

**ANALYSIS OF IMPORTANT JUDICIAL DECISIONS**  
**REGARDING SECTIONS 54 / 54F**  
**OF THE INCOME TAX ACT, 1961**

By

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**Introduction:**

As per Section 54 of the Income Tax Act, 1961 (the Act), if an assessee invests capital gains arising from sale of long term capital asset being a residential property, in another residential property, he gets the deduction of the amount so invested and thus has to pay no or very little income tax on such capital gains. Similarly, if the entire consideration received on sale of any other long term capital asset is invested in a residential property, the assessee needs to pay no tax on capital gains arising from sale transaction.

Certain conditions have to be followed to get such tax benefits. Recently, there have been numerous judicial decisions regarding these conditions. If the army personnel assesseees get the knowledge of these decisions, they can make better tax planning. I am writing this article with this aim in mind.

**Gist of Section 54 as Given in the Act**

If the assessee is an individual or a Hindu Undivided Family (HUF), and if he has got capital gains arising from transfer of long term capital asset being a residential property (that means sale of a house property after three years from the date of purchase), and if he has purchased a new house during the period from one year before the sale to two years after the sale or has constructed a new house during the period from date of sale to three years after the sale; he will get deduction of capital gains as follows:-

If the cost of the house purchased is less than the capital gains, deduction of the cost of the house (and tax to be paid on balance amount) and if the capital gains are less than the cost of the house, deduction of capital gains.

If the capital gains are not used for such purchase / construction of new house before date of filing tax returns as per section 139 of the Act, such balance amount of capital gains can to be deposited in Capital Gains Account Scheme (CGAS) (to delay paying tax on such capital gains). If the amount of capital gains kept in the CGAS is not utilized for purchase / construction of the house during the period mentioned (three years from the date of sale), then it will be assumed to be income of last year and shall be liable to tax at that time and shall be permitted to be withdrawn after payment of tax. Account can be opened under CGAS in selected branches of all nationalized banks.

**Gist of Section 54F as Given in the Act**

Section 54F is similar to section 54. Only difference is that the entire consideration received (less expenses) from transfer of a long term capital asset other than house

property is required to be invested in a new house property. Also, before taking advantage of section 54F, the assessee should not own more than one house.

Example: Say Mr. A purchased a house H1 on 01-05- 2000. Say he sold that house on 02-05-2003 for Rs. 12 lakh. Say the indexed purchase cost of house H1 on 02-05-2003 is Rs. 2 lakh. Since the house is sold after holding for more than three years, it will be a case of Long Term Capital Gain (LTCG) eligible for taking benefit under section 54. If Mr. A buys another house H2 for Rs. 10 lakh or more during the period from 03-05-2002 to 02-05-2005 the entire LTCG will be tax free. If the purchase cost of H2 was Rs. 8 lakh, he will have to pay tax on balance Rs. 2 lakh. Alternatively, if he constructs house H2 during the period from 03-05-2003 to 02-05-2006 and the cost of construction is Rs. 10 lakh or more, no tax will be payable on LTCG, if the cost of construction is Rs. 8 lakh, he will have to pay the tax on balance Rs. 2 lakh. If the amount of LTCG is not used for purchase / construction before filing the tax returns of Financial Year 2003-04, he will need to keep the money in CGAS to avoid / delay paying tax on it. If the money kept in CGAS is not used for eligible purpose before 02-05-2006, he will need to pay tax on balance amount and will be allowed to take out the balance amount. Everything else being the same in this example, if Mr. A had a plot instead of house H1, he would have to invest Rs. 12 lakh and not only Rs. 10 lakh to take benefit under section 54F and to avoid paying tax.

There have been certain important judicial decisions regarding Section 54 / 54F in past few months. However, these decisions are for litigants of those cases only and one can use them to his advantage only if there are similar facts. For this, entire case decisions have to be thoroughly studied. Also, the jurisdiction of the decision making bodies has to be kept in mind.

### **1. The Deduction is Available even if the New House is Purchased in Joint Name or in the Name of Family Member.**

In the case CIT Vs. Ravindra Kumar Arora, [342 ITR 38 Delhi also ITA No. 1106 (2011)], the Delhi High Court held that Section 54F mandates that the house should be purchased by the assessee and it does not stipulate that the house should be purchased in the name of the assessee only. The house was purchased by the assessee and that too in his name and wife's name was also included additionally. Such inclusion of the name of the wife for the above-stated peculiar factual reason should not stand in the way of the deduction legitimately accruing to the assessee. Objective of Section 54F and the like provision such as Section 54 is to provide impetus to the house construction and so long as the purpose of house construction is achieved, such hyper technicality should not impede the way of deduction which the legislature has allowed. (In the given case the Income Tax Officer (ITO) had granted only 50% deduction to the assessee as the purchased house was on joint name)

The Madras High Court and Haryana High Court have given similar decisions in the cases CIT Vs Natrajan (2007) 287 ITR 271 (Madras) and in CIT Vs. Gurnam Singh (2010) 327 ITR 278 respectively.

