

# INCOME TAX IMPLICATIONS ON NOTIONAL UNDER VALUATION OF REAL ESTATE TRANSACTIONS

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Transactions in real estate and its tax implications make a very interesting study. Over a period of time, real estate transactions have become subject matters of substantial litigation not only under the general law, but also under the income tax law and therefore it essential for all of us to understand the implications of the tax provisions before closing any real estate

deal. Our endeavour in this article is to analyse the tax implication arising on account of notional under valuation in case of a real estate transactions under the provisions of Sections 43CA, 50C and 56(2)(x) of the Income Tax Act, 1961 ("Act") in light of current economic turmoil prevailing in the country.

## I. BACKGROUND

- (a) Section 50C of the Act provides that, if the amount of consideration received or accruing as a result of transfer of land or building or both, held as a capital asset, is less than its stamp duty value, then stamp duty value shall be taken to be full value of consideration. These provisions are applicable to a seller / transferor of an immovable property.
- (b) Similarly, Section 43CA of the Act provides that if the amount of consideration received or accruing as a result of transfer of land or building or both, held as stock-in-trade, is less than its stamp duty value, then stamp duty value shall be taken to be full value of consideration. These provisions are also applicable to a seller / transferor of an immovable property.
- (c) Section 56(2)(x) of the Act provides that where a land or a building or both is received for a consideration which is less than its stamp duty value, then the difference between the stamp duty value and the amount of consideration is chargeable to tax. These provisions are applicable to a recipient/ purchaser / transferee of an immovable property.
- (d) Until 31<sup>st</sup> March, 2020, aforesaid Sections 43CA, 50C and 56(2)(x) of the Act provided for a tolerance limit of 5% of the consideration i.e. if the difference between the stamp duty value and the amount of consideration received or accruing as a result of transfer is up to 5% of the amount of consideration, then stamp duty value was not required to be taken as full value of consideration and accordingly the difference between the stamp duty value and the amount of consideration was not chargeable to tax. **However, the Finance Act, 2020 has increased the aforesaid tolerance limit from 5% to 10%, which shall take effect from 1<sup>st</sup> April 2020 applicable to F. Y. 2020-21 and subsequent assessment years.**

## II. ANALYSIS

- (a) The impact of the tolerance limit stated hereinabove on a real estate transaction undertaken during the F. Y. 2019-20 and F. Y. 2020-21 is explained by way of an illustration as under :

Particulars	Scenarios			Remarks
	I	II	III	
Agreement Value (Rs.)	100	100	100	
Stamp Duty Value (Rs.)	105	110	115	
Difference between the Stamp Duty Value and Agreement Value (Rs.)	5	10	15	
Difference as a % of Agreement Value	5%	10%	15%	
<b>For F. Y. 2019-20 :</b>				
Value which shall be subjected to tax in the hands of the seller/ transferor under Section 50C/ 43CA	100	110	115	In Scenarios II and III, where the Stamp Duty Value exceeds 5% of the Agreement Value, the exemption of 5% is lost.
Value which shall be subjected to tax in the hands of the recipient / transferee under Section 56(2)(x), in case where the recipient has received the immovable property otherwise than for adequate consideration	Nil	10	15	
Value which shall be subjected to tax in the hands of the recipient / transferee under Section 56(2)(x), in case where the recipient has received the immovable property without consideration e.g. by way of a gift.	105	110	115	

Particulars	Scenarios			Remarks
	I	II	III	
<b>For F. Y. 2020-21 :</b>				
Value which shall be subject to tax in the hands of the seller/ transferor under Section 50C/ 43CA	100	100	115	In Scenario III, where the Stamp Duty Value exceeds 10% of the Agreement Value, the exemption of 10% would be lost.
Value which shall be subjected to tax in the hands of the recipient / transferee under Section 56(2)(x), in case where the recipient has received the immovable property otherwise than for adequate consideration	Nil	Nil	15	
Value which shall be subjected to tax in the hands of the recipient / transferee under Section 56(2)(x), in case where the recipient has received the immovable property without consideration e.g. by way of a gift	105	110	115	

- (b) **Although the Act allows safe harbour limit of 10% with effect from F. Y. 2020-21 onwards, in our view it will not be difficult to justify tolerance limit up to 25% for the transactions undertaken during the F. Y. 2020-21 on account of additional rebate / discount that may become available due to distress sale conditions created by COVID-19 crisis on the basis of past judicial pronouncements and further substantiated by latest available comparable sale instances of transfer of immovable property in the near vicinity.**
- (c) Relying on the decision of Supreme Court in the case of C. B. Gautam Vs. Union of India [1993] [199 ITR 530], the Developer shall be entitled to *inter alia* make following contentions before the tax authorities :
- (i) The safe harbour limit of 10% can not be applied mechanically in all cases and a reasonable margin for probable error in estimation has to be taken into consideration;
  - (ii) **Supreme Court in the foregoing case has recognized and permitted 15% margin of**

