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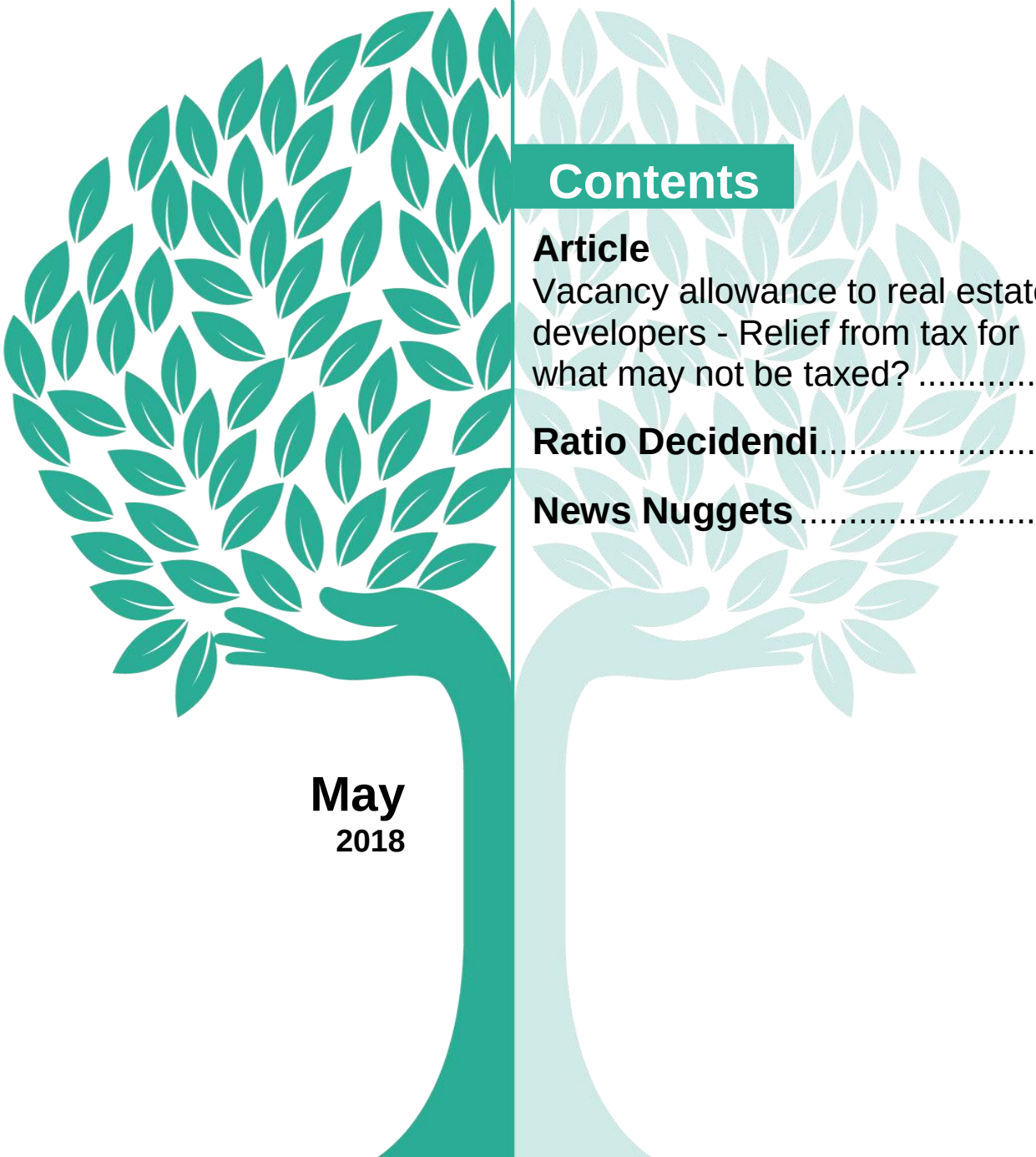

May
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Vacancy allowance to real estate developers - Relief from tax for what may not be taxed?

