

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

Mayur gifted amount of ₹ 5,00,000 to the wife of his brother which was used by her for the purchase of a house and simultaneously, on the same day, Mayur's brother gifted shares owned by him in a foreign company worth ₹ 5,00,000 to the minor son of Mayur. What will be the impact of such transfers in the hands of both the transferors and the transferees?

Answer

In the given case, Mayur is making a gift of ₹ 5,00,000 to the wife of his brother for the purchase of a house by her and simultaneously, his brother is making a gift to the minor son of Mayur, shares owned by him in a foreign company worth ₹ 5,00,000. These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

The Supreme Court has, in *CIT vs. Keshavji Morarji* (1967) 66 ITR 142, held that if two transactions are inter-connected and are part of the same transaction in such a way that it can be said that the circuitous method was adopted as a device to evade tax, the implication of clubbing provisions would be attracted.

Accordingly, the income arising to the wife of Mayur's brother from the house property would be included in the total income of his brother and the dividend from shares transferred to Mayur's minor son would be taxable in the hands of Mayur. This is because both Mayur and his brother are the indirect transferors of the income yielding assets to their minor child and spouse, respectively, with an intention to reduce their burden of taxation.

However, since husband's brother and father's brother fall within the definition of "relative" under Section 56(2)(vii), hence, the sum of money and property, respectively, received from them would be exempt in the hands of the concerned transferee.

Question 2

Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2011 was ₹ 5 lacs, out of which ₹ 3 lacs was contributed out of her own sources and ₹ 2 lacs was contributed out of gift from her husband.

As further capital was needed by the firm, she further invested ₹ 2 lacs on 01-05-2011 out of the funds gifted by her husband. The firm paid interest on capital of ₹ 80,000 and share of profit of ₹ 60,000 for the financial year 2011-12.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

Answer

As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of ₹ 3 lacs out of her own resources to the capital of the firm.

As per Explanation 3 to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion has to be computed by taking into account the value of the aforesaid investment as on the first day of the previous year to the total investment by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of ₹ 32,000 i.e., $\text{₹ } 80,000 \times \frac{\text{₹ } 2,00,000}{\text{₹ } 5,00,000}$.

Share of profit amounting to ₹ 60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% per annum.

Question 3

State the situations under which the clubbing provisions of income-tax operate as to the incomes of husband and wife.

Answer

As per section 64(1), in computing the total income of any individual, there shall be included all such income arising directly or indirectly to the spouse by way of –

- (1) salary, commission, fees or any other form of remuneration, whether in cash or in kind, from a concern in which such individual has substantial interest;
- (2) income from any asset transferred, subject to provisions of section 27(i), to the spouse by the individual otherwise than for adequate consideration or in connection with an agreement to live apart.

9.4 Direct Tax Laws

As per section 27(i), an individual who transfers, otherwise than for adequate consideration, any house property, to his or her spouse, not being a transfer in connection with an agreement to live apart, is deemed to be the owner of the house property so transferred.

Question 4

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y. 2012-13:

Interest of ₹ 20,000 on bank FDRs received by minor son of Rajesh. These FDRs were made by the minor son out of his earnings from stage acting.

Answer

According to section 64(1A), all income accruing or arising to a minor is to be included in the income of his parent, whose total income [excluding the income includible under section 64(1A)] is higher. The income derived by the minor from manual work or from any activity involving his skill, talent or specialised knowledge or experience will not be included in the income of his parent.

Since, interest of ₹ 20,000 on bank FDRs received by minor son of Rajesh does not arise to minor on account of his manual work or on account of an activity involving his skill, talent or specialized knowledge or experience, therefore, such interest should be included in income of Mr. Rajesh or Mrs. Rajesh, whosoever total income (before including minor's income) is higher.

Question 5

Mr. Korani transferred 2,000 debentures of ₹ 100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 3.10.2010 without consideration. The company paid interest of ₹ 30,000 in September, 2011 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2011. Kartar Finance Co. paid interest of ₹ 3,000 upto March, 2012. How would both the interest income be charged to tax in A.Y. 2012-13?

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), ₹ 30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2011 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2010.

However, the interest of ₹ 3,000 upto March 2012 earned by Mrs. Rekha 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 6

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.

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 ₹ 1,500 under section 10(32) assuming that Antaryami's total income is greater than his spouse's total income.

Question 7

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 8

H, a mentally retarded minor, has a total income of ₹ 1,20,000 for the assessment year 2012-13. The total income of his father L and of his mother R for the relevant assessment year is ₹ 3,40,000 and ₹ 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 9

Dinesh, an individual engaged in the business of finance, advances ₹ 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 ₹ 2 lacs from this money. Can the assessing officer add a sum of ₹ 1,40,000 (i.e. ₹ 2,00,000-₹ 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 ₹ 5 Lacs 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 10

Mr. Rose, out of his own funds, had taken an FDR for ₹ 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 2010-11 of ₹ 1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31.03.2012. How shall the interest on FDR and income from business be taxed for the Assessment Year 2012-13?

