KEY INCOME TAX ISSUES IN REAL ESTATE INDUSTRY (FROM BUILDERS PERSPECTIVE)

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Real Estate developers earlier were booking revenue based on percentage of completion method because income tax department were favouring percentage of completion method and listed companies were preferring percentage completion method because they can book revenue earlier before project is completed so that they can show good quarterly profits and accordingly their share price will increase. Real Estate Developers were following Guidance Note on Accounting for Real Estate Transactions or Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind As is applicable).

As per Guidance Note on Accounting for Real Estate Transactions (Revised 2012), Accounting for Real Estate Transactions:

Real estate activities and transactions take diverse forms. While some are for sale of land (developed or undeveloped), others are for construction, development or sale of units that are not complete at the time of entering into agreements for construction, development or sale.

The typical features of most construction/development of commercial and residential units have all features of a construction contract – land development, structural engineering, architectural design and construction are all present. The natures of these activities are such that often the date when the activity is commenced and the date when the activity is completed usually fall into different accounting periods. It is not unusual for such activities to spread over two or more accounting periods.

For recognition of revenue in case of real estate sales, it is necessary that all the conditions specified in paragraphs 10 and 11 of Accounting Standard (AS) 9, Revenue Recognition, are satisfied.

Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection.

When recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised.

As stated above, real estate sales take place in a variety of ways and may be subject to different terms and conditions as specified in the agreement for sale. Accordingly, the point of time at which all significant risks and rewards of ownership can be considered as transferred, is required to be determined on the basis of the terms and conditions of the agreement for sale. In case of real estate sales, the seller usually enters into an agreement for sale with the buyer at initial stages of construction. This agreement for sale is also considered to have the effect of transferring all significant risks and rewards of ownership to the buyer provided the agreement is legally enforceable and subject to the satisfaction of conditions which signify transferring of significant risks and rewards even though the legal title is not transferred or the possession of the real estate is not given to the buyer. Once the seller has transferred all the significant risks and rewards to the buyer, any acts on the real estate performed by the seller are, in substance, performed on behalf of the buyer in the manner similar to a contractor. Accordingly, revenue in such cases is recognised by applying the percentage of completion method on the basis of the methodology explained in AS 7, Construction Contracts.

Application of Percentage Completion Method

The percentage completion method should be applied in the accounting of all real estate transactions/activities in the situations described above, i.e., where the economic substance is similar to construction contracts. Some further indicators of such transactions/activities are:

(a) The duration of such projects is beyond 12 months and the project commencement date and project completion date fall into different accounting periods.

(b) Most features of the project are common to construction contracts, viz., land development, structural engineering, architectural design, construction, etc.

(c) While individual units of the project are contracted to be delivered to different buyers these are interdependent upon or interrelated to completion of a number of common activities and/or provision of common amenities.

(d) The construction or development activities form a significant proportion of the project activity. This method is applied when the outcome of a real estate project can be estimated reliably and when all the following conditions are satisfied:

- (a) total project revenues can be estimated reliably;
- (b) it is probable that the economic benefits associated with the project will flow to the enterprise;
- (c) the project costs to complete the project and the stage of project completion at the reporting date can be measured reliably; and
- (d) the project costs attributable to the project can be clearly identified and measured reliably so that actual project costs incurred can be compared with prior estimates.

Further to the conditions mentioned above there is a rebuttable presumption that the outcome of a real estate project can be estimated reliably and that revenue should be recognised under the percentage completion method only when the events in (a) to (d) below are completed.

(a) All critical approvals necessary for commencement of the project have been obtained. These include, wherever applicable: (i) Environmental and other clearances. (ii) Approval of plans, designs, etc. (iii) Title to land or other rights to development/construction. (iv) Change in land use

(b) When the stage of completion of the project reaches a reasonable level of development. A reasonable level of development is not achieved if the expenditure incurred on construction and development costs is less than 25 % of the construction and development costs

(c) Atleast 25% of the saleable project area is secured by contracts or agreements with buyers

(d) Atleast 10 % of the total revenue as per the agreements of sale or any other legally enforceable documents are realised at the reporting date in respect of each of the contracts and it is reasonable to expect that the parties to such contracts will comply with the payment terms as defined in the contracts. To illustrate - If there are 10 Agreements of sale and 10 % of gross amount is realised in case of 8 agreements, revenue can be recognised with respect to these 8 agreements.