By **Karanjot Singh Khurana**

Introduction:

Finance Act, 2017 amended[1] the Income-tax Act, 1961 ('IT Act') to provide that the annual value of building or land appurtenant thereto which is held by the assessee as stock-in trade will be deemed to be Nil for a period of one year from the end of the financial year in which the certificate of completion is obtained in respect of such property. It was explained in the Memorandum to the Finance Bill, that the provision had been inserted after *"considering the business exigencies in case of real estate developers."*

However, the provisions of IT Act do not expressly provide that the income from vacant house property can be taxed in the first place. As will be discussed in the subsequent paragraphs, there are contrary views of different fora on the taxation of the house property which has been vacant throughout the year.

The said amendment provides for a limited period relief beyond which the taxability will have to be ascertained as per regular provisions. Therefore, the inserted provision needs to be analysed in light of the judicial pronouncements to examine as to whether a benefit to this extent was required to be provided by the legislature. If the annual value can be said to be nil even without the help of this amendment, then there won't be tax liability even beyond the one-year period specified in the said amendment. In order to appreciate the dispute, it is pertinent to understand the legal provisions providing taxation of income from house property.

Legal Provisions:

The provisions[2] of IT Act create a charge of tax on *annual value* of property (consisting of buildings or land appurtenant thereto) which is owned by the assessee other than properties which are occupied for business or profession of the assessee.

The term 'annual value' has been defined in section 23 of the IT Act:

> *"(1) For the purposes of section 22, the annual value of any property shall be deemed to be—*
> *(a) the sum for which the property might reasonably be expected to let from year to year; or*
> *(b) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or*
> *(c) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable……."*
>
> (Emphasis Supplied)

[1] Inserted section 23(5) of the IT Act

[2] Section 22 of IT Act

Dispute in interpretation:

It is evident from the perusal of the provisions of Section 23 of the IT Act, that the legislature seeks to tax not only the actual income which has been received by the assessee by letting out the property (vide clause (ii) of section 23(1)), but also the notional income which the assessee might have realised from letting out such property (*vide* clause (i) of section 23(1)). The constitutional validity of subjecting such notional income to tax has been examined by the Supreme Court[3] and it has been upheld that the legislature is competent to tax not only what has been received by the assessee from exploitation of the property but also what can be converted income from use of property. The competency of the legislature to tax notional income is therefore, not a subject matter of dispute.

The divergence of views lies in interpretation of section 23(1)(c) of the IT Act which seeks to provide a relief in respect of vacant house properties. Section 23(1)(c) of IT Act provides that where a house property was 'let' but remained vacant during 'whole or any part' of the year owing to which the rent received or receivable is less that its lettable value (as provided in section 23(1)(a) of IT Act), then such sum received or receivable shall be deemed to be annual value of the property.

The clause, it seems, encompasses two diametrically opposite situations. On one hand, the qualifying condition for the clause is that the property should have been let out by the tax payer and on the other hand, the clause includes even those properties which have been vacant throughout the year. This peculiar use of words has led to a dispute between the taxman and the taxpayer. It is contested by the former that in case of house properties which have been vacant throughout the year, clause (c) cannot be applied, as the qualifying condition (i.e. property should be let) is not met and the annual value in such cases should be computed in terms of section 23(1)(a) of IT Act. On the other hand, the taxpayers contest the express inclusion of a property which is vacant throughout the previous year in section 23(1)(c) of IT Act makes it evident that the legislature seeks not to tax the notional income from the property. It is evident that the latter interpretation will make the annual value of property 'nil' and consequentially will result in a nil tax from house property.

Judicial Precedents:

There have been divergent views by different fora on interpretation of Section 23(1)(c) of IT Act:

(i) **<u>In favour of revenue</u>**: Hon'ble High Court of Andhra Pradesh[4] held that provisions of section 23(1)(c) will not apply in a situation where the property has not been let in the previous year. The Court also held that the condition of a property (which has been let) being vacant throughout the year can also be met in a case where the property is let for more than a year but is vacant throughout the year. In reaching its conclusion, the Court heavily relied on the CBDT circular[5] and the judgment of the Hon'ble Supreme Court[6]. In the latter case, the Supreme Court was interpreting the erstwhile provision relating to vacancy allowance contained in section 24(1)(ix) of IT Act. Since the provisions relating to vacancy allowance were *pari-materia* to section 23(1)(c) of the IT Act, the Court supplied the interpretation of the Hon'ble Supreme

[3] *Bhagwan Dass Jain* v. *Union of India:* [1981] 128 ITR 315 (SC); and *CIT* vs. *G.R. Karthikeyan*: [1993] 201 ITR 866 (SC)

