

RELATIVES UNDER THE INCOME TAX ACT – A RELATIVE CONCEPT

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Human Society – a cobweb of relationships

- 1.0 Human being is called a social animal. The edifice of the society is built on the formal and informal relationship between human beings *inter se*. Society consists of near and dear one i.e. with whom an individual interacts at various times, occasions and for various reasons viz. financial, religious, business etc.. A human being also deals with unknown in day-to-day life for limited purposes, but largely for commercial reasons, i.e. for buying or selling commodities or services. Such transactions are at arm's length prices, not involving any dimension of relationship. Interaction with near and dear ones have always encompassed all the types of above said transactions. Mutual confidence in each other has been preferred as it provides comfort while dealing with money.
- 1.1 Law is supposed to be blind as it is expected to be applicable to each and every human being. Taxing statutes are also equally supposed to be neutral to relationship between the two taxpayers. Transactions attracting tax are expected to be entered into at arm's length prices. Although business / financial dealings with relatives are expected to be at par or at arm's length level, reality is not so. Human beings not perfectly rational, element of relationship do creep into financial / business transactions. Taking care of this aspect, taxing statute of each country make suitable provisions in their direct and indirect taxes. For example, in the case of direct taxes viz. income tax, suitable provisions are made to take care of loss in revenue by transferring assets to one's relatives.
- 1.2 Each society / country is unique as it possesses its distinct identity of culture and traditions. This is the outcome of *inter se* relationship between its members. Since the taxing statutes are drafted for the taxpayers of a society, it cannot be oblivious of such cultural values and relationship arising out thereof. For example, since centuries, Indian society is having extended form of family. Till few years back, in the Indian traditional social system, relationship used to relate back to seven generations. Even today, the relationship is traced to the three / four generation levels. Not only that, it is also extended to one's spouses lineal ascendant / descendant as well. This relationship is not restricted to religious or social functions only. It also extends to business / financial transactions as well. In fact, interaction at such functions gives an opportunity for entering into financial relationship. It is for these reasons that one comes across distinctly visible provisions in the arena of direct taxes. Indian Income Tax Act, 1962 is also one piece of such legislation. It makes extensive provisions for disallowance of expenses for transactions between relatives, transfer of assets amongst relatives etc.

Impact of Indian Tradition on Tax System

- 2.0 A unique form of reflection of such social system is recognition of Hindu Undivided Family (HUF) under the Income Tax Act as a separate taxable entity. The concept of HUF relates back to century old system of undivided family as described extensively in *Manusmriti*. India is the only country in the world where, in the case of a male, apart from assessing him on his income, a separate entity is also being presumed belonging to

him. Another such case of reflection of social custom in the taxing statute is provisions of S. 56(2)(v) i.e. regarding transfer of assets amongst relatives. One will be surprised to read the length and width of relationship to which exemptions granted under S. 56(2)(v) are extended. For a non-Indian, this may appear to be stretching the matter too far. However, those who are familiar with Indian traditions, offering gift to one's relatives on the occasions of birth, marriage and various other occasions are very common.

- 2.1 Law makers have been aware of attempts made by the taxpayers to organize affairs through relatives to keep the tax impact at lower level. Attempts to curb role of relatives in tax saving can be traced back to insertion of S. 64(1) and 64(2) i.e. regarding clubbing of income derived by spouse, daughter-in-law, grand son etc. out of assets gifted. In the same manner, transferring business income to wife / minor children was plugged by inserting provisions like S. 64(1)(iv) and (vi). During the period up to October, 1998 tax was also levied in the form of gift tax for assets transferred without consideration. Once again, transfer of assets through gift came to limelight when the base for taxation was shifted from the donor, as in the case of Gift tax, to the donee.

Relatives under the Income Tax Act

- 3.0 Income Tax Act contains various sections, which invoke relationship between two individuals and try to see the real motive behind the transactions. These sections are as follow:

1	S. 13(2)	Application of income / assets of charitable trust for the benefit of relatives of the trustee, founder, manager etc.
2	Proviso to S. 17(2)(iii)	Issue of shares to relatives of the promoters under ESOP Scheme
3	40A(2)(a)	Disallowance of payments made towards expenses to relatives of the assessee.
4	S. 56(2)	Charging of amount received as gift as Income from Other sources.
5	S. 64	Clubbing of income in the case of spouse, daughter-in-law, minors out of assets transferred without consideration.
6	S. 79	Disallowance of set-off of loss carried forward in the case of transfer of shares of a closely held company
7	S 80 DD	Deduction in respect of medical treatment of a dependent who is a person with disability
8	S. 80 DDB	Deduction in respect of medical treatment of specified ailments of a dependent who is a person with disability
9	S. 92A	Associated Enterprises under Transfer Pricing Regulations

Are relatives relative under the Income Tax Act?

- 4.0 For majority of these provisions, S. 2(41) provided a yardstick to define the term "*relative*". In other cases, each section provides for separate definition. Sections which are governed by the definition under section 2(41) are S. 40A(2)(a), 64, 79, 92A. However, section 13, Guidelines under section 17(2)(iii), 56(2)(v), 80DD and 80DDB carries its own definition. All these provisions are designed to achieve certain objectives and, therefore, carry different set of definitions.

