

CHAPTER 2

LEGAL FRAMEWORK

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CHAPTER 2

LEGAL FRAMEWORK

Following inconsistencies in the Act have been discussed in this chapter.

- The objective of introduction of the benefits under section 80IB(10) was to build housing for low and middle income groups. The Act did not provide for the conditions defining the low and middle income groups for the purpose of allowing the deduction under section 80IB(10). We observed that in West Bengal charge, in three housing projects, more than 50 percent units were earmarked for HIG whereas in Tamil Nadu charge, in four projects, around 50 percent flats measuring less than 1500 square feet were sold for ₹ 40 lakh or more. Thus, the legislative intent behind introduction of the scheme has not been achieved.
- MAT was introduced to ensure that the registered companies earning huge profits and declaring substantial dividends to its shareholders but not contributing to the Government by way of corporate tax, pay at least certain percentage of book profit as MAT. We noticed that a number of entities assessed in construction business were registered as firms/AOP with their turnover and profits being comparable to some companies in the same sector got away by paying nil or minimal tax as MAT provisions are not applicable to them.
- Builders/developers are using Transfer of Development Rights (TDRs) for constructing extra Floor Space Index (FSI)⁵ or selling these TDRs to any other persons. In absence of TDS provisions, the department could not levy TDS on TDR transactions.
- Builders/developers are paying compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/payment of mobilization advances. There is no provision in the Act to collect TDS on these payments leaving the risk of the related receipt not being offered to tax.
- Section 80(IB) allows deduction of profits to undertakings engaged in developing and building housing projects. This Section, however, does not provide for any disallowance of corresponding amount that is disallowed under Section 40(a)(ia) when TDS is not deducted against certain payments. Consequently, disallowance under section 40(a)(ia) is nullified when deduction claimed for the same transaction is allowed

⁵ Ratio of the total floor area of buildings to the size of the land.

under Section 80(IB), thereby defeating the purpose of the introduction of the former section.

- We found lack of clarity on deduction/treatment of certain elements of income and expenditure like interest towards Borrowed Fund, income derived from leasing of properties held in stock in trade, sale of parking space & allowing TDS credit on mobilization advances etc.
- Exemption allowed to Housing Development Authorities under section 10(20A) was withdrawn with effect from 1 April 2003. We noticed that these entities were trying to avoid tax by claiming exemptions incorrectly.

2.1 It is essential that the legal framework governing the computation of income and eligibility for deductions/exemptions from business of civil construction ensures that correct income from business is brought to tax. The Income Tax Act lays down certain responsibilities in terms of declarations and audited statements that are to be submitted by the assessee along with the returns. During the course of the review, we found certain gaps and inconsistencies in the legal framework that needed to be addressed to ensure that income from business of civil construction is properly brought to tax. These inconsistencies have been discussed in this Chapter.

2.2 Admissibility of fiscal incentives

The objective of introduction of the benefits under section 80IB(10) in 1999 was to build housing stock for low and middle income groups. While conditions for admissibility of special deductions from income assessed were laid down in terms of size of built up property, proportion of commercial area, size of plot etc., the Act, however, did not provide for the conditions defining the low and middle income groups for the purpose of allowing the deduction under section 80IB(10).

Our small sample analysis revealed that in West Bengal charge, in three housing projects that availed of tax benefits, more than 50 percent units were earmarked for HIG whereas in Tamil Nadu charge, in four projects, around 50 percent flats measuring less than 1500 square feet were sold for ₹ 40 lakh or more. Thus, the legislative intent behind introduction of the special provisions was not being met.

2.3 Non applicability of MAT on Firms/AOPs

2.3.1 The concept of MAT was introduced under section 115JB of the Income Tax Act to ensure that companies having huge profits and declaring substantial dividends to its shareholders but not contributing to the Government by way of corporate tax by taking advantage of various exemptions and deductions provided in the Act, pay at least certain

percentage of book profit as MAT. However, the said provision is not applicable for Firms/AOPs.

