

Lessee cannot claim depreciation under section 32 in the absence of legal ownership; to avail the benefit of depreciation lessee has to undertake the construction activity himself as per Explanation 1

April 6, 2017

In brief

The Apex Court (SC), in a recent case¹, held that since the taxpayer (lessee) had not become the owner of the immovable property in question, depreciation could not be allowed to the taxpayer as per section 32 of the Income-tax Act, 1961 (the Act). The title in the immovable property could not be passed from lessor firm when its value was more than INR 100, unless it was executed on a proper stamp paper and was duly registered with the sub-registrar. In the absence thereof, the taxpayer could not be said to be the owner of the immovable property and depreciation could not be allowed in such circumstances. On the alternative argument of claiming depreciation under Explanation 1 to section 32, the SC held that the lessee was entitled to depreciation on the capital expenditure incurred by him by way of renovation, extension or improvement to the building and not on the construction carried out by the owner, the cost of which was subsequently reimbursed by the lessee.

In detail

Background

- In this case, the taxpayer¹ (lessee) was a private limited company, running a super speciality hospital in Thrissur Town in central Kerala.
- Earlier a partnership firm was set up to run a hospital on land belonging to the firm and it started the construction of the hospital building.
- As it was felt expedient to form a private limited company to run and manage the hospital (then under construction), a company was formed for the said purpose and was incorporated on 30 December, 1988.
- Thereafter, an agreement was entered into between the firm and the company and it was agreed that the firm would complete the construction of the building and hand over possession to the taxpayer on the condition that the entire cost of construction shall be borne by the taxpayer.
- The taxpayer took possession of the building on its completion on 18 December, 1991 and started the hospital operations with effect from 19 December, 1991.
- The accounts of the taxpayer have been debited with the cost of construction of the building, i.e., INR 13.7 million. The accounts of the firm were also credited with the payment of INR 10.6 million made by the taxpayer.
- The balance amount payable by the taxpayer to the firm was carried as liability in taxpayer's balance sheet, for

¹ Civil Appeal No. 3360 of 2006 (Supreme Court)

which the firm had a lien on the building. The balance amount was also paid to the firm in due course.

- The one time building tax payable by the owner of the building under the Kerala Building Tax Act was also paid by the taxpayer.
- As the ownership of the land had to remain with the firm, the taxpayer agreed to lease the land from the firm for a monthly ground rent of Rs.100 from 1 April 1993.
- The taxpayer filed its first tax return for assessment year (AY) 1992-93 in which it claimed depreciation on the building part under section 32 of the Act on the ground that it had become the “owner of the property.”
- The tax officer rejected the aforesaid claim of taxpayer holding that it had not become the owner of the property during the relevant AY.
- The taxpayer preferred an appeal before the Commissioner of Income-tax (Appeals), which met with the same fate. However, in further appeal before the Income-tax Appellate Tribunal (Tribunal), the taxpayer succeeded.
- Revenue filed an appeal before the High Court (HC), against the order of the Tribunal, which was allowed by HC in favour of the Revenue.

Issues before the SC

- Whether the taxpayer would be considered as “owner” for claiming depreciation under section 32 of the Act?
- Whether depreciation can be allowed to taxpayer, where construction is carried out by the owner-lessor and

expenditure is reimbursed by taxpayer-lessee under the terms of Explanation 1 to section 32 of the Act?

Taxpayer’s contention

- The taxpayer contended that it had become the “owner of the property” for the purpose of section 32 Act, and was eligible for claim of depreciation.
- It also contended that even otherwise, it had become the lessee of the property in question, and since the construction was undertaken from taxpayer’s funds, by virtue of Explanation (1) to section 32 of the Act, the taxpayer was entitled to claim depreciation.

Revenue’s contention

The Revenue contended that the taxpayer had not become the owner of the property in question during the relevant assessment year, and hence, not eligible for depreciation.

SC’s ruling

- The SC held that the building constructed by the firm belonged to the firm. As the property in question was an immovable property, the title in the said property could not pass unless it was executed on a proper stamp paper and was duly registered with the sub-registrar. In the absence of transfer of title, it could not be said that the taxpayer had become the owner of the building.
- Further, the SC also mentioned that it was only when the taxpayer held a lease or other right of occupancy and any capital expenditure was incurred by the taxpayer on the construction of any structure or doing of any work

in or in relation to and by way of renovation or extension of or improvement to the building, that the taxpayer would be entitled to depreciation to the extent of any such expenditure.

- In the present case, the records show that the construction was undertaken by the firm. It was a different thing that the taxpayer had reimbursed the amount. The construction was not carried out by the taxpayer. Therefore, the Explanation 1 to section 32 would not come to the aid of the taxpayer.

The takeaways

Section 32 allows depreciation on buildings, etc., which are owned by the taxpayer and used for its business and profession.

Therefore, the word “owned” is at the core of the controversy. Is it only an absolute owner or an owner of the asset as understood in its legal sense who can claim the depreciation? The Indian judiciary has—in few instances—interpreted this issue.

The SC in the case of Poddar Cement Limited² and Mysore Minerals Limited³ held that beneficial ownership is relevant for claim of depreciation under the provisions of the Act.

However, in the present case, the SC has upheld the concept of legal ownership for the purpose of claiming depreciation. Hence, the present ruling may further lead to controversies in the claim of depreciation on account of ownership of assets without the transfer of legal title.

Let’s talk

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

² CIT v. Poddar Cement (P) Limited [1997] 226 ITR 625 (SC)

³ Mysore Minerals Limited v. CIT [1999] 239 ITR 775 (SC)

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Telangana
+91-40 44246000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Bengaluru

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata – 700 091,
West Bengal
+91-033 2357 9101/
4400 1111

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greaves Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road (Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR (Gurgaon), Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

©2017 PwC. All rights reserved

Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2017 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.