Joint Development Agreement in Real Estate Sector and it's Taxation Issues

***Dr. Rachna Garg**

Joint Development Agreement is a popular method of development of property. Here, an owner of a site and a developer come together to enter into an arrangement to develop a property jointly. In case the owner of a site decides to develop the property on his own, he will have to arrange for funds, look for a builder, monitor the construction and go through all the associated formalities.

It is a fairly common arrangement too to developers and builders to enter into development related arrangements with land owners rather than making an outright purchase of the land identified for their project in as much as the cost of land constitutes a major portion in the cost of development.

Land owners may grant rights to develop their land under an agreement entered on mutually agreed terms and conditions. In such agreement, the land owner contributes the land and developer undertakes the responsibility of obtaining approvals, property development and marketing of the project with the help of his financial resources. A certain percentage of the area is earmarked for the owner of the site. The owner is entitled to dispose off the constructed property delivered to him under the joint development agreement. The owner may also decide to retain his share of the built-up area, or may sell it off at a later stage without any involvement of the builder. The builder developer can sell the constructed area of his or her share directly. Normally, consideration is discharged in the form of upfront payment, sharing of gross revenue, sharing of constructed area or a combination of all three.

As a procedural aspect, the Developer is not the transferee or buyer of the flats as per the Transfer of Property Act, 1882 under the Joint Development Agreement. The sole ownership lies with the owner of the land, but the land owner grants the developer along with development rights, a license to enter the land for the purpose of development but not as a transferee/buyer. The license/authority to enter the land is typically given by way of a power of attorney issued in favor of the developer. The site owner has to execute an irrevocable general power of attorney (GPA) in favour of the builder. The General Power of Attorney should be registered on appropriate value stamp paper with the authorities concerned (registrar) in order to be legally binding on both parties. The stamp duty payable for this kind of GPA given to the builder under a joint development agreement may vary from State to State. In case there is a breach of contract on the part of the builder, either financially or otherwise, the site owner has a right to revoke the General Power of Attorney.

Development Agreement vis a vis Joint Ventures :

Development Agreements are not joint ventures. The words `joint venture' or `collaboration' in the title of an agreement or even in the body of the agreement will not make the transaction a joint venture, if there are no provisions for shared control of interest or enterprise and shared liability for losses.

A Development Agreement is one where the land-holder provides the land. The Builder puts up a building. Thereafter, the land owner and builder share the constructed area. The builder delivers the `owner's share' to the land-holder and retains the `builder's share'. The land-holder sells/transfers undivided share/s in the land corresponding to the Builder's share of the building to the builder or his nominees. The land-holder will have no say or control in the construction or have any say as to whom and at what cost the builder's share of apartments are to be dealt with or disposed of. Such an agreement is not a "joint venture" in the legal sense. It is a contract for "services".

On the other hand, an agreement between the owner of a land and a builder, for construction of apartments and sale of those of apartments so as to share the profits in a particular ratio may be a joint venture, if the agreement discloses an intent that both parties shall exercise joint control over the construction/development and be accountable to each other for their respective acts with reference to the project.

There are two ways of sharing benefits under Joint Development Agreement between Land Owner and a Developer :

(i) Contracts in which after development of property area of built up structure is shared between land owner and the developer i.e. Area Sharing

(ii) Contracts in which sale proceeds of developed property is shared by the land owner and the developer i.e. Revenue Sharing

Advantage of Joint Development Agreement :

1. Usually, cost of land constitutes a substantial part of the cost of a project whether residential or commercial, and as such this expense is saved for the builder. The funds of the builder do not get blocked.
2. The Land owner also escapes from getting blocked a lot of funds before he can get any returns.
3. This is fast mode of development of property and working capital requirement is restricted towards approval and construction.
4. Secured loan can be obtained by the Developer through pledging land which is obtained under the agreement.

Disadvantages of Joint Development Agreement :

1. Land owner has to wait for a long time till the construction gets over and in course, real estate market might suffer changes.

2. Land owner needs to take measures to protect the property till the project is completed and handed over to him/her.
3. Amendments in Tax laws at later stage, may impact on pre-planned revenues of the developer as well as land owner.
4. Prospective buyers have to take substantial care while they purchasing the property constructed under the agreement.

Though, the Joint Development Agreement is not devoid of limitations, but it suits the needs of both the parties i.e. and owner and developer. The owner of the site does not have to get into the trouble of constructing the property, nor has he/she to arrange for funds for construction. At the same time, the builder gets access to land and does not have to raise money for purchase of land. The builder need not block his funds and in fact can use his resources for a number of projects simultaneously.

The nature of the structure may be commercial or residential; the percentage of the benefit of land owner may be different and the time of passing on the benefits or project period may differ. The form of arrangement will decide the statutory obligations arising out of it.

Income Tax Issues regarding Joint Development Agreement :

The taxability of Joint Development Agreements and also similar arrangements has become a controversial issue. To determine the year of taxability i.e. whether it is taxable in the year in which the agreement is entered into or year in which land owner gets his share in constructed property along with the monetary consideration, if any, received, has generally been in dispute. This is absolutely required to find out in which year the capital gains tax shall be chargeable. It is important to understand 'when transfer of possession of property pursuant to execution of Joint Development Agreement amounts to taxable transfer and is liable to capital gains tax'.

