

Income from Property

The rent received or receivable by a person for a tax year, other than rent exempt from tax under this Ordinance, shall be chargeable to tax under the head "Income from Property". This is a second source of income.

BASIC CONCEPTS UNDER THE HEAD "INCOME FROM PROPERTY"

Following concepts have key importance to categorize any income as "Income from Property".

1) Property

Generally, the word 'property' has so wider concept; different meanings are given in different laws and also in common life to the word 'Property'.

However, u/s 15 of the Income Tax Ordinance, 2001, '**property**' means *land or building*.

1.1) Land

Land means *vacant or open land*.

- ❖ In simple words, a piece of land not shaped in building.
- ❖ A piece of land not structurally improved in any other way.

Examples:

- Land used by Oil Company for parking their oil tankers.
- Open plot used by manufacturing company for storing its raw material.

1.2) Building

- ❖ Building means a structure that has a roof and walls; or
- ❖ Block of bricks or stones covered by roof; or
- ❖ Building is an enclosure which may even consist of mud walls.

Examples:

- Shop or commercial building
- Residential building
- Stadium

Note: *Roof is not necessary for non-residential buildings like large stadium or open air swimming pool etc.*

2) Rent

Rent means any amount received or receivable by the owner of land or building as consideration for the use or occupation of, or the right to use or occupy the land or building. It includes any forfeited deposit paid under a contract for the sale of land or a building.

3) Tenant or Lessee

A person who receives property (land or building) on rent is called **tenant or lessee**.

Example:

Mr. A provided his residential building to Mr. B on rent. Here, Mr. B is called tenant.

4) Landlord or Lessor

A person who provides property (land or building) on rent is called **landlord or lessor**.

Example:

Mr. A provided his residential building to Mr. B on rent. Here, Mr. A is called landlord.

5) Actual Rent

An amount of rent decided by the landlord and tenant for the use of land or building is called actual rent.

Example:

Mr. A provided his residential building to Mr. B on rent of Rs. 20,000 p.m. Here, Rs. 20,000 is called actual rent.

6) Fair Market Rent (FMR)

Common rate of rent prevailing in a particular locality or immediate vicinity for a similar property is called fair market rent. It is an amount of rent where sufficient numbers of people are ready to get same property on rent. In simple words, it is not an amount of rent where a special favor has been given to a specific tenant.

Example:

Mr. A provided his residential building to Mr. B (his friend) on rent of Rs. 20,000 p.m. in Peoples Colony, Faisalabad. Building of this nature or condition is available on rent for Rs. 50,000 p.m. to common public in Peoples Colony. Rs. 50,000 p.m. is a Fair Market Rent while Rs. 20,000 p.m. is actual amount of rent.

Tax Treatment of Fair Market Rent

Where actual amount of rent is less than fair market rent, then fair market rent shall be taxable under the head "Income from Property".

Note: Fair market rent shall not be taken as "Income from Property"; although it is higher than actual rent; where lessee is deriving "Income from Salary" and value of property has already been included in his Salary at Fair Market Rent.

NECESSARY CONDITIONS FOR RENT TO BE CHARGED AS "INCOME FROM PROPERTY"

To charge rental income under the head "Income from Property" following conditions shall be fulfilled:

- 1) The property shall consist of only land or building.
- 2) Recipient of the rental income shall be owner of the property.
- 3) The rent shall be, "for the use or occupation of", or "the right to use" the land or building".

RENTAL INCOME OF PROPERTY TREATED AS "INCOME FROM OTHER SOURCES"

Rental income of following properties is treated as "Income from Other Sources".

- 1) Rent from lease of a building together with plant and machinery.
Example: Business units like cotton ginning factories, rice mills etc. where factory building is acquired on lease only due to plant installed in it.
- 2) Rent from sub-lease of land or a building.
Example: Mr. A rented out his house to Mr. B and Mr. B rented out part of such house to Mr. C.
 - i) Rent received by Mr. B (tenant of Mr. A) from Mr. C shall be chargeable to tax under the head "Income from Other Sources".
 - ii) Rent received by Mr. A (owner of the house) from Mr. B shall be chargeable to tax under the head "Income from Other Sources".

- 3) Ground rent

Ground rent occurs in a situation where the owner of land and building are separate. Simply, one person constructs building on the land of other person; then the rent received by the owner of land is called ground rent. Ground rent is taxable under the head "Income from Other Sources".

