Taxation of Gifts (including valuation)

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Historical Perspective

- Gift Tax Act introduced in 1958 – applicable to gifts on or after 1.4.1957
- Inapplicable to gifts on or after 1.10.1998 by Finance Act, 1998
- S.56(2)(v) introduced and made applicable to gifts on or after 1.9.2004 by the Finance (No.2) Act, 2004
- S.56(2)(vi) replaced s.56(2)(v) - applicable to gifts on or after 1.4.2006 - Taxation Laws (Amendment) Act, 2006
- S.56(2)(vii) replaced s.56(2)(vi) - applicable to gifts on or after 1.10.2009 - Finance (No.2) Act, 2009
- S.56(2)(viia) introduced for gifts to firm or company on or after 1.6.2010 by Finance Act, 2010
- Rules 11U, 11UA notified on 7th April,2010 w.e.f. 1.10.2009 – valuation rules for both s.56(2)(vii) and (viia)

Historical Perspective

- CBDT Circular 5/2005 dated 15th July 2005:

  "In order to curb bogus capital building and money-laundering, a sub-section has been inserted in s.56 to provide that any sum received without consideration on or after the 1st September 2004 by any individual or a HUF from any person shall be treated as income from other sources"
- Explanatory Memorandum –
  - Measures to Plug Revenue Leakages

Historical Perspective

- S.56(2)(v) applied only to sums of money
- To individual receipts exceeding Rs.25,000
- S.56(2)(vi) applied to aggregate value of receipts during the year exceeding Rs.50,000– applicable only to sums of money
- S.56(2)(vii)
  - Extended to certain specified assets received
  - Deemed gift concept introduced
  - List of assets subsequently modified to include bullion

Persons Covered – s.56(2)(vii)

- Applicable only to individual or HUF – not applicable to AOP/BOI, firm, company, artificial juridical person
  - Trustees of a trust – whether covered?

    Marsons Beneficiary Trust 188 ITR 224 (Bom)

    Shri Krishna Bandar Trust 201 ITR 989 (Cal)

    Shardaben Bhagubhai Mafatlal Trust 247 ITR 1 (Bom)
- Applicable to minors also
- Applicable to residents as well as non-residents
- To residents, wherever received – to non-residents, if received in India (subject to DTAA relief)

Receipts – s.56(2)(vii)

- Applicable not only to gifts but to all receipts
  - Compensation
- Whether applicable to loans?
  - *Chandrakant H. Shah v. ITO 121 TTJ 145 (Mum)* – interest free loan without repayment stipulation obtained from sister concerns for purchase of flat from one of them – loans to be examined in context of s.68

Receipts – s.56(2)(vii)

- Receipt in capacity as owner

  "The word receipt of income refers to the first occasion when the recipient gets the money under his own control" – Keshav Mills Ltd. v. CIT 23 ITR 230 (SC)

- Point of time of receipt
  - S.122 & 123 of Transfer of Property Act
  - Immovable Property – possession or conveyance or registration?
  - Movable Property - delivery
  - Shares – demat/physical – *Vasudev Ramachandra Shelat v. Pranalal Jayananda Thakar 45 Comp. Cases 43 (SC)*
  - Mere investment in joint names does not constitute delivery

Items Covered – s.56(2)(vii)

- Without consideration:
  - Any sum of money, aggregate value of which exceeds Rs.50,000
  - Any immovable property, the stamp duty value of which exceeds Rs.50,000
  - Any property, other than immovable property, aggregate fair market value of which exceeds Rs.50,000
- For consideration less than aggregate fair market value:
  - Any property, other than immovable property, by amount exceeding Rs.50,000

Definition of "Property"

- Means following capital asset of assessee:
  - Immovable property, being land or building or both;
  - Shares and securities;
  - Jewellery;
  - Archaeological collections;
  - Drawings;
  - Paintings;
  - Sculptures;
  - Any work of art; or
  - Bullion.
- Capital asset of recipient – not of donor
  - stock in trade/personal effects received without consideration not covered
  - Agricultural land not covered

Money

- The medium of exchange authorised by a Govt. as part of its currency; Assets that can be easily converted to cash (*Black's Law Dictionary*)
- "Money" includes a cheque, postal order, demand draft, telegraphic transfer or money order – *s.2(b) of Prize Chits & Money Circulation Schemes (Banning) Act, 1978*
- Whether money:
  - Foreign Currency
  - Bank/company fixed deposit?
  - Negotiable instruments – e.g. bill of exchange
  - Debts/Loans

Immovable Property

- Land or Building or both
    - Joint Ownership
- Rights in Immovable Property
    - Tenancy Rights
    - Flat under construction
    - Leasehold Rights
- Agricultural Land not covered

Shares & Securities

- Equity as well as preference shares
- Listed as well as unlisted
- Securities – *s.2(h) of Securities Contracts (Regulation) Act, 1956 - "securities" include—*
    - *(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;*
    - *(ia) derivative;*
    - *(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;*
    - *(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;*

