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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ ITA 507/2022

PRINCIPAL COMMISSIONER OF INCOME TAX-04

..... Appellant

Through: Mr. Abhishek Maratha, Sr.SC.

versus

M/S MICROSOFT INDIA (R AND D) PVT LTD

..... Respondent

Through: Mr. Nageswar Rao, Mr. Parth
and Mr. Aman Rewaria, Advs.

8

+ ITA 509/2022

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CORAM:

HON'BLE MR. JUSTICE YASHWANT VARMA

HON'BLE MR. JUSTICE PURUSHAINDRA KUMAR

KAURAV

ORDER

19.03.2024

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PER: PURUSHAINDRA KUMAR KAURAV, J.

1. The present batch of appeals, at the instance of the Revenue, seek to assail the common orders dated 14 June 2021 and 24 September 2021 passed by the Income Tax Appellate Tribunal [“**TTAT**”] for the Assessment Year [“**AY**”] 2011-12 [ITA 509/2022], AY 2012-13 [ITA 510/2022], AY 2014-15 [ITA 514/2021], AY 2015-16 [ITA 507/2022], respectively.

2. The brief facts which are relevant to decide the controversy in hand are that the assessee is a company registered under the provisions of the Companies Act, 1956 and is engaged in the business of providing software development and product support services. On 10 February 2010, two lease agreements were signed between the assessee and Microsoft Global Services Centre (India) Private Limited



for letting out floors of the buildings which included fixtures like centralised air conditioning, battery back-ups etc. attached to the buildings. For AY 2014-15, on 30 November 2015, the assessee filed its Income Tax Return [“**ITR**”], declaring income to the tune of INR 441,97,88,190/-. However, on 31 March 2017, the assessee filed its revised ITR declaring an income amounting to INR 252,08,79,880/-. Thereafter, an assessment order was passed under Section 143(3) of the Act on 29 August 2019.

3. The assessment order would reflect that the Assessing Officer [“**AO**”] made an addition to the tune of INR 11,22,02,118/- on account of assessing rental income under the head of ‘income from house property’. Moreover, the AO resorted to a further addition of INR 170,09,60,683/- on account of the transfer pricing adjustment.

4. Assailing the aforementioned assessment order, the assessee preferred an appeal before the ITAT under Section 253 of the Act. The ITAT *vide* its common order dated 24 September 2021 for AYs 2014-15 and 2015-16 ruled in favour of the assessee on the ground that the assessee had entered into an advance pricing agreement with respect to international transactions. Furthermore, regarding the question of rental income to be placed under the head of ‘income from other sources’, the ITAT noted its earlier order dated 14 June 2021 for AYs 2011-12 and 2012-13 and held that a similar issue has already been decided in favour of the assessee.

5. In order to mount a challenge against the impugned orders, the Revenue has proposed the following substantial questions of law for our consideration:-

“A. Whether on the facts and circumstances of the case, the Ld. ITAT was justified in law in directing to treat the income from letting out the building as income under the head income from



other sources, where the assessee itself had claimed it under the head of income from rental property for all earlier years?

B. Whether on the facts and circumstances of the case, the Ld. ITAT was justified in law in granting the assessee benefit of deduction under Section 57(iii) of the Income Tax Act, 1961 without giving an opportunity to the AO to dispute such deduction?”

6. Mr. Abhishek Maratha, learned counsel appearing on behalf of the Revenue, while assailing the impugned orders, submits that the assessee for all previous AYs had been showing the rental income under the head of ‘income from house property’. He further argues that the lease agreement is not a composite agreement and the ITAT has wrongly applied the rationale encapsulated in the decision of this Court in **Jay Metal Ind. Pvt. Ltd. v. CIT** [2017 SCC OnLine Del 9114]. He further submits that the deduction under Section 57(iii) of the Act should not be allowed as the rental income derived from letting out the premises in question is the ‘income from the house property’ and not ‘income from the other sources’.

7. Mr. Nageswar Rao, learned counsel appearing on behalf of the assessee, vehemently opposes the submissions advanced by the Revenue. He argues that the instant appeals raise no substantial questions of law as the ITAT has correctly followed the test laid down by the Hon’ble Supreme Court in **Sultan Brothers (P) Ltd. v. CIT** [(1964) 51 ITR 353]. He further argues that the lease in question is a composite lease agreement i.e., the premises are let out alongwith the fixtures attached to it and the ITAT has correctly analysed the clauses of the lease agreement in order to ascertain the underlying intention of the signatories to the lease agreement.

