



Rental income is to be treated as business income of the taxpayer who is engaged in the business of leasing of property – Supreme Court

Background

Recently, the Supreme Court of India in the case of Rayala Corporation Pvt. Ltd.¹ (the taxpayer) held that the rental income earned from a leased property is to be treated as business income. The Supreme Court observed that the taxpayer was having only one business of leasing of its property and earning rent therefrom. Accordingly, the income so earned should be treated as its business income.

Facts of the case

- The taxpayer, a private limited company, has a house property, which has been rented and the taxpayer is receiving income from the said property by way of rent.
- The taxpayer claimed that since it is in the business of renting its properties and receiving rent as its business income, the said income should be taxed under the head 'profits and gains of business or profession'. However, the tax department contended that since the income is arising from house property, the said income must be taxed under the head 'income from house property'.
- The Madras High Court accepted the contention of the tax department and held the decision in favour of the tax department.
- Aggrieved by the decision of the High Court, the taxpayer filed an appeal before the Supreme Court.

Supreme Court's ruling

- The law laid down by the Supreme Court in the case of Chennai Properties and Investments Ltd.² indicates the correct position of law. The facts of the present case are similar to the case of Chennai Properties and Investments Ltd.
- The tax department contended that the rent should be the main source of income or the purpose for which the company is incorporated, should be to earn income from rent, so as to make the rental income to be the income taxable under the head 'profits and gains of business or profession'. However, we do not find any substance in the argument of the tax department since it is an admitted fact that the taxpayer in the present case has only one business, and that is of leasing its property and earning rent therefrom.
- The decision relied on by the taxpayer squarely covers the facts of the present case. The business of the taxpayer is to lease its property and to earn rent and therefore, the income so earned should be treated as its business income.
- In view of the law laid down by the Supreme Court in the case of Chennai Properties and Investments Ltd. and looking at the facts of the present case, the High Court was not correct while deciding that the income of the taxpayer should be treated as 'income from house property'.

¹ Rayala Corporation Pvt. Ltd v. ACIT (Civil Appeal No.6437 of 2016) (Supreme Court)– Taxsutra.com

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

- Accordingly, the income of the taxpayer shall be subject to tax under the head 'profits and gains of business or profession'.

Our comments

The issue whether the rental income is chargeable under the head 'income from house property' or 'profits and gains of business or profession' has been a matter of debate before the Courts.

The Supreme Court in the case of Chennai Properties and Investment Ltd and the Calcutta High Court in the case of Shyam Burlap Co. Ltd.³ have held that in the case of companies where a memorandum of association provides that the company is carrying on the business of letting out, the income is to be treated as business income and not income from house property.

The Supreme Court in the case of East India Housing and Land Development Trust Ltd.⁴ observed that since there is a separate head of income provided in the Income-tax Act, 1961 (the Act) for taxability of income from house property, the income is chargeable under that head. If the income from a source falls within the specified head set out in sections, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head.

Further, in the case of Karanpura Development Co. Ltd.⁵, the Supreme Court observed that the deciding factor is 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 them. The objects of the company must also be kept in view to interpret the activity. The nature of the business was trading within the objects of the company and not the enjoyment of property as a landowner. There was also no sale of its fixed capital at a profit. Accordingly, it was held that the income was in the nature of business income and not income from house property.

The Supreme Court, in the present case, has followed the ratio laid down in the case of Chennai Properties and Investments Ltd. and held that rental income earned by the taxpayer from a leased property is to be characterised as business income because the main business of the taxpayer was to lease its property and to earn rent therefrom.



³ Shyam Burlap Co. Ltd. v. CIT (ITA No. 163/2005, dated 4 September 2015)

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

⁵ Karanpura Development Co. Ltd. v. CIT [1961] 44 ITR 362 (SC)

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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