

Rental income taxable as business income if assessee has shut down its main business activity

Summary – The Mumbai ITAT in a recent case of Raj Jain., (the Assessee) held that where assessee closed down its business of manufacturing tiles during relevant year and earned rental income by giving premises on lease, since main activity of assessee was of letting out properties, rental income in question was to be taxed under head 'income from business or profession'

Where rental income earned by assessee was assessed as 'business income' remuneration paid to directors for rendering services in order to earn said rental income was to be allowed as deduction

Facts

- The assessee-company was engaged in the business of development of property and rent collection.
- During the course of assessment proceedings, the Assessing Officer noticed that the assessee had derived rental income from two properties and treated the same under the head 'Income from business and profession'.
- The Assessing Officer, called upon the assessee to explain as to why the rental income received from letting out properties should not be treated as income from house property.
- In response to show cause notice, the assessee submitted that it had earned rental income from letting out of properties which were once used by themselves for the business purpose in the past. However, as the business of manufacturing tiles was closed down, they had given the premises on lease to others so as to earn rental income and accordingly it was termed rent under the head 'Income from business or profession'.
- The Assessing Officer rejected assessee's explanation and treated rental income received from letting out of properties as assessable under the head 'Income from house property'.
- Further, the Assessing Officer disallowed expenses being remuneration paid to directors on the ground that once rental income had been treated as income from house property consequent deductions towards expenses under section 24(a) had been given. Therefore, no further deductions could be given towards remuneration to directors under the head 'Income from house property'.
- The Commissioner (Appeals) confirmed the order passed by Assessing Officer.
- On second appeal:

Held

- It is admitted fact that the assessee has discontinued its manufacturing activity and continued the activity of letting out its properties and derived rental income. The activity of assessee is also supported by main objects clause in memorandum of association. Except letting out properties the assessee has not carried out any other business activity. Once the assessee has carried out its main activity of letting out properties to derive rental income, such rental income should be considered under the head 'Income from business'.

- If the main activity of the assessee was of letting out properties and derive rental income without any other business activity, then such rental income had to be considered under the head "Income from business or profession" but not under the head "Income from house property". Therefore, the Assessing Officer is directed to assess rental income under the head 'Income from business or profession' as claimed by the assessee.
- Coming to disallowance of expenses being directors' remuneration and motor car expenses including depreciation on motor car, the Assessing Officer disallowed remuneration paid to directors on the ground that the expenditure was not wholly and exclusively incurred for the purpose of business of the assessee. The Assessing Officer further observed that once the rental income has been considered under the head "Income from house property" after allowing the deductions available towards expenses as per the provisions of section 24(a), further deductions towards expenses cannot be allowed.
- There is no merit in the arguments of the Assessing Officer for the reason that the allowability of expenses has to be considered in the light of the nature of business of the assessee and its relevance. Since the Assessing Officer has already been directed to consider rental income under the head "Income from business", the Assessing Officer is directed to consider expenses incurred by the assessee against such income.
- In this case, the assessee had paid remuneration to directors and also furnished evidences for payment of remuneration for services rendered by them to the company. Therefore, the Assessing Officer was incorrect in disallowing remuneration paid to directors by holding that the expenses were not wholly and exclusively incurred for business and also which is excessive and unreasonable. Hence, the Assessing Officer is directed to allow expenses claimed by the assessee against business receipts.
- Insofar as motor car expenses and depreciation on motor car, the assessee has used motor car for the purpose of business even though the car is in the name of director. Merely because the car is in the name of director the usage of car for the purpose of business cannot be ruled out. However, the fact remains that when the Assessing Officer has specifically asked for production of log book, the assessee failed to furnish log book to prove the use of vehicle for the purpose of business. Therefore, the issue needs to be examined by the Assessing Officer in the light of the claim of the assessee that the motor car has been used for the business purpose. If the assessee substantiates its claim with necessary evidences and also by producing the log book to prove that car is used for business purpose, then the Assessing Officer is directed to allow motor car expenses including depreciation on motor car.
- In the result, the appeal filed by the assessee is partly allowed for statistical purpose.