

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

Some Key Points

Transfer of income without transfer of asset [Section 60]

- (i) If any person transfers the income from any asset without transferring the asset itself, such income is to be included in the total income of the transferor.
- (ii) It is immaterial whether the transfer is revocable or irrevocable and whether it was made before the commencement of this Act or after its commencement.
- (iii) For example, Mr.X confers the right to receive rent in respect of his house property on his wife, Mrs.X, without transferring the house itself to her. In this case, the rent received by Mrs.X will be clubbed with the income of Mr.X.

Exceptions to transfer [Section 62]

- (i) Transfer not revocable during the life time of the beneficiary or the transferee – If there is a transfer of asset which is not revocable during the life time of the transferee, the income from the transferred asset is not includible in the total income of the transferor provided the transferor derives no direct or indirect benefit from such income. If the transferor receives direct or indirect benefit from such income, such income is to be included in his total income even though the transfer may not be revocable during the life time of the transferee.
- (ii) Transfer made before April 1, 1961 and not revocable for a period exceeding six years – Income arising from the transfer of an asset before 01.04.1961, which was not revocable for a period exceeding six years, is not includible in the total income of the transferor provided the transferor does not derive direct or indirect benefit from such income.

In both the above cases, as and when the power to revoke the transfer arises, the income arising by virtue of such transfer will be included in the total income of the transferor.

“Income” includes “loss”

As per Explanation 2 to section 64, ‘income’ would include ‘loss’. Accordingly, where the specified income to be included in the total income of the individual is a loss, such loss will be taken into account while computing the total income of the individual. It is to be noted that this Explanation applies to clubbing provisions under both sections 64(1) and 64(2)

Distinction between section 61 and section 64

It may be noted that the main distinction between the two sections is that section 61 applies only to a revocable transfer made by any person while section 64 applies to revocable as well as irrevocable transfers made only by individuals.

Question 1

Mr. Korani transferred 2,000 debentures of Rs.100 each of Wild Fox Ltd. to Mrs. Rekha Korani on 3.10.09 without consideration. The company paid interest of Rs.30,000 in September, 2010 which was deposited by Mrs.Korani with Kartar Finance Co. in October, 2010. Kartar Finance Co. paid interest of Rs.3,000 upto March, 2011. How would both the interest income be charged to tax in A.Y. 2011-12?

Answer

As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), Rs.30,000, being the interest on debentures received by Mrs. Korani in September, 2010 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2009.

However, the interest of Rs.3,000 upto March 2011 earned by Mrs. Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

Question 2

Antaryami settled 1/4th share of his property under a trust for the education and maintenance of his minor daughter, Poulomi. Under the terms of the trust deed, the income accruing to the trust, after meeting the expenses of maintenance and education of Poulomi, was to be accumulated and paid over to her on her attaining majority. The Assessing Officer assessed the income arising from 1/4th share of the property, settled for the benefit of Poulomi, in the hands of Antaryami. Examine the correctness of the assessment.

Answer

As per section 64(1A), the income of a minor child should be included in the total income of that parent, whose total income before such inclusion is higher.

The Supreme Court, in *CIT v. M.R. Doshi* (1995) 211 ITR 1, held that where the income from the trust was to be accumulated until the child attained majority, the clubbing provisions would not get attracted, since no benefit accrues to the minor child during the period when such child is a minor.

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However, in this case, the minor daughter Paulomi is eligible for the benefits during the period when she is a minor, since income from the trust is being used for meeting her education and maintenance expenses. Only the remaining income is to be accumulated and paid over to her on her attaining majority. Therefore, since benefit under the terms of the trust deed is accruing, even though to a limited extent, to the minor daughter Paulomi during the period when she is a minor, the ratio applicable in the Supreme Court decision cited above cannot be applied in this case. Accordingly, the clubbing provisions under section 64(1A) will get attracted.

Therefore, the stand taken by the Assessing Officer to tax the income in the hands of Antaryami is correct. However, only so much of income as is used for meeting the education and maintenance expenses of Paulomi during the current year should be clubbed in the hands of Antaryami after providing for an exemption of Rs.1,500 under section 10(32).

Question 3

Mr. Siddharth was a partner in a firm, representing his HUF, holding 25% of the share in the firm. His wife Vineeta, a house lady, was admitted in her individual capacity in the firm for 25% share. She was paid remuneration which has been proposed by the Assessing Officer to be clubbed in the hands of Siddharth-HUF by invoking section 64 of the Act.

Answer

As per section 64(1)(ii) of the Income-tax Act, in computing the total income of any "individual", the remuneration paid to spouse by a firm in which the individual has substantial interest shall be liable for clubbing. In the present case, Mr. Siddharth is not a partner in his individual capacity, but a partner in representative capacity.

