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WHETHER RENTAL INCOME TO BE TAXED UNDER THE HEAD OF INCOME FROM "HOUSE PROPERTY" OR "PROFITS AND GAINS OF BUSINESS AND PROFESSION" - JUDICIAL INTERPRETATIONS

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Abstract

This project refers to the debate, whether the income received from renting or leasing will be taxable under "income from house property" or "income from business", which is grappling the courts because of the lack of clarity in tax laws. This article is based on judicial interpretations, and assessing the facts of each case, that in what criteria of income, renting and leasing, would fall. The aim is to bring out the areas of the tax provisions which is dealing with such cases, what are the lacunas in these provisions, and what changes has been introduced, on the basis of few judicial precedents.

Key Words: taxable income, house property, business property.

INTRODUCTION

Rental income to be taxed under which head "income from house property" or "income from business and profession", there are many judicial precedents which has been pronounced on this topic, but still there is unclarity towards its approach. Income received from the immovable property can be classified under business income, income from house property, income from other sources or in any combination of these.¹ There has been so many issues to declare income as business property or house property. This is aroused due to the benefits if one declares its property as business income. One can claim higher amount of tax deductions under the head business than income from house property. Maximum deduction of 30 percent of net annual value and interest on borrowed capital will be allowed as deduction if income received is from house property.² It is irrespective of the total expenditure incurred. If the property is declared

¹Nitin Bhatia, 'Is Your Property Income A Business Income From Tax Perspective' <<https://www.nitinbhatia.in/personal-finance/property-income-business-tax/>> accessed 12 April 2019.

² The Income Tax Act, 1961, Section 24.

under income from business and profession there is no maximum limit and the tax payer can claim deductions on the actual expenditure.³ The concept of composite rent has been introduced in Income Tax Act which includes rent of the building and rent of the other attached assets. Tax treatment in the composite rent can be done in two ways:⁴

- If letting out of building and letting out of assets are inseparable, then the income will be charged under business income.
- If letting out of the building and letting out of assets are separable then the income received from letting out building will be charged under income from house property and the rent received from other assets will be charged under income from business or income from other sources.

There is always a difference in opinion between taxpayer and tax authorities regarding the matter of tax liability of rental income because of the deductions. As there are provisions in income tax to decide that whether income will fall under income from house property or income from business and profession, but the complexity rise in deciding the fact whether renting or leasing is business or not. It can be decided only on the basis of facts of each case. However there has been given many judicial pronouncements due to which certain principles have evolved for characterisation of income. In this project researcher intends to discuss the provisions, judicial pronouncements and its interpretations related to the topic- whether the rental income will be charged under income from house property or income from business and profession.

PROVISIONS

Section 22 to 27 of Income tax Act, 1961 mentions income from house property. Section 22 is the charging section. The income received from the annual value of any property consisting of any buildings or land appurtenant thereto will be considered as income from house property if it fulfils two conditions:

- assessee should be the owner of such property.
- should not be occupied for any business or profession.

If owner is not occupying the building for his own business or profession and let out to the employees will be charged under business head and, if let out to others will be charged under the head house property.

³ The Income Tax Act, 1961, Section 28.

⁴ The Income Tax Act, 1961, Section 22.

Section 28 to 45 of Income tax Act, 1961 mentions income chargeable under income from business and profession and provisions related it. Section 28 is the charging section which mentions that income received by carrying any business and profession by the assessee in previous year. If income is in form of any compensation received or payment due.⁵ If income has occurred by carrying any trade and profession or any similar occupation by any person.⁶ Any income which is accrued by the profits on a sale of license granted⁷, any duty on customs and excise⁸ etc. Income will be computed under income from business and professions if it is received by any compensation or payment due or received by:

- a. running the affairs of an Indian company
- b. termination and modification of any agency, company or partnership firm.
- c. vesting of management for running business or corporation

Income received by performing specific services performed by any professional or business assessee. Income received Expert assessee by profits on sale of import license, cash assistance received from government of India, customs duties or excise repaid, customs duties or excise repaid, profits and transfer of duty entitlements. Income received by any other means like keyman insurance policy, amount received for not carrying any activity in relation to business or profession will be taxed under income from business and profession, and will be given deductions under section 32 to 37 of Income Tax Act, 1961.

