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Basis of Taxation for Income from House Property

The annual value serves as the basis for computing income from house property under the Income-tax Act. This value reflects the property's potential to generate rental income, whether or not it is actually rented out. Unlike other heads of income, income from house property is charged on a notional basis, based on the inherent capacity of the property to yield income rather than actual receipts.

Conditions for Taxability Under 'Income from House Property'

For income to be taxed under this head, three essential conditions must be met:

1. The property must consist of buildings and land appurtenant thereto.

2. The assessee must be the legal owner of the house property, though sometimes taxation applies to a deemed owner.
3. The property must not be used by the owner for business or professional purposes, where the profits are taxable under the head business income.

Definition of 'Property' for Tax Purposes

The term 'property' in Sections 22 to 27 refers only to buildings and land appurtenant thereto, not vacant land. If income is derived from vacant land, it is taxable under income from other sources or business income, depending on the circumstances [Chitpore Golabari Co. P. Ltd v CIT (1971) 82 ITR 753 (Cal)].

Buildings include houses, shops, godowns, platforms, and auditoriums, while a vacant site is not considered house property [Bhupalam Venkatasubbayyar v G.L. Mallappa AIR 1983 Mad 636].

A market comprising shops, buildings, godowns, and open space falls under house property taxation [Raju (P.V.G.) v CIT (1967) 66 IT 122 (AP)].

House property also includes gardens, compounds, and yards appurtenant to the building [Subharayulu v Venkataramanamma AIR 1953 Mad 450].

Definition of 'Building'

A building refers to any structure occupied or intended for occupation, such as residential houses, godowns, warehouses, factories, stalls, or cinema halls [London Hotel (1968) 68 ITR 62 (Bom)].

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A roof is generally necessary for classification as a building, but certain non-residential structures may be recognized even without a roof [Ghansham Das Devi Prasad AIR 1966 SC 1998].

Factory roads, courtyard walls, and garages attached to a building qualify as part of the building for tax purposes [CIT v Gwalior Rayon Silk Manufacturing Co. Ltd AIR 1992 SC 1782].

### **Fencing and Boundary Walls**

A boundary wall alone is not considered a building. However, if the wall encloses an area used as an extension of a residence, it is taxable under house property [V. Chandramani Patta Maha Devi Varo v Collector of Visakhapatnam AIR 1923 Rang 65].

### **Tax Treatment of Income from Land Appurtenant to a Building**

If the land appurtenant to a building generates independent commercial income, that income is not taxed as house property. Instead, it is taxable as business income or income from other sources. For instance, if a water source on the land is commercially exploited, the income from water sales is not treated as house property income [Ramalakshmi Reddy (M.) v CIT (1998) 232 ITR 281 (Mad)].

### **Who is Considered the 'Owner' of a Property?**

The 'owner' is the individual legally entitled to receive income from the property, even if the property title is not formally registered in their name [CIT v Podar Cement Pvt. Ltd (1997) 226 ITR 625 (SC)].

If an assessee constructs a school and leases it perpetually for ₹1 per year, the property is still taxable in the hands of the assessee [DLF United Ltd v CIT (1984) 149 ITR 24 (Del)].

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If a firm builds a house using its funds but assigns ownership to its partners, each partner is taxed as the owner of their respective flat [CIT v Jetta Lal Nanji & Bros (1987) 167 ITR 191 (AP)].

For tax purposes, the Assessing Officer can look beyond the registered owner to determine the real owner based on who funded the property purchase [CIT v Hasina Begum (1986) 158 ITR 215 (Cal)].

Special Cases of Ownership

1. **Mortgaged property** – The mortgagor (borrower) is the taxable owner.
2. **Association of Persons (AOP)** – The AOP, and not its members, is liable to tax.
3. **Partnership firms** – If a property is owned by a firm, the firm (not individual partners) is taxed [Sarvamangla Properties Ltd v CIT (1973) 90 ITR 267 (Cal)].
4. **Property bequeathed under a will** – If a will grants life interest to a legatee, the legatee (not the executor) is taxable [Estate of Ambalal Sarabhai v CIT (2000) 245 ITR 455 (Guj)].

Ownership by Partners of a Firm

Even though partners ultimately own firm assets, a property included in the firm's books is taxable in the firm's name, not in the partners' individual capacity [Ram Narain & Bros. v CIT (1969) 73 ITR 423 (All)].

Ownership of Land vs. Superstructure

An individual may own a building but not the land on which it stands. If an assessee constructs a superstructure on leased land,

they are taxed as the owner of the building during the lease term [Puttanna Sons P. Ltd v CIT (1986) 162 ITR 468 (Karn)].

Taxation in Case of Disputed Ownership

If ownership is under legal dispute, the Income Tax Department will determine the owner for tax purposes until the court gives a ruling [Re Keshardeo Chamaria (1937) 5 ITR 246 (Cal)].

Deemed Ownership of House Property

Under Section 27 of the Income-tax Act, certain individuals who are not legal owners of a property are still considered deemed owners for taxation under Sections 22 to 26. These include:

1. Transfer to Spouse (Section 27(i))

If an individual transfers house property to their spouse without adequate consideration, the transferor remains the deemed owner. However, this rule does not apply if the transfer is part of a legal agreement to live separately.

