Tax alert: Annual let out value of commercial property lying vacant for whole year to be taken as Nil

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The Mumbai Bench of the Income-tax Appellate Tribunal has held that in case of a commercial property which is vacant for the whole year, its annual value is to be taken as 'Nil' under section 23(1)(c) of Income-tax Act (ITA).

In a nutshell

In a scenario where the property is 'vacant for whole of the year', since 'actual rent' is to be taken into account, it will be 'Nil', as there is no tenant. However, the sum referred to in section 23(1)(a) of the ITA shall continue to be for the entire year. Hence, by having reference to 'less' for comparison, the aspect of vacancy is factored in to arrive at the annual value of the property in section 23(1)(c) of the ITA, which will be 'Nil' in the scenario where property is 'vacant for whole of the year'.

Vacancy denotes a temporary break for a period a property was let out. To effectively apply the situation of 'vacant for the whole year' under section 23(1)(c) of ITA, intent of letting out is of vital importance which needs to be considered, for the taxpayer.

By applying the principles of purposive interpretation to section 23(1)(c) of the ITA and to not to render the words 'vacant for the whole year' infructuous, the word 'let' used in the said section had to be interpreted as intended to be let out or available to let out.
The requirement that 'house is actually let' during the year is not to be taken as a pre-requisite for bringing the case of taxpayer within the sweep of section 23(2)(c) of the ITA, as long as the property is let out, in the earlier period and remains vacant for the whole year

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Background

- The taxpayer[1] is a company engaged in the development of malls, entertainment centres, multiplexes, etc. During the Financial Year (FY) 2015-16 corresponding to Assessment Year (AY) 2016-17, the taxpayer earned rental income by letting out certain units of the mall and offered the same under the head 'Income from house property'.
- The taxpayer did not offer income on the units which were not let out during the year, stating that it was on look-out for prospective tenants but could still be let out due to commercial reasons and hence claimed vacancy allowance under section 23(1)(c) of the Income-tax Act, 1961 (ITA), as these units were let out either in earlier AY or in subsequent AY but not in the year under consideration.
- During audit proceedings, the Assessing officer (AO) computed deemed rent for these units under section 23(1)(a) of the ITA.
- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings the matter reached before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

- **Relevant extract of section 23 of the ITA:**

"Section 23(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...

...(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" ...

Decision of the ITAT:

The ITAT held as follows:

- Finance Act, 2001 w.e.f. 1 April 2002 inserted clause (c) in section 23(1) of the ITA and the notes on clauses relating to the said amendment read as follows:

"Clause 14 seeks to substitute new section for section 23 of the Income-tax Act relating to determination of annual value of house property.

The existing provision of the said section provides for the determination of annual value of a property in certain circumstances including where the property is let, or is self-occupied, or **is vacant**, or **is partially let**, or **is let for part of the year**. The annual value so determined **is subject to the deductions allowable under section 24, including deductions on account of vacancy for any part of the year in respect of the property let, and on account of rent which cannot be realized**.

It is **proposed** to substitute the said section so as to provide for determination of annual value **in certain circumstances specified in the proposed new section** after allowing deductions in computing the annual value **on account of vacancy and unrealised rent**."

(Emphasis supplied).

- Section 23(1)(c) of the ITA deals with the situation where the property is let and remains vacant during the year. Vacancy referred in the clause envisages two scenarios, i.e. 'vacant during the whole of the year' or 'vacant during any part of the year'.

[1] Classic mall development Company Ltd v/s ACIT [ITA No. 5320/MUM/2024] (Mumbai ITAT)

Thus, the said two scenarios address the requirement of allowing deduction in computing the annual value due to vacancy and unrealized rent as mentioned in the notes on clauses relating to the amendment to section 23(1) by the Finance Act, 2001. For this, actual rent, whether received or receivable by the owner, is compared with the sum referred to in section 23(1)(a) of the ITA [which provides for determining the Annual Letting Value (ALV) at a sum for which the property might reasonably be expected to let from year to year'] and the lesser of the two is adopted to bring the deeming provision to a logical conclusion to arrive at the annual value of the property.

- In a scenario where the property is 'vacant for part of the year', since 'actual rent' is to be taken into account, it will be only for that part of the year for which it is let out. In comparison to this, the sum referred to in 23(1)(a) shall be for the entire year.

  In a scenario where the property is 'vacant for whole of the year', since 'actual rent' is to be taken into account, it will be 'Nil'; there being no tenant. However, the sum referred to in section 23(1)(a) of the ITA shall continue to be for the entire year. Hence, by having reference to 'less' for comparison, the aspect of vacancy is factored in to arrive at the annual value of the property in section 23(1)(c) of the ITA which will be 'Nil' in the scenario where property is 'vacant for whole of the year'.

- In a case where the property is vacant, owner cannot realise actual rent owing to such vacancy. Where the property is vacant for whole of the year under section 23(1)(c) of the ITA, there is no occasion for the owner to realise actual rent of the property, there being no tenant.

  Even the notes on clauses while explaining the proposed substitution to section 23(1) by Finance Act, 2001 mention about allowing deduction on account of 'vacancy' and 'unrealized rent' in computing the annual value. It is also evident that 23(1)(c) has been inserted as a protection to the taxpayer in cases where, on account of vacancy, the rent received or receivable on a property which has been let out, is less than the sum referred to in 23(1)(a). Prior to its amendment, even in such cases, it was the sum referred to in 23(1)(a) which was to be taken as the annual value of the property.

- The question which arose was, as to what determines 'vacancy'. It denotes a temporary break for a period a property was let out. In the case under consideration, certain units were let out in the immediately preceding AY or in the one before immediately preceding year and in the subsequent AYs.

