

Notional interest earned on refundable security deposit is not 'consideration' for supply of renting services

The Hon'ble AAAR Karnataka, in the matter of *M/s. Midcon Polymers Pvt. Ltd. [Order No. KAR/AAAR/01/2020-21, dated January 11, 2021]* held that the property tax paid to the Municipal Authority cannot be deducted from the monthly rental income for arriving at the value of supply of the renting service. However, the notional interest on the security deposit shall not be taken into consideration for the purposes of arriving at total rental income.

Facts:

M/s Midcon Polymers Pvt Ltd. ("**Appellant**") is engaged in the business of renting of commercial property, who intends to enter into commercial agreement with educational institution in Bangalore, 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 discharges the statutory taxes levied by the Municipal authority i.e., Bruhat Bengaluru Mahanagara Palike ("**BBMP**") on the property.

The present appeal has been filed by Appellant against the order of the Hon'ble AAR, Karnataka in *Order No. KAR ADRG 48/2020, dated September 16, 2020*, wherein it was held that the Appellant cannot deduct the property taxes and other statutory levies for the purpose of arriving at the value of rental income. Further, 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 monthly rent. Furthermore, the Appellant is entitled for exemption of tax under the general exemption of INR 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.

Issues:

1. Whether the property tax paid by the Appellant to the Municipal Authority can be deducted from the monthly rental income received?
2. Whether the notional interest on the security deposit is to be included for the purpose of calculating the total rental income?

Held:

The Hon'ble AAAR Karnataka, in *Order No. KAR/AAAR/01/2020-21, dated January 11, 2021* held as under:

- Noted that, 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 INR 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 Goods and Services Tax (“GST”) has to be paid.

- Analyzed Section 15(2) of the Central Goods and Services Tax Act, 2017 (“CGST Act”), and stated that it 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, and no other statutory levy can be deducted from the value of supply other than the above levies.
- Stated that the concept of the notional interest on the security deposit has been deliberated at length by many Courts with respect to the Income Tax Act, 1961. 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 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 INR 5 crore which will be returned to lessee upon vacation of the scheduled property.
- Observed that the interest is paid by the person with whom 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 definition of 'consideration' 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.
- Modified the order of the Hon’ble AAR Karnataka and held that, 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 BBMP cannot be deducted from the monthly rental income for arriving at the value of supply.

- Further held that, 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, the Hon'ble AAAR disagreed with the findings of the lower authority on this aspect and held that **the notional interest earned on the security deposit is not to be included to the total rental income.**

Relevant Provisions:

Section 2(31) of the CGST Act:

“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”

Section 7(1)(a) of the CGST Act:

“Scope of supply.

(1) For the purposes of this Act, the expression “supply” includes—

(a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business”

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