Cost of tenancy rights if determinable should be considered while computing capital gains

13 May 2014

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Mrs. Tauqueer Fatema Rizvi\(^1\) (the taxpayer) held that once the cost of acquisition of tenancy rights is determinable, the benefit of such acquisition has to be given while computing the tax on capital gain. Accordingly, the market value of the flat received against tenancy rights, as on the date of its possession, would be the cost of its acquisition, and such cost is deductible while computing capital gains.

Facts of the case

- The taxpayer, an individual, was an old tenant, residing in the building admeasuring 1,200 sq.ft. under joint tenancy.
- On 6 May 1982, an agreement was entered into by the builder whereby the builder has undertaken the tenancy property of the taxpayer for development. In lieu of the surrender of tenancy rights, the builder had offered two flats admeasuring 728 sq.ft. and 500 sq.ft. on ownership basis as permanent alternate accommodation.
- In terms of the agreement, the taxpayer was required to deposit INR2000 with the builder towards society deposit.
- During the Assessment Year 2005-06, the taxpayer sold the said property for a consideration of INR3.87 million. While computing capital gain, the cost of acquisition of the flat has been taken by the taxpayer as amounting to INR0.364 million, which was computed on the basis of sale agreement entered into by the builder in the same month in the same building with other persons.
- The Assessing Officer (AO) held that as per Section 48 of the Income-tax Act, 1961 (the Act), only amount actually incurred wholly and exclusively in connection with transfer of capital asset and actual cost of acquisition of the asset can be allowed to be deducted from full value of consideration. In the present case, since the taxpayer has not paid any consideration except for making security deposit of INR2000 with the builder, the AO rejected the cost of acquisition of the flat at INR0.364 million and the same was taken at INR2000.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

\(^1\) Tauqueer Fatema Rizvi v. ITO (ITA No. 8862/Mum./2011) – Taxsutra.com
**Tribunal’s ruling**

- For determining the cost of acquisition under Section 48 and 49 of the Act, the tenancy rights have to be taken into consideration. This is also evident from Section 55(2)

- The builder has given the alternate flat to the taxpayer only by virtue of surrender of tenancy rights by the taxpayer. Had there been no tenancy right, the builder would have not offered any flat to the taxpayer on ownership basis. Thus, it is a valuable right on which cost of acquisition has to be determined.

- It is not a case that the cost of acquisition cannot be determined in lieu of the surrender of tenancy right at all. Once the cost of acquisition is determinable, the benefit of such acquisition has to be given while computing the tax on capital gain.

- In the present case, the tenancy right got converted into acquisition of a flat, when the taxpayer must have got the possession of a new flat constructed by the builder. Thus, the market value of the said flat as on the date of its possession would be the cost of its acquisition and, accordingly, such cost is deductible while computing income by way of capital gains.

- Accordingly, the Tribunal set aside the order passed by the CIT(A)’s order and directed the AO to take the value of the flat for the purpose of cost of acquisition from the year in which the taxpayer got the actual possession of the flat and only then he shall compute the capital gain.

**Our comments**

The Mumbai Tribunal in the case of Balmukund P. Acharya3 has held that the consideration for surrender of tenancy right was the market value of the asset at the point of time when it was given to the taxpayer without consideration. The cost of acquisition may be ‘nil’ on the facts of a case, but yet the cost of acquisition may have been incurred (such as by surrender of tenancy rights on the facts of the case) and it may be capable of being determined i.e., market value of premises at the point of time when tenancy rights were surrendered.

---

3 Balmukund P. Acharya v. ITO [2011] 48 SOT 385 (Mum)