

Security deposit received from lessee isn't deductible as 'debt owed' for computation of net wealth

Summary – The Mumbai ITAT in a recent case of S.T. Holding (P.) Ltd., (the Assessee) held that Security deposit received from lessee is not deductible as 'debt owed' for computing net worth.

Facts

- The assessee, was owner of 2/5th part of a flat at Mumbai. During the relevant year it acquired the remaining 3/5 th share from the other three co-owners, holding 1/5 share each, for a consideration of Rs.93 lakhs each, i.e., for a gross consideration of Rs.279 lakhs.
- The assessee took loans for financing this purchase and also for repaying the security deposit (of Rs.310 lakhs), which had been taken by the owners in respect of the lease of the said flat. In view of termination of lease during the year, the assessee claimed said amount as debt owed under section 2(m). The assessee claimed deduction of the said loan amount while computing net wealth.
- The Assessing Officer rejected said claim and held the debt owed to be nil.
- The Commissioner (Appeals) gave partial relief, by taking debt owed at Rs. 58 lakhs.
- On appeal by assessee to the Tribunal:

Held

- A security deposit taken by the assessee-lessor leads to an inflow of funds with it. He is thus without doubt better placed than a person not in receipt of the security deposit, result as it does in a corresponding increase in his cash/bank balance, which could be profitably deployed/ invested. Of course, there is a concomitant liability to repay the debt on the termination of the agreement, i.e., the assessee's assets and liabilities both undergo an increase by the same amount. It would therefore be at best a tax-neutral exercise in-as-much as, though it makes the assessee cash rich, does not enhance his net worth in view of the funds carrying an obligation of repayment, but shall not cause a decrease in his net wealth. In fact, to the extent it allows the assessee access to interest-free funds, it confers upon it a valuable right. One only needs to deposit the sum in the bank for the corresponding term to generate risk free (or almost so) interest, realizing the value of access to such funds, making the depositor wealthier to that extent, and in any case of the matter, even disregarding the same, would lead to a status quo, so that the transaction is, as aforesaid, tax-neutral. The deduction of the sum deposited by way of security (for the performance of the contract) as a debt owed under section 2(m) was unacceptable. True, the words 'in relation to' occurring in section 2(m), in the context of section 14A, are very wide. A lease agreement, however, is towards 'exploitation of the property for gain', i.e., is essentially an agreement for the 'user' of the property, so that the sum realized under the said agreement by way of deposit may not qualify to be considered as a debt owed in relation to an asset under section 2(m) in-as-much as it has no bearing

or relation with the acquisition, holding or even the valuation of the asset. On the contrary, valuation models, as indeed under the relevant Rules itself (Schedule III to the Act, rule 5), recognize the transfer of a benefit to the owner (by the tenant) thus, providing for a percentage (15 per cent) of such interest-free deposit as a part of the 'gross maintainable rent', i.e., with reference to which valuation is made, further limiting the addition to the differential interest where the deposit is interest bearing.

- It was further observed on fact that even if security deposit would have been a debt owed under section 2(m), even then assessee's claim was inadmissible as the lease was terminated prior to the valuation date and the deposit was refunded. There is no subsisting lease agreement in favour of the said lessee-depositor as on the valuation date. Thus, once security deposit had been paid there was no liability in its respect at the year-end, and therefore, there was no question of the same being a debt owed under section 2(m) in relation to the assessee's flat. Therefore, no part of the loan would qualify as a debt owed as on the valuation date.