Tax treatment on compulsory acquisition of land

Capital gains on compulsory acquisition of immovable property [Section 45(5)]

The capital gains arising from the compulsory acquisition of immovable property shall be taxable in the following previous year:

(a) Where the government acquires a capital asset under any law or where consideration for transfer of the capital asset is determined or approved by the government or RBI, the capital gains shall be chargeable to tax in the previous year in which initial compensation (or part thereof) is received.

(b) Where any amount of compensation is to be received in pursuance of an interim order of a Court or Tribunal, it is chargeable to tax in the previous year in which the final order of such Court or Tribunal is made.

(c) When the owner of the capital asset is not satisfied with the amount of compensation, he can approach the judicial authorities to enhance it. When compensation is enhanced, the capital gains computed originally shall not be re-computed. The capital gains shall be computed separately for the enhanced compensation part only, and it shall be taxable on a receipt basis.Where due to the death of the original transferor or for any other reason, enhanced compensation is received by any other person, the recipient of such compensation is taxable on such capital gain.

Computation of period of holding

The period of holding of the asset transferred shall be counted from the date of purchase or acquisition till the date of compulsory acquisition of the capital asset. In the subsequent computation of capital gain in respect of enhanced compensation, the nature of capital gain is determined with reference to the first computation.

Computation of full value of consideration

The compensation received or receivable by the assessee in respect of the compulsory acquisition of capital assets will be treated as the full value of consideration for the purpose of computing the capital gains in respect of original compensation.

Similarly, the enhanced compensation received by the assessee in respect of the compulsory acquisition of capital asset will be treated as sales consideration for the purpose of computing the capital gains in respect of enhanced compensation.

Where compensation is reduced subsequently by any Court, Tribunal, or other authority, the assessed capital gain of that year is re-computed with reference to the reduced compensation, taking it as the full value of consideration.

Computation of cost of acquisition/improvement

The cost of acquisition/improvement of the capital asset transferred by way of compulsory acquisition shall be computed as per general provisions. Where compensation is received in installments, the cost of acquisition is allowed to be deducted in full in the year in which the first installment is received.

For computing capital gain from enhanced compensation, the cost of acquisition and cost of improvement is taken nil.

Computation of exemptions

Certain exemptions can be claimed under Sections 54 to 54GB from the capital gains arising from the transfer of a capital asset by way of compulsory acquisition subject to the fulfilment of certain conditions.

TDS in case of compulsory acquisition of immovable property [Section 194LA]

Section 194LA provides that where any immovable property, other than agricultural land, is compulsorily acquired under any law in force, the person responsible for paying any sum to a resident by way of compensation or enhanced compensation is required to deduct tax. The tax shall be deducted at the rate of 10% from the compensation paid or payable.

Who is required to deduct tax under this section?

Any person responsible for making payment of consideration or enhanced consideration on account of compulsory acquisition of immovable property shall be required to deduct tax at source. The tax shall be deducted at the time of payment of compensation or enhanced compensation.

Who is a deductee?

Tax is required to be deducted under this provision only if the sum is paid or payable to a person who is resident in India.

Rate of TDS and Threshold limit

Tax is required to be deducted at the rate of 10% from the compensation paid or payable to the resident person.

If the deductee does not furnish PAN, the tax shall be deducted at the rate of 20% as per Section 206AA, or if the deductee has not furnished a return of income for a specified period, the payer shall deduct tax at the rate of 20% as per the Section 206AB.

Where both the provision of Section 206AA and Section 206AB are applicable, the tax shall be deducted at the rates provided in Section 206AA or Section 206AB, whichever is higher.

Note: The provisions of Section 206AB are omitted w.e.f. 01-04-2025.

There is no requirement to deduct tax if the amount of compensation or aggregate of compensation paid or payable during the financial year does not exceed Rs. 5,00,000. [Rs. 2,50,000 upto 31-03-2025]

Exemption from TDS

The tax shall not be deducted under Section 194LA in the following circumstances:

• If the amount of compensation is exempt from Income-tax under Section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013.

