") with effect from 1st April, 2013 i.e. with effect from F. Y. 2012-13 and onwards.

(b) Section 92(2A) was inserted by the Finance Act, 2012 to provide that "***any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction shall be computed having regard to the arm's length price***".

(c) Further, Section 92BA was inserted by the Finance Act, 2012 to provide for the definition of SDT to broadly cover the following two types of transactions having an aggregate value exceeding Rs. 20 crores in a previous year :

(i) any expenditure in respect of which payment has been made or is to be made to a resident related person referred to in Section 40A(2)(b); and

(ii) Transactions where one of the entities / unit of the entity involved is a related party and such transactions enjoys specified profit linked deduction viz., Section 80IA, Section 10AA, etc.

(d) Further, an assessee undertaking SDT are required to maintain the prescribed documentation as mentioned in Section 92D and obtain requisite report in Form 3CEB from a Chartered Accountant as per the provisions of Section 92E.

(e) The assessee is also required to file Form 3CEB obtained from a Chartered Accountant with the assessing officer along with his income tax return.

Proposed Amendments

(a) It has been proposed to restrict the scope of domestic transfer pricing only if one of the entities involved in the related party transaction enjoys specified profit-linked deduction.

(b) Sub-clause (i) to Section 92BA is proposed to be omitted. Thus any expenditure in respect of which payment has been made or is to be made to a resident related person referred to in Section 40A(2)(b) shall not be subjected to Specified Domestic Transfer Pricing provisions.

This amendments will take retrospective effect from 1st April, 2016 and will, accordingly, apply in relation to the A. Y. 2017-18 and subsequent years.

Comments

(a) In order to reduce hardship and the compliance burden faced by the domestic companies due to domestic transfer pricing provisions, the transactions in the nature of any expenditure in respect of which payment has been made or is to be made to a resident related person referred to in Section 40A(2)(b) and having an aggregate value exceeding a sum of Rs. 20 crores in a previous year will be outside the purview of Specified Domestic Transfer Pricing provisions.

(b) The proposed amendment will take retrospective effect from F. Y. 2016-17 and subsequent years and accordingly no compliance with respect to the Specified Domestic Transfer Pricing provisions shall be required to be made by the Developers during the F. Y. 2016-17 in respect of the following expenditure paid / payable to the related parties :

- Purchase of construction materials from related parties
- Remuneration to Directors
- Interest on loans to related parties
- Reimbursement of services availed from related parties
- Transfer of projects from the holding company to SPV, for the purpose of availing private equity funding
- Project Management Fees/ Marketing Fees paid by an SPV (having a private equity investor) to the Developer
- Compensation to related parties in an internal arrangement
- Brokerage to related parties.

2.12 Concessional tax rate on interest in case of specified borrowings [Section 194LC] and concessional tax rate on interest to FIIs and Foreign Portfolio Investors [Section 194LD]

Presently, Section 194LC provides for a concessional rate of TDS of 5% on interest payable to a non-resident by an Indian company on specified borrowings made in foreign currency from a source outside India under a loan agreement or by way of issuance of long term bonds on or before 1st July, 2017. It is now provided that the concessional rate of TDS shall extend to such specified borrowings made before 1st July, 2020. Furthermore, the scope of specified borrowings in Section 194LC has been expanded to include monies borrowed from a source outside India by way of issuance of rupee denominated bonds before 1st July 2020. This provision is inserted with retrospective effect from 1st April, 2016.

Presently, Section 194LD provides for a concessional rate of TDS of 5% from the interest income payable before 1st July, 2017 to Foreign Institutional Investors and Qualified Foreign Investors (now known as Foreign Portfolio Investors) in respect of their investments in government securities and rupee denominated corporate bonds, provided that the rate of interest does not exceed the rate specified by the Central Government in this behalf. It is now provided to extend the concessional rate of TDS on interest payable before 1st July, 2020.

Comments

(a) The NCDs issued by an Indian real estate company to Foreign Portfolio Investors ("**FPIs**") and complying with the requisite conditions are characterized as Rupee Denominated Corporate Bonds. Substantial foreign funding in Indian real estate is a structured debt, being infused as non-convertible debentures ("**NCDs**"), since this benefits the company to obtain interest expense benefit and the investor to have security over the asset. Interest on NCDs payable to FPIs earlier taxable at the rate of 20%, was reduced to 5%, under the proposed provisions till 1st July, 2017. This was a major boost for the real estate sector, where back-ending the coupon rate is quite common due to the liquidating nature of real estate.

