

Requirement of valuation reports in capital gain valuation (with notes)
(Under 55, 45, 50B, 50C, 45(5A) 56(2) (x) and rule 111UAE for company act valuation)

1. Under Section 55

1. Self-acquired Immovable property

a) Purchased before 01.04.1981, sold on or before 31.03.2017

The report must be based on either Cost of acquisition or the Fair Market Value of the property at the option of the assessee. This condition prevails when the property is sold on or before 31.03.2017. In this case, the assessee option of choosing any one of the above is allowed. (Application: Old Cost Inflation Index)

b) Purchased before 01.04.1981, sold on or after 01.04.2017 but before 31.03.2020

The report must be based on the fair market value as of 01.04.2001, if the property sold after 01.04.2017, but on or before 31.03.2020. The Fair Market Value as of 01.04.2001 will be treated as the acquisition cost. The valuer is restricted to adopt only the fair market value as of 01.04.2001. (Application: New Cost Inflation Index)

c) Purchased before 01.04.1981 sold on or after 01.04.2020

The report must be based on the fair market value, if the property sold after 01.04.2020. The Fair Market Value as of 01.04.2001 will be treated as the acquisition cost. The valuer is restricted to adopt the fair market value as of 01.04.2001 with a stipulation that, the **FMV should not exceed the stamp duty value** of the registration department. (Application: New Cost Inflation Index)

2. Section 49 - Immovable property acquired from the previous owner) gift, will, settlement, succession, etc.

a) Acquired before 01.04.1981, sold on or before 31.03.2017

The report must be based on either cost of acquisition of the previous owner or the Fair Market Value of the property at the option of the assessee. This condition prevails when the property is sold on or before 31.03.2017. In this case, the assessee option of choosing any one of the above is allowed. The report for the property selling earlier to 31.03.2017 may not arise in the present instance for capital gain valuation purposes. (Application: Old Cost Inflation Index)

b) Acquired before 01.04.1981 sold on or after 01.04.2017 but before 31.03.2020

The report must be based on the fair market value only as of 01.04.2001, if the property sold after 01.04.2017 but on or before 31.03.2020. The Fair Market Value as of 01.04.2001 will be treated as the acquisition cost. The valuer is restricted to adopt only the fair market value as of 01.04.2001. (Application: New Cost Inflation Index)

c) Acquired before 01.04.1981 sold on or after 01.04.2020

The report must be based on the fair market value only as of 01.04.2001, if the property sold after 01.04.2020. The Fair Market Value as of 01.04.2001 will be treated as the acquisition cost. The valuer is restricted to adopt the fair market value as of 01.04.2001 with a stipulation that, the **FMV should**

not exceed the stamp duty value of the registration department. (Application: New Cost Inflation Index).

3. Section 45

1. Section 45 (1A) Damage Claim from Insurance

Any profits or gains arising from the receipt of the insurance money or other assets is considered to be a capital gain in nature and is chargeable to income-tax. An insurer gives the insurance claim on account of damage or destruction of the capital asset because of natural calamities or other reasons. Some of the reasons which may lead to the destruction of a capital asset are as follows: 1. Natural hazards such as floods, hurricanes, earthquakes, cyclone or other natural calamities. 2. Communal riots or a civil disorder. 3. Accidental fire or an explosion. 4. Negative action was taken by an enemy to harm the business.

If a building is destroyed due to fire, the cost of improvement of the building is determined as on the date of improvement. The improvement cost is indexed till the date of the damage. When the damage claim is received, the difference between the compensation and the indexed cost of improvement will be the profit or gain. The gain may be a long term or short term capital gain. If it is a short term capital gain, the gain is added to the income of the year. If it is a long term capital gain, it will be taxed under capital gain tax.

There are cases, the entire manufacturing unit consisting of many structures is covered under group insurance. The insurance company may require a valuation report for the reproduction cost of the destructed building alone for the claim to be awarded. For the new structure, they may require a cost of construction as on the date of improvement, to substantiate or compare the claim to be awarded. This will be an additional scope apart from the capital gain valuation report for the valuer.

Note: In the book of accounts, normally these type of building will be subject to depreciation. The asset cost will be depreciated every year under IT Act stipulation. The capital gain will always be in short term for depreciable asset.

2. Section 45 (2) – Conversion of capital assets into Stock-in-trade

This normally happens in cases, when a business owning fixed assets, at a later date start a new business of selling them, the fixed assets will lose the fixed assets classification and be converted into stock-in-trade classification of the new business. On the date of conversion into stock-in-trade, it triggers a capital gain. The fair market value of the asset is to be determined on the date of conversion as Stock-in-trade. Sale price less FMV will be a capital gain.

