



Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2021 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

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Exemption under Section 54 of Capital Gain under Income Tax Act, 1961

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Received 23 June 2021; Accepted 09 July 2021; Published 12 July 2021

Income Tax Act, 1961 was passed in India in the year 1961 and came into force on 1 April 1962. Income Tax is the basic source of income that is used by the Government for the country. Income Tax is a tax that is levied directly on a person's income. When an individual earns, it becomes an obligation towards the country to pay tax. As the income increases, the taxpayer is supposed to pay tax on a higher slab rate.

There is a total of five heads under the Income Tax Act, 1961 – Salaries, Income from House Property, Profit and Gains of Business or Profession, Capital Gains, and Income from Other Sources. When a taxpayer has computed income under each head, he shall know his Gross Total Income (GTI). A taxpayer's Total Income is calculated by deducting the Deductions applicable from the Gross Total Income. Every year on the first day of February, The Union Budget is presented by the Finance Minister of India. Amendments are made in the Finance Act as the environment changes of an economy.

People tend to pay more by not showing the capital assets in their balance sheets. But what they do not know is that when an assessee (an assessee is a person who pays tax) would show the capital assets by filing a return on time, they would have to pay less amount of tax. In the era of development in India, a person should know all the advantages that are available. Every person wants at least one house which belongs to them. It gives them a feeling of being secured. When an assessee sells a residential house and buys a new residential house. The assessee should know what benefit an individual can claim. This will help them in the reduction of tax liability which an individual holds by following the conditions mentioned in this section.

Keywords: *income tax, exemption, section 54.*

INTRODUCTION

When an assessee sells or transfers its Capital Assets by gaining profit, it is known as Capital Gain. A property which an assessee holds and excludes stock-in-trade, personal effects (excluding jewellery, drawings, painting, or any art), rural agricultural land, and bonds which are certified by the Government any securities as per SEBI Regulations is called Capital Assets (Section 2(14)). Section 2(47) defines the term transfer as any type of transaction with respect to capital asset includes - when an assessee sales, exchange or relinquishment of the asset or extinguishment of any rights or compulsory acquisition by the government or transfer of assets into stock-in-trade or maturity or redemption of a zero-coupon bond or part performance.

A short-term capital asset is a capital asset which an assessee holds for less than 36 months whereas a long-term capital asset is that capital asset that does not come in the category of a short-term capital asset. Under Section 45(1), it is specifically mentioned any profit or gain which arises from the transfer (as mentioned in this act) of a capital asset, will be chargeable in the previous year (P.Y.) when the transfer took place.

PROVISIONS UNDER SECTION 54 OF CAPITAL GAIN

An Individual or HUF is eligible for this exemption. The assessee shall satisfy all the following conditions before taking this exemption -

Firstly, a transfer shall take place of a residential house. The residential house can be a building or land which are to be a part of the building. Secondly, the gain should be a long-term capital gain. Lastly, the income is to be charged under "Income from House Property".

These conditions are cumulative in nature. Even if one condition remains unsatisfied, the assessee cannot avail the exemption.

A house property includes residential units like a flat in a complex. It does not only mean independent houses¹.

It is the responsibility to file a return. When an assessee makes an investment before filing their return, he should deposit the total amount of capital gain under CGAS (Capital Gain Account Scheme). The amount which shall be utilised shall be considered as the cost of the new asset.

It is to be the unutilised amount which is deposited into Capital Gain Saving Account Scheme cannot be taxed with the tax liability of their heir or in the hands of the deceased².

Section 54 divides the exemption as –

- When an assessee transfers a residential house in India and the capital gain exceeds Rs. 2 crores, the assessee may purchase ONE residential house in India within 2 years from the date of transfer or may purchase one new residential house before 1 year from the date of purchase or may construct a new house within 3 years from the date of transfer. The assessee has three options.

Example: 1, if there is a long-term capital gain of Rs. 2.35 crores on the transfer of asset on 1st June 2021 and the assessee purchases a new house for Rs. 4 crores on 16th June 2021. The assessee will be eligible to claim the exemption available under section 54.

- When an assessee transfers a residential house in India with a capital gain not exceeding Rs. 2 crores, the assessee can purchase TWO residential houses in India within 2 years from the date of transfer or purchase two houses before 1 year from the date of transfer or may construct two residential houses in India within 3 years from the date of transfer.

When an assessee shall claim this benefit of purchasing or constructing two residential properties, he will NOT be eligible to claim any benefit from Section 54 of Income Tax Act, 1961 in any of the following assessment years.

Example 2: If an assessee has a long-term capital of Rs. 1.95 crores on the transfer of asset on 1st June 2021 and the assessee purchases two houses for 2.20 crores (total of

¹ *CIT (Addl) v Vidya Prakash Talwar* (1981) 132 ITR 661 (Del)

² Income Tax Department, Circular No 743, dated 06-05-1996

both houses) on 16th June 2021. The assessee shall be eligible for the exemption but he shall be able to only claim it once as per Section 54.