(b) The Finance Bill now extends the benefit of reduced withholding of 5% on interest payable to non-residents on NCDs for all interest payments till 1st July, 2020. The extension of the reduced withholding benefits would greatly encourage further foreign investment into the real estate sector.

2.13 Extension of Capital Gains exemption to transfer of Rupee Denominated Corporate Bonds ("Masala Bonds") [Section 194LC]

The Reserve Bank of India has permitted Indian corporates to issue Rupee Denominated Bonds ("**RDBs**") or the Masala Bonds as is commonly known outside India for raising funds outside India. The Finance Act, 2016 *inter alia* amended Section 48 of the Act w.e.f. 1st April, 2017 to provide that the gains arising to a non-resident investor on account of appreciation of Rupee against a foreign currency at the time of redemption of Rupee Denominated Bond of an Indian Company subscribed by him, shall be ignored for the purpose of computation of full value of consideration.

In this regard, the Government received following representations for increasing acceptability and transferability of RDBs in the foreign market :

(i) Secondary holders being non-residents acquiring such RDBs from an existing non-resident investor be also exempted in respect of capital gains arising due to appreciation of Rupee against foreign currency at the time of its redemption;

(ii) Transfer of RDBs from non-resident to non-resident also to tax exempt.

In order to address the above representations towards acceptability and ease of transferability of RDBs, the Finance Bill proposes the following amendments to the Act :

(a) Insertion of sub-clause (viiaa) in Section 47 of the Act such that the transfer of RDBs by a non-resident to another non-resident shall not be regarded as transfer for the purposes of Capital Gains.

(b) Substitution of the word ‘subscribed’ with ‘held’ in 5th Proviso to Section 48 of the Act to facilitates that appreciation of rupee at the time of redemption of RDBs shall not considered as full value of consideration even in the hands secondary holder besides the original subscriber.

This amendment will be effective from Assessment Year 2018-19 onwards.

3. OTHER SIGNIFICANT AMENDMENTS RELEVANT TO REAL ESTATE SECTOR

3.1 Measures to discourage cash transactions [Section 40A]

The existing provision of sub-section (3) of section 40A of the Act, provides that any expenditure in respect of which payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds Rs.20,000/-, shall not be allowed as a deduction unless the case falls within the exception to Rule 6DD.

Further sub-section (3A) of section 40A also provides for deeming a payment as profits and gains of business of profession in such year of payment, if the expenditure is incurred in a particular year but the payment is made in any subsequent year otherwise than by an account payee cheque drawn on a bank or account payee bank draft where such payment exceeds Rs.20,000/- to a person in a day.

In order to disincentivise cash transactions, it is proposed to amend the provision of section 40A of the Act to provide the following:

(i) Restrict allowability of cash payment to a person in a single day from Rs.20,000/- to Rs.10,000/-;

(ii) Deeming a payment in subsequent year as profits and gains of business or profession of that year, if the expenditure is incurred in a particular year but the cash payment is made in such subsequent year and such expenditure exceeds Rs.10,000/- to a person in a single day; and

(iii) Expand the specified mode of payment under section 40A to include payment made by way of electronic clearing system through a bank account.

This amendment will be effective from AY 2018-19 onwards.

3.2 Disallowance of depreciation in respect of assets acquired by cash payment [Section 43(1)]

Section 43(1) of the Act provides for the definition of “actual cost” for the purposes of claiming depreciation under Section 32 of the Act.

As a measure to disincentivise cash payments, it is proposed to insert a proviso to Section 43(1) to provide that any expenditure for acquisition of any asset in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account, exceeds Rs.10,000/-, shall be ignored for the purposes of determination of 'actual cost'.

In other words, expenditure made in cash on acquisition of an asset in excess of Rs.10,000/- will not be eligible for depreciation. This amendment is made to discourage cash payments and include electronic payment within the permitted modes of payments.

This amendment will be effective from AY 2018-19 onwards.