2.3.2 We noticed that a number of construction entities were registered as firms⁶/ AOPs and the turnover and profits of some of these entities were comparable to Companies of similar size. However, the MAT provisions being inapplicable to these entities, the revenue collected from their business was low. A comparison between the firms and Companies test checked in Mumbai is given in Table 2 below:

(₹ in crore)

Firm				Company			
Name / AY	Net profit as per P&L account	Tax paid Under normal provision	Tax that would have been due as per MAT	Name/ AY	Net profit as per P&L account	Tax due as per normal provision	Tax paid as per MAT
M/s Dosti Associates 2007-08	14.60	0	1.64	M/s Lavina Estates Pvt Ltd 2007-08	15.37	0	1.75
M/s Jain Associates 2007-08	10.74	0.08	1.20	M/s Emerald Realtors Pvt Ltd 2007-08	8.69	0	0.97

2.3.3 We found in Mumbai charge that deductions under section 80IB(10) aggregating ₹ 295.37 crore were allowed in case of assessments of 66 partnership firms/AOP (Joint Ventures). As these deductions formed a major portion of taxable income of these firms, they got away by paying nil or minimal tax and Government could not collect revenue from them despite comparable profits from their business. The revenue implication of non applicability of MAT provisions to firms amounted to ₹ 24.87 crore.

2.4 Absence of TDS provision on compensation paid

Under TDS provisions, collection of tax is effected at source when income arises or accrues. The builders/developers are paying compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract. Such compensation is paid over and above refunds of any money paid by the concerned allottees/tenants, etc in view of more lucrative propositions. There is no provision in the Act to collect TDS on these payments leaving the risk of the related receipt not being offered to tax.

⁶ Section 4 of The Indian Partnership Act 1932 defines 'partnership' in a commercial entity. It has limited legal identity for the purpose of tax law.

We noticed 12 cases of the above nature during test check of records at various charges. These included seven cases in Mumbai where compensation of ₹ 445.52 crore was paid on account of redevelopment. In absence of TDS provision on these transactions potential tax of ₹ 46.18 crore could not be realized. An illustration is given below:

2.4.1 Charge: CIT-IX Mumbai, AY 2007-08

M/s Agromach Spares Corporation booked commercial premises on part payment of ₹ 3.05 crore in a building proposed to be developed by M/s Axis Realty Pvt. Ltd. The developer, in view of a better offer by a different party requested the assessee Company to surrender its allotment rights in the said property. As per agreement (January 2006), the assessee agreed to surrender its rights in the above property and the developer M/s Axis Realty Pvt. Ltd paid ₹ 3.60 crore to the assessee as compensation over and above the refund of booking amount as per agreement. We verified the records of the assessee, M/s Agromach Spares Corporation and found that the commercial compensation received from M/s Axis Realty was not accounted for in its accounts resulting in escapement of income involving tax effect of ₹ 1.21 crore.

2.5 Transfer of Development Rights (TDR)

When land is acquired for public amenities like roads, gardens, schools, markets, etc. by Municipal Corporations, the owner of the land is often granted a Development Rights Certificate (DRC) instead of monetary compensation. This DRC is transferable and can be sold in the market and such transactions are commonly referred to as TDR⁷. The plot where TDR is created is called the 'originating plot' and the plot where the TDR is actually used is called the 'receivable plot'. It indicates the FSI credit in square meter of the built-up area to which the owner or lessee of the reserved plot is entitled, the place and user zone in which the development rights are earned, and the areas in which they may be utilised. TDR can be utilised by the original recipients or transferred to any other person. When the DRC holder intends to transfer it to another individual, he must submit the DRC to the Municipal Commissioner with an appropriate application for endorsement of the new holder's name on the certificate, without such an endorsement, the transfer will be invalid and the certificate will continue to be in the name of the original holder. A TDR transaction is entered into by the concerned parties at a mutually agreed price. Presently, there is no provision of TDS on TDR transactions.

⁷ Under a transfer development rights system, a landowner whose property is restricted to open space is assigned development rights in proportion to some overall desirable density for the jurisdiction. The landowner may either utilize the rights or sell them in the open market to landowners in other locations who are allowed to develop their properties. The rights may be used to develop additional structures on the unrestricted properties. In this way, restricted areas may be maintained as open space without completely destroying the development value of the properties.

