Chargeability of Capital Gain in the context of Transfer of Residential House and Exemption u/s 54 and 54F of the Income Tax Act 1961

I. Introduction

The transfer of a Residential House Property results in capital gains, which are taxable under the Income Tax Act, 1961. The Act, however, contains several provisions to grant exemption on such capital gains if reinvested in specified manners. Sections 54 and 54F are two such critical provisions available to individuals and Hindu Undivided Families (HUFs), designed to promote reinvestment in residential real estate. This article aims to provide a comprehensive overview of the taxation of capital gain on transfer of residential house property, available exemption under Sections 54 and 54F applicable tax rates on capital gains, and the role of indexation in computing taxable gains.

While Section 54 applies specifically to long-term capital gains from the transfer of a *residential house property*, Section 54F covers long-term capital gains from any capital asset *other than a residential house*, provided investment is made in a residential house.

II. Nature of Capital Gains and Taxability

Capital gains arising from the transfer of a capital asset are taxed as per its holding period:

- **Short-term capital gain (STCG):** Property held for **up to 24 months**. [Section 2(42A)]
- **Long-term capital gain (LTCG):** Property held for **more than 24 months**. [Section 2(29AA)]

Tax Rates (as applicable to capital gain on transfer of residential property):

- **STCG:** Taxed as per applicable slab rate (for individuals/HUFs).
- **LTCG (Section 112):**
    - Where transfer is made before 23.07.2024: Taxed at **20%** + applicable surcharge & cess (with indexation benefit).
    - Where transfer is on or after 23.07.2024: Taxed at **20%** + applicable surcharge & cess (with indexation benefit) or 12.50% + applicable surcharge + cess (without indexation benefit); whichever is lower.

Indexation Benefit:

Indexation adjusts the purchase price of the property for inflation using the Cost Inflation Index (CII) notified by the CBDT every year. It reduces the amount of capital gains and accordingly the tax liability.

Indexation benefit is not available to non-resident Assessee where transfer is on or after 23.07.2024

III. Section 54 – Exemption on long term capital gain arising on transfer of Residential House Property

1. Long term capital gain arises from transfer of Residential House in India by an individual/HUF (Resident/Non-Resident).

2. Assessee purchases residential house in India within one year before or two years after the date of transfer or constructs residential house in India within a period of three years.

3. Where LTCG does not exceed Rs 2 Crore, two residential houses can be purchased or constructed. This option can be exercised once in a lifetime. (Applicable w.e.f Assessment Year 2020-21).

4. Where cost of purchase/construction exceeds LTCG, the whole amount of LTCG shall not be taxable.

5. Where cost of purchase/construction does not exceed LTCG, the LTCG shall not be taxable to the extent of cost of purchase/construction.

6. Where cost of purchase/construction of new residential house exceeds Rs 10 crore, the excess amount shall not be taken into consideration for the purpose of exemption from capital gain. (Applicable w.e.f. Assessment Year 2024-25)

7. Where the new residential house purchases/constructed is transferred within a period of three years of its purchase/construction, its cost of acquisition will be reduced by the amount of capital gain for which benefit of exemption has been taken.

8. When the purchase/construction of new asset has not been made/done before the due date of filing of Return of Income as specified in section 139(1), the amount of capital gain is to be deposited in bank under *the Capital Gain Accounts Scheme (CAGS), 1988* and whenever the house is to be purchased or construction is to be made, the amount can be withdrawn from this account in accordance with *the Capital Gain Accounts Scheme (CAGS), 1988*.

9. Where amount deposited under Capital Gain Accounts Scheme (CAGS) is either not utilized or partly utilised within the specified period for purchase/construction, the unutilized portion becomes taxable as capital gain in the previous year, in which three years from the date of transfer expires.

10. Capital gain exceeding Rs 10 crore shall not be considered for the purpose of deposit in CGAS.

11. For computing long term capital gain, indexed cost of acquisition and indexed cost of improvement as well as transfer expenses shall be reduced from sale consideration where indexation benefit is available.

12. For computing long term capital gain, cost of acquisition and cost of improvement as well as transfer expenses shall be reduced from sale consideration where indexation benefit is not available.

13. Where sale consideration is less than stamp duty value of such residential house, the stamp duty value shall be considered as deemed sale consideration. However if variation does not exceed 10% of sale consideration, then the actual sale consideration will be considered instead of stamp duty value. If assessee claims before Assessing Officer that stamp duty value exceeds fair market value of such property on date of transfer, then Assessing Officer may refer the valuation of residential house to Valuation Officer. (Section 50C)

14. Tax on Long Term Capital gain, if transfer takes place before 23.07.2024 (Section 112)

- Tax on long term capital gain as computed in foregoing paras @ 20% + applicable surcharge & cess (with indexation benefit). Provided where the total income as reduced by such long term capital gain is below the maximum amount which is not chargeable to Income Tax (Rs 2.50 Lac under the Old Regime and Rs 4.00 Lac under the new regime), then such LTCG shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income tax and tax on the balance on such LTCG shall be computed.

15. Tax on Long Term Capital Gain, if transfer takes place on or after 23.07.2024 (Section 112).

The resident assessee has to pay 12.50% tax + applicable surcharge & cess on amount of long term capital gain computed without benefit of indexation as well as exemption specified in section 54 or to pay tax @ 20% + applicable surcharge & cess as computed in earlier paras by taking benefit of indexation as well as exemption as specified in section 54, whichever is lower.

