

Clubbing of Income

Basic concepts that one must know

Generally, an assessee is taxed for the income that he earns. In some cases however the income tax act deviates from this principle and the assessee may be taxed for income, which legally belongs to some body else. These are enumerated under section 60 to section 64 of the act and which are known as clubbing provisions also. These are the sections where the government would like to make people pay tax on those adjustments that they make for evading the same. This is done by transferring the income of that person to some other close relative of the real earner for reducing or nullifying the tax liability and indirectly also enjoying the benefits of such income

The following is the list of instances where the income is clubbed with the assessee.

SECTION 60: TRANSFER OF INCOME WITHOUT TRANSFER OF ASSETS

If a real owner of an asset of property is earning some income from the said property then it would be taxed in the hands of the real owner. Many times in order to evade tax this real owner transfers this income to one of his pals or kin [relative in simple language] without transferring the asset to the recipient. This section makes it clear that if such kind of income is transferred to the beneficiary whether under a revocable or irrevocable agreement which is revocable or irrevocable without transferring the asset from which such income arises, is chargeable to tax as the income of the 'transferor' and shall be included in his total income and not in the hands of the beneficiary. It is also made clear that even if the transfer is made before the commencement of the act it would still be clubbed in the income of the transferor.

SECTION 61: REVOCABLE TRANSFER OF ASSETS

Under this section it is indicated that if an asset is transferred by a transferor under a revocable agreement to the transferee then in such a case all incomes arising from that asset in the hands of the transferee on account of this transfer would be taxed in the hands of the transferor and not the transferee.

What is a transfer?

Section 63 defines transfer as any settlement, trust, agreement, arrangement or covenant. (a covenant means any clause in agreement).

What is a revocable transfer?

It is which contains provisions for the re-transfer directly or indirectly of the whole or part of the Income or Asset of the transferee or it contains rights to resume the powers of such Income or Asset, by the transferrer.

It is a transfer where the transferor reserves the right to call back the asset at his own wish and will. In short, it means a temporary transfer of property with the right to call the asset back to the original owner.

For e.g. if A transfers a House Property to his close relative B. The condition of the transfer was that B can enjoy the income of the said property for himself for any such time

till he is the owner of the property but A reserves the right to take the property back from B in case he is in financial problems in the event of which has to surrender the income as well as the asset to A. this is a case of revocable transfer and the income of the property is not to be taxed in the hands of B but it would be taxed in the hands of A

Thus, this section will apply when the following conditions are fulfilled.

1. The transfer is revocable
2. It contains any provision for retransfer either in whole or part the asset or its income or both
3. It gives the transferor the right to reassume power over the asset and its income.

This section will not apply if the following conditions are fulfilled in spite of a revocable transfer

1. When transfer is by way of a trust, which is not revocable during the lifetime of the beneficiary
2. Any other transfer which is not revocable during the lifetime of the transferee.
3. The Transferor should not receive any direct or indirect benefit from such income.
4. If the transfer is made prior to 1.4.61, and is not revocable for a period exceeding 6 years

The following example would make this provision clear.

Continuing the same example that we have given above if A transfers the asset to B under a revocable transfer which has the condition that A will not take back the asset from B till B is alive and if B dies then the property will become the asset of A. in this situation we can say that the income of such a property will be taxed in the hands of B and not A

INSTANCES OF CLUBBING OF INCOMES

When the assessee is assessable for the remuneration received by the spouse [section 64(1)]

An individual would be chargeable to tax on the salary that would be received by his spouse from a concern in which the individual has substantial interest. It means that if Mrs. A is receiving salary from a company X ltd where her husband B is a director and having substantial interest then the salary of Mrs. A would not be taxable in the hands of Mrs. A but would be taxed in the hands of Mr. B.

However, the following conditions have to be considered before the clubbing such income.

[Section 64 (1)(ii)]

1. An individual is deemed to have substantial interest, if he (individually or along with his relatives) beneficially holds equity shares carrying not less than 20% voting power in the case of a company or is entitled to not less than 20% of the profits in the case of a concern, other than a company, at any time during the previous year.

