Enhanced compensation received on transfer of tenancy rights in a land is liable to capital gains tax

Summary – The High Court of Delhi in a recent case of Gulab Sundri Bapna, (the Assessee) held that where assessee was paid enhanced compensation on acquisition of land in which assessee was a tenant, capital gains was to be computed

Facts

- The assessee, on handing over of vacant possession of land taken on sub-lease and of the factory building, was paid compensation under the Land Acquisition Act, the land was under sub-tenancy and occupation of the assessee.
- On reference, the additional district judge enhanced the compensation Pending appeal in the High Court, the assessee was allowed to withdraw Rs. 94.89 lacs as compensation on furnishing security for restitution.
- The Assessing Officer brought to tax Rs. 59.63 lakh after excluding 50 per cent of the compensation so awarded in terms of section 48(2).
- On appeal, the Commissioner (Appeals) observed that assessee was only a sub-lessee of the land and her interest was only that of a tenant. He held that, as there was no cost of acquisition of the tenancy right and Capital gain was not chargeable/computable, the compensation paid was not taxable.
- On second appeal, the Tribunal relying upon section 45(5) observed that the word 'received' would not include or mean compensation received, if the assessee was liable to refund the amount received. Further, the compensation paid was for acquisition of tenancy right and not for the acquisition of the ownership rights. Thus, the Tribunal rejected the appeal of the revenue.
- On an appeal to the High Court :

Held

- The ratio of the Supreme Court decision in *CIT* v. *D.P. Sandu Bros. Chember* (*P.*) *Ltd.* [2005] 273 ITR 1/142 Taxman 713 has to be applied. The Court has to proceed on the basis that cost of acquisition of leasehold rights could be determined and was capable of being ascertained and this was the position even before section 55(2) was amended by Finance Act, 1994 with effect from 1st April, 1995.
- Applying the ratio of the decision of the Supreme Court in *D.P. Sandu Bros.'s* case (*supra*), it has to be held that the tenancy right had computable cost of acquisition and, therefore, the consideration received on surrender or acquisition was taxable as capital gains even prior to 1st April, 1995. In the present case, as noticed, the sub-lease was for 17 years and even construction had been raised by the predecessors of the respondent assessee.

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- Applicability of section 45(5) was interpreted by the Supreme Court in *CIT* v. *Ghanshyam* (*HUF*) [2009] 315 ITR 1/182 Taxman 368, and it was held that the profits and gains from transfer of a capital asset by compulsory acquisition was chargeable under the head 'capital gains'. Section 45(5) was enacted as it was noticed that in case of compulsory acquisition, additional compensation was/is awarded at several stages by different authorities. This had necessitated multiple rectifications in the original assessment order causing great administrative difficulty and problem in collection of the additional demand. With a view to remove these difficulties, by Finance Act, 1987, section 45(5) was enacted to provide for taxation of additional compensation as deemed income in the year of receipt in the hands of the recipient. The section also stipulated that the cost of acquisition in the hands of the receiver of the additional compensation would be deemed to be *NIL* and this would not affect the compensation already taxed at the first instance in the earlier previous year when the transfer of capital asset took place. Thus, in case of compulsory acquisition of assets, capital gain was/is charged on the compensation originally awarded in the year of transfer, and the additional compensation was/is deemed to be taxable income and was/is taxed in the year in which it was/is received and, it was/is not taxed in the year of transfer of the capital asset. In light of the aforesaid decision, it has to be held that the additional compensation received would be taxable in the present assessment year, *i.e.* 1988-89. Therefore, decision of the Tribunal to the contrary cannot be sustained and has to be set aside.
- Whether acquisition of tenancy rights being interminate, capital gain tax was not payable on enhanced compensation under section 45(5)
- In *D.P. Sandu's Bros. case* (*supra*), Supreme Court in categorical terms has held that the cost of acquisition could be computed in case of acquisition of tenancy rights. In the present case, sub-lease in question was for a period of 17 years and the respondent assessee also had constructed a super-structure, a factory, which was constructed by the predecessor of the respondent assessee. The respondent assessee had in the land acquisition proceedings, claimed that they were entitled to compensation on acquisition of their land under the sub-lease. Their rights had been acquired. Value of the sub-lease rights of the respondent assessee was ascertained and accordingly, the compensation was assessed and paid. Thus, the tenancy right had value and, therefore, compensation was paid. Once it was held that it was possible to ascertain the cost of acquisition of tenancy rights then it follows that capital gains could be computed and shall be payable. Further, section 45(5) is both the charging section as well as the computation section. It specifically provides for how and in what manner capital gain on compulsory acquisition of land is to be computed and taxed. For the purpose of taxation of enhanced compensation received, cost of acquisition has to be taken as *NIL* as per the statutory mandate of section 45(5). Logically, therefore, it follows that the compensation received in this year by the respondent assessee has to be taxed. For the purpose of taxation of enhanced compensation received, cost of acquisition is to be taken as *NIL* as per the statutory mandate of section 45(5). The stand that the compensation received in any year pertains to only one transfer and gain, has been undone and negated by enactment of section 45(5). Each

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assessment year is separate and distinct and enhanced compensation received is to be taxed in the year of receipt i.e. the year in question. Thus, the argument of the respondent assessee is untenable.

- Whether capital gains on enhanced compensation received is taxable only when the original or earlier compensation itself was taxed.
- Firstly, there is no evidence that original compensation received by the respondent assesse was not taxed and there is no such factual finding to that effect by any authority. Secondly, each assessment year/order is separate and distinct. The assessee or revenue cannot take advantage of a wrong computation or failure to tax or erroneous taxation in an earlier year. The argument also fails to take notice of the fact that the courts declare the law as it exists and when the Supreme Court pronounced the judgment in Ghanshyam (HUF)'s case (*supra*), it declared the legal position as it was. As per the ratio of *D.P. Sandu's case* (*supra*), it is possible to compute and calculate cost of acquisition of tenancy rights and, therefore, gain on transfer of tenancy rights is taxable as capital gains.

Contention that Assessee would have availed benefit of section 54/54F.

- This contention is fallacious. It is not the case of the respondent assessee that they had taken benefit under section 54/54F. The respondent assessee wanted to take and sought advantage of legal opinion to claim that the gain was not taxable. The risk was inherent in the said stance and stand and had its consequences. The legal position as it unfolded and evolved, is against the respondent assessee. Tax, therefore, has to be paid. Income has been certainly earned is not exempt from tax.

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