8. We have heard the learned counsel on behalf of the parties and perused the record.



9. The short controversy involved in the instant appeals placed before us is— whether the income received from letting out the premises in question should be calculated under the head of ‘income from other sources’ or under the ‘income from the house property’?

10. It is pertinent to point out that almost a similar controversy has been decided by this Court in the case of *Jay Metal (supra)*, wherein, rental income accrued out of the lease of the building alongwith fixtures attached to it was the question for consideration before the Court. The Court, while upholding the ITAT order, noted the composite nature of the lease agreement in question and ruled that when the lease is given in addition to the fixtures, furniture etc. attached to the building, then in such a case of composite lease, the rental income shall be calculated under the head of ‘income from other sources’. The relevant extracts of the said decision are culled out as under:-

“19. In the present case, the preamble clauses of the lease deed, extracted hereinbefore, make it plain that what was given on rent to the lessee was not just the basement, ground floor, first floor and second floor of the building but also the fixtures, furniture which included the air conditioning and power backup through a 200 KVA diesel generator set. In particular, clause 2(d) makes it clear that the lessor had to hand over the office "with furniture and fixture, 200 KVA diesel generator and adequate air conditioners to the lessee in good working condition".

22. However, in the present case, as already discussed, it is plain that letting is not merely of the building but a composite letting of both, the building as well as the equipment, furniture etc. and thereby section 56(2)(iii) of the Act was attracted. Applying the test laid down in Sultan Bros. (supra) the income from the letting in the hands of the assessee was "a new kind of income" which could be considered to be income from house property since the income not from the ownership of the building alone "but an income which though arising from a building would not have arisen if the plant, machinery and furniture had not also been let along with it".



23. The court is, therefore, not persuaded to take a view different from that by the Income-tax Appellate Tribunal in the present matter. Consequently, the question urged, viz., whether the Income-tax Appellate Tribunal erred in holding that the rental income should be treated as "income from other sources", is answered in the negative i.e., in favour of the Revenue and against the assessee."

[Emphasis supplied]

11. Furthermore, while addressing the claim for deduction under Section 57(iii) of the Act, this Court in *Jay Metal (supra)*, also held as under:-

"Claim for depreciation

26. However, the last plea made by the assessee is that in that event the entire income from the letting is treated as "income from other sources", it cannot be deprived of the corresponding deduction in terms of section 57(iii) of the Act. The Revenue too has not disputed the fact that the assessee has not claimed depreciation.

27. Accordingly, it is directed that while giving the appeal effect, the Assessing Officer will grant the assessee the benefit of section 57(iii) of the Act."

[Emphasis supplied]

12. It be noted that the Constitution Bench of the Hon'ble Supreme Court in the case of *Sultan Brothers (supra)* carved out an elementary test for determining "whether the lease for letting out the building together with fixtures should be considered a composite one or not". In the said case, the issue involved was related to the lease of a building alongwith the furniture and fixtures, which was leased for the purpose of running a hotel. The recitals of the said lease provided the monthly rent of INR 5,950/- for the building and the hire of INR 5,000/- for furniture and fixtures. The Hon'ble Supreme Court opined that inspite of different rent fixed for building and fixtures, the intention of the parties may still be that the two shall be enjoyed



together. While ascertaining the intention of the parties from the clauses of the lease, the Hon'ble Supreme Court noted that the building and the fixtures and furniture were to be used for one purpose, namely, for the purpose of running a hotel. The relevant extracts of the said decision are reproduced hereinbelow:-

“20. What, then, is inseparable letting? It was suggested on behalf of Respondent Commissioner that the sub-section contemplates a case where the machinery, plant or furniture are by their nature inseparable from a building so that if the machinery, plant or furniture are let, the building has also necessarily to be let along with it. There are two objections to this argument. In the first place, if this was the intention, the section might well have provided that where machinery, plant or furniture are inseparable from a building and both are let etc. The language however is not that the two must be inseparably connected when let but that the letting of one is to be inseparable from the letting of the other. The next objection is that there can be no case in which one cannot be separated from the other. In every case that we can conceive of, it may be possible to dismantle the machinery or plant or fixtures from where it was implanted or fixed and set it up in a new building. As regards furniture, of course, they simply rest on the floor of the building in which it lies and the two indeed are always separable. We are unable, therefore, to accept the contention that inseparable in the sub-section means that the plant, machinery of furniture are affixed to a building.