• If the sum is payable to the Govt., RBI, Mutual Fund, or any Corporation established under the Act which is exempt from tax.

Certificate for lower or nil deduction

Where the estimated tax liability of an assessee justifies nil or lower deduction of tax, he can apply to the assessing officer for the issue of nil or lower deduction certificate under Section 197.

How to deposit TDS?

Tax deducted under this provision is required to be deposited to the credit of the Central Government through Challan ITNS 281 within 7 days from the end of the month in which the tax was deducted. However, the tax deducted during the month of March shall be deposited by 30^{th} April of the next financial year.

Filing of TDS statement

The person responsible for the deduction of tax at source under this provision is required to file a statement of tax deducted at source in Form 26Q quarterly.

TDS Certificate

The deductor shall issue a TDS certificate to the assessee in Form No. 16A within 15 days from the due date of furnishing of the TDS statement.

Consequences for failure to deduct or deposit tax

Where any person responsible for deducting tax at source fails to deduct tax or after deducting fails to deposit the same, he shall be treated as assessee-in-default. In that case, interest under section 201 will be applicable.

Penalty and Prosecution

Failure to comply with the provisions of deduction of tax at source under this provision may result in penalties and prosecution as per the following provisions:

(a) If a person fails to deduct tax at source, he shall be liable for payment of penalty under Section 271C;

(b) If a person deducts tax but fails to deposit the same to the credit of the Central Government, he shall be liable for the penalty under Section 221 and prosecution under Section 276B. However, the prosecution shall not be intiated if payment in respect to TDS has been made to the credit of the Central Government at any time on or before the time prescribed for filing the TDS statement in respect to such payment.

Consequences for failure to furnish TDS Statement

Where any person fails to furnish a TDS statement, Section 234E shall be applicable, wherein the deductor is liable to pay fees at the rate of Rs. 200 per day during which such default continues. However, such fees should not exceed the amount of TDS.

Moreover, he shall be liable for penalties under Sections 271H of Rs. 10,000 which can be extended to Rs. 100,000, and Section 272A of Rs. 500 for every day during which failure continues.

Consequences for failure to issue TDS Certificates

Where any person responsible for issuing TDS certificates fails to issue such certificates, a penalty under Section 272A shall be applicable of Rs. 500 for every day during which failure continues.

Interest on compensation or enhanced compensation [Section 56(2)(viii)]

Income received by way of interest on compensation or enhanced compensation is taxable under the head Income from Other Sources. A deduction of 50% of such interest income shall be allowed under Section 57.

Further, in view of Section 145B, such interest shall be taxable in the previous year in which it is received. The interest on compensation or enhanced compensation shall be chargeable to tax only if the original or enhanced compensation is taxable. Thus, if compensation is exempt from tax, the interest payable on such compensation shall also be exempt from tax.

Capital gains in case of compulsory acquisition of urban agricultural land [Section 10(37)]

An individual or Hindu Undivided Family (HUF) can claim exemption in respect of capital gain arising on transfer by way of compulsory acquisition of agricultural land situated in an urban area, provided compensation is received on or after April 1, 2004. This exemption is available if the land was used by the assessee (or by his parents in the case of an individual) for agricultural purpose for a period of 2 years immediately preceding the date of its transfer.

MCQs on Tax treatment on compulsory acquisition of land

Q1. Where a capital asset is acquired by the government under any law, the capital gains shall be chargeable to tax in the previous year in which the ________________.

(a) Capital asset is compulsorily acquired

(b) Initial compensation (or part thereof) is received

(c) Final compensation is received

(d) Compensation amount is finalised by the government

Correct Answer - (b)

Explanation: *Where a capital asset is acquired by the government under any law or where consideration for transfer of the capital asset is determined or approved by the government or RBI, the capital gains shall be chargeable to tax in the previous year in which initial compensation (or part thereof) is received.*

Q2. Where any amount of compensation is to be received in pursuance of an interim order of a Court or Tribunal, it is chargeable to tax in the previous year in which the ________.

