RENTAL INCOME

House Property or Business Income?

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Section 4 & Section 14

Charge of Income Tax under various Heads

- Section 4 of the IT Act deals with charge of income tax on total income earned by the assessee in the previous year.
- The tax on the total income of the previous year has to be classified under the heads of income as provided in Section 14 of Act and accordingly the liability has to be computed.
- At times, an income can be classified under multiple heads of income.
- Each head of income is different from other head and has different entitlements, restrictions and prohibitions in the total scheme of the Act.
- Hence, classifying an income under the appropriate head is important because of different tax consequences under each head.

Income from House Property

Types of income and taxability

Suresh Anchaliya & Co.

Income from house Property

Section 22 of Income Tax Act

- As per section 22, the chargeability under Income from House property states that annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".
- On a reading of section 22 of the Income Tax Act, it is understood that to be taxed under IFHP-
  - Assessee must be the owner of the property
  - Property should consist of any building or land appurtenant thereto.
  - Use of property i.e. it should be used for any purpose other than business purpose.

Income from House Property (IHFP)

Types

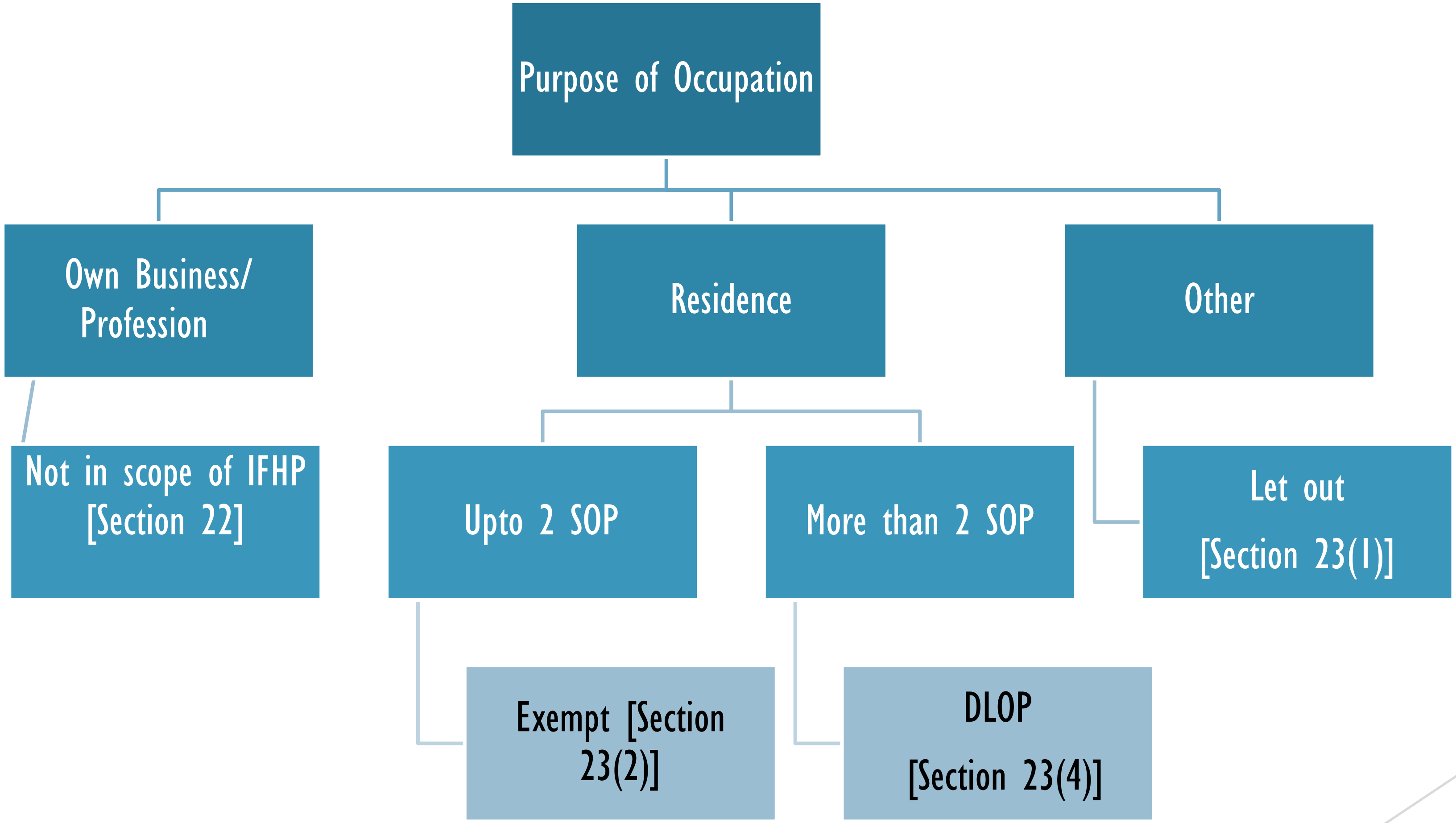
- Let out property (LOP) –
  - LOP means the house property that is being leased out by the assessee to earn any income on it.
- Self-occupied property (SOP) –
  - SOP means the house property that the assessee is using for residence i.e. he lives in
- Deemed Let Out Property (DLOP) –
  - DLOP in case of IHFP means any property in excess of 2 Self-occupied properties, that have not been let out.