Shares & Securities

- *(id) units or any other such instrument issued to the investors under any mutual fund scheme;*
- *(ii) Government securities;*
- *(iia) such other instruments as may be declared by the Central Government to be securities*; and
- *(iii) rights or interest in securities;*

- Mutual Fund units also securities
- Stock options also securities

Jewellery

- Jewellery - expln. to s.2(14) – includes
    - Ornaments made of gold, silver, platinum or precious metals, whether or not containing precious/semi-precious stones & whether or not worked/sewn into wearing apparel
    - Precious/Semi-precious stones, whether or not set in any furniture, utensil or other article or worked/sewn into wearing apparel
- Whether jewellery:
    - Silver utensils
    - Gold watch

Archaelogical Collection/ Work of Art

- Archaeology –
  - The scientific study of material remains (as fossil relics, artifacts and monuments) of past human life and activities; remains of the culture of a people – *Merriam Webster Online Dictionary*
  - the study of human history and prehistory through the excavation of sites and the analysis of artifacts and other physical remains – *Oxford Dictionary*
- Work of Art –
  - a creative product with strong imaginative or aesthetic appeal – *Oxford Dictionary*
  - A product of one of the fine arts; esp. a painting or sculpture of high artistic quality; something giving high aesthetic satisfaction to the viewer or listener – *Merriam Webster Online Dictionary*

Archaelogical Collection/ Work of Art

- Artistic work –
  - Any visual representation, such as a painting, drawing, map, photograph, sculpture, engraving or architectural plan – *Black's Law Dictionary*
- Whether archaeological collection/work of art?
  - Stamp collection
  - Coin collection
  - Antique Furniture

Bullion

- With effect from 1st June 2010
- Meaning
  - An uncoined solid mass of gold or silver (*Black's Law Dictionary*)
  - gold or silver considered as so much metal; metal in the mass (*Merriam-Webster Online Dictionary*)
  - a metal (esp. gold or silver) in bulk before coining, or valued by weight (*Oxford English Dictionary*)
- Bars or Ingots of precious metals covered
- Whether following covered?
  - Gold/silver coins
  - Gold watches
  - Silver utensils

Without Consideration

- Both immovable property & movable property
- Definition of Consideration - S.2(d) of Indian Contract Act
- Consideration flowing from third party
- Natural love and affection?
- Amounts received under personal accident policy?
- Compensation in disaster/accident? Exemption u/s.10(10BC)
- Damages /Compensation for sub-standard goods/deficient service?
- Compensation on cancellation of contract for purchase of property – *Mrs. Yogesh Aurora v. ITO 2009 TIOL 511 ITAT (Bang)*
- Amounts received for personal inconvenience?
- Amounts received with obligations – e.g. amounts settled in trust?
    - *Shardaben Jayantilal Mulji v. Commissioner of Wealth Tax 106 ITR 667 (Bom)*

For Consideration less than FMV

- Any property other than immovable property
- Immovable property – originally intended to be covered, now not covered
- Not same as inadequate consideration – applicability of SC decision in K.P. Varghese 131 ITR 597 (SC)
- Saving in expenditure – whether can constitute income?
  - Jewellery purchased at a discount

Exemptions – s.56(2)(vii)

- Gifts from relative
  - "Relative" defined
  - Inconsistency – nephew/uncle
  - Relative vis-à-vis HUF
- On occasion of marriage of individual
  - Prior to marriage (engagement, etc) not exempt
  - Naming ceremony, thread ceremony, etc. not exempt
- Under will or by way of inheritance
- In contemplation of death of payer/donor
- From local authority
- From trust covered by s.10(23C)
- From trust registered u/s.12AA

Exemptions – s.56(2)(vii)

- No specific exemption for assets received in following cases – whether taxable?
  - Under family settlement
  - On partition of HUF
  - On dissolution of trust
  - On throwing into hotchpotch of HUF
  - On settlement in trust
  - Allotment of shares on exercise of options
  - Grant of stock options

Limits – s.56(2)(vii)

- 4 separate limits for 4 classes of receipts
  - Entire amount taxable if limits exceeded – not just excess over limits
- Rs.50,000 for sums of money
  - Aggregate during the year
- Rs.50,000 for each immovable property
  - Not aggregate of all properties during the year
- For property other than immovable property
  - Rs.50,000 for receipts without consideration
  - Rs.50,000 for receipts for consideration less than FMV
  - Aggregate of all such properties (irrespective of type)
- Separate limits under clauses (vi) and (vii) prior to and after 1.10.2009
- Whether separate limits for minor and parent?

Settlements on Trusts

- Who is recipient – trustees or beneficiaries?
  - Specific trusts
  - Discretionary trusts
- Whether receipt without consideration by trustees?
- Status of Trustees
- What if all beneficiaries are “relatives”?
- Whether taxable at time of distribution by trustees to beneficiaries?

