

Exploring Provisions

2015, June Issue

**Gopal Nathani &
Associates**

dailytaxreporter.com

Clubbing provisions- marring Transfers

©reserved

 303,DLFQutab Plaza,

DLF City Phase I,

Gurgaon, Haryana



0124-4061226



www.dailytaxreporter.com



Disclaimer

The information contained in this document is published for the knowledge of the recipient but is not to be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient. This document is not intended to be a substitute for professional, technical or legal advice or opinion and the contents in this document are subject to change without notice.

Whilst due care has been taken in the preparation of this report and information contained herein, GNA does not take ownership of or endorse any findings or personal views expressed herein or accept any liability whatsoever, for any direct or consequential loss howsoever arising from any use of this document or its contents or otherwise arising in connection herewith. In no event shall GNA become liable to users of this data, or any other party, for any loss or damages, consequential or otherwise, including but not limited to time, money, or goodwill, arising from the use, operation or modification of the data. In using this data, users further agree to indemnify, defend, and hold harmless GNA for any and all liability of any nature arising out of or resulting from the lack of accuracy or correctness of the data, or the use of the data.

“YathaDrishti, TathaSrishti- As the vision, so the world”

PREFACE

The situation in which income of other person is included in the income of the taxpayer better known as clubbing provisions are found in Chapter V of the Act. Sections 60 to 64 define various situations relating to clubbing of income. In any assessment proceedings the Income-tax Officer is to investigate in whose hands a particular income should be assessed. These days all income tax information is available with the AO on a click. Hence it is always better to know in advance the clubbing provisions in the Income tax Act that guide us through assessment of certain class of incomes / assessees

Purpose of this Document

This Tax Alert attempts to highlight various scenarios under which assessee's income may go hay wired.

Table of Contents

S.No.	Particulars	Page No
I	Introduction	5
II	General Transfers under any settlement , trust, covenant, agreement or arrangement	
1	Section 60 scenario- Application of income	7
2	Section 61 scenario- Revocable transfers	9
III	No relief to transferee of incomes	12
IV	Revocable vs irrevocable transfers	13
V	Particular class of transfers	14
VI	Round up of Clubbing provisions	16
VII	Situations in which the clubbing provisions do not apply in case of income from assets transferred to spouse	29
VIII	Conclusion	30
	Annexure 1	31

I. Introduction

Normally, a person is taxed in respect of income earned by him only. However, in certain special cases income of other person is included (i.e. clubbed) in the taxable income of the taxpayer and in such a case he will be liable to pay tax in respect of his income (if any) as well as income of other person too. The situation in which income of other person is included in the income of the taxpayer better known as clubbing provisions are found in Chapter V of the Act. Sections 60 to 64 define various situations relating to clubbing of income. The object of such provisions is to prevent avoidance of tax or reducing the incidence of tax on the part of the assessee by transfer of his assets, incomes directly to his wife, minor child, son's wife etc. or by way of a settlement, agreement, arrangement, covenant, trust to benefit his wife, minor child, son's wife etc.

The Supreme Court in *S P Jaiswal v CIT* (1997) 224 ITR 619 held that Chapter V of the Income-tax Act, 1961, is designed to discourage the tendency of the taxpayer to avoid or reduce his tax liability by disposal of part of his property in such a way that the income should no longer be receivable by him, while at the same time he retained certain powers over, or interest in, the property or its income. Chapter V to be precise is titled as 'Income of other persons, included in assessee's total income'.