For applying the percentage of completion method in respect of a project, the provisions of ICDS III on Construction Contract shall apply mutatis mutandis.

In ICDS III on Construction Contract rest 3 conditions mentioned in (b) , (c) & (d) are same except condition (a) is dispensed with. The same may be because now all new projects are registered under RERA and as per Section 4 (2) (c) The promoter shall enclose with application for registration of real estate projects an authenticated copy of the approvals and commencement certificate from the competent authority obtained in accordance with the laws as may be applicable for the real estate project mentioned in the application, and where the project is proposed to be developed in phases, an authenticated copy of the approvals and commencement certificate from the competent authority for each of such phases.

But after introduction of Ind AS 115 Revenue from contracts with customer's, view came that the completion contract method is to be applicable instead of percentage completion method in case of under construction projects.

My article on Ind AS 115- Revenue from Contracts with Customers – Impacts on Real Estate Industry is already published in CVO CA's News and Views and the same is also uploaded in www.taxguru.in website.

As per this standard below mentioned 5 steps are to be followed for Revenue Recognition

1 Identify the contract(s) with the customer

2 Identify the separate performance obligations

3 Determine the transaction price

4 Allocate the transaction price to the performance obligations

5 Revenue Recognition when performance obligations are satisfied

Sale of Completed Property

It is possible that a Real Estate Developer will sell Real Estate flats/commercial units after the construction of property is completed. Nowadays if a Real Estate Developer will sell property after it is completed then the same can be outside the ambit of RERA & also at the same time the same will be outside the ambit of GST. But mainly for funding purpose Developer tries to sell under construction property so that with internal accruals they can complete the construction to save interest burden on Loan/Debt. In case of sale of completed property as per Ind AS 115 Real Estate Developer will be required to recognize revenue when control is transferred to the customer i.e. at a point in time

Sale of Under Construction Property

Majority of the transactions entered by the Real Estate Developers are sale of under construction property. With the introduction of Ind AS 115 now Real Estate Developer has to account for Revenue by following the above stated 5 steps approach wherein as per step 5 revenue is to be recognized when entity satisfy each performance obligation. So now the question is whether the performance obligation is satisfied when the real estate unit is handed over to customer on delivery or it can be proved that performance obligation is satisfied over a period of time. However, to prove performance obligation is satisfied over a period of time one of the criteria to be met out of three which are

a) The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs

<u>My Comments:</u> if a certain slab is completed then the customer neither receives nor consumes any benefit.

b) The entity's performance creates or enhances an asset (for example work in progress) that the customer controls as the asset is created or enhanced or

<u>My Comments:</u> Again going by the same example if certain slab is completed then customer cannot control that asset.

c) The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

<u>My Comments:</u> Here again if certain slab is completed then the Real Estate Developer does not have any alternative use of that part construction as the same is done only for the customer to whom completed units will be given. Similarly, an entity does not have an enforceable right to payment for performance completed to date. As nowadays majority of the schemes are 20 (advance): 80 (on possession) / 10: 90 / 30: 70 etc where in advance is taken from the customer on registration of agreement & balance amount will be taken only when possession of completed property is given. Based on the above findings one can conclude that Real Estate Developers have to recognize Revenue on Completed contract method as against percentage of completion method (POCM).

The same is against Guidance note on Real Estate Transactions & Draft Income Computation & Disclosure Standard (ICDS) on Real Estate transactions as both are advocating on booking of revenue as per percentage of completion method.

As Ind AS 115 is now applicable instead of guidance note & also as the principles mentioned in Ind AS 115 & Guidance note on real estate transactions to whom Ind AS is applicable were different so on 01-06-2018 ICAI had withdrawn the said Guidance Note on Accounting for Real Estate Transactions (for entities to whom Ind AS is applicable).

Institute of Chartered Accountants of India has released press release on **Implementation of Ind AS 115, Revenue from Contracts with Customers in context of Real Estate Sector**

"It has come to ICAI's attention that there have been misleading and confusing media reports that Ind AS 115, Revenue from Contracts with Customers, (issued by MCA vide notification dated March 28, 2018) permits only Completed Contract Method of accounting for real estate companies. We have come across statements like, *"revenue in case of real estate transactions can be booked only after the project is completed and the customer has taken possession of the unit (house/flat)"*. These kind of reports may lead to misinterpretation of the principles laid down in the Standard.

