Tax-treatment in respect of receipt on transfer / sale of Transferable Development Rights (TDRs)

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By. S.K. Tyagi

I. Introduction

Of late, the concept of Transferable Development Rights (TDRs) has been very much in vogue, in regard to the developers and builders engaged in the business of estate development, as also the Central, State Governments or other semi-Government agencies, which are required to provide civic amenities like roads, playgrounds, parks, etc.

The term Transferable Development Rights (TDRs) means making available certain amount of additional built-up area, in lieu of the area relinquished or surrendered by the owner of the land, so that he can use extra built-up area, either himself or transfer it to another, in need of the extra built-up area for an agreed sum of money. As per Advanced Law Lexicon, 3rd Edition, 2005, by P.R. Aiyar, Transferable Development Rights (TDRs) means certificates issued in respect of category of land acquired for public purpose either by Central or State Government, in consideration of surrender of land by the owner with monetary compensation, which are transferable in part or whole.

In regard to the **purpose of TDR**, it may be stated that the process of land acquisition in urban areas for public purpose specially for road widening, parks, playgrounds and schools, etc, is complicated, costly and time-consuming. In order to minimize the time needed and to enable a process which could be advantageously put into practice to acquire land for reservation purposes, the concept of TDR comes in handy.

In this context, another note-worthy aspect is whether Development Rights Certificate (DRC) is transferable / inheritable. As already stated, if the owner of any land which is required for road widening or development of parks, playgrounds, civic amenities, etc, such land shall be eligible for the award of Transferable Development Rights (TDRs). Such award will entitle the owner of the land, rights in the form of Development Rights Certificate (DRC), which he may use for himself for transfer to any other person.

II. Discussion about Development Control Regulations, 1991, Greater Bombay

In this context, it will be appropriate to refer to the Development Control Regulations, 1991, Greater Bombay. Rule 34 of the aforesaid regulations defines TDR, which stands for Transferable Development Rights. As per rule 34, in certain circumstances, the development potential of a plot of land may be separated from the land itself and may be made available to the owner of the land in the form of TDRs. These rights may be made available, and be subject to regulations in Appendix VII hereto. Appendix VII lays down the rules for the grant of Transferable Development Rights to owners / developers and conditions for grant of such rights, which may be broadly listed as follows :

1. The owner (or lessee) of a plot of land which is reserved for public purpose under the development plan and for additional amenities deemed to be reservations provided in accordance with these regulations, excepting under certain conditions, shall be eligible for the award of TDR in the form of floor space index (FSI) to the extent and on the condition that such award will entitle the owner of the land to FSI in the form of Development Rights Certificate, which he may use himself or transfer to any other person.

2. Subject to regulation 1, where a plot of land is reserved for any purpose specified in section 22 of Maharashtra Regional and Town Planning Act, 1966, the owner would be eligible for development rights to the extent stipulated in Rules 5 and 6 in the aforesaid Appendix, after the said land is surrendered free of cost or after completion of development.

3. TDRs will be available only for prospective development of reservations.

4. Development Rights Certificates will be issued by the Commissioner himself, giving details of FSI credit.
5. The built-up area for the purpose of FSI shall be equal to the gross area of the reserved plot to be surrendered. When the owner or lessee also develops or constructs the amenity on the surrendered plot at his cost, he may be granted a further development right in the form of FSI equal to area of construction / development done by him.

Similar rules have been framed in other big cities like Bangalore, where the concept of TDR is being made use of for the purpose of development of public amenities.

III. Whether the receipt on transfer / sale of TDRs is liable to capital gains tax.

In this Article, we are concerned with the issue, whether the receipts on sale of such TDRs could be brought to tax.

At the outset, most of the Judicial Fora have held that surrender of land for the acquisition of TDR would be completely exempt, because in case of acquisition of TDR, the land which is transferred is different and TDR right received is different, for which there is no cost of acquisition and therefore, when the TDRs are sold, there is no capital gains liability. In this context, it is relevant to state that Courts have consistently been taking a view that any amount received by an assessee from the transfer of an asset, for which no cost can be attributed, cannot be made exigible to tax. In this regard, a landmark judgement has been delivered by the Supreme Court in *CIT Vs B. C. Srinivasa Setty [1981] 128 ITR 294 (SC).* It was held in this case that all transactions encompassed by section 45 must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by section 45 to be the subject of the charge. What is contemplated by section 48(ii) is an asset in the acquisition of which it is possible to envisage a cost; it must be an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. None of the provisions pertaining to the head "*Capital gains*" suggests that they include an asset in the acquisition of which no cost at all can be conceived. When goodwill generated in a new business is sold and the consideration brought to tax, what is charged is the capital value of the asset and not any profit or gain. Further, the date of acquisition of the asset is a material factor in applying the computation provisions pertaining to capital gain; but in the case of goodwill generated in a new business it is not possible to determine the date when it comes into existence.

