Taxation of Gifts and Unexplained Investments

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Back Ground

- Till 1.10.1998, all gifts (including gifts to relatives), barring few exceptions, were chargeable to Gift Tax in the hands of the Donor under Gift Tax Act, 1957;
  - The Gifts were taxed at flat rate of 30 %
  - Basic exemption of Rs. 30,000 was given
  - Levy stopped for gifts made on or after 1.10.1998
- Gifts have since been used not only for wealth and income distribution amongst family members / HUFs, but also for conversion of money
  - The concept of donee based income tax on gifts have been introduced for curbing this practice

Donee Based Tax on Gifts

- Finance (No. 2) Act, 2004 introduced the concept of Donee Based taxation of Gifts w.e.f. 1.4.2005 (i.e. A.Y. 2005-06)
  - Section 2 (24) amended by inserting clause (xiii) to include gifts received as Income of a person;
  - Section 56 (2) amended to provide for defining the scope and granting the exemption
  - Provisions further amended by Taxation Laws (Amendment) Act, 2006 w.e.f. A.Y. 2007-08
- Referred to as "Gift Tax" in the Presentation

Gifts – Tax (Basic Scheme)

- Gifts received by Individual / HUF only covered by Gift Tax
- Gifts received to be included as part of Income from Other Sources
- Basic Exemption provided (Rs. 25,000 for each gift upto A.Y. 2006-07 and Rs. 50,000 in aggregate thereafter)
- Further exemptions given for gifts received from relatives, etc.

Entities Covered / excluded

- Individual and HUF only covered
- All other entities are excluded
  - Firm, Company
  - AOPs, BOIs
- Above applies to the recipient of the Gifts and not to the Donor and therefore Donor could be any entity

Application of Section 5 and 9

- Gifts Received by Resident individuals / HUFs
  - From whichever source, wherever situated
  - Received wherever in the world
- Non-Residents / Not Ordinary Residents Recipients
  - Received or deemed to be received in India
  - Accrues or Arises (or is deemed to) in India
  - Section 9 (1)(i) provides for source based taxation and therefore if the Source (in this case Donor) is in India, then the Gift may become taxable in India

Amended Clause 56 (2)(va)

Original Clause (v)

Where any sum of money, exceeding twenty five thousand rupees, is received without consideration, by an individual or a HUF, in any previous year from any person or persons on or after 1.9.2004, the whole of such sum

Amended Clause (va)

Where any sum of money, the aggregate value of which exceeds fifty thousand rupees, is received without consideration, by an individual or a HUF, in any previous year from any person or persons on or after 1.4.2006, the whole of the aggregate value of such sum

Effect of the Amendment

- Upto A.Y. 2006-07 limit of Rs. 25,000 would apply to each of the gifts separately
- From AY 07-08, aggregate limit of Rs. 50,000 would be applicable for all the gifts taken together *[Amendment Retro-active]*
- In Both the cases, once the limit is exceeded, the whole of the sum would get included in the income

Significance of word “Value”

- Whether would now include “Gifts in Kind”?
  - Section Provides that it has to be “Any sum of money”
  - Section 80 G (5), refers to “a sum of money” for excluding Donations in Kind
  - No rules of valuation provided
  - No concept of deemed gifts necessary for inadequate consideration
  - Terminology of Gift Tax Act, 1957

Gift Tax Act, 1957

- Defined Gift in Section 2 (xii) as “the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money’s worth, and includes the transfer or conversion of property referred to in section 4, deemed to be a gift under that section;
- Included “movable or immovable property”
- Without consideration in money or money’s worth;
- Section 56 does not exclude non-monetary consideration

“Consideration”

- 2 (d) of Contract Act, 1872
  - “When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”
- Sir Frederick Pollock
  - “An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable.”

Exclusions

- Not to include sum of money received
  - From any relative
  - On the occasion of the marriage of the individual
  - Under a will or by way of inheritance;
  - In contemplation of death of the payer;
  - *from any local authority as defined 10 (20)*
  - *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 10 (23C); or*
  - *from any trust or institution registered under section 12AA;*
  - [Yellow Words inserted by TLAA, 2006 w.e.f. 06-07]

Common Questions

- Gifts received by an HUF where the donor is a relative, within the meaning of Explanation to 56 (2)(v) / (vi)
- Gifts given by an HUF where the Karta of Donor HUF is relative of the recipient of the Gift
- Definition of Relative refer to the term like "spouse of *the* individual" .. etc. ;
- Under Hindu Law, right of the Manager (Karta) to give gift out of HUF property is limited and restricted (Pl. see Para No. 225 (Movable Property) and 226 (Immovable Property) of Mulla on Hindu Law)

Gifts Received – Section 68

- Gifts received are not excluded from the provisions of section 68 and therefore onus to prove the source of gift is on Assessee
  - Only when the Gifts are not taxable
  - Provisions of Prevention of Money Laundering Act, 2002 and various rules notified on 1.7.2005 may also be kept in mind

Unexplained Investment

- Sections Dealt with
  - Section 69 (Unexplained Investment)
  - Section 69 A (Unexplained money, bullion, etc.)
  - Section 69 B (Investment not fully disclosed)
  - Section 142 A, whether can be used as charging provision, itself

Section 69

Where in financial year immediately preceding the AY the assessee has made investments which are not recorded in the books of accounts, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the AO, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year.

Important Issues

- Taxable in the financial year in which the investment made (and not found)
  - No presumption available that investment made when found by the Department
  - If Documentary Evidence available, then could be earlier periods – may impact valuation
    - Cases of Wills, Locker not operated, Bills of purchase available, contract note of broker available
- Fact of having made investment cannot be presumed
- What is taxable is “value of investment”
- Investment has to be completely unrecorded

Importance of use of term "may"

- Decision in the case of P. K. Noorjahan [1999] 237 ITR 570 (SC)
  - Intention of the legislation is not to tax in all cases where explanation not satisfactory
  - HC was right in taking note of the fact that there was complete absence of resources of assessee also her age and circumstances
  - Addition was deleted, though assessee could not satisfactorily prove the source

Section 69 A - concepts

- Deals with money, bullion, jewellery or other valuable article or thing
- Taxable in the year in which the Assessee is “found to be owner” and not in the year in which the investment made
- Presumption U/s. 132 (4A) for ownership
- Whether conceptually different then “made the investment” used in Section 69?
- Has to be totally undisclosed

Section 69 B

- Investment / Money, bullion, etc. partially disclosed
- Issue of Valuation – Terminology used is important
  - “AO finds that the amount expended …the excess amount may be deemed …”
  - Can it be said that Section 69 B has restricted application then Section 69 / 69A?

Implication of Section 142 A

- Inserted with the primary purpose of nullifying the decision of Amiya Bala Paul [262 ITR 407(SC)]
- Is amendment capable of being interpreted to make mere valuation difference chargeable to tax?
- Whether it can have same impact for Section 69 and 69 B?
- Retrospectivity of the Amendment
  - Inserted w.e.f. 15.11.72
  - Does not apply to concluded proceedings
  - What is meant by concluded proceedings?
    - See [2005] 277 ITR 477 (P & H) Krishan Lal Dua
    - 197 CTR (Delhi) 78 – Indo – Kenyan ("Concluded")
    - 195 CTR (Delhi) 77 – Sudhish Kumar
    - 202 CTR (MP) 83 - Against

Thank You