

**KARNATAKA APPELLATE AUTHORITY FOR ADVANCE RULING
6TH FLOOR, VANIJYA THERIGE KARYALAYA, KALIDASA ROAD,
GANDHINAGAR, BANGALORE – 560009**

**(Constituted under section 99 of the Karnataka Goods and Services Tax Act, 2017 vide
Government of Karnataka Order No FD 47 CSL 2017, Bangalore, Dated:25-04-2018)**

BEFORE THE BENCH OF

SHRI. D.P.NAGENDRA KUMAR, MEMBER

SHRI. M.S.SRIKAR, MEMBER

ORDER NO.KAR/AAAR/01/2020-21

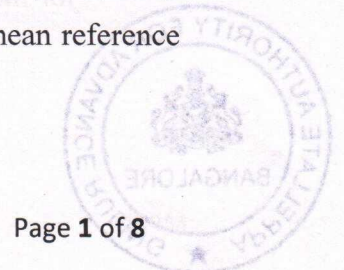
DATE:11-01-2021

Sl. No	Name and address of the appellant	M/s Midcon Polymers Pvt Ltd, 3, 3 rd Cross, Lalbagh Road, Near Garuda Maruthi Showroom, Bangalore 560027
1	GSTIN or User ID	292000000413AR6
2	Advance Ruling Order against which appeal is filed	KAR/ADRG 48/2020 Dated: 16th Sept 2020
3	Date of filing appeal	21-10-2020
4	Represented by	Mr Ramesh Ananthan, CA & Mr Sundar Raman, Authorised representatives
5	Jurisdictional Authority- Centre	The Commissioner of Central Tax, Bangalore South Commissionerate.
6	Jurisdictional Authority- State	LGSTO 70, Bangalore
7	Whether payment of fees for filing appeal is discharged. If yes, the amount and challan details	Yes. Challan CPIN No 20102900429171 dated 21-10-2020 for Rs 20,000/-.

PROCEEDINGS

(Under Section 101 of the CGST Act, 2017 and the KGST Act, 2017)

1. At the outset we would like to make it clear that the provisions of CGST, Act 2017 and SGST, Act 2017 are in *parimateria* and have the same provisions in like matter and differ from each other only on a few specific provisions. Therefore, unless a mention is particularly made to such dissimilar provisions, a reference to the CGST Act would also mean reference to the corresponding similar provisions in the KGST Act.



2. The present appeal has been filed under section 100 of the Central Goods and Service Tax Act 2017 and Karnataka Goods and Service Tax Act 2017 (herein after referred to as CGST Act, 2017 and SGST Act, 2017) by M/s Midcon Polymers Pvt Ltd, 3, 3rd Cross, Lalbagh Road, Near Garuda Maruthi Showroom, Bangalore 560027(herein after referred to as Appellant) against the Advance Ruling order No. KAR ADRG 48/2020 dated: 16th Sept 2020.

Brief Facts of the case:

3. The Appellant is engaged in the business of renting of commercial property on monthly rents and allied business. The Appellant intends to enter into a commercial agreement of renting of immovable property with educational institution in Bangalore. The contract is on the basis of the reserved monthly rent and also refundable caution deposit/security deposit. As per the terms of the contract, the deposit received shall be returned without interest on the termination of the tenancy. The refund of the advance caution deposit does not in any way determine the quantum of rent or enhance the services. The Appellant also discharges the statutory taxes levied by the BBMP on the property and the property tax so paid is no way related to the supply of services.

4. In this regard, the Appellant approached the Authority for Advance Ruling (AAR) seeking a ruling on the following question:

“For the purpose of arriving at the value of rental income, whether the applicant can seek deduction of property taxes and other statutory levies?”

For the purposes of arriving at total income from rental, whether notional interest on the security deposit should be taken into consideration?

Whether the applicant is entitled for exemption of tax under the general exemption of Rs 20 lakhs?”