Another important judgement delivered by the Supreme Court in this context is *CIT Vs D. P. Sandhu Bros. Chembur P. Ltd or Union of India Vs Cadell Weaving Mills Co. P. Ltd [2005] 273 ITR 1 (SC).* It was held in this case that –

(i) The tenancy right was a capital asset. Surrender of tenancy right was a transfer and the consideration received therefor was a capital receipt, within the meaning of section 45, and

(ii) The amendment to section 55(2) took effect from 1.4.1995 and applied in relation to assessment year 1995-96 and subsequent years. Therefore, till that amendment in 1995, the law was that if the cost of acquisition could not, in fact be determined, the transfer of such capital asset would not attract capital gains tax.

In this regard, it will also be relevant to refer to the provisions of section 55(2)(a), which are reproduced as follows :

"55. Meaning of "adjusted", "cost of improvement" and "cost of acquisition".

(2) For the purposes of sections 48 and 49, "cost of acquisition",—

(a) in relation to a capital asset, being goodwill of a business or a trade mark or brand name associated with a business or a right to manufacture, produce or process any article or thing or right to carry on any business, tenancy rights, stage carriage permits or loom hours,—

(i) in the case of acquisition of such asset by the assessee by purchase from a previous owner, means the amount of the purchase price ; and

(ii) in any other case not being a case falling under sub-clauses (i) to (iv) of sub-section (1) of section 49, shall be taken to be nil ;"

From the aforesaid provisions of section 55(2)(a), it may be seen that the same do not include Transferable Development Rights (TDRs). Therefore, the sale of TDR will not be liable to capital gains tax.

IV. Legal precedents in support of the view that there will be no capital gains tax on transfer / sale of TDR

There are a number of legal precedents which support the view that there will be no capital gains tax on the transfer / sale of Transferable Development Rights (TDRs). The same are discussed as follows :

1. *CIT Vs Sambhaji Nagar CHS Ltd. [2015] 370 ITR 325 (Bom) : 113 DTR 89 (Bom)*

In this case the assessee-society, with the promulgation of Development Control Rules (DCR) for Greater Mumbai, 1991, acquired the right of putting up additional construction through Transferable Development Rights (TDR). Instead of utilizing the right itself, the assessee decided to transfer the right to a developer for a consideration. The Assessing Officer (AO), for the assessment year 2007-08, held that the assessee transferred a valuable right, which was a capital asset under section 2(14) of the Income-Tax Act, 1961 (the Act). The right created by the DCR, 1991, attached to the land owned by the assessee which was acquired for a value. Its title or ownership of the plot enabled the assessee to consume this floor space index (FSI) / transferable development right. Under these circumstances, the AO held that this was a transfer of capital asset held by the assessee, which was chargeable to tax. This was confirmed by the CIT(A). The Tribunal, however, held that the sale of transferable development rights did not give rise to any capital gains chargeable to tax.

It was concluded by the Tribunal that the assessee had not incurred any cost of acquisition in respect of the right which emanated from the 1991 Rules, making the assessee eligible to additional FSI. The land and the building earlier in the possession of the assessee continued to remain with it. Even after the transfer of the right or the additional FSI, the position did not undergo any change. The Revenue could not point out any particular asset as specified in section 55(2) of the Act.

On appeal by the Revenue to the High Court, dismissing the appeal, it was held that the Tribunal was justified in concluding that the additional FSI / TDR which was generated by the plot / property / land and came to be transferred under a document, in favour of the purchaser, would not result in the gains being assessed to capital gains. Accordingly, the conclusion of the Tribunal was imminently possible on the facts and in the light of the legal position as noted by the language of section 55(2) of the Act.

In effect it was held by the High Court that an asset which is capable of an acquisition at a cost would be included in the provisions pertaining to the head "*Capital gains*", as opposed to assets in the acquisition of which no cost at all can be conceived.