2. Transfer to Minor Child (Section 27(i))

Similarly, if an individual transfers property to a minor child without adequate consideration, the transferor remains the deemed owner. This does not apply to a minor married daughter.

If cash is transferred to a spouse or minor child, who then buys property with that money, the transferor is not a deemed owner of the house. However, clubbing provisions under Section 64(1)(iv) will apply.

3. Holder of an Impartible Estate (Section 27(ii))

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An individual who holds an impartible estate is deemed its owner. An impartible estate refers to property inherited through primogeniture (eldest son inheritance) under Mitakshara law.

After the Hindu Succession Act, 1956, only estates granted by covenant remain impartible.

Impartible estates by custom were abolished, and such property is now assessed as Hindu Undivided Family (HUF) property, not individual property [CIT v Maharaja Chintamani Sarannath Sahdeo (1986) 157 ITR 358 (Pat)].

#### **4. Member of a Cooperative Society, Company, or Association (Section 27(iii))**

A member of a cooperative society, company, or association to whom a building is allotted or leased under a housing scheme is deemed the owner, even though legal ownership remains with the society, company, or association.

#### **5. Possession Under Part Performance of Contract (Section 27(iia))**

A person holding possession of a property under an agreement covered by Section 53A of the Transfer of Property Act is deemed the owner. This applies if:

- Possession is handed over to the buyer,
- Sale consideration is paid or agreed to be paid,
- The sale deed is not executed, but supporting documents (such as a Power of Attorney or agreement to sell) exist.

#### **Important Notes:**

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1. Agreements to sell must be registered, otherwise, they will be treated as benami transactions under the Prohibition of Benami Property Transactions Act, 1988.
2. The Supreme Court in CIT v Balbir Singh Maini ruled that Section 53A applies only to registered agreements.

6. Long-Term Lease Rights (Section 27(iii))

A person who acquires rights in a building through a lease agreement for at least 12 years is deemed the owner.

Short-term leases (less than 12 years) and month-to-month leases do not qualify.

In Radio Components & Transistors Co. Ltd v ITO (2012) 50 SOT 237 (Mum) (Trib), the court ruled that an assessee holding lease rights and sub-letting the property was deemed the owner.

However, in Nahalchand Laloochand (P.) Ltd v ACIT (2014) 52 taxmann.com 157 (SC), the Supreme Court remanded the case because the lease term was not verified.

Relevance of Building Use for Taxation Under ‘Income from House Property’

The use of a building is not a determining factor for taxation under ‘Income from House Property’. The key consideration under Section 22 is that the income should arise from a building or land appurtenant to it, irrespective of its use—whether residential or commercial [CIT v Kanaiyalal Mimanani (1979) 120 ITR 892 (Cal)].

Even if an individual is engaged in renting properties as a business, the rental income is taxable under ‘Income from House Property’ unless the property is actively used for business

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operations. A property held as stock-in-trade does not automatically qualify for taxation under business income.

## **Cases Where Rental Income is Taxed as ‘Income from House Property’**

### **1. Basic Rental Activity:**

If a building is leased out without additional services, the rental income is house property income.

Example: A building leased to a nursing home was taxed under house property income, as it was a simple lease arrangement without additional services [Hotel Arti Delux (P.) Ltd. v ACIT (2014) 50 taxmann.com 422 (Allahabad)].

### **2. Rental Income from Unsold Flats:**

A builder’s rental income from unsold flats qualifies as house property income, and the 30% deduction under Section 24 applies [Azimganj Estate Pvt. Ltd. v CIT (2012) 206 Taxman (Cal)].

Similar rulings were given in CIT v Gundecha Builders (2019) 102 taxmann.com 27 (Bom)] and \*\*New Delhi Hotels Ltd. v ACIT (2014) 360 ITR 187 (Del)].

### **3. Temporary Leasing Due to Business Slowdown:**

When a real estate company temporarily leases out unsold properties due to market conditions, the rental income is house property income [Mangal Homes (P) Ltd v ITO (2010) 215 Taxation 511 (Bom)].

### **4. Long-Term Leasing:**

If a property is leased for an extended period, the income is house property income.



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Example: A lease agreement for 12 years with an extension option was considered house property income, as the intention was to earn rental income [Batra Palace P. Ltd. v CIT (2016) 385 ITR 144 (P&H)].

5. Sub-Licensing with No Business Component:

If an assessee sub-lets a property but does not engage in any organized service activity, the income is house property income.

Example: A taxpayer sub-leased stalls in a shopping mall without providing any additional business services. The Supreme Court ruled it as house property income [Raj Dadarkar & Associates v ACIT (2017) 81 taxmann.com 193 (SC)].

Cases Where Rental Income is Taxed as ‘Business Income’

1. Leasing as a Core Business Activity:

If the main business objective of a company is to own and lease properties, the rental income is business income.

Example: Chennai Properties & Investments Ltd. v CIT (2015) 56 taxmann.com 456 (SC): The Supreme Court ruled that a company whose sole business was renting properties should be taxed under business income.

