

The other side of bayana

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It is a general practice to make a token payment towards an agreement to sell, referred to as '*bayana*' which is forfeited/payable as per the terms of the agreement if any of the parties to the agreement fails to honour the commitment. What complications can it cause to the calculation of capital gain under the Income Tax Act 1961 has to be seen. Also there are other considerations to be kept in mind like indexation of cost and whether the advance was towards a capital asset or a business current asset.

Let us consider a few hypothetical situations:

What happens if a person enters into an agreement for sale of a residential house and gives advance money of Rs.1,00,000 and fails to honour the deal on the due date and in the event the advance payment gets forfeited?

The amount so forfeited shall go to reduce the cost of acquisition of the asset and the receipt will not lead to any tax liability as the asset cost will be reduced by the advance money forfeited as provided in section 51 of the Income Tax Act 1961.

If the vendor commits a default and the vendee receives some compensation besides the refund of the earnest money paid by him, such compensation shall be subject to capital gains as it will amount to relinquishment of a right by the vendee..

What happens if the advance money was towards purchase of an office building, can it be treated as a business expenditure in the hands of the supposedly purchaser?

The amount cannot be claimed as revenue expenditure, because it has been held in *CIT v. Jaipur Mineral Develop Syndicate (1995) 216 ITR 469 (Raj)*, that where the payment is towards a capital asset the amount lost upon forfeiture will not be revenue loss though the sum may not have the same consequence or character in the hands of the recipient or beneficiary.

Therefore, irrespective of the nature of receipt in the hands of the recipient, the nature of loss should be decided w.r.t. the nature of payment i.e., capital/revenue., in the hands of the payee. If the advance was paid towards purchase of capital asset, the amount lost on forfeiture could only be capital loss. On the other hand if the advance was paid for purchase of inventory dealt with by the assessee loss arising upon forfeiture will be revenue loss. Though Bombay high court differed in *CIT v Sterling Investment Corpn.Ltd (1980) 123 ITR 441 (BOM)*

How will the indexation of the asset be done in the hands of the owner, in case of future sale?

The cost of acquisition will be indexed upto the year of forfeiture of advance money and out of it the amount of advance money forfeited shall be reduced. Then again this value shall be indexed upto the year of sale in order to compute the indexed cost of acquisition. This indexed cost of acquisition shall then be deducted out of the total sale proceeds to compute the taxable capital gains.

Opinion : Though a plain reading of section 51 would mean otherwise, I am of the firm opinion that indexation has been brought in with the intention to talk in the terms of present value of money involved in the transaction; therefore it shall not be expected to reduce the actual cost of acquisition by the forfeited amount and then to index it.

Other points to be kept in mind

(i) Only when the advance or the other money has been a)received ,and b)retained or forfeited by the assessee , then only it has to be deducted from the cost of the asset. If such an advance was received and retained by any previous owner, the same shall not be deducted from the cost of the asset.

(ii) If the advance money forfeited was received by the assessee before 1.4.1981 and the assessee has assumed the F.M.V of the asset as on 1.4.1981 as the cost of acquisition, such advance money received (though before 1.4.1981) shall also be deducted as in the section it is written that it will be deducted from the fair market value.

Opinion : This situation is also illogical since once the valuation is being done with reference to a particular date then all or any transaction prior to that date should be treated to be have been accounted for.

(iii) A situation may arise where advance money forfeited is more than the cost of 'acquisition'. In such a case, the excess of the advance money forfeited over the cost of 'acquisition' of such asset shall not be taxable in the previous year in which advance money is forfeited as there is no transfer. However, such excess may be taxable as capital gain in the previous year in which such asset is actually sold either to such party or any other party .This can be inferred from CIT v Sterling & Investment Corporation Ltd.,(1980) 123 ITR 441 (BOM) case.

(iv) For purposes of section 51 , no distinction is made between moneys received and retained by way of 'advance' and 'other money'. The phrase 'other money' would cover deposits made by the purchaser for guaranteeing due performance of the contracts and not forming part of the consideration.