The Delhi High Court held that several independent units can constitute a residential house for claiming exemption under Section 54 of the Income-tax Act

7 March 2013

Background
Recently, the Delhi High Court (High Court) in the case of Ms. Gita Duggal1 (the taxpayer) held that two independent houses within the same building can constitute ‘a residential house’ and accordingly, exemption under Sections 54 or 54F of the Income-tax Act, 1961 (the Act) can be claimed.

As per Section 54 of the Act, if an individual transfers a long-term capital asset being a residential house and invests the sales proceeds in purchasing or constructing a residential house (subject to the specified conditions), then the capital gains would be exempt from tax.

Similarly, Section 54F refers to transfer of any long-term capital asset, other than a residential house, and subsequent investment of proceeds into a residential house.

In recent times, it has become a common practice for owners of land and / or residential houses to enter into a collaboration agreement with builders. Under the said agreement, the builder is responsible for the construction of a new property and related construction expenditure. Further, the agreement defines the treatment of the houses built in new building, the builder may retain one or more houses / units constructed and allot the others to the seller, with or without a cash consideration. The computation of capital gains and whether exemption under Section 54 of the Act is available in these transactions has been a matter of much debate.

Facts of the case
- The taxpayer was the owner of a property comprising of basement, ground floor, first floor and second floor. In 2006, the taxpayer entered into a development agreement pursuant to which the builder demolished the property and constructed a new building comprising of three floors.

1 CIT v. Gita Duggal (ITA 1237/2011, dated 21 February 2013, Assessment Year 2007-08)
In consideration of the development rights, the taxpayer received INR 40 million and two floors of the new building. Third floor was retained by the builder. While filling the tax return, the taxpayer showed INR 40 million as consideration and thereafter computed capital gains, after indexation of purchase cost. Exemption under Section 54EC [investment into Rural Electrification Corporation (REC) Bonds] was claimed.

INR 34.3 million was incurred by the builder in construction of the new building. The Assessing Officer (AO) held that in computing capital gains, the cost of construction i.e. INR 34.3 million had to be added to the consideration of INR 40 million received by the taxpayer.

The taxpayer claimed that if the cost of construction incurred by the builder is to be added to the consideration then the same should also be correspondingly taken to have been invested in the residential house namely the two floors which the taxpayer got and the amount should be allowed as deduction under Section 54 of the Act.

However, the AO rejected the claim partially on the basis that the units on the said floors were independent and self-contained. He thus allowed the exemption for only one unit.

Aggrieved, the taxpayer filed an appeal with the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) agreed with the taxpayer’s contention and also followed the judgment of the Karnataka High Court in case of D. Ananda Bassappa2. The CIT(A) held that the taxpayer was eligible for the deduction under Section 54 in respect of the basement, ground floor, first floor and the second floor.

The tax department carried the matter in appeal before the Income-tax Appellate Tribunal (the Tribunal).

The Tribunal confirmed the decision of the CIT(A), also relying upon another decision of the Karnataka High Court in the case of K.G. Rukminiamma3, wherein it was held that the context in which the expression ‘a residential house’ is used in Section 54 of the Act makes it clear that it refers to the nature of residential use. Therefore, the letter ‘a’ in the context should not be construed as meaning ‘singular’. The said expression should be read in consonance with the other words ‘building and land’. The singular ‘a residential house’ also permits use of plural, by virtue of Section 13(2) of the General Clauses Act.

The tax department had thereafter proposed the questions as substantial question of law and carried the matter in appeal before the High Court.

**Issues before the High Court**

- Whether the Tribunal is correct in deleting the addition made by the AO under Section 54F of the Act?
- Whether the Tribunal is correct in holding that the taxpayer should be given deduction under Section 54 of the Act?

**High Court’s ruling**

- The High Court held that Sections 54 and 54F of the Act required the taxpayer to acquire a ‘residential house’ and so long as the taxpayer acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the Section should be taken to have been satisfied.

- There is nothing in these Sections which require residential house to be constructed in a particular manner. The only requirement is that it should be for the residential use and not for commercial use.

- The High Court was of the view that, if there is nothing in the Section which requires that the residential house should be built in a particular manner, it seems that the income-tax authorities cannot insist upon that requirement.

- The High Court also highlighted the two decisions by the Karnataka High Court, which squarely covered the taxpayer’s contentions.

Thus, both the grounds raised by the tax department were rejected by the High Court and it was upheld that several independent units can constitute ‘a residential house’ and accordingly, exemption under Section 54 or 54F can be claimed by the taxpayer.

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Our comments

This is a notable judgment that provides insight into the interpretation of the term ‘a residential house’ for the purpose of claiming exemption under sections 54 and 54F. Being a High Court decision, it strengthens the position vis-a-vis these sections.

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