5. The AAR vide its order KAR ADRG No 48/2020 dated 16th Sept 2020 held as under:

“The applicant cannot deduct the property taxes and other statutory levies for the purpose of arriving at the value of rental income.



The notional interest on the security deposit shall be taken into consideration for the purposes of arriving at total income from rental, only if it influences the value of supply of RIS service i.e monthly rent.

The applicant is entitled for exemption of tax under the general exemption of Rs 20 lakhs, subject to the condition that their annual turnover which includes monthly rent and notional interest, if it influences the value of supply, does not exceed the threshold limit. “

6. Aggrieved by the ruling given by the AAR, the Appellant has filed this appeal on the following grounds.

6.1. In any tax regime, no tax can be imposed on the tax levied on the immovable property which does not form a part and parcel of the service rendered. When the property tax being levied irrespective of whether the property is rented or otherwise, the same cannot be a part of the rental services rendered. Further since the tax being levied by the Municipal Corporation on property, the same cannot be attributed to the services of rent. They submitted that the property tax is not forming part of the consideration of the rental service and so the question of its inclusion and exclusion does not arise under GST law. Therefore, the property tax is abatable from the total amount in arriving at the total rental income.

6.2. As regards notional interest, they submitted that notional interest cannot be loaded unless and until it is shown that the same is part of the monthly rent. This has been the consistent view taken by different courts and also authorities of Advance Ruling in different States. Even the Supreme Court decision quoted by the lower Authority states that notional interest cannot be added unless and until there is evidence to prove that the interest free deposit taken has influenced the price. This evidence right now is very difficult to prove since in the lease agreement there is clear mention to the effect that the deposit shall be refunded without interest at the time of vacating the schedule premises. Since the Appellant is required as per law to refund the advance caution deposit, the same does not in any way determine the quantum of rent. The Appellant also submitted that apart from the activity of leasing of immovable property for commercial activity, they have no other taxable activity. Hence they are at present claiming exemption since their turnover is less than RS 20 lakhs.



PERSONAL HEARING

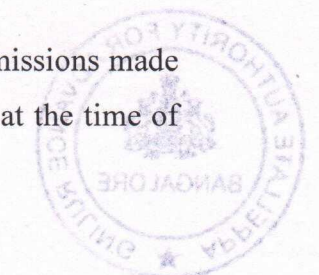
7. The appellant was called for a virtual hearing on 17th November 2020. The hearing was conducted on the Webex platform following the guidelines issued by the CBIC vide Instruction F.No 390/Misc/3/2019-JC dated 21st August 2020. The Appellant was represented by their Advocates Mr Ramesh Ananthan and Mr Sundar Raman.

7.1. On the issue of property tax, they submitted that the lower Authority has held that the same cannot be deducted for the purpose of arriving at the value of the service. They referred to Section 15 of the CGST Act and submitted that the Appellant is not charging property tax separately from any of the tenants; that the property tax has to be paid to the BBMP irrespective of whether the property is rented out or not. In other words, the property tax has no relevance to the provision of service and it also does not form part of the consideration received for renting service. Therefore, the property tax paid should not form part of the rental income. On a specify query from the Members regarding the category under which the property tax is paid to the BBMP, he submitted that the same was paid under the category of 'leased property' and not under the category of 'self-occupied property'.

7.2. On the issue of notional interest, they submitted that the lower Authority has held that there is a nexus between the security deposit and the rent charged and therefore, the same should be considered for computing the total income from rentals. In this connection, they submitted that the notional interest is not forming part and parcel of the monthly rent and hence the ruling given by the lower Authority that the notional interest is to be added to the total rental income for computing the threshold limit is against the principals of law. This is also not in accordance with the decisions on the same issue which has been taken by other Advance ruling authorities and which has been relied upon in the grounds of appeal. They also drew attention to the decision rendered in the case of Kalani Infrastructure Pvt Ltd wherein it was held that the notional interest is not to be included in the consideration for payment of service tax.