These are the provisions which charges income under any one of these heads, income from house property, income from business and profession or income from other sources. But still there is complexity in deciding about the rental income received from the house property. As these provisions gives an overview about the taxability of income, but how rental income is accrued will be decided on the basis of facts of each case, as it might differ from the another. So any strict rule cannot be applied while deciding the matter that whether income aroused from renting will fall under income from house property or income from business head.

⁵ The Income Tax Act, 1961, Section 28(iii).

⁶ The Income Tax Act, 1961, Section 28(iii).

⁷ The Income Tax Act, 1961, Section 28 (iii) (d).

⁸ The Income Tax Act, 1961, Section 28 (iii)(c).

JUDICIAL DECISIONS

1. Sultan Brother's Private Limited vs. CIT, Bombay City II⁹

Facts:

The appellant has a company named, Sultan Brothers and company, located in Mumbai. A building was constructed on Plot No.-7, Church Gate Reclamation Mumbai and was leased along with furniture and fixtures, for running a hotel. The assessee contended that the income should be assessed under section 10, Income from Business Head or section 12 Income from other sources, Income Tax Act, 1922. The Income Tax Officer assessed and mentioned that the income which has been received by the way of rent will fall under section 9 of Income Tax Act, 1922 i.e. Income from house property and the charges occurred by furniture and fixtures will fall under section 12 of Income Tax Act, 1922. Then the matter was taken to Assistant Commissioner of Income Tax as an appeal, where ACIT confirmed the decision of the Income Tax Officer. The Appellant appealed to the Income Tax Appellant Tribunal, ITAT confirmed the order of the ACIT. Tribunal said that it could have allowed the income as income from business, had the letting of the building was incidental to the letting of the furniture & fixtures, which had not happened in the present case and hence the rent could not be assessed under section 10 or section 12. The Tribunal also rejected the assessee's contention that the rental income should have been taxed under section 10, since there was a specific head in regard to income from property i.e. section 9. According to section 12(4) of Income tax Act 1922 "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, he shall be entitled to allowances in accordance with the provisions of clauses (iv), (v), (vi) and (vii) of sub-section (2) of section 10 in respect of such buildings." (insurance, current repairs, depreciation, replacement cost)]"¹⁰

This issue was taken to the High Court, it was held that the income received by the building will be assessed under section 9, income received from furniture and fixtures under section 12 and no part of the income is taxable under section 10.

Appeal was filed before the Supreme Court. The first contention of the assessee was that, the rent should be taxed under section 10. This is to claim much larger allowances as deduction. The appellant put it in this way, as letting out of a commercial asset is a business and what it did was to let out a commercial asset, namely, a fully equipped hotel building. It also said that

⁹ Sultan Brother's Private Ltd vs CIT Mumbai [1964 SCR 807].

¹⁰ The Income Tax Act, 1922, Section 12(4).

the lessor's covenants in the lease showed that in making the lease, the appellant was carrying on a business and not letting out property. This is somewhat different from the way in which it was put before the Tribunal. The argument advanced before the Tribunal was not advanced in this court and need not, therefore, be considered. It is indeed not very clear. The object of the appellant company no doubt was to acquire land and buildings and to turn the same into account by construction and reconstruction, decoration, furnishing and maintenance of them and by leasing and selling the same. The activity contemplated in the aforesaid object of the company, does not mean that the object of the company was to do business. Court took reference of this case, *East India Housing and Land Development Trust Ltd. v. Commissioner of Income tax*¹¹ where it was observed that "the income derived by the company from shops and stalls is income received from property and falls under the specific head as per described in the section."