In view of the above, the ICAI would like to clarify that the Ind AS 115 does allow recognition of revenue using Percentage of Completion Method (POCM) and has explicit and specific requirements to recognise revenue, where performance obligation is satisfied over a period of time etc"

However, based on the above discussion in case of an under construction project also now it is almost impossible to apply percentage of completion method and therefore many listed companies and even private limited companies having high net worth to whom Ind AS is applicable have started applying completed contract method of Revenue Recognition.

Only disadvantage is when projects are under construction no revenue will be booked so there will be adent in the profitability as a result of which pressure may be seen in the prices of shares during those periods in case of listed companies. But once a project is completed i.e. when Occupancy certificate is received Developer will apply completed contract method so profit will be shoot up in that quarter/year so again share price will go up. Normally Developers prefer one project in one SPV but now they may plan more projects/phases in one SPV in such a fashion that almost every year one project will get Occupancy certificate or at least one phase registered with RERA will get Occupancy certificate so that they can book profits every year and there will be no dent in the profitability and therefore there will not be any pressure in share price of that listed companies and private companies having high net worth can get sufficient construction finance.

Occupancy certificate is an important legal document certifying that the construction of the building complies with the approved plans. In Maharashtra, occupancy certificate is issued by the Department of Urban Development only if the constructed building is in the appropriate condition for occupancy.

The same is advisable because real estate developers in case of completed contract method, offer 100% income when project is completed so they are in a better position to book 100% expenses against 100% revenue booked i.e. they also estimate further expenses to be incurred like finishing expenses of buildings and flats because Occupancy certificate can be issued to developer even if finishing activities is pending. Further now as per RERA section 14(3) "In case any structural defect or any other defect in workmanship, quality or provision of services or any other obligations of the promoter as per the agreement for sale relating to such development is brought to the notice of the promoter within a period of five years by the allottee from the date of handing over possession, it shall be the duty of the promoter to rectify such defects without further charge, within thirty days, and in the event of promoter's failure to rectify such defects within such time, the aggrieved allottees shall be entitled to receive appropriate compensation in the manner as provided under this Act."

Therefore, the developer has to also provide for such expenses that may or may not be incurred within 5 years from the date of possession is given to the allottees.

Here to avoid litigation with income tax department regarding allowability of provision for expenses they have to provide all expenses scientifically i.e. all relevant proof of provision of expenses should be kept properly so that the same can be submitted to auditors as well as income tax department in case of assessments or in case of audit queries after assessment or to appellate authorities.

Drawback of percentage of completion was Developers were booking revenue periodically by following percentage of completion method but certain expenses if not provided they were not getting allowance of the same because normally real estate developers are opening one company per project so after 100% revenue is booked if certain expenses were not provided and developer has to incur as mentioned above then they were incurring loss in those years which they were not able to get set off because that project is over. Such kind of problems they will not be facing if they follow a completed contract method in line with Ind AS 115 Revenue from contracts with customers.

CIT vs. Bilahari Investments (P) Ltd. (2008) 299 ITR 1(SC)

It is held that Recognition/identification of income under the Act, is attainable by several methods of accounting. It may be noted that the same result could be attained by any one of the accounting methods.

Completed contract is one such method. Similarly, percentage of completion is another such method.

Under the completed contract method, the revenue is not recognised until the contract is complete. Under the said method, costs are accumulated during the course of the contract. The profit and loss is established in the last accounting period and transferred to a P & L account. The said method determines results only when the contract is completed. This method leads to objective assessment of the results of the contract.

On the other hand, the percentage of completion method tries to attain periodic recognition of income in order to reflect current performance. The amount of revenue recognised under this method is determined by reference to the stage of completion of the contract. The stage of completion can be looked at under this method by taking into consideration the proportion that costs incurred to date bears to the estimated total costs of the contract.

Now based on the above sift of revenue recognition from percentage of completion method to completed contract method department may not like the same so the change in method of accounting will be subject to dispute by the income tax department. In that scenario below decisions will come to rescue.

Disclosure of changes in an accounting policy used for revenue recognition should be made in the financial statements giving the effect of the change and its amount.

Commissioner of Income Tax II Vs Mapin Publishing Pvt Ltd. (Gujarat High Court at Ahmedabad): Tax Appeal No. 902 of 2013

Issue: - It was noticed by the assessing officer that the assessee Company has changed its accounting policy during the year under consideration and it was found that the Company has assessed loss of Rs.6,29,200/-. During the year under consideration as compared to last year profit of Rs.1,27,860/- and therefore, the assessing officer was of the opinion that the impact of change in system has resulted in reduction of revenue during the year. Assessing officer passed an assessment order making addition of Rs.45,78,354/- into total income of the assessee by observing that the assessee has deviated from the accounting system and has shown less profit of Rs. 45,78,354/-.