Income from House Property

Taxability

- Let out property (LOP) u/s 23(1) is always taxable
- Self-occupied property u/s 23(2) –
  - If upto 2 SOP are exempt under IFHP
  - Any more property than 2 shall be deemed to be let out property.
- Self-occupied property that is used for the purpose of business or profession are outside the preview of IHFP as per section 22.

IFHP – Taxability Summary



Income from House Property

Owner and Deemed owner

Owner –

- As per CIT v. Podar Cement (P.) Ltd. [1997] 92 Taxman 541/226 ITR 625 (SC)-

  In context of section 22, 'owner' is a person who is entitled to receive income from property in his own right

Deemed Owner –

- As per section 27(iiib) r.w.s. 269UA(f),

  a person who acquires any rights by means of transfer of such property by way of sale or exchange or lease for a term of not less than 12 years and includes allowing the possession of such property to be taken or retained in part performance of a contract of the nature shall be 'deemed owner of the property'.

Rental income

Types and taxability

Rental Income

Taxability under Income Tax Act

- Rental Income generally taxed under 2 heads of Income i.e. Income from House Property and Income from Other Sources.
  - IFHP
    - Let out
    - Deemed Let out
- Rental income was taxed under the head- Income from House property by default as long as the ownership criteria was fulfilled by assessee.

- If the ownership criteria was not met, then the income was taxed under the head- Income from Other Sources. (Example: Sub-letting, Composite rent as discussed later).
- Section 56(1) of Income Tax Act states that income of every kind which is not to be excluded from the total income shall be chargeable to tax under IFOS, if it is not chargeable to income tax under any of the heads as mentioned in Section 14.

Rental Income

Income from House Property vs. Profit and Gains from Business or Profession (PGBP)

Let's take an example –

- Let us say, ABC Limited has constructed a mall for the purpose of letting out it's units to various business/commercial outlet. PQR Limited engaged in operating restaurant, banquet, and other related services. PQR Limited is interested in taking on lease one of the unit in mall and has approached ABC Limited for the leasing of the said unit.
- The question would be, whether the rental income earned by ABC Limited should be offered to tax under IFHP or PGBP or IFOS?
- Before analyzing the same, it is not out of place to mention that classification of income under each of the above head have different tax consequences.

IFHP vs. PGBP vs. IFOS

Tax Consequences- Deductions available

Treated in which head of income as per Section 14	Treatment in particular head of income
Income from House Property	ABC Ltd can claim deduction upto 30% of the net annual value as under standard deduction u/s 24(a). As well as deduction on interest on borrowed capital can be claimed. (restricted upto Rs. 2,00,000 u/s 24(b) in case of SOP)
Profit and Gain from Business or Profession	Assessee can claim deduction for all the expenses in relation to the business i.e. there is no quantum on the limit of deduction that can be claimed.
Income from Other Sources	Expenditure made wholly and exclusively for the purpose of earning income u/s 57(iii)

IFHP vs. PGBP

Tax Consequences - Set off and carry forward of losses

- Apart from the above, there is also carry-forward of losses (the quantum and years for which they are allowed to carry forward), which are dependent again upon the classification of income and differ from one head to another.