In any assessment proceedings the Income-tax Officer is to investigate in whose hands a particular income should be assessed. These days all income tax information is available with the AO on a click. Hence it is always better to know in advance the clubbing provisions in the Income tax Act that guide us through assessment of certain class of incomes / assesseees. Often by clubbing we tend to limit our focus to the provisions of section 64 viz a viz income of spouse and minor or son's wife as are specified therein or those that are earned directly or indirectly from transfer of assets to them. For instance we often ignore that in view of the provisions contained in section 60 of the Income-tax Act, 1961, any transfer of income without transfer of source of such income would also be chargeable to income-tax as the income of the transferor and would be included in his total income. Again u/s 61 any income arising to any person by virtue of revocable transfer of assets shall be chargeable as income of the transferor. Section 62 further provide for an exception to the case of transfer by way of formation of an irrevocable trust subject however to the condition that no direct or indirect benefit accrues to the transferor. Under the income tax law income is thus chargeable only in the hands of the person who is its real owner. Every other person would be a benamidar in that sense. And owner of income would be the one who owns the source i.e. the owner of an asset.

Further the term transfer and revocable trust are defined in section 63. Section 63 specifies certain situations in which a "transfer" shall be deemed to be "revocable". The object of this provision is to enlarge the meaning of the words "revocable transfer" for the purposes of sections 60, 61 and 62 and to include certain transfers therein which otherwise might or might not fall within that expression. Transfer is further defined to include any settlement, trust, covenant, agreement or arrangement. The income tax forms also include a separate Annexure by which disclosure is made about income of the specified persons liable to be included in the income of the assessee. (Annexure 1)

II. General Transfers under any settlement , trust, covenant, agreement or arrangement

1. Section 60 scenario- Application of income

1.1 Mining lease scenario

Here is a case of an assessee (CIT v. Late Banwarilal Agarwala (1987) 167ITR321) who derived commission from a company from leasing out coal bearing lands and coal mines along with the machinery, furniture, other assets etc. The commission was receivable by virtue of an agreement which provided a stipulation that the company would pay Rs. 1.50 per tonne as commission on coal dispatch of which 50 paise per tonne were to go to the assessee and Re. 1 per tonne was to be

paid to a private trust. Thus, according to the assessee, 1/3rd of the income received was to go to the assessee and the balance 2/3rds was to go to the trust. The Income-tax Officer found that the coal mines and the coal-bearing lands and the other assets belonged to the assessee and no part of these assets had been transferred to the trust. The Income-tax Officer assessed the whole of the commission in the hands of the assessee. The Appellate Assistant Commissioner and the Tribunal, however, held that an overriding title for 2/3rds of the commission income had been created in favour of the trust and deleted 2/3rds of such income from the assessment of the assessee.

The Patna High Court held that the commercial assets from which the income arose were not transferred to the trust and only the income was transferred to the trust (application of income) and consequently section 60 applied hence the entire commission had to be included in the assessee's total income. More importantly the Court held that the assessee entered into an agreement with Company, the legal obligation, if any, was by the assessee's own volition and the trust had no enforcement right against Company. The trust being not a party to the agreement could not enforce its rights by adopting any legal proceeding. Hence, there was no diversion of income by overriding title.

2. Section 61 scenario- Revocable transfers

2.1 advancing monies to spouse and children

The income from revocable transfers of assets or income is to be included in the hands of transferor for the purpose of charge of income-tax. What is a revocable transfer will depend on various factors including the operation of law. In CIT v. Mr. & Mrs. Govind B C Ghanekar (1994) 206ITR438 the Bombay High Court held that if the law itself provides that a certain transfer shall be revocable, it cannot be held to be irrevocable with reference to the provisions of section 63 of the Act. Section 63 specifies certain situations in which a "transfer" shall be deemed to be "revocable".

The P & H High Court in S P Jaiswal v CIT (1981) 130ITR643 case (supra) was cornered with a question, whether the amounts advanced by the assessee to his three major children and his wife were transactions which fell within the provisions of s. 61 of the Act. The High Court held that since the amount transferred by the assessee had been paid back to the assessee, the transfer of the assets was a revocable one. The case was found covered by s. 61 of the Act and the interest on the amounts therefore were included in the total income of the assessee.