Held: - Court agreed with the arguments made by the Appellant that during the year under consideration the change in method of accounting was bona fide and with the compliance of the Accounting Standard – AS 9 – Revenue Recognition issued by the Institute of Chartered Accountants of India and provisions of S.5 of Income Tax Act. As per the provisions of the Act, the income is required to be accounted for or offered for taxation in the year in which it is accrued to the assessee and during the year under consideration, the Appellant has changed method of accounting to account for the income in the year in which the project is completed i.e. on the basis of accrual of income. This method of accounting is more accurate, scientific and as per the various statutory requirements and therefore in my opinion, the change in such method of accounting is bona fide and the same cannot be rejected on the ground that it has resulted into claiming more expenditure during the year under consideration. Therefore, I hold that the action of the assessing officer in rejecting change in the method of accounting is incorrect and not sustainable and accordingly the addition made by the assessing officer is hereby deleted.

Satish H. Patel [93 TTJ 458 (Pune)]

It is held that the assessee having changed his method of accounting from work-in- progress in original return to project completion method in revised return, assessment had to be made as per revised return.

Case Laws on Issues relating to Provision of Expenses

Calcutta Co. Ltd. vs CIT (37 ITR 1) (SC)

Section 28(i), read with section 145 of the Income-tax Act, 1961 [Corresponding to section 10(1), read with section 13 of the Indian Income-tax Act, 1922] - Business deductions - Allowable as - Assessment year 1948-49 - Assessee dealt in land and property and carried on land developing business - It maintained its accounts in mercantile method - In relevant accounting period it sold certain plots and even though assessee received only a portion of sale price, it entered in credit side of its account books whole of sale price of plots - Under terms of sale deeds assessee undertook to carryout developments within six months from date of sale - Accordingly, it estimated a sum as expenditure for developments to be carried out in respect of plots sold out during relevant year and debited said sum in its books of account as accrued liability - Department did not take any exception to said estimated expenditure in regard to quantum but disallowed assessee's claim for deduction of that sum by relying upon provisions of section 10(2) of 1922 Act - Whether estimated expenditure which had to be incurred by assessee in discharging a liability which it had already undertaken under terms of sale-deeds of lands in question was an accrued liability which according to mercantile system of accounting assessee was entitled to debit in its books of account for accounting year as against receipts which represented sale proceeds of said lands - Held, yes

Thyssenkrupp Industrial Solutions (India) Private Limited [TS-192-ITAT- 2019(Mum)]

Mumbai ITAT allows provisions made by assessee (ThyssenKrupp) for future expenses relating Lumpsum Turnkey Projects during AY 2006-07, holds thatsubsequent reversal of provision not bar; The assessee carried out Lumpsum Turnkey Projects [LSTK] and the revenue was recognized upon commissioning of the plant, till the final acceptance of the plant by the customer, certain expenses for trialruns and salaries were to be incurred by the company, for which the provision wasmade by the assessee and which was denied by the AO; ITAT notes that since therevenue from the project is recognized after commissioning of the plantwhereas some expenditure is certainly required to be incurred by the assesseebetween the stage of commissioning of the plant and final acceptance of the plant bythe customer, the estimation of expenditure was required to be made; Statesthat these estimations are mere projections which may or may not crystallizedin the subsequent years and may require suitable adjustment by way of furtherdebit or reversal to profit & loss account in subsequent years; Therefore, holdsthat reversal of expenditure in future could not deprive the assessee to claimlegitimate business expenditure under mercantile system of accounting following matching concept of income, especially when the reversals weretaxed in subsequent years, also notes that the estimations were made on thescientific basis.

HUGHES NETWORK SYSTEMS INDIA LTD Vs DCIT(A) NEW DELHI (2008-TIOL-315-ITAT-DEL)

If a business liability has definitely arisen in the accountingyear, the deduction should be allowed although the liability may have to bequantified and discharged at a future date. What should be certain is the incurringof the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in present though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.

Interest on Borrowing Costs

As per clause 2(1)(b)(iii) of ICDS IX inventories that require a period of twelve months or more to bring them to a saleable condition are Qualifying assets.

Recognition

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset.

As the real estate project takes more than 12 months so Interest to be added to the cost of inventories and will be allowed when income from the project will be offered for income tax.