Note: Only the rent of vacant land is taxable under the head "Income from Property".

Example: Mr. B constructed a building on the land of Mr. A. Rent paid by B to A for land is called ground rent. Although, it is rent of land; it shall be taxable under the head "Income from Property" but land of Mr. A is not vacant.

COMPUTATION OF RENT CHARGEABLE TO TAX

Rent chargeable to tax under the head "Income from Property" may consist of following elements:

- i) Rent received or receivable (actual or fair market rent, whichever is higher)
- ii) Forfeited deposit (if a contract for sale of this specific land or building has been breached)
- iii) $1/10^{\text{th}}$ of un-adjustable advance received by the owner (where advance has been received from tenant; it shall be refunded to the tenant at the termination of tenancy)
- iv) Any obligation of the owner paid by the tenant (obligation may in the form of property tax paid by the tenant, insurance premium of the property paid by the tenant etc.)

Simply, it may be presented as follows:

Rent received or receivable	XXX
Add: Forfeited deposit	XXX
$1/10^{\text{th}}$ of un-adjustable advance	XXX
Obligation of the owner paid by the tenant	XXX
Rent chargeable to tax	<u>XXX</u>

FORFEITED DEPOSIT (BIANA)

Forfeited Deposit occurs, where in a contract of sale, a buyer of property (land or building) pays any amount as deposit (biana) to seller of property and ultimately fails to buy the property due to any reason. Deposit (biana) is also called token money.

Tax Treatment of forfeited deposit:

Under Section 15 of the Income Tax Ordinance, 2001, forfeited deposit is considered as rent. In simple words, forfeited deposit shall be included in rent chargeable to tax.

Illustration:

Mr. Yousaf rented out his building for Rs.30,000 p.m. to Mr. Ali. During the year, he contracted with Mr. Ajmal for sale of building and received Rs.70,000 as deposit (token money). Mr. Ajmal refuses to buy the building and Yousaf forfeited token money. Compute rent chargeable to tax.

Solution:

Rent received or receivable ($30,000 \times 12$)	360,000
Add: Token money forfeited	<u>70,000</u>
Rent chargeable to tax	<u>430,000</u>

NON-ADJUSTABLE ADVANCE RECEIVED FROM TENANT OF BUILDING

Advance received by the owner of building from tenant which is not adjustable against rent is called un-adjustable advance. In simple words, it is received as security which shall be refunded at the time of vacation of building.

Tax Treatment of un-adjustable advance

According to section 16 of the Income Tax Ordinance, 2001, un-adjustable advance shall be taxable in the tax year in which it is received and the following nine tax years. In other words, $1/10^{\text{th}}$ of un-adjustable advance shall be included in rent chargeable to tax for the tax year in which it is received and the following nine tax years.

Illustration:

Mr. Sheraz let out his building to Mr. Ansar at Rs. 20,000 p.m. in the tax year 2019 and received Rs.100,000 as un-adjustable advance. Compute rent chargeable to tax.

Solution:

Rent received or receivable ($20,000 \times 12$)	240,000
Add: $1/10^{\text{th}}$ of un-adjustable advance ($100,000/10$)	<u>10,000</u>
Rent chargeable to tax	<u>250,000</u>

Un-adjustable Advance Refunded

Where un-adjustable advance is refunded to the tenant on termination of tenancy (before the expiry of ten years); nothing shall be included in rent in the year of refund.

Illustration:

By continuing previous illustration, suppose Mr. Sheraz has refunded an advance of Rs.100,000 in the tax year 2022 to Mr. Ansar on vacation of building.

Solution:

Nothing shall be included in rent chargeable to tax for the tax year 2021 as un-adjustable advance.

Un-adjustable Advance Received from Subsequent (Next) Tenant

Where owner of land or building refunds un-adjustable advance to first (previous) tenant and receives un-adjustable advance from subsequent (current) tenant. The amount to be included in the rent chargeable to tax as un-adjustable advance shall be computed as follows:
Current amount of un-adjustable advance – Already adjusted amount of previous un-adjustable advance = Balance amount of current (subsequent) advance $\times 1/10^{\text{th}}$

Illustration:

By continuing previous illustration, suppose in the tax year 2021, Mr. Sheraz let out his building to Mr. Shahid at Rs. 20,000 p.m. and received Rs.110,000 as un-adjustable advance. Compute the amount to be included in rent chargeable to tax as un-adjustable advance.