Example: Rayala Corporation Pvt. Ltd. v ACIT (2016) 386 ITR 500 (SC): The company’s core business was leasing, so rental income was business income.

2. Warehousing and Infrastructure Services:

If rental income arises from an organized warehousing business or an industrial park, it qualifies as business income.

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Example: CIT v Karnataka State Warehousing Corporation (2014) 44 taxmann.com 205 (Karnataka): The warehousing business was classified as business income.

Example: CIT v Information Technology Park Ltd. (2014) 46 taxmann.com 239 (Kar): Rental income from an IT park was considered business income.

3. Property Leasing with Comprehensive Services:

If a property is leased along with significant facilities and services, the income is business income.

Example: PCIT v Krome Planet Interiors (P.) Ltd. (2019) 107 taxmann.com 443 (Bom): A shopping mall leased with amenities was business income.

Example: CIT v Velankani Information Systems (P.) Ltd. (2013) 218 Taxman 88 (Ker): Leasing of a specialized IT facility with integrated services was considered business income.

4. Rental Agreements with Additional Business Functions:

If a building is let out with additional business rights, the income is business income.

Example: Shambhu Investment (P.) Ltd v CIT (2003) 263 ITR 143 (SC): If a property lease includes additional rights like furniture, fixtures, and maintenance, it remains house property income.

However, if the entire lease package includes significant commercial services, it may be business income.

Exceptions – When Property Income is NOT Taxed Under ‘House Property’

1. Self-Occupied for Business or Profession:

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If a property is used for the assessee's business, rental value is not taxed under house property [CIT v Modi Industries Ltd (1994) 210 ITR 1 (Del)].

## **2. Leasing is an Incidental Business Activity:**

If leasing is not the main business but supports the primary business, rental income is business income.

Example: CIT v National Newsprint & Paper Mills Ltd (1978) 114 ITR 388 (MP): Renting space for a police station within a factory was business income.

Example: CIT v Delhi Cloth & General Mills Co. Ltd (1966) 59 ITR 162 (Punj): Leasing quarters to employees was business income.

## **3. Income is Part of a Composite Business Model:**

If a property is let out along with equipment, furniture, and services, it may qualify as business income.

Example: Attukal Shopping Complex Pvt. Ltd v CIT (2003) 259 ITR 567 (Ker): Leasing a shopping complex with common facilities was taxed as both house property and business income.

Example: Jay Metal Industries (P.) Ltd. v CIT (2017) 396 ITR 197 (Del): Leasing furniture along with a building made the income business income.

## **Taxability of Property Used by a Firm or Not Directly Used for Business**

### **1. Property Leased to a Firm by a Partner – Taxable Under House Property**

If a partner leases a property to a firm in which he is a partner, it does not qualify for exemption under Section 22, as the owner and occupier must be the same person. The rental income will be taxed under 'Income from House Property' in the partner's hands [Prodip Kumar Bothra v CIT (2012) 18 Taxmann.com 177 (Kol)].

## **2. Property Owned by an Individual and Used by the Partnership Firm**

If an assessee owns a property used by a firm in which he is a partner, exemption from house property tax applies.

### **Court Rulings in Favor of Exemption:**

- [CIT v Thomas (PM) (1990) 181 ITR 256 (Ker)]
- [CIT v Syed Anwar Husain (1990) 186 ITR 749 (Pat)]
- [CIT v Rabindernath Bhol (1995) 211 ITR 799 (Ori)]

### **Contrary View:**

If the property is used by a firm but owned by one of the partners, the notional rental income is taxable in the partner's hands [CIT v Guruswamy (K.N.) (1984) 146 ITR 34 (Kar)].

## **3. Property Owned by an HUF but Used by a Partnership Firm**

No exemption if an HUF owns a property, but it is used by a firm where the karta and members are partners in an individual capacity. The property is not considered used for the business of the HUF [CIT v Shiv Mohanlal (1993) 202 ITR 60 (All)].

Exemption applies if the karta is a partner in a representative capacity and the firm uses an HUF-owned property. In this case,

share income from the firm is treated as HUF business income [CIT v Champalal Jeev Raj (1995) 215 ITR 289 (Mad)].

#### **4. Property Acquired for Business but Not Used – Taxable Under House Property**

If a property is acquired for business but remains unused, no exemption applies.

The rental value must be computed under Section 23(1)(a) [Boltzen (P.) Ltd v ITO (2014) 41 taxmann.com 161 (Delhi-Trib.)].

#### **5. Residential Flat Owned by a Partner but Used by a Firm's Employee**

If an assessee owns a flat used by an employee of a firm without charging rent, notional rental income is taxable in the assessee's hands [Prakash Vasantbhai Golwala v ACIT (2014) 41 taxmann.com 122 (Ahmedabad-Trib.)].

#### **6. House Property Occupied by Employees of a Sister Concern**

A property occupied by employees of a sister concern does not qualify as a business asset. Rental income is taxable under 'House Property' [CIT v T.V. Sundaram Iyengar & Sons Ltd (2004) 271 ITR 79 (Mad)].