[4] *Vivek Jain* vs. *ACIT*: [2011] 337 ITR 74 (Andhra Pradesh)
[5] Circular No. 14 of 2001
[6] *Liquidator of Mahamudabad Properties (P.) Ltd.* v. *CIT*: [1980] 124 ITR 31 (SC)

Court to section 24(1)(ix) of IT Act. Similar interpretation to section 23(1)(c) of IT Act have been supplied by Hon'ble High Court of Gujarat[7], Hon'ble High Court of Delhi[8] and Hon'ble High Court of Punjab and Haryana[9]. The SLP preferred by the assessee against the latter judgment was dismissed by the Hon'ble Supreme Court[10].

(ii) **In favour of assessee**: In a matter before Mumbai Bench of ITAT[11], the Bench held that since the provisions of section 23(1)(c) also cover a situation where a property can be vacant for whole of the previous year, the income from property which has been vacant for whole of the previous year will be computed in terms of section 23(1)(c) of the IT Act. The aforesaid judgment of Mumbai Bench was followed by Pune Bench[12] and Bangalore Bench[13]. While the judgment of Hon'ble Andhra Pradesh *(supra)* was not relied on by the revenue in the latter judgment, the bench in the former judgment held that the judgment of Hon'ble Court '*cannot be read in a manner that if the property remains vacant throughout the year, section 23(1)(c) do not apply at all more so when the property was let out in the proceeding or subsequent year".* However, in a subsequent judgment, Hon'ble Mumbai Bench[14] held that the understanding stated in its earlier judgment could not be supplied to section 23(1)(c) as such judgment was delivered prior to the judgment of Hon'ble Andhra Pradesh High Court. But when the issue was again brought up before the Hon'ble Mumbai Bench[15] recently, the bench did not follow the law laid down by High Courts (as per the judgment, it seems judicial precedents of High Court were not cited before the Bench by the revenue) and followed the interpretation supplied in *Premsudha Exports*[11] and held that income from property vacant throughout the year will be deemed to be Nil.

Author's analysis:

It is pertinent to note that the text of the section as interpreted by the Apex Court[6] was materially different from the current text. It used the phrase 'let and was vacant during a part of the year' as against the present text which reads as 'let and was vacant during *the whole* or any part of the year'. The conscious insertion of the expression 'the whole' cannot be ignored and left redundant unless such result is unavoidable. The difficulty that one may find is as to how to reconcile the situation of whole year's vacancy with the condition that the property should have been let. It is obvious that both cannot co-exist therefore ideal interpretation is to attribute a sense of rationality to the law maker and assume that they would not have intended self-contradictory conditions. The problem can be solved if the application of the word 'let' is confined to the phrase 'any part of the year' and not extended to 'vacant during the whole…year'. This interpretation will:

a) Avoid any words in the clause becoming redundant;
b) Attribute a sense of rationality to the Parliament; and
c) Would not offend one's sense of justice else one may have to grant vacancy

[7] *Gujarat Ginning & Mfg. Co. Ltd.*: [1994] 205 ITR 314
[8] *Ansal Housing & Construction Ltd.:* [2018] 89 taxmann.com 238 (Delhi)
[9] *Susham Singla* vs. *CIT*: [2017] 244 Taxman 302 (Punjab and Haryana)
[10] [2017] 247 Taxman 312 (SC)
[11] *Premsudha Exports (P.) Ltd.* vs. *ACIT*: [2008] 110 ITD 158 (Mumbai)
[12] Vikas Keshav Garud vs. *ITO*: ITA No. 747/PN/2014
[13] *Shakuntala Devi*: 1524/bang/2010
[14] *Sharan Hospitality Private Limited* vs. *DCIT*: ITA No. 6717/Mum/2012
[15] *ITO* vs. *Metaoxide (P.) Ltd.*: [2018] 92 taxmann.com 302 (Mumbai-Trib.)

deduction and tax only for one day to a case of 364 days of vacancy due to one day's letting while on the other hand tax for 365 day for a vacancy of 365 days.

d) Ensure that an objective interpretation is supplied over a subjective interpretation. Thus, subjective criteria like intent to let[16] or the relevance of the extent of the period for which the property should be let[17] before it becomes vacant etc., will be no consequence.