In this case the assessee transferred deposit held in a company to a firm comprising of his two sons and a daughter who then enjoyed interest income among them. Also the assessee sold some

shares and transferred the money to his wife who then parked it with the company and earned interest thereon. The assessee argued that what he advanced is in the nature of a loan. Rubbishing such argument the Court went on to say the following after quoting section 63(b):-

“Hence, for the purpose of construing the word “transfer ” occurring in these sections, one is not limited to its connotation and meaning as given in the Transfer of Property Act or other Acts. The expression “arrangement ” would, in my opinion, clearly cover the transaction of the kind entered into between the assessee and his family members. The word arrangement has not been used here as a term of art, but has been used in the business sense, The factum of the assessee transferring the sum of Rs. 1,74,639, on which he was himself earning interest (as would be clear from para. 4 of the order dated July 6, 1974, of the Tribunal ITR No. 65 of 1974) and another sum representing the value of the shares which carried dividends in order to enable his family members to earn what he himself was earning from the said assets, clearly amounted to an arrangement construed in the business sense and, therefore, the said assets underwent a transfer. Since the amount so transferred by the assessee has been paid back to the assessee, no further proof is needed that the transfer of the assets in question was a revocable one. In view of the above, the, case

would squarely fall within the four corners of s. 61 of the Act which envisages that all income arising to any person by virtue of a revocable transfer of assets shall be chargeable to income-tax as the income of the transferor and shall be included in his total income.”

On the further subject of loan to spouse or children etc, the Court held that the loan in every such instance must be for purpose or use and that it must therefore be used for such purpose. As in this case the entire value of deposit is held for earning income that hitherto were enjoyed by the assessee the entire arrangement of transfer of asset failed in this case. The following observations of the Court meticulously touch this subject:

“ In my opinion, the factum of advance carrying or not carrying any interest is not decisive of the fact as to whether the advance in question qualified to be called a loan or not. What is decisive is the circumstance as to whether the advance was made to meet some genuine need for a loan such as (without being exhaustive of the contingencies) to square up a genuine antecedent debt, to float a genuine business adventure, or to meet genuinely felt need for food, shelter and clothing or to discharge social obligations such as performing of marriage, etc.

Testing on the touchstone of the above requirements, the advance in question cannot be considered to be a genuine loan in that out of the money so advanced not a penny had been spent by the alleged loanees. The entire amount, which was advanced to them, remained deposited with the company, on which they earned interest.”

This case a clear pointer to every individual to be cautious and do advance planning of his investments at the time of acquiring an asset or source of income as every subsequent arrangement for restructuring incomes may end up inviting application of sections 60-63 of the Act. For instance assigning a contract or a right midway could invite trouble sometimes as it may turn out to be a case of mere application of income.

III. No relief to transferee of incomes

Interestingly the High Court in S P Jaiswal case (supra) also held that when an assessee shows certain income in his return the revenue does not act inconsistently if it accepts the return of that assessee on its face value and at the same time tax that income in the hands in which it ought really to be taxed. In this case the interest earned on company deposits is assessed to tax both in the hands of the

spouse/children as well as in the hands of the assessee father/husband.

IV. Revocable vs irrevocable transfers

Section 61 clubbing would come into effect if a transfer of an asset under any settlement, agreement etc. is revocable. The situation when a transfer is revocable is well defined under section 63(a) meaning that there is re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor or if the agreement etc. provide for a right to re-assume power directly or indirectly over the whole or part of the income or assets. Importantly the revocability as regards even a part of the assets or the income renders the entire settlement revocable *Chunilal Mulji Motani v CIT* (1983) 139 ITR 166, 176-77 (Cal). So what matters is the underlying terms and conditions in the agreement or arrangement.

