

## Notional interest cannot be added to rental income without making an enquiry about Annual Letting Value

**Summary – The Mumbai ITAT in a recent case of Diven Dembla., (the Assessee) held that notional interest cannot be added to rental income to determine fair/market rental value of property without making necessary enquiries about fair/market rental income or Annual Letting Value of property.**

### Facts

- The Assessing Officer, being not satisfied with the amount of rental income shown by the assessee, deputed an Inspector to enquire about market rate of rent.
- Inspector reported higher rate of rent in that area.
- Thereafter, Assessing Officer determined the rental value of the property by adding notional interest at the rate of 15 per cent on the interest-free security deposit.
- On appeal the Commissioner (Appeals) called for a remand report from the Assessing Officer directing him to make available the relevant material to determine the market rate of rent of the property in question on the day on which it was rented to the tenant in question and further to make necessary enquiries. The concerned Assessing Officer, instead of making enquiries regarding the fair/market rent of the property as on the day of tenancy, reported in the remand report dated 28-2-2011 that the addition was not made on the basis of report of the Inspector, and therefore, there was no necessity to make any enquiry regarding the fair/market rent value of the property or to allow the assessee an opportunity to cross examine the Inspector regarding his report. The Commissioner (Appeals) deleted the addition holding that the Assessing Officer neither made available the report of the Inspector to the assessee nor conducted any enquiry to determine fair rental value of the property.
- On revenue's appeal:

### *Issue involved*

- Whether notional interest on interest-free security deposit was to be added to rental income of assessee for determining ALV under section 23(1)(a)?

### Held

- Section 23(1)(a) requires determination of the 'fair rent' being 'the sum for which the property might reasonably be expected to let from year to year. The Assessing Officer has to make an enquiry as to what would be the possible rent that the property might fetch. If he finds that the actual rent received is less than the 'fair/market rent' because the assessee has received abnormally high interest-free security deposit, he can undertake necessary exercise in that behalf. For determination of fair rent, the Assessing Officer can take into account various factors including standard rent. If the standard rent is not fixed, then the procedure provided under the Rent Control Act for fixation of

[www.tenettaxlegal.com](http://www.tenettaxlegal.com)

© 2013, Tenet Tax & Legal Private Limited

standard rent can be taken into consideration. However, the ALV fixed by the municipal authorities cannot be the sole criteria for determining the fair rent of the property. The Assessing Officer can ignore the municipal valuation if he finds that the same is not based on relevant material for determining the 'fair rent' in the market and there is sufficient material on record for taking a different valuation. In determining the reasonable/fair rent, extraneous circumstances may inflate/deflate the 'fair rent'. Various circumstances can be taken into consideration by the Assessing Officer while determining the fair rent, though no particular test can be laid down and it would depend on facts of each case.

- In the case in hand, the Commissioner (Appeals), while calling for remand report, had in specific terms directed the Assessing Officer to conduct enquiry so as to determine the fair/market rent of the property. Even he had directed the Assessing Officer to give an opportunity to the assessee to cross-examine the Inspector regarding his report relating to the market value. However, the Assessing Officer neither made available the said report to the assessee nor conducted any enquiry to determine the fair/market rental value of the property. Despite directions by the Commissioner (Appeals), he reported that there was no requirement to do so. Even he did not allow the assessee to cross-examine the Inspector. When despite directions by the Commissioner (Appeals), the Assessing Officer did not choose to determine the fair/market rental value of the property by making necessary enquiries, then the rental income offered by the assessee is to be treated as the fair/market rental income or the Annual Letting Value of the property. The notional interest on the interest-free security deposit cannot be taken as determining factor to arrive at the fair rent. Therefore, the notional interest cannot be added back to the rental income of the assessee.
- At this stage, the department submitted that the matter be remanded back to the Assessing Officer for making necessary enquiries relating to the fair/market rental value of the property. This contention cannot be accepted at this stage. In view of the fact that despite specific directions given by the Commissioner (Appeals), the Assessing Officer did not choose to comply the same and to make enquiries regarding the fair rental value of the property, the assessee cannot be harassed by prolonging the matter further on the issue, especially when the Assessing Officer himself has chosen not to make such enquiry. There is no evidence on the file that annual rental value of the property was higher during the relevant year than that declared by the assessee. In view of above observation, there is no merit in this ground of appeal of the revenue and as such the findings of the Commissioner (Appeals) on this issue are upheld.