#### **7. Hotel Given on Lease – Business or House Property Income?**

If a hotel is leased with basic furnishings, the income is taxed under 'House Property' [ACIT v Palmshore Hotels (P.) Ltd. (2013) 55 SOT 198 (Cochin-Trib.)].

If the rent is a percentage of turnover, it may qualify as business income [CIT v Plaza Hotels (P.) Ltd. (2019) 107 taxmann.com 287 (Bom)].

## **8. Rent from Property Constructed Using Borrowed Funds from Holding Company**

If a subsidiary constructs a property using borrowed funds from a holding company and rents it back to the holding company, it does not qualify as a business asset.

Rental income is taxable as house property income [*Prefect Scale Company (P.) Ltd. v DCIT (2013) 38 taxmann.com 279 (Mumbai-Trib.)*].

## **Taxability of Unsold Flats and Notional Rent**

### **1. Notional Rent on Unsold Flats – Stock-in-Trade**

Notional rent on unsold flats is taxable as ‘Income from House Property’ if held as stock-in-trade [CIT v Ansal Housing and Construction Ltd. (2013) 40 taxmann.com 305 (Del)].

Exception: If an assessee’s main business is letting properties, rental income is business income [Chennai Properties & Investments Ltd. v CIT (2015) 56 taxmann.com 456 (SC)].

### **2. Annual Value of House Property Held as Stock-in-Trade**

Section 23(5) of the Income Tax Act (Amended by Finance Act, 2019): If a property held as stock-in-trade is not let out, its annual value is considered ‘nil’ for up to two years from the completion certificate date.

Example: A builder completes construction on 15-12-2021 and gets a completion certificate on 6-5-2022. The annual value

remains nil until 31-3-2025 if unsold. From 1-4-2025 onwards, notional rent applies.

## **Taxability of Rent from Leasing a Business Center**

If an office, initially used for business, is later leased as a business service center due to scaled-down operations, the rental income is typically taxable under Income from House Property. However, if the premises function as a business center providing temporary office space, the income may be considered business income. Rent including electricity charges should be assessed net of electricity costs. [*Anik Financial Services (P.) Ltd. v ITO (2013) 144 ITD 151 (Mum)(Trib)*].

## **Treatment of Composite Rent**

When rent includes payments for additional facilities (e.g., lift, security, electricity), it is classified as composite rent. The taxability is as follows:

1. **Rent + Service Charges** – The portion related to property rent is taxable under Income from House Property, while service charges are taxable under Income from Other Sources. [*CIT v Kanak Investments P. Ltd (1974) 95 ITR 419 (Cal)*]
2. **Rent + Other Assets (Machinery/Furniture)** – If separable, rent from property is taxed under House Property, and charges for other assets under Business Income or Other Sources. If inseparable, the entire rent is treated as Business Income.

Where a separate agreement covers amenities (e.g., security, maintenance), such charges are excluded while computing *Annual Letting Value (ALV)*. [*DCIT v Sir Sobha Singh & Sons (P.) Ltd. (2014) 41 taxmann.com 378 (Delhi – Trib.)*]

## **Taxability of Rent from Hoardings and Telephone Towers**

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Hoardings – Rent for placing hoardings is taxed under Income from Other Sources as hoardings are not part of the building.
[Mukherjee Estate (P) Ltd v CIT (2000) 244 ITR 1 (Cal)]

Telecom Towers – If terrace space is rented for telecom towers, the rental income is taxable under Income from House Property. However, if the assessee is in the business of leasing space for towers, it is considered business income. *[Manpreet Singh v ITO (2015) 53 taxmann.com 244 (Delhi – Trib.)]*

Taxability of Foreign Property Income

For Resident and Ordinarily Resident (ROR) individuals, foreign property income is taxable in India, whether repatriated or not.
[Arunachalan Chettiar v CIT (1945) 13 ITR 183 (Mad)]

For Non-Residents (NR) and Resident but Not Ordinarily Residents (RNOR), such income is taxable only if received in India.

Under Double Taxation Avoidance Agreements (DTAA), foreign property income is generally taxed in the country where the property is located. *[CIT v R. Venugopala Reddiar (1965) 58 ITR 439 (Mad)]*

Conversion of Foreign Property Income to INR

Foreign property income is converted to INR at the Telegraphic Transfer Buying Rate (TT Buying Rate) on the last day of the financial year.

Exemptions from Tax on Property Income

Property income is exempt under the following cases:

- **Agricultural Income** – *Section 10(1)*

- **Palace of Ex-Ruler** – *Section 10(19A)*
- **Local Authorities** – *Section 10(20)*
- **Scientific Research Associations** – *Section 10(21)*
- **Educational Institutions** – *Section 10(23C)*
- **Hospitals & Medical Institutions** – *Section 10(23C)*
- **Khadi and Village Industries** – *Sections 10(23B), 10(23BB)*
- **Registered Trade Unions** – *Section 10(24)*
- **Scheduled Caste/Scheduled Tribe Organizations** – *Sections 10(26B), 10(27)*
- **Charitable or Religious Trusts** – *Section 11*
- **Political Parties** – *Section 13A*

Additionally, property owned by clubs following the mutuality principle is exempt. [*Chelmsford Club v CIT (2000) 243 ITR 89 (SC)*]

Meaning of Annual Value

As per Section 23(1)(a), the annual value of a property is the amount it could reasonably be expected to fetch if rented out yearly, irrespective of actual rent received.