Sections 60 and 61 would get into operation in case of revocable transfer of assets or incomes case. On the other hand section 64 would apply irrespective of whether the transfer is made under any revocable or irrevocable arrangement. Thus something that is transferred under irrevocable arrangement even when may escape application of sections 60-61 may well come under the ambit of section 64 as transfer to a particular class of persons viz spouse, minor child or son's wife. For instance where a husband makes a

settlement for the exclusive and independent maintenance of his wife, it cannot be said that he receives an indirect benefit from it within the proviso to section 62(1) merely because he is under obligation to maintain his wife . Ramji v CIT (13ITR105). However where the settlor husband himself took an advantage of drawing even a loan from the trust that he made for his wife the same would lend it a character of a revocable trust. Abbay v CIT (31ITR861)

V. Particular class of transfers

1. Clubbing provisions not applicable to second generation income

The Madras High Court in CIT v. M S S Rajan (2001) 252ITR126 held that section 64 is in the nature of a special provision which makes a departure from the ordinary law regulating transfers and is required to be given effect only to the extent specifically provided for therein. It can only be applied to the income directly or indirectly realised from assets transferred or to the income realised from the transferred asset or the one substituted for the transferred asset. In this case the rental income from the transferred asset which constituted first generation income having been taxed in the hands of the assessee, the interest income derived from depositing the rental income in a fixed deposit which stood in the name of the transferee wife being counted as second generation income is therefore held not includible to the total income of the assessee.

E.g., Mr. K gifted Rs. 1,00,000 to his wife, she purchased debentures from the gifted money and earned interest of Rs. 10,000. Now in this situation, Rs. 10,000 will be taxed in the hands of Mr. K. If Mrs. K purchased bonds worth Rs. 10,000 from the aforesaid interest income and earned Rs. 1,200 as interest on these bonds, then such interest on bonds being second generation income will not be clubbed with the income of Mr. K.

2. Under section 64, not only income (i.e. positive), but negative income (i.e. loss) is also clubbed

Vide Explanation 2 in section 64 of the Income-tax Act, 1961, the assessee is entitled to set off and also carry forward to subsequent years not only his share but also the share of his wife in the loss of the firm. Even though such explanation was not retrospective in its operation however according to the Supreme Court in CIT v. P. Doriswamy Chetty 183 ITR 559 the same serves as a legislative exposition of the import of section 64(1)(i). In other words the explanation of beneficial nature as in this instance found retrospective application on implied basis.

E.g. Mr. S transferred Rs. 84,000 to his wife. From the said amount his wife started a business and suffered a loss of Rs. 2,520. In this situation, loss of Rs. 2,520 will be clubbed with the income of Mr. S, and accordingly, Mr. S can adjust such loss from his income.

3. Clubbing scheme

Income will be clubbed under the same head of income as if such income would have been charged to tax if the clubbing provisions would have not been applied. In other words, first, the income to be clubbed is to be computed in the hands of the receiver of income under the respective head (i.e., the head of income depending upon the nature of income). Then, the income so computed will be taxed (i.e., clubbed) in the income of respective person under the same head of income.

VI. Round up of Clubbing provisions

Section	Nature of transaction	Clubbed in the income of	Conditions/exceptions	Relevant reference
60	Transfer of Income without transfer of Assets	Transferor who transfers the income.	When there is transfer of asset or source of income itself	Section 60 does not apply if corpus itself is transferred. [CIT v. Grandhi Narayana Rao 173 ITR 593 (1988) (AP)]
61	Revocable transfer of	Transferor who transfers	Clubbing not	Transfer held as

Assets.	the Assets.	applicable if:	revocable
		<ol style="list-style-type: none"> 1. Trust/transfer irrevocable during the lifetime of beneficiaries/transferor 2. Transfer made prior to 1-4-1961 and not revocable for a period of 6 years. Provided the transferor derives no direct or indirect benefit from such income in either case. 	<ol style="list-style-type: none"> 1. If there is provision to re-transfer directly or indirectly whole/part of income/asset to transferor; 2. If there is a right to reassume power in the settlement/transfer deed, directly or indirectly, the transfer is held revocable and actual exercise is not necessary.