IFHP vs PGBP vs IFOS

Set off and carry forward of losses

Sections	Losses to be Carried Forward	Intra head adjustment	Inter head adjustment	Carried forward time limit
71B	Loss from HP	Allowed	Can be set off against any head upto Rs. 2,00,000.	8 years
72	Business Income	Allowed	Can be set off Except – i) Speculative income ii) Specified income iii) Salary	8 Years
74A	IFOS	Allowed	Allowed	Carry forward provisions are not applicable

Which would the Assessee prefer?

- PGBP
  - Deduction of repair, maintenance, depreciation on the property and specific and general business deduction u/s 36 and u/s 37.
- IFHP
  - IFHP provides a standard deduction of 30% of the income along with deduction of interest paid on borrowed capital for of acquisition, construction, repair, reconstruction, (subject to limitations provided under the Act). (Refer Gundecha Developers (Bom HC) discussed later)
- IFOS
  - Here, assessee gets deduction in relation to expenses solely incurred for the purpse of earning such income (section 57(iii))

As per Department’s point of view

- As the income tax department doesn’t want to suffer revenue loss, authorities want to tax rental income under the head Income from House property as the deduction is restricted to 30%, whereas under PGBP all the deductions based on the actual basis can be taken leading to less income to be taxed.

Paradigm Shift

Supreme Court decision in case of Chennai Properties

Chennai Properties & Investments Ltd v. CIT.- [2015] 373 ITR 673 (SC) – Business Income/ PGBP

- Facts of the case:
  - Assessee is a private limited company incorporated under Indian Companies Act.
  - Main Object as per MOA – to acquire properties in the city of Madras (now Chennai) and to let out those properties
  - The entire income of assessee disclosed in Return of Income constituted of such Rental Income.
  - The AO was of the view that rental income should be taxed under IFHP.
  - The CIT(A) as well as ITAT accepted assessee's claim holding that rental income was to be taxed as business income.
  - The Madras High Court, however, restored the order of AO.
  - Against Madras HC's order, assessee filed an appeal before SC

- Controversy before the SC –
  - Whether rental income from letting out of properties, which constitutes business of assessee, is to be charged to tax under the head of ‘Income from House Property’ or ‘Profit and Gains from Business or Profession’?

- Considerations of other SC decisions:
  - The Supreme Court referred to judgment in case of **East India Housing & Land Development Ltd (SC)**, which was relied upon by HC. The SC observed that in East India's case, the question was whether rent income from letting out shops and stalls, was to be treated as income from house property or income from business. In holding that such income was to be treated as income from house property, SC rested its decision on the context of the main objective, which was to develop the landed properties into market.
  - The next reference made by SC was the judgment in the case of **Karanpura Development Co. Ltd. v. CIT [1962] 44 ITR 362 (SC)**, here the assessee was engaged in the business of acquiring and disposing of the underground coal mining rights, while restricting its activities to developing them as coal mines and then sub-leasing them to collieries and other companies. The question raised as to whether the income which was received from letting out of those mining leases is to be shown as business income or income from house property?

- The Court pointed out that the deciding factor is not the ownership of land or leases but the nature of the activity of the assessee and the nature of the operations in relation to them.
- It was highlighted and stressed that the objects of the company must also be kept in view to interpret the activities in support of the aforesaid proposition, number of judgments of other jurisdictions, i.e. Privy Counsel, House of Lords in England and US Courts were taken note of. The position in law, ultimately, is summed up in the following words: —

"As has been already pointed out in connection with the other two cases where there is a letting out of premises and collection of rents the assessment on property basis may be correct but not so, where the letting or sub-letting is part of a trading operation. The diving line is difficult to find; but in the case of a company with its professed objects and the manner of its activities and the nature of its dealings with its property, it is possible to say on which side the operations fall and to what head the income is to be assigned."