- 4.1 Relationship between individuals encompassed in S. 2(41) is not absolute. This is borne out of the fact that, at various places under the I. Tax Act, the law makers have considered it prudent to widen its scope, depending upon the need of the objects of the provision. What may be true in the context of disallowance of expenditure with reference to a transaction with “relative” need not be so in the case of income arising out of assets transferred.
- 4.2 This has another dimension as well. IT Act treats relative for transfer of assets and income derived there from differently. Consider the case of asset transferred to spouse and brother’s wife. Both the cases will be considered as exempt u/s 56(2)(v) and not to be treated as income of the donee. However, S. 64(1)(iv), i.e. clubbing of income, will be applicable to income derived from assets transferred to one’s wife and not to one’s brother’s wife.
- 4.3 Introduction of S. 56(2)(v) has given to the taxpayers an unintended benefit. This is for the reason that what was being done with trepidation till date, has been given legal sanctity. When we look at these provisions with reference to enhanced basic exemption limit, do we have any ground to complain about difficulty in organizing tax affairs efficiently? If one looks at it holistically, one will find new avenues / methodology, which perhaps, the draftsman might not have visualized.

Relative u/s 2(41)

- 5.0 What is the meaning of the term relative? S. 2(41) defines it as

*“relative”, in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant **of that individual**;*

Salient features of the definition are as follow:

- 5.1 Firstly, it is applicable to an individual, for it is specifically provided that relative has to be looked into “*in relation to an individual*” only. Therefore, the question of applying the said term, in the case of a partnership firm or a company by invoking the relationship of the partners or the directors, does not arise.
- 5.2 Secondly, at the first level, it extends to both the variants of relationship i.e. vertically and horizontally. Vertically it covers father, mother, son, daughter etc. Horizontally, it covers brother, sister. But it doesn’t extend beyond that. However, vertically, it extends to second and third level as well, as it covers both i.e. lineal ascendant and descendant as well.
- 5.3 Thirdly, the relationship is required to be looked from the perspective of an “*individual*”. Therefore, it covers both, a male and female. It means that, in the case of a married woman, her father, mother, brother and sister will be considered as relative.
- 5.4 Fourthly, S. 2(41) refers to “*lineal ascendant / descendant*”. Lineal means in a straight unbroken line of descent from parent to child. Therefore, horizontal relationship viz. lineal descendant of brother and sister are not covered.

- 5.5 Fifthly, in the same manner, lineal ascendant / descendant of the spouse's brother and sister are also not covered.
- 5.6 Sixthly, ***relatives of the relatives are not covered***. Son of an individual is a relative of an individual as he is his father. However, brother's son will not be considered as relative u/s 2(41) though brother is considered as relative. This is for the reason that lineal ascendant / descendant relationship should be looked into from the perspective of "***that individual***" and not any other person.

Each of these aspects has been covered in this paper at length.

What is the meaning of the term brother / sister?

- 6.0 According to dictionary meaning brother means "*a male with the same parents as someone else*". Here, the word "*parents*" used is in plural. It presupposes that in order to be brother/sister, both the individuals, should have the same parents i.e. father and mother. In these days, when divorces are becoming common and marrying second time is no longer a taboo, such a definition of relationship may no longer remain valid. In fact as observed in the case of *Mahabir Jute Mills [1983] 17 TTJ (ALL.) 49* it was observed that "Brother" is a male human being considered in his relation to another person having the same parent or having one parent in common. The Courts have also taken note of change in social trends and new relationship arising thereof.
- 6.1 Although, Income Tax Act does not contain any direct reference to such a relationship, definition of the word "*child*" u/s 2(15B) may perhaps support it. S. 2(15B) defines "*child*", in relation to an individual, includes a stepchild and an adopted child of that individual. If stepchild and adopted child is child then it is not necessary that, in order to be a brother/sister, one should have the same parents.

Are cousins relatives?

- 7.0 In our day-to-day life, the word brother and sister are used in a broader sense i.e. to say father's brother's son/daughter is referred to as brother/sister. In the same manner, mother's brother's son/daughter is also called brother/sister. This is on account of cultural values imbibed in the Indian society and to some extent the concept of extended family followed. A question that arises whether S. 2(41) covers cousins? On plain reading of the section, the term relative would not include cousins of an individual. Chamber's Twentieth Century Dictionary defines the word cousin as "*the son or daughter of an uncle or aunt*". This is also for the reason, as explained above; the relationship has to be identified with "***that individual***". In the case of *Income-tax Officer v. Mahabir Jute Mills Ltd. [1983] 17 TTJ (ALL.) 49* it was held that cousins cannot be considered as relatives. It was also observed that:

The term brother will not include cousins in its natural sense. "Brother" is a male human being considered in his relation to another person having the same parent or having one parent in common. It is in this sense that the term brother has been used in section 2(41), it cannot include cousins where there is no common parent involved and only some of the ancestors are common. If the legislature has intended to rope in the term relative cousin also it could have done so and not taken support of the word brother.

What is lineal ascendant / descendant?

- 8.0 As per the dictionary meaning ascendant means “*someone from whom one is descended (but usually more remote than a grandparent)*” and descendant means “*a person considered as descended from some ancestor or race*”. Lineal means “*in a straight unbroken line of descent from parent to child*”. Therefore, lineal descendant means in a straight unbroken line of descent from parent to child. A question can arise whether an individual can be considered as descendant of father only? Or can one be considered as descendant of mother as well? Since the word used is parent, the term will include both, the father and mother as well. However, the draftsman, while drafting the clause (vi) of Explanation I to S. 13, thought otherwise and provided for spouse of the lineal descendant as well!

Whether stepchild is covered under the definition of “lineal descendant”?

