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Mesne profits received for unauthorised occupation of immovable property is revenue receipt

The Delhi High Court rendered its decision that mesne profits and interest thereon received for unauthorised occupation of immovable property is a revenue receipt taxable as income from house property.

Background:

- The taxpayer¹ in the original income-tax return for the Financial Year (FY) 1998-99, corresponding to Assessment Year (AY) 1999-00, had declared mesne profits as taxable income, whereas in the revised income-tax return for the said year, the taxpayer claimed mesne profits as a capital receipt and excluded it from taxable income.

As per section 2(12) of the Civil Procedure Code, mesne profits mean those profits those profits which the person in wrongful possession of the suit property actually received, or might have with ordinary diligence received therefrom, together with interest on such profits, but shall not include profit due to improvements made by the person in wrongful possession.

- The claim that mesne profits were a capital receipt was made by the taxpayer on the basis that:
 - The taxpayer had let out its property in the year 1980 for a period of five years, and the monthly rent was liable to be increased by 20% after expiry of the first three years.
 - The lessee did not comply with the terms and increased the rent by only 10%. The taxpayer terminated the lease agreement w.e.f. 31 January 1990 by serving a notice upon the lessee.
 - Since the lessee failed to vacate the premises, the taxpayer filed a suit for damages / mesne profit and for restoration of the premises to itself. The said suit of the taxpayer was decreed vide judgment / decree dated 27 July 1998. The decree included award of mesne profits and damages with interest.
 - In compliance with the court's decree, the lessee paid the amount (as determined) to the taxpayer.
- The Assessing Officer (AO) did not accept the contention of the taxpayer and placing reliance on the decision of the Madras High Court (HC) in an earlier case², the AO held that mesne profits awarded to the taxpayer was a revenue receipt and taxable as income.
- The matter in the course of appeal proceedings reached the Delhi High Court.

¹ M/s. Skyland Builders P. Ltd. Vs. ITO ITA No.754/AHD/2017

² CIT v. P. Mariappa Gounder [1984] 17 Taxman 292 (Madras HC)

Decision of the High Court (HC):

- The HC noted the following with respect to the key case laws relied upon by the taxpayer:
 - The Bombay HC case³ relied upon by the taxpayer related to a case where the tenancy right was surrendered by the tenant and, in lieu thereof, the tenant had received consideration.
 - In the Supreme Court case⁴ relied upon by the taxpayer, the amount received by the taxpayer towards compensation for sterilisation of the profit earning source, not in the ordinary course of their business, was held to be a capital receipt in the hands of the taxpayer.
- The HC distinguished the above case laws relied upon by the taxpayer and held that in the case under consideration:
 - The tenant had suffered a decree for its continued use and occupation of the premises of the taxpayer (even after the termination of contractual tenancy). The income was generated in the hands of the taxpayer and not in the hands of the tenant.
 - The receipt of mesne profits and interest thereon by the taxpayer, was a revenue receipt. The capital asset of the taxpayer i.e. the property in question was earning revenue for the taxpayer by way of rent till so long as the lease subsisted. After the termination of the lease, the erstwhile tenant continued to occupy the premises unauthorisedly.

It was in lieu of the rent which the taxpayer would have otherwise derived from the tenant, that the mesne profits and interest thereon were awarded. Had it been a case where the capital asset would have been subjected to physical damage, or of diminution of the title to the capital asset, and damages would have been awarded under the head, there would have been merit in the taxpayer's claim that damages received for harm and injury to the capital asset, or on account of its diminution, would be a capital receipt.

- Further the HC observed that the facts of the case under consideration were more or less identical to the facts of the decision rendered in an earlier case⁵ by co-ordinate Bench of the HC, wherein it was held that receipt of mesne profits constituted revenue receipt. Further, the HC pointed out that the said decision was rendered by the co-ordinate Bench of the HC after following the decision of the Madras HC² (which was affirmed by the Supreme Court⁶) and therefore, the HC was bound by that decision.

In view of the above, the HC held that the ITAT was right in holding that mesne profits and interest on mesne profits received under the direction of the civil court for unauthorised occupation of the immovable property of the taxpayer by the erstwhile tenant of the taxpayer, was liable to tax under

³ Cadell Weaving Mill Co. Pvt. Ltd. v. CIT [2001] 249 ITR 265 (Bombay HC)

⁴ CIT v. Saurashtra Cement Ltd. [2010] 325 ITR 422 (SC)

⁵ CIT v. Uberoi Sons (Machines) Limited [2012] 193 DLT 148 (Delhi HC)

⁶ P. Mariappa Gounder v. CIT [1998] 232 ITR 2 (SC)

Section 23(1) of the ITA (i.e. as income from house property), since mesne profits, and interest on mesne profits, in the facts of the present case constituted revenue receipt.

Comment:

This ruling lays down that mesne profits received on account of unauthorised occupation of immovable property by a tenant constitutes revenue receipt, taxable under section 23(1) of the ITA.



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