3.3 Curbing transactions in cash [Sections 269ST, 271DA and 206C]

(a) With a view to curb the generation and circulation of black money and encourage a cashless economy, the Finance Bill as amended and passed by the Lok Sabha on 22nd March, 2017 has proposed to insert Section 269ST **with retrospective effect from 1st April, 2016** and onwards to provide that no person shall receive an amount of Rs. 2 lakhs or more :

- in aggregate from a person in a day; or
- in respect of a single transaction; or
- in respect of transactions relating to one event or occasion from a person.

otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account.

(b) The provisions of Section 269ST shall not apply to receipt by certain classes of persons, such as government, banking company, post office savings bank or co-operative bank, or such other person or class of persons or receipts as may be notified.

(c) The provisions of Section 269ST shall also not apply to transactions of the nature referred to in Section 269SS.

(d) To facilitate the provisions dealing with the contravention of Section 269ST, Section 271DA is proposed to be inserted to for levy of a penalty of a sum equivalent to the amount received by the person. No penalty is leviable if there were good and sufficient reasons for the contravention.

Insertion of Section 269ST with retrospective effect from 1st April, 2016 would mean that even the cash transactions undertaken by any person in excess of Rs. 2 lakhs or more during the F. Y. 2016-17 and more particularly during the demonetization period would fall within the purview of Section 269ST and would be liable to penalty under Section 271DA of the Act.

3.4 <u>Donations in cash [Section 80G]</u>

Currently, under provisions of Section 80G(5D) deduction in respect of donation in excess of Rs.10,000 made in cash is not allowable. An amendment has been made to reduce this limit to Rs.2,000. This has been done with a view to promote cashless economy and also bringing in transparency.

3.5 <u>Exemption of Long Term Capital Gains on Sale of Shares through Recognised Stock Exchange [Section 10(38)]</u>

Presently Section 10(38) of the Act provides that any income arising from a transfer of long term capital asset, being equity share of a company or a unit of an equity oriented fund, is exempt from tax if the transaction of sale is undertaken on or after 1st October, 2014 and is chargeable to Securities Transaction Tax under Chapter VII of the Finance (No. 2) Act, 2004.

With a view to prevent this abuse of this provision by certain persons for declaring their unaccounted income as exempt long-term capital gains by entering into sham transactions, it is proposed to amend Section 10(38) to provide that exemption under this Section for income arising on transfer of equity share acquired or on after 1st day of October, 2004 shall be available only if the acquisition of share is chargeable to Securities Transactions Tax under Chapter VII of the Finance (No. 2) Act, 2004.

However, to protect the exemption for genuine cases where the Securities Transactions Tax could not have been paid like acquisition of share in IPO, FPO, Bonus or Rights issue by a listed company, acquisition by a non-resident in accordance with FDI policy of the Government etc., it is also proposed to notify transfers for which the condition of chargeability to Securities Transactions Tax on acquisition shall not be applicable.

This amendment will be effective from A. Y. 2018-19 onwards.

3.6 Conversion of preference shares into equity shares [Section 2(42A), 47 and 49]

Under the existing provisions, there is no specific exemption from levy of capital gains tax on conversion of preference shares of a company into equity shares of that company. Section 47 has now been amended to provide that such conversion shall not be treated as a transfer.

Section 2 (42A) and section 49 relating to period of holding and cost of acquisition, respectively, have been consequently amended to provide that the period of holding of the said equity shares shall include the period for which the preference shares were held by the assessee and cost of acquisition of equity shares shall be the cost of preference shares.

3.7 Investment in bonds to be notified by Central Government [Section 54EC]

Subject to satisfaction of conditions mentioned in Section 54EC, long term capital gains up to Rs. 50 lakhs is exempted under Section 54EC, if the assessee invests the capital gain in bonds issued by National Highways Authority of India or Rural Electrification Corporation Limited. Explanation to Section 54EC has been amended to provide that investment in bonds notified by Central Government will also qualify for deduction under Section 54EC. Therefore, now bonds issued by other bodies may also be notified to qualify for investment for the purpose of claiming exemption.

However, there is no change in the current limit of Rs. 50 lakhs for investing long term capital gains.