- The SC also mention **Sultan Brothers (P.) Ltd.'s case**, where Court has clarified that merely an entry in the object clause showing a particular object would not be the determinative factor to arrive at an conclusion whether the income is to be treated as income from business. This is so stated in the following words:

  "We think each case has to be looked at from a businessman's point of view to find out whether the letting was the doing of a business or the exploitation of his property by an owner. We do not further think that a thing can by its very nature be a commercial asset. A commercial asset is only an asset used in a business and nothing else, and business may be carried on with practically all things. Therefore, it is not possible to say that a particular activity is business because it is concerned with an asset with which trade is commonly carried on. We find nothing in the cases referred, to support the proposition that certain assets are commercial assets in their very nature."

- Interesting Aspects of Supreme Court Judgement –

- In the beginning of the ratio decidendi of the judgment, in para 5-6, the seminal features of the case were emphasized such has
  - ✓ main object of the assessee company (acquiring properties to earn rental income by letting out)
  - ✓ Entire income of assessee company consisted of rental income
- In view of these facts and circumstances, the SC, in para 11, had held that letting of properties was the business of the assessee

❑ Held:

Taking all the facts and circumstances the Apex court stated that the circumstances of this case it had arrived at an irresistible conclusion that letting of property in this case, is in fact income from business of the assessee, thus cannot be treated as Income from house property. The Court kept aside the judgment of Madras HC and restored that of the ITAT.

Implications

- According to the tax authorities the deciding factor is not the ownership of the land or leases, but the nature of the activity of the taxpayer and the nature of the operations in relation to the same.
- Further, the Apex court has emphasized that for income to be characterized as business income, the activities actually carried out by the taxpayer need to be in line with its main object, according to its constitution documents.
- Section 28(i) states that the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year shall be classifiable under PGBP.

Rayala Corporation Pvt. Ltd v. ACIT. [2016] 386 ITR 500 (SC)- Business Income/ PGBP

- Assessee was in the business of renting its properties and was receiving rent as its business income. The assessee claimed that the said income should be taxed under the head 'Profits and gains of business or profession' and not under the head 'Income from house property'.
- In the appeal to HC, the revenue argued that leasing and letting out of shops and properties was not the main business of the assessee-company as per Memorandum of Association and, therefore, the income earned by the assessee-company should be treated as income earned from house property.

- The SC holds that rental income arising to assessee from leasing property is taxable as ‘business income’ and not ‘house property’ income, as that assessee has only one business of leasing its property as all other business activities were stopped. Even though it was not included in the MOA of the company, the intention of the company was to earn business income by renting its properties. Thus, its business income and should be taxed under head PGBP and not under the head IFHP.

Raj Dadarkar & Associates v. Assistant CIT [2017] 394 ITR 592(SC)- Income from House property

- Assessee acquired leasehold rights in a property from MCGB, for which the assessee had to make the entire property fit to be used in market, including construction of walls, common amenities and run and maintain the premises.
- Assessee constructed various shops and stalls on said property and gave same to various persons on sub-licensing basis. It considered this subletting income as business income
- The AO took the view that since assessee had acquired leasehold right in land for more than 12 years, it was to be regarded as 'deemed owner' of premises by virtue of section 27(iiib), hence taxing it under IFHP.
- The assessee's contention was as the object clause of the firm as per the partnership deed, which reads as under: "The Partnership shall take the premises on rent and to sub-let or any other business as may be mutually agreed by the parties from time to time.", thus as per Chennai Properties case it shall be taxable under business income.

- However, the Court also stated that as in the case of Sultan Bros. (P) Ltd. v. CIT, the Constitution Bench of this case stated that each business has to be looked at from the businessman's point of view to find out whether the letting was the doing of a business or the exploitation of his property by an owner.
- The Tribunal also held that assessee had not established that it was engaged in any systematic or organized activity of providing service to the occupiers of the shops/stalls so as to constitute the receipts from them as business income. The assessee received income by letting out shops/stalls, and therefore, the same had to beheld as income from house property.
- Merely that the activity of renting of property was mentioned in the partnership deed cannot be the sole factor to determine the nature of income.
- This was upheld by HC as well as SC.

Based on the above case laws we can make a following comparison-

Nature of activity undertaken by the assessee	Case Law applicable
When the object and intention of the assessee consist of letting out of properties as per MOA	Chennai Properties and Investment
When the object of the assessee is not letting out of properties as per MOA	Not to be considered as PGBP but before that intention needs to be considered
When the object of the assessee is not letting out of properties but the intention of the assessee is to let out property and earn income	Rayala Corporation Pvt. Ltd
When the object of the assessee is neither letting out of properties nor there are any intention of the assessee is to let out property and earn income	It should be taxed under the head Income from house property.