2. *CIT Vs Amrik Singh [2008] 299 ITR 14 (P&H) : 3 DTR 325* (P&H)

In this case, the assessee entered into an agreement with Shri Surjan Singh, vide agreement dated 14.2.1970, recognizing him to be the occupancy tenant in respect of certain land. A declaratory decree was subsequently passed by the Court on 31.1.1972, whereby the agreement dated 14.2.1970 was given the Court's sanction in terms of section 3 of the Punjab Occupancy Tenants (Vesting of Proprietary Rights) Act, 1952. Thus, the assessee became the owner of the land in respect of which he had earlier acquired only the tenancy rights. Thus, the assessee had acquired the ownership rights in the land by operation of law and not by purchase or inheritance. There is no record of any payment made for the acquisition of land in question either by the assessee or his predecessor-in-interest.

The assessee, therefore, contended that he was not liable to pay any capital gains tax for the said land. The ITO did not agree with the assessee but the Tribunal held that no taxable capital gains arose.

On a reference, it was held by the High Court that the assessee became the owner of the land in respect of which he had earlier acquired only tenancy rights. Thus, the assessee had acquired the ownership rights in the land by operation of law and not by purchase or inheritance. Therefore, the assessee was not liable to pay any capital gains tax.

3. *Land Breez Co-operative Housing Society Ltd. Vs ITO [2013] 21 ITR (Trib) 467 (Mum)*

In this case, a part of a land was transferred by its owner to the assessee, a housing co-operative society, for a consideration. Upon the demise of the original owner, her daughter entered into an agreement with another developer granting comprehensive development rights in respect of the balance portion of the land. Apprehending that the developer and the daughter would seek to develop the property by, *inter-alia*, utilizing the floor space index (FSI) pertaining to its part of the land, the assessee-society through its members instituted legal proceedings. An agreement was reached between the parties and the assessee-society and its members were paid certain amount for grant of permission and towards settlement of disputes between the builders, the assessee-society and its members. The Assessing Officer (AO) sought to tax the consideration so received in the hands of the assessee-society, *inter-alia*, on the ground that the land was acquired by the assessee-society after paying a consideration and ownership of the land carried with it a bundle of rights attached to it and of which the right of development was an important one. Therefore, the benefit in the form of transferable development rights (TDRs) arising out of the existing land was an immovable property, the transfer of which was liable to be taxed as income under the head "*Capital gains*". The Assessing Officer's stand was upheld by the CIT(A).

On further appeal to the Tribunal, it was held that even though the Transferable Development Rights amounted to the transfer of a capital asset, it could not be subjected to tax under the head "*Capital gains*", for the reason that there was no cost of acquisition in acquiring the right which has been transferred. Therefore, taxing of the receipts on the transfer of Transferable Development Rights under the head "Capital gains" could not be sustained.

4. *ACIT Vs I G E India Ltd. [2013] 22 ITR (Trib) 365 (Mum)*

The assessee, in the year 1984, purchased a residential flat in a co-operative society. Under the Development Control Regulations (DCR) 1991, the assessee became entitled to the right to allow the usage of additional floor space index (FSI) of an area equivalent to the existing FSI, which worked out to 1608.67 sq. mtrs, and was available for development. Looking at the dilapidated state of the building, it was decided by the society to demolish the existing building and construct two new buildings on the property making use of the additional FSI granted under the DCR. Accordingly, the development of the building was undertaken under an agreement dated 18.11.2004 with M/s Gulmohar Developers and the transferable development rights were sold to the builder for a consideration of Rs.8.35 crores towards collective share of twenty four occupants of the flats of the society. The assessee's share, as a member of the society was allocated at Rs.33,23,522, out of which Rs.16,61,761, was receivable at the time of execution of the agreement. The Assessing Officer held that the net amount was chargeable to capital gains under section 50 of the Income-Tax Act, 1961. The CIT(A) held that the capital gains tax was not payable.

On appeal before the Tribunal, it was held that even though the transfer of transferable development rights (TDRs) amounts to transfer of a capital asset, the gains could not be subjected to tax under the head "*Capital gains*" for the reason that there was no cost of acquisition in acquiring the flat which had been transferred and the computation mode given under section 48 was, thus, inapplicable in such cases.

5. *Maheshwar Prakash-2 Co-operative Housing Society Ltd. Vs ITO [2009] 313 ITR (AT) 103 (Mum) : 20 DTR 269 (Mum)*

In this case, the assessee, a co-operative housing society, owned a building which had been constructed utilizing the floor space index (FSI) available to it. By virtue of the Development Control Regulations (DCR) 1991, additional right of availing of additional FSI through transferable development rights (TDRs) accrued to the assessee. The assessee entered into an agreement with M/s V S Magnet Pvt. Ltd. and M/s Spartek Properties and Securities Pvt. Ltd. on 25.11.2002 for construction of additional floors on the existing structure of the building and development of the property against a consideration of Rs.42 lakhs. According to the agreement, the TDRs had to be arranged by the developers at their own cost. The Assessing Officer (AO) assessed the amount received by the assessee under the agreement as long-term capital gains on the ground that the right to construct will be embedded in the land held by the assessee for more than three years. Accordingly, the AO made an addition of Rs.42 lakhs on account of long-term capital gains. The CIT(A) rejected the contention of the assessee that no capital gains arose to the assessee inasmuch as there was no cost of acquisition and upheld the order of the AO.

