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HC Rules : Long term capital gain exemption u/s 54 available for investment in more than one residential house**Executive Summary**

This tax alert summarizes the recent ruling of Andhra Pradesh High Court (HC) in the case of Syed Ali Adil (Taxpayer) on an issue: whether exemption under section 54 of the Income Tax Act (ITA) from long term capital gain arising from sale of ancestral residential house property should be denied for the reason that the Taxpayer invested the sale proceeds of the property in two residential flats purchased from different vendors by separate sale deeds.

The HC held that expression "a residential house" in section 54 of ITA, has to be understood in a sense that a building should be of residential nature; and "a" should not be understood to indicate a singular number such that a taxpayer who purchases multiple residential units is denied the exemption pursuant to the said section.

The HC approved the rulings of Karnataka High Court on the same subject matter and disapproved the ruling of the Special Bench of Tribunal which held that a taxpayer who purchases more than one house will have to choose any one of the house, the cost of which, would qualify for the exemption under section 54.

Our comments

Exemption from capital gains under section 54 of ITA in the case of investment of capital gains amount for purchase of more than one flat has been the subject matter of litigation with different tribunals adopting varied interpretations. However, some consensus had emerged that if the flats which are adjacent or constructed at different floor levels, may still be entitled to exemption if the flats are so designed as to constitute as one residential house. However, the Special Bench of Tribunal (Mumbai)'s ruling in the case of Shushila Jhaveri, to the effect that the taxpayer will have to choose one of the flats whose cost can be considered for the purpose of exemption, was cited by the tax department to deny the exemption, in the case of flats situated at different locations or, the flats which otherwise do not pass through the test of being regarded as one house.

However, this HC ruling which has disapproved the aforesaid Tribunal's decision while approving Karnataka HC's rulings in the cases of other taxpayers, is a welcome relief for the taxpayer community. The HC ruling would be equally applicable for the claim of exemption under section 54F of the Act, which is couched in the language similar to section 54 referred to in the ruling.

Background

Pursuant to section 54 of ITA, an individual or a Hindu Undivided Family (HUF) is entitled to claim exemption from long term capital gain tax arising on transfer of a residential house upon purchase or construction of another residential house within the prescribed time period. The expression "a residential house" has been interpreted by the tax department to deny the claim of exemption of a tax payer who purchases or constructs more than one residential unit.

In the instant case, Mr Syed Ali Adil (Taxpayer), an individual, claimed exemption under the said section in respect of sale proceeds of an ancestral house property which were invested in two independent residential flats. The Tax authority allowed the exemption with reference to the cost of only one flat. On an appeal, the first appellate authority allowed the exemption with reference to cost of both the flats. On further appeal by Tax Authorities, the tribunal confirmed the relief granted by the first appellant authority, against which, the revenue filed an appeal before the Andhra Pradesh High Court (HC) whose ruling¹ is discussed.

Taxpayer's contentions

- The Karnataka High Court² in a case with similar facts ruled in favour of the taxpayer
- Even though section 54 refers "a residential house", it being a beneficial provision, should be construed liberally
- The benefit of section 54 is available for investment in two residential flats which are adjacent

Tax authority's contentions

- Exemption is not available with reference to multiple independent residential flats in view of clear language of the section which refers to the exemption being available to "a residential house" which indicates a singular number
- The fact that the units were separated by a strong wall, purchased from two different vendors, under two separate sale deeds, also indicate that the two adjacent flats do not meet with the test of a single residential house

High Court Ruling

- The expression "a residential house" has to be understood in a sense that the building should be of residential nature and "a" should not be understood to indicate a singular number
- The Taxpayer who has purchased two residential flats, is entitled to the exemption in respect of cost of both the flats, more so, when the flats are adjacent and modifications have been made to make it as one unit
- The purchase of the flats from two different vendors or by two separate sale deeds is of no relevance to decide the eligibility for the exemption
- The decision of the rulings of the Karnataka High Court³ and D Ananda Basappa (Supra) has laid down the law correctly
- The contrary ruling of the Special Bench of the Tribunal in the case of Ms Shushila M Jhaveri⁴ which held that only one residential house investment should be given relief, is disapproved.

¹ I.T.A No of 2012

² In the case of Ananda Basappa 309 ITR 329

³ KG Rukminiamma 96 taxmann 87

⁴ 107 ITD 327 (Mumbai)

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