Vacancy allowance is available only for a property that was ‘let out’; ‘intention to let’ is not relevant

Background

The Income-tax Act, 1961 (the Act) allows for a deduction1 (vacancy allowance) from the taxable rental value in cases where a let-out property was vacant during the year. Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Sharan Hospitality Private Limited2 (the taxpayer) held that a vacancy allowance cannot be availed where a property was not let out during the year, irrespective of the ‘intention to let’ such a property.

Facts of the case

- The taxpayer was the owner of two properties in Mumbai. One of the properties was acquired in December 2008 with the intention of letting the property in order to earn rental income.
- The taxpayer entered into an agreement with Super Religare Laboratories Limited (the tenant) in February 2009 for letting the said property effective 1 April 2009. The property was in fact let to the tenant from April 2009.
- The taxpayer filed its Income Tax Return (ITR) for the financial year 2008-09 claiming the Annual Value (AV) of the said property as nil.
- Upon assessment, the Assessing Officer (AO) computed the AV of the property for the three month period (January to March 2009) based on the annual rent of the property as per the lease agreement with the tenant.
- The taxpayer placed reliance on the decision in the case of Premsudha Exports3 and other judicial precedents4 in claiming the AV as nil on the following grounds:
  - The property was held with an intention to let. Hence, the condition of ‘being let’ was satisfied.
  - The Legislature did not require the property to be actually let out for the purpose of claiming vacancy allowance. Where required, the Legislature had stated so, as in Section 23(3)(a) of the Act.
  - In case vacancy allowance is not allowed for a property which was vacant for the entire year, it would result in an anomaly wherein a property that was vacant for the entire year would have a higher AV (based on a notional value) than a property which was vacant for part of the year (actual rent for the period of letting).

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1 Section 23(1)(c) of the Act
2 Sharan Hospitality Private Limited v. DCIT (ITA No. 6717/Mum/2012)
3 Premsudha Exports Private Limited v. ACIT [2007] 295 ITR (AT) 341 (Mum)
4 Kamal Mishra v. ITO [2008] 19 SOT 251 (Del); Smt. Poonam Sawhney v. AO [2008] 29 SOT 69 (Del); ACIT v. Dr. Prabha Sanghi [2012] 139 ITD 504 (Del); DLF Office Developers v. ACIT [2008] 23 SOT 19 (Del); Indu Chandra v. DCIT (ITA No. 96/2011 (Luck.); Shakuntala Devi v. DDIT (ITA No. 1524/Bang/2010); Aryabhata Properties Ltd. v. ACIT (ITA No. 6928/Mum/2011); and ACIT v. Suryashankar Properties Ltd. (ITA No. 5256/Mum/2013)
• On an appeal by the taxpayer, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO on the basis that the cases relied upon by the taxpayer were factually distinct from the taxpayer’s case.

• Aggrieved by the order of the CIT(A), the taxpayer went on appeal before the Tribunal.

• The tax department relied on the decision of the Andhra Pradesh High Court in the case of Vivek Jain\(^5\) where it was held that ‘where the property is let’ cannot be read as ‘where the property is intended to let’.

• The tax department contended that the AV of the property in question was to be computed as per the AO’s order on the following grounds:

  ➢ AV of a property is the income which a property would potentially earn. The laws bring to tax AV of property, regardless of whether the property was let out or not. As decided by the Supreme Court in the case of Sultan Brothers\(^6\), only where the actual rent from a property is higher than its AV, then the actual amount is considered as income for taxation.

  ➢ In the case of let out properties, the law seeks to tax the AV of a vacant property based on a notional sum representing its potential income. This is so, irrespective of the actual rent from the property or of the fact whether the property was actually let out or not.

**Tribunal’s ruling**

• Section 23(1) of the Act which deals with taxation of income from a property provides for the following:

  ➢ Income from a property is taxed based on its AV, which is the income potential (Fair Rental Value – FRV) of the property. This is so, irrespective of whether the property was actually let or not.

  ➢ AV of one property could be considered as nil in cases where such a property could not be occupied by the owner by reason of his/her employment or business/profession.

  ➢ Where the rent received from a property is higher than the FRV, the actual rent becomes the AV for such a property. Further, in case the rent received is lower than the FRV owing to the property being vacant, the actual amount realised/realisable is taken as the AV, irrespective of the FRV.