Solution:

Amount of un-adjustable advance received from Mr. Shahid – Already adjusted amount of un-adjustable advance received from Mr. Ansar = Balance amount of current advance $\times 1/10^{\text{th}}$
 $110,000 - 20,000 = 90,000 \times 1/10^{\text{th}} = 9,000$

Simply, it may be presented as follows:

Advance received from new tenant (Mr. Shahid)	110,000
Less: Advance already charged to tax in previous two years $(100,000/10 \times 2)$	<u>20,000</u>
Un-adjustable advance to be adjusted	<u>90,000</u>
Amount to be included in rent chargeable to tax for the tax year 2021 $(90,000 / 10)$	9,000

ANY OBLIGATION OF THE OWNER PAID OR PAYABLE BY THE TENANT

Where any obligation / burden / liability of the owner in respect of his property is paid by the tenant (as a result of any contract); such amount shall be considered as rental income of the owner. It shall be treated as rent chargeable to tax.

Illustration:

Suppose, Mr. B hired a building from Mr. A at Rs. 30,000 p.m., further, it is contracted that Mr. B shall pay insurance premium of rented property of Rs. 10,000 p.a. and property tax of Rs. 5,000 p.a. Compute rent chargeable to tax.

Solution:

Rent received	360,000
Add: Insurance premium paid by tenant (Mr. B)	10,000
Property tax paid by the tenant (Mr. B)	<u>5,000</u>
Rent chargeable to tax	<u>375,000</u>

Illustration:

Compute rent chargeable to tax for the tax year 2016 in the light of following data. Monthly rent Rs.25,000. Un-adjustable advance Rs.80,000. Forfeited token money Rs. 20,000. Property tax paid by the tenant Rs.10,000

Solution:

	Rent received or receivable (25,000 × 12)	300,000
Add:	1/10th of un-adjustable advance (80,000/10)	8,000
	Forfeited token money	20,000
	Property tax paid by the tenant	10,000
	Rent chargeable to tax	<u>338,000</u>

ALLOWABLE (ADMISSIBLE) DEDUCTIONS IN COMPUTING INCOME CHARGEABLE UNDER THE HEAD "INCOME FROM PROPERTY" [15A]

In computing the income of a person chargeable to tax under the head "Income from Property" for a tax year, a deduction shall be allowed for the following expenditures or allowances, namely:-

Repair Allowance

[15A (1)(a)]

In respect of repairs to a building, an allowance equal to one-fifth of the rent chargeable to tax in respect of the building for the year, computed before any deduction allowed under this section.

Insurance Premium

[15A (1)(b)]

Any premium paid or payable by the person in the year to insure the building against the risk of damage or destruction.

Property Tax

[15A (1)(c)]

Any local rate, tax, charge or cess in respect of the property or the rent from the property paid or payable by the person to any local authority or government in the year, not being any tax payable under this Ordinance.

Ground Rent

[15A (1)(d)]

Any ground rent paid or payable by the person in the year in respect of the property.

Profit (interest) Paid or Payable on Borrowed Money

[15A (1)(e)]

Any profit (interest) paid or payable by the person in the year on any money borrowed including by way of mortgage, to acquire, construct, renovate, extend or reconstruct the property.

Share in Rental Income of Financial Institution

[15A (1)(f)]

Where the property has been acquired, constructed, renovated, extended, or reconstructed by the person with capital contributed by the House Building Finance Corporation or a scheduled bank under a scheme of investment in property on the basis of sharing the rent made by the Corporation or bank, the share in rent and share towards appreciation in the value of property paid or payable by the person to the said Corporation or the bank in the year under that scheme.

Profit Paid or Payable on Mortgage

[15A (1)(g)]

Where the property is subject to mortgage or other capital charge, the amount or profit or interest paid on such mortgage or charge.

Collection and Administrative Charges

[15A (1)(h)]

Any expenditure (not exceeding four percent of the rent chargeable to tax in respect of the property for the year computed before any deduction allowed under this section) paid or payable by the person in the year for the purpose of collecting the rent or administrative expenditures due in respect of the property.

Legal Expenditures

[15A (1)(i)]

Any expenditure paid or payable by the person in the tax year for legal services acquired to defend the person's title to the property or any suit connected with the property in a court.

Unrealized Rent

[15A (1)(j)]