Held:

In this case the Supreme Court held that just because there has been an entry in the object clause showing the nature of business will not determine the nature of such income. Therefore each case will be decided on the basis of facts. Thus, the court allowed the appeal stating that the rent from the building will be computed separately from the income from the furniture and fixtures and in the case of rent from the building the appellant will be entitled to the allowances mentioned in sub-section (4) of section 12 and in the case of income from the furniture and fixtures, to those mentioned in sub-section (3) [similar deduction as in sub section(4)], and that no part of the income can be assessed under section 9 or under section 10. Judgment of the High Court was set aside.

2. Chennai Properties and Investment Ltd. v. Commissioner of Income Tax¹²

Facts:

The appellant is a company incorporated under Companies Act, 2013 and is used to let out properties. This was mentioned in their memorandum of association. The income received from letting these properties, was filed under Income from business and profession. The tax officer refused to tax it under the head of Income from business and profession. Assessing officer held that this income was received by letting out properties that is why it will be counted as income from house property. An appeal was made to CIT, it was said that income will be computed as

¹¹ *East India Housing and Land Development Trust Ltd. v. CIT* [1961] 42 ITR 49 (SC) and *Sultan Brothers (P) Ltd. v. CIT* [1964] 51 ITR 353 (SC).

¹² *Chennai Properties and Investment Ltd. v. CIT* [2015] 373 ITR 673 (SC).

income from house property as leasing and letting out property was not primary business of the appellant as per MOA.

The matter was taken to High Court, there high court held that the income obtained from leasing property should be taxed under "Income from House Property". High Court said that this judgement was given on the basis of previous judgement, East India Housing and Land Development Trust Ltd. v. CIT and West Bengal and Sultan Brothers (P) Ltd. v. CIT. In East India Housing and Land development case, the company used to buy lands and develop into markets, thus the main object of the company was to transform the land into markets. In this case some of the shops and stalls were rented. Here the issue was that the rented property's income to be calculated under which head of income, "income from house property" or "income from business". Thus, court held that the income was derived from the house property so the main objective was not letting out of the property, it was for developing and setting up properties.

Facts in issue:

Whether the income received by letting out property should be taxed under "income from house property" or "income from business and profession"?

Held:

SC in this case held that if letting out property is the business of the tax payer, then the income will be taxed under the head of "income from business and profession". It was said by the court that in this case, the business of the company was to lease and derive income from its property, so it would be calculated under income from business and profession and not under income from house property. It was also said that to look into such matter, it is necessary to look into companies by laws and regulations, whether its business is of letting out property or not.¹³

Therefore income earned from that property should be treated under business income, and is taxable under the head of "Profit and gains of business and profession".

¹³PWC, 'Rental Income From Property Assessable Under The Head 'Profits And Gains Of Business Or Profession'' (2015).

3. Principal Commissioner of Income Tax, Central-4 v Shreeji Enterprises¹⁴

Facts:

Assessee is a partnership firm which is doing a business of sale and purchase of readymade garments as well as they also let out properties for commercial purpose. Assessing officer in while assessing the income tax for the assessment year of 2008-2009 charged the income of the assessee under the head of "income from house property" as taxable income. Assessee filed an appeal to the CIT in 2011, his appeal was dismissed. In 2012, again assessee filed an appeal to the appellate tribunal.

Facts in issue:

Whether the assessee property which is used 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"?

Held:

The tribunal took reference of two cases Shreeji Exhibitors and Chennai Properties and Investment Limited vs. CIT and gave the decision in favour of assessee, saying that income shall be taxed under "income from business and profession". Tribunal was of the opinion that the main object of the business was to deal in property by construction and letting out the property. Tribunal said that the facts in this case is similar to the case of Chennai Enterprises. Thus, tribunal held that income from letting out premises will come under "Income from business and profession". Assessing officer argued that the facts of both the cases are different, so decision of Shreeji Exhibitors and Chennai Investment case should not have been applied, because in this case respondent is involved in business of purchase and sale of ready garments as well as letting out properties. But the tribunal said that the object of the business of the respondent is clear and it is not restricted to only selling of garments, they are also involved in letting out of properties. So both the case Chennai Investments and Shreeji Exhibitors would apply in respondent's case.

It is a common order for this case and Shreeji Exhibitors. It is an undisputed position that the respondent is involved in the business of purchase and sale of ready-made garments and also letting out of commercial premises. The object of the business of the respondent firm is not

¹⁴ **Principal Commissioner of Income Tax, Central-4 v Shreeji Enterprises 2018 (12) TMI 705.**

restricted to only ready-made garments. Thus, it was held that income received by the assessee will be taxable as income from business and not under the head of income from house property.

In *Agya Ram case (2016)*¹⁵, land was given on lease by Delhi Development authority to the assessee. Assessee laid factory premises in which he used to repair batteries and also rendered license fees from other person for rendering services. Issue was whether the income will fall under income from house property or income from business and profession. It was argued by the assessing officer that license fees earned by assessee on the part of premises that is owned by assessee will be computed under income from House Property. This appeal was allowed by CIT and ITAT. But it was reversed by the high court, and was pointed that payment received would not be calculated as rent. There is nothing colourable about this, as the assessee had license deed and receipts, and it was solely used for business purpose. It was held by court that the income earned from licensing premises will be treated as "income from business".

In *Tamil Nadu Tourism Development case (2014)*¹⁶, assessee was a government body which was wholly functioned by Tamil Nadu government and was engaged in tourism business. Tamil Nadu government notified for an open tender for leasing uneconomic units to compensate losses. The assessee corporation took the tender and became franchisee, and was involved in the same business of tourism activity. Issue here was whether the income received under franchisee fee will be computed under income from house property or income from business. It was held that income from leased property to franchisee will be taxed under "business income" not under "income from house property". As there is a contract between the assessee and franchisees, and there is a special right given by assessee to franchisee to involve in tourism business. Rental income charged by tenant by subletting will be charged under "income from business and profession" or "income from other sources".

CONCLUSION

The judicial decisions are relevant in determining the head of particular income. Recent trends of judicial decisions has shown that ownership of property and leasing it out, might be incorporated as part of a business. The residential and commercial property, from a tax perspective will be treated in the same way, the only significant factor which will decide that under which head income received will be computed i.e. income from house property or income

¹⁵Agya Ram vs. CIT (Delhi High Court) ITA No.- 290-293/2004.

¹⁶ Tamil Nadu Tourism Development Corporation Ltd. vs. Deputy , CIT (2014) 368 ITR 0533.

from business, is upto the business of the owner.¹⁷

These are the following interpretations made on the basis of previous judicial decisions:

- ▶ Whether a particular letting is business has to be decided on the circumstances of each case.¹⁸
- ▶ The previous cases decided will not lay down a test for deciding when a letting amounts to a business.
- ▶ It is necessary to look into companies bye laws, whether its business is of letting out property or not. If the letting out property is not the main business then the rent from the commercial property will be treated as income from house property or other sources.¹⁹ Intention and conduct of the tax payer is important to determine the business of the assessee.
- ▶ If property from its legal existence is used by owner for rental income, then it will computed under house property.
- ▶ If income is received by letting out of premises with other assets in an industrial park or SEZ will be computed under income from business and profession.²⁰

Thus, it will be decided on the basis of facts of each case and business of the tax payer, whether the rental income will be charged under the "income from business or profession" or "income from house property".

¹⁷ Saloni khandelwal, 'Rental Income- House Property Vs. Business Income' <<https://taxguru.in/income-tax/rental-income-house-property-business-income.html>> accessed 12 April 2019.

¹⁸ Supra note 9.

¹⁹ Supra note 12.

²⁰ Central Board of Direct Taxes, Circular No. 16/2017, 25th April, 2017.