SC decisions	Objective as well as intention of assessee (PGBP)	No object but intention of assessee (PGBP)	Object is present but intention isn't there (IFHP)
Chennai Properties & Investment	✓		
Rayala Corporation Pvt. Ltd		✓	
Raj Dadarkar & Associates			✓

Other judgments on IFHP vs. PGBP

Supreme Court and High Court decisions in relation to Rental Income

National Storage (P.) Ltd [1967] 66 ITR 596 (SC) – Business Income/PGBP

- In this case, the assessee let out the vaults for storing cinema films. The assessee entered into agreements with the film distributors. The agreements are licenses and not leases.
- The assessee purchased a plot of land and had constructed 13 units. Each unit was divided into four vaults.
- The key to each vault was retained by the vault holder but the Key to the entrance was kept in the exclusive possession of the assessee. The building was constructed as per the requirement for storing the films.
- As per HC, it was the business of the assessee to enter into licensing with the film distributor, thus the income should be taxable under PGBP and not under IFHP.
- The SC dismissed the revenues appeal.

Keyaram Hotels P Ltd [2015] 235 Taxman 512 (SC)- Income from House property

- The assessee company earned rental income from letting out a commercial complex and declared such income as business income.
- The Assessing Officer computed the income under the head 'Income from house property' stating that the assessee had not engaged in any business activity but had given its premises on rent.
- The HC held that since the transaction was only by way of exploitation of the property by the assessee and not by way of exploitation of business assets, it should be taxed under 'IFHP' and not income from business.
- The SLP was dismissed by SC.

Shambhu Investments Pvt Ltd v. CIT- [2003] 263 ITR 143 (SC)- Income from House property

- The assessee, owner of certain furnished premises, let out the same to various persons or firms or organizations. The assessee also provided services like watch and ward staff, electricity, water and other common amenities.
- The assessee taxed this income under business income and the same was same was assessed accordingly by the AO.
- Subsequently, the Commissioner, invoking section 263, passed the assessment order and after giving hearing to the assessee, held that the same was erroneous and prejudicial to the interests of the revenue and, therefore, remanded the matter to the Assessing Officer with a direction to assess the said income as property income.

- Prime object of assessee was to let out portion of property to various occupants, additionally providing various services, for which rent was paid.
- HC held that it is wrong to say that assessee was exploiting property for its commercial business activities and such business activities were primary motto and letting out property was secondary one and from agreement between two parties.
- It was clear that primary object was to let out portion of said property with additional right of using furniture and fixtures and other common facilities for which rent was being charged from month to month and, therefore, income derived from said property was income from property which should be assessed as such.

CIT 12 v. Sane & Doshi Enterprises- /[2017] 245 Taxman 128 (SC)- Income from House property

- The respondent being a partnership firm engaged in the business of engaged in the real estate business and constructed a commercial complex.
- The assessee claimed rental income as income from house property and claimed deduction under section 24.
- The AO pointed out the assessee was engaged in the business of construction of building and thus rental income should be taxed as business income.
- It was held by Commissioner that the assessee is engaged in the business of construction and real estate development and it earned income in the form of rent from the tenants/lessees to whom the property was let out, then, whether the property is held as stock-in-trade or otherwise is not what is material. The real and main issue is whether this income is earned in the capacity as a trader or in the capacity of the owner of the premises. If the property belongs to the assessee and part of it which was unsold has been let out, then, the income generated therefrom has been treated as income from house property.
- It was confirmed by the HC as well as SC.

CIT v. Gundecha Builders [2019] 102 taxmann.com 27 (Bom.)- Income from House property

- The respondent-assessee was engaged in the business of developing real estate projects and not in the business of letting out of properties.
- The assessee claimed the rental income under the head income from the house property taking a standard deduction of 30% on rental income.
- The AO rejected the assessees claim and held that the rental income should be taxed under business income,(as per Chennai Properties and Investment case law), subsequently disallowing 30% deduction claimed by the assessee under IFHP on account of repairs and maintenance.
- The Commissioner (Appeals) held that rental income received by the assessee has to be classified as IFHP. Thus, the deduction of 30% of repairs and maintenance should be allowed.
- The HC dismissed the appeal of revenue and decided that the assessee had correctly shown its income from letting out of property under IFHP as the same did not pertain to its regular business.