The Supreme Court has, in the case of *CIT vs. Om Prakash* (1996) 217 ITR 785, held that an individual can be a partner in a partnership firm in his individual capacity or in the capacity of the karta of a Hindu undivided family or, for that matter, in any other capacity, e.g., as a trustee. Where a person is a partner as the karta of a Hindu undivided family, the capacity in which he is a partner in the partnership firm is relevant as between him and the other members of the Hindu undivided family. The income the karta receives as a partner is not his individual income; it is the income of the Hindu undivided family and he receives it on behalf of the Hindu undivided family. It is for this reason that the income of the wife arising from her membership of the partnership firm, is held not includible in the income of the Hindu undivided family since the total income of the Hindu undivided family is not the total income of the individual (husband). For section 64(1) to get attracted, it is necessary that the spouse should be a partner in a partnership firm in his individual capacity. It is not attracted where he is a partner as the karta of the Hindu undivided family to which his wife belongs.

The action of the Assessing Officer in this case is, therefore, not correct.

Question 4

H, a mentally retarded minor, has a total income of Rs.1,20,000 for the assessment year 2011-12. The total income of his father L and of his mother R for the relevant assessment year is Rs.3,40,000 and Rs.2,80,000 respectively. Discuss the treatment to be accorded to the total income of H for the relevant assessment year.

Answer

Section 64(1A) provides that all income accruing or arising to a minor child has to be included in the income of that parent, whose total income is greater. However, the income of a minor child suffering from any disability of the nature specified in section 80U shall not be included in the income of the parents but shall be assessed in the hands of the child. Thus, the total income of H has to be assessed in his hands and cannot be included in the total income of either his father or his mother.

Question 5

Dinesh, an individual engaged in the business of finance, advances Rs.5 lacs to his HUF on interest at 12% p.a., which is the prevailing market rate. The HUF invests the amount in its business and earns profit of Rs.2 lacs from this money. Can the assessing officer add a sum of Rs.1,40,000 (i.e. Rs.2,00,000-Rs.60,000) as income of Dinesh under section 64(2) of the Income-tax Act? Will it make any difference if Dinesh does not charge any interest?

Answer

Section 64(2) shall be applicable only where an individual member of HUF converts his property into the property of HUF or throws it into the common stock of the HUF without adequate consideration.

In this case, Dinesh does not transfer money to his HUF but only lends an amount of Rs.5 lakhs to his HUF at an interest of 12%, which is the prevailing market rate. This is a transaction of loan, which pre-supposes, repayment. Dinesh continues to be the owner of the amount lent. Thus, there is no transfer of property from Dinesh to the HUF. Therefore, the Assessing Officer cannot add the profit arising to HUF in the total income of Dinesh by invoking section 64(2).

Even if no interest is charged by Dinesh, the nature of transaction will not change. It still remains as a loan transaction.

Question 6

Mr. Rose, out of his own funds, had taken an FDR for Rs.10,00,000 bearing interest @ 10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned during the financial year 2009-10 of Rs.1,00,000 was invested by Mrs. Lilly in the business of packed spices which

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resulted in a net profit of Rs.55,000 for the year ended 31.03.2011. How shall the interest on FDR and income from business be taxed for the Assessment Year 2011-12?

Answer

Section 64(1)(iv) of the Act specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of Rs.1 lakh on the FDR of Rs.10 lakhs shall be clubbed with the income of Mr.Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor. *CIT v. M.S.S.Rajan (2001) 252 ITR 126 (Mad).*

Question 7

In the following cases discuss whether the loss could be set off:

- (i) *Smt. Shanti carried on business with gifted funds of her husband Mahesh. For the financial year 2010-11 Shanti incurred loss of Rs.2 lakhs which loss Mahesh wants to set-off from his taxable income.*
- (ii) *Smt. Bhanu succeeded to the business of her husband Sri.Bhavesb who died on 10th September 2010. She carried on the business as proprietrix. The business of Bhavesb upto the date of his death resulted in a loss. Smt. Bhanu earned profit in business for the period ending 31.03.2011. Bhanu wants to set off the loss of her husband for the period ending 10th September,2010 against her income.*

Answer

- (i) Under section 64(1)(iv), where any asset is transferred directly or indirectly to the spouse by an individual, otherwise than for adequate consideration or in connection with an agreement to live apart, the income arising therefrom is included in the hands of the transferor. The term "income" in this context includes "loss" as well. Therefore, the loss sustained by Shanti in the business carried on by her with funds gifted by her husband can be set off by her husband.
- (ii) Section 78(2) says that where any person carrying on any business or profession is succeeded in such capacity by another person otherwise than by inheritance, no person other than the person incurring the loss is entitled to carry forward the loss and set it off against his income.

The facts of the case seem to indicate that Smt.Bhanu has succeeded to the business by inheritance and is not affected by the provisions of section 78(2). Therefore she is

eligible to carry forward and set off the loss of her husband against her own income. Succession by inheritance is an exception to the general bar against carry forward and set off contained in section 78(2).

Question 8

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of Rs.10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands.

Discuss the correctness of the action of the Assessing Officer

Answer

This question is based on the principles laid down by Madras High Court in the case of *CIT v. Smt. R.Bharati* (240 ITR 697) (240 ITR 772) where the interpretation of the terms “professional qualifications” and “knowledge” came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term “qualification” must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word “professional” is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

A model in the light of above is having skill, competence and experience in her line and is thus professionally qualified. Hence, the action of the Assessing Officer is not correct.