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Income accrues / arises only on performance of all obligations under joint development agreement

The Mumbai Bench of the Indian Income-tax Appellate Tribunal (ITAT) rendered its decision that income accrued only when all the obligations necessary for receiving such income are performed and not on receipt of money or partial performance of obligations (i.e. transfer of development rights).

Facts of the case:

- Newtech (India) Developers (the taxpayer)¹ is a builder and developer.
- The taxpayer had entered into a joint venture ('JV') with Shivalik Ventures Pvt. Ltd. ('Shivalik'). As per the joint venture agreement, the taxpayer was to transfer development rights to the JV and receive a consideration of INR 54 million in exchange. The consideration was to be paid by Shivalik in the following manner:

Payment of consideration	INR (million)	% of total consideration
On entering of the JV agreement	8.64	16%
On obtaining intimation of approval and commencement certificate	22.68	42%
On all the slum dwellers vacating the property and shifting to alternate temporary transit accommodation	22.68	42%
Total	54.00	100%

Further, as per the JV agreement, the amount of INR 8.64 million was to be treated as an advance till at least 25% of the slum dwellers (occupying the said property) had vacated the premises. In case the taxpayer was unable to do so within 5 years, the entire money was to be refunded to Shivalik.

- During the Financial Year (FY) 2008-09, corresponding to the Assessment Year (AY) 2009-10, the taxpayer had received INR 8.64 million as per the JV agreement. However, since the taxpayer was unable to get at least 25% of the occupants to vacate the property, it had treated the sum of INR 8.64 million as an advance and offered Nil income to tax.
- During the course of reassessment proceedings before the Assessing Officer (AO) for AY 2009-10, the taxpayer explained the above. Further, the taxpayer mentioned that it had not been able to get

¹ ITO v. Newtech (India) Developers [2020] 116 taxmann.com 898 (Mumbai - Trib.)

at least 25% of the occupants to vacate the property even when the reassessment proceedings were ongoing.

- The AO did not accept the taxpayer's contentions and subjected the entire amount of INR 54 million to tax during AY 2009-10, because:
 - The taxpayer was following mercantile method of accounting, as per which the transactions were to be recognised as and when they took place.
 - The taxpayer had transferred development rights and handed over the possession of the property and hence, the said transaction qualified as transfer under section 53A of the Transfer of Property Act, 1872.
 - The condition of treating INR 8.64 million as an advance till at least 25% occupants had vacated the property, was provided by way of a modification agreement (to the original JV agreement) and hence, it was a colourable device to evade taxes.
- On appeal by the taxpayer, the Commissioner of Income-tax Appeals [CIT(A)] held that:
 - Income accrued or arose only when the taxpayer rendered / performed the relevant services. Further, as per the accounting standards, revenue was to be recognised on sale or rendering of services. However, if there was a significant uncertainty in ultimate collection of revenues, the revenue recognition was to be postponed and recognised only when it became reasonably certain.
Accordingly, in the case under consideration, the income accrued only when the taxpayer was able to evacuate 25% of the slum dwellers.
 - The sum of INR 8.64 million was shown as advance in the financial statements of the taxpayer. Further, the balance amount of INR 45.36 million was neither received by the taxpayer nor accrued to the taxpayer.
 - A businessman was free to take any business decisions and could enter into a modification or cancellation or addendum agreement as required for business prudence. In the case under consideration, merely because the modification agreement was submitted towards end of audit by the AO could not be a ground for its rejection.
 - In view of the above, the income had not accrued to the taxpayer for the year under consideration.
- Aggrieved by the CIT(A)'s order, the AO filed an appeal before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT held that the nature of arrangement between the taxpayer and Shivalik was a joint venture arrangement and the taxpayer was required to perform various obligations under the JV agreement, such as:

- Procure / obtain the letter of intent and intimation of approval from the Slum Rehabilitation Authority, etc. along with Shivalik.
 - Procure and furnish to the JV the resolution passed by the cooperative societies (formed by the slum dwellers) in the general body meeting, consenting to:
 - Redevelopment of the property by Shivalik in JV;
 - Construction of multi-storeyed building for rehabilitation of its members;
 - Shift to permanent rehabilitation tenement in the nearby vicinity from the property under consideration.
 - Procure resignation and no objection certificate from the architects appointed by the taxpayer in favour of the architect appointed by Shivalik.
 - To shift all the slum dwellers from the property under consideration to the temporary alternate accommodation.
 - To shift all the slum dwellers / occupants from temporary alternate accommodation to permanent accommodation constructed.
- The ITAT held that the JV agreement was a composite agreement and all the terms of the agreement were to be read in conjunction with each other. Accordingly, if the taxpayer had neither performed the required obligations nor seemed to be in a position to perform them, then the partial payment for fulfilling the obligations could not be treated as income in the hands of the taxpayer.
 - The ITAT noted the following principles laid down by various rulings:
 - While a loss is to be accounted for as soon as it can be reasonably anticipated, the anticipated profits are not to be accounted for until these profits actually arose – case of Chainrup Sampatram v. CIT².
 - A receipt cannot have an income character in the hands of the person, who is still to perform the obligations for which the amount is received – case of E D Sassoon & Co Ltd v. CIT³.
 - Once someone has earned the right to receive the money in income character, it is immaterial (for recognition of the same as income) whether the income is received or not – case of ACIT v. Mahindra Holiday Resorts Pvt Ltd⁴.
 - If income does not result at all, there cannot be a tax, even if in book-keeping an entry was made for a hypothetical income which did not materialise – case of CIT v. Shoorji Vallabhdas & Co⁵.
 - The ITAT held that the AO could not disregard the modification agreement just because it negated tax liability in taxpayer's hands. Further, whether the advance amount was actually refunded or not, did not matter for accrual of income.

² Chainrup Sampatram v. CIT [1953] 24 ITR 481 (SC)

³ E D Sassoon & Co. Ltd. v. CIT [1954] 36 ITR 27 (SC)

⁴ ACIT v. Mahindra Holiday Resorts Pvt Ltd [2010] 3 ITR(T) 600 (Chennai)

⁵ CIT v. Shoorji Ballabhdas & Co [1962] 46 ITR 144 (SC)

- In view of the above, the ITAT held that when the obligations of the taxpayer under the JV agreement were not performed, there was no occasion to bring the consideration for performance of such obligations to tax. The action of the AO to tax INR 54 million for transfer of development rights was incorrect and devoid of merits.

Comments:

- The ruling affirms the principle that income accrues / arises only once all the obligations necessary for earning such income are performed in entirety and not partially.



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