Income tax Appellate Tribunal (ITAT) Hyderabad, has given a similar decision on 10-08-2012 in the case N. Ramkumar Vs. CIT, [ITA No. 1901 / Hyderabad/2011]. In this case, the assessee had purchased a new house in the name of his minor daughter. Entire money was used from the long term capital gains.

## **2. The Money can be invested in CGAS up 31<sup>st</sup> March of the Year Following the Assessment Year provided Tax Returns are Not Filed before the Investment Date**

The due dates for filing Income Tax Returns for the previous financial year are given in Explanation 2 to Section 139(1) of the Act. As per this explanation, the due date is 31<sup>st</sup> July for persons not required to get their accounts audited by a Chartered Accountant and is 30<sup>th</sup> September for other assesses. Hence, the assesseees are likely to assume that these are the sacrosanct dates for investment under section 54 or 54F.

However, it is stated in section 139(4) that any person who has not furnished a return within the time allowed to him under sub-section (1), or within the time allowed under a notice issued under sub-section (1) of section 142, may furnish the return for any previous year at any time before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

That means, if an assessee sells a property being long term capital asset on 01-04-2012 and gets LTCG of any amount – say Rs. 50 Lakh, he can invest it in CGAS even on 31-3-2015 without having to pay any tax, provided he has not filed the income tax returns before that date (and has received no notice under section 142). I strongly advise not to delay beyond 31-03-2014 in such case because of various other consequences.

Such a decision is given in the case R.K.P. Elayarajan vs. Deputy CIT [IT Appeal No. 106 (Mds.) of 2012] decided by ITAT Chennai Bench 'A' on 15<sup>th</sup> June 2012. Similar decisions have been earlier given by Punjab and Harayana High Court in the case CIT Vs. Jagriti Aggarwal – 339 ITR 610(P&H): 245 CTR 629 (P&H) [BCAJ], Karnataka High Court and Assam High Court.

## **3. Residential House must have Basic Amenities for Living**

The Punjab and Haryana High Court, in the case of Ashok Syal Vs. CIT [IT Appeal No. 566 of 2005], decided on 4<sup>th</sup> May 2012, held that the term 'house' has not been given any statutory definition, and has to be understood in common parlance. As per dictionary, it means 'a place or building for human habitation'. A building, in order to be habitable by a human being, is ordinarily required to have minimum facilities of washroom, kitchen, electricity, sewerage etc. Merely, building four walls is not sufficient.

## **4. Section 54F is available even if Borrowed Funds are used for Investment**

The ITAT Hyderabad Bench 'A' has given an important decision on 15-06-2012 in the case JV Krishna Rao vs. Deputy CIT Circle 3(3) Hyderabad [IT Appeal Nos 1866 & 1867 (HYD) of 2011]. In this case, the assessee received LTCG of Rs. 3,03,77,343 /- from sale of shares. He used the money for some months and invested the amount in CGAS at right time. However, the invested amount included amount of loan taken of Rs. 33,47,333 /-. ITO objected and disallowed the benefit arising out of the loan amount. The tribunal rejected the plea of the income tax department and totally accepted the plea of the assessee. The tribunal stated, "as long as the amount as required by the section 54 or section 54F is invested, the benefit has to be given to the assessee. The source of money has no relevance."

The plain meaning of this decision is that the LTCG (under section 54) or consideration received (under section 54F) can be used for any purpose whatsoever; however the

required amount must be invested at the required time to avoid paying tax. That money can even be borrowed.

**5. Benefit of Section 54F is available even if House is Constructed on Agricultural Land.**

In the case Assistant CIT Vs. Om Prakash Goyal, [IT Appeal No. 647 (JP) of 2011] decided by the ITAT Jaipur on 02-02-2012, it was held that even if agricultural land was purchased and a house was constructed on that land, the benefit of Section 54F is available.

**6. Benefit of Section 54F is to be denied if No House is Constructed within the given period of Three Years.**

In the case Anu Agarwal Vs. Income Tax Officer, [IT Appeal No. 655 (CHD) of 2011] decided by the ITAT Chandigarh Bench 'B' on 27-11-2012, it was held that if the construction is not completed within the given period of three years, the benefit of Section 54F is not available.

If we analyze the above referred decisions, it becomes clear that the judiciary have been taking a lenient view towards assesseees as far as granting benefits of Section 54 or Section 54F are concerned. One of the reasons is that the intention of the legislature in introducing Section 54 / 54F as explained in Board's Circular No.346 dated 30th June, 1982 is for encouraging house construction. It is an encouragement given to the assessee to exchange one of the residential houses for another or where he has none to convert any of his long term assets into a residential house. The object behind such a provision is to encourage large scale house building activity or investment in house property to meet acute housing shortage in the country. Therefore, looking at the legislative intent, a liberal interpretation has been given to section 54 / 54F which are beneficial provisions.

**At the same time, it must be understood that if the beneficial provisions are used merely for tax evasion, the courts are likely to come down harshly on the assesseees.**

(Approximate 2000 Words)

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