As per Ind AS 23 Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

As per Clause (2)(1)(c)(A)(ii) of Draft ICDS on real estate transaction

Borrowing costs – Costs which are incurred directly in relation to a project or which are apportioned to a project in accordance with Income Computation and Disclosure Standard IX relating to Borrowing Costs.

36 (1) (iii)

The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—

(*iii*) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession:

> **Provided** that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

In above section it appears that there is a conflict between treatment of borrowing cost suggested in ICDS IX and Ind AS 23 Borrowing cost because the said section 36 (1) (iii) is only telling that if interest paid in respect of capital borrowed for the purpose of the business or profession then the same should be allowed in the year in which interest is incurred. Only exception is given to Fixed Assets, till the time asset is not first put to use the same should be added to the cost of the said Fixed Assets. Real Estate projects like under construction of Real Estate Projects are stock in trade (Inventories) and not fixed assets so Developers will follow Accounting Standards/Ind AS which is telling that interest to be capitalised to Inventories till substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Therefore Developers will claim such Interest cost when income from the project will be offered for income tax.

However, if Developer is developing a Mall and will generate rental income from subletting commercial units then they will show Mall not under stock in trade/inventories but under Fixed Assets so in that case there is no conflict between ICDS IX and Ind AS 23 Borrowing cost & 36 (1) (iii) of the Income Tax Act.

Lokhandwala Construction Inds. Ltd. 260 ITR 579 (Bombay HC)

The assessee-company was engaged in the business of construction of buildings. The assessee followed the Mercantile System of accounting. The assessee had secured development rights from Bombay Gaw Rakshak Mandal under Agreement dated 13th December 1984 in respect of a plot of land situate at Kandivali admeasuring 788000 sq. metres for total consideration of Rs 11 crores or Rs 50/- per sq. ft of FSI that may be sanctioned by BMC. During the Assessment Year in question, no activities were carried out and, therefore, work-in-progress came to be carried forward. The assessee had taken loans amounting to Rs. 1.15 crores, out of which an amount of Rs 1.10 crores came to be utilised during the Assessment Year in question for payment to the Mandal. The assessee claimed deduction of Rs. 14,09,942/- paid as interest on moneys borrowed under Section 36 (1) (iii) of the Income-tax Act.

On the above facts, the following question of law arises

"Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the interest claimed as revenue expenditure amounting to Rs. 14,09,942/- cannot be treated as capital expenditure and added to work-in-progress in spite of the fact that other expenses on project were being capitalised by the assessee itself and holding that the Commissioner of Income Tax was wrong in directing the Assessing Officer to disallow the said interest and treat the same as capital expenditure as a part of work-in-progress, thereby quashing the order under Section 263 of the Act of the Commissioner of Income Tax?"

Findings

In the case of India Cements Ltd. V. CIT, Madras reported in 60 ITR Page 52, it was held by the Supreme Court that in cases where the act of borrowing was incidental to carrying on of business. That, for the purposes of deciding the claim of deduction under Section 10(2)(iii) of the Income-tax Act 1922 [section 36(1) (iii) of the present Income-tax Act], it was irrelevant to consider the purpose for which the loan was obtained. In the present case, the assessee was a builder and the assessee had undertaken the Project of construction of flats under the Kandivali Project. Therefore, the loan was for obtaining stock-in-trade. That, the Kandivali Project constituted the stock-in-trade of the assessee. That, the Project did not constitute a fixed asset of the assessee. In this case, we are concerned with deduction under Section 36(1)(iii). Since the assessee had received a loan for obtaining stock-in-trade (Kandivali Project), the assessee was entitled to deduction under Section 36(1)(iii) of the Act. That, while adjudicating the claim for deduction under Section 36(1)(iii) of the Act, the nature of the expense - whether the expense was on capital account or revenue account -was irrelevant as the Section itself says that interest paid by the assessee on the capital borrowed by the assessee was an item of deduction. That, the utilization of the capital was irrelevant for the purposes of adjudicating the claim for deduction under Section 36(1)(iii) of the Act (See judgment of the Bombay High Court in the case of Calico Dyeing and Printing Works v. CIT, Bombay City-II, reported in 34 ITR 265). In that judgment, it has been laid down that where an assessee claims deduction of interest paid on capital borrowed, all that the assessee had to show was that the capital which was borrowed was used for business purpose in the relevant year of account and it did not matter whether the capital was borrowed in order to acquire a revenue asset or a capital asset. The said judgment of the Bombay High Court applies to the facts of this case and decision came in favour of the assessee.