16. Non- Resident Assessee has to pay 12.50% + applicable surcharge & cess on the amount of Long Term Capital Gain computed without taking benefit of indexation.

IV. Section 54F – Exemption on Capital Gain arising on transfer of Capital Asset Other than Residential House

1. Long term capital Gain arises from transfer of Capital Asset other than Residential House in India by an individual/HUF (Resident/Non-Resident).

2. Assessee purchases residential house in India within one year before or two years after the date of transfer or constructs residential house in India within a period of three years.

3. Where cost of purchase/construction exceeds net sale consideration, the whole amount of LTCG shall not be taxable.

4. Where cost of purchase/construction does not exceed net sale consideration, the LTCG shall not be taxable to the extent of proportionate amount. [(LTCG X Cost of purchase/construction) divided by net sale consideration].

5. Where cost of purchase/construction of new residential house exceeds Rs 10 crore, the excess amount shall not be taken into consideration. (Applicable w.e.f. Assessment Year 2024-25)

6. This benefit is available only when assessee does not own more than one residential house other than new residential house on date of transfer

7. Where the assessee transfers the new residential house within a period of 3 years from the date of its purchase or construction, the amount of long-term capital gain that was earlier exempted under Section 54F shall be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer takes place

8. When the purchase/construction of new residential house has not been made/done before the due date of filing of Return of Income as specified in section 139(1), the amount of net sale consideration is to be deposited in bank under *the Capital Gain Accounts Scheme (CAGS), 1988* and whenever the house is to be purchased or construction is to be made, the amount can be withdrawn from this account in accordance with *the Capital Gain Accounts Scheme (CAGS), 1988*.

9. Where amount deposited under Capital Gain Accounts Scheme (CAGS) is either not utilized or partly utilised within the specified period for purchase/construction, the capital gain corresponding to unutilized portion becomes taxable as capital gain in the previous year, in which three years from the date of transfer expires.

V. Comparative Table – Section 54 vs. Section 54F

Particulars	Section 54	Section 54F
Eligible Assessee	Individual / HUF (Resident & NRI)	Individual / HUF (Resident & NRI)
Original Asset	Residential House Property	Any Long-Term Capital Asset (other than Residential House)
New Asset	Residential House in India	Residential House in India

Time Limit for Investment	Purchase: 1 yr before / 2 yrs after Construction: within 3 yrs	Purchase: 1 yr before / 2 yrs after Construction: within 3 yrs
Basis of Exemption	Based on Capital Gains invested	Based on Net Sale Consideration invested.
Ownership Restriction	No restriction	Must not own more than 1 Residential House (other than new Residential House) on date of transfer
Option to Invest in 2 Houses	Permitted if gains ≤ Rs. 2 crore (once in lifetime)	Not available
Effect of Exemption if new Residential House is transferred within 3 years	Cost of acquisition of new house will be reduced by amount of capital gain, the exemption benefit of which was taken.	The benefit of exempted amount of capital gain taken is taxed in the previous year of sale.
Deposit under Capital Gain Accounts Scheme	Required if investment not made before due date of Return	Required if investment not made before due date of Return

VI. Judgements

1. Though not directly on Sec 54/54F, this case emphasized that exemption provisions must be interpreted liberally to fulfil legislative intent - **Pr. CIT v. Bajaj Tempo Ltd. (1992) 196 ITR 188 (SC).**

2. Construction of the house should be completed within 3 years from the date of transfer. Date of commencement of construction is irrelevant. Construction may be commenced even before the transfer of the house - **CIT v. J.R. Subramanya Bhat [1986] 28 Taxman 578 (Kar.)**

3. Case of allotment of a flat under the self-financing scheme of DDA (or similar schemes of co-operative societies and other institutions) is treated as construction of house for this purpose—**Circular No. 471, dated October 15, 1986, and Circular No. 672, dated December 16, 1993.**

4. If the whole of the consideration is paid and possession of the house is obtained, the exemption contemplated under section 54 is clearly attracted—**CIT v. Laxmichand Narpal Nagda [{1995]78 Taxman 219 (Bom.).**

5. Nowhere it has been mentioned in section 54 that the same funds must be utilized for the purchase of another residential house; requirement of law is that the assessee should purchase a residential house within the specified period and the source of

funds is quite irrelevant - **Muneer Khan v. ITO[2010] 41 SOT 504 (Hyd.), Keshav Dutt Shreedhar v. DCIT (2019) 202 TTJ (Chd) 117.**

6. Once it is demonstrated that consideration received on transfer of a capital asset has been invested either in purchase or in construction of a residential house, even though these transactions are not complete in all respects as required under law, the same would not disentitle assessee from benefit of exemption under section 54F – **CIT v. Sambandam Udaykumar [2012] 206 Taxman 150 (Kar.), V. A. Tharabai v. CIT [2012] 50 SOT 537 (Chennai), Mrs. Seema Sabharwal v. ITO (2018) 193 TTJ (Chd) 128**

7. Exemption under section 54 will be admissible even where the assessee has purchased residential house property jointly with her daughter and son in law – **ITO v. Rachna Arora: (2021) 191 ITD 667 (Chd)**

8. Period of due date of filing of Return of Income u/s 139(1) is subject to extended period specified u/s 139(4)/ 139(5) – CIT V. Jagriti Aggarwal (2011) 245 CTR (P&H) 629, CIT V. Rajesh Kumar Jalan (2006) 206 CTR (Gau) 361

Note: The article is based on the provisions of Income Tax Act, 1961 in force as on 27.06.2025

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