2. If the spouse possesses technical or professional skill or qualification and Income is solely attributable to such qualification knowledge or experience then such income cannot be clubbed.
3. If both the husband and the wife have substantial interest in the company then the clubbing would be done in the income of that person whose income before clubbing this income is higher amongst the two persons.
4. The income is to be added after giving the respective standard deduction that would be applicable to the spouse to whom the income is paid.

Section 64(1)(iii) This section is omitted from 1.4.93

When an individual is assessable to income on an asset [other than a House Property] transferred to a spouse without adequate consideration [Section 64(1)(iv)]

When the individual transfers an asset other than a House Property to his spouse for inadequate consideration or no consideration then the Income of such an asset that accrues to the spouse from the asset would be taxed in the hands of the transferor. However, the following conditions should be taken into consideration before the clubbing is made under the above-mentioned section.

The relation of husband and wife should subsist

The relation between the transferor and the transferee should that of a husband and wife and this relation should remain both at the time of transfer of asset and as at the close of the Previous year i.e. at 31st March.. Similarly, if transferrer-spouse dies, income, though continued to be enjoyed by the transferee, cannot be included in the income of the deceased transferor's heir, as a widow or a widower is not a spouse.

Transfer of assets before marriage is outside the scope of this section.

If any asset is transferred before the marriage then the income of such an asset should not be clubbed in the income of the transferor.

Assets should be transferred for inadequate consideration or no consideration.

If asset is transferred under and agreement to stay separately then the clubbing provisions would not be attracted.

If the income is received from an asset that is purchased by the spouse from the pin money given by the other spouse then it cannot be clubbed.

(Pin money is that allowance, which is given by husband to wife for dress and house hold expenses)

The income should not be an income that is already pre taxed i.e. clubbed with the transferor or an accretion to the assets.

In other words, if an asset is transferred to wife and income accrues to the wife then this first income from the asset is clubbed in the hands of the transferor. But if such income is

then reinvested in some other avenues and the same gets further income then in that cases the income is not to be taxed as in this case the income which accrues is not transferred by the transferor.

When an individual is assessable to income on an asset including a House Property transferred to a son's wife directly or indirectly without adequate consideration [Section 64(1)(v)]

When the individual transfers an asset [at any time after 31.5.1973] inclusive of House Property to his son's wife for inadequate consideration or no consideration then the Income of such an asset that accrues to the son's wife is to be added in the income of the transferor

When individual is assessable in respect of income from assets transferred to son's wife.

[Section 64(1) (vi)]

If an individual transfers, an asset after 31st may 1973 without adequate consideration to son's wife the income arising there from is included in the total income of the transferor. For e.g. if Mr. X the father in law of Y transfers a bank deposit to Ms. Y the daughter in law of Mr. X any income which will accrue to the said deposit would be considered as the income of Mr. X and not Ms. Y.

The following points are relevant to be noted in this regard

1. The relationship between the father in law and the daughter in law should subsist both at the time of transfer of deposit and also at the time of accrual of income.
2. If any gift is made before the marriage to the would be daughter in law then the same is not considered in clubbing of income.
3. Transfer also includes indirect or direct transfer.

When an individual is assessable to income on an asset transferred to a third party for the immediate benefit of the spouse or relative [Section 64(1) (vii)]