3.8 Disallowance for non-deduction of tax from payments to residents [Sections 58 & 40(a)(ia)]

Section 58 lists certain amounts which are not deductible in computing the income under the head “Income from Other Sources”. These disallowances are similar to those made while computing income under the head “Profits and Gains of Business or Professional” and include disallowance of cash expenditure, disallowance for non-deduction of tax from payment to non-resident, etc.

Section 58 now provides that provisions of Section 40(a)(ia), providing for 30% disallowance for non deduction of tax from payments made to residents shall, so far as may be, also apply in computing income chargeable under the head “Income from other sources” as it applies in computing income chargeable under the head “Profit and Gains of Business or Profession”

3.9 Tax on dividend from Domestic Company [Section 115BBDA]

Presently, income by way of dividend from a domestic company or companies in excess of Rs.10 lakhs is taxed at the rate of 10% in case of a resident Individual/ HUF/ Firm.

Now such taxation is extended to all resident assessees, except domestic companies and certain funds, institutions referred to in sub-clauses (iv) to (via) of section 10(23C) and trusts registered under Section 12AA, receiving dividend income exceeding Rs.10 lakhs.

3.10 Exemption from audit under Section 44AB in presumptive tax cases - Sections 44AB and 44AD

The Finance Act, 2016 raised the threshold limit for applicability of presumptive taxation in case of eligible business carried on by eligible person under Section 44AD to Rs.2 Crores from Rs. 1 Crore with effect from A. Y. 2017-18. However, Section 44AB required every person carrying on business to get his accounts audited if his total sales, turnover or gross receipts in the previous year exceeded Rs.1 Crore. The CBDT clarified, vide press release dated 20th June, 2016, that if an eligible person opts for presumptive taxation scheme as per Section 44AD (1), he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed Rs.2 Crore.

To give effect to the above clarification consequent to the higher threshold of total sales, total turnover or gross receipts in Section 44AD, Section 44AB is now amended to provide that an eligible person who declares profits for the previous year in accordance with the provisions of Section 44AD(1) and his total sales, total turnover or gross receipts, as the case may be, in business do not exceed Rs.2 Crores in such previous year, is not required to get his books of account audited under section 44AB.

This amendment is applicable with immediate effect from A. Y. 2017-18.

3.11 Time Limit for completion of Assessment, Reassessment and Recomputation - [Section 153(1)]

Section 153 provides for time limit for completion of assessment, reassessment and recomputation, being specified number of months from the end of the assessment year. It is proposed to revise these time limits. Accordingly, the existing and the revised time limits are given as under :

Particulars	Earlier Time Limits (from end of Assessment Year)	Revised Time Limits (from end of Assessment Year)
Completion of assessment under Section 143 or 144 :		
(i) Relating to A. Y. 2018-19	21 months	18 months (30.9.2020)
(ii) Relating to A. Y. 2019-20 or later	21 months	12 months (31.3.2021)
Completion of assessment under Section 147 where notice under Section 148 is served on or after 1st April, 2019	9 months from end of financial year	12 months from end of financial year
Completion of fresh assessment in pursuance to an order passed by the ITAT or revision order by CIT	9 months from end of financial year	12 months from end of financial year
Order giving effect to an order of the CIT(A), ITAT, High Court, Supreme Court which requires verification of any issue by way of submission or where opportunity of being heard is to be provided to the assessee (w.e.f. 1st June 2016)	9 months from end of financial year	12 months from end of financial year

Similar time limits have been prescribed for completion of assessments in the case of search under Section 153A.

3.12 Amendments made by the Taxation Laws (Second Amendment) Act, 2016 vis-à-vis tax, surcharge and penalty on Income from Unexplained Sources – [Sections 115BBE and 271AAC]

Background

(a) As a step forward to curb black money, bank notes of high denominations of Rs.500 and Rs.1,000 have been recently withdrawn by the Reserve Bank of India. Concerns have been raised that some of the existing provisions of the Act can be possibly be used for concealing black money. Accordingly, the government passed Taxation Laws (Second Amendment) Act, 2016 to amend the provisions of the Act and the Finance Act, 2016 to ensure that the defaulting taxpayers are subjected to tax at a higher rate of tax and stringent penalty provision.