Factors Determining Annual Value of a Property

The annual value of a property is assessed based on four key factors:

1. Actual Rent Received or Receivable

The actual rent forms the base for computation. If the owner bears any tenant expenses (e.g., electricity, water), the rent is

adjusted downward. Conversely, if the tenant pays the owner's obligations, the rent is adjusted upward.

Municipal taxes, being the tenant's liability, are not added to rent received. [*CIT v Gillanders Arbuthnot & Co Ltd* (1983) 142 ITR 598 (Cal)]

If repair expenses are contractually borne by the tenant, rent should not be increased for computation. [*CIT v Parbutty Churn Law* (1996) 57 ITR 609 (Cal)]

Maintenance charges paid by the landlord but included in rent qualify for deduction under Section 23. [*Asha Ashar v ITO* (2017) 81 taxmann.com 441 (Mumbai – Trib.)]

2. Municipal Value

The valuation determined by municipal authorities for levying property tax is considered but is not always binding.

3. Fair Rent of the Property

The rental value of similar properties in the same locality is assessed for a fair estimate.

4. Standard Rent (Rent Control Act)

If applicable, rent cannot exceed the legally fixed standard rent. The Assessing Officer must determine standard rent if not already fixed. [*Smt. Kokilaben D. Ambani v CIT* (2014) 49 taxmann.com 371 (Bom)]

Can the Assessing Officer Ignore Municipal Valuation?

The AO is not bound by municipal valuation if evidence suggests that rent and security deposits do not reflect the market rate. In such cases, an independent inquiry into local market rates is

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warranted. [*CIT v Tip Top Typography (2014) 48 taxmann.com 191 (Bom)*]

If the taxpayer presents a municipal valuation report, the AO must provide valid reasons for rejection. [*Sanjay Brahmdev Kapoor v ACIT (2020) 113 taxmann.com 320 (Mum)*]

### **Impact of Security Deposits on Annual Value**

Security deposits are capital receipts and not included in income. [*CIT v Asian Hotels Ltd (2008) 168 Taxman 59 (Del)*]

Notional interest on security deposits is not taxable unless it affects the actual rent charged.

If actual rent is below market rate due to a high deposit, the AO can reassess fair rent but cannot add notional interest. [*CIT v Moni Kumar Subba (2011) 333 ITR 38 (Del)*]

If interest on security deposits is taxed under *Income from Other Sources*, including it again in *Annual Letting Value (ALV)* leads to double taxation. [*PCIT v Karia Can Co. Ltd. (2018) 257 Taxman 189 (Bom)*]

### **Effect of Renting to Family or Friends at Lower Rent**

If property is let at below-market rent to family or friends, the AO may compute the fair rent instead of actual rent. [*Maneklal Agarwal v DCIT (2017) 396 ITR 721 (SC)*]

### **Difference Between Letting and Licensing**

Legal distinction may not always be necessary for tax purposes. A license agreement may still be considered letting if it effectively allows occupation by the tenant. [*Smt. Indumati v Adyaanr Ninte ITO (1983) 4 ITD 349 (Bom)*]

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If a license agreement is used as a colorable device (e.g., between closely related entities), income is taxable as *Income from House Property*. [*Ocean Structures Pvt. Ltd v ACIT (2008) 171 Taxman 42 (Del)*]

Taxability of Non-Occupiable or Unoccupied Properties

No tax on notional rental income if a property is legally unoccupiable. [*Sharan Hospitality (P.) Ltd. v DCIT (2019) 112 taxmann.com 372 (Bom)*]

Rental income from an under-construction building is not taxable until occupancy is legally permitted. [*Brigade Enterprise Ltd. v ACIT (2021) 124 taxmann.com 437 (Kar)*]

Tax Treatment of Composite Rent

Rent for Property + Service Charges (e.g., maintenance, utilities) – Property rent is taxable under House Property, and service charges under Other Sources. [*CIT v Kanak Investments P. Ltd (1974) 95 ITR 419 (Cal)*]

Rent for Property + Machinery/Furniture Charges

If separable, property rent is House Property Income, while charges for other assets are Business Income or Other Sources.

If inseparable, entire income is Business Income or Other Sources.

Mixed Business & House Property Income

If a company builds and leases properties as a core business, the income is treated as Business Income.

If the company simply owns and leases property, it is taxed as House Property Income. [*Attukal Shopping Complex P. Ltd v CIT (2003) 259 ITR 567 (Ker)*]

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## **Steps to Compute Annual Value of a Let-Out Property**

The annual value of a property that is let out throughout the year is determined using the following steps:

### **Step 1: Compute Gross Annual Value**

Under Section 23(1), the annual value is the higher of:

- Expected Rent – The reasonable amount the property could fetch if rented out (determined based on municipal valuation and fair rent).
- Actual Rent – If the rent received is higher than the expected rent, it is considered as the annual value.