21. It seems to us that the inseparability referred to in sub-section (4) is an inseparability arising from the intention of the parties. That intention may be ascertained by framing the following questions : Was it the intention in making the lease — and it matters not whether there is one lease or two, that is, separate leases in respect of the furniture and the building that the two should be enjoyed together? Was it the intention to make the letting of the two practically one letting? Would one have been let alone a lease of it accepted without the other? If the answers to the first two questions are in the affirmative, and the last in the negative then, in our view, it has to be held that it was intended that the lettings would be inseparable. This view also provides a justification for taking the case of the income from the lease of a building out Section 9 and putting it under Section 12 as a residuary head of income. It then becomes a new kind of income, not covered by Section 9, that is, income not from the ownership of the building alone but an income which though arising from a building would not have



arisen if the plant, machinery and furniture had not also been let along with it.

22. That takes us to the question, was the letting in the present case of the building and the furniture and fixtures inseparable in the sense contemplated in the sub-section as we have found that sense to be? It is true that the rent for the building and the hire for the furniture were separately reserved in the lease but that does not, in our view, make the two lettings separable. We may point out that the Tribunal has taken the same view and the High Court has not dissented from it. **In spite of the sums payable for the enjoyment of two things being fixed separately, the intention may still be that the two shall be enjoyed together. We will now refer to the provisions in the lease to see whether the parties intended that the furniture, fixtures and the building shall all be enjoyed together.** Clause 1 of the lessee's covenant, in our opinion, puts the matter beyond doubt and it is as follows:

1. (a) To use the demised premises and the said furniture and fixtures for the purpose of running hotel, boarding and lodging house, restaurant, confectionary and such other ancillary businesses as are usually or otherwise can be conveniently carried on with the said business in the said premises such as providing show-cases, show-windows, newspaper stall, dancing and other exhibition of arts, meeting rooms etc. and not for any other purpose without the previous permission in writing of the lessors.

23. It is clear from this clause that the building and the fixtures and furniture were to be used for one purpose, namely, for the purpose of running a hotel, with them all together. Again clause 1 (h) of the lessee's covenant provided that the lessee, is not to remove any article or thing from the premises except for the purposes of and in the course of the hotel business which latter would be for effecting repairs to them or for replacing them where it was the duty of the lessee to do so under the lease. We think, therefore, that the lease clearly establishes that it was the intention of the parties to it that the furniture and fixture and the building should be enjoyed all together and not one separately from the other.”

[Emphasis supplied]

13. Reliance can also be placed upon the decision of this Court in the case of **Garg Dyeing & Processing Industries v. Asst. CIT** [2012 SCC OnLine Del 5823], wherein, this Court has also held that



where the rent is received towards the composite let out i.e., letting out of the building alongwith the furniture, fixtures, fittings, air conditioning, plants etc., then the same shall be taxable as ‘income from other sources’ and not under the head of ‘income from house property’. The relevant extracts of the said decision are reproduced herein for reference:-

“8. It is only by applying the aforesaid tests to the facts of the present case that the Tribunal held that the letting in the present case was a composite one. In so concluding the Tribunal contrasted the terms under which the ground and first floors of the building were leased to Haldirams. What was let out to Haldirams was the bare space with only a right given to the lessee to use the common facilities such as lift, lobby, staircases, corridors, etc., in order that the property can be enjoyed effectively ; there was no letting out of machinery, plant or furniture to Haldirams. **However, in the disputed cases there was a letting of the fixtures, fittings, air-conditioning plant, furniture, etc., together with the building and both were inseparable. This is what the Tribunal has found. It further found that the intention of the parties was that there was to be a single inseparable letting as evidenced by a composite lease deed for which a consolidated lease rent was fixed. In these circumstances, we are of the view that the substantial question of law has to be answered in the affirmative and against the assessee.”**

[Emphasis supplied]

14. It is evident in light of the discussion above that when the intention of the parties is crystal clear that the lease in question is a composite lease i.e., fixtures attached to the building are also let out alongwith the building, then the income derived from such lease shall be calculated under the head of ‘income from other sources’ and not under the head of the ‘income from house property’.

