

IN THE INCOME TAX APPELLATE TRIBUNAL
“A” BENCH : BANGALORE

BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER
AND SHRI S. JAYARAMAN, ACCOUNTANT MEMBER

ITA Nos.1607 & 1692/Bang/2012
Assessment years : 2007-08 & 2009-10

M/s. Sobha Interiors Pvt. Ltd., E-106, Sunrise Chambers, # 22, Ulsoor Road, Bangalore – 560 022. PAN: AA ECS 6275L	Vs.	The Deputy Commissioner of Income Tax, Circle 12(3), Bangalore. ITO, Ward 12(2), Bangalore.
APPELLANT		RESPONDENT

ITA No.1630/Bang/2012
Assessment year : 2007-08

M/s. Sobha Glazing & Metal Works Pvt. Ltd., # 10, Bommasandra Jigani Link Road, Bommasandra Indl. Area, Anekal Taluk, Bangalore – 562 158. PAN: AAACR 8801M	Vs.	The Deputy Commissioner of Income Tax, Circle 12(3), Bangalore.
APPELLANT		RESPONDENT

Appellants by	:	Shri V. Srinivasan, CA
Respondent by	:	Shri Kamaladhar, Standing Counsel

Date of hearing	:	26.10.2016
Date of Pronouncement	:	23.11.2016

ORDER

Per Sunil Kumar Yadav, Judicial Member

All these three appeals preferred by the assesses for the assessment years 2007-08 & 2009-10 were heard together and are disposed of by this common order for the sake of convenience.

ITA Nos.1607 & 1692/Bang/2012

These appeals are preferred by the assessee against the respective order of the CIT(Appeals) on the common grounds, which are as under:-

“[1] The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of evidence, probabilities, facts and circumstances of the case.

[2] The learned CIT[A] is not justified in upholding the ALV adopted by the learned AO at Rs. 52,16,768/- rejecting the income reported by the appellant under the facts and in the circumstances of the appellant's case.

[3] Without prejudice to the right to seek waiver with the Hon'ble CCIT/DG, the appellant denies itself liable to be charged to interest u/s. 234-B and 234-C of the Act, which under the facts and in the circumstances of the appellant's case and the levy deserves to be cancelled.

[4] For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs.”

2. The main issue involved in these appeals relate to the computation of annual value of the property let out to the assessee's sister concern, M/s. Sobha Developers Ltd. The house property including land appurtenant thereto was let out to Sobha Developers Ltd. vide lease deed dated 1.4.2006 for a market rent of Rs.5 lakhs per month. By supplementary lease deed entered on 29.3.2007, the monthly rent was refixed and reduced to Rs.25,000 per month from Rs.5 lakhs per month. While reducing the monthly rent, interest free security deposit was also negotiated whereby the lessee would pay the assessee an interest-free deposit of Rs.25 crores. The assessee accordingly reduced the annual letting value (ALV) of the rented property at Rs.3 lakhs which was not accepted by the Assessing Officer and he assessed the ALV at Rs.52,16,768 by estimating the market value of the same at Rs.7/- per sq.ft. on the basis of local enquiries made by him.

3. The assessee preferred an appeal before the CIT(Appeals) and in support of the arrangement made through supplementary lease deed, the assessee has stated that it had taken certain trade advances from Sobha Developers Pvt. Ltd., its sister concern, which were used for the construction of its factory shed. Since the assessee was not in a position to return these advances after the sale of its assets & liabilities, these advances were converted into interest free security deposit and on account of these security deposits, rent was reduced from Rs.5 lakhs per month to Rs.25,000 per month with effect from the date of execution of the

supplementary lease deed i.e., 29.3.2007. It was also contended that the AO does not have the power to enhance the ALV on the basis of higher deposit in view of the decision of the Calcutta High Court in the case of Satya & Company, 75 Taxman 183.