Conclusion:

Although, the High Courts seem to have unanimously held that the income from property which has been vacant whole of the previous year, will be determined in accordance with provisions of section 23(1)(a) of the IT Act, the difference in interpretation supplied by ITAT in its Orders which have been delivered even after the aforesaid judgments, has led to a situation where computation of income from a vacant house property is uncertain. In light of this fact, one may even question, as to whether the income from property held as stock in trade after the expiry of time period mentioned in provisions of section 23(5) of IT Act, can be brought to tax. Until there is a clarity which is brought to this issue by a judgment of Supreme Court, it is likely that divergent views may be taken by taxpayers and taxman as a result of which the matter may continue to be litigated.

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Ratio Decidendi

Deductions to be allowed in both export turnover and total turnover under Income Tax Section 10A

Supreme Court has held that software development charges relatable to technical services provided outside India are to be excluded from 'total turnover' while working out deduction under Section 10A of Income Tax Act. The main issue revolved around the claim of certain expenses attributable to the delivery of software outside India or in providing technical services, from 'total turnover' by the assessee under Section 10A. The Court in this regard noted that the term 'total turnover' was neither defined in Section 10A nor in Section 2, and that though same is defined in clause (ba) of the Explanation to Section 80HHC, but said definition cannot be adopted for the purposes of Section 10A as the technical meaning of total turnover does not envisage reduction of any expenses from the total amount the taken into consideration for computing the deduction under Section 10A. The Apex Court however observed that Section 10A is a special beneficial provision and the purpose of deduction under such section is to encourage and boost the new business undertakings situated in the free trade zone by providing suitable deductions to such business entities. It was thus held that if deductions on freight, telecommunication and insurance are allowed only in export turnover and not total turnover, then intention of legislature would get

[16] Para 18 of judgment of Mumbai Bench of ITAT in the case of *Premsudha Exports (P.) Ltd.* v. *ACIT*: [2008] 110 ITD 158 (Mumbai)

[17] Para 15 of judgment of High Court of Andhra Pradesh in the case of *Vivek Jain* vs *ACIT*: [2011] 337 ITR 74 (AP)

defeated. [*CIT* v. *HCL Technologies* – Judgement dated 24-4-2018 in Civil Appeal Nos. 8489-8490/2013 and Others, Supreme Court]

Re-assessment cannot be initiated on mere change of opinion

Supreme Court has upheld High Court's Order where the lower court had set aside re-assessment proceedings under Section 147 of Income Tax Act. Observing that Assessing Officer in such proceedings should have 'reason to believe' that income escaped assessment, it held that these words have to be interpreted schematically. Noticing that re-assessment is not to be allowed merely for 'change of opinion' of Assessing Officer on same facts, Court while deliberating on its meaning, held that question of extent of deduction under Section 10A was well considered in original assessment itself and hence reopening on this ground that it had been allowed in excess was not valid. [*ITO* v. *TechSpan India* – Judgement dated 24-4-2018 in Civil Appeal No. 2732 of 2007, Supreme Court]

Reopening of assessment on basis of audit objection earlier opposed by AO, not valid

Bombay High Court has held that reopening of assessment even though within the stipulated period but on the ground which AO earlier opposed in response to audit objection was not valid. The AO had previously allowed deduction under Section 80-IB (4) on duty drawback at the time of original assessment and also treated the deduction as allowable in his reply to audit objection. But after one and half years, the AO reopened the assessment denying the deduction, contending that he applied his mind afresh without considering the audit objection. Observing that the reasons as recorded by the AO were in substance identical with the audit objection, the High Court held that it cannot be said that AO had formed his own view of the income escaping assessment without getting influenced by the audit objection. Thus, reopening of the assessment on the basis of audit objection was held to be invalid. Revenue department's alternate contention that the reopening was on the basis of Apex Court judgement disallowing the deduction on duty drawback, was also rejected by the Court here. It observed that the Supreme Court judgement was non-existent at the time when the reasons for reopening were recorded by AO. [*CIT* v. *Rajan N Aswani* - [2018] 403 ITR 30 (Bom)]

Tranfer pricing - Comparables with high brand value, functional dissimilarity to be excluded

