CBDT Circular: TDS under Section 194-I of the Income-tax Act is not applicable on lump-sum lease premium which is not adjustable against periodic rent

Background
Recently, the Central Board of Direct Taxes (CBDT) has issued a circular\(^1\) clarifying that lump-sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property are not in the nature of rent within the meaning of Section 194-I of the Income-tax Act, 1961 (the Act). Therefore, such payments are not liable for deduction of tax at source under Section 194-I of the Act.

CBDT Circular
Section 194-I of the Act provides that tax is to be deducted at source at the prescribed rates from payment of any income by way of rent. Section 194-I defines the term 'rent' as any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or building or machinery or plant or equipment or furniture or fittings.

Considering the representation received, CBDT examined the issue of whether or not Tax Deducted at Source (TDS) under Section 194-I of the Act is applicable on 'lump sum lease premium' or 'one-time upfront lease charges' paid by the taxpayer for acquiring long-term leasehold rights for land or any other property.

The CBDT considered the decision of Delhi High Court in the case of The Indian Newspaper Society\(^2\) wherein lump-sum lease premium paid by the taxpayer for acquiring a plot of land on an 80 years lease was considered as in the nature of capital expenditure not falling within the ambit of Section 194-I of the Act. Further, the Madras High Court in the case Foxconn India Developer (P.) Limited\(^3\) and Tril Infopark Limited\(^4\) held that the one-time non-refundable upfront charges for lease premium paid by the taxpayer for the acquisition of leasehold rights over an immovable property for 99 years could not be taken to constitute rental income in the hands of the lessor, obliging the lessee to deduct tax at source under Section 194-I of the Act.

Subsequently, in all the aforesaid cases, the tax department has accepted the decisions of the High Courts and has not filed a Special Leave Petition.

Accordingly, CBDT has issued a circular whereby it is clarified that lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property are not in the nature of rent within the meaning of Section 194-I of the Act. Therefore, such payments are not liable for TDS under Section 194-I of the Act.

---

1. CBDT Circular No. 35/2016, dated 13 October 2016
2. The Indian Newspaper Society (ITA No. 918 & 920/2015) (Del)
3. Foxconn India Developer (P.) Limited v. ITO [2016] 239 Taxman 513 (Mad)
4. Tril Infopark Limited v. ITO [2016] 385 ITR 465 (Mad)
Our comments

The applicability of withholding tax on development charges/lease premium has been a subject matter of litigation before courts.

In a recent phase of overall infrastructural development (which often requires parties to enter into such long-term lease arrangements), the CBDT after considering various judicial precedents, felt the need to bring clarity on this issue. Accordingly, CBDT has issued a clarification that lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property is not payments in the nature of rent within the meaning of Section 194-I of the Act. Thus, this Circular has finally put an end to the prolonged controversy in the matter.

With a view to reduce litigation and the recent trend of giving clarity on various litigative issues, the CBDT clarification on the long-term lease is a welcome move. The Circular will provide relief to such taxpayers.
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.