Meeraj Estate & Developers v. CIT [2020] 113 taxmann.com 231 (Allahabad)

- Assessee had acquired leasehold rights over a commercial property. Assessee entered into three separate agreements with GAIL. In terms of first and second agreements, assessee agreed to let out certain area in said property to GAIL with various amenities and third agreement required assessee to maintain leased out area to satisfaction of GAIL. Assessee filed its return declaring income from said agreements under head 'business income'.
- AO held that income from first and second agreements was taxable under head 'income from house property' whereas income arising from third agreement was to be taxed as 'income from other sources'.
- It was held that since assessee did not indulge in any kind of recurring, systematic and organized business activity nor there was any volume frequency, continuity and regularity of transactions and, moreover, in respect of upkeeping and maintenance of let out premises, assessee appointed only one person to look after leased out premises meaning thereby that no business activity was carried out by assessee.

- It was held that since assessee did not indulge in any kind of recurring, systematic and organized business activity nor there was any volume frequency, continuity and regularity of transactions and, moreover, in respect of upkeeping and maintenance of let out premises, assessee appointed only one person to look after leased out premises meaning thereby that no business activity was carried out by assessee.

Classification of Rental Income

Basis of classification under different heads

Classification of Rental income

- Under current prevailing provisions, rental income may be classified in either of the heads:
  - Income From House Property
  - Profits or Gains from Business or Profession
  - Income from other Sources

Basis of classification –

- Some of the salient ones are as follows:
  - Active ownership of property – if a property yields rental income by virtue of its ownership it may be classified as HP.
  - Intent of the taxpayer – this intention can be gathered from the agreement for lease, Memorandum of Association and subsequent conduct of the parties.
  - Constitution documents of the taxpayer [provide that the main object is to hold the properties (presumably not for gains) and let them out to earn rental income] – the activities carried out by the taxpayer should be in line with the constitution documents.

Basis of classification –

- Some of the salient ones are as follows:
  - Regular income or occasional income – when earning rental income by way of letting out properties doesn't not constitute main business or is earned on occasional circumstances, then such income is taxed under IFHP. On the other hand, if facts and circumstances of the case indicate that letting out of properties is the main business of assessee, such income is taxed under PGBP.
  - Exploitation of property for commercial purposes.

Composite Rent

Composite Rent

- At times when a property is being let out it, it can so happen that it is let out alongside with some other assets (furniture or a refrigerator) or some services (lift, watchman, water supply, etc.)
- In a case where letting out of building and letting out of other assets are inseparable, entire rent (i.e. composite rent) will be charged to tax under the head "Profits and gains of business and profession" or "Income from other sources", as the case may be. Nothing is charged to tax under the head "Income from house property".
- In a case where, letting out of building and letting out of other assets are separable, rent of building will be charged to tax under the head "Income from house property" and rent of other assets will be charged to tax under the head "Profits and gains of business and profession" or "Income from other sources", as the case may be.

- In such a case, composite rent includes rent of the building and charges for different services - In this situation, the composite rent is to be bifurcated and the sum attributable to the use of the property will be charged to tax under the head "Income from house property" and charges for various services will be charged to tax under the head "Profits and gains of business and profession" or "Income from other sources" (as the case may be).

Sultan Brothers (P.) Ltd v. CIT [1964] 51 ITR 353 (SC)

- The assessee-company was the owner of certain building. By lease the assessee let out the building fully equipped and furnished to one 'V' for running a hotel and for certain other ancillary purposes.
- The assessee claimed that the entire income should be assessed as business income.
- However, the AO considered of the hire received from the furniture and fixtures in income from other sources.
- HC held that the income from the building would be computed IFHP whereas income from furniture and fixtures under section IFOS and that no part of the income was taxable under PGBP.

- Assessee had two separate leases for rent for the building and the hire for the furniture.
- SC stated that intention of assessee has to be considered i.e. every business is to be viewed from businessman’s point of view. Even if assessee had separate leases we have to check the true intention.
- Hence, in this case SC held that income from rent for the building taxable under IFHP and the hire for furniture was taxable under IFOS, and no income was taxed under PGBP.