The taxation of income arising out of the agreement is determined by provisions of Section 2(47) of Act, which defines the term 'Transfer' for computation of income under the head 'Capital Gain. Section 2(47)(v)/(vi) of the Income-tax Act, 1961 provides that "transfer" includes (a) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 [TPA] or (b) any transaction entered into in any manner which has the effect of transferring or enabling the enjoyment of any immovable property and capital gains would be taxable in the year in which such transactions are entered into, even if the transfer of immovable property is not effective or complete under the general law.

In the case of agreement, though possession is given to developer immediately on entering into agreement but in terms of Section 2(47)(v) of the act possession will give rise to transfer only if conditions of section of Section 53A of Transfer of Property Act are satisfied. It can be said that when an assessee hands over or parts with possession of its land (being a capital asset) to a developer in part performance of its obligation as stated in section 53A of the Transfer of Property Act then it will attract the deeming provisions of section 2(47)(v) of the Income-tax Act and, thus, taxable as capital gains in the year in which the development agreement is executed. In other words, it reiterates that if the execution of a development agreement together with the transfer of possession of property through a power of attorney would be construed as a taxable event in the hands of the property owner. However, there is a clear cut distinction which has been carved out, i.e., mere execution of a development agreement cannot be construed to give rise to a transfer, unless all the conditions of Section 53A of Transfer of Property Act are satisfied.

In the case of Ranjith Reddy v. Dy. CIT [2013] 35 taxmann.com 415 (Hyd. – Trib.) it was held that it was not the act of entering into an agreement or contract that mattered but the event of allowing the transferee to enter into possession of the land that mattered. In order that a contract be construed as being 'of the nature referred to in section 53A of TPA' it is one of the pre conditions that the transferee should have performed, or should be willing to perform his part of the contract. Unless the party has performed or is willing to perform its obligations under the contract, it cannot be said that the provisions of section 53A of the TPA will come into play.

There was no certainty in the matter of year of taxability and the amount of consideration while computing the income. In order to overcome this anomalous situation sub-section (5A) was inserted in section 45 of the Income-tax Act (the Act) with effect from 01.04.2018, i.e., from the assessment year 2018-19 by the Finance Act, 2017. Sec. 45(5A) reads as under :

“Notwithstanding anything contained in sub-section (1), where the capital gain arises to an assessee, being an individual or a Hindu undivided family, from the transfer of a capital asset, being land or building or both, under a specified agreement, the capital gains shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority; and for the purposes of section 48, the stamp duty value, on the date of issue of the said certificate, of his share, being land or building or both in the project, as increased by the consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset :

Provided that the provisions of this sub-section shall not apply where the assessee transfers his share in the project on or before the date of issue of the said certificate of completion, and the capital gains shall be deemed to be the income of the previous year in which such transfer takes place and the provisions of this Act, other than the provisions of this sub-section, shall apply for the purpose of determination of full value of consideration received or accruing as a result of such transfer.”

Though, this section was introduced with a view to minimise the genuine hardship which the owner of land was facing in paying capital gains tax in the year of transfer, yet the provisions of this section has been restricted to individuals and HUFs only while the capital gain provision as contained in Section 45(1) is applicable to all assessees.

Further, unlike the other charging section(s) [as sec. 45(5A) starts with a non-obstante clause indicates that there are other cases not covered by this section] regarding capital gain tax liability on transfer of property, the capital gain liability gets triggered only after certificate of completion for the whole or part of the project is issued by the competent authority instead of at the moment the property is put in possession of the builder/developer. Therefore, a moot question arises whether there is a change in definition of "transfer" consequent to insertion of section 45(5A) of the Act under the heading "Special provisions for computation of capital gains in case of joint development agreement". Also, there are no proper guidelines in this regard in the sense that if the developer does not complete the project in full but completes the project partially and hands over a few residential properties with proper completion certificates as a result of which the land owner pays capital gains tax or claims exemption on that portion of the property but the developer leaves midway and the project remains incomplete resulting in loss for the land owner.

Moreover, as per Explanation (ii) to Sec. 45(5A), the "specified agreement" means a registered agreement which clearly indicates that the provisions of new section 45(5A) will apply only in case where the agreement is registered. In such a situation, the question arises as to whether registration of agreement is mandatory to apply normal capital gain provisions of the Act, other than Section 45(5A). Registration and Other Related Laws (Amendment) Act 2001 (w.e.f. 24.09.2001) provides that the documents containing contracts to transfer for consideration any immovable property for the purpose of Section 53A of Transfer of Property Act shall be registered if they have been executed on or after the Commencement of the Registration and Other Related Laws (Amendment) Act, 2001. If such documents are not registered on or after such commencement, then they shall have no effect for the purpose of Section 53A of Transfer of Property Act.

In the case of C.S. Atwal v. CIT [2015] 378 ITR 244/234 Taxman 69/59 taxmann.com 359 (Punj. & Har.), the hon'ble Punjab and Haryana High Court held that unless registration of JDA, it was not enforceable under general law and transaction would not fall u/s 2(47)(v) of Income Tax Act, 1961.

Conclusion

In nutshell, Joint Development Agreement is a win-win situation for both the parties i.e. for the land owner and builder/developer in as much as the said arrangement would save huge cash flow for the builder as he/she won't be required to purchase the land. For the land owner, the exploitation of the land shall be the blessing with builder/developer having construction expertise, which the land owner generally lacks.

But, one has to exercise great caution and has to understand the *pros and cons* of entering into such agreements. The time of trigger of taxable event and applicable tax provision would depend on case to case basis.

***Lecturer**
Department of ABST
Government Girls College
Dausa (Raj.)

References

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2. Income Tax Act, 1961
3. Registration and Other Related Laws (Amendment) Act 2001
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