A. Fixed asset on conversion to stock-in-trade (Section 45(2))

1. Asset acquisition cost on purchase
2. Conversion date as stock-in-trade
3. Period of holding till conversion
4. Indexed FMV as on the date of conversion
5. Capital gain on conversion

B. Converted stock-in-trade (Section 43CA)

1. Asset acquisition cost on conversion
2. Period of holding after conversion till sale
3. Business income

3. Section 45 (3) transfer of a capital asset by the partner as a capital contribution

1. Cost of acquisition of the asset on the date of purchase
2. Holding period till transfer by the partner as capital contribution
3. FMV of the asset on the date of transfer by the partner as capital contribution
4. Capital gain in the hands of the individual (partner)

4. Section 45 (4) Dissolution of firms

When the partnership firm or company or AOP or BOI dissolves, the capital asset of the company will be sold or distributed among the partners. If on dissolution, the capital asset is distributed to the partner / member, the FMV will be treated as full value consideration.

This will be the capital gain for the partnership firm/ company/ AOP/BOI. The book value as recorded in the book of accounts will not be relevant.

5. Section 45(5) compulsory acquisition

Fair market value on the date of notification to be determined.

The cost of acquisition on the date of acquisition or FMV on the base date to be determined

6. Depreciable Assets - Section 50 B (Company assets)

Computation of capital gains in case of slump sale

Section 50B of the Income-tax Act, 1961 provides the mechanism for computation of capital gains arising on slump sale. Section 50 reads as 'Special provision for computation of capital gains in case of slump sale'. Since slump sale is governed by a 'special provision', this section overrides all other provisions of the Act.

Amendment of section 50B.

21. In section 50B of the Income-tax Act,—

(a) for sub-section (2), the following sub-section shall be substituted, namely:—

'(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) the 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.';

(b) in *Explanation 2*, after clause (a), the following clause shall be inserted, namely:—

(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*;"

Notwithstanding anything contained in clause (42A) of section 2, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed under this Act or

under the Indian Income-tax Act, 1922 (11 of 1922), the provisions of sections 48 and 49 shall be subject to the following modifications:—

(1) where the full value of the consideration received or accruing as a result of the transfer of the asset together with the full value of such consideration received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year, exceeds the aggregate of the following amounts, namely:—

- (i) Expenditure incurred wholly and exclusively in connection with such transfer or transfers;
- (ii) The written down value of the block of assets at the beginning of the previous year; and
- (iii) The actual cost of any asset falling within the block of assets acquired during the previous year, such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets;

4. Section 50 C (seller)

Section 50C (2) states that: The assessee can claim before the ITO that the value assessed by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer by giving evidentiary proof of FMV with a registered valuer's report.

Section 50C (2) states that: It is open to the taxpayer to plead that such stamp value is abnormal and contest the same in appeal under Section 47A of the Stamp Act, requiring acceptance of a reduction in the stamp value.

The Revenue Collector (Stamps) or the District Revenue Officer is empowered to reduce the stamp value of the land. If such value is reduced in appeal under Section 47A of the Indian Stamp Act (relevant stamp law), such reduced value would alone be adopted.

Section 50C (2) states that: If the value assessed for stamp duty purposes exceeds the fair market value of the property as on the date of transfer, and if the assessee has not disputed the value so adopted in any appeal before the Court or revision of Stamp duty value before the stamp duty authority, then, the ITO may refer the valuation of the relevant asset to a valuation officer. The valuation officer will submit his valuation report by adopting the procedure, under section 55A of the IT Act.

1. Evidentiary proof of FMV with a registered valuer's report to the IT Assessing Officer

2. The Registered valuers (on behalf the assessee) can submit an advisory report on FMV to the Stamp collector under section 47A of stamp act)

3. A justification report on FMV by the registered valuer can be submitted by the assessee.

4. Points of Objection report on the valuation cell report on several points not recorded or under recorded.

5. Buyer under Section 56(2) (x)

Section 56(2)(x) of the Income Tax Act provides that where any person receives any property (including shares of a company) for a consideration less than its fair market value (computed as per the

prescribed method), the fair value as exceeding the consideration would be taxable in the hands of the person.

Tax treatment in the hands of the buyer

The Finance Bill 2013 has amended the provisions of Clause (vii) of subsection (2) of Section 56 and as per this amendment if a buyer purchases a property for a price below the circle rate and the difference in the “price at which the property has been purchased” and the “circle rate” is more than Rs. 50,000, such difference would be assumed to be the income of the purchaser and would be chargeable to tax under the head income from other sources. This amendment will come into force on 1st April 2014.