Year of Taxability is immaterial when tax rates are same

CIT vs. EXCEL INDUSTRIES LTD. (2013) 358 ITR 295 (SC)

Held that

The real question concerning us, is the year in which the assessee is required to pay tax. There is no dispute that in the subsequent accounting year, the assessee did make imports and did derive benefits under the advance licence and the duty entitlement pass book and paid tax thereon. Therefore, it is not as if the Revenue has been deprived of any tax. We are told that the rate of tax remained the same in the present assessment year as well as in the subsequent assessment year. Therefore, the dispute raised by the Revenue is entirely academic or at best may have a minor tax effect. There was, therefore, no need for the Revenue to continue with this litigation when it was quite clear that not only was it fruitless (on merits) but also that it may not have added anything much to the public coffers.

For the aforesaid reasons, we dismiss the civil appeals with no order as to costs, but with the hope that the Revenue implements its litigation policy a little more practically and a little more seriously.

In above decision court has not only dismissed the appeal filed by CIT but given advise that Revenue should implements its litigation policy more seriously i.e. should file appeal only in genuine cases and cases when there is a tax leakage and not when tax is already paid but revenue feels that tax is postponed because overall there is no difference in overall tax collection.

Slump Sale

Slump sale is purely a tax concept governed by Section 50B and Section 2(42C) of the Income Tax Act, 1961.

Section 2(42C) of the Act defines slump-sale as follows: "transfer of one or more undertakings as a result of the sale for a lump-sum consideration without values being assigned to the individual assets and liabilities". The prerequisites to a business transfer being in the nature of slump sale will be – a) transfer of a business undertaking, b) by way of sale, c) for a lump sum consideration and c) without values being assigned to the individual assets and liabilities.

So to consider slump-sale following are conditions

1) Transfer of one or more undertaking or one or more business segment

2) Both assets and liabilities have to be transferred i.e. if only assets are transferred then will not qualify under slump sale but then will be considered as sale of individual assets only.

3) Transfer to be done by way of sale

4) For a Lump sum consideration without assigning any values to the individual assets or liabilities

As mentioned above if assets are transferred individually without transferring liability then the same is not considered as slump sale.

The said view is supported by below decision

The Income-tax Appellate Tribunal, Mumbai Bench "J", in the case of Mahindra Sintered Products Ltd v. Deputy CIT [2004] 279 ITR (AT) 1; [2005] 95 ITD 380 has held that where the price had been fixed beforehandin respect of identifiable assets of undertaking and no liability was transferred to the buyer, the transfer of undertaking would not constitute a slump sale.

If all the assets and liabilities of an undertaking is not transferred then the same is not considered as a slump sale.

The said view is supported by below decision

The Income-tax Appellate Tribunal, Kolkata Bench "D", in the case of Deputy CIT v. ICI (India) Ltd. [2008] 23 SOT 58 has held the same view that Hindustan Engg. & Ind. Ltd., AY 2009-10 cannot be a case of slump sale, if all the assets and liabilities of an undertaking have not been transferred to the vendee. The assessee has sold the chemical unit not as a going concern but itemized sale was made vide agreement and hence, the sale cannot be treated as slump sale.

Similarly, the Income-tax Appellate Tribunal, Mumbai Bench "J", in the case of Mahindra Sintered Products Ltd v. Deputy CIT [2004] 279 ITR (AT) 1; [2005] 95 ITD 380 has held that where the price had been fixed beforehand in respect of identifiable assets of undertaking and no liability was transferred to the buyer, the transfer of undertaking would not constitute a slump sale.

Section 50 B is reproduced below

50B. (1) Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place

Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

47**[(2) In relation to capital assets being an undertaking or division transferred by way of such slump sale,—**

(*i*) the "net worth" of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 and no regard shall be given to the provisions contained in the second proviso to section 48;

(*ii*) fair market value of the capital assets as on the date of transfer, calculated in the prescribed manner, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.]

(3) Every assessee, in the case of slump sale, shall furnish in the prescribed form, a report of an accountant as defined in the *Explanation* below sub-section (2) of section 288 before the specified date referred to in section 44AB] indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived at in accordance with the provisions of this section.