- 9.0 Step child means the child of one’s spouse by a former marriage. Here, the individual is not biological father/mother of the child. A question arises, whether in order to be lineal descendant, the individual should be biological father/mother? Whether the relationship of father and son/daughter sanctified under any statute will also make it “lineal descendant”? Such relationships come under scrutiny under various statutes for varieties of reasons. To what extent rationale followed therein should be recognized is a matter of legal controversy. However, S. 2(15B) of I. Tax Act to some extent has resolved this issue. S. 2(15B) extend the definition of child to stepchild and adopted child as well. Therefore, lineal descendant will include stepchild and adopted child also.

Illegitimate child

- 10.0 Whether illegitimate child of an individual can be considered as lineal descendant? Under the Income tax Act for the purpose of levying tax, legitimacy of the source or activity is not considered. As long as the assessee has derived income, which falls within the term “*income*” tax will have to be paid on it. This is irrespective of the fact that for the purpose of earning the said income, the assessee has violated provisions of some other laws. If so, whether any illegitimate child of an assessee, can be considered lineal descendant? If so, whether legitimate and illegitimate children can be called brother/sister?
- 11.0 In the case of *First GTO v. A.K.C. Natarajan [1986] 16 ITD 359 (Mad.)* such an issue came for consideration under section 5(1)(xii) of the Gift tax Act. The question was whether exemption u/s 5(1)(xii) is available in respect of a gift made by assessee to his illegitimate child.
- 11.1 According to the GTO, the term ‘*children*’ mentioned in section 5(1)(xii) referred to legitimate children only. Hence, the exemption under section 5(1)(xii) is not admissible. It was also submitted that the word ‘*child*’ used in section 5(1)(xii) cannot refer to a illegitimate child. It was also argued that section 2(15B) of the Income-tax Act, 1961 defines ‘*child*’ in relation to an individual, includes a step-child and an adopted child of that individual. It does not include the illegitimate child. Reliance was also placed on a decision of the Kerala High Court in the case of *Executors of the Will of T.V. Krishna Iyer*.
- 11.2 The assessee’s representative, contended that illegitimate daughters are also entitled to maintenance as contemplated under sections 20 and 21 of the Hindu Adoptions and

Maintenance Act, 1956 and, therefore, the gifts given to them should be exempted under section 5(1)(xii).

- 11.3 The Tribunal referred to the observations made by the Madras High Court in the case of *Narayani Ammal v. Govindaswami Naidu* [1975] 1 MLJ 359 (FB). The Court had observed that

“Courts cannot lose sight of the progressively changing views of social outlook and insist upon only applying time-old notions. We are, with great respect, unable to concur with Seshagiri Aiyar, J. that an illegitimate daughter has no place at all under the Hindu law except in limited cases, which he pointed out. The change in the social outlook in respect of succession is reflected in the recent legislations, particularly the Hindu Succession Act, 1956, which has done away with the distinction between legitimacy and illegitimacy within certain limits in the matter of succession either to property of a male or a female, dying intestate. We also note that section 3(i), which defines the word ‘related’ has a proviso according to which illegitimate children shall be deemed to be related to their mother and to one another. In fact, it goes further and says that their legitimate descendants shall be deemed to be related to them and to one another and any word expressing relationship or denoting a relative shall be construed accordingly. It seems to us that ***having regard to this trend of legislation reflecting the changing social approach to succession, we will be justified in interpreting the word ‘daughter’ in the original text as including an illegitimate daughter as well. We are also of opinion that once an illegitimate daughter is an heir, as we hold she is, to succeed to her mother’s stridhana property, so long as she is available, the son, who is not in the nearer line of stridhana heirs, cannot have preference and exclude an illegitimate daughter.***”

[Emphasis supplied]

In view of the above the Tribunal held that illegitimate child is a child as defined under the Gift Tax Act.

- 11.5 However, in the case of *Vairavan Servai (A.) Vs. Comm. of Agrl. I. tax* [1980] 124 ITR 558 the Madras High court had taken a contrary view. A question arose whether for the purpose of levying tax under Tamil Nadu Agricultural Income Tax, agricultural income of any individual shall include agricultural income of a minor child of such individual as arising from assets transferred to the minor by such individual otherwise than for adequate consideration.
- 11.6 It was argued by the assessee that the provisions contained in s. 9(2) of the Tamil Nadu Agrl. I.T. Act, 1955, are modelled on the provisions contained in the Indian I.T. Act, 1922, and with reference to the analogous provisions contained in the Indian I.T. Act, 1922, the court had, in the case of *CIT v. C. S. Rajasundaram Chetty* [1950] 18 ITR 145 taken the view that the word “child” will take in only a legitimate child and will not take in an illegitimate child. While construing s. 16(3)(a) of the Indian I. T. Act, 1922, as it was held that the normal connotation of the term “child” in the said section will be only a legitimate child when there is nothing in the context to the contrary. The Court also referred to the observations of Denman C. J., in the case of *Queen v. Totley* [1845] 7 QB 596 at 600, to the effect that the law does not contemplate illegitimacy. Therefore, the proper description of a legitimate child is ‘child’. It was further submitted that there is no

decision to the contrary and notwithstanding this construction of the word “*child*” occurring in the corresponding provision in the Indian I.T. Act, Parliament has not taken any steps to amend the Act so as to make it clear that the word “*child*” was intended to include the illegitimate child also.