4. While disallowing the claim of assessee, the AO observed that in the interim period of one year i.e., from 1.4.2006 to 29.3.2007, no payment of rent appears to have actually made to the assessee by the lessee, M/s. Sobha Developers Ltd. and as on 1.4.2006, the so-called trade liability of Rs.25 crores should be appearing in the balance sheet of the assessee, for the same to be converted into interest free advance of rent. However, this item does not seem to appear in the Loans & Advances grouping of the appellant as on 31.3.2006 i.e., on the day before the sale. The AO accordingly issued show cause notice to the assessee detailing the figures of liabilities as per the sale deed which do not match the figures in the appellant's balance sheet.

5. The CIT(Appeals) has examined both the aspects i.e., with regard to bare position of law for determination of ALV under the Income-tax Act and, secondly, implication of business expediency and advantage which is sought to be harnessed from the arrangement with reference to an adverse effect upon the revenue. He also examined the contentions of the assessee that on account of commercial expediencies the rent was reduced from Rs.5 lakhs to Rs.25,000 per month. The CIT(A) has

examined the legal position for determination of ALV in the light of commercial expediencies and has come to the conclusion that the AO has rightly worked out the ALV in the light of first lease deed in which the rent was fixed at Rs.5 lakhs per month. The relevant observations of the CIT(Appeals) is extracted hereunder for the sake of reference:-

“4.12. On a consideration of the submissions, I find therein several glaring discrepancies. Firstly, the Advances from Customers represent trade advances and hence they are grouped under "Current Liabilities" in Schedule-9 of the Balance sheet. The appellant's claim that these were used for building the factory is neither borne out by the nature of the entry in the accounts, and neither by evidence at the time of assessment or appellate hearings. Infact, it is clear that the appellant has been a regular supplier of interior materials to M/s SDL over several years, and hence the entry in respect of Current Liabilities cannot per se be said to relate to a loan given out for construction activities. Secondly, by a mere change of accounting appellation from Advances from Customers, the appellant has claimed to have transferred this current liability as a rent advance, which moves it from the grouping itself to Loan liabilities. I find no mention of this sudden shift of liabilities from Advances to Loans in the Notes on Account or the Director's report, inspite of the magnitude of the amount and its long-term implication on the appellant's rental incomes. Thirdly, the AO has noted that no property tax documents were produced in spite of being given several opportunities, which also speaks its own story. Lastly, the AO has mentioned at Para 5 of his assessment order that the appellant's arrangement was made in the context of the impending public issue in the case of the parent company, and the Rs. 25 crores in the balance sheet of the appellant on 31.3.2007 cannot represent a rent deposit as claimed. I find this argument of the AO to be persuasive and based on a reasonable interpretation of the facts and circumstances of the transaction.

4.13. In the circumstances, I find no reason to accept this kind of artificial accounting jugglery indulged in by the appellant merely to justify the charging of a lower rental after already

having entered into an agreement earlier to charge a much higher rate (in-fact, twenty times higher than the reduced rate adopted later). The circumstances of this claim do not carry credibility in view of the manipulative nature of the transaction which is claimed to have been entered into on grounds of commercial expediency. I have already mentioned above that there was an impending public issue in the case of M/s SDL at the time, and the so-called "commercial expediency" appears to have been connected to that in the form of some kind of window-dressing exercise.

4.14. In connection with the above discussion on commercial expediency, I also observe that the justification of the appellant towards reduction of rent is found to be based on a convenient arrangement whereby, from a taxation point of view, the parent body (SDL) receives no interest income on the loan advanced of Rs. 25 crores (reckoned at Rs. 3.00 crores @ 12% for the first year itself) and at the same time, the appellant does not receive any rental income to the extent of the differential value of Rs. 57 lakhs from M/s SOL with the rent being reduced from Rs. 60 lakhs per annum to Rs. 3,00,000/-. If the arrangement had included payment of interest @ 12% (the notional rate adopted by the appellant in his notes on arguments) by the appellant to the principal and also full payment of the agreed rent, M/s SDL would still have had to account for a net income of Rs. 2,40,00,000/- [Rs. 3,00,00,000 (-) Rs. 60,00,000 being the payment of rent claimed as business expenses]. At the same time, the appellant would have clocked up a house property income of Rs 42,00,000/- (Rs 60 lakhs less 30% for repairs) since the interest payment would not be covered as a deduction u/s 24 in the absence of the so-called "loan" appearing in its books prior to 1.4.2006 at all; and in any case the so-called trade advances cannot automatically be termed a loan given for construction of the buildings, which were already very much in existence at the time of the lease deed coming into force, and never having been shown as such in the appellant's accounts earlier to 31.3.2007.