The builders/developers are using TDRs for constructing extra floor space index (FSI)⁸. However, the state authorities (sub-registrars) have refrained till date from determining the fair market value of TDR units. As no ready reckoner rates (division wise) were available, the genuineness of values declared on TDR transactions could not be ascertained.

It was also difficult to know whether the corresponding income was being offered by the TDR transferor/seller as there was no provision for TDS on TDR transaction.

2.5.1 We noticed eight cases in Mumbai charge where expenditure aggregating ₹ 128.93 crore on account of TDR was allowed. The department could not levy TDS⁹ of ₹ 2.57 crore in absence of TDS provision for TDR Transaction. An illustration is given below:

2.5.2 Charge: CIT, Central II, Mumbai, AY 2007-08

M/s K. Raheja Corporation Pvt. Ltd. was allowed expenditure of ₹ 76.45 crore on account of cost of TDR. Due to absence of provision of TDS on TDR, tax of ₹ 1.53 crore (calculated at the minimum TDS rate of 2%) in the hands of the transferors of development rights could not be realized.

2.6 TDS on payment of mobilization advances

The Board¹⁰ had prescribed that credit of tax deducted at source from advance rent will be allowed in proportion in which such income is offered for taxation for different assessment years based on a single certificate furnished for tax deduction. However no such clarification has been issued for similar transaction of tax deducted on mobilization advances¹¹ given to contractors. Tax credit shall not be given on mobilization advances as these do not form part of income. We noticed 3 cases of incorrect credit allowed for mobilization advances involving tax effect of ₹ 16.12 crore.

An illustration is given below:

2.6.1 Charge: CIT V Mumbai, AYs 2005-06 to 2007-08

M/s Essar Construction Ltd claimed and was allowed TDS credit of ₹ 14.33 crore on mobilization advance/progressive payments incorrectly as the corresponding income was not offered to tax during the assessment years under consideration. Further, interest of ₹ 0.75 crore granted on above TDS credit was also not in order. This resulted in tax effect of ₹ 15.08 crore.

⁸ Ratio of the total floor area of buildings to the size of the land.

⁹ TDS has been worked out at the minimum rate of 2%.

¹⁰ Circular No.5 dated 2 March 2001

¹¹ Advances given to contractors to make arrangements for mobilization of men, material and machinery at the project site.

2.7 Inconsistency in provisions

As per Section 40(a)(ia) of the Act, certain payments, in respect of which TDS was not deducted/remitted, shall not be allowed as deduction when computing the income chargeable under the head 'profits and gains of business or profession'. Section 80(IB) of the Act, on the other hand, allows hundred per cent deduction of profits to undertakings engaged in developing and building housing projects under certain conditions. This Section, however, does not provide for any disallowance of corresponding amount that is disallowed under section 40(a)(ia) when TDS is not deducted against certain payments. Consequently, disallowance under section 40(a)(ia) is nullified when deduction claimed for the same transaction is allowed under section 80(IB), thereby defeating the purpose of the introduction of the former section.

We noticed two cases relating to this inconsistency in provisions mentioned above involving tax effect of ₹ 8.50 crore. An illustration is given below:

2.7.1 Charge: CIT III, Chennai AY 2006-07

In the assessment of **M/s. Shriram Properties Ltd.**, we found out that ₹ 23.79 crore was disallowed under section 40a(ia) and added back to the income. Deduction under section 80 IB (10) was, however, allowed to the corresponding extent of ₹ 23.79 crore involving potential revenue impact of ₹ 8.01 crore.

2.8 Lack of clarity in provisions

We noticed that there was lack of clarity in instructions relating to treatment of certain elements of income and expenditure for the purpose of allowing deductions/exemptions. As a result we found similar issues being treated differently by Assessing Officers.

2.8.1 Income derived from leasing of properties held in stock in trade

The properties held in stock in trade by the builders and developers were being given on rent and rental income was being classified under the head income from house property to get benefit of additional deduction of 30 per cent. The treatment was incorrect as the income was being derived from properties held in stock in trade, a business asset and resulted in excess allowance of deduction of 30 per cent.

