

How waiver or fall in rent may impact your tax liability

3 min read. Updated: 10 Aug 2020, 08:20 AM IST [Gautam Nayak](#)

If a landlord defers payment of some part of rentals, he or she would still have to pay tax

Due to the lockdown, many people working in cities have relocated temporarily to their home towns, leaving their rented city homes empty. Many tenants have been unable to pay the rent in the present scenario. Such tenants may or may not have been able to use the rented premises during the lockdown. Rental rates have fallen due to lower demand.

Landlords have been approached by such tenants for waiver or reduction of rentals during the lockdown period, and at times, even for subsequent months. In some cases, landlords have agreed to partially waive or reduce the rent, either for a few months, or on an ongoing basis. How does such waiver or rent reduction impact the income tax liability of the landlord? What if the tenant defaults in payment of rent? What is more advantageous for the landlord—to waive the rent for a few months, or reduce the rent partially for a longer period?

Under the income tax law, every house property is liable to tax each year on an annual value, except for one residential house which is occupied by the owner himself. The annual value is a sum for which the property may reasonably be expected to be let, or, if the property is let out, and the actual rent receivable is higher, then such higher actual rent. Further, if the property was vacant for a part of, or for the entire year, then the actual rent received or receivable would be the annual value, even if it is lower than the sum for which it may reasonably be expected to be let.

In places where municipal taxes are levied on the basis of an annual rateable value, or where the rent control law applies with standard rent, courts have taken a view that the standard rent or the annual rateable value would be the annual value, for taxation of self-occupied property or for comparison with actual rent. However, where there is no rateable value nor does standard rent apply, determining the annual value becomes highly subjective.

In normal times, the rent is fixed at the market rent and, therefore, a landlord may face no difficulty in paying tax on the actual rent receivable. However, where the rent is waived partially, the question is with which figure should the actual rent be compared—the market rent prevalent before the pandemic and the lockdown, or the reduced rental prevalent post the commencement of the pandemic and lockdown? Logically, the comparison has to be done with the lower rentals prevalent post the pandemic and lockdown commencement, for a fair and proper comparison. Therefore, even the reduced rental or rents after partial waiver would be more or less in line with the now prevalent market rentals. Since the comparison is of the annual rent, it does not make any difference whether a few months' rent is waived or whether there is a reduction in rent for a larger number of months.

Interestingly, the premises cannot be regarded as having been vacant during the lockdown period, because technically, it was still occupied by the tenant who was in possession of the premises, though he may not have been able to use them.

If the landlord merely defers the payment of some part of the rentals to the subsequent year, the landlord would still be liable to pay tax during the current year on the rental income for the entire year, as such rent is receivable by the landlord.

What if the tenant fails to pay the rent altogether? Would the landlord still have to pay tax on unpaid rent, which is never realized? The law provides that rent receivable shall not include rent which cannot be recovered. However, certain conditions are prescribed for such rent to be excluded from taxable income. These are that the tenancy should be bona fide, the defaulting tenant has vacated or steps have been taken to make him vacate the property, the defaulting tenant should not be in occupation of any other premises of the landlord, and the landlord should have taken all reasonable steps to initiate legal proceedings for recovery of the rent or should satisfy the tax officer that such legal proceedings would be useless.

Given the seriousness of the current pandemic and the severe financial impact of the lockdown, the government should consider softening the impact of these tax provisions. This could be done by doing away with the requirement of initiation of legal proceedings for the current year. Another step which would help tenants renegotiate rents would be by amending the law to tax only the actual rent receivable for the year, and not requiring comparison with market rents, at least for the current year.

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