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DRAFT INCOME COMPUTATION AND DISCLOSURE STANDARD

ON

REAL ESTATE TRANSACTIONS

MAY 2017

**Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes**

Draft Income Computation and Disclosure Standard [ICDS]

Real Estate Transactions

Preamble

This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” and not for the purpose of maintenance of books of account.

In case of conflict between the provisions of the Income Tax Act, 1961 (‘the Act’) and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Scope

1. This Income Computation and Disclosure Standard shall be applicable for determination of income from all forms of transactions in real estate, which refers to land as well as buildings and rights in relation thereto. This will include:
 - a) Sale of plots of land (including long term sale type leases) without any developments.
 - b) Sale of plots of land (including long term sale type leases) with development in the form of common facilities.
 - c) Development and sale of residential and commercial units, row houses, independent houses, with or without an undivided share in land.
 - d) Acquisition, utilization and transfer of development rights.
 - e) Redevelopment of existing buildings and structures.
 - f) Joint development agreements for any of the above activities.

Definitions

2 (1) The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

(a) **“Fair value”** is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm’s length transaction.

(b) **“Project”** means the smallest group of units, plots or saleable spaces, as the case may be, which are linked with a common set of basic facilities, if any, in such a manner that unless the facilities are made available and functional, these units, plots or saleable spaces cannot be put to their intended effective use. A larger venture shall be split into smaller projects when these basic conditions are fulfilled.

(c) **“Project Costs”** in relation to a project

A. shall comprise of :-

- (i) Cost of land and cost of development rights - All costs related to the acquisition of land, development rights in the land or property including cost of land, cost of development rights, rehabilitation costs, registration charges, stamp duty, brokerage costs and incidental expenses.
- (ii) Borrowing costs – Costs which are incurred directly in relation to a project or which are apportioned to a project in accordance with Income Computation and Disclosure Standard IX relating to Borrowing Costs.

(iii) Construction and development costs – Costs that relate directly to the specific project and costs that may be attributable to project activity in general and allocated to the project.

B. shall exclude costs that cannot be attributed to any project activity or cannot be allocated to a project.

(d) “Project revenues” include revenue on sale of plots, undivided share in land, sale of finished and semi-finished structures, consideration for construction, consideration for amenities and interiors, consideration for parking spaces and sale of development rights.

2(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Real Estate Projects

3(1) Project revenue and project cost shall be recognised as revenue and cost respectively by reference to the stage of completion of the project on the last date of the previous year for projects where the economic substance is similar to construction contracts. The recognition of revenue and expenses by reference to the stage of completion of a project is referred to as the percentage of completion method.

3(2) Indicators that economic substance of a project is similar to a construction contract are:

(a) The duration of such projects is beyond 12 months and the project commencement date and project completion date fall into different previous years.

(b) Project involves activities similar to construction contracts such as land

development, structural engineering, architectural design, construction or activities of similar nature.

- (c) While individual units of the project are contracted to be delivered to different buyers these are interdependent upon or interrelated to completion of a number of common activities with or without provision of common facilities.
- (d) The construction or development activities form a significant proportion of the project activity.

3(3) In case of a project where the economic substance is not similar to construction contract, revenue shall be recognised in accordance with Income Computation and Disclosure Standard IV relating to Revenue Recognition and provisions of para 3, para 4 and para 5 of the said standard shall apply *mutatis mutandis*, provided :-

- (a) the seller has transferred to the buyer all significant risks and rewards of ownership and the seller retains no effective control of the real estate to a degree usually associated with ownership or the seller has effectively handed over possession of the real estate unit to the buyer forming part of the transaction;
- (b) no significant uncertainty exists regarding the amount of consideration that will be derived from the real estate sales;
- (c) there is a reasonable certainty that the revenue will be ultimately collected from buyers.

Application of Percentage of Completion Method

4(1) The revenue in respect of a project shall be recognised under the percentage of completion method when:-

- (a) the expenditure incurred on construction and development costs is 25 % or more of the construction and development costs;

- (b) 25% or more of the saleable project area is secured by contracts or agreements with buyers; and
 - (c) 10 % or more of the total revenue as per the agreements of sale or any other legally enforceable documents are realised in respect of each of the contracts and it is reasonably certain that the parties to such contracts will comply with the payment terms as defined in the contracts.
- 4(2) Revenue shall be recognised in respect of such units which satisfy the condition mentioned in para 4(1)(c) with reference to the percentage of completion of the project.
- 4(3) For applying the percentage of completion method in respect of a project, the provisions of ICDS III on Construction Contract shall apply *mutatis mutandis*.