15. On the touchstone of the dictum laid down by judicial precedents noted above, we shall now proceed to examine the challenge which stands raised before us.

16. The ITAT *vide* its common order dated 14 June 2021 for AYs



2011-12 and 2012-13 held that the lease in question was composite in nature i.e., the premises are let out alongwith the fixtures attached to it and thus, the rent received towards letting out the said premises shall be calculated under the head of 'income from other sources'. Furthermore, the ITAT noted that since the lease in question was a composite agreement, therefore, the provisions of Section 56(2)(iii) shall be attracted. Following the rationale of the decision of the Hon'ble Supreme Court in *Sultan Brothers (supra)*, the ITAT further held that the assessee shall be eligible for the benefit of deductions as per the provisions of Section 57(iii) of the Act. For the sake of convenience, the relevant extracts of the said order are reproduced herein for reference:-

“16. We have given thoughtful consideration to the findings of the Assessing Officer but we do not concur with the findings. **There is no dispute that the lease agreement is a composite lease agreement which included the inbuilt infrastructural facilities provided which included central air conditions with ducting, DG power supply, net workequipments, access control equipments, electrical equipments, VAVs and controllers, smoke detectors and occupancy sensors.**

17. The agreement also included other amenities, namely installation of dish antenna/satellite, parking space, repair and maintenance which includes repairs, interior or exterior, electrical and plumbing work, repair and maintenance of common and open areas and facilities provided at the building like compounds, gardens, passage, elevators, lifts, terrace, DG sets etc and also 100% power backup and centralised air conditioning.

18. **In our considered opinion, for similar set of amenities/facilities, the Hon'ble Supreme Court in the case of Sultan Brothers [supra] has laid down certain tests which have been followed by the Hon'ble High Court of Delhi in the case of Garg Dyeing & Processing Industries [supra] and later on in the case of Jay Metals [supra]. We are of the considered view that in light of the facts discussed hereinabove, there can be no doubt that lease deed was composite one and rental receipt thereunder answered the description u/s 56(2)(iii) of the Income tax Act, 1961.**



19. We find that the main thrust in rejecting the claim of the assessee by the Assessing Officer is that it is a related party transaction. The undisputed fact is that the assessment was subject to transfer pricing assessment for determination of ALP with AE and no such determination has been done by the TPO. We further find that though the Assessing Officer has discarded the claim of the assessee stating that it is a related party transaction, but the provisions of section 40A(2) of the Act have never been invoked.

20. In fact, the Assessing Officer himself has extracted the relevant clauses of lease deed himself showing that the lessor has agreed to provide services which have been enumerated hereinabove elsewhere. Therefore, considering the facts of the case in hand, we find that letting is not merely of the building but a composite let out of both the building as well as equipment/furniture etc and thereby section 56(2)(iii) of the Act is attracted.

21. Respectfully following the ratio laid down by the Hon'ble Supreme Court in the case of Sultan Brothers [supra] and the Hon'ble High Court of Delhi in the case of Jay Metals [supra], we direct the Assessing Officer to treat the income from letting out of the building as income under the head "Income from other sources".

22. The other ground which relates to the claim of expenses and depreciation u/s 57 of the Act has already been answered by the Hon'ble High Court of Delhi in the case of Jay Metals [supra] as under:

"26. However, the last plea made by the Assessee is that in that event the entire income from the letting is treated as 'income from source sources', it cannot be deprived of the corresponding deduction in terms of Section 57 (iii) of the Act. The Revenue too has not disputed the fact that the Assessee has not claimed depreciation.

27. Accordingly, it is directed that while giving the appeal effect, the AO will grant the Assessee the benefit of Section 57 (iii) of the Act."

[Emphasis supplied]

17. Furthermore, for AYs 2014-15 and 2015-16, *vide* common order dated 24 September 2021, the ITAT followed its earlier order dated 14 June 2021 and ruled in favour of the assessee.

