Amount paid for operating an executive lounge at Airport is "rent" under section 194-I of the Act and not Royalty

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In brief

The Delhi High Court (HC) in a recent decision[1] has held that the payments made by the taxpayer to the Airport Authority of India (AAI) for operating an executive lounge at the airport are for the use of the space provided and not towards any services provided by the AAI. Accordingly, the said payment will be "rent" as defined under section 194-I of the Income-tax Act, 1961 (the Act).

In detail

Facts

- The taxpayer under a bidding process was awarded a contract for operating an executive lounge at the IGI by the AAI. The bidder had to quote the "royalty" amount for being granted a license to operate the executive lounge. The AAI was to fix the license fee for the space to be provided to the successful bidder for operating the lounge.
- In terms of the License Agreement (LA) the premises at the first floor of the IGI Airport, referred to as the "lounge premises," were given on license to the taxpayer for the purpose of operating an executive lounge available for all operating airlines for the benefit of their transit passengers. As far as the license fee was concerned, the LA specified two payments from the taxpayer:
  - (i) A fixed monthly payment as advance by way of "royalty" for the first year of the contract, with the provision that the said royalty should be subject to 10% annual compound escalation in the subsequent years of the contract and should be paid in advance on or before the tenth of each month; and
  - (ii) A license fee for space allotted for operating the lounge premises at the rates as may be fixed from time to time.
- The stand taken by the taxpayer was that the payments were not in the nature of "rent" but in the nature of "royalty," and hence did not warrant withholding under section 194-I of the Act.
- The Tax Officer (TO) held that the mere fact that one part of the payment under the LA was termed as "royalty" could not take away the character of the payments being "rent" for the use of land and premises at the IGI in respect of the International terminal. Accordingly, the taxpayer was held as a taxpayer in default to the extent of non-withholding of tax under section 201(1) of the Act. Interest under section 201(1A) was charged additionally, as applicable.
- The matter carried to the HC.

[1] ITA No 73, 74, 75, 77 to 82, 86, 100, 113, 123, 200, 561, 633, and 688 of 2005

Issues before the HC

Whether the payments made by the taxpayer to the AAI for operating the executive lounge at the IGI, was in the nature of "rent" under section 194-I of the Act or in the nature of "royalty"?

Revenue's contention

Reading the LA as a whole, it was plain that the payment made, although in two parts, was for operating an executive lounge. The non-payment of even one component, as either of royalty or of the fee for the space, would entail the taxpayer losing the right to operate the executive lounge.

Taxpayer's contention

- A distinction needs to be drawn between the payment of royalty that was for the right to operate the executive lounge, and the amount was quoted by the taxpayer itself, and the amount paid to use the space where the lounge was operated that alone could be characterised as "rent."
- The fixed royalty payment was spread over the period of license, and therefore, it should have been construed as payment of royalty in instalments.
- The payment was for the grant of two different rights. Even where both the rights were granted under the same LA, the payments for each of them had to be treated as two distinct payments. The taxpayer referred to the certificate issued by the AAI to the effect that both payments were distinct.

High Court's decision

- Although the payments by the taxpayer for operating the executive lounge at the IGI was split into parts, it was in effect a payment for the use of the lounge for the purpose of operating it. If there was a default in payment of either of the components of the license fee, the inevitable consequence was that the taxpayer loses the right to operate the executive lounge.
- Clause (i) of the Explanation to section 194-I of the Act states that the word "rent" for the purposes of that provisions means "any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any-....."
- In each case, the agreement in question had to be examined to ascertain if the payment was predominantly for the use of space. In the present case, the taxpayer was permitted to operate an executive lounge. The question of being able to operate the lounge without the actual use of the space simply does not arise. The payment for the use of space was inseparable from the payment of royalty for the right to operate the lounge.
- The certificate issued by the AAI stating that the payment of license fee for the space was different from the payment of royalty would not make a difference to the legal position as regards section 194-I of the Act.

The takeaways

- The HC has explained how the essence of the transaction is to be considered while evaluating the characterisation of the payments.
- However, it should be noted that the case relates to financial years 1994-95 to 2001-02. In the Taxation Laws (Amendment) Act, 2006, withholding tax was specifically introduced on royalty, and the definition of "rent" was also widened. Therefore, the issue has already been addressed by subsequent amendments.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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