Propositions laid down by SC in Sultan Brothers:

- 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 and 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, it has to be held that it was intended that the lettings would be inseparable.

Composite Rent

Section 56(2)(iii) of Income Tax Act 1961:

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely :—

iii) where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income-tax under the head "Profits and gains of business or profession";

Composite Rent

Section 56(2)(iii) of Income Tax Act 1961:

- In order that clause (iii) may apply:
  - Letting of machinery, plant or furniture should be inseparable
  - From letting of building
- The word inseparable does not connote that it should by its very nature be inseparable so that the building has also necessarily to be let along with it, or that it should be fixed to the building.
- The inseparability arises from the intention of the parties.
- The parties should intend that the subject-matter of the lease should be enjoyed together, and the letting out of the building and the other assets should be practically one letting.

Composite Rent

Deduction available

Where the letting does not amount to a business, the income is assessable under IFOS, and in such a case, section 57 permits:

- In addition to the general allowance granted by s. 57(iii)
- Deductions of current repairs, insurance premium and depreciation of the leased asset as per provision of "PGBP" (CIT vs. Jagannatha 45 ITR 61)
- This deduction is over and above the general deduction available u/s 57(iii)
- As per the decision in the case of New Savan Sugar & Gur Refining Co. Ltd v. CIT (74 ITR 7) (SC) additional depreciation and development rebate is not allowed as deduction under section 57.

Composite Rent

Summary

- Composite Rent
  - Letting out is separable
    - Rent of HP — Taxable under IFHP
    - Rent of other assets — Rent is taxable under IFOS or PGBP
  - Letting out is inseparable
    - Total rent is taxable under IFOS or PGBP

Composite Rent
Judicial Precedence

- As per the judgment in case of Sultan Bros. (P.) Ltd. v. CIT [1964] 51 ITR 353 (SC) the inseparability referred to in section 56(2)(iii) 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 it is one lease or two - 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 and 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 it has to be held that it was intended that the letting would be inseparable.

Composite Rent

Judicial Precedence

- In the case of CIT v. Kanak Investments (P.) Ltd. [1974] 95 ITR 419 the Calcutta HC has held that where the assessee received composite rent from its tenant towards building as well as services/amenities, such rent should be split up and the portion of rent attributable to the building should be assessed as 'income from house property' and the other portion attributable to services/amenities should be assessed as 'income from other sources'.
- In the cases of CIT v. Kuya & Khas Kuya Colliery Co. [1985] 156 ITR 206 and CIT v. Bishwanath Roy [1985] 156 ITR 217 the Patna HC has held that the letting out of business as a whole is distinct from letting out commercial assets of the business. If business is as a whole let out, the rental income is assessable as income from other sources and not as income from business.

Composite Rent
Judicial Precedence

- Leasing of shops in a mall along with various other facilities held as assessable as business income and not as income from house property held in PCIT v. Krome Planet Interiors (P.) Ltd. (2019) 265 Taxman 308 (Bom.) (HC).
- Leasing the hotel and charging one percentage of total revenue held as assessable as business income and not as income from house property, held in CIT v. Plaza Hotels (P.) Ltd. (2019) 107 taxmann.com 287/265 Taxman 90 (Bom.)(HC).
- It is the nature of arrangement and the reasons therefore that are relevant for the purpose of determining whether one has let out the property for business purposes or merely for enjoying the rent. This is the type of test which is common to all cases, held in CIT v. Super Fine Cables (P.) Ltd. [1985], Dharak Ltd. v. CIT [1987] and 163 ITR 734 (Kar.)

Composite Rent
Judicial Precedence

PCIT v. City Centre Mall Nashik Pvt. Ltd (Bom)(HC)- [2020] 424 ITR 85 [Bom HC]

- Assessee-company was engaged in construction and running of commercial complex and shopping malls - Assessee let out various shops in a commercial complex/mall - Apart from letting out premises, assessee provided various other services to occupants of said premises such as security services, housekeeping, maintenance, lightening, air condition repairing, marketing and promotional activities, advertisement and such other activities – Assessee declared its income received from letting out of these shops under head income from business.
- However, AO treated same as income from house property.