Explanation 1. **For the purposes of this section, "net worth" shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account:**

Provided that any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

Explanation 2. **For computing the net worth, the aggregate value of total assets shall be,—**

(*a*) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in sub-item (*C*) of item (*i*) of sub-clause (*c*) of clause (*6*) of section 43;

[(*aa*) in the case of capital asset being goodwill of a business or profession, which has not been acquired by the assessee by purchase from a previous owner, *nil;*]

(*b*) in the case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD, *nil;* and

(*c*) in the case of other assets, the book value of such assets.

If you are selling any undertaking or division whose major assets are under fixed assets more than 3 years then also if you will sell, income of that assets will be taxed under short term capital gain under section 50 if depreciation is claimed/allowed.

But if all assets and liabilities are transferred and if conditions mentioned above in Section 50B and Section 2(42C) of the Income Tax Act, 1961 are fulfilled and if classified as slump sale and if held for more than 36 months then income will be classified under long term capital gain (20% Plus surcharge (if applicable)& cess). If not classified under slump sale then rate of short term capital gain will be normal tax i.e. 25.17% to 34.944% etc based on type of assessee and which section assessee is following in case of companies. So to save 2% to 10% plus and on that difference of 2% to 10% surcharge and cess will be also saved if assessee sale under slump sale as discussed above.

How to calculate income under slump sale is specified under section 50B as mentioned above i.e.

Sales Consideration

Less expenses on transfer

= Net consideration

Less Cost of acquisition i.e, Net worth to be calculated as per section 50B as mentioned above

= Capital Gain/Loss

If Net worth is negative, then cost of acquisition to be taken as NIL as per below decisions:

In the case of Zuari Industries Ltd. [(2007) 105 ITD 569 (Mumbai)] and

Paper Base Co. Ltd. [(2008) 19 SOT 163 (Delhi)]: it was held that if the net worth of the undertaking is negative, the same should be considered as zero and should be disregarded for the purposes of computing capital gains under Section 50B of the Act.

If Net worth is negative then negative networth to be added to the sales consideration to arrive at capital gains tax:

However, if net worth is negative then as per Mumbai special bench in case of Summit Securities Ltd. [2012] 19 taxmann.com 102 (Mum.) (SB) dissented from the above decisions and held that negative networth to be added to the sales consideration to arrive at capital gains which is the killer i.e. very purpose of transaction to be classified under slump sale to save tax will be defeated.

The Hon'ble Special Bench opined that the negative net worth of an undertaking cannot be equated to zero and the same should be added to the sale consideration to arrive at capital gains. In the case before Special Bench, sale consideration of the business was Rs. 143 crore and there was negative 'net worth' of Rs. 157 crore as per section 50B. It was held that, negative figure of net worth of Rs. 157 crore could not be ignored and, thus, capital gain chargeable to tax in case of slump sale would be Rs. 300 crore (i.e., Rs. 143 crore plus Rs. 157 core) and not Rs. 143 crore only as declared by assessee.

In case of negative net worth selling individual assets will be more beneficial even if classified as short term capital gain under section 50 if depreciation is claimed, then if sold under slump sale as in slump sale if negative net worth is there, then the same will be added to sales consideration then even if long term capital gain is to be paid as per section 50B but that tax payable amount as per section 50B will be higher than section 50 amount.

Is Slump sale being liable to GST?

Schedule II of CGST Act deals with ACTIVITIES TO BE TREATED AS SUPPLY OF GOODS OR SUPPLY OF SERVICES

4. Transfer of business assets (a) where goods forming part of the assets of a business are transferred or disposed of by or under the directions of the person carrying on the business so as no longer to form part of those assets, whether or not for a consideration, such transfer or disposal is a supply of goods by the person;

As per entry 4 (a) of Schedule II of CGST Act if assets of a business are transferred or disposed of then the same are considered as supply of Goods.

4. Transfer of business assets (c) where any person ceases to be a taxable person, any goods forming part of the assets of any business carried on by him shall be deemed to be supplied by him in the course or furtherance of his business immediately before he ceases to be a taxable person, unless— (i) the business is transferred as a going concern to another person; or (ii) the business is carried on by a personal representative who is deemed to be a taxable person.

As per clause 4 (c) if the entire business is transferred as a going concern then the same is not considered as a Supply of Goods under GST.

As per Notification No. 12/2017- Central Tax (Rate) (SI No 2) Services by way of transfer of a going concern, as a whole or an independent part thereof is exempt from GST.

As per the said Notification Services by way of transfer of going concern as a whole or part thereof is exempt from GST.

