Taxation of Gift

(Under Income Tax Act, 1961)

- Brijesh Pitroda

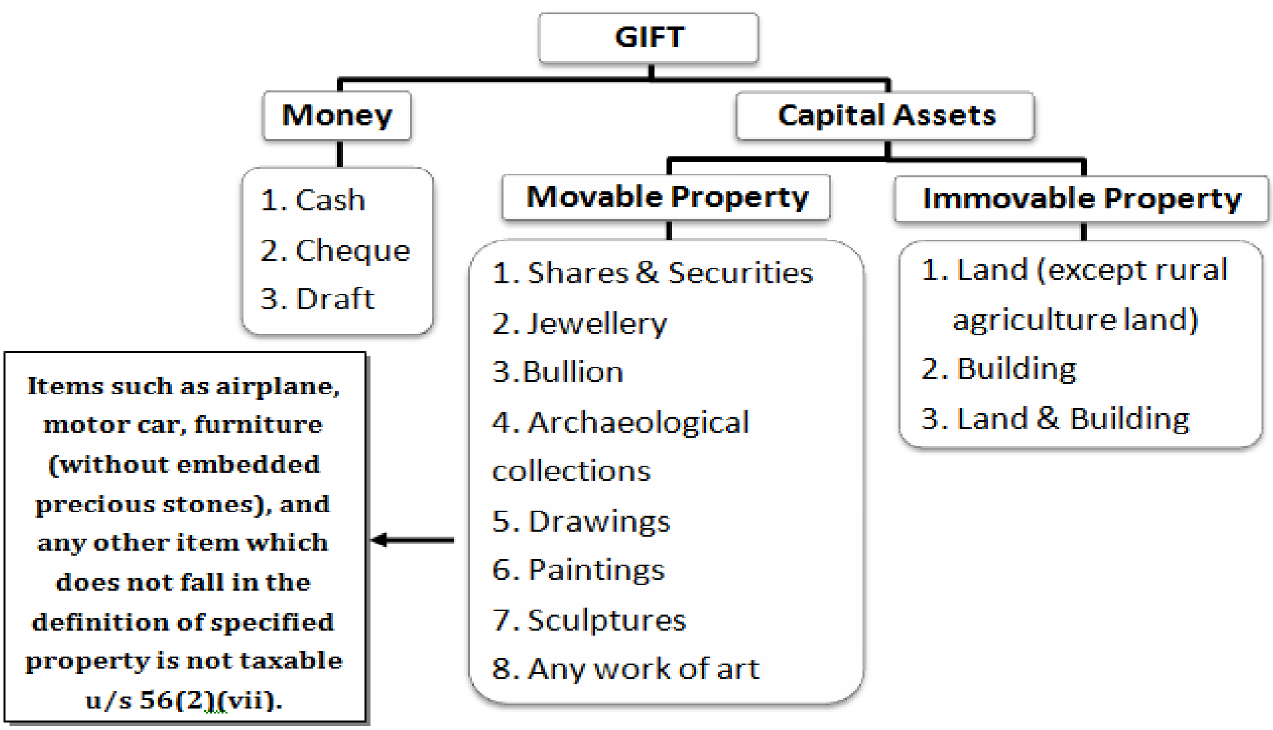
Contents

Introduction

"It's always a pleasure to give gifts and more pleasure to receive it."

On many occasion/events like Dipawali, Marriage, Birthday etc., gifts are commonly exchanged among friends and relatives to show one's love and affection to others. It is from ancient times one of the most famous modes of transferring movable as well as immovable property. The legislation and revenue officers are often frowned upon the concept of gift, as in several cases, gifts are used as a tool for converting of illegal money (black money) into legal gifts and minimizing tax liability.

However to ensure that there are no leakages of revenue through the mechanism of gifts, government introduced the Gift Tax Act on 1st April 1958. This act had been demolished on 1st October 1998 and all the transactions related to gift made thereafter were become tax free. Then the gift legislation got renewed in a new avatar, by inserting section 56(2)(v) under the Income Tax Act 1956 on 1st September 2004, which further amended by clause (vi) on 1st April 2006 and now with effect from 1 October 2009clause (vii) has been inserted under section 56(2),which state that *any sum of money or value of property received without consideration or value of property received for inadequate consideration is chargeable to tax in the hands of recipient, being an individual or HUF under the head "Income from Other Source".*



As per section 56(2)(vii)gift is chargeable to tax if it satisfies the following conditions:

1. It is received by an ***individual or a HUF.***
2. If it is received on or after ***1st October, 2009***.
3. The gift falls in any of the following ***three categories*** .
4. The gift does not fall in the ***excluded category.***

Categories of Transactions:

1. **Any sum of money (gift in cash or by cheque or draft):**
   If **aggregate amount** of sum of money received by an individual/ HUF from one or more persons during a previous year (but on or after 1st October, 2009) exceeds Rs. 50,000/-, the **whole of such aggregate value** will be chargeable to tax.