We noticed four cases in Mumbai charge of the above nature with consequent underassessment of income of ₹ 8.52 crore with tax effect of ₹ 2.98 crore. Two illustrations indicating divergent views taken by the department are given below:

2.8.1.1 Charge: CIT (Central) II, Mumbai, AYs 2005-06 to 2008-09

M/s K. Raheja Pvt Ltd offered income from leasing of buildings constructed by him and shown in the closing stock as income from house property and claimed 30 per cent deduction available under provisions of house property income. Lease rent from stock in trade properties was not treated as business income resulting in underassessment of income of ₹ 4.35 crore involving short levy of tax of ₹ 1.53 crore.

2.8.1.2 Charge: CIT (Central) II, Mumbai, AY 2007-08

M/s Rockfort Estate Development offered income from leasing of buildings constructed by him and shown in the closing stock, as income from house property and claimed 30 per cent deduction available under provisions of house property income. The Department assessed the income as income from business. However, in earlier year, said income was assessed as income from house property. This resulted in underassessment of income of ₹ 1.82 crore involving short levy of tax of ₹ 0.64 crore.

2.8.2 Income from sale of parking space

Parking space does not form part of either the maximum built up area of the residential unit or the permissible commercial establishment for allowing prescribed condition for allowing deduction under section 80IB(10).

The Act is silent on the allowance or disallowance of this deduction towards sale of parking space.

2.8.2.1 We noticed seven cases in Goa, Mumbai, Pune and Thane charges where AOs allowed deduction in four cases and disallowed in remaining three cases against sale of parking space. Thus, there was no uniformity in treatment of such income. An illustration is given below:

2.8.2.2 Charge: CIT Goa, AY 2007-08

M/s Devashri Real Estate Developers was allowed deduction of ₹ 67.90 lakh under section 80IB(10) towards sale of space for car parking. Since the sale of car parking with profit motive amounts to commercial activities, deduction allowed under section 80IB (10) was incorrect involving short levy of tax of ₹ 0.23 crore.

2.8.3 Treatment of certain expenses

Due to lack of clarity on treatment of expenses on 'Interest towards the Borrowed Fund' and 'Directors' Meeting Fee', we found different treatment of claims of the same assessee in Delhi charge in two consecutive assessment years. Two cases are illustrated below:

2.8.3.1 Charge: CIT Central-I Delhi, AY 2007-08

In the assessment of **M/s Ansal Properties and Infrastructure Ltd.**, the expenses on 'Interest towards the Borrowed Fund' and 'Directors' Meeting Fee' were proportionately disallowed and debited to the Profit and Loss account of the project eligible for deduction u/s 80IB(10). This reduced the profit eligible for deduction. However, this treatment was not followed in the earlier assessment year 2006-07, for the same assessee.

2.8.3.2 Charge: CIT IV Delhi, AY 2007-08

The instructions on treatment of project management fees were found to be ambiguous resulting in different treatment by AOs.

In the assessment of **M/s Gulab Farms Pvt. Ltd**, the AO disallowed ₹ 1.59 crore booked as 'Project Management Fees', treating it as expenditure of capital nature. We

found that the expenditure under same head with same contents was allowed by another Assessing Officer of Circle-7(1) under CIT III charge, in the case of M/s Sweet Peas Farms Pvt. Ltd., in the same assessment year.

2.9 Assessments of Housing Development Authorities/Boards

Exemption allowed to an Authority constituted for the purpose of providing housing accommodation or for the purpose of planning, development or improvement of cities, towns under section 10(20A) was withdrawn with effect from 1 April 2003. One of the major implications of this amendment was that all entities covered under the erstwhile Section 10(20A) would be required not only to pay Income Tax but also to file returns, be subject to tax audit u/s 44AB and to maintain proper books of accounts as stipulated in Section 44AA.