For claiming this exemption, the entire amount of capital gain must be invested.

Where a property is purchased as co-owned by 2 assesseees, the amount of exemption that they can avail is according to their share in the property of each assessee. It shall be deemed as a purchase. This satisfies the condition of Section 54 and can claim this exemption³.

WHAT WILL BE THE AMOUNT OF EXEMPTION UNDER SECTION 54?

When the cost of the new house or houses purchased by an assessee is more than the long-term capital gain, the amount will be the total of long-term capital gain. In the other case, when the cost of the new house or houses purchased by an assessee is less than the long-term capital gain, the amount which shall be exempt should not exceed the cost of the new residential house.

Case 1:

Mr. X sold a residential house for Rs. 50, 00,000 and purchased a new residential house for Rs. 35, 00,000. Long-term capital gain shall be as -

PARTICULARS	AMOUNT (Rs.)
Capital Gain by the sale of residential house	50,00,000
Less: Investment made by purchasing a new residential house	35,00,000
Balance	15,00,000

The exemption amount shall be lower than the capital gain or investment made by purchasing. Therefore, in this case, the amount of exemption shall be Rs. 35, 00,000. The balance would be taxable as long-term capital gain @ 20% i.e., Rs. 3, 00,000.

³ *CIT v TN Aravinda Reddy* (1979) 120 ITR 46 (SC)

Case 2:

Mr. X sold a residential house for Rs. 50, 00,000 and purchased a new residential house for Rs. 60, 00,000. Long-term capital gain shall be as –

PARTICULARS	AMOUNT (Rs.)
Capital gain on transfer of residential property	50,00,000
Less: Investment made by purchasing a new residential house	60,00,000
Balance	NIL

The exemption amount shall be up to the amount of capital gain when the investment is more than the capital gain. An assessee can claim exemption only up to Rs. 50, 00, 00. In this case, there will be no capital gain as the balance is nil.

WHY WAS THIS SCHEME INTRODUCED?

Before this amendment came into existence, an assessee was only allowed to purchase one residential house. This scheme was amended in the Union Budget of 2019. From the assessment year 2020-21, an assessee can purchase 2 residential houses and claim the exemption under section 54 when its capital gain does not exceed Rs. 2 crores.

An investment in property is a low risk and secured investment. The value of a property is said to increase as time passes. If the assessee holds the property for a long duration of time and sells, he would claim a benefit of indexation under long-term capital gain.

There might be a case when an individual had transferred the residential property and there is a long-term capital gain that does not exceed Rs. 2 crores. When a taxpayer earns income, he would have a responsibility to pay tax. However, to reduce the burden of tax, they have an opportunity to claim the exemption under Section 54. The taxpayer will have an option to purchase 2 new residential properties but once this exemption is claimed, it cannot be exercised for further any other assessment year.

When an individual has purchased 2 residential houses in Jaipur and Udaipur for 1.65 crores in the assessment year 2020-21 and enjoys the benefit of the exemption under Section 54. Further in the assessment year 2022-23, if he sells the same residential house in Jaipur for Rs. 1.98 crores and purchases another 2 residential houses in Nainital and Mumbai. The taxpayer shall not be able to exercise the claim the exemption under Section 54.

If this option is exercised more than once, then they shall start investing in residential properties. Selling a residential property and buying 2 residential properties. To avoid this the authorities have given only one opportunity to claim this exemption.

DIFFERENCE BETWEEN SECTION 54 AND SECTION 54F

Section 54 and Section 54F are eligible for both individuals and HUF and on the transfer of long-term capital gain.

Section 54 is allowing exemption on the transfer of residential houses whereas Section 54F allows the exemption on the transfer of a long-term capital asset other than residential houses. Section 54F also gives exemptions on the transfer of plots. This Section does not allow the purchase of 2 assets but to claim this exemption the assessee shall purchase ONE residential house within 2 years from the date of transfer or one residential house before 1 year from the date of transfer. The assessee may also construct a new residential house within 3 years from the date of transfer.

There is a condition while claiming exemption under 54F that says that the assessee shall own under his name not more than one residential house on the date of transfer but in the case of Section 54, there is no such limit.

The assessee shall invest the entire amount of capital gain to claim the exemption under Section 54. But in the case of Section 54F, the assessee may or may not invest the total amount of capital gain or sale receipts. The exemption shall be provided in proportion as -

Exemption = Cost of the new house * Capital gain or sale receipts

CONCLUSION

The Ministry of Finance has always made amendments that would benefit the taxpayer and have also tried that there are no cases of fraud. It is mandatory to file a return as per Section

139. The income tax Act is an act that helps in taking advantage of the exemptions only when the assessee has filed a return of income on time. When an individual shall disclose all its assets in its return, he may also have the benefit of claiming the exemptions regarding the same. But when the assessee hides or does not plan the investment he would end up paying more.

An individual can plan with its investment with a person who would have complete knowledge in the fields of income tax. This would help to reduce the burden of the tax. Section 54 is an important section as when an individual wants to invest in property, he shall consult regarding the same.