- 11.7 The Revenue relied on the amendment made to s. 16 of the Hindu Marriage Act, 1955, by s. 11 of the Marriage Laws (Amendment) Act, 1976, and contended that by the said amendment a child, born as a result of bigamous marriage declared to be void under the Act, will continue to be a legitimate child and not an illegitimate child. It is clear that the provision contained in the amended S. 16(1) of the Hindu Marriage Act, 1955, is declaratory in character. Once the marriage is void in law, the offspring of that marriage cannot be legitimate. However, the section, by means of this amendment, declares that notwithstanding that a marriage is null and void under s. 11, the child shall be legitimate.
- 11.8 To what extent this statutory declaration contained in the amended s. 16 of the Hindu Marriage Act, 1955, can be imported into s. 9(2) of the Tamil Nadu Agrl. I.T. Act? The Court was of the view that there is no justification for importing that declaration into this section. The reason for this is that the Tamil Nadu Agrl. I.T. Act is applicable to all citizens irrespective of faith or religion. The provisions of the Indian Income tax Act are an enactment applicable to all persons irrespective of their faith or religion. The fact that amongst Sudras, illegitimate sons get a share of the inheritance on the death of the putative father will not entitle the court to introduce that consideration in interpreting the word ‘*child*’ in section 16(3X)(a) of the Act which applies to Hindus as well as to Christians, Muhammadans and members of the other communities.
- 11.9 By importing such interpretation an anomalous situation will arise. For instance, an offspring of concubinage will still continue to be an illegitimate child and s. 9(2) of the Tamil Nadu Agrl. I. T. Act will not take in such a child. Similarly, the children of a bigamous marriage contracted by a Christian will be illegitimate and those children also will not be covered by s. 9(2) of the said Act. In view of this the Court did not rely on amended s. 16 of the Hindu Marriage Act, 1955 and held that illegitimate child cannot be considered at par with legitimate one.

Are married daughters relatives?

- 12.0 Once a woman gets married she ceases to be member of her parent’s family. She becomes member of her husband’s family. Whether ceasing of relationship will end her status as daughter of her parents? No. She will continue to remain daughter of her father and mother forever. S. 2(41) embrace the case of lineal descendant also. Therefore, from the perspective of father, daughter is lineal descendant. Hence, she will continue to be relative with reference to her parents, irrespective of the fact whether she is married or not.
- 12.1 In the case of *Manibhai Gaur V Controller of ED* [1980] 122 ITR 652 MP, in a matter related to Estate Duty, it was contended by the I. Tax Department that married daughters were not “*children*” within the definition of “*relatives*” as contained in s. 27(7)(i)(b) of Estate Duty Act. The court did not find any merit in this contention. It was also observed that the word “*children*” has been used in a comprehensive sense as is clear from cl. (ii) of s. 27(7) which specifically says that the word “*children*” shall include illegitimate children and also adopted children. Unmarried and married daughters will both fall

within the description of to “*children*” and will be covered by the definition of “*relative*” as given in s. 27(7)(i) of the Act.

- 12.2 Although these observations were in the context of the word “*children*” as defined under the Estate Duty Act, what is important is that it was interpreted in comprehensive sense. Applying the same analogy, one can say that married daughters are also relative within the meaning of S. 2(41).

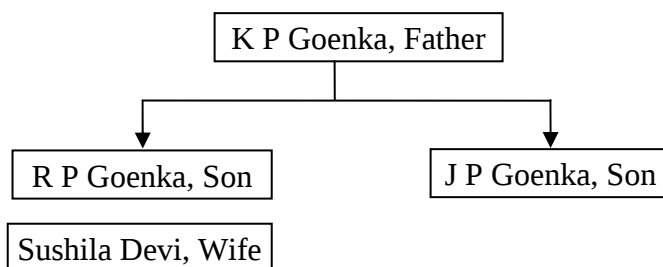
Whether daughter-in-law and the sister-in-law are relatives?

- 13.0 Applying the definition given in the S. 2(41) in many relationships one may get absurd and anomalous results. For example, under the Indian tradition, daughter-in-law and sister-in-law are considered as relatives as they are member of the family. To term them not as relatives will be sacrilegious. Under the Indian tradition both are part and parcel of the family and it will be difficult to digest such an interpretation. However, looking to the terminology used, one is left in no doubt that such relationships have not been recognized u/s 2(41).

Are relatives of relative relative?

- 14.0 An attempt was made by the I. Tax Department to extend the term relative by treating relative of relative as relative i.e. the concept of joint terminology and to rope in such relationship as well within the mischief of S. 2(41). An interesting question arose in the case of *Bhagwati Trading Co. Ltd. Vs. Commissioner of Income-tax [1977] 109 ITR 035*. To what extent this relationship should be extended? It was argued by the I. Tax department that the term “*relative*” be applied as a joint terminology and then it should be found out, if any of them, is related to the other by the said meaning given in the definition. However, the argument did not find favour with the Court for the reason that the section clearly enjoins that ***relationship must be between one another mentioned in the section***. When the expression “relative” has been defined, it is not proper to construe the relationship by some other notion because there cannot be two different meanings to the same expression used in the Explanation.

In order to appreciate the reasoning, let us try to understand the relationship, which the Court was trying to define in the said case. Shri K P Goenka, father had two sons viz. Shri R P Goenka and Shri J P Goenka. Shri R P Goenka’s wife was Smt. Sushila Devi. The question was whether Smt. Sushila Devi can be said to be relative of Shri K P Goenka or Shri J P Goenka as defined under section 2(41)?



Looking to the above facts, the Court interpreted S. 2(41) in following manner.