Delhi High Court has upheld the ITAT's decision of excluding the selected comparables considered by TPO for making transfer pricing adjustment. The comparable were deleted due to difference in functional requirements and non-availability of segmental data. The assessee in the instant case, was engaged in IT enabled infrastructure development and testing, system and performance operations management, etc., but, the comparables selected, were engaged in providing high end BPO services, high end KPO services in health sector and high value financial services respectively. Thus, these comparables were deleted on two grounds i.e., they were functionally different and there was lack of availability of segmental data. The fourth comparable even though functionally similar was having a high brand value which had a direct impact on its profitability and therefore, was excluded. The case also involved the issues pertaining to forex gains and notional interest on delayed payment, in which the Court held that the foreign exchange gain shall be treated as part of operating income for determining arm's length price and notional interest shall be excluded for

TP adjustment. [*Principal CIT* v. *B.C. Management Services Pvt. Ltd.* - [2018] 403 ITR 45 (Delhi)]

WDV of assets after its useful life can be claimed as additional depreciation

The assessee being a charitable trust, running a hospital, had claimed written down value of the assets i.e. hospital equipment as additional depreciation. These assets after completing their useful life were written off in the books of the assessee. As per the rules, the assessee was prohibited from selling these assets as scrap. Since the assessee could neither use these assets nor sell them as scrap, the written down value (remaining after the claim of normal depreciation) was claimed as additional depreciation. Section 32(1)(iii) of the Income Tax Act provides that when certain assets are sold, discarded or demolished then the amount by which the moneys payable (including scrap) in respect of such asset falls short of the WDV then, the excess WDV shall be allowed as depreciation provided the asset is written off in books of accounts of the assessee. By applying the aforesaid provision to the present case, the Court dismissed the Revenue department's claim, while also observing that the nomenclature as 'additional depreciation' rather than 'depreciation', would not decide a claim. It also held that on application of commercial principles, the deduction could also be alternatively claimed under Section 37 as expenditure incurred wholly and exclusively for carrying out activity as a hospital. [*CIT (Exemption)* v. *Bhatia General Hospital* - [2018] 254 Taxman 285]

Entertainment tax subsidy received by newly set up multiplex is capital receipt

The assessee under UP State Government's incentive scheme was given entertainment tax subsidy in the form of an exemption from payment of tax to the Government for initial 5 years. As per the scheme, the assessee was allowed to collect and retain entertainment tax for an amount equivalent to cost of construction of complex for an initial period of five years but, subject to a condition that if the cost of construction is recovered before the said period of five years then, no benefit of exemption from payment of tax shall be granted for the remaining period. The assessee treated subsidy as a capital receipt (non-taxable) as it was for the promotion of construction of multiplex and the quantum of subsidy was limited to cost of construction of multiplex (excluding cost of land). The assessing officer contended that since the subsidy was given after multiplex had started the operations, the purpose is to help the multiplex run profitably and was therefore a revenue receipt. The Tribunal relying upon the judgment of Supreme Court in the case of *CIT-1, Kolhapur v. Chaphalkar Brothers, Pune* held that since the object of the scheme was that the persons come forward to construct multiplex theatre complexes, it was a capital receipt. [*DCIT* v. *Shipra Hotels Ltd.* - [2018] 63 ITR (Trib.) (S.N.) 70 (Delhi)]

ICDs are Inland Ports - Deduction under Income Tax Section 80-IA for AYs 2003-06 available

Supreme Court while perusing through the issue of whether the Inland Container Depots (ICDs) under the control of the assessee, during assessment years 2003-04 to 2005-06, qualified for deduction under Section 80-IA(4) of the Income Tax Act, has held that Inland Container Depots are inland ports and that deduction under said provisions can be claimed for income earned out of these depots. The Court in this regard was of the view that such deduction allowed for a period of 10 years by notification issued in 1998 (incorporating ICDs as infrastructure facility) will not get nullified by Finance Act, 2001, retrospectively. Observing that part of activities carried out at ports such as customs clearance

are also carried out at these ICDs, the Apex Court held that the claim has to be considered within the scope of the term 'inland port' in Explanation (d) of Section 80-IA(4).