1. Evidentiary proof of FMV with a registered valuer's report to the IT Assessing Officer
2. The Registered valuers (on behalf the assessee) can submit an advisor report on FMV to the Stamp collector under section 47A of stamp act)
3. A justification report on FMV by the registered valuer can be submitted by the assessee.
4. Points of Objection report on the valuation cell report on several points not recorded or under recorded.

6. Section 43 CA Applicable for stock-in trade (for real estate development promoters)

Treatment of an asset, held as stock-in-trade u/s. 43 CA

- a) If the **agricultural land is held as stock-in-trade**, then the sale of such land would result in **business income** and the provisions of section 43CA would be applicable.
- b) If the **immovable property is a business asset** it is taxed under section 43CA in the hands of the transferor and the same provisions of 56(2) are applied in the hands of the transferee.

1. Certification of cost of construction for the amount spent by the promoter by a registered valuer's report to the IT Assessing Officer
2. The Registered valuers (on behalf the assessee) can submit an advisor report on FMV to the Stamp collector under section 47A of stamp act
3. A justification report on FMV by the registered valuer can be submitted by the assessee.
4. Points of Objection report on the valuation cell report on several points not recorded or under recorded.

Interplay by Sec.50C, 43CA, and 56(2) of the Income Tax Act

Whenever there is a sale of an asset, there is a possibility of all three sections may play a role on the assessee, either the buyer or the seller.

Section 50 C will be on the seller for the deemed sale consideration which will automatically reflect on the buyer under section 56 (2) (X). If the asset is a business asset section 43CA will impact the seller as well as the buyer.

The consideration for assets has to be fixed under the stamp duty value /fair market value. If not then, such an undervalued transaction will lead to tax both in the hands of the seller and the buyer. The income on the transaction on the sale of the property is taxed in the hands of the seller under 50C and

the same amount on the same transaction is once again taxed in the hands of the buyer under section 56(2).

Verdict: Jain Brothers and Others vs. Union of India and Others (1970) **77 ITR 107 (SC)** –

Though double taxation on the same income is against the Constitutional rights, the constitution does not prevent double taxation if the legislature provides it as held in this case as follows:

“It is not disputed that there can be double taxation if the legislature has distinctly enacted it. It is only when there are general words of taxation and they have to be interpreted; they cannot be so interpreted as to tax the subject twice over to the same tax..... If any double taxation is involved, the Legislature itself has, in express words, sanctioned it. It is not open to anyone thereafter to invoke the general principles that the subject cannot be taxed twice over.”

7. Section 45(5A)

Taxation of joint venture Agreements Pre Introduction of Sec.45 (5A) on or before 31.03.2017

Transfer Includes any arrangement or transaction where any rights are handed over in execution of part performance of a contract, even though the legal title has not been transferred.

Applying the definition of transfer, under these Joint development agreements, the transfer took place in the year in which Immovable property, being land or building or both handed over to the developer.

Consequently, the capital gains tax liability in the hands of the owner would arise in the year in which the possession of the immovable property is handed over to the developer for development, even though the consideration for such transfer may be received after a year or two.

Taxation of Specified Agreements Post Introduction of Sec.45 (5A) on or after 01.04.2017

The concept of postponement of taxability of capital gains is being introduced in this section to minimize the genuine hardship being faced by the owner of land or building in paying capital gains in the year of transfer

1. Certification of cost of construction for the project (amount spent by the promoter) by a registered valuer's report to the IT Assessing Officer
2. The Registered valuers (on behalf the assessee) can submit a justification report on FMV to the Stamp collector under section 47A of stamp act
3. Sale of flats by the land owner for capital gain purpose (before & after Section 45 (5A) insertion)
4. A justification report on FMV by the registered valuer can be submitted by the assessee.
5. Points of Objection report on the valuation cell report on several points not recorded or under recorded.

Notes on agricultural land

Section 10 (37) - agricultural land

in the case of an assessee, being an individual or a Hindu undivided family, any income chargeable under the head “Capital gains” arising from the transfer of agricultural land, where—

- (i) Such land is situated in any area referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of sec 2;
- (ii) Such land, during two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu Undivided Family or individual or a parent of his;
- (iii) Such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India;
- (iv) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after the 1st day of April 2004.

Capital gain on urban agricultural land

An urban agricultural land qualifies to be a capital asset, hence capital gains shall arise on sale or transfer of urban agricultural land. The nature of capital gains like the long term or short term will depend upon the asset's holding period of the assessee.

Holding agricultural land as stock-in-trade

If a promoter is buying and selling land regularly or a part of his business, in such a case, any gains from its sale are taxable under the head of business and profession. The sale proceeds derived from stock in trade will be subjected to his business income and profit will be based on the prevailing income tax bracket. **Section 43CA** of the Income Tax Act will be applicable.