DISCUSSIONS AND FINDINGS

8. We have gone through the records of the case and considered the submissions made by the Appellant in their grounds of appeal as well as the submissions made at the time of personal hearing.

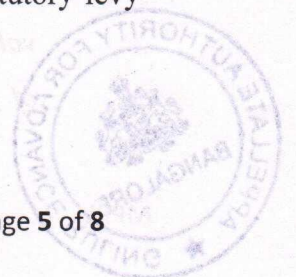


9. The Appellant is engaged in the business of renting of commercial property. They intend to enter into contractual agreements with prospective tenants wherein the premise is rented out for a monthly rent. The Appellant also collects a caution deposit/security deposit from the prospective tenant which is refundable without interest at the time of termination of the rental agreement. In addition, the Appellant pays the property tax on the said property to the Municipal authority i.e BBMP which is a statutory levy by the said Authority. In the above background, there are two issues which are before us for determination:

- a) Whether the property tax paid by the Appellant to the Municipal Authority can be deducted from the monthly rental income received?
- b) Whether the notional interest on the security deposit should be taken into consideration for determining the total income from rental service?

10. As regards the first issue, the value of supply of goods and services is governed by Section 15 of the CGST Act which states that the value of supply shall be the transaction value, which is the price actually paid or payable for the said supply, where both the supplier and the recipient are not related and price is the sole consideration for sale. In this case, the fact that the supplier and the recipient of the service (i.e lessee) are not related and that the rent is the sole consideration for the service of renting of immovable property, are not in dispute. It is seen from the draft rental agreement that the lessee is required to pay monthly rental of Rs 1,50,000/- plus applicable taxes, subject to deduction of tax as may be applicable. Therefore, the amount received from the lessee towards the monthly rent as per the invoice that will be raised by the Appellant, will be the transaction value and it is on this value that GST has to be paid.

11. Section 15(2) of the CGST Act, provides for certain inclusions to the value of supply. One such inclusion is that all taxes levied under any law in force will be included in the value. The only taxes which qualify for exclusion from the value are the CGST, SGST, IGST, UTGST and Compensation Cess which are levied under the respective Acts. Even in respect of these taxes, they can be permissible deductions subject to the condition that the supplier charges them separately in the invoice. Other than the above levies, no other statutory levy can be deducted from the value of supply.



12. We observe that unlike the earlier service tax regime, where Notification No 24/2007-S.T dated 22nd May 2007 had specifically provided for abatement of the property tax paid to the local bodies from the value of taxable service of renting of immovable property, there is no such exemption/abatement provided under the GST law. As stated earlier, all taxes levied under any law in force are to be included in the value of the renting of immovable property service supplied by the Appellant. Therefore, the property tax paid to the Municipal Authority (BBMP) cannot be deducted from the monthly rental income for arriving at the value of supply.

13. Coming to the second issue of whether the notional interest on the security deposit is to be included for the purpose of calculating the total rental income, we find that this is a concept which has been deliberated at length by many Courts with respect to the Income Tax Act. As far as GST law is concerned, the issue is to be examined in the context of 'supply' and the 'consideration' received for the supply. What constitutes a 'supply' in GST has been provided in Section 7 of the CGST Act and it includes all forms of supply (such as rental) made or agreed to be made for a consideration. In this case, the monthly rental received from the lessee is a consideration for the supply of the renting service. The terms of the rental agreement also state that the lessee shall pay an interest free refundable security deposit of Rs 5 crore which will be returned to lessee upon vacation of the scheduled property. This security deposit is no doubt linked to the supply of the renting service. However, to determine whether the security deposit is a consideration for the renting service or not, one has to refer to the definition of 'consideration' as given in Section 2(31) of the CGST Act which is reproduced below:

