Housing and the budget impact on redevelopment

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Sellers who enter into redevelopment agreements for existing houses can be impacted

In the recent budget, the limit for reinvestment in a residential house to claim the benefit of long-term capital gains exemption on sale of a house (under Section 54) or on sale of any other asset (under Section 54F) is proposed to be restricted to ₹10 crore. This limit of ₹10 crore is proposed to be applicable from assessment year 2024-25, i.e. for capital gains chargeable to tax from the financial year 2023-24 onwards.

The budget memorandum has outlined the reason for introducing this cap. “The primary objective of sections 54 and section 54F of the Act was to mitigate the acute shortage of housing, and to give impetus to house building activity. However, it has been observed that claims of huge deductions by high-net-worth assesses are being made under these provisions, by purchasing very expensive residential houses. It is defeating the very purpose of these sections."

One category of sellers that will be significantly impacted is those who enter into redevelopment agreements for their existing houses. In cases where the house was in a dilapidated condition and needed reconstruction, lacking funds for reconstruction himself, the homeowner would enter into a redevelopment agreement with a builder, whereby the owner would get as consideration, the same amount of newly constructed space as that being earlier occupied by him till the development. The only benefit that the homeowner got was a new construction in place of his old dilapidated house, of the same area or slightly larger.

In such cases, the homeowner did not end up paying any tax since he had transferred an existing house and acquired a new residential house. At best, if he got some money in addition, he would end up paying capital gains tax on that amount.

Post-amendment, the position in such cases would be that the homeowner may be subjected to capital gains tax, even if he does not get any money, if the value of his new house exceeds ₹10 crore. The homeowner may therefore have to necessarily raise funds from his other sources to pay off the capital gains tax, if he does not receive any monetary consideration. This amended provision would therefore act as a significant deterrent to development of old houses, particularly the ones inherited.

This amendment may also impact cases of redevelopment of housing societies, particularly in expensive locations, where the value of the new flat received by the member exceeds ₹10 crore. Such members may also need to take a relook at their possible capital gains tax liability, even though they may be merely receiving a new apartment in lieu of their existing flat.

This amendment is therefore highly unfortunate for cases of redevelopment, where a taxpayer may end up paying tax on a notional gain which he does not really get in monetary terms.

The worst part is that this amendment may affect individual taxpayers who have already entered into such agreements for redevelopment of their old houses prior to

the amendment, but where the construction is not yet complete. This is on account of the fact that in such cases, there is a provision that the capital gains tax liability arises only on completion of construction of the new building, i.e. on obtaining the occupation certificate or completion certificate, as the case may be, and not on entering into the redevelopment agreement, as in cases of other taxpayers.

This provision, when inserted a few years ago, was intended to benefit such individual (and Hindu undivided family) taxpayers, postponing their liability to capital gains tax to a year in which they got their new houses. This beneficial provision will now turn into a disadvantage and may now hit taxpayers who have entered into redevelopment agreements before the amendment, but who would be taxed on the capital gains in any year after the amendment. It is likely that the benefit of exemption for such taxpayers would now be restricted to the new house cost of only ₹10 crore, and not extend to the entire value of such new house, as anticipated when they entered into the redevelopment agreement.

Though it may be possible for taxpayers to contend that they had acquired a vested right to claim the exemption of the larger amount on entering into the redevelopment agreement itself, which could not be restricted by a subsequent amendment, the matter is highly likely to be subject to litigation. In the interest of fairness, it is necessary that the amendment is made inapplicable to such cases where the registered redevelopment agreement was entered into prior to 1 February.

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