18. In order to ascertain the character of the lease agreement, this



Court has also perused the lease dated 10 February 2010 signed between the assessee and Microsoft Global Services Centre (India) Private Limited. The recitals of the said lease agreement are reproduced herein for reference:-

“WHEREAS

i .The LESSOR is in lawful possession and has a clear, absolute, unrestricted title and registered ownership rights with respect to plot of land comprising of Parcel A in Manikonda Village having a plot area of approximately 18.05 acres ("PLOT").

ii. The LESSOR has constructed a multi storied Office Building No.2 on the PLOT having 4 floor levels and covered area of the building being 3,93,600 sq. ft. and entrance, passages, staircases, landings, lobbies, lifts and other common & open belonging thereto (hereinafter referred to as the "BUILDING") and also provided other infrastructural facilities like centralised air conditioning, networking, 100% D. G. Set Power back up, UPS, EPaBX in the said building as inbuilt provisions more in the nature of warm shelland core.

iii. The LESSOR is the owner and is fully entitled to give on lease a part/portion of the 3rd floor of the BUILDING having a covered area of approximately 59861 sq. ft. alongwith the exclusive right to use and occupy the open areas thereto marked in the plan attached as Annexure A together with the exclusive right to park vehicles in the BUILDING and right to use common areas, facilities of the BUILDING including the sharing of the inbuilt infrastructural facilities as detailed in Annexure B (hereinafter referred to as the "LEASED PREMISES").

iv. The LESSEE is desirous of taking the LEASED PREMISES on lease and agreed to share the inbuilt infrastructural facilities as set forth in Annexure B and the LESSOR has agreed to give the LEASED PREMISES on lease for rent and also permit to share inbuilt infrastructural facilities as set forth in Annexure B and the LESSOR has agreed to give the LEASED PREMISES on lease for rent and also permit to share the inbuilt infrastructural facilities and also the other assets on the terms and conditions hereinafter contained.



2 RENT

2.1 The LESSEE shall pay to the LESSOR monthly rent of Rs.29,93,050 (Rupees Twenty Nine Lakhs Ninety-Three Thousand Fifty only) calculated at the rate of Rs. 50/- per square feet for the super built up area of 59, 861 square feet of the LEASED PREMISES, (hereinafter referred to as "Rent"). The Rent shall be payable monthly in arrears subject to deduction of applicable taxes at source as is required by law, starting April 2010. The Rent payable in arrears shall be payable by cheque/DD/Pay Order by the Tenth (10th) of each month of the Lease Term, No Rent shall be paid for unused period in any month.

2.2 It is further agreed between the parties that apart from the Rent, no additional charges shall be payable by the LESSEE for the entry, use and occupation of the LEASED PREMISES or for any reason whatsoever including sharing of inbuilt infrastructural facilities as set forth in Annexure B. The Rent shall be inclusive of all cost, expenses, charges, taxes and the like incurred and, or, paid or payable by the LESSOR for performing its obligations under this LEASE DEED and specifically for provision of services as detailed in clauses 3.3, 3.5, 3.6, 3.7 and 7.14 below.

2.3 For the purpose of clarity between the parties, there is no security deposit paid under this Agreement.”

[Emphasis supplied]

19. It is evident from the aforementioned clauses of the lease agreement that the underlying intention of the parties is to let out the premises alongwith the fixtures attached to it. As a natural corollary, the rent towards the leased premises includes the cost of the fixtures attached to the building. Therefore, applying the test propounded by the Hon'ble Supreme Court in the case of *Sultan Brothers (supra)*, it is amply clear that the lease agreement in question is composite in character and the premises are let out alongwith the fixtures attached to it and is inseparable in nature.

20. Once it is ascertained that the lease agreement in question is composite in nature, the income derived from such lease shall be calculated under the head of 'income from other sources' and not



under the head of the ‘income from house property’

21. We have noted that the ITAT in the impugned orders noted the dictum laid down by the Hon’ble Supreme Court in the case of *Sultan Brothers (supra)* and this Court in *Jay Metals (supra)*. The ITAT further analysed the recitals of the lease agreement and ascertained the composite character of the lease agreement before reaching the conclusion that the rent received towards letting out the said premises shall be calculated under the head of ‘income from other sources’ and not under the ambit of ‘income from house property’.

22. Therefore, taking into consideration the aforementioned discussion and judicial precedents analysed above, the instant appeals raise no substantial questions of law which would merit our consideration. Therefore, we do not find any reason to interfere with the judgment rendered by the ITAT.

23. In view of the aforesaid, the instant appeals stand dismissed and are disposed of alongwith pending application(s), if any.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

MARCH 19, 2024/p