> **Example:** If 'A' received an amount of Rs. 50,000 from 'B' without any consideration is not taxable. But if the amount received is Rs. 50,001 then the entire Rs. 50,001 is taxable in the hands of the 'A', the receiver.

2. **Immovable property:**

(i) **If any immovable property (land or building or both) is received without any consideration** on or after 1st October, 2009and the stamp duty value of which exceeds Rs. 50,000/-, stamp duty value will be chargeable to tax in **every such transaction.**

(ii) Presently for the A.Y 2013-14, **if immovable property purchased for a consideration which is less than the Stamp duty value** (i.e. inadequate consideration) nothing will be taxable in the hands of recipient.

But as per the amendment made by the Finance Act 2013, (applicable for the A.Y. 2014-15), the difference between stamp duty value and consideration is chargeable to tax.

Example: If 'A'(transferee) received a gift of a house property on 17th June 2013 from his friend 'B'(transferor) without any consideration, Stamp duty value of the property is 12,00,000. In the hand of A, Rs. 12,00,000 will be chargeable to tax u/s 56(2)(vii) under the head "Income from Other Source". In the hands of 'B'(transferor), it is not treated as transfer u/s 47(iii) and therefore not be chargeable under the head "Capital Gain".

In the same case if 'A' purchases an house property from 'B' for Rs. 10,00,000(i.e. for inadequate consideration), the difference between the stamp duty value and consideration i.e., Rs. 2,00,000 will be chargeable as gift u/s 56(2)(vii)(b) in the hands of 'A' for the A.Y 2014-15.Here **section 50C of the Act will also come into play,** where transfer or transfers an immovable property for a consideration lower than the stamp duty value, then the stamp duty value of such property (i.e. 12,00,000) is deemed to be the consideration and capital gain will be calculated accordingly in the hand of 'B'(transferor).

Does this mean that at the time of transfer of immovable property for inadequate consideration, there would be double taxation– one in the hands of the transferor u/s 50C and the other in the hands of the transferee u/s 56(2)(vii) of the Act? It appears to be so, but it is not.

Nevertheless, when the 'A'(transferee) would transfer such a property, a solace would be available in the form of **section 49(4) of the Act, which provides that value of a property considered for the purpose of section 56(2)(vii) (i.e. Rs. 12,00,000) shall be deemed to be the cost of acquisition.**

3. **Movable property:**

(i) If **movable property is received without consideration** during a previous year (but on or after 1st October, 2009) exceeds Rs. 50,000/-, the **whole of aggregate FMV** will be chargeable to tax.

(ii) **If movable property is received for a consideration which is less than the aggregate FMV** of the property by an amount exceeding Rs. 50,000/-then the difference between **aggregate FMV and consideration is chargeable to tax.**

> **Example:** 'A' received a painting without consideration from 'B'. The fair market value of the painting is Rs. 11,00,000. The FMV will be chargeable to tax in the hands of 'A' under section 56(2)(vii). In the hands of 'B', it is not treated as transfer u/s 47(iii) and therefore not be chargeable under the head "Capital Gain".
>
> If 'A' purchases a painting for Rs. 8,00,000 from 'B'. The difference of Rs. 3,00,000(i.e. 11,00,000-8,00,000) is taxable in the hands of 'A' under section 56(2)(vii). If 'A' transfers this painting, the cost of acquisition for the purpose of calculating capital gain will be Rs. 11,00,000[considering section 49(4)]. In the hands of 'B' for the purpose of calculating capital gain, the full value of consideration will Rs. 8,00,000(Section 50C is not applicable in the case of movable properties).

> **Note:** Valuation of Movable and immovable properties for the purpose of section 56 shall be valued in accordance with the provision of rule 11U and 11UA.