Relative from the perspective of Shri K P Goenka

	Husband	Wife	Brother	Sister	Lineal Ascendant	Lineal Descendant
R P Goenka	No	No	No	No	No	Yes
J P Goenka	No	No	No	No	No	Yes
Sushila Devi	No	No	No	No	No	No

Smt. Sushila Devi is not related to Shri K P Goenka

Relative from the perspective of Shri R P Goenka

	Husband	Wife	Brother	Sister	Lineal Ascendant	Lineal Descendant
K P Goenka	No	No	No	No	Yes	No
J P Goenka	No	No	Yes	No	No	No
Sushila Devi	No	Yes	No	No	No	No

Relative from the perspective of Shri J P Goenka

	Husband	Wife	Brother	Sister	Lineal Ascendant	Lineal Descendant
K P Goenka	No	No	No	No	Yes	No
R P Goenka	No	No	Yes	No	No	No
Sushila Devi	No	No	No	No	No	No

Smt. Sushila Devi is not related to Shri J P Goenka

Relative from the perspective of Smt. Sushila Devi

	Husband	Wife	Brother	Sister	Lineal Ascendant	Lineal Descendant
K P Goenka	No	No	No	No	No	No
R P Goenka	Yes	No	No	No	No	No
J P Goenka	No	No	No	No	No	No

Shri K P Goenka and Shri J P Goenka are not related to Smt. Sushila Devi

- 14.1 As can be seen from above though Smt. Sushila Devi is daughter-in-law of Shri K P Goenka she was not regarded as relative as defined in S. 2(41). The Court observed:

Relative, again, has been defined in this sub-clause as meaning husband, wife, lineal ascendant or descendant, brothers and sisters. Therefore, the person must be related with "one another" by the relationship as indicated in the said definition. Section 23A, therefore, requires not only that one must be related to the other; the other must be related to the next person. Each must be related to the other in view of the expression "one another ". In this case, therefore, it is necessary to find out if the persons in the serial number 2 of shareholding, i.e., Sri K. P. Goenka, M/s. R. P. Goenka & Ors., Smt. Sushila Devi Goenka and Sri Jagadish Pd. Goenka, can be said to be related to one another in terms of the definition provided in the Explanation to the section. R. P. Goenka and Jagadish Pd. Goenka are brothers. Therefore, they are related to each other. K. P. Goenka

is also related to R. P. Goenka as being the father of the son. Smt. Sushila Devi Goenka is not related either to Sri K. P. Goenka or to Sri Jagadish Pd. Goenka in terms of the definition because Sushila Devi is neither the husband nor the wife nor lineal ascendant or descendant or brother or sister either of Sri K. P. Goenka or Sri Jagadish Pd. Goenka..

- 14.2 Same issue was also considered in the case of *ACIT v Motor & Gen Fin.* 246 ITR wherein following observations were made.

“... unless two or more persons are relatives of one another, they cannot be treated as a single person. The expression “relative” as appearing in section 2(41) is in relation to an individual and persons who are included in the category of “relatives” have been spelt out in the provision itself i.e., husband, wife, brother or sister or any lineal ascendant or descendant of that individual. The expression “that individual” is the key to the intention of the Legislature. It has link with the expression “an individual” which appears in the earlier part of the provision. Therefore, while husband, wife, brother and sisters or lineal ascendants of an individual is concerned, merely because another person who is relative being one of the indicated categories, the relatives of that person are not covered by the expression “relative” under section 2(41), so far as the other individual is concerned....”

In view of this, relative of a relative cannot be called relative.

Whether the provisions relating to relatives can be applied to a corporate body?

- 15.0 S. 2(41) defines the term relative in relation to an individual. Therefore, it cannot be applied to a corporate body or partnership firm as it cannot have husband, wife or lineal ascendant etc. Is it possible to trace this relationship with reference to, say, directors of the Company? Whether wife, husband etc. of the office bearers can be called relatives of the companies? A question arose in the case of *CIT V Britannia Indus. Ltd.* [2006] 280 ITR 527 wherein it was argued by the I. Tax Department that relationship should be looked into from the perspective of individual office-bearers of the assessee. However, this did not find favour with the Court and it was held that the firm consisting of the relatives of the directors of the assessee company can, by no stretch of imagination, be said to be a firm of relatives of any of the directors of the assessee. So, at least, the Courts have not recognized the concept of “corporate brother”, “corporate mummy” or “corporate Sister-in-Law (bhabhi)”. Although, in reality, we all know, barring few companies run by professionals, the concept of “corporate papa” and “corporate bhabhi” is very much in vogue in India.

Comparative analysis of S 2(41) and 56(2)

- 16.0 S. 2(41) forms part of definition section. By its nature, it defines the term relative in a general manner. However, provisions of S. 56(2) were drafted keeping in mind to achieve certain objectives i.e. to levy tax on assets transferred in the form of gift. As explained above the lawmakers were required to provide for extended relationship under the exemption category. At times, this gives strange results. For example, purchase of goods from brother will invoke provisions of S. 40A(2), may be perhaps, leading to disallowance and additional tax liability. However, gift by the same individual of the

same amount to his brother will not attract provisions of S. 56(2) i.e. addition to income for the reason that he is relative.

Relatives and Charitable Trusts

17.0 S. 11 contains extensive provisions for providing certain benefits to charitable and religious trusts. S. 13(1) provides for denial of such benefits to certain types of trusts for applying its income or assets for the benefit of relatives of the settler or manager. S. 13(2) lists various transactions, which amount to application of income or assets of the Trust for the benefit of relatives of the Settler or Manager. S. 13(3) defines the specified persons for whose benefits income or asset of the Trust has been applied. Apart from various other persons it provides for relative of author, founder, person, member trustee or manager of the Trust.