Consideration in relation to the supply of goods or services includes

(a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

*(b) the monetary value of any act or forbearance, **whether or not** **voluntary**, in respect of, in response to, or for the inducement of, the supply of goods or services, whether by the recipient or by any other person but*



shall not include any subsidy given by the Central Government or a State Government:

PROVIDED that a deposit, given in respect of the supply of goods or services or both shall not be considered as payment made for such supply unless the supplier applies the deposit as consideration for the said supply

14. The proviso to the above definition states that a deposit given in respect of supply of goods or services shall not be considered as payment made for such supply unless the supplier applies the deposit as consideration for the said supply. In the case of renting service, the security deposit is collected at the beginning of the term of the tenancy and is refunded to the lessee when the term of tenancy is terminated. The purpose of collecting the security deposit in rental services, is to provide a security in case there is a default in payment of rent by the lessee or if there is a damage to the leased property. Therefore, such security deposit cannot be considered as a consideration for the rental service. However, as per the proviso to Section 2(31) of the CGST Act, if, at the time of refund of the security deposit, any amount is adjusted by the supplier (lessor) towards the supply of the renting service, then it will be considered a consideration.

15. As regards the notional interest earned by the supplier on the security deposit, it is an amount earned by investing the security deposit. The interest is paid by the person with who the amount is invested. The interest earned by the supplier from a third person, on account of investing the security deposit amount is not a payment made by the third person "in respect of, in response to, or for the inducement of" the supply of the renting service. There is no connection between the payment of interest by the third person and the renting service supplied by the supplier to the lessee. The phrase "in respect of, in response to, or for the inducement of" used in the above definition of 'consideration' as given in Section 2(31)(a) of the CGST Act, means there must be a direct link between the supply of the service and the consideration received in the form of interest on the security deposit. Such a connection is absent in this case. We also take note that during the period of tenancy, the monthly rent may be revised as per the terms of the agreement but there is nothing in the lease agreement to suggest that such revision in the monthly rent is influenced by the amount of security deposit paid by the lessee. In the absence of any such evidence, we hold that in this case, the consideration received by way of monthly rental is not influenced by the security deposit given by the lessee or the notional interest earned on such security deposit. Therefore, we



disagree with the findings of the lower authority on this aspect and hold that the notional interest earned on the security deposit is not to be included to the total rental income.

16. In view of the above discussion, we pass the following order

ORDER

We modify the advance ruling No KAR ADRG 48/2020 dated 16-09-2020 and answer the questions raised by the Appellant in the original advance ruling application and in this appeal, as follows:

1. For the purpose of arriving at the value of rental income, the Appellant cannot deduct the amount paid as property tax to the Municipal Authority or any other statutory levies levied under any law for the time being in force, other than the CGST, SGST, IGST and Compensation Cess, subject to the condition that it is charged separately by the Appellant.
2. For the purpose of arriving at the total rental income, the notional interest earned on the security deposit is not to be taken into consideration.

The appeal filed by M/s Midcon Polymers Pvt Ltd, 3, 3rd Cross, Lalbagh Road, Near Garuda Maruthi Showroom, Bangalore 560027 is disposed off on the above terms.


(D.P.NAGENDRAKUMAR)
Member

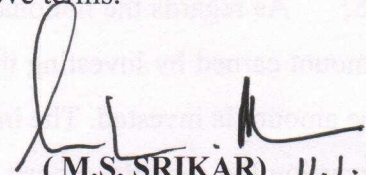
Karnataka Appellate Authority
for Advance Ruling
Member

Appellate Authority for Advance Ruling

The Appellant

Copy to

1. The Member (Central), Advance Ruling Authority, Karnataka.
2. The Member (State), Advance Ruling Authority, Karnataka
3. The Commissioner of Central Tax, Bangalore South Commissionerate
4. The Assistant Commissioner, LGSTO-70, Bangalore
5. Office folder


(M.S. SRIKAR) 11.1.2021
Member

Karnataka Appellate Authority
for Advance Ruling
Member

Appellate Authority for Advance Ruling