				<p>Mere transfer or enjoyment of any income or assets by the transferor without there being any right to reassume power would not make it revocable. If the trustees act in derogation or in breach of the deed of transfer and a benefit is derived thereby by the settlor, it cannot be said</p>
--	--	--	--	--

				<p>that the deed of transfer was revocable.</p> <p>[CIT v. S. Raghbir Singh (1965) 57 ITR 408 (SC) and Mrs. Leela nath v CIT (1982) 134 ITR 507 (Kol)]</p> <p>3. Section 63 of the Income-tax Act, 1961, does not say that the power of revocation vesting in the transferor (settlor) should be absolute or</p>
--	--	--	--	--

				<p>unconditional.</p> <p>Merely</p> <p>because the</p> <p>concurrence</p> <p>of the trustee</p> <p>had to be</p> <p>obtained by</p> <p>the</p> <p>transferor/sett</p> <p>lor does not</p> <p>make it</p> <p>anywhere less</p> <p>than</p> <p>revocable.</p> <p>[Jyotendrasin</p> <p>hji vs. S. I.</p> <p>Tripathi</p> <p>(1993)201 ITR</p> <p>611 (SC)]</p>
64(1) (ii)	Salary, Commission, Fees or	Spouse whose total income	Clubbing not applicable if: Spouse possesses	1. The relationship of husband

	remuneration paid to spouse from a concern in which an individual has a substantial* interest.	(excluding income to be clubbed) is greater.	technical or professional qualification and remuneration is solely attributable to application of that knowledge/qualification.	and wife must subsist at the time of accrual of the income. [Philip John Plasket Thomas v CIT (1963) 49 ITR 97 (SC)]
				2. Income other than salary, commission, fees or remuneration is not clubbed under this clause
64(1) (iv)	Income from assets transferred	Individual transferring the asset.	Clubbing not applicable if: The assets are	1. Income earned out of Income

directly or indirectly to the spouse without adequate consideration .		transferred; 1. With an agreement to live apart. 2. Before marriage. 3. Income earned when relation does not exist. 4. By Karta of HUF gifting co-parcenary property to his wife. L. Hirday Narain vs. ITO 78 ITR 26 (SC) 5. Property acquired out of pin money. R.B.N.J. Naidu vs. CIT	arising from transferred assets not liable for clubbed. [M.S.S. Rajan 252 ITR 126 (Mad)] 2. Direct transfer- Cash gifted to spouse and he/she invests to earn interest. [Mohini Thaper vs. CIT 83 ITR 208 (SC)] 3. Capital gain on sale of property
---	--	--	---

			29 ITR 194 (Nag.)	<p>which was received without consideration from spouse also to be clubbed. The Court held that there is no logical distinction between income arising from assets transferred by the assessee to his wife and income arising from sale of the assets so</p>
--	--	--	-------------------	--

				<p>transferred.</p> <p>[Sevential M. Sheth vs. CIT (1968)68 ITR 503 (SC)]</p> <p>4. Section 64(iii) does not apply to sham or nominal transactions or to benami transactions. It applies to real transactions. [O.N. Mohindroo 99 ITR 583 (Delhi)]</p>
64(1) (vi)	Income from the assets	Individual transferring	The transfer should be without adequate	Cross transfers are also covered as

	transferred to son's wife.	the Asset.	consideration.	indirect transfers. It is not necessary that the same assets belonging to the husband should have reached the wife. The assets might, in the course of being transferred, be changed deliberately into assets of a like value of another person. [C.M. Kothari 49 ITR 107 (SC)]
64(1)(vii), (viii)	Transfer of assets by an individual to a person or AOP for the	Individual transferring the Asset.	Condition: 1. The transfer should be without adequate consideration.	1. Transferor need not necessarily have taxable income of his