If the property falls under the Rent Control Act, the standard rent (if fixed or determinable) acts as a ceiling for the annual value. [Sheila Kaushish v CIT (1981) 131 ITR 435 (SC)]  
However, if the actual rent exceeds this limit, the actual rent received becomes the annual value. [Smt. Kokilaben D. Ambani v CIT (2014) 49 taxmann.com 371 (Bom)]

### **Step 2: Deduct Municipal Taxes**

Municipal taxes (including service taxes) are deductible from the gross annual value if:

- They are paid by the owner (not the tenant).
- They are actually paid in the relevant year.

Municipal taxes due but unpaid are not deductible. However, taxes paid in the current year for past or future years are deductible.

If a cheque for municipal taxes is issued before year-end but encashed later, it is considered paid. [*CIT v Punalur Paper Mills Ltd. (2019) 441 ITR 563 (Ker)*]

Taxes paid on foreign properties are also deductible. [*CIT v R. Venugopala Reddiar (1965) 58 ITR 439 (Mad)*]

The value after deducting municipal taxes is the Net Annual Value, from which deductions under Section 24 are made to compute income from house property.

### **Relevance of Actual Rent in Determining Annual Value**

If a property is leased at below-market rent to related parties (e.g., family or employees) and subsequently sublet at a higher rate, the higher rent is considered the annual value. [*N. Natraj v DCIT (2004) 266 ITR 277 (Mad)*]

If a genuine sub-letting arrangement exists, the owner's actual rent received is the taxable annual value. [*CIT v Indra Co. Ltd (2004) 268 ITR 240 (Cal)*]

Notional interest on security deposits is not included unless proven to influence the rent. [*CIT v Hemraj Mahabir Prasad Ltd (2005) 279 ITR 522 (Cal)*]

If the agreed rent was fair at the time of letting, it must be accepted as the annual value. [*CIT v Modi Industries Ltd (1993) 200 ITR 350 (Del)*]

For properties under rent control laws, where actual rent is low, the property's annual value is assessed in isolation for each year. [*CIT v Kishanlal & Sons (Udyog) Pvt. Ltd (2003) 260 ITR 481 (Cal)*]

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A reasonable rent agreement is determined by a hypothetical bargain between a willing landlord and tenant. [*Corporation of Calcutta v Padma Debi AIR 1962 SC 151*]

The standard yardstick for valuation is what a landlord can reasonably expect to earn from a hypothetical tenant. [*Dewan Daulat Rai Kapoor v NDMC (1980) 122 ITR 700 (SC)*]

Taxability of Refund of Municipal Tax

Unlike Section 41(1), there is no provision for taxing refunds of municipal taxes under Income from House Property. [*CIT v India Automobiles (1960) Ltd (2001) 251 ITR 117 (Cal)*]

Annual Value of a Let-Out Property That Was Vacant

Under Section 23(1), the annual value is:

1. The sum for which the property could reasonably be let (*Expected Rent*).
2. If the actual rent received is higher, it is taken as the annual value.
3. If the property was vacant for any part of the year and actual rent received is lower than expected rent, then actual rent received is the annual value.

Key Rulings on Vacant Properties

If an owner intended to let a property but could not find a tenant, the annual value is nil under *Section 23(1)(c)*. [*Premisudha Exports Pvt. Ltd v ACIT (2007) 295 ITR 341 (Mum)(AT)*]

If a property was never let out in the past and was vacant throughout, Section 23(1)(c) does not apply, and the notional rent is determined instead. [*Sushma Singla v CIT (2017) 81 taxmann.com 167 (SC)*]

Determining Gross Annual Value in Two Situations

Situation	Annual Value Computation
Vacant for part of the year, but actual rent is higher than expected rent	Actual rent received (as it exceeds expected rent)
Vacant for whole or part of the year, and actual rent is lower than expected rent due to vacancy	Actual rent received (if lower than expected rent)

The following three conditions must be satisfied for applying Section 23(1)(c):

1. The property is let out.
2. It remained vacant during the year.
3. Due to vacancy, actual rent received is lower than expected rent.

If these conditions are met, the gross annual value is the actual rent received.

Deductions Allowed for Computing Income from House Property

Income under the head 'Income from House Property' is computed after allowing the following deductions:

1. **Standard Deduction (30%):** A flat deduction of 30% of the *Net Annual Value* is allowed.