  To effectively apply the situation of 'vacant for the whole year' under section 23(1)(c) of ITA, intent of letting out is of vital importance which needs to be considered, for the taxpayer.

  The taxpayer demonstrated that it had issued letter of intent for the vacant units reflecting its intention to let out these units. Based on these letters of intent, units were given on rent in subsequent years, when the lease arrangement materialized.

- Amendment was brought in section 23(1) of ITA by way of Finance Act 2001. There was no provision in the erstwhile section to grant vacancy allowance to a property which was vacant for the whole of the year. In order to continue to grant vacancy benefit and also include a property which remained vacant for the whole year, appropriate amendment was brought in by section 23(1)(c) of ITA reflecting legislative intent. The legislative intent was to allow benefits of vacancy to the taxpayer for house property remaining vacant for the whole year.

  This amendment factored in the vacancy aspect of a property for whole of the year for the purpose of computing annual value from bringing it to charge under the head 'Income from house property'. There could never be a situation where a property was let out and at the same time 'vacant for the whole year'. Thus, by applying the principles of purposive interpretation to section 23(1)(c) of the ITA and not to render the words 'vacant for the whole year' infructuous, the word 'let' used in the said section had to be interpreted as intended to be let out or available to let out. To put it differently, the requirement that 'house is actually let' during the year is not to be taken as a pre-requisite for bringing the case of taxpayer within the sweep of section 23(2)(c) of the ITA, as long as property is let in the earlier period and remains vacant for the whole year under consideration which taxpayer continues to hold the same for the purpose of letting out.

- Provisions under section 23(1)(c) are deeming provisions and hence to be interpreted strictly in terms of legislative intent. Deeming provision contained in section 23(1)(c) has created a legal fiction to tax annual value of a property. In the present case, it has neither received or accrued income either real or notional on the units which remained vacant for whole of the year.

Past Judicial precedents

The ITAT noted the following judicial precedents:

- The Andhra Pradesh High Court (HC) in an earlier ruling[2]held that though the benefit of computing the annual value under section 23(1)(c) of ITA could not be extended to a case where the property was not let out at all, however, the same would duly encompass and take within its sweep cases where the property has remained let out for 2 or more years, but had remained vacant for the whole of the previous year.

  The taxpayer argued that aforesaid ruling is of a non-jurisdictional HC and therefore does not carry a force of binding nature but has only a persuasive effect. Reliance was placed on earlier rulings[3] in this regard.

- The coordinate Bench of the Mumbai ITAT in an earlier ruling[4] wherein the decision of Andhra Pradesh HC was dealt with, held that when the property had remained vacant for the whole of the year under consideration, the annual value of the said property is to be computed under section 23(1)(c) of ITA.

  The Mumbai ITAT, in case[5] of taxpayers holding company (engaged in activity of operating and managing commercial complex) wherein the AO made addition in respect of deemed rent on vacant units, held that it was obvious that the taxpayer would have taken sufficient efforts to let out the property. No reasonable business would want to let out its property at the loss of revenue, if any opportunity exists.

  Accordingly, the assumption that the properties were not intended to be let out was held to be erroneous. It was concluded that since the property was vacant for the whole year, taxpayer was entitled to vacancy allowance under section 23(1)(c) of ITA and thus, the additions made by AO was deleted.

In view of the above, the ITAT held that the actual rent received or receivable by the taxpayer was Nil on account of vacancy, there being no tenant for the property. Accordingly, under the deeming provision of section 23(1)(c) of the ITA, in the case of a property which was vacant for whole of the year, its annual value was ‘Nil’.

Comments:

Commercial property may remain vacant for the entire or part of the year, though efforts may be made by the taxpayer to let out such property. In such cases, a question could arise whether the vacancy allowance could be granted under section 23(1)(c) of the ITA (for the period when the property could not be let out) and thereby the ALV of such property could be considered as Nil.

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[2] Vivek Jain v/s ACIT (2011) 337 ITR 74 (AP-HC

[3] CIT vs. Thane Electricity Supply Ltd. [1994] 206 ITR 727 (Bom) and Consolidated Numatic Tools Co. (India) Ltd. vs. CIT [1994] 209 ITR 277 (Bom)

[4] Sonu Realtors Pvt. Ltd. v/s DCIT- ITA No. 2892/Mum/2016 (Mum-Trib.)

[5] Phoenix Mills Ltd [ITA No. 241&242/Mum/2015]

The ITAT in this ruling, has upheld / laid down the following principles:

- In a scenario where the property is 'vacant for whole of the year', since 'actual rent' is to be taken into account, it will be 'Nil', as there is no tenant. However, the sum referred to in section 23(1)(a) of the ITA shall continue to be for the entire year. Hence, by having reference to 'less' for comparison, aspect of vacancy is factored in to arrive at the annual value of the property in section 23(1)(c) of the ITA which will be 'Nil' in the scenario where property is 'vacant for whole of the year'.
- Vacancy denotes a temporary break for a period a property was let out. To effectively apply the situation of 'vacant for the whole year' under section 23(1)(c) of ITA, intent of letting is of vital importance which needs to be considered, at the end of taxpayer.
- By applying the principles of purposive interpretation to section 23(1)(c) of the ITA and not to render the words 'vacant for the whole year' infructuous, the word 'let' used in the said section had to be interpreted as intended to be let or available to let.

  The requirement that 'house is actually let' during the year is not to be taken as a pre-requisite for bringing the case of taxpayer within the sweep of section 23(2)(c) of the ITA, as long as property is let in the earlier period and remains vacant for the whole year under consideration which taxpayer continues to hold the same for the purpose of letting out.

Taxpayers with similar facts may evaluate the impact of this ruling to the specific facts of their cases.