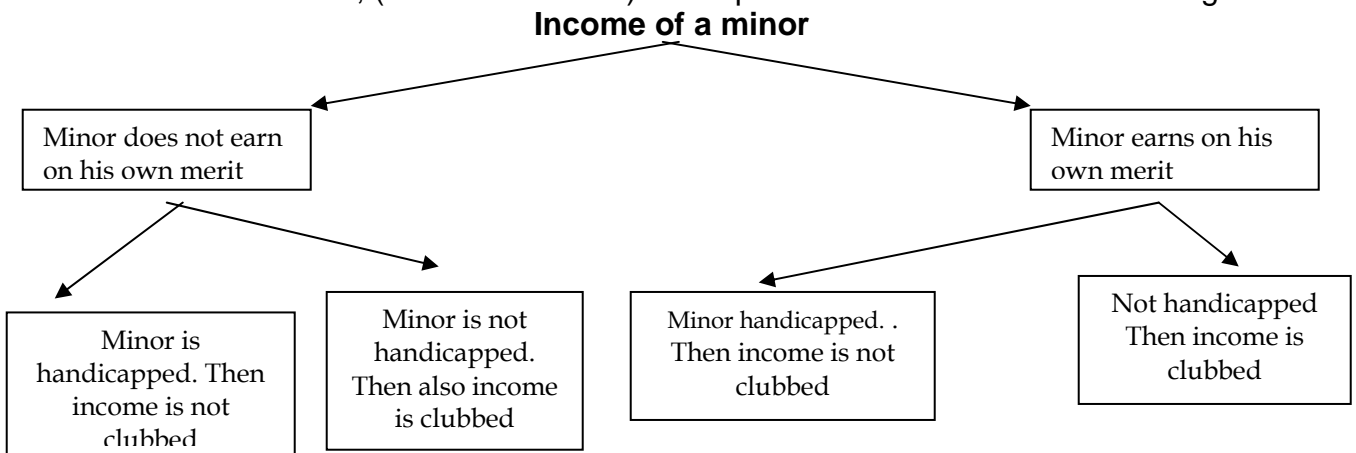
Where an asset is transferred by an individual to an association or a trust or a third party with a condition that the income of such asset should be given in full or part to the spouse or the relative of the transferor then the income of such asset is not taxed in the hands of the beneficiary but would be taxed in the hands of the transferor or settler of the trust. For E.g. if X transfers a house property to a trust formed by him with the condition that the entire income of the House Property which was been received should be given to the wife of Mr. X. In this case, the income of this House Property would not be taxed in the hands of Mrs. X but would be taxed in the hands of Mr. X

Sec. 64(1A): where an individual is assessable for income of his minor child.

If an individual has a minor child or children and then earn income from certain sources then the decision to club such income to that of the parent would depend on the type of

the income and the capability and status of the minor child. However, before clubbing the income it is important to note the following points

1. If the child earns the money by doing manual work or due to a special skill, which is possessed by the child, then the income cannot be clubbed. In other words if the child had earned on special skill or talent then the income is not clubbed
2. It will be added in the Income of the parent (father or mother) whose Income is greater (before such clubbing), provided, the marriage subsists; otherwise it will be added in the Income of the parent who maintains the child.
3. Deduction under section 80 except 80U, if eligible to the minor will be allowed to the parent after clubbing In other words the parent can claim the deduction under section 80D, 80DD or 80L or 80G on behalf of the child but not the deduction under section 80 U.
4. A special deduction of Rs. 1,500 under Sec. 10(32) will be allowed per child or the income clubbed, (whichever is less) to the person in whose income it is merged.



Income of the house property that is transferred by the member from his own personal asset to the family and later on there is a partition in the family. SECTION 64 (2)

When personal property of an individual is converted after 31.12.69 into the property of family, then the Income from such converted property will be included in the Income of the individual. (Total income clubbed i.e. not only to the extent of inadequate consideration). If however, the converted property is subsequently partitioned amongst the members of the family, the income derived from such converted property, as is received by the spouse of the transferrer, will be taxable in the hands of the transferrer. For instance, X transfers his self acquired property yielding an annual income of Rs. 1,00,000 to his Hindu Undivided Family, consisting of X, Mrs. X, his major son Y and minor son Z. Income of Rs. 1,00,000 will included in the income of X (and not the HUF) by virtue of this section. If, however, the property is partitioned among the family members, income derived from converted property by Mrs. X (i.e. ¼th of Rs. 1,00,000) will be included in the income of X under section 64(2), share of minor Z (i.e. 1/4th of 1,00,000) will be included in the income of X by virtue of section 64(1A) after allowing exemption under section 10(32) Rs. 1,500 or the

income clubbed, whichever is less, on the assumption that X's income is more than income to the transferee also.

Negative Income can be clubbed also –Section 64

Under section 64, the income of the specified person is liable to be included in the total income of the individual in the circumstances mentioned above. The Finance Act of 1979 has inserted an explanation to section 64 to the effect that for the purpose of including the income of the specified persons in the income of the individual, the word "income" includes a loss.

Sec. 65: Notice to the transferee if transferor cannot be located and tax cannot be recovered.

The Assessing Officer can issue notice for the levy and recovery of tax on such income to the transferee also if he cannot recover the tax from the transferor.

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