17.1 Explanation 1 to S. 13 provides for following types of relationship for application to S. 13. As can be seen, as compared to S. 2(41), it is far more extensive. It should be noted that Explanation 1 was inserted in 1973 when provisions of S. 2(41) already existed. The Government found misuse of the property / income of the charitable trusts through extended relationships of the founder, trustees etc. Hence, the extended definition as follows:

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of the spouse of the individual;
- (vi) spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv) or sub-clause (v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

17.2 At a first glance this definition will look similar to the one given in S. 56(2)(v). However, there is a difference. This will be clear from the following comparative table.

Explanation I to S. 13		S. 56 (2)(v)	
i	spouse of the individual	i	spouse of the individual
ii	brother or sister of the individual	ii	brother or sister of the individual
iii	brother or sister of the spouse of the individual	iii	brother or sister of the spouse of the individual
iv	any lineal ascendant or descendant of the individual	iv	brother or sister of either of the parents of the individual
v	any lineal ascendant or descendant of the spouse of the individual	v	any lineal ascendant or descendant of the individual
vi	spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv) or sub-clause (v);	vi	any lineal ascendant or descendant of the spouse of the individual

vii	<i>any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.</i>	vii	spouse of a person referred to in clauses (ii) to (vi)
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- 17.3 As can be seen from above, ***brother or sister of either of the parents of the individual (chacha, bua, mama and mausi)*** are not covered under section 13. In the same way ***any lineal descendant of a brother or sister of either the individual or of the spouse of the individual (cousins)*** are not covered under section 56(2)(v). Both the types of relationship are strong in our tradition and they are almost considered as part of family only.

Employees’ Stock Option Plan or Scheme

- 17.4 In the case of income from salary, reference to the term relative can be found in the provisions relating to Employees Stock Option Plan (ESOP). Proviso to S. 17(2) (iii)(c) carves out an exception to the provisions relating to perquisites. ESOPs are not taxable as perquisites provided the same have been issued under the guidelines issued by the Central Government. The Central Government has formulated Guidelines for issuing ESOP. As per clause no. 5 of the Guidelines, an employee of the Company who is a promoter or belongs to the “promoter group” holding more than 10.00% of the equity shares of the company, is not eligible to participate in ESOP Scheme. Guidelines issued by the Government read as follow:

Employees’ Stock Option Plan/Scheme - the Central Government hereby specifies that the aforesaid proviso shall apply to the shares, debentures or warrants allotted under any Employees’ Stock Option Plan or Scheme framed in accordance with the following guidelines:—

.....

(5) An employee who is a promoter or belongs to the promoter group or a director who either by himself or through his relative or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in such Plan or Scheme.

Explanation.—For the purposes of these guidelines—

....

(vi) “promoter group” means—

(a)***an immediate relative*** of the promoter (i.e. spouse of that person, or any parent, brother, sister or child of the person or of the spouse) ;

.....

(vii) “relative” means ***immediate relative*** namely spouse, parent, brother, sister or child of the person or the spouse

- 17.5 Clause 5(vii) of the Guidelines introduces a new terminology in this respect. It gives a new term “*immediate relative*” to relatives like spouse, parent, brother, sister, child or child of the spouse. When compared to S. 2(41), it covers the same relationship, but in a narrower sense. For example, there is a reference to parent but not to lineal ascendant

or descendant. It should also be noted that except in the Guidelines there is no reference to the term ‘immediate relative’ under the Income Tax Act.

Expenses or payments not deductible in certain circumstances.

- 18.0 Relations with relatives have always remained relative, for there are high and low tides in it throughout ones life. There are relatives who, on high tide, appear to be very close today, may look, on a low tide, like stranger after sometime, While one may not have social relationship with the relatives as defined u/s 2(41), at times, for mutual benefits, business relations continues. S. 40A(2)(a) of Income tax Act provides for disallowance of expenses incurred if the payment made for such expenditure is excessive or unreasonable and has been made to persons who are relatives of the assessee. This section has always remained a controversial one for obvious reasons. The Assessing Officer (AO) while assessing the income will always look with suspicion any amount paid to relatives. Here, it should be noted that the AO is empowered to invoke provisions of S. 40A (2)(a) the moment he comes across payment to any relatives. This is despite the fact of having low tide in relationship. The guiding criteria for AO is S. 2(41) only and nothing else.
- 18.1 Another redeeming feature of this section has been, unlike Explanation I to S. 13 and S. 56(2)(v), definition of relative has not been provided. Therefore, one has to look at much narrower definition as provided u/s 2(41). This also beneficial to Chartered Accountants conducting Tax Audit as they will have to remember few relatives of the assessee while filling data in Form 3CD. Imagine the plight of tax auditor keeping track of almost 70 types of different relatives as defined u/s 56(2)(v). In the case of partnership firm, such number of relatives to be tracked will be in multiple of 70, meaning thereby if there are four partners not related to each other, the tax auditor will have to track payments to 280 different types of relatives of the assessee.