S.56(2)(viia) - Rationale

- Explanatory Memorandum to Finance Act 2010

  "In order to prevent the practice of <u>transferring</u> unlisted shares at prices much below their fair market value, it is proposed to amend s.56 to also include within its ambit transactions undertaken in shares of a company (not being shares of a company in which public are substantially interested) either for inadequate consideration or without consideration where the recipient is a firm or a company (not being a company in which the public are substantially interested).

Persons Covered - S.56(2)(viia)

- Firm
- Company, not being company in which public are substantially interested
- Firm includes LLP
- Listed companies, subsidiaries excluded
- Foreign listed companies?
- AOP, BOI not covered
- Artificial juridical person not covered – e.g. deity

Assets Covered - S.56(2)(viia)

- Shares of a company in which public are not substantially interested
  - Both equity and preference shares covered
  - Warrants, options, convertible debentures not covered
  - Listed company shares not covered
  - Not necessarily capital asset – applicable also to stock-in-trade

Receipts

- Whether transactions by company itself covered –
  - Bonus issue
  - Rights issue
  - Allotment on conversion of warrants
  - Allotment on exercise of options
  - Buyback of shares

Exemptions – s.56(2)(viia)

- S.47(via) – Transfer of shares in closely held Indian co. in scheme of amalgamation between two foreign companies
- S.47(vic) – Transfer of shares in closely held Indian co. by demerged foreign co to resulting foreign co
- S.47(vicb) – Transfer on reorganisation of two co-operative banks
- S.47(vicd) – Transfer or issue of shares by resulting co in scheme of demerger to shareholders of demerged co
- S.47(vii) – Transfer by shareholder in scheme of amalgamation of shares held in amalgamating co

Transactions not Specifically Exempt

- S.47(iv)/(v) – Transfer of shares by holding co to subsidiary/vice versa
- S.47(vi) – Transfer of shares held by co on amalgamation with another co
- S.47(vib) – Transfer of shares held by Indian co on demerger to resulting Indian co
- S.47(xiii)/(xiv) – Transfer of shares held by firm/ proprietary concern on conversion to co
- S.47(xiiib) – Transfer of shares held by co on conversion into LLP
- Transfer of shares held by firm on conversion into LLP
- Contribution of shares by partner to firm below FMV
- Distribution of shares to partner on dissolution of firm at cost

Cost of assets taxed u/s.56(2)(vii)/(viia)

- S.49(4) – Value taken for purposes of s.56(2)(vii)/(viia) to be taken as cost – overlap with s.49(1) in cases of gift
- Holding period & indexation in cases of gift?
  - Circumstances mentioned in s.49(1)

Valuation – Rules 11U, 11UA

- Valuation Date – date of receipt by assessee
- Jewellery/Archaeological Collection/Works of Art, etc.
  - Open market value if sold on valuation date
  - If receipt by purchase from registered dealer on valuation date, invoice value
  - If received by any other mode and value exceeds Rs.50,000, assessee to obtain report of registered valuer in respect of open market value
  - What if received as gift on same date/soon after date of purchase?

Valuation – Rules 11U, 11UA

- Shares & Securities
- Quoted Shares & Securities
  - If received by transaction on recognised stock exchange, transaction value as per exchange
  - Whether Brokerage, STT, Turnover Tax to be included?
  - If received by transaction carried out other than through recognised stock exchange:
    - Lowest price on any recognised stock exchange on valuation date
    - If no trading on valuation date, lowest price on any recognised stock exchange on a date immediately preceding valuation date when traded

Valuation – Rules 11U, 11UA

- Unquoted Equity Shares
  - $\frac{\text{BV of Assets - BV of Liabilities}}{\text{Paid-up Equity Capital}}$ X Paid-up Value per share
  - Debit balance of P & L Account to be excluded from assets
  - Liabilities not to include:
    - Paid-up capital
    - Provision for dividends
    - Reserves
    - P & L Account
    - Provision for taxation
    - Provision for Unascertained Liabilities
    - Contingent liabilities, other than arrears of cumulative preference share dividends

Valuation – Rules 11U, 11UA

- Other Unquoted Shares & Securities –
  - Open Market Value – to obtain valuation report from merchant banker/accountant – whether report binding on AO?
  - Method of Valuation not prescribed

Valuation of Unquoted Company Shares - Issues

- Whether Balance Sheet to be made up to date of gift or last available or nearest Balance Sheet can be used?
- Whether yield method can be followed for running companies?
- Adjustments for Auditor Qualifications
- No discount for restricted transferability
- Revaluation of Assets
- Deferred Tax Asset/Liability
- MAT credit

Valuation of Unquoted Company Shares - Issues

- Unascertained Liabilities
  - Gratuity/leave encashment – whether unascertained
- Provision for Diminution in Valuation of Assets
  - Provision for Doubtful Debts
  - NPA/Investment Diminution Provisions
- Difference from FEMA norms

Direct Taxes Code

- Entire receipt taxable u/s.58(2)(h)/(i)/(j)
- U/s.59(3)(b) – Deduction of aggregate amount referred to in clause (h) or clause (i) or clause (j) to extent aggregate does not exceed Rs.50,000 – combined limit

THANK YOU!