- error in valuation i.e. tolerable limits for variation between the agreed sale consideration and fair market value of an immovable property;**
- (iii) Reasonable discount for all the mitigating factors ought to be given for the purpose of valuation;
  - (iv) In a given transaction of an Agreement for Sell, there might be several bona fide considerations which may induce a Developer to sell the immovable property for a consideration less than what might be considered to be the fair market value of such immovable property. For instance, the Developer being in immediate need of funds would be unable to wait till the time a willing buyer is found, who is willing to pay the fair market value of the immovable property intended to be sold;
  - (v) Apart from some disputes as regards the title of the immovable property intended to be sold by the Developer, there may be other genuine reasons which may compel the Developer to sell the immovable property to a particular bonafide purchaser, who is neither a relative nor an associate concern of the Developer, at a price lower than its fair market value i.e. transaction at arms length.
- (d) Furthermore, **on account of current crisis in the economy due to COVID-19, it can be successfully contended by the Developer / Transferor / Purchaser before the Divisional Valuation Office ("DVO") / CIT (Appeals) / ITAT of the Income Tax Department to allow a minimum margin of 25% on account distress sale conditions taken place during the F. Y. 2020-21.** Such distress sale conditions can be substantiated by proper documentation and few of the following evidences:
- (i) Currently, available and comparable sale instances in the near vicinity; and Sale instances of the premises in the same building taken place during the F. Y. 2019-20, after giving minimum rebate of 25%;
  - (ii) Demonstrating the cash flow and liquidity position of the Developer;
  - (iii) Default Notice received by the Developer from its Lender declaring an Event of Default on account of failure on the part of the Developer to pay the interest and installment amounts on or before the applicable due dates;
  - (iv) Any financial exigencies faced by the Developer in payment of statutory dues or such other payments of critical nature;

- (v) Refusal on the part of the Lender to disburse to the Developer the undisbursed loan amount as committed under the sanction letter for enabling the Developer to complete the Project in time; and
- (vi) Unauthorised withdrawal of funds by the Lender from the Escrow Bank Account of the Developer.

**The above factors should also be brought to the notice of the Purchaser and relevant evidences should also be made available to the Purchaser, for use in his income tax assessment proceedings.**

- (e) Your attention is invited to Section 194-IA of the Act requiring TDS @ 1% on the consideration for transfer of any immovable property. With effect from 1<sup>st</sup> September, 2019, Explanation (aa) has been inserted to Section 194-IA of the Act to the define the term "consideration for transfer of any immovable property" to include all charges of the nature of club membership fees, car parking fees, electricity and water facility fees, maintenance fees, advance fees or any other charges of similar nature, which are incidental to the transfer of the immovable property. **As such the consideration for transfer of any immovable property may increase to**

**the extent of incidental charges for transfer thereby reducing the difference between the consideration and market value.**

- (f) **Based on the foregoing discussion, the Developer may with a view to sustain its organisation, take an appropriate business call and sell the immovable property by giving a discount of upto 25% from the stamp duty value or latest sale instance of the same immovable property taken place prior to Covid-19 pandemic. In the Circumstances the Developer as well as the flat purchaser can expect a reasonable and favourable decision from the judicial authorities in such type of distress sale transactions taken place during the COVID-19 pandemic, due to well established jurisprudence and settled case laws on the subject. However, while making distress sale of an immovable property, the Developer may face challenge of obtaining consent from its Lender for effectuating such distress sale. Scope of this Article is limited to Income Tax valuation perspective and should not be construed as an advise or suggestion "directly or indirectly" for reduction in Real Estate prices.**

### III. CONCLUSION

- (a) **From the foregoing analysis, it is quite evident that adequate care and caution needs to be taken while drafting the transaction documents recording the unique facts, extraordinary circumstances of distress sale and other salient / distinguishing features of the transaction, so as to ensure that the likely litigation on the direct tax front is avoided or minimised at a later stage.**
- (b) If the transaction is properly documented and substantiated then any action initiated by the Income Tax Department
- (c) This topic assumes more significance in view of the Maharashtra State Govt.'s Decision to keep the Stamp Duty Ready Reckoner Rates of F.Y. 2019-2020 to continue for the current F.Y. 2020-2021 and not to reduce the rates aligning with the market conditions.
- to invoke the aforesaid notional under valuation provisions during the F. Y. 2020-21 may not survive before judicial authorities on account of unprecedented economic conditions prevalent in the country and State Govt.'s refusal to reduce Ready Reckoner Rates.

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**DISCLAIMER**

The analysis / views in this article do not purport to be and should not be treated as a professional opinion. This article should not be relied upon for taking any actions / decisions on the basis of contents of this article, without taking proper professional or legal advise.

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