Relatives and Income from other sources

- 19.0 With the discontinuation of the Gift Tax Act with effect from 1-10-1998, tax is not levied on gifts made. This might have perhaps led to proliferation of the transactions relating to transfer of unaccounted income as gift. In order to curb such devices, amendments have been carried out in S. 56 of the I. Tax Act. The scope of S. 56 relating to charging of tax on other income i.e. not clubbed under any of the head of income, has been widened. Henceforth, any amount received as a gift, subject to certain exceptions, is treated as income of the donee, and the tax is payable thereon. As a result of this, the burden of tax has been shifted from the donor to the donee.
- 19.1 As all of us know, gift to relatives is part of social custom in any society. Indian society following an extended family system, relationship is wide and varied. At times, it extends to relatives to relatives and beyond that. Such relationship gets manifested at the time of marriage, birth, death etc. During the occasions of marriage or birth, offering by the relatives in the form of money is quite common, particularly money offered by elders to younger is considered as part of good wishes. Taxing of gift received as that of the assessee in such a social scenario, without appropriate exclusion would have created chaos. It is for these reasons proviso to S. 56(2)(v) carves out four exceptions. One of them is any sum of money received from any relative. Here, looking to the Indian social system, application of S. 2(41) would have been found rather too narrow. Therefore,

despite the provision being taxing in nature, relaxations have been provided by defining “relative” in a much wider term. As we have seen looking to the social scenario, it is certainly difficult to define the term relative, particularly keeping in mind sensitivity of the subject. The draftsman has done a good job by doing so in seven sub-clauses in 60 words only. It reads as follow:

i	spouse of the individual
ii	brother or sister of the individual
iii	brother or sister of the spouse of the individual
iv	<i>brother or sister of either of the parents of the individual</i>
v	any lineal ascendant or descendant of the individual
vi	any lineal ascendant or descendant of the spouse of the individual
vii	spouse of a person referred to in clauses (ii) to (vi)

19.2 An exploded form of these seven sub-clauses given in the table attached herewith. The Table will reveal that these 60 words cover more than 70 types of complex relationship. It also contains various relationships as defined under section 2(41), Explanation I to S. 13 etc.

19.3 An omission that catches the notice is that of exclusion of the category of any lineal descendant of a brother / sister of either of the individual or the spouse of the individual. As all of us know, descendant of brother are close family members and there do not appear to be any justifiable reason to exclude them.

Relatives and clubbing provisions (S. 64(1))

20.0 The urge to provide for close family members, combined with the tax benefit, has been very strong across all the taxpayers. One cannot have any dispute about a taxpayer making provision for the future requirements of his son and daughter. However, it attracts attention of the tax collector when this process involves reduction / avoidance of tax revenue. Transferring ones income-earning asset to wife or minor children is very old method of reducing tax liability. However, it had caught the attention of the tax authorities at an early stage itself. These are reflected in provisions relating to clubbing of income as provided in S. 64 (1) of the I. Tax Act.

20.1 S. 64(1) makes provision with certain identified relatives viz. spouse, daughter-in-law, minor children. Reference to relative is for the purpose of computing substantial interest in a concern only. Though S. 64(1) refers to clubbing of income of spouse, daughter-in-law and minor children under certain circumstances, computation of substantial interest is with reference to relatives as defined u/s 2(41). This is for the reason that the term relative has not been defined under section 64(1).

S. 64(1) vis-a-vis S. 56(2)(v)

21.0 S. 64(1) provides for clubbing of income of spouse or minors derived from assets gifted. Clubbing provisions are applicable till the income is derived out of such gifted asset and, in the case of spouse, till the assessee survives. In the case of minors, it will be applicable till the minor becomes major. Its consequential effect is to increase the tax burden of the

donor. It is for these reasons that such devices of tax planning are not in vogue. However, compare this with the provisions of S. 56(2)(v). Provisions of S. 64(1) and 56(2)(v) are independent and have no relationship whatsoever. Therefore, any amount given as a gift by an individual to his wife will not be taxable under section 56(2)(v). However, income derived there from will be clubbed for tax purposes.

Relatives and Carry forward and set off of losses in the case of certain companies.

- 22.0 S. 79 provides for disallowance of set-off of losses in the case of transfer of not less than 51.00% shares of a company. An exception to the rule has been provided in the case of transfer of shares by way of gift to any relative of the shareholder. Once again, the term relative has not been defined. Therefore, one will have to look at the definition as provided in S. 2(41).

Deduction in respect of maintenance including medical treatment of a dependant who is a person with disability.

- 23.0 As a measure of relief, Chapter-VI contains two sections viz. 80DD and 80DDB granting deductions from gross total income. S. 80DD refers to deduction of Rs. 50,000 for the assessee having incurred for the medical treatment and rehabilitation of a dependent with disability. Explanation to S. 80DD defines dependent as spouse, children, parents, brothers and sisters of the assessee. Surprisingly, the term relative has not been used. Instead relatives have been identified on the basis of relationship. Same terminology has been used in the case of provisions of S. 80DDB.

Relatives and Transfer pricing

- 24.0 Chapter X contains provisions relating to transfer pricing. For the said chapter, thirteen criteria have been laid down for determining relationship of associated enterprises. S. 92A(2)(j) defines it in the form control of an enterprise by an individual or his relative. Sub-clause (k) defines control of an enterprise by Hindu Undivided Family or relative of a member of such HUF. Although S. 92F contains definition of various terms for S. 92, 92A to 92E, there is no reference to the term relative in it. It means that definition as given under s. 2(41) will be applicable.