Finance Act, 1995 had amended Section 80-IA with the purpose of boosting country's infrastructure and specially the transport infrastructure, thus allowing deduction in respect of profits and gains from industrial undertaking or enterprises engaged in the infrastructure development, etc. By Finance Act 2001, the power of the Board to extend the benefit of the said provisions to any infrastructure facility of similar nature by issuing a notification was taken away. [*CIT* v. *Container Corporation of India* – Judgement dated 24-4-2018 in Civil Appeal No. 8900 of 2012, Supreme Court]

Interest on deposits of share application money not 'income'

The assessee did not offer interest earned on deposit of share application money to tax. The assessee was statutorily required to keep share application money in bank till allotment of shares was complete. The Apex Court viewed that the interest accrued to such deposit is liable to be set-off against expenditure involved for share issue. The Supreme Court held that since income accrued was merely incidental and not the prime purpose of doing the act, the additional income is eligible for deduction against public issue expenses. [*CIT* v. *Shree Rama Multi Tech* – Judgement dated 24-4-2018 in Civil Appeal No. 2732 of 2007, Supreme Court]

Undisclosed income - When can same AO issue notices under Sections 158BC & 158BD

Supreme Court has held that second notice issued under Section 158BD of the Income Tax Act against the partner of firm is sustainable even when a notice under Section 158BC has already been issued against the firm after a search conducted under Section 132. It noted that Assessing Officer was *prima facie* satisfied that undisclosed income belonged to the partner. The Apex Court observed that same jurisdictional Assessing Officer can proceed to make block assessment against both assessee. It however noted that proceedings under Section 158BD must contain reasons coupled with mental and dispassionate thought process of Assessing Officer. [*Tapan Kumar Dutta* v. *CIT* – Judgement dated 24-4-2018 in Civil Appeal No. 2014 of 2007, Supreme Court]

Lease rentals – Bifurcation according to ICAI guidance note, correct

Observing that there is no express bar in the Income Tax Act on application of ICAI accounting standards, Supreme Court has allowed deduction on account of lease equalization charges from lease rental income, on the basis of ICAI Guidance Note. The Court noted the purpose behind the amendment in Section 211 of Companies Act, 1956, and held that the accounting method is a valid method of capturing real income based on substance of finance lease transaction. Such bifurcation according to the guidance note was held to be correct. [*CIT* v. *Virtual Soft Systems* – Judgement dated 24-4-2018 in Civil Appeal No. 4358 of 2018, Supreme Court]

Income from Stock Appreciation Rights not taxable prior to 2000

Supreme Court has held that amount received on redemption of Stock Appreciation Rights to be treated as 'perquisites' under Section 17 of Income Tax Act which was not taxable during the relevant Assessment Year 1998-99. It was noted that such benefits transferred by employer to employees were brought within the tax ambit only after amendment in 2000 and that the amendment was not retrospective. The Court observed that the assessee was allotted SARs by

his employer which was not allotment of shares, and that said transaction can be treated as Capital Gains but was not taxable since it was not possible to compute cost of acquisition, the mechanism for which was provided only in the amendment in 2000. [*Addl. CIT* v. *Bharat Patel* – Judgement dated 24-4-2018 in Civil Appeal No. 4380 of 2018, Supreme Court]

Double taxation allowed only when language of legislature provides for it

Supreme Court has held that assessee can be subjected to double taxation provided the legislature contains a special provision in this regard. It observed that Income Tax Act was made applicable in Sikkim only after 1989, thus, Income-tax for 1986-87 would be payable under Sikkim State Income Tax Rules and not under Income Tax Act. The lottery income earned by assessee (person not resident of Sikkim) was held not taxable under Indian Act as it had already been taxed under Sikkim Rules. The deduction under Section 80TT was allowed on gross income. [*Mahaveer Jain* v. *CIT* – Judgement dated 19-4-2018 in Civil Appeal No. 4166 of 2006, Supreme Court]

News Nuggets

Export incentive under Section 80HHC to supporting manufacturer – Supreme Court refers issue to Larger Bench

Supporting manufacturer who receives export incentives in the form of duty drawback (DDB), Duty Entitlement Pass Book (DEPB), etc., whether is entitled for deduction under Section 80HHC of Income Tax Act at par with the direct exporter? Supreme Court has referred the question to its Larger Bench. The Apex Court in this regards in its judgment dated 27-4-2018 in the case of *Commissioner* v. *Carpet India* observed that earlier cases of the Court in *Baby Marine Exports* and *Sushil Kumar Gupta* are not identical and cannot be related with the deduction of export incentives.

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