

Indexation and cost of acquisition of an under-construction property



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When one sells a property that is under construction, the date on which the property has been acquired is the date of acquisition.

SUMMARY

- *There is no clarity from the tax authorities yet on how indexation is calculated.*

How is capital gains calculated on transfer of an under-construction property? This question arises both when the property is sold before taking possession of the same, as well as when the property is sold after possession. There are primarily two issues here, both relating to the date of acquisition. One, from what date is the holding period to be considered for treatment of capital gains, either as long term or short term? Two, how is the indexed cost computed, since the payments for acquisition of the property would have been made over a number of years linked to the progress of construction.

When one sells a property that is under construction, the date on which the property has been acquired—date of booking or allotment—is the date of acquisition. Even in a case where one is selling the fully built property after having taken possession of the same, various high courts have now made it fairly clear that for determining whether the capital gain is long-term or short term, one has to consider the date of allotment of the property as the date of acquisition.

However, there is still some confusion in the matter of determining the indexed cost of acquisition. In calculating long-term capital gains, one has to deduct the indexed cost of acquisition instead of the cost of acquisition. The definition of “indexed cost of acquisition” as per the plain reading of the law is that the cost of acquisition of the asset has to be indexed by applying the cost inflation index of the year in which the asset was first held and considering the cost inflation index of the year in which the asset is being disposed of. This clearly suggests that the entire cost of acquisition, irrespective of the year in which such cost is actually paid, is to be indexed from the year in which the asset was acquired. Therefore, logically, if one considers the date of booking or allotment of the property as the date of acquisition of the property, the entire cost of acquisition is to be indexed from the year of booking or allotment.

To illustrate, let’s assume a property costing ₹1 crore was booked and allotted in 2008-09, and payment for the property was made in instalments of ₹20 lakh each year, over the period of five years from 2008-09 to 2012-13, in which year the property was built and transferred. If the property is being sold in the current year, the entire cost of acquisition of ₹1 crore should be indexed from 2008-09 till 2023-24.

Unfortunately, however, the issue has been the subject of litigation since tax authorities often seek to grant the benefit of indexation only from the year of completion of the property, or, at best, from the respective years in which the payments were made for acquisition of the property. While most tribunal decisions have taken the view that the indexation of the entire cost should be available from the year of booking or allotment of the property, a few tribunal decisions (and one high court) have taken a contrary view that indexation of cost would be allowable from each year in which the payment was made.

Many of these decisions were rendered at a time when the correct date of acquisition for determining the long-term or short-term nature of the capital gains was a disputed issue. Therefore, in a sense, as against the argument of the tax authorities that indexation would be available only from the year of completion of construction of the property (which according to them was the year of acquisition), the tribunals and court, in a sense, provided relief to the taxpayer by allowing indexation from the respective years of payment. Given the fact that there is now some clarity on the date of acquisition of the property, and that there is a circular from the central board of direct taxes (CBDT), clarifying a similar issue in the context of acquisition of a particular type of property, the position as to the cost indexation of the entire cost from the year of acquisition is much clearer.

This is also evident from the fact that each instalment is a part of the cost of acquisition agreed to be paid for the property, and is not a part of cost of improvement (for which indexation is available from the year of improvement). It is therefore perhaps time that the CBDT clearly clarifies the correct position in law, so as to reduce unnecessary litigation on the issue, which affects so many taxpayers.

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Right way to arrive at indexed cost

If you bought under-construction house...

Cost of acquisition = Date of booking/allotment

Indexed cost of acquisition = Indexation to be calculated from year of booking

Mr X booked property worth **₹1 crore** in 2008 and paid 5 installments of **₹20 lakh** each between 2008 and 2012.

↓
He sold property in 2023

↓
To calculate capital gains, cost of acquisition to be indexed from 2008 till 2023.



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