Test check of 22 cases of Housing Developing Authorities/Boards revealed that there was no uniformity in the assessments of Housing Development Authorities. Four illustrations are given in Table 3 below:

(₹ in crore)

Sl. No.	Name of Housing Authority/ CIT charge	AY	Status of exemption claim after withdrawal of admissibility under section 10(20) with effect from 2003.	Audit comments	Tax effect
1	Delhi Development Authority Trust Circle II Delhi	2003-04 to 2007-08	Assessee applied for exemption as a charitable trust in March 2003 which was denied by DIT (Exemption) but on appeal before ITAT, the same was allowed in January 2006 with	Department neither went in for further appeal against ITAT decision nor finalized assessment proceeding. In December 2008, the department sought a	N A

			retrospective effect from 01 April 2002.	special audit of the accounts of the DDA under section 142(2A) of the Act due to complexities of accounts. The High Court issued a stay order.	
2	Chandigarh Housing Board Chandigarh I	2004-05 to 2008-09	The assessee claimed exemption under Section 10(20) but AO denied the status of local authority as per present provision and assessed income as AOP.	AO did not levy surcharge correctly	38.40
3	Varanasi Development Authority Varanasi	2007-08	Exemption claimed as trust and was incorrectly granted by AO.	The entity did not fulfill the necessary condition for grant of exemption and therefore certificate was not issued by CIT. Besides incorrect exemption, the assessee had shown ₹. 9.10 crore as accrued income against stamp fees in the Balance Sheet under "Sundry Debtors" which was not taken as income.	3.84
4	Silchar Development Authority Shillong	2006-07 to 2009-10	Exemption granted under Section 10(20) contrary to the provisions of the Act	The AO (ACIT, TDS Silchar) in May 2010 accepted incorrect exemption granted	0.05

2.10 Recommendations

We recommend that

- *A cap linked to Housing Pricing Index on the sale value of the flats constructed by the builders/contractors may be considered as a condition for claiming deduction under section 80IB(10) so that legislative intent of providing affordable housing is met.*

(Para no. 2.2)

The CBDT stated (June 2011) that the provisions of section 80IB(10) are being phased out as the last date for approval for housing projects have expired on 31.03.2008 and no further extension has been granted to the same in the latest Finance Bill 2011.

- *The purview of section 115JB ie MAT may be extended to Firms/AOP who are taking advantage of deduction or incentive available in the Act.*

(Para no. 2.3)

The CBDT stated (June 2011) that Limited Liability Partnerships (LLPs), which are business entities similar to partnership firms have been recently proposed to be brought under the purview of alternate minimum tax (similar to MAT for corporate) through the insertion of a new Chapter in the Income Tax Act, vide Finance Bill 2011. The issue will be further examined for including other entities while finalizing the DTC. However, as majority of Firms/AOPs are in the unorganized and Small/Medium Enterprise Sector, imposing MAT may hamper this sector.

- *Suitable provisions for assessment and collection of tax on TDR transactions and payment of compensation on commercial consideration on surrender of booked flat/commercial space/tenancy right or on vacating premises for redevelopment or as part of contract/mobilization advances may be introduced to safeguard the interest of revenue.*

(Para nos. 2.4, 2.5 and 2.6)

The CBDT stated (June 2011) that as the sale and purchase of TDR and surrender of premises takes place between organized entities, there is negligible chance of non reporting of transactions by the concerned parties and introduction of TDS provision for such transaction will only increase the compliance burden on the tax payers. CBDT accepted the recommendation on payment of TDS on mobilization advances.

We are of the view that in case the TDS provisions are not feasible in respect of sale & purchase of TDR and surrender of premises, CBDT may consider introducing other suitable mechanism to reduce tax evasion in such cases.

- *The inconsistency between Section 80(IB) and Section 40a(ia) may be removed by making admissibility of deductions under Section 80(IB) conditional to admissibility under section 40a(ia).*

(Para no. 2.7)

The CBDT stated (June 2011) that in view of the DTC Bill providing for phasing out of profit linked incentives, no further action seems necessary on the issue.

- *CBDT may issue necessary instructions for uniform treatment of income derived from leasing of properties held in stock in trade, income from sale of parking space and expenses on 'Interest on borrowed funds' and 'Directors' meeting fee/project management fee'.*

(Para nos. 2.8 & 2.9)

The CBDT (June 2011) accepted the recommendation.