Transferable Development Rights

- 5(1) Transferable Development Rights are acquired in different ways as mentioned hereunder:
 - (a) Direct purchase.
 - (b) Development and construction of built-up area.
 - (c) Giving up of rights over existing structures or open land.
- 5(2) When development rights are acquired by way of direct purchase or on development or construction of built-up area, cost of acquisition would be the cost of purchases or amount spent on development or construction of built- up area, respectively. Where development rights are acquired by way of giving up of rights over existing structures or open land, the development rights shall be recorded at fair value of the development rights so acquired.
- 5(3) When development rights are utilised in a real estate project by a person, the cost of acquisition shall be added to the project costs.

5(4) When development rights are sold or transferred, revenue shall be recognised when both the following conditions are fulfilled:

(a) title to the development rights is transferred to the buyer; and

(b) it is reasonable to expect that the revenue will be ultimately collected.

Transactions with multiple elements

6(1) A person may contract with a buyer to deliver goods or services in addition to the construction or development of real estate. In such cases, the contract consideration shall be split into separately identifiable components including one for the construction and delivery of real estate units.

6(2) The consideration received or receivable for the contract shall be allocated to each component on the basis of the fair value of each component.

6(3) The recognition of revenue of each of the components shall be in accordance with provisions of relevant ICDS.

Transitional Provisions

7(1) Project revenue and project costs associated with the real estate project, which commenced on or after 1st day of April, 201X shall be recognised in accordance with the provisions of this standard.

7(2) Project revenue and project costs associated with the real estate project, which commenced on or before the 31st day of March, 201X but not completed by the said date, shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 201X.

Disclosure

- 8(1) A person shall disclose:
- (a) the amount of project revenue recognised as revenue in the period;
 - (b) the methods used to determine the project revenue recognised in the period;
 - and
 - (c) the method used to determine the stage of completion of the project.
- 8(2) A person shall also disclose each of the following for projects in progress at the end of the previous year:
- (a) the aggregate amount of costs incurred and profits recognised (less recognised losses) to date;
 - (b) the amount of advances received;
 - (c) the amount of work in progress and the value of inventories; and
 - (d) Excess of revenue recognised over actual bills raised (unbilled revenue).

Significant changes made in the draft ICDS on Real Estate transactions

vis-à-vis

Guidance Note on Real Estate transactions issued by the ICAI

The draft ICDS on Real Estate Transactions is based on Guidance Note on Accounting for Real Estate Transactions issued by the ICAI. While recommending the ICDS, the Committee suggested the following significant changes in the Guidance Note:

- (i) **Definition of project** – As per the Guidance Note, the set of units which are connected by a common set of amenities will constitute a single project. To bring certainty in this matter, the Committee recommends use of term ‘Basic facilities’ in place of common amenities. This would ensure restricting the definition of the term Project to the smallest possible group of units. Accordingly, the revenue will be required to be recognised on such smallest group of units without linking the same to peripheral common amenities like club-house, entertainment, sports, gymnasiums, health club, restaurants etc.,.
- (ii) **Definition of project cost** – The Guidance Note contains illustrative list of items to be included, allocated or excluded in the project cost. Consistent with the framework of ICDS, the illustrations have been excluded in the standard while retaining the main principle that costs that cannot be attributed to any project activity or allocated to project shall be excluded from project cost. This is also consistent with ICDS III relating to Construction Contracts.
- (iii) **Real estate projects** – As per the Guidance Note, the revenue in respect of real estate projects is required to be recognised based on principles of either AS 9 or AS 7 depending on the economic substance of the project. The Guidance Note further provides that in cases where economic substance of the project is in the nature of construction contract, the revenue is required to be recognised as per percentage of completion method (POCM) in accordance of AS 7. The proposed ICDS retains the

same principles for recognition of revenue and cost without usage of illustrative language of the Guidance Note to provide simplicity and certainty.

- (iv) **Application of POCM for Real estate projects** – The Guidance Note in para 5.3 contains four conditions to be satisfied for recognition of revenue including the condition of obtaining **all critical approvals**. Since the recognition of revenue under other conditions is deferred upto incurrence of 25% of construction and development cost (which does not include land cost), the condition in respect of obtaining critical approval is not found by the Committee to be very relevant for recognition of revenue under ICDS in view of the newly enacted ‘The Real Estate (Regulation and Development) Act, 2016’ (RERA). All other conditions have been retained in the proposed ICDS.

Further, the Guidance note permits all methods for determination of stage of completion like cost incurred, survey of work done, technical estimation, etc,. The Guidance Note however puts a cap on recognition of revenue based on stage of completion determined with reference to project cost incurred. In order to make it consistent with the provisions of ICDS III relating to Construction contract, the proposed ICDS does not provide for capping the recognition of revenue based on stage of completion determined with reference to project cost incurred.

- (v) **Transferable Development Rights (TDRs)** – In case of acquisition of TDRs, the Guidance Note provides that where development rights are acquired by way of giving up of rights over existing structures or open land, the development rights shall be recorded at the fair market value or net book value. To bring certainty and consistency with other ICDSs, the Committee recommends that in this situation, the development rights shall be recorded at the fair value of the development rights so acquired.