The assessee preferred an appeal before the Tribunal contending that there could not be any transfer without having TDRs, that the right to construct additional floors was acquired by the assessee free of cost by virtue of the 1991 DCR and consequently, no capital gains arose. The Revenue contended that in view of the amended provisions of section 55 of the Act, the cost of acquisition had to be taken as Nil and the entire receipt was to be treated as capital gains.

Held, allowing the appeal of the assessee, that the right to construct the additional storeys on account of increase in the FSI by virtue of 1991 DCR, was a capital asset held by the assessee. Therefore, assignment of the right to construct the additional storeys in favour of the developers amounted to transfer of a capital asset. The contention of the assessee that there could not be any transfer without having transferable development right was without force since the right to construct additional floors and the transferable rights were different and distinct rights which could be transferred for a consideration. The amended provisions of section 55(2) were not applicable as the assessee was not carrying on any business and the right to construct additional floors was not covered by any of the assets mentioned under section 55(2). The authorities were not justified in taking the cost of acquisition of the right to construct the additional floors as Nil. The right was not embedded in the land as the additional right which accrued to the assessee by virtue of 1991 DCR was distinct and separate from the original right. The right to construct additional floors exclusively belonged to the building owned by the assessee and it could not be transferred to any other society. Similarly the right belonging to other societies could not be purchased by the assessee for the purpose of constructing additional floors in its own building. Therefore, such right had no inherent quality of being available on expenditure of money and therefore, a cost for such an asset could not be envisaged. The right acquired by the assessee did not fall within the ambit of section 45. The consideration received in terms of the agreement was a capital receipt which was not chargeable to tax.

In other words it was held that the right to make additional construction for acquiring of additional FSI by operation of DCRs 1991, having no cost of acquisition to the assessee, receipt on transfer thereof, was capital receipt which could not be charged to tax as capital gains.

6. *New Shailaja Co-operative Housing Society Ltd. Vs ITO [2009] 18 DTR (Trib) 385 (Bom)*

In this case, the assessee, a co-operative housing society had acquired land in the year 1972 along with building thereon constructed by use of floor space index (FSI) of apprx. 11,000 sq. ft. By virtue of enactment of the Development Control Regulations (DCRs) 1991, the assessee became entitled to additional FSI of around 11,000 sq. ft. The assessee sold such entitlement right to M/s D.K. Builders for a consideration of Rs.48,96,225. The Assessing Officer (AO) called upon the assessee to show cause as to why the income on transferable development rights (TDRs) should not be treated as adventure in the nature of trade. The assessee claimed that the right to transfer by the assessee did not have any cost of acquisition and therefore, provisions of section 45 did not apply. The AO did not accept the aforesaid claim of the assessee and accordingly, he computed the capital gains at Rs.1.22 crores. The CIT(A) did not find any merit in the submission of the assessee on this issue and dismissed the assessee's appeal.

On further appeal by the assessee before the Tribunal, it was held that the assessee having incurred no cost of acquisition for additional FSI to which it became entitled under the newly promulgated Development Control Regulations of Municipal Corporation, cannot be subjected to capital gains tax on transfer of such additional FSI. It was also held that the right to additional FSI was not included in any asset as specified in section 55(2) of the Act.

7. *ITO Vs Lotia Court Co-operative Housing Society Ltd. [2008] 12 DTR (Trib) 396 (Mum) : 118 TTJ 199 (Mum)*

In this case, the assessee, a registered society consisted of eleven members. The assessee society was entitled to receive certain TDRs from the Municipal Corporation of Mumbai, according to which additional floors could be constructed on the existing building. The said right to receive TDR was assigned to a builder by the members of the society for the purpose of repairing the said building. The assessee entered into an agreement with the developer, wherein the terms of settlement vis-a-vis the members of the society were agreed upon. Separate agreement was entered into by the respective owners of the flats, i.e. the members of the society with the developer, for the assignment of TDR and construction of additional floors, in respect of each flat owner by the respective parties. The benefit of additional TDR was derived and enjoyed by the members of the assessee society and no consideration whatsoever was received by the assessee society for the assignment of TDRs and for carrying out the repairs of the building and construction of additional floors. The Assessing Officer (AO) treated the consideration received / receivable by the members of the society as income in the hands of the society. The CIT(A) noted that neither an income had been received by the society, nor any income had accrued to the society and following the ratio laid down by the Mumbai Bench of the Tribunal in the case of *Jethalal D. Mehta Vs Dy.CIT* (ITA No.672 / Mum / 2000, for the AY 1996-97 dt.27.1.2005), it was held that there was no merit in computing any capital gains on the sale of such TDRs in the hands of the assessee society.