- Question raised before the HC is "Whether, on the facts and in the circumstance of the case and in law, the Hon'ble Tribunal was justified in holding that the assessee had exploited its property commercially by way of complex commercial activities and hence, the rental income received by the assessee to be taxable as income from business and not under the head 'Income from House Property'?"
- The Hon'ble Court considered the object clause of the company and various services provided such as marketing and promotional activities and also organizing various events and programs.
- The Intention of the Assessee is also a material circumstance and the objects of Association, the kind of services rendered clearly point out that the Income is from Business. All the factors cumulatively taken demonstrate that the assessee had intended to enter into a Business of renting out commercial space to interested parties.

New Controversy

Taxation of income from ‘Notional’ Rent

CIT v. Ansal Housing Finance & Leasing Co. Ltd [2013] 354 ITR 180 (Delhi)

- The assessee was engaged in the business of development of mini-townships, construction of house property, commercial and shop complexes etc.
- The AO assessed the ALV of flats which the assessee had constructed, but were lying unsold, under the head 'income from house property'.
- The assessee contended that the said flats were its stock-in-trade and, therefore, the ALV of flats constructed could not be brought to tax under the head ‘income from house property’.
- The AO didn’t accept the stand of assessee and therefore, added the notional value of unsold flats to the total income of the assessee.

- The revenue argued that whether the income was earned from vacant flats, the assessee had to, in its capacity as owner, pay tax on the ALV. Counsel emphasized the fact that tax incidence did not depend on whether the assessee actually rented out with the intention of carrying on business, but on the mere factum of ownership. Hence it should be taxable under IFHP and not PGBP.
- Here, the Court has to discern the intention of the assessee; in this case the intention of the assessee was to hold the properties till they were sold.
- It was held that even if an item of income is earned in the course of carrying on a business, it will not necessarily fall within the head "profits and gains of business". For example if securities are held as stock-in-trade, interest income from those securities will be taxable under head IFOS. Thus, even if the property is held as stock-in-trade, the income from unsold stock will be taxed under IFHP taking notional annual letting value into consideration.

Amendment by FA 2017

Notional Rent

- Section 23(5) inserted by Finance Act, 2017 w.e.f. 01.04.2018

  "Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of the such property or part of the property, for the period up to two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be nil."

Amendment by FA 2017

Notional Rent

- Before the amendment, the stock-in-trade when left unsold there was a debate as to whether notional rent is to be taken or not. As done in Ansal Housing Finance & Leasing Co. Ltd.
- After amendment, the Act says that property is held as SIT, and the property or part of property is not let for the whole year or part of the year, the annual value of such property or part of property, for the period will be NIL upto 2 years from the end of the financial year in which certificate of completion of construction of property is obtained, thereafter it shall be taxable under the head Income from House Property taking notional rent of the property into consideration.
- Intention of the legislature.

CIT v. Neha Builders (P.) Ltd (2008) 296 ITR 661 (Guj)

- The assessee is engaged in the business of construction of the property. The assessee included one of the properties in closing stock in the balance sheet drawn for the business.
- The assessee filed revised return submitting that a part of its property was given on rent and the income derived on that basis should be computed under the head 'Income from house property' and not as business income.
- The Assessing Officer, observed that the expenses on maintenance of the property were debited to the P&L a/c and so also the building was shown as stock-in-trade, therefore property had the character of stock and any income derived from the stock cannot be taken to be income from the property.

- Income derived from the property would always be termed as 'income' from the property, but if the property is used as 'stock-in-trade', then the said property would become or partake the character of the stock, and any income derived from the stock, would be 'income' from the business, and not income from the property
- As the assessee was treating the property as stock-in-trade it should be included under business income.

Notional Rent
Unsettled controversy

- Department is following Ansal judgment for pre amendment Assessment Years
- Multiple Tribunals have distinguished Ansal (Supra)
- One view: Despite amendment, notional rent still not taxable if stock is treated as business income (as per Neha Builder case)
- Recent Mumbai ITAT judgment

Food for thought

- Treatment in case of individuals?
- Quantum of income criteria?
- Karnani Properties Ltd. vs CIT [1971] 82 ITR 547 (SC)

Questions?

Thank you!

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