

Compensation paid by developers to tenants for alternative accommodation not in nature of rent; section 194-I of Act inapplicable

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In brief

The Mumbai Income-tax Appellate Tribunal (Tribunal), in the taxpayer-developer's case, held that the compensation paid by the taxpayer towards alternative accommodation under a development agreement was not in the nature of rent covered under the provisions of section 194-I of the Income-tax Act, 1961 (the Act). Hence, no disallowance could be made under section 40(a)(ia) of the Act, for non-withholding of tax.

In detail

Facts

- The taxpayer¹ was a company engaged in the business of development of real estate, including carrying out Slum Rehabilitation Projects (SRA project). The taxpayer was required to provide flats to the hut-dwellers for NIL consideration under SRA Projects.
- The land/ property in question for one such SRA project was owned by the municipal corporation and inhabitants of the said building were tenants of the municipal corporation.
- As per the terms of the development agreement, the taxpayer was also required to provide alternative accommodation to the tenants during the

construction period.

However, since the taxpayer was unable to provide the alternative accommodation to the tenants, the taxpayer agreed to pay them compensation (revised from time to time) to enable them to meet expenditure to be incurred towards rent.

- During assessment year 2010-11, the taxpayer had not withheld tax on payment of such compensation.
- The tax officer (TO) held that the said payment was in the nature of 'rent' and hence tax was required to be withheld under section 194-I of the Act. Accordingly, the TO made a disallowance under section 40(a)(ia) of the Act.
- The Commissioner of Income-tax (Appeals) upheld the disallowance made by the TO.

Issue before the Tribunal

- Whether the compensation paid by the taxpayer to the tenants for enabling them to meet expenditure for alternative accommodation was in the nature of rent covered under section 194-I of the Act?

Taxpayer's contentions

- There was no tenancy agreement between the taxpayer and the inhabitants of the property and hence, the payments could not be termed as 'rent' within the meaning of section 194-I of the Act.
- Since the taxpayer was unable to provide alternate accommodation, it made payments to the tenants for enabling them to meet the expenditure incurred by them towards rent payable. Hence, the payments made by the taxpayer were purely in nature of compensation.

¹ I.T.A. No. 5963/Mum/2013

- Reliance was placed on the decision of Mumbai Tribunal in the case of Jitendra Kumar Madan² where similar compensation received for alternative accommodation was treated as 'income from other sources' in the hands of the recipient, thereby indicating that such income was not in the nature of 'rent'.

Revenue's contentions

- As per the development agreement, the taxpayer was required to provide alternative accommodation to the tenants. However, the taxpayer made payments to tenants towards rent, to enable them to arrange for alternative accommodation. Hence, the same was in nature of 'rent' within the purview of section 194-I of the Act.

Tribunal's ruling

- On account of the reasons listed below, the Tribunal held that the payments made by the taxpayer were not in the nature of 'rent' as per section 194-I of the Act.
 - The concerned persons to whom the taxpayer had made the payments were

neither tenants of the taxpayer nor had the taxpayer in reality paid rent on their behalf. Such compensation was payable by the taxpayer irrespective of whether the tenants actually incurred any expenditure on account of rent or not.

- As per Explanation 1 to section 194-I of the Act, 'rent' *inter alia* included payment for use of land or building. The taxpayer had not made the payment for use of any land or building. Hence, the payment was not in the nature of 'rent', but was in the nature of compensation.

- The Tribunal relied on the decision in the case Jitendra Kumar Madan².
- Accordingly, the Tribunal deleted the disallowance made under section 40(a)(ia) of the Act.

The takeaways

The Tribunal has attempted to create a distinction between 'rent' and 'compensation' in the context of redevelopment projects.

Payments made by the developers to tenants/ members of the society for arranging alternative accommodation should not be regarded as 'rent', being subject to deduction of tax at source under section 194-I of the Act.

This distinction between 'rent' and 'compensation' is important, as deduction of tax at source under section 194-I of the Act would affect the net cash flows in the hands of the tenants/ members of the society.

In view of the introduction of section 194-IA of the Act with effect from 1 June 2013, it needs to be analysed whether, going forward, such payments (held to be in the nature of 'compensation') should be subject to deduction of tax at source under section 194-IA of the Act.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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² Jitendra Kumara Madan v. ITO [2012] 32 CCH (Mumbai-Tribunal)

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