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License fee for operating a hotel cannot be taxable under the category of renting of immovable property service – SC

22 September 2022

Summary

The Supreme Court (SC) has affirmed the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) Chennai Bench's view that the license fees received by the appellant for running the hotel is not covered under the scope of renting of immovable property services. Earlier, the CESTAT had observed that renting of immovable property service, as defined under the service tax law, includes renting, letting, leasing, licensing or similar arrangements of immovable property. In the present case, however, the agreement was not merely for renting of the hotel or land appurtenant thereto, etc., but was license to run, conduct and operate the hotel together with all the related facilities and business appertaining thereto. The employees and other staff, goodwill and other paraphernalia are also taken into consideration by the two parties involved while framing the license agreement. Further, the appellant was not receiving any fixed rent as is in case of normal renting transaction instead they received license fee based on certain percentage of the turnover. Therefore, the CESTAT had held that the demand of service tax on such license fees under the category of renting of immovable property services along with interest is not tenable in law and hence liable to be set aside.

Facts of the case

- The appellant[1] was engaged in the business of running hotels. The appellant was transferred one hotel by way of demerger.
- The appellant started receiving license fees in respect of such hotel which were based on a certain percentage of the income from the operations of the hotel.
- A Show Cause Notice (SCN) was issued to the appellant alleging to pay service tax under the category of renting of immovable property service on the licence fees received along with interest and penalty[2].
- The aggrieved appellant filed an appeal before the CESTAT.

Chennai CESTAT observations and ruling[3]

- **Scope of renting of immovable property:** The renting of immovable property, as defined under the service tax law[4], includes renting, letting, leasing, licensing or similar arrangements of immovable property. To fall under the said definition the immovable property rented out should be the genre exemplified in the definition.
- **Agreement to run the hotel business:** In the instant case, the agreement was not merely for renting of hotel but was for license to run, conduct and operate the transferred hotel together with all the related facilities and business appertaining thereto. In addition to the immovable property portion of the hotel, the employees and other staff, goodwill and other paraphernalia have also

[1] Grand Royale Enterprises Ltd
[2] U/s 76,77 and 78 of the Finance Act, 1994
[3] Order No. - 42539/2018 dated 01 October 2018
[4] Section 65 (90a) of the Finance Act, 1994

taken into consideration by the two parties involved while framing the license agreement.

- **License fees based on turnover of the hotel:** The amount of rent is not fixed like all other rented agreements instead the appellant has received license fees equivalent to some percentage of the annual sales from operation of the hotel. The license fees accruing to the appellants therefore have an umbilical card relation with the turnover and profits of the hotel business.
- **Not regular renting of immovable property transaction:** The transaction is not one of renting of immovable property but a business transaction between the two, where the consideration is not like a regular rent but is dependent on the annual performance and profits of the hotel.
- **Proceedings hit by limitation:** Since the verifications were initiated in 2005 and although all clarifications were submitted, the Revenue did not issue the SCN till 2014. Therefore, the proceedings were clearly hit by limitation.
- **Appeal allowed:** The CESTAT stated renting of a building for a hotel, i.e., buildings used for purpose of accommodation including hotels is covered by exclusion clause and does not fall within ambit of taxable service namely 'renting of immovable property'. Therefore, the demand of service tax on license fees under the category of renting of immovable property is not tenable in law.

SC observations and ruling[5]

- **Upheld the CESTAT order:** The SC upheld the CESTAT's order and stated that based on the reasoning given by the CESTAT no interference is required and dismissed the appeal.

Our comments

Similar ruling was pronounced by the Delhi Bench of the CESTAT[6], wherein it had held that the renting of a building for a hotel, i.e., buildings used for purpose of accommodation, including hotels, is covered by the exclusion clause and does not fall within the ambit of taxable service namely 'renting of immovable property service'.

This is a welcome judgment and an analogy can also be drawn under the GST regime in similar matters. However, the nature of the transaction determines the taxability, therefore, it is imperative to evaluate the agreements and transaction on a case-to-case basis.

[5] Civil Appeal No. 7326/2019 dated 01 August 2022

[6] M/s Jai Mahal Hotels Pvt Ltd

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