4.15. It is obvious to me therefore, that the cause of revenue has been completely subverted within this arrangement entered into by the appellant, and the so-called "commercial expediency" claimed by it is actually just a case of aggressive tax avoidance. It is significant to note that though the so-called "loan" of Rs.25 crores is claimed to have existed in the form of advances towards

land and buildings, this aspect was not considered relevant enough for a full year from 3.4.2006 till 31.3.2007 in fixation of the rental rate for the properties of the appellant. For apparently inexplicable reasons from an accounting point of view, the supplementary rental agreement was suddenly entered into after a year, and the justification given for the same of "commercial expediency" on account of the so-called loan was now advanced. I have already mentioned above that the appellant has failed to adequately clarify the entries with regard to the existence of this loan in the balance sheet as on 31.3.2006 in course of the appellate hearings. The explanations offered only reflect a rather desperate attempt to juggle figures in the balance sheet from one head to another, making light of established accountancy principles whereby current trade liabilities have been made to change their character overnight to loans simply by means of a journal entry.

4.16. In this connection, I note that it is made clear by the Ld. Supreme Court in the McDowell case (154 ITR 148) that where a transaction was found to be colorable, the AO would be within his rights to treat it as a sham one when it is seen that apart from the satisfaction of legal formality and documentation, there existed an angle of lack of credibility and the flavor of an intention towards tax evasion. Though the appellant has challenged the decision of the AO in bringing the FMV of the property to tax on the ground that the law does not empower him to do so, it is patently clear that the appellant has entered into a sham transaction and been unable to defend it at the appellate stage in spite of being given sufficient opportunity on several occasions. In the circumstances, I am not convinced with the arguments of the appellant, and his claims remain unsubstantiated even at the appellate stage.

4.17. With respect to the appellant's claim that even if the ALV was to be revised upwards, only the municipal value of Rs. 1.60 per sq ft was to be adopted as against the Rs.7 taken by the AO, I find the claim is not made with any factual basis. The AO has adopted the rate of Rs. 7 on the basis of local enquiries and reference to a comparable case in the locality, since he found no consistency in the appellant's approach, as detailed at Para 3.4(k) of the assessment order. The comparable cases of MTR Food Products and MTR Foods Ltd. were taken by the AO since the type and constitution of the leased properties were similar to the

appellant's case. On the other hand, the appellant in the course of the appeal could not adduce any specific reason why the comparison is invalid. Apart from stating that the two cases may not be comparable, no specific items of difference are pointed out. As such, I do not find the argument raised by the appellant in this matter to be sufficient. The appellant's alternative argument that the AO was bound to accept the ALV at Rs. 1.60 as per the municipal value is without basis, as held by the Ld. Supreme Court in the case of Mrs. Sheila Kaushish Vs CIT 131 ITR 435(SC) wherein the Ld. Court held that standard rents fixed by authorities or the Rent Control Act need not be binding while determining annual value where the actual rent is found to be far higher. In the present case, it is the appellant itself that had signed a lease deed fixing the rent at Rs. 5 lakhs per month, which was suddenly and inexplicably reduced to Rs. 25000 per month citing reasons which have already been found to be completely unsubstantiated and even sham ones. Hence, the appellant does not in the case command the credibility or bona-fides required to interpret the Supreme Court's judgment referred to above to its advantage. The ground raised is accordingly dismissed.”