Exemption in case of compulsory acquisition of urban agricultural land

Though the urban agricultural land is a capital asset, any capital gain arising from the **compulsory acquisition** of such land shall be exempt as per Section 10(37) of the Income Tax Act, if certain conditions mentioned in that section are satisfied.

Exemption in other cases of transfer of urban agricultural land

The exemption can be claimed under Section 54B of the Income Tax Act, for capital gains arising from the transfer of agricultural land. This exemption is available when capital gain arising on the sale of urban agricultural land (as rural agricultural land is not a capital asset) and such capital gain is used for another agricultural land.

Cost of acquisition for subsequently converted non-agricultural land

CBDT: Only during the period between 1st August 1969, when Instruction No.90 of CBDT was issued till 23rd September 1971. When this instruction was withdrawn, the Cost of Acquisition for agricultural land had to be determined based on the value as estimated on the date of conversion of agricultural land into non-agricultural land.

After Instruction No.90 was expressly withdrawn on 23-09-1971..... till today, now the cost of acquisition is considered as the cost to the previous owner irrespective of the fact that the asset on the relevant date of acquisition fell within the ambit of definition of a capital asset or not. Therefore, such land should be valued as agricultural land as on the relevant date of 1-04-1981/2001, and conversion charges paid to authority would be allowed as improvement in the year when it is converted to non-agricultural land.

CBDT Circular No. 36 of 2016 - F. No. 225/S8/2016-ITA.II, Government of India, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes, Dated: 25th October 2016

Subject: Taxability of the compensation received by the landowners for the land acquired under the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 ('RFCTLAAR Act')-

Capital gains arising from the transfer (including compulsory acquisition) of such agricultural land are not taxable. Finance (No. 2) Act, 2004 inserted section 10(37) in the Act from 01.04.2005 to provide a specific exemption to the capital gains arising to an Individual or a HUF from compulsory acquisition of agricultural land situated in the specified urban limit, subject to fulfilment of certain conditions.

Therefore, compensation received from compulsory acquisition of agricultural land is not taxable under the Act (subject to fulfilment of certain conditions for specified urban land).

The RFCTLARR Act which came into effect from 1st January 2014, in section 96, inter alia provides that income-tax shall not be levied on any award or agreement made [except those made under section 46) under the RFCTLARR Act

Therefore, compensation received for compulsory acquisition of land under the RFCTLARR Act (except those made under section 46 of RFCTLARR Act), is exempted from the levy of income tax. As no distinction has been made between compensation received for compulsory acquisition of agricultural land and non-agricultural land in the matter of providing an exemption from income-tax under the RFCTLARR Act, the exemption provided under section 96 of the RFCTLARR Act is wider in scope than the tax-exemption provided under the existing provisions of Income-tax Act, 1961.

This has created uncertainty in the matter of taxability of compensation received on compulsory acquisition of land, especially those relating to the acquisition of non-agricultural land.

The matter has been examined by the board and it is hereby clarified that compensation received in respect of award or agreement which has been exempted from levy of income-tax vide section 96 of the RFCTLARR Act shall also not be taxable under the provisions of income-tax Act, 1961 even if there is no specific provision of exemption for such compensation in the Income-tax Act, 1961.

Notes on RFCTLAAR Act, 2013

Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013.

Section 96. Exemption from income tax, stamp duty, and fees.—No income tax or stamp duty shall be levied on any award or agreement made under this Act, except under section 46 and no person claiming under any such award or agreement shall be liable to pay any fee for a copy of the same.

Section 46. Provisions relating to rehabilitation and resettlement to apply in the case of certain persons other than specified persons.__

(5) Any purchase of land by a person other than specified persons without complying with the provisions of Rehabilitation and Resettlement Scheme shall be void ab initio: Provided that the appropriate Government may provide for rehabilitation and resettlement provisions on sale or purchase of land in its State and shall also fix the limits or ceiling for the said purpose.

(6) If any land has been purchased through private negotiations by a person on or after the 5th day of September 2011, which is more than such limits referred to in sub-section (1) and, if the same land is acquired within three years from the date of commencement of this Act, then, forty percent of the compensation paid for such land acquired shall be shared with the original landowners.

Explanation.—For the purpose of this section, the expression—

(a) original land owner refers to the owner of the land as on the 5th day of September 2011;

(b) Specified persons include any person other than—

(i) appropriate Government;

(ii) A Government company

(iii) Association of persons or trust or society as registered under the Societies Registration Act, 1860 (21 of 1860), wholly or partially aided by the appropriate Government or controlled by the appropriate Government.