2. **Interest on Borrowed Capital:** If the property is acquired, constructed, repaired, renewed, or reconstructed using borrowed capital, the interest payable is deductible annually, regardless of whether it has been actually paid. [*Circular No. 363, dated 24-6-1983*]

A direct link must exist between the borrowed capital and the property's acquisition or construction. [*CIT v Devendra Bros & Co. (1993) 200 ITR 146 (All)*]

If a company took over a business and paid interest on partner's credit balances, this interest cannot be deducted unless it directly financed the property purchase. [*CIT v Four Fields P. Ltd (1998) 231 ITR 262 (P&H)*]

Interest on instalments for commercial property purchases is deductible under Section 24. [*CIT v Sunilkumar Sharma (2002) 254 ITR 103 (P&H)*]

Prepayment charges and processing fees for securing a lower interest rate qualify for deduction. [*Peepul Tree Properties (P.) Ltd. v ACIT (2016) 71 taxmann.com 332 (Mum) (Trib)*]

Treatment of Interest Before Completion of Construction

If a loan is taken before the property is acquired or completed, **interest for the pre-construction period** is accumulated and allowed as a deduction in **five equal installments** starting from the year in which the property is completed.

Is a Bank Loan Necessary for Claiming Deduction Under Section 24(b)?

No, interest on any loan used for property acquisition or construction is deductible, even if not taken from a bank or financial institution. However, for Section 80C (principal

repayment), the loan must be from a recognized bank or financial institution.

Interest on Partners' Capital Contribution

Interest paid to partners on capital used for constructing a rented property is deductible under Section 24(b). [*CIT v Sane & Doshi Enterprises (2015) 58 taxmann.com 111 (Bom)*]

Interest on Loan Taken After Property Acquisition

Interest on a loan taken after acquiring the property is not deductible under Section 24(b) since the borrowed capital was not used for acquisition. [*Vijay Aggarwal v CIT (2016) 236 Taxman 542 (P&H)*]

Deduction for Interest on a Second Loan Taken to Repay an Original Loan

Interest on a second loan used to repay an original loan qualifies for deduction, provided it is used solely for repayment of the original property loan. [*Circular No. 28, dated 20-8-1969*]

This applies even if the first loan was interest-free. [*ITO v Makrupa Chemicals Pvt. Ltd (2007) 12 SOT 68 (Mum)*]

If the original loan qualified for a deduction, interest on the second loan is also deductible. [*K.S. Kamalakannan v Asst CIT (2010) 126 ITD 231 (Chennai)*]

Interest on Security Deposits Used to Repay a Loan

If security deposits from tenants are used to repay a property loan, interest paid on such deposits is deductible. [*ITO v Structmast Relator (Mum) (P.) Ltd. (2015) 56 taxmann.com 107 (Mum – Trib.)*]

Interest on Credit for Construction Material

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Interest payable to suppliers of construction materials qualifies for deduction under Section 24(b). [*Jyoti Metal & Allied Industries (P.) Ltd. v ITO (2015) 53 taxmann.com 168 (Delhi – Trib.)*]

### **Prepayment Charges as Deductible Interest**

Prepayment charges for early closure of a loan are considered interest under Section 2(28A) and deductible under Section 24(b), as they are directly related to loan repayment. [*Windermere Properties (P.) Ltd. v Dy. CIT (2013) 58 SOT 167 (Mum) (Trib.)*]

### **Is Interest on Interest Deductible?**

Only primary interest on borrowed capital is deductible, not additional interest due to non-payment. [*CIT v Saifuddin M. Moonum 1990 Tax LR 328 (Bom)*]

Compound interest (interest on unpaid interest) is not deductible. [*Shew Kissen Bhattar v CIT (1973) 89 ITR 61 (SC)*]

Banks' penalty interest on late loan repayments is also not deductible. [*Naman Kumar v CIT (2014) 221 Taxman 269 (P&H)*]

### **Deduction for Co-Borrowers (Husband & Wife)**

For self-occupied property, each co-owner can claim actual interest (up to ₹2,00,000), provided they pay the interest from their own income. Scenarios:

#### **1. Equal Ownership (50:50)**

Interest is split equally, assuming repayment is also shared equally.

#### **2. Unequal Ownership (60:40)**

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Deduction is in the same proportion (60:40), provided interest payments match the ownership ratio.

### 3. Sole Ownership with Co-Borrower

If the husband is the sole owner, but the wife is a co-borrower, only the husband can claim the deduction. If both pay interest, only the owner (husband) can claim it.

#### Deduction for Brokerage or Loan Arrangement Fees

Brokerage or commission paid to arrange a loan is not deductible. [*Circular No. 28, dated 20-8-1969*]

Brokerage paid to rent out property cannot be deducted from rent under Section 23 or Section 24. [*Tube Rose Estates (P) Ltd v ACIT (2010) 123 ITD 498 (Del)*]

#### Deduction for Stamp Duty or Lease/Rent Deed Registration Expenses

Expenses incurred on stamp duty or registration of a lease/rent deed cannot be deducted from the annual value of the house property. [*CIT v H.G. Gupta & Sons (1984) 149 ITR 253 (Del)*; *CIT v Premnath Motors (Raj) Pvt. Ltd (2007) 163 Taxman 383 (Raj)*]

#### Computation of Income for a Self-Occupied Property or One That Could Not Be Occupied Due to Employment

If a house (or part of it) is:

- (a) Used by the owner for residential purposes, or
- (b) Left unoccupied because the owner resides elsewhere due to employment, business, or profession (in a rented place), then its annual value is taken as nil.