Excluded category:

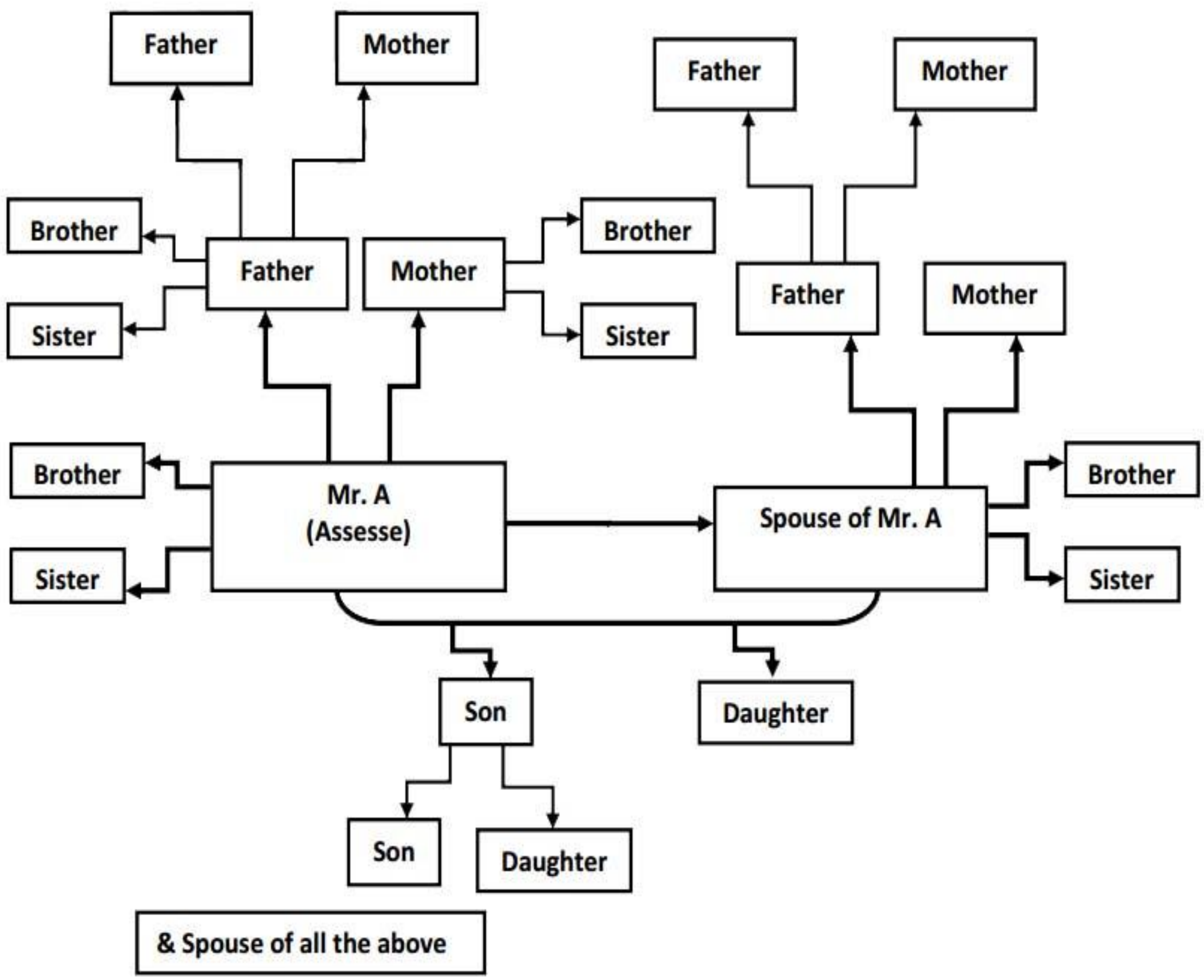
Gift receive on any of the following occasions will be exempted from tax u/s 56(2)(vii).

(i) From any relative.
(ii) On the occasion of the marriage of an individual.
(iii) Under a will or by way of inheritance.
(iv) In contemplation of death of the payer.
(v) From any local authority as defined in section 10(20).
(vi) From any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C).
(vii) From any trust or institution registered under section 12AA.

<u>Definition of Relative:</u>

A relative can be any of the following:

(i) In the case if individual
  a) Spouse of the individual (Fiancé not included)
  b) Brother or sister of the individual, spouse or of either parents
  c) Lineal ascendants or descendants of individual or of spouse
  d) Spouse of person referred to in scenario(ii) and(iii) above



(ii) In the case of Hindu undivided family, any member thereof.

