

IN THE HIGH COURT OF KARNATAKA

AT BANGALORE

ITA No.83/2007

ITA No.84/2007

ITA No.83/2007

**1) COMMISSIONER OF INCOME TAX
C R BUILDING QUEENS ROAD, BANGALORE**

**2) INCOME TAX OFFICER
WARD-12(2) C R BUILDING
QUEENS ROAD, BANGALORE**

Vs

**M/s SHASTHA PHARMA LABORATORIES PVT LTD
NO 16/2, OVH ROAD, BASAVANAGUDI, BANGALORE-04**

JUDGEMENT

The Revenue has preferred these two appeals against the order passed by the Income Tax Appellate Tribunal, (for short, hereinafter referred to as 'the Tribunal'), dated 11-8-2006, in ITA No.106/Bang/2003 and ITA No.604/Bang/2005, wherein the Tribunal has held that notional interest on the advance received cannot be added to the actual rent paid, but the annual rental value has to be determined independently.

2. The assessee, for the assessment years 1998-99 and 1997-98 respectively has disclosed the lease rent income of Rs.6,00,000/-. The assessee had received Rs.80,00,000/- as lease rent deposit. The Assessing Authority held that the interest on deposit should be taken into account for computation of the rent received by the assessee. Therefore, he assessed the annual letting value of Rs.20,40,000/- which includes notional interest in respect of the deposit of Rs.80,00,000/-. The assessee preferred appeals before the Commissioner of Income Tax (Appeals) in respect of the assessment years 1998-99 and 1997-98, who in turn dismissed the appeals by upholding the order of the Assessing Authority. Aggrieved by the said order, the assessee preferred two appeals before the Tribunal.

3. The Tribunal after hearing the learned counsel for the parties, after referring to Section 23 of the Income Tax Act, 1961 and further taking note of several judgments relied on, was of the view that for the purpose of computing annual letting value of the property, the notional interest cannot be added. Therefore, restored the matter to the Assessing Authority to decide afresh the annual rental value in accordance with law. Aggrieved by the said order, the Revenue has preferred these two appeals.

4. Learned counsel for the Revenue contends that the finding recorded by the Tribunal that the notional interest of lease deposit of Rs.80,00,000/- cannot be taken into consideration for the purpose of computing the annual lease value of the property as per Section 23(1)(a) and 23(1)(a)(b) of the Income Tax Act, 1961 is erroneous. It has to be taken into account and therefore, the order of the Tribunal is erroneous.

5. Per contra, the learned counsel appearing for the assessee supported the impugned order.

6. In the light of the arguments addressed by the parties, the substantial question of law that arise for our consideration in these two appeals is as under:

“Whether the interest received on leaserent deposit is to be added to the actual rent agreed to be paid between the parties for the purpose of determining the annual letting value of the property under Section 23 of the Income Tax Act, 1961.?”

7. Section 23 reads as under:

(1) For the purposes of section 22, the annual value of any property shall be deemed to be -

(a) the sum for which the property might reasonably be expected to let from year to year; or

(b) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or

(c) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable :

Provided that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year in which the liability to pay such taxes was incurred by the owner according to the method of accounting regularly employed by him) in determining the annual value of the property of that previous year in which such taxes are actually paid by him.

8. The Full Bench of the Delhi High Court had an occasion to interpret this provision in the case of *COMMISSIONER OF INCOME TAX v/s MONI KUMAR SUBBA reported in (2011) 333 ITR 38 (Delhi)(FB)*, wherein it has been held as under:

“Where clause (a) of Section 23(1) of the Income-tax Act, 1961 is applicable, i.e., in cases where the property is not let at all during the entire year, the exercise is to be done to ascertain as to what would be the rent which the property might fetch if let from year to year, that is, the fair rent which the property can fetch, if let, is to be arrived at. Even while ascertaining the annual letting value for the purposes of clause (b) of section 23(1), it is necessary to determine the fair rent in terms of clause (a). The actual rent at which the property had been let is to be compared with the fair rent for which the property might reasonably be expected to be let from year to year and the higher of the two is to be taken as the annual letting value. If the rent actually received is more than that, that sum shall be treated as income from house property. On the other hand, if it is less than the amount at which the property can reasonably be expected to be let from year to year, the amount determined under clause (a) shall be the income from house property.

The operative words in section 23(1)(a) of the Act are “the sum for which the property might reasonably be expected to be let from year to year.” These words provide a specific

direction to the Revenue for determining the fair rent. The Assessing Officer, having regard to this provision is expected to make an inquiry as to what would be the possible rent that the property might fetch. Thus, if he finds that the actual rent received is less than the fair/market rent because the assessee has received an abnormally high interest-free security deposit and because of that, the actual rent received is less than the rent which the property might fetch, he can undertake necessary exercise in that behalf. However, the notional interest on the interestfree security cannot be taken as the determinative factor to arrive at a fair rent. The provisions of section 23(1)(a) do not mandate this. In a taxing statute it would be unsafe for the court to go beyond the letter of the law and try to read into the provision more than what is already provided for."

Thereafter, they have applied the following principles which read as under:

(i) The annual letting value would be the sum at which the property may be reasonably let out by a willing lessor to a willing lessee uninfluenced by any extraneous circumstances.

(ii) An inflated or deflated rent based on extraneous consideration may take it out of the bounds of reasonableness.

(iii) Actual rent received, in normal circumstances, would be a reliable evidence unless the rent is inflated/deflated by reason of extraneous consideration.

(iv) Such annual letting value, however, cannot exceed the standard rent under the rent control legislation applicable to the property.

(v) If the standard rent has not been fixed by the Rent Controller, it is the duty of the Assessing Officer determine the standard rent according to the provisions of the rent control enactment.

(vi) The Standard rent is the upper limit, and if the fair rent is less than the standard rent, it is fair rent which shall be taken as the annual letting value and not the standard rent."

9. In the light of the aforesaid discussion, the addition of notional interest on the interest free security deposit to the rent agreed upon is not permissible in law. It is open to the Assessing Authority to take note of the amount of advance paid which gives an indication of the fair rent of the property that fetches in the market. But the interest accrued on such deposit cannot be added to the agreed rent, so as to make a fair rent or market rent. Therefore, the Tribunal is justified in setting aside the said finding recorded by the authorities below.

10. In that view of the matter, the order of remand do not call for interference by this court. The substantial question of law is answered in favour of the assessee and against the Revenue. Ordered accordingly.