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Annual Value of Property When Employee Resides in Official Quarters Instead of Own House

If an employee must stay in government-provided housing due to official requirements, Section 23(2)(b) applies, and the annual value of their own house remains nil. [*CIT v Justice Avadh Behari Rohtagi* (1985) 21 *Taxman* 409 (Del)]

Tax Treatment for Multiple Self-Occupied Houses & Recent Amendments

If a taxpayer owns multiple self-occupied houses, they may choose one house as self-occupied while the others are deemed let out, and their annual value is determined as per Section 23(1)(a).

Finance Act, 2019 Amendment

The benefit of Section 23(2) is now extended to two self-occupied houses (instead of one). The annual value of these two houses is taken as nil, while any additional house(s) is considered deemed let out.

Deduction for Interest on Loan When One Property is Deemed Let Out

If a taxpayer has two (or three, after the amendment) properties, and one is deemed let out, the full interest on borrowed capital is deductible, as Section 24(b) does not impose a limit on let-out properties. [*Smt. Tupur Chatterji v ACIT* (2014) 51 *taxmann.com* 240 (Mumbai Trib.)]

Can a House Be Treated as Self-Occupied If It Is Rented to the Employer?

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If a taxpayer rents their house to their employer, and the employer allots it back to them as rent-free accommodation, it cannot be treated as self-occupied, since the taxpayer does not occupy it as an owner. [*D.R. Sunderraj v CIT (1980) 123 ITR 471 (AP)*]

### **Can a Hindu Undivided Family (HUF) Claim Self-Occupation Benefits?**

Yes, an HUF can claim self-occupation benefits under Section 23(2), as an HUF is a group of individuals related by family ties, capable of residing in a jointly owned house. [*CIT v Hariprasad Bhojnagarwala (2012) 342 ITR 69 (Guj)(FB)*]

### **Deduction for a Self-Occupied Property with Nil Annual Value**

For a self-occupied house with nil annual value, no standard deduction (30%) is allowed, but interest on borrowed capital is deductible:

1. If the loan was taken on or after 1-Apr-1999, and the property was completed within 5 years, the deduction is:
  - Actual interest paid, up to ₹2,00,000
  - A certificate confirming interest payment must be obtained.
2. For loans taken before 1-Apr-1999 or for repairs/renewal, the deduction is:
  - Actual interest paid, up to ₹30,000

### **Finance Act, 2019 Amendment**

If a taxpayer opts for two self-occupied houses, the total interest deduction across both properties cannot exceed ₹2,00,000.

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Deduction for Interest on Self-Occupied Property Under Section 115BAC

Starting A.Y. 2021-22, taxpayers opting for Section 115BAC (New Tax Regime) cannot claim an interest deduction of ₹30,000 or ₹2,00,000 for self-occupied properties.

Tax Computation for a Partly Let-Out & Partly Self-Occupied Property

For a property that is partly let out and partly self-occupied, each portion is taxed separately:

- **Let-out portion:** Assessed under let-out property rules.
- **Self-occupied portion:** Assessed under self-occupied property rules (annual value = nil).

If fair rent or municipal valuation is not specified separately, it should be apportioned based on built-up area.

Finance Act, 2016—Taxation of Unrealized Rent & Rent Arrears

New Section 25A (effective A.Y. 2017-18) simplifies taxation of arrears of rent and unrealized rent as follows:

1. Taxation of Unrealized Rent/Rent Arrears (Section 25A(1))

Any arrears of rent or previously unrealized rent received in a later year is taxable in the year of receipt, even if the taxpayer no longer owns the property.

2. Deduction for Rent Arrears (Section 25A(2))

A standard deduction of 30% applies to arrears of rent/unrealized rent received.

Taxation of House Property Owned by Co-Owners

If a property is jointly owned, and the shares are clearly defined, each co-owner's income from the property is separately assessed, and they are not taxed as an Association of Persons (AOP).

Self-Occupied Property:

- Annual Value = Nil for each co-owner.
- Each co-owner can claim a deduction of ₹2,00,000 (or ₹30,000 for repairs) on interest on borrowed capital.

Let-Out Property:

Rental income is first computed for the property and then apportioned among co-owners based on their ownership share.

Can the Annual Value of a Property Be Negative?

Yes, if municipal taxes paid exceed the gross annual value, the net annual value can be negative.

Deduction of Municipal Taxes for Property Outside India

For resident taxpayers, global income is taxable, and house property income from foreign properties is computed under Section 22. Thus, municipal taxes paid abroad are deductible.

[CIT v Venugopala Reddiar (1965) 58 ITR 439 (Mad)]

Can There Be a Loss Under "Income from House Property"?

Yes, a loss can arise under this head in two cases:

1. **Self-Occupied Property:** Since the annual value is nil, only interest on borrowed funds (up to ₹2,00,000) can be deducted, leading to a loss of up to ₹2,00,000. Taxpayers under *Section 115BAC (New Regime)* **cannot** claim this deduction.


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2. **Let-Out Property:** If municipal taxes + deductions (30% standard deduction + interest) exceed the rental income, a loss can occur.

For deemed let-out properties, interest deductions are unrestricted, which may also lead to a loss under this head.

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