6. Aggrieved, the assessee is in appeal before the Tribunal and reiterated its contentions as raised before the CIT(Appeals). It was further contended that assessee has constructed a building measuring 1,29,538 sq.ft. on a land measuring about 7,84,107 sq.ft. The said plot was given on lease to assessee's sister concern, M/s. Sobha Developers Pvt. Ltd. [SDPL] for a monthly rental of Rs.25,000 per month against an interest-free security deposit of Rs.25 crores. It was further contended that assessee has availed the financial assistance from its sister concern, SDPL in order to purchase the land and construction thereon in the form of interest free trade advances. When the assessee was not in a position to return the advances taken from its sister concern, it had let out the constructed

building for a period of 25 years at a monthly rent of Rs.25,000 per month. The outstanding amount was converted into interest free security deposit with the assessee. The AO has estimated the ALV of the property u/s. 23(1)(a) of the Act at Rs.54,88,798 calculated at Rs.7/- per sq.ft., being the rent as per lease deed between M/s. MTR Distributors and MTR Foods Ltd. It was further contended that while determining the ALV, interest free security deposit taken by the assessee cannot be taken into account as the same amount is to be refunded on vacation of the property. Only the rent fixed between the parties can be considered while fixing the ALV. Therefore, the AO has wrongly adopted the ALV at Rs.7/- per sq.ft. of the let out property. It was further contended that ALV has to be computed in the light of rates prescribed by the municipal authorities and the municipal authorities have prescribed the rates for the impugned property at Rs.1.60 per sq.ft., therefore for computing the ALV the rate at Rs.1.60 per sq.ft. should be adopted. In support of the contentions, he has placed reliance upon the order of the Tribunal of this Bench in the case of *DCIT v. Rajiv Chandrashekar in ITA No.1440/Bang/2013* and *ITO v. Surge Enterprises Ltd., ITA No.1593/Mum/2010*.

7. The Id. DR, on the other hand, has contended that the assessee has initially let out the property in question for Rs.5 lakhs per month through lease deed dated 1.4.2006 which was later on reduced to Rs.25,000 per month against the interest free security deposit of Rs.25 crores. The ALV of the property is to be computed as per the provisions of section 23(1)(a)

& (b) of the Act. As per section 23(1)(a), the annual value of any property shall be deemed to be the sum for which the property might reasonably be expected to let from year to year. Whereas as per section 23(1)(b), where 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 shall be the annual letting value. Therefore, while computing the ALV as per section 23(1)(b), actual rent received or receivable is to be taken into account. Undisputedly, the property was let out for a sum of Rs.5 lakhs per month to its sister concern, SDPL, through lease deed dated 1.4.2006, but later on through supplementary lease deed dated 29.3.2007, the rent was reduced from Rs.5 lakhs to Rs.25,000 per month. Merely by reduction of rent, the ALV originally computed cannot be reduced without looking into the factum of receipt of interest free deposit of Rs.25 crores.

8. The Id. DR further contended that the decisions referred to by the assessee are not applicable. The facts in those cases are that the property was not let out and ALV was computed as per provisions of section 23(1)(a) of the Act. When the property is let out, the ALV is to be computed as per section 23(1)(b) of the Act. The Id. DR placed heavy reliance upon the judgment of Hon'ble Punjab & Haryana High Court in the case of *CIT v. K. Streetlite Electric Corporation, 336 ITR 348 (P&H)* in which it has been categorically held that interest free security deposit taken by the assessee hugely disproportionate to monthly rent charged is a device to circumvent

liability to income tax. Therefore, notional interest on security deposit is to be treated as income from house property. Copy of the judgment is placed on record. The Id. DR further contended that the issue is squarely covered by the judgment of Hon'ble Punjab & Haryana High Court.

9. We have carefully examined the orders of authorities below and the issue in dispute in the light of rival submissions and we find that undisputedly the property in question was let out to its sister concern vide lease deed dated 1.4.2006 for a monthly rent of Rs.5 lakhs. At that time, no interest free security deposit was given or credited to the assessee's account. By supplementary lease deed dated 29.3.2007, the terms of the lease were modified and monthly rent was reduced to Rs.25,000 per month from Rs.5 lakhs per month. At that time, interest-free security deposit was also negotiated and as per the revised terms of lease deed, the lessee would pay the appellant an interest-free security deposit of Rs.25 crores. Meaning thereby that on receipt of substantial amount of Rs.25 crores, monthly rent was reduced from Rs.5 lakhs to Rs.25,000 per month. Therefore, the notional rent earned on this Rs.25 crores cannot be ignored at the time of computing the ALV of the property.