• The law\(^7\) as it stood in 1976-77 allowed vacancy allowance as a deduction only where the vacancy occurred after the property had been let out. The law was amended in 1977-78 in order to grant vacancy allowance irrespective of whether the vacancy allowed prior to or following the period in which the property had been let out. Hence, vacancy allowance was available only if the property was let out for at least a part of the relevant year. Accordingly, in case a property was not let out at all during the entire year, vacancy allowance cannot be availed. This was a well-settled principle.

• The question before the Tribunal was whether the provision of the law relating to vacancy allowance extends to a property which was not let but was intended to be let, especially on the grounds that the Finance Act, 2001 amended the language of Section 23(1)(c) so as to include ‘during the whole or any part of the previous year’.

• In the case of Vivek Jain, the High Court held that in case a property was not let out at all during the year, no vacancy allowance could be claimed on the following basis:

  ➢ The provisions of a taxing statute were to be strictly construed.

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\(^5\) Vivek Jain vs. ACIT [2011] 337 ITR 74 (AP)
\(^6\) Sultan Brothers Private Limited v. CIT [1964] 51 ITR 353 (SC)

\(^7\) Section 24(1)(ix) of the Act prior to the amendment made by the Finance Act, 2001 effective 1 April 2002
The intention of Section 23(1)(c) was not to exclude self-occupied properties from the ambit of taxable AV as such properties were already covered under Section 23(2)(a) of the Act.

The said provision was introduced to mitigate the hardship faced by a taxpayer where the actual rent earned from the property was lower than its AV due to its vacancy. Such a case was not dealt with by Section 23(1)(b) of the Act.

The Central Board of Direct Taxes (CBDT) had clarified that the amendment made by the Finance Act, 2001 was with a view to rationalize the provisions of section 23 and 24 of the Act as these provisions had become complicated on account of various amendments. Hence, the position of the law relating to vacancy allowance had not changed. Vacancy allowance was allowed as a deduction from AV prior to the said amendment. After the amendment, the vacancy allowance has the effect of reducing the AV.

The purpose of the vacancy allowance was to provide relief to the taxpayer to the extent of rent which could not be earned owing to its vacancy, despite being let.

As observed in the case of Vivek Jain, the concept of vacancy was intrinsically linked with the actual letting of the property. The Tribunal observed that a property which had not been let out any time since assuming its ownership could not be regarded as a property let.

The Tribunal noted that in the case of Premshudha Exports, it was held that ‘intention to let’ was sufficient for a property to qualify as being let and eligible for vacancy allowance. It held that ‘where the property is let’ represents actual letting of a property and cannot be extended to a state of ‘intended letting’. The words ‘actually let’ are of no significance in this regard.

The decision in the case of Vivek Jain by the High Court has higher precedential value than the decision in the case of Premshudha Exports which was rendered by the Mumbai Tribunal.

The Tribunal upheld the order of the AO in computing the AV of the property for the period January to March 2009 without considering any vacancy allowance.

**Our comments**

The Tribunal had denied vacancy allowance in the present case on the grounds that a property that had not been let out is not eligible for vacancy allowance and the scope of the provisions relating to ‘actual letting’ could not be expanded to cover ‘intention to let’. The Tribunal has arrived at its decision based on the provisions of the Act relating to the taxation of house property and on the principle laid in the case of Vivek Jain by the Andhra Pradesh High Court. This decision is divergent to the other judicial precedents in support of the view that ‘intention to let’ was sufficient to claim a vacancy allowance.

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8 Premshudha Exports Private Limited v. ACIT [2007] 295 ITR (AT) 341 (Mum), Kamal Mishra v. ITO [2008] 19 SOT 251 (Del); Smt. Poonam Sawhney v. AO [2008] 20 SOT 69 (Del); ACIT v. Dr. Prabha Sanghi [2012] 139 ITO 504 (Del); DLF Office Developers v. ACIT [2008] 23 SOT 19 (Del); Indu Chandra v. DCIT (ITA No. 96/2011 (Luck)); Shakuntala Devi v. DDIT (ITA No. 1524/Bang/2010); Aryabhata Properties Ltd. v. ACIT (ITA No. 6928/Mum/2011); and ACIT v. Suryashankar Properties Ltd. (ITA No. 5258/Mum/2013)