Therefore, in case of slump sale not only income will be classified under long term capital gain so less tax but the same is also exempt under GST. So huge tax saving is possible.

Now the **General Anti Avoidance Rule (GAAR)** is applicable, so all companies are advised to keep provisions of GAAR in mind before entering any arrangement where tax benefit is there to avoid further litigation and to avoid additional tax, interest and penalty.

As per Rule-10U, Income-tax Rules (1) (a)

Chapter X-A not to apply in certain cases. —(1) The provisions of Chapter X-A shall not apply to—

(a) an arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of rupees three crore;

Therefore, if any arrangement is entered where tax benefit is up to Rs 3 crores to all the parties to the arrangement then GAAR provisions are not applicable. So in such cases there is less worry.

Determination of consequences of impermissible avoidance arrangement.

10UA . For the purposes of sub-section (1) of section 98, where a part of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only.

96. Impermissible avoidance arrangement. —(1) An impermissible avoidance arrangement means an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and it—

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

(d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

(2) An arrangement shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

So based on the above it appears that if an arrangement, main purpose or one of the main purpose is to obtain a tax benefit then the entire arrangement or part of the arrangement is called impermissible avoidance arrangement. If an arrangement creates rights or obligations not at arm's - length, results directly or indirectly in the misuse or abuse of the provisions of Income tax act and lacks commercial substance (open ended so scope is wide) or is deemed to lack commercial substance under section 97 or is entered into or carried out in a manner which are not ordinarily employed for bona fide purpose.

GAAR empowers the tax authorities, to not only target sham transactions and colourable devices, but also to counteract the abusive elements of arrangements that are otherwise legally valid.

A self serving evaluation, which is not bona fide, leading to claim of reduced tax burden for the Assessee will be a colourable device within the meaning of the landmark decision of **Hon'ble Supreme Court in the case of McDowell and Co. Ltd. Vs. Commercial Tax Officer 154 ITR 148 (SC)**. **A colourable device to evade tax has to be rejected.**

In above decision below was also quoted:

W.T. Ramsay v. Inland Revenue Commissioners, [1982] AC

300; Inland Revenue Commissioners v. Burmah Oil Company Ltd. 1982 STC 30; Furniss v. Dawson, [1984] I All E.R. 530 quoted with approval.

HELD: (Per Ranganath Misra, J.)

Tax planning may be legitimate provided it is within the framework of law, Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges.

[823 H, 824 A]

Taxability of Unsold Flats

Section 23 (5) Where the property consisting of any building or land appurtenant there to is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period up to two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be nil.

Normally Developers develops the flat or commercial premises to sell and not to sublet so if flats are unsold then up to 2 years from the end of the financial year in which the certificate of completion of construction of property is obtained from the competent authority then annual value of such property or part of the property should be considered as Nil. Afterwards the same will be taxable as Income from House Property even if the Developer has developed flats or commercial premises for sale and not for subletting. The purpose of introduction of the said section appears two fold, one reason is to get more tax and another reason is to penalise developer if they are not able to sale flats which are completed so they may reduce the price and sell the same so people will get flats at some discount and developer will be able to repay loan taken on construction of the project.

Here word certificate of completion of construction of property is mentioned i.e. taxability will start after 2 years from the end of the financial year in which Building Completion Certificate (BCC) is obtained and not Occupancy Certificate (O.C.). Developers receive BCC after receipt of OC so Developers will rightly get some more time of exemption from taxation of Unsold flats.

Annual Information Return (AIR) of 'high value financial transactions' (statement of financial transaction (SFT)) is required to be furnished under section 285BA of the Income-tax Act, 1961 by 'specified persons' in respect of 'specified transactions' registered or recorded by them during the financial year.

Serial No	Class of persons Nature and value of transaction (3)	Nature and value of transactions
6	Registrar or Sub-Registrar appointed under section 6 of the Registration Act, 1908.	Purchase or sale by any person of immovable property valued at thirty lakh rupees or more.

Registrar or Sub-Registrar appointed under section 6 of the Registration Act, 1908.

Based on above details received by Income tax department (SFT) & 26 AS, software of Income tax department will try to compare data received with income tax return of developer so if some mismatch is found then many notices are issued by income tax department to many Builders for escapement of income. Developers follow a percentage of completion method or completed contract method of revenue recognition so it is possible that income is offered for tax but may be in a different year/s but still they get income tax escapement notices. Lot of time, energy and money goes in replying to such notices.