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Upfront payment for acquisition of leasehold rights over an immovable property for 99 years is not rental income hence not liable for deduction of tax at source under Section 194-I of the Income-tax Act

Background

Recently, the Madras High Court in the case of Foxconn India Developer (P) Ltd.[1] (the taxpayer) held that the upfront payment for the acquisition of leasehold rights over an immovable property for 99 years is not rental income hence not liable for deduction of tax at source under Section 194-I of the Income-tax Act, 1961 (the Act). The taxpayer was chosen not merely as a lessee of the land, but as a co-developer along with SIPCOT to establish a project in the 'Product Specific Special Economic Zone' (PSSEZ). The one time non-refundable upfront charges paid by the taxpayer was not merely under the agreement of lease or for the use of the land. The payment was made for various purposes such as becoming a co-developer, developing a PSSEZ, for putting up an industry on the land, etc. The lessor as well as the lessee intended to treat the lease virtually as a deemed sale.

Facts of the case

- The State Industries Promotion Corporation of Tamil Nadu Limited (SIPCOT), registered as a Government of Tamil Nadu Undertaking, acquired a vast extent of land for developing it as an Industrial Park. Thereafter, the Government of Tamil Nadu (Government) chose the taxpayer as a 'Developer' to establish a project known as PSSEZ in the Special Economic Zone (SEZ), in partnership with SIPCOT.
- Pursuant to a Government Order, the taxpayer signed a Memorandum of Understanding (MOU) with the Government. Thereafter, the taxpayer signed another MOU with SIPCOT, agreeing to be a co-developer for the development of the project i.e. PSSEZ.
- Subsequently, SIPCOT issued two orders of allotment for the land. Under the first order of allotment, the taxpayer was required to pay an amount of INR105 million at the rate of INR1.05 million per acre towards upfront lease rent. Under the second order of allotment, the taxpayer was liable to pay INR 1.75 million at the rate of INR3.2 million per acre.
- The order of allotment stipulated that the amount indicated therein was to be paid as non-refundable one time upfront charges and that a lease deed would be executed only after payment of 100 per cent of the upfront charges.

[1] Foxconn India Developer (P) Ltd. v. ITO [Tax case appeal no. 801 of 2013] – Taxsutra.com

- The taxpayer paid the upfront charges, and the SIPCOT executed two lease deeds, granting a lease of the land. Under both the lease deeds, the taxpayer was entitled to enjoy the land for a period of 99 years, upon payment of annual lease rent of INR1 per year for 98 years and INR2 per year for the 99th year.
- Both the lease deeds contain two important indicators namely (a) that the payment of upfront charges as fixed under the orders of allotment were actually non-refundable one time upfront charges and that even the annual lease rent should be paid in advance. Since the non-refundable one time upfront charges was considered by both SIPCOT as well as the taxpayer, not to be part of the rent, the taxpayer did not deduct tax at source.
- The Assessing Officer (AO) held that the upfront charges constituted rent on which tax should have been deducted at source under Section 194-I and that since the taxpayer did not do so, they were liable to pay the tax together with interest under Section 201(1) and Section 201(1A) of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that the AO was justified in treating the appellant as 'taxpayer-in-default,' due to failure to deduct tax at source, but partly allowed the appeal of the taxpayer.

The High Court's ruling

- As per the first part of Section 105 of the Transfer of Property Act, the first type of consideration is described as 'price', whereas the second type is indicated by the use of the expressions 'money', 'share of crops', 'service' or 'any other thing of value'. The use of the disjunction 'or' between these parts, makes it clear that Section 105 recognises two different types of consideration.
- Therefore, the consideration payable for the acquisition of a lease of immovable property can take different forms. One such form is termed as the price or premium and the other termed as rent, and a distinction cannot be made between them, solely on the basis of Section 105 of the Transfer of Property Act, as sought to be projected by the taxpayer.
- The obligation to deduct tax at source, primarily arises under Section 194-I, out of the responsibility of a person (not being an individual or an HUF) to pay 'any income by way of rent' to a resident. The definition of the expression 'rent' in Section 194-I of the Act includes 'any payment by whatever name called'. But two conditions are to be satisfied i.e. (i) the payment should be under any lease, sub-lease, tenancy or any other agreement or arrangement and (ii) the payment should be for the use of one or more of certain things such as land, building, machinery, etc.
- Even if the person to whom the payment is made, does not happen to be the owner of what is allowed to be used, the payment could still be rent within the meaning of Section 194-I of the Act.
- Therefore, what is indicated by the word 'price' or 'premium' in Section 105 of the Transfer of Property Act, would certainly constitute rent within the meaning of Section 194-I, by virtue of the exhaustive definition contained in Clause (i) of the Explanation. Premium, in many cases, could take different forms such as 'security deposit', 'rental advance', etc. hence; it is treated as capitalised rent.
- In the case of a normal lease of property, one can conceive of any number of situations, where premium paid at the inception of the lease, could be part of the rent. Many times, the amount of the premium collected, is equivalent to the rent for a fixed number of

months. It is only then that the same becomes either adjustable or refundable upon the termination of the lease. Therefore, a general proposition that premium collected as a lump sum at the time of inception of the lease is completely different from rent can never be accepted.