(b) Accordingly, the government has introduced Section 115BBE with effect from 1st April, 2017 (A. Y. 2017-18) to provide for the rate of tax applicable on income referred to in Sections 68, 69, 69A, 69B, 69C or 69D (income from unexplained sources) at the enhanced rate of 60% instead of 30%.

Amendment Introduced

(a) Under Section 115BBE, the taxpayer is liable to pay income-tax at the rate of 60% where the total income of the taxpayer includes any income in the nature of cash credits, unexplained investments, unexplained money, amount of investments, etc., not fully disclosed in the books of account, unexplained expenditure, etc., amount borrowed or repaid on hundi. The enhanced rate of 60% shall apply to :

 (i) where such income is reflected in the return of income; or

 (ii) Where the total income of the tax payer determined by the Assessing Officer includes such income.

(b) The surcharge as applicable otherwise, if the total income exceeds the specified amount, is not applicable on the tax calculated in accordance with the provisions of Section 115BBE. Instead, surcharge of 25% shall apply on the amount of such tax irrespective of the amount of income from unexplained sources and also irrespective of the amount of total income.

Accordingly, the total incidence of tax under Section 115BBE (including surcharge) would be 75%.

(c) New Section 271AAC is inserted which provides for levy of penalty if the income of the assessee includes income from unexplained sources. The penalty is 10% of the tax payable under Section 115BBE and may be levied by the Assessing Officer.

No penalty is leviable under Section 271AAC if the following conditions are satisfied :

(i) The income from unexplained sources has been included by the assessee in the return of income furnished under Section 139; and

(ii) Tax in accordance with the provisions of Section 115BBE has been paid on or before the end of the relevant previous year.

(d) The penalty under Section 270A for under-reporting of income is not leviable in respect of income on which penalty can be levied under Section 271AAC.

These amendments are applicable with retrospective effect from 1st April, 2016 and will, accordingly apply in relation to A. Y. 2017-18 and subsequent years.

3.13 Mandatory quoting of Aadhaar Number for filing the Return of Income and for applying for PAN

The Finance Bill as amended and passed by the Lok Sabha on 22nd March, 2017 has introduced a new Section 139AA which provides that every person who is eligible to obtain Aadhaar Number shall on or after 1st July, 2017 quote Aadhaar Number in -

(a) Application for allotment of Permanent Account Number ("**PAN**")

(b) Return of Income

However, where the person does not possess the Aadhaar Number as on 1st July, 2017, the enrollment ID of Aadhaar application form issued to him at the time of enrolment shall be quoted in the application for PAN or as the case may be, in the return of income furnished by him.

Every person who has been allotted PAN shall intimate his Aadhaar Number to the authority which will be notified by the Central Government. In case of failure to intimate the Aadhaar Number to such authority, PAN allotted to such person shall be deemed to be invalid and it shall be deemed that the person has not applied for allotment of PAN.

The aforesaid provisions will put curbs on instances of obtaining multiple PAN by a single individual. Further, quoting of Aadhaar Number would restrict granting of subsidies to only those individuals who are eligible to claim it.

III. SERVICE TAX :

The Finance Bill has proposed very few changes in Chapter V of Finance Act, 1994 ("**Act**"), the law governing the service tax, in view of the impending GST Law.

Further, the effective rate of service tax has been maintained at 15% (i.e. 14% Service Tax + 0.5% Swachh Bharat Cess + 0.5% Krishi Kalyan Cess). The significant changes made to service tax provisions relevant to real estate sector are discussed hereunder :

1. Exemption on upfront lease premium received by State Government Industrial Development Corporations retrospectively with effect from 1st June 2007

1.1 The Service Tax Department had sought to collect service tax on upfront lease premium received by the State Government Industrial Development Corporations / Undertakings (e.g. MIDC, GIDC, etc.) pursuant to long term lease (30 years, or more) of industrial plots to industrial units on the premise that it is liable for service tax under the category of 'Renting of Immovable Property Service' with effect from 1st June 2007.

1.2 Subsequently, the Central Government issued a Notification No. 41/2016-51 dated 22nd September 2016 providing for service tax exemption on one time upfront amount (called as premium, salami, cost, price, development charges or by any other name) received by the State Government Industrial Development Corporations / Undertakings pursuant to long term lease (30 years, or more) of industrial plots.