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 ₹ 1 Lac on the FDR of ₹ 10 Lacs 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 11

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 2011-12 Shanti incurred loss of ₹ 2 Lacs which loss Mahesh wants to set-off from his taxable income.*
- (ii) *Smt. Bhanu succeeded to the business of her husband Sri.Bhavesh who died on 10th September 2011. She carried on the business as proprietrix. The business of Bhavesh upto the date of his death resulted in a loss. Smt. Bhanu earned profit in business for the period ending 31.03.2012. Bhanu wants to set off the loss of her husband for the period ending 10th September, 2011 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 12

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of ₹ 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.

Self-examination Questions

1. Write short notes on the following in the context of clubbing of income -
 - a) Substantial interest
 - b) Transfer and revocable transfer.

2. Under what circumstances can an income arising to the spouse of an individual be included in the income of the individual? Discuss.
3. State when the income arising to the son's wife can be included in the hands of the individual.
4. Discuss the provisions of the Income-tax Act, 1961, regarding inclusion of the income of minor child in the assessment of the parent. Enumerate the exception to this provision.
5. Write a short note on cross transfers, explaining the meaning and tax treatment of the same, in the context of clubbing of income.
6. Discuss the tax consequences arising on conversion of self-acquired property into joint family property.
7. Compute the total income of Mr. & Mrs. A for the A.Y.2012-13 from the following information relevant for P.Y.2011-12 -

	Particulars	₹
(a)	Salary income (computed) of Mrs. A	2,30,000
(b)	Income from profession of Mr. A	3,90,000
(c)	Income of minor son B from company deposit	15,000
(d)	Income of minor daughter C from application of her painting skills	32,000
(e)	Interest from bank received by C on deposit made out of income earned by application of her painting skills	3,000
(f)	Gift received by C from friend of Mrs. A	2,500

8. A proprietary business was started by Smt. Poorna in the year 2009. As on 1.4.2010, her capital in business was ₹ 3,00,000.
Her husband gifted ₹ 2,00,000, on 10.4.2010, which amount Smt. Poorna invested in her business on the same date. Smt. Poorna earned profits from her proprietary business for the P.Y.2010-11, ₹ 1,50,000 and P.Y.2011-12, ₹ 3,90,000. Compute the income to be clubbed in the hands of Poorna's husband for the A.Y.2012-13 with reasons.
9. Dinesh, an individual engaged in the business of finance, advances ₹ 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 ₹ 2 lacs from this money. Can the Assessing Officer add a sum of ₹ 1,40,000 (i.e. ₹ 2,00,000 - ₹ 60,000) as income of Dinesh under section 64(2) of the Income-tax Act, 1961?
10. Mr. Ram has a salary income (computed) of ₹ 2,50,000 for the P.Y.2011-12. His minor son, Arjun, has agricultural income of ₹ 1,20,000 for the same year. The Assessing Officer clubbed the income of the minor son for determining the rate of income-tax applicable to Mr. Ram. However, Mr. Ram contended that agricultural income was exempt under section 10 and also not specified in the definition of income under section 2(24). Therefore, agricultural income of minor son should not be clubbed and the

provisions of section 64(1A) are not attracted in this case. Discuss the correctness or otherwise of Mr. Ram's contention.

Answers

9. 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 ₹ 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 re-payment. 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).
10. The facts of the case are similar to the case of *Suresh Chand Talera v. Union of India* (2006) 152 Taxman 348 (M.P). In this case, the High Court observed that the definition of income under section 2(24) is inclusive and not exhaustive. Hence, the fact that agricultural income has not been specified as one of the items in section 2(24) does not mean that agricultural income is not included in the word "income" wherever the word "income" has been used in the Act. Section 10 of the Act provides that in computing the income of the previous year of a person, any income falling in any of the clauses mentioned therein shall not be included. The first clause mentioned therein is "agricultural income". Thus, section 10 makes it clear that agricultural income is income but by express provision therein, agricultural income has been excluded from the total income of an assessee for the purpose of levy of income-tax. Section 4(1), which is the charging section, provides that while the total income of a person is to be determined in accordance with the provisions of the Income-tax Act, 1961, the rate or rates at which such income-tax will be paid on such income for any assessment year will be stipulated in the relevant Finance Act. The Annual Finance Act provides [under Chapter II section 2] that the net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rates of income-tax applicable to the income of the assessee. Therefore, in view of the above provisions, the High Court held that agricultural income of the minor son of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee.

Therefore, in this case, the contention of Mr. Ram is incorrect. The agricultural income of his minor son, Arjun, has to be included in the income of Mr. Ram for rate purposes, since the words "income as arises or accrues to his minor child" used in section 64(1A) includes agricultural income also.