New category of transaction taxable u/s56(2)(viia)(w.e.f. 1st June 2010).

Where a firm or a closely held company, receives, any shares of a closely held company:

(i) without consideration and the aggregate FMV of such shares exceeds Rs. 50,000,the whole FMV will be treated as income of the assessee.

(ii) for inadequate consideration when compared to FMV exceeds Rs. 50,000, the difference would be treated as income of the assessee.

Different Situation	Taxability in the hands of recipient(i.e. a firm or closely held company)
Shares are received without consideration and aggregate FMV of these shares received during the P.Y. does not exceed Rs. 50,000.	Nothing is taxable in the hand of recipient.
Shares are received without consideration and aggregate FMV of these share received during the previous year exceed Rs. 50,000.	Aggregate FMV will be taxable in the hand of recipient.
Shares are received for a consideration which is less than FMV and the aggregate difference does not exceed Rs. 50,000.	Nothing is taxable in the hand of recipient.
Shares are received for a consideration which is less than FMV and the aggregate difference exceed Rs. 50,000.	Aggregate FMV *minus* aggregate consideration, will be taxable in the hand of recipient.

However, this provision would not apply in the case of transfer of shares:

a) **of/to** a company in which the public are substantially interested.

b) Share are not received by way of transaction referred to in section 47(via)/(vic)/(vicb)/(vid)/(vii)(i.e. receipt of share in the scheme of amalgamation, demerger, etc.)

Premium on shares Section (2)(viib) (applicable from the A.Y. 2013-14)

New clause (viib) has been inserted in section 56(2) to bring tax on the consideration received from a resident person by a company, other than a company in which public are substantially interested, which is in excess of the FMV of shares (i.e. at a premium). **Such premium is to be treated as the income from other source under this head.**

However, these provisions would not be attracted where consideration for issue of shares is received:

(i) by a Venture Capital Undertaking from a Venture Capital Fund or Venture Capital Company; or

(ii) by a company from a class or classes of persons as notified by the Central Government for this purpose.

Sr. No.	Face value of share	FMV of share	Issue price of share	Applicability of sec. 56(2)(viib)
1.	100	120	130	Since the shares are issued at a premium. The excess of the issue price of the shares over the FMV Rs.10 (Rs. 130 – Rs.120) would be taxable.
2.	100	120	110	Since the shares are issued at a premium. However, no sum shall be chargeable u/s 56(2)(viib) as the shares are issued at a price less than the FMV.
3.	100	90	98	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
4.	100	90	110	Since the shares are issued at a premium. The excess of the issue price of the shares over the FMV Rs.20 (Rs.110–Rs.90) would be taxable.

Some Important Issues:

1. **Gift by HUF to Member/Distribution of HUF assets on Partition is taxable?**
   In the case of gift by HUF to any of the member, the same will be taxable in the hands of recipients u/s 56(2)(vii). However the amount spent by an HUF on the education/marriage of any member or for any other common purpose, the same will not be treated as income of any particular member.
   In the case of partition of assets of HUF amongst the members, if a member receives cash or assets of value less than the value of the assets to which he was entitled and the other member or members receive cash or assets of value more than the value to which he or they were entitled according to his or their share/shares, the transaction will be **held as gift and will be taxable u/s 56(2).**

2. **Gifts received by children, is it taxable?**
   The gifts received in the names of one's minor children will **be clubbed with the parents' income for taxation purpose.** Also the taxman is very alert in saying that, in case of both parents having income, clubbing will be done with that parent who is earning more. So, one cannot hide under the cover of their minor children receiving the gifts.

3. **Motor car received as a gift, is it taxable?**
   Suppose you received a gift as a motor car from your friend. FMV of the car is Rs. 2,10,000. Nothing is taxable in your hands u/s 56(2)(vii). This section is applicable only if gift received falls under the definition of specified property. So, if a **car received as a gift or purchased for a consideration which is lower than FMV, Section 56 (2)(vii) is not applicable.**

Conclusion:

Such tightened mechanism of the gift inserted with the intension to curb the tax evasion, is also affecting the genuine gift transactions like gift to fiancé, friends etc. by increasing its tax liability. However it is always in the interest of receiver to be aware of above provisions while receiving the gift and also to get a gift deed signed by the donor that can be used as evidence of gift in the case of future litigation/investigation by the Income tax department.