On appeal by the I.T. Department before the Tribunal, it was held that transfer of TDR rights by individual members of the assessee society, which was not owner of the land, to the developer, against repairs of the building and construction of additional floors without receipt of any consideration by individual flat owners of the society and without allocating any area in the constructed portion, did not give rise to any chargeable income or for that matter, capital gains.

In other words, it was held that there was no question of taxable receipt on account of sale of additional floor space index (FSI) received by the assessee by virtue of transfer of TDRs under the Development Control Regulations, 1991, of Municipal Corporation, Mumbai.

V. Discussion about a novel judgement of Mumbai Bench of the Tribunal

Recently an interesting decision has been delivered by the Mumbai Bench of the Tribunal in the case of *Kushal K.Bangia (a tax-payer) (ITA No.630 / Mum / 2006).* In this case, it has been held that the cash compensation received by a member of the housing society under a development scheme from a developer is to be treated as "*capital receipt*" and hence not taxable as "*revenue receipt*" in the hands of the member. Consequently, the said compensation would reduce the cost of acquisition of the new flat at the time of computing the capital gains in respect of the said new flat. The brief facts of the case and ruling of the Tribunal are worth noting, which are listed as follows :

1. Facts of the case

(i) The tax-payer, an individual was a member of a housing society. The housing society, along with its members entered into an agreement with a developer for demolishing the residential building and construction of a new multi-storied building by using the FSI arising out of the property and by utilizing the TDR.

(ii) Under this agreement, the tax-payer received a slightly larger flat in the new building, a displacement compensation of Rs.6,12,000 (computed at the rate of Rs.34,000per month) for the period of construction of the new building and an additional compensation in cash of Rs.11,75,000.

(iii) The Assessing Officer (AO) brought to tax both the estimated value of the additional space in the new building and also the cash compensation received by the tax-payer.

(iv) Aggrieved by the order of the AO, the tax-payer preferred an appeal before the CIT(A). The CIT(A) deleted the addition of the estimated value of the additional space. However, the treatment of cash compensation as "*casual income*" chargeable to tax as "*Income from other sources*" was upheld by the CIT(A).

2. Tribunal's ruling

The ruling of the Tribunal may be summarized as follows :

(i) A capital receipt in principle is outside the scope of income chargeable to tax.

(ii) Hence, the connotation of income howsoever wide and exhaustive, can take into account only such capital receipts as taxable income as are provided as specifically taxable in the Income-Tax Act.

(iii) Unless it is in the nature of revenue or is brought within the ambit of income by way of specific provision under the Act, the receipt would not be taxable.

(iv) Further, one has to analyze the nature of payment in the hands of the receiver and not what is in the hands of the payer.

(v) The compensation received by the tax-payer is relating to the flat owned by the tax-payer and is clearly capital in nature (as the flat is a capital asset) even if it is revenue expenditure for the developer.

(vi) The impugned receipt though not taxable as revenue receipt would end up reducing the cost of acquisition of the flat and would be taken into account as and when the occasion arises for computing the capital gains in respect of the new residential flat.

VI. Conclusion

In the light of the discussion in the preceding paragraphs, it may be safely stated that there will be no capital gains tax on the receipts on transfer / sale of TDRs.

The developer or the builder, as also the other connected parties may make use of the aforesaid provisions, in order to avoid payment of any capital gains tax in the scenario discussed in the aforesaid paragraphs.

S. K. TYAGI	**Office**	: (020) 26133012	Flat No.2, (First Floor)
M.Sc., LL.B., **Advocate**		: (020) 40024949	Gurudatta Avenue
Ex-Indian Revenue Service	**Residence**	: (020) 40044332	Popular Heights Road
Income-Tax Advisor	**E-mails**	: sktyagidt@airtelmail.in	Koregaon Park
Website: www.sktyagidt.com		: tyagi@sktyagidt.com	PUNE - 411 001