Relativity of Income Tax Act

- 25.0 As can be seen from the discussion above, various provisions of the I. Tax Act treats the same set of persons in a different manner. A glance at the Table annexed herewith will reveal that lineal descendant of Settler's brother or sister cannot derive any benefit from the assets/income of the Trust. However, same category of persons is not covered under S. 56(2). The clause "*any lineal descendant of a brother or sister of the individual or of the spouse of the individual*" is missing in S. 56(2). It means that any sum of money received from brother/sister's son/daughter will have to be treated as Income from other sources as they have not been covered under the definition of relative.
- 25.1 One more glaring variation is in respect of brother/sister of either of the parents. This category of persons are covered under the term relative and, therefore, any sum of money received from them will not be treated as income from other sources u/s 56(2)(v). However, the same set of persons has not been included in the definition of the term

relative for the purpose of S. 13. It means that Settler's father/mother's brother/sister can derive benefit from assets/income of a Trust.

- 25.2 One may not be in a position to comprehend of the reasons for such variations. The subject itself is such that one may get lost in the jungle. For example, read the following two clauses of Explanation I to S. 13 and try to find out the difference.

(iv) any lineal ascendant or descendant of the individual

(vi) spouse of any lineal ascendant or descendant of the individual

Can an individual be descendant of father only? Can one not be descendent of mother as well? If one can be descendant of both, the father and mother, is the clause (vi) not redundant to that extent?

Or consider the following clause:

(iv) any lineal ascendant or descendant of the spouse

(vi) spouse of any lineal ascendant or descendant of the spouse

- 25.3 In our day-to-day life we do, at times, miss out one or two relatives at various occasions. There is no reason why the draftsman should be an exception to it. Incidentally, the Table annexed herewith can, apart from helping in computing tax liability, can also serve as ready reckoner for preparing list for wedding invitation cards! Considering the size of the cobweb, the draftsman has done a good job in defining more than 50 relationships in less than 60 words!

Conclusion:

- 26.0 Till the survival of human being, relatives and relationships, whether formal or informal, will continue to play its role in the sphere of economic activities. Despite the best efforts by the Revenue, leakage of tax revenue through transactions with relatives will continue forever. With the westernization of the Indian society, number of relatives and type of relationships shows perceptible change. Role of formal relatives can be curbed through statutory provisions. However, role of informal relatives, like close friends, in business transactions cannot be curbed.

**TABLE SHOWING RELATIONSHIPS AS DEFINED AND APPLICABLE UNDER
VARIOUS SECTIONS OF THE INCOME TAX ACT**

	Sections→ Relatives ↘	2(41)	13	40A(2) (a)	56(2)	64(1)	80DD	92A	ESOP
1	Father	Y	Y	Y	Y		Y	Y	Y
2	Mother	Y	Y	Y	Y		Y	Y	Y
3	Husband	Y	Y	Y	Y	Y	Y	Y	Y
4	Wife	Y	Y	Y	Y	Y	Y	Y	Y
5	Son	Y	Y	Y	Y		Y	Y	Y
6	Son's wife		Y		Y	Y			Y
7	Daughter	Y	Y	Y	Y		Y	Y	Y
8	Daughter's Husband		Y		Y				Y
9	Brother	Y	Y	Y	Y		Y	Y	Y
10	Brother's Wife		Y		Y				
11	Brother's Son		Y						
12	Brother's Daughter		Y						
13	Sister	Y	Y	Y	Y		Y	Y	Y
14	Sister's Husband		Y		Y				
15	Sister's Son		Y						
16	Sister's Daughter		Y						
17	Husband's Brother (<i>Jeth/Dewar</i>)		Y		Y				
18	Husband's Brother's Wife		Y		Y				
19	Husband's Sister (<i>Nanand</i>)		Y		Y				
20	Husband's Sister's Husband		Y		Y				
21	Wife's Brother (<i>Sala</i>)		Y		Y				
22	Wife's Brother's Wife		Y		Y				
23	Wife's Sister (<i>Sali</i>)		Y		Y				
24	Wife's Sister's Husband		Y		Y				
25	Father's Brother (<i>Chacha</i>)				Y				
26	Father's Brother's Wife (<i>Chachi</i>)				Y				
27	Father's Sister (<i>Bua</i>)				Y				
28	Father's Sister's Husband (<i>Fufa</i>)				Y				
29	Mother's Brother (<i>Mama</i>)				Y				
30	Mother's Brother's Wife (<i>Mami</i>)				Y				
31	Mother's Sister (<i>Mausi</i>)				Y				
32	Mother's Sister's Husband				Y				
33	Great Grand Father	Y	Y	Y	Y			Y	
34	Grand Father	Y	Y	Y	Y			Y	
35	Great Grand Mother	Y	Y	Y	Y			Y	
36	Grand Mother	Y	Y	Y	Y			Y	

37	Grand Son's Son	Y	Y	Y	Y			Y	
38	Grand Son	Y	Y	Y	Y			Y	
39	Grand Daughter's Daughter	Y	Y	Y	Y			Y	
40	Grand Daughter	Y	Y	Y	Y			Y	
41	Husband's Father (<i>Sasur</i>)		Y		Y				
42	Husband's Grand Father		Y		Y				
43	Husband's Great Grand Father		Y		Y				
44	Husband's Mother (<i>Saas</i>)		Y		Y				
45	Husband's Grand Mother		Y		Y				
46	Husband's Great Grand Mother		Y		Y				
47	Husband's Brother's Son		Y						
48	Husband's Sister's Son		Y						
49	Wife's Father (<i>Sasur</i>)		Y		Y				
50	Wife's Grand Father		Y		Y				
51	Wife's Great Grand Father		Y		Y				
52	Wife's Mother (<i>Saas</i>)		Y		Y				
53	Wife's Grand Mother		Y		Y				
54	Wife's Great Grand Mother		Y		Y				
55	Wife's Brother's Son		Y						
56	Wife's Brother's Daughter		Y						