1.3 The Finance Bill seeks to insert Section 104 in the Act so as to provide that the aforesaid exemption in respect of one time upfront amount for such lease would be applicable retrospectively from 1st June 2007 i.e. from 1st June 2007 to 21st September 2016.

Consequently, refund of Service Tax for the period 1st June 2007 to 21st September 2016 shall be given if refund claim is made within 6 months from date of enactment of the Bill.

2. <u>Valuation rules sought to be amended retrospectively with effect from 1st July 2010 to provide for exclusion of value of land in composite works contracts</u>

2.1 The Delhi High Court in the case of Suresh Kumar Bansal Vs. UOI (2016) 43 STR 3 (Del.) has held that service tax on sale of under construction flat by a builder to the buyer under the category of 'construction of complex service' [prior to 1st July 2012 - Explanation to Section 65(105)(zzzh)] is not payable since there are no statutory machinery provisions to ascertain the value of services in a composite works contract involving sale of land / undivided share of land. The Court further held that providing for abatement [towards value of land] by notification is not a substitute for statutory valuation provisions.

2.2 In order to counter the above judgment of the Delhi High Court, the Finance Bill seeks to amend Rule 2A of the Service Tax (Determination of Value Rules), 2006 ('**Valuation Rules**') with effect from 1st July 2010, so as to make it clear that value of service portion in execution of works contract involving transfer of goods and land or undivided share of land, as the case may be, shall not include value of property in such land or undivided share of land.

2.3 Accordingly, as provided in Rule 2A of Valuation Rules, there would be two methods of valuation :

(i) Service tax would be payable on the gross amount charged for the works contract less the value of transfer of property in goods as well as in land / undivided share of land involved in the execution of the said works contract.

(ii) If the value of services under the method mentioned in sub clause (i) above cannot be determined, the value of services shall be determined as under :

Sr. No.	Period	Description	Taxable Value	Conditions to be complied with
1	1.7.2010 to 30.6.2012	All Works Contract	25%	No. 1, 2 & 3
2	1.7.2012 to 28.2.2013	All Works Contract	25%	Nos. 1 & 4
3	1.3.2013 to 7.5.2013	Works Contract - (a) For construction of residential units satisfying either of the following conditions, namely: (i) The carpet area of the unit is less than 2,000 square feet; or (ii) The amount charged for the unit is less than Rs.1 crore;	25%	Nos. 1 & 4
		(b) For other than (a) above	30%	Nos. 1 & 4
4	8.5.2013 to 31.3.2016	Works Contract - (a) For residential units satisfying both the following conditions, namely: (i) The carpet area of the unit is less than 2,000 square feet; and (ii) The amount charged for the unit is less than Rs.1 crore;	25%	Nos. 1 & 4
		(b) For other than (a) above	30%	Nos. 1 & 4
5	1.4.2016 onwards	All Works Contract	30%	Nos. 1 & 4

Conditions:

1. Gross amount charged shall include value of goods as well as value of land / undivided share of land.

2. No input credit in respect of duties paid on input goods or capital goods or input services have been taken.

3. Exemption providing for value of goods and materials sold from the value of taxable service is not availed under Notification No. 12/2003-ST dated 20.6.2003.

4. CENVAT Credit on inputs would not be available but CENVAT credit on capital goods and input services would be available.

3. Extension of Mega Exemption Notification No. 25/2012-ST dated 20th June 2012 to slum development schemes and affordable housing projects

The government in its last Union Budget 2016-17 had announced service tax exemptions to slum development schemes and affordable housing projects which are summarized hereunder :