10. We have also carefully examined the judgments referred to by the assessee and we find that in those judgments, ALV was computed as per the provisions of section 23(1)(a) of the Act. Section 23(1)(a) of the Act would apply where the property was not let out and the AO has worked out

the ALV of the property which shall be deemed to be the sum for which the property shall be reasonably be expected to let from year to year. But, where the property has been let out, the ALV shall be deemed to be 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. Undisputedly, the amount received or receivable is certainly higher than the annual rent as contended by the assessee on the basis of municipal value as per the provisions of section 23(1)(a) of the Act. The rent was reduced from Rs.5 lakhs to Rs.25,000 per month on account of interest free security deposit of Rs.25 crores. Now the question arises whether the proportionate receipt of interest-free security deposit can be taken into account while computing the ALV or the ALV is to be computed on the basis of actual rent received, ignoring the other surrounding facts and circumstances. According to us, while computing the ALV all surrounding factors should be looked into and more particularly the interest-free security deposit received by the assessee while letting out the property should be taken into account. In most of the cases, substantial amount of interest-free security deposit is being taken and annual rent is fixed on the lower side in order to avoid the tax implication. This aspect was examined by the Hon'ble Punjab & Haryana High Court in the case of *CIT v. K. Streetlite Electric Corporation, 336 ITR 348 (P&H)* and Their Lordships have categorically held that interest-free security deposit taken by the assessee hugely disproportionate to monthly rent charged is a

device to circumvent liability to income-tax. Therefore, notional interest on security deposit is to be treated as income from house property. The relevant observations of the Hon'ble High Court along with the facts of the case are extracted hereunder for the sake of reference:-

“The assessee earned rental income from letting facilities of factory, land, building and offices. The assessee had taken interest-free security of Rs. 35 lakhs from two parties to whom the assets were leased out, but the assessee showed a very low rental income of Rs. 1.50 lakhs as annual letting value in respect of those properties. There was no provision in the agreement for increase in rent from year to year. The Assessing Officer determined the annual value at Rs. 7,80,000 by adding notional interest of Rs. 6,30,000 calculated at the rate of 18 per cent. per annum on Rs. 35 lakhs taken as security deposit, to the value of Rs. 1.50 lakhs shown by the assessee. The Commissioner (Appeals) deleted the notional interest of Rs. 6,30,000. The Tribunal affirmed the order of the Commissioner (Appeals). On further appeal:

Held, allowing the appeal, that under the lease deeds and on a conjoint reading of all the documents and an analysis of the factual aspects, the security deposit of Rs. 35 lakhs which amounted to 140 times the monthly rent was disproportionate to the actual contractual rent of Rs. 25,000 per month, i.e., total Rs. 12,500 per month for land and building, etc. and Rs. 12,500 per month for furniture, fixtures, plant and machinery, etc. It had no rationale with the agreed rent and the assessee had adopted a device to circumvent its liability to tax. Further, the rent deed did not contain any provision for increase of rent from year to year. Moreover, the security deposit of Rs. 35 lakhs where the value of the property let out was Rs. 17.62 lakhs, plant and machinery of Rs.1.69 lakhs and furniture of Rs. 48,673 could not be held to be justified as a genuine transaction. Therefore the security deposit was a sham device to avoid tax and had no real basis with the actual rent that was received by the assessee. According to section 23(1)(b) of the Income-tax Act, 1961 where the property was actually let out, the actual amount of rent received or receivable would form part of the income from house property. Ordinarily, the notional interest that may accrue on the security deposit would not form part of income from house

property. However, where payment of the security deposit was to circumvent liability to tax on the real rent, it would fall within the ambit of income from house property. Therefore the interest on the security deposit amount of Rs.35 lakhs would be treated as income of the assessee. Interest at the rate of 9 per cent per annum on the security amount of Rs.35 lakhs would be just to meet the ends of justice and it would be treated as taxable income of the assessee under the head "Income from house property" relating to the land and building."