- The decision of the Patna High Court in the case of Raja Shiva Prasad Singh[2], cannot assist the taxpayer since, a lease of property such as land, building, plant, machinery, etc. would stand on a different footing than the lease of mineral rights. When someone takes a land on lease, he merely uses the land, but when someone takes the lease of mineral rights, he excavates the land, carries out mining operations and takes away the minerals so mined.
- The decision of the Supreme Court in the case of Panbari[3] indicates that the substance of the transaction and not its form should be followed. The question in the present case is not about the nature of the receipt but about the obligation under Section 194-I of the Act. Subsequent to the ruling in Panbari' case, the definition of the expression 'rent' in Section 194-I of the Act underwent a change under and therefore, the question has to be decided based on the present statutory provision and not solely upon the ratio in Panbari.
- In the case of R. K. Palshikar (HUF)[4], the Supreme Court held the grant of those leases for 99 years amounted to a transfer of capital assets in terms of Section 12-B of the 1922 Act. This was reaffirmed in the case of A. R. Krishnamurthy[5].
- In the present case, the leasehold right of land does not include any other benefit such as the right to mine minerals, and therefore, the question of apportionment, does not arise. Further, the High Court has distinguished certain decision[6], from the facts of the present case and therefore, held that the ratio of those cases cannot be applied in the present case.
- The substance of the transaction is of importance and the answer to the present question would depend upon the agreement between the parties. As per the letter issued by SIPCOT to the taxpayer, the lessor as well as the lessee intended to treat the transaction as 'deemed sale'.
- There is also intrinsic evidence in the two deeds of lease themselves to suggest that the taxpayer was chosen not merely as a lessee of the land, but as a co-developer along with SIPCOT to establish a project in the 'Product Specific Special Economic Zone'.
- The Government of India, Ministry of Commerce and Industry issued a letter of approval for the proposal jointly made by the taxpayer and SIPCOT. Based on this letter, it is clear that the upfront charges paid by the taxpayer were not (i) under the agreement of lease and (ii) merely for the use of the land.
- The payment was made for a variety of purposes such as (i) becoming a co-developer (ii) developing a Product Specific SEZ in the Sriperumbudur Hi-Tech SEZ (iii) for putting up an industry in the land. The lessor as well as the lessee intended to treat the lease virtually as a deemed sale giving no scope for any confusion.

[2] Raja Shiva Prasad Singh v. King Emperor [AIR 1924 Patna 679]
[3] CIT v. Panbari Tea Co. Ltd. [1965] 57 ITR 422 (SC)
[4] R. K. Palshikar v. CIT [1988] 172 ITR 311 (SC)
[5] A. R. Krishnamurthy v. CIT [1989] 176 ITR 417 (SC)
[6] Bharat Steel Tubes Ltd. v. CIT [2001] 252 ITR 622 (Del)

- In such circumstances, the upfront payment made by the taxpayer for the acquisition of leasehold rights over an immovable property for a long duration of time say 99 years could not be taken to constitute rental income at the hands of the lessor, obliging the lessor to deduct tax at source under Section 194-I of the Act.
- The taxpayer was not under an obligation to deduct tax at source, and therefore, the taxpayer cannot be termed as a taxpayer in default.

Our comments

The Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal), in the taxpayer's case[7] had observed that Section 194-I of the Act does not make any differentiation between capital outgo and revenue outgo. The payment made by the taxpayer to SIPCOT Ltd., by whatever name called, was under a lease agreement. Definition of 'rent' under Section 194-I of the Act will definitely include payments of any type under any agreement or arrangement for use of land. In view of such a clear statutory definition, the normal meaning of 'rent' cannot be applied while interpreting Section 194-I of the Act.

The Madras High Court while reversing the decision of the Chennai Tribunal held that the taxpayer was chosen not merely as a lessee of the land, but as a co-developer along with SIPCOT to establish a project in the PSSEZ. The one time non-refundable upfront charges paid by the taxpayer was not merely under the agreement of lease or for the use of the land. The payment was made for a variety of purposes such as becoming a co-developer, developing a PSSEZ, for putting up an industry on the land, etc. The lessor as well as the lessee intended to treat the lease virtually as a deemed sale. Therefore, the upfront payment for the acquisition of leasehold rights over an immovable property for 99 years was not rental income hence not liable for deduction of tax at source under Section 194-I of the Act.

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[7] Foxconn India Developer (P) Ltd v ITO [2012] 24 taxmann.com 48 (Chen)

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