Sr. No. of Mega Exemption Notification	Particulars	Effective Date
13(ba)	Services by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a civil structure or any other original works pertaining to the 'In-situ Rehabilitation of existing slum dwellers using land as a resource through private participation" under the Housing for All (HWA) (Urban) Mission / Pradhan Mantri Awas Yojana, only for existing slum dwellers.	1st March 2016
13(bb)	Services by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of a civil structure or any other original works pertaining to the "Beneficiary-led individual house construction / enhancement" under the Housing for All (Urban) Mission / Pradhan Mantri Awas Yojana (PMAY).	1st March 2016
14(c)	Services by way of construction, erection, commissioning or installation of original works pertaining to low- cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the "Scheme of Affordable Housing in Partnership" framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India	1st March 2016
14(ca)	Services by way of construction, erection, commissioning or installation of original works pertaining to low cost houses up to a carpet area of 60 sq. mt. per house in a housing project approved under : (a) the "Affordable housing in partnership" component of the Housing for All (Urban) Mission / PMAY. (b) a housing scheme of a State Government.	1st March 2016

CONCLUSION

Although Finance Minister's speech appeared to offer lot of incentives to the real estate sector, the fine print of the Finance Bill as discussed length hereinabove presents a different picture. The combined effect of the measures announced in Union Budget 2017-18 could result in the growth of the real assets sector as a whole, but with introduction of thin capitalization norms and withdrawal of deductions on housing loans, this government has made its priorities very clear. Incentivize only where needed, and tax where possible. In light of the setback suffered due to demonetisation, the Finance Minister in his budget speech has made some key announcements which would provide the much needed impetus to the real estate sector. However, there are still certain significant areas which remain to be addressed in Union Budget, 2017 which are discussed hereunder :

- Granting infrastructure status to the real estate sector (other than affordable housing) to help attract higher investments in the sector.

- Single window clearance mechanism to reduce gestation period of realty projects and cost to end buyer.

- Allowing FDI in an LLP engaged in real estate development and construction and doing away with performance linked criteria.

- Allowing developers to raise funds through External Commercial Borrowings (ECB).

- Removal of MAT levy on SEZ developers and affordable housing projects.

- Rationalise and revitalise laws related to land acquisition and development, eliminate multiple local levies and taxes to foster growth of the real estate sector

- Rationalisation of RERA provisions across various states and fair implementation of RERA regime

- Rationalisation of provisions relating to REIT/InvIT more specifically:

    - Relaxation of holding period of 36 months for units to qualify as a long-term capital asset;

    - Providing exemption from tax and stamp duty for transfer of immovable property directly to REIT;

    - Exemption provisions relating to DDT and interest income should be extended to two level SPV structure

- Removal of deemed taxation based on stamp duty valuation

- Relief by way of additional tax incentives to first time home buyers (including enhanced deduction on principal repayment and interest on housing loan)

- Only in the case of individuals and HUF, the capital gains taxability on JDA transaction has been shifted to the year of completion of a project. The said relaxation should also be extended to corporate and other non-corporate entities

- Clarity around some of the contentious issues such as applicability of service tax on transfer of development rights, long-term leasing of land, etc. would have helped the real estate sector

- Allowing CENVAT credit of service tax paid against the renting activity would have resulted in reducing the cascading effect.

The announcements made in the Union Budget, coupled with policy reforms undertaken such as RERA and Model GST Law earlier this fiscal are expected to lead to higher investments in the real estate sector, especially in the affordable housing segment. Although, the progressive steps made by the government in the budget are worth acknowledging, a lot more needs to be done to address the challenges presently being faced by the real estate sector. It is expected that some more measures such as relaxation of norms for REITs and ECB and removal of MAT, which could have led to significant improvement in liquidity may be considered by the government later this year.

As regards the demand side, in the short run, it is quite possible that the perspective of individual flat buyers, towards real estate (due to withdrawal of tax deductions on loss from housing property) changes from that of an investment asset to being limited to merely a consumption story. Further, various measures have been announced to reduce the supply side constraints, however, we believe that the Union Budget 2017-18 lacked any major announcement and incentives to boost the sluggish housing demand and we expect that the same may be addressed by the government going forward. Also, the focus to boost rental housing in India which was completely missed out in the budget must be considered in the coming months. These measures could be quite beneficial and would enable the government in achieving the 'Housing for All by 2022' vision.

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PRIVATE CIRCULAR

SALIENT FEATURES OF FINANCE BILL, 2017

(AS AMENDED AND PASSED BY THE LOK SABHA ON 22ND MARCH, 2017)

DIRECTLY CONCERNING THE REAL ESTATE SECTOR

Compiled by
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CHARTERED ACCOUNTANTS

23rd day of March, 2017