(a) Interim order of such Court or Tribunal is made

(b) Interim compensation is received

(c) Final order of such Court or Tribunal is made

(d) Final compensation is received

Correct Answer - (c)

Explanation: *If any amount of compensation is to be received in pursuance of an interim order of a Court or Tribunal, it is chargeable to tax in the previous year in which the final order of such Court or Tribunal is made.*

Q3. The period of holding of the asset transferred by way of compulsory acquisition shall be counted from the date of purchase or acquisition till the date of ________.

(a) Compulsory acquisition of the capital asset

(b) Receipt of initial compensation (or part thereof)

(c) Receipt of final compensation

(d) None of the above

Correct Answer: (a)

Explanation: *The period of holding of the asset transferred by way of compulsory acquisition shall be counted from the date of purchase or acquisition till the date of compulsory acquisition of the capital asset.*

Q4. Where compensation is received in installments, the cost of acquisition is allowed to be deducted in full in the year ________.

(a) in which asset is compulsorily acquired

(b) in which the first installment is received

(c) in which the last installment is received

(d) None of the above

Correct Answer: (b)

Explanation: *Where compensation is received in installments, the cost of acquisition is allowed to be deducted in full in the year in which the first installment is received.*

Q5. Tax in case of compulsory acquisition of an immovable property (other than agricultural land) is deducted under ________.

(a) Section 194-IC

(b) Section 194-IA

(c) Section 194LA

(d) Section 194LC

Correct Answer: (c)

Explanation:*Section 194LA provides that where any immovable property, other than agricultural land, is compulsorily acquired under any law in force, the person responsible for paying any sum to a resident by way of compensation or enhanced compensation is required to deduct tax.*

Q6. What is the tax rate for deduction of tax under Section 194LA?

(a) 1%

(b) 5%

(c) 10

(d) 20%

Correct Answer: (c)

Explanation: *Section 194LA provides that where any immovable property, other than agricultural land, is compulsorily acquired under any law in force, the person responsible for paying any sum to a resident by way of compensation or enhanced compensation is required to deduct tax. The tax shall be deducted at the rate of 10% from the compensation paid or payable.*

Q7. Tax under Section 194LA is not required to be deducted if the amount of compensation or aggregate of compensation paid or payable during the financial year does not exceed _________.

(a) Rs. 1,00,000

(b) Rs. 2,50,000

(c) Rs. 10,00,000

(d) Rs. 50,00,000

Correct Answer: (d)

Explanation: *There is no requirement to deduct tax under Section 194LA if the amount of compensation or aggregate of compensation paid or payable during the financial year does not exceed Rs. 5,00,000.*

Q8. What is the amount of deduction allowed under Section 57 against the income received by way of interest on compensation or enhanced compensation?

(a) No deduction is allowed

(b) 20% of such interest income

(c) 50% of such interest income

(d) Actual expenses incurred in earning such interest income

Correct Answer: (c)

Explanation: *Income received by way of interest on compensation or enhanced compensation is taxable under the head Income from Other Sources. A deduction of 50% of such interest income shall be allowed under Section 57.*

Q9. An individual or Hindu Undivided Family (HUF) can claim an exemption in respect of capital gain arising on transfer by way of compulsory acquisition of agricultural land situated in an urban area if the land was ___________ immediately preceding the date of its transfer.

(a) used for any purpose for a period of 2 years

(b) used for agricultural purpose for a period of 2 years

(c) acquired and used for 5 years

(d) None of the above

Correct Answer: (b)

Explanation: *An individual or Hindu Undivided Family (HUF) can claim an exemption under section 10(37) in respect of capital gain arising on transfer by way of compulsory acquisition of agricultural land situated in an urban area provided compensation is received on or after April 1, 2004. This exemption is available if the land was used by the taxpayer (or by his parents in the case of an individual) for agricultural purpose for a period of 2 years immediately preceding the date of its transfer.*