LTCG exemption on building new house tricky

Time limits differ for purchase and construction of new house to avail tax benefit on sale of old

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In a recent decision, the Madras high court held that since the construction of the new house was completed after the date of sale of the old asset, the construction qualified for the purposes of capital gain exemption. Photo: Indranil Bhoumik/Mint

One of the exemptions available for long-term capital gains (LTCG) arising on sale of a residential house or any other capital asset is by acquisition of a new residential house, either by purchase or by construction. There are different time limits for purchase and for construction. For purchase, the new house should have been purchased one year prior to the date of the capital gain accrual, or within two years after the date of the capital gain accrual. For construction, the construction of the house should be done within a period of three years from the date of accrual of the capital gain.

In the past, there was an issue as to whether purchase of a **house or flat** under construction amounted to purchase or construction. A number of high court decisions have more or less settled the issue, holding that purchase of a flat under construction amounts to construction of a house, not purchase of a house. Therefore, the time limit of three years from the date of accrual of the capital gain applies. The question of the time limit in case of construction has now gained more significance, in view of these decisions.

The significant difference between the two time limits is that in case of purchase, the purchase of the new house can be within one year prior to the date of sale of the old capital asset, whereas in the case of construction, the construction can only be after the sale of the old capital asset.

The interesting issue that has arisen of late has been as to what is the relevant date for the purposes of considering the construction, since construction is an ongoing process. Another issue is whether only expenditure incurred after the date of **sale of the old asset** qualifies for exemption, or the entire cost.

For example, consider a case where you have sold some shares in July 2018, resulting in **LTCG** of about ₹30 lakh. You have also been constructing a residential house, for which you had acquired land five years ago for ₹5 lakh, and have spent ₹20 lakh for construction up to July 2018. Subsequently, the construction is completed in October 2018, with an expenditure of ₹6 lakh from August to October 2018. Is the gain eligible for exemption, and what is the eligible expenditure—the entire cost of ₹31 lakh, the cost of construction after July 2018 of ₹6 lakh, or the entire cost of construction of ₹26 lakh?

In a recent decision, on the basis of a similar fact pattern, the Madras high court held that since the construction of the new house was completed after the date of sale of the old asset, the construction qualified for the purposes of capital gain exemption. According to the Madras high court what was relevant was the date of completion of construction of the new house. So long as the date of completion of construction was within the period of three years after the date of sale of the old asset, even if the construction had commenced before the date of sale of the old asset, it qualified for the purposes of exemption.

The Madras high court held that the entire cost of the new house qualified for exemption. Though the **land** was acquired more than five years before, it still formed part of the cost of the new house, whose construction was completed within the eligible period. Even the cost of construction before the date of sale of the old asset qualified for exemption by the same logic. Therefore, according to the Madras high court, it did not matter when the cost was incurred. What was important was whether the date of completion of construction was within the required period of three years from the date of sale of the old capital asset.

An interesting question arises as to what is the date of completion of construction in cases of flats acquired on a bare shell basis, i.e. with just the walls, where the flooring, electrical wiring and fittings and plumbing fitting etc. is done later after possession. In such cases, though the occupation certificate is obtained for the entire building, the flat is not habitable, without the flooring, electrical wiring and plumbing fittings. Therefore, the real date of completion of the construction is not the date of occupation certificate, but the date of completion of the flooring, electric wiring and plumbing fittings, after which the flat is fit to be occupied for residence. It is only then that the construction is complete and can be called a house, though it may be furnished later.

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