

Rental income from property assessable under the head ‘profits and gains of business or profession’

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In brief

The Supreme Court (SC), in the case of M/s Chennai Properties & Investments Limited, held that if letting out of properties was the business of the taxpayer, then its income would be chargeable to tax under the head ‘profits and gains of business or profession’ as opposed to ‘income from house property’.

In detail

Facts

- The taxpayer¹ (company) was incorporated with the main object (under the Memorandum of Association) of acquiring properties on an ownership basis and letting it out on lease.
- In the return of income filed by the taxpayer, the rental income from such properties was offered to tax under the head ‘profits and gains of business or profession’. The taxpayer had not received any other income apart from rental income.
- The tax officer (TO) held that since the income was received from the letting out of properties, the income was taxable under

the head ‘income from house property’.

- The Commissioner of Income-tax (Appeals) [CIT (A)] reversed the order of the TO. The Income-tax Appellate Tribunal dismissed the appeal filed by the revenue authorities against the order passed by the CIT (A).
- On further appeal, the Madras High Court (HC) held that the rental income was taxable under the head ‘income from house property’. The HC placed reliance on the decisions of the SC in the case of East India Housing and Land Development Trust Limited² and Sultan Brothers (P) Limited³.

Issue before the Supreme Court

Whether the income earned by the taxpayer was taxable under the head ‘profits and gains of business or profession’ or under the head ‘income from house property’?

Supreme Court's decision

- The SC observed that according to the taxpayer’s memorandum of association, it held the stated properties and letting them out was the main objective. The entire income earned by the taxpayer was from the letting out of the said properties. No other income was earned by the taxpayer.
- While deciding on the case, the SC distinguished its ruling in the case of East India Housing and Land Development Trust Limited². The SC observed

¹ Chennai Properties & Investments Limited v. CIT [TS-238-SC-2015]

² East India Housing and Land Development Trust Limited v. CIT [1961] 42 ITR 49 (SC)

³ Sultan Brothers (P) Limited v. CIT [1964] 5 SCR 807 (SC)

that in the case of East India Housing and Land Development Trust Limited², the main object of the taxpayer company was (i) buying and developing the properties, and (ii) promoting and developing markets. The letting out of properties was not the object of the company. In such a case, income earned from the renting out of shops and stalls, developed by it, was held to be taxable under the head 'income from house property'.

- The SC placed reliance on its decision in the case of Karanputra Development Co. Limited⁴ wherein it had held that the deciding factor was not the ownership of land or leases, but the nature of the activity of the taxpayer and the nature of the operations in relation to the same. The objectives of the company must also be kept in view to interpret the activities of the company.
- The SC took into account the principles laid down in its decision in the case of Sultan Brothers (P) Limited³ wherein

it had held that merely an entry in the objects clause showing a particular object would not be a determining factor to arrive at a conclusion that income was to be treated as business income. Each case needed to be looked at from a businessman's point of view, to determine whether the letting out was for doing business or exploitation of property by its owner.

- Based on the object of the taxpayer company, the SC held that income earned by the taxpayer by letting out of its property was taxable as business income. While arriving at the conclusion, the SC took into account the position in law held by various Courts that the dividing line was difficult to determine; 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 was possible to say on which side the operations fell, and to what head the income was to be assigned.

The takeaways

This decision would be relevant in determining the characterisation of a particular income; the SC has emphasised that for income to be characterised 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. Going by the recent trend of judicial precedents, the judicial authorities have shown acceptance of the fact that ownership of property and leasing it out may also be done as a part of a 'business' apart from doing it as a mere 'owner'.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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⁴ Karanputra Development Co Ltd v. CIT [1962] 44 ITR 362 (SC)

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