	<p>immediate or deferred benefit of his:</p> <p>(vii) – Spouse.</p> <p>(viii) – Son's wife.</p>			<p>own. [P. Murugesan 245 ITR 301 (Mad)]</p> <p>2. Wife means legally wedded wife. [Executors of the will of T.V. Krishna Iyer 38 ITR 144 (Ker)]</p>
64(1A)	<p>Income of a minor child [Child includes step child, adopted child and minor married</p>	<p>1. If the marriage subsists, in the hands of the parent whose total income is greater;</p>	<p>Clubbing not applicable for:—</p> <p>1. Income of a minor child suffering any disability specified u/s. 80U.</p>	<p>1. Income out of property transferred for no consideration to a minor married daughter,</p>

	daughter].	or;	2. Income on account of manual work done by the minor child.	shall not be clubbed in the parents' hands. [Section 27]
	2. If the marriage does not subsist, in the hands of the person who maintains the minor child.	3. Income once included in the total income of either of parents, it shall continue to be included in the hands of some parent	3. Income on account of any activity involving application of skills, talent or specialized knowledge and experience.	2. The parent in whose hands the minor's income is clubbed is entitled to an exemption up to Rs. 1,500 per child. [Section 10(32)]

		in the subsequent year unless AO is satisfied that it is necessary to do so (after giving that parent opportunity of being heard)		
64(2)	Income of HUF from property converted by the individual into HUF property.	Income is included in the hands of individual & not in the hands of HUF.	Clubbing applicable even if the converted property is subsequently partitioned; income derived by the spouse from such converted property will be taxable in the	Fiction under this section must be extended to computation of income also. [M.K. Kuppuraj 127 ITR 447 (Mad)]

			hands of individual.	
--	--	--	-------------------------	--

* An individual shall deemed to have substantial interest in a concern for the purpose of Section 64(1)(ii)

If the concern is a company	If the concern is other than a company
Person's beneficial shareholding should not be less than 20% of voting power either individually or jointly with relatives at any time during the Previous Year. (Shares with fixed rate of dividend shall not be considered)	Person either himself or jointly with his relatives is entitled in aggregate to not less than 20% of the profits of such concern, at any time during the previous year.

VII. Situations in which the clubbing provisions do not apply in case of income from assets transferred to spouse:

The clubbing provisions of section 64(1)(vi) are not applicable in the following situations:

- If the transfer of asset is for adequate consideration;
- If the transfer of asset is in connection with an agreement to live apart- If the asset is transferred before marriage, no income will be clubbed even after

marriage, since the relation of husband and wife should exist both at the time of transfer of asset and at the time of accrual of income;

- If on the date of accrual of income, transferee is not spouse of the transferor (i.e. the relation of husband and wife does not exist).

VIII. Conclusion

These provisions must be kept in mind especially in regard to rental arrangements where under any agreement or arrangement the incomes are split between husband and wife without transfer of ownership rights in the property there would be application of the provisions of section 60/63 meaning clubbing of income in the hands of the owner of property. Also registration of property in the name of spouse or lease execution by the spouse would not do away with application of the clubbing provisions especially when the incomes are channeled to a joint bank account as even re-transfer directly or indirectly the whole or any part of the income are termed as a case of revocable transfer vide section 63 (a). Likewise advancing monies to spouse/children for sole purpose of investments would invite clubbing of incomes derived from such investments so one must be watchful of the fact that any such lending could fall within the ambit of arrangement terminology under section 60/61. Also care must be taken to see that there is no legal provision which prohibits the assessee from transferring or assigning his right to receive an income in which case the very act of transfer will be void.

Annexure 1

Sch SPI	Income of specified persons (spouse, minor child etc) includable in income of the assessee (income of the minor child, in excess of Rs. 1,500 per child, to be included)					
	Sl No	Name of person	PAN of person (optional)	Relationship	Nature of Income	Amount (Rs)
	1					
	2					
	3					
	4					
	5					
	6					
	Total					0

Contact us:

gnathani@dailytaxreporter.com

rnathani@dailytaxreporter.com

Our Values:

