

Rental income earned by the “deemed owner” from letting out of properties taxable as “income from house property”; mere entry in the object clause not enough to characterise the rental income as business income

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In brief

In a recent decision¹, the Supreme Court (SC) has held that mere reliance on the object clause of the taxpayer would not be the determinative factor in characterising the rental income as business income. In absence of providing any evidence that the taxpayer carried out systematic or organised activities to provide services to the lessees, the rental income earned was held to be taxable as “income from house property.”

In detail

Facts

- The taxpayer¹ a partnership firm was engaged in the business of taking properties on rent and earning income by sub-letting them. The object clause of the partnership deed read as follows:

“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”

- The taxpayer acquired from the Market Department of Municipal Corporation

Greater Mumbai (MCGB), the right to build and lease a shopping centre (market area) named “Saibaba Shopping Centre.”

- The taxpayer was allotted a bare structure on stilts (i.e., pillars/ columns with four walls). The taxpayer made additions/ alternations to the premises, including demolishing the existing platform and reconstructing it according to plans sanctioned by the MCGB. The taxpayer constructed 95 shops and 30 stalls of different carpet area.
- The taxpayer was responsible for the day-to-

day maintenance, cleanliness and upkeep of the market premises. The taxpayer incurred expenses on account of water charges, electricity charges, taxes and repairs of the premises.

- The taxpayer sub-leased the premises and earned the following income:
 - Compensation from sub-licensees;
 - Leave and license fees; and
 - Service charges for providing various services, including

¹ Civil Appeal Nos 6455-6460 of 2017

security charges and utility.

- For financial year (FY) 1999-2000, the taxpayer offered the income to tax as business income. The income was assessed as business income. Subsequently, the case was reopened and the income was reassessed under the head “income from house property.”
- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] allowed the appeal of the taxpayer. However, the Income-tax Appellate Tribunal (Tribunal) reversed the order of the CIT(A). The High Court (HC) dismissed the appeal filed by the taxpayer.

Issue before the Supreme Court

Whether the income earned by the taxpayer is to be taxed as “business income” or as “income from house property”?

Taxpayer’s contention

- The taxpayer contended that based on the object clause as per the partnership deed, the main business was to take the premises on rent and to sub-let the same.
- The taxpayer relied on the decisions of the Hon’ble Supreme Court (SC) in the case of *Chennai Properties & Investments Ltd v. CIT*² and *Rayala Corporation (P) Ltd v. ACIT*³

Revenue’s contention

The Revenue relied on the order passed by the ITAT.

Supreme Court’s ruling

- The SC observed that, the fact that the taxpayer was the deemed owner of the property,

was not disputed by the taxpayer.

- The SC held that normally, the income from letting out of property is to be regarded as “income from house property.” However, depending on the facts of the case, the income can also be characterised as business income.
- The SC held that merely an entry in the object clause for letting out of property would not be the determinative factor in concluding that the income should have been treated as business income. The SC observed that the taxpayer had only relied on the object clause in the partnership deed. The taxpayer did not produce any material to suggest that it was engaged in systematic or organised activity of providing services to the occupiers of shops/ stalls.
- The SC relied on the findings of the ITAT, being the last forum for factual determination. The SC held that it was for the taxpayer to produce sufficient material on record to show that its entire income or substantial income was from letting out of property, which was its principal business activity.
- The SC relied on its decision in the case of *East India Housing and Land Development Trust Limited*⁴ and held that the income earned by the taxpayer was taxable as “income from house property.” The reliance by the taxpayer in the cases of *Chennai Properties & Investments Limited*⁵ and *Rayala Corporation (P.) Limited*⁶ were distinguished and hence not applicable.

The takeaways

This decision lays down the principle that mere object clause would not be relevant for determining the characterisation of rental income as “income from house property” or as “business income.” The actual conduct of the business in terms of providing systematic services along with letting out of property would be relevant in characterising the income as business income. This is consistent with the judicial precedents rendered by other appellate authorities in the context of commercial properties, especially industrial parks.

The Central Board of Direct Taxes (CBDT) has acknowledged that the activity of rendering complex services in addition to renting out of property gives rise to business income. The CBDT has recently issued a Circular⁷ to the effect that the income earned by letting out property along with other amenities in an Industrial Park/ SEZ should be taxable as business income.

In this decision, the initial assessment order was passed by treating the rental income as “business income.” Subsequently, the income was reassessed as “income from house property.” This decision does not discuss the validity of the reassessment order, as to whether or not the re-characterisation of income can be regarded as “change of view,” and hence, not liable for reassessment.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

² Chennai Properties & Investments Limited v. CIT [2015] 373 ITR 673 (SC)

³ Rayala Corporation (P.) Limited v. ACIT [2016] 386 ITR 500 (SC)

⁴ East India Housing and Land Development Trust Limited v. CIT [1961] 42 ITR 49 (SC)

⁵ Chennai Properties & Investments Limited v. CIT [2015] 373 ITR 673 (SC)

⁶ Rayala Corporation (P.) Limited v. ACIT [2016] 386 ITR 500 (SC)

⁷ Circular no. 16 dated 25 April, 2017

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