11. In the light of the aforesaid judgment of the Hon'ble Punjab & Haryana High Court, we are of the considered view that receipt of Rs.25 crores as interest-free security deposit cannot be ignored while computing the ALV. Therefore the AO has rightly adopted the ALV which was even lesser to the monthly rent of Rs.5 lakhs per month initially agreed upon by the parties. Thus, we find no infirmity in the order of CIT(Appeals) and we confirm the same.

12. So far as ground No.3 relating to interest u/s. 234B and 234C is concerned, we find it is consequential in nature and needs no independent adjudication. Accordingly, the appeals of the assessee stand dismissed.

ITA No.1630/Bang/2012

13. This appeal is preferred by the assessee *inter alia* on the following grounds:-

“[1] The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of evidence, probabilities, facts and circumstances of the case.

[2] The learned CIT[A] is not justified in upholding the ALV adopted by the learned AO at Rs. 21,81,669/- rejecting the income reported by the appellant under the facts and in the circumstances of the appellant's case.

[3] Without prejudice to the right to seek waiver with the Hon'ble CCIT/DG, the appellant denies itself liable to be charged to interest u/s 234-B and 234-C of the Act, which under the facts and in the circumstances of the appellant's case and the levy deserves to be cancelled.

[4] For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs.”

14. The main issue involved in this appeal is determination of ALV of the property let out to the assessee's sister concern.

15. The facts borne out from the record are that during the F.Y. 2006-07, the assessee on 3.4.2006 sold all its assets and liabilities, except land and buildings to M/s. Sobha Developers Pvt. Ltd. [SDPL] for an amount of Rs.13,20,82,084. Two days before the date of sale i.e., on 1.4.2006 lease deed was entered into whereby the assessee leased out its land and buildings to SDPL for a monthly rent of Rs.5 lakhs. Supplementary lease deed was entered into on 30.3.2007 whereby the terms of lease were renegotiated and monthly rent reduced to Rs.25,000 per month from Rs.5 lakhs per month. In this case, interest-free security deposit was also negotiated whereby the lessee would pay the assessee a deposit of Rs.11 crores. The assessee has computed the ALV as per reduced rent of

Rs.25,000 per month @ Rs.3 lakhs, but it was not accepted by the AO and he assessed it at Rs.24,12,039 on the estimated fair market value of the same at Rs.7/- per sq.ft. on the basis of local enquiries made by him.

16. In this case also, it was contended that the assessee was financially helped by its sister concern, SDPL, and once the assessee was not able to return the amount, the liability was converted into interest-free security deposit. The facts of this case are almost similar to the earlier case and similar arguments were also raised before us. Under similar set of facts, we have examined the issue of determination of ALV and we have held in the foregoing appeals that interest-free security deposit is to be taken into consideration while computing the ALV. In the instant case also, the assessee has received interest-free security deposit of Rs.11 crores which certainly cannot be ignored while computing the ALV. Therefore, following the reasons and the view taken in the foregoing appeals, we hold that CIT(Appeals) has properly adjudicated the issue in the light of given facts and circumstances of the case and we find no infirmity therein. Accordingly, we confirm the same.

17. The other issue relates to charging of interest u/s. 234B & 234C of the Act. Since it is consequential in nature, it does not require any independent adjudication.

18. Thus, the appeal of the assessee stands dismissed.

19. In the result, all the three appeals of the assessee stand dismissed.

Pronounced in the open court on this 23rd day of November, 2016.

Sd/-

(S. JAYARAMAN)
Accountant Member

Sd/-

(SUNIL KUMAR YADAV)
Judicial Member

Bangalore,
Dated, the 23rd November, 2016.

/D S/

Copy to:

1. Appellant
2. Respondents
3. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.
6. Guard file

By order

Assistant Registrar,
ITAT, Bangalore.