

**INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES**

[ISSN 2581-5369]

Volume 4 | Issue 5

2021

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Provisions Relating to Clubbing of Income under Income Tax Act, 1961

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ABSTRACT

Albert Einstein has rightly said, "The hardest thing in the world to understand is the income tax."

Many a times a tax payer feels the need to club income of someone else with his income. This happens when he is planning to transfer any of his assets/ income to another person as a means of tax planning to avoid the income getting taxed in his hands. The outcome of such transfers is clubbing provisions under the Income Tax Act, 1961.

Keywords: *Income tax, Provisions, Spouse, Transfer.*

I. INTRODUCTION

"Taxation is the price which civilized communities pay for the opportunity of remaining civilized."

-Albert Bushnell Hart

A tax payer is always looking out for ways and means to escape tax or save money on tax. If a tax payer intends to give gifts to his near and dear ones then also clubbing of income can save him from tax implications. It is therefore imperative for every tax payer to find out tactics on how to save tax.

One such endeavor is transfer of assets to kith and kin or one can split the income in different names under the pretext that it is not taxable. Transferring of house property to family members or making investments in the name of wife or children or paying salary to the wife from an entity where husband is the owner, etc. are some of the commonly used devices or tricks to reduce the tax strain. However, due to lack of knowledge of provisions relating to 'clubbing of income' given in the Income Tax Act, 1961, these attempts to save tax by common man ends in fiasco.

Let us understand the consequences of each transaction entered into by the tax payer:

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(A) Transfer of Income:

If a person transfers income from any asset to wife, children or a relative under a settlement, trust or agreement without the actual transfer of the asset then such income shall be included in the total income of the transferor. This rule applies even if such agreement to transfer the income was entered into prior to the Income Tax Act.

(B) Transfer of assets for insufficient consideration:

When a person transfers his asset in the name of his wife, for an insufficient consideration, the clubbing provision will come into effect. Under such circumstances, the income arising from such asset is clubbed in the income of the transferor.

Example: If husband invests Rs. 3 lakhs in Fixed Deposits in the name of his spouse, the interest earned from such FD shall be clubbed with the income of husband.

In case of transfer of house property by the owner to his or her spouse for inadequate consideration, the transferor will remain the deemed owner. As a result, the income arising from such house property is taxed in the hands of transferor. When any asset is transferred to wife for a consideration, be it adequate or inadequate the provisions of clubbing of income is not applicable.² Hence, the income from the asset transferred is deemed to be the income of the transferee and is subject to taxation.

(C) Remuneration or reward from a firm in which spouse has substantial interest:

When a person receives reward by way salary, fees, commissions or in any other form in cash or kind from a firm in which his or her spouse has major interest, then such income is merged with the income of spouse. Such clubbing provision applies if income is received without any qualification (professional or technical).³ If person is apt for the job on account of his technical and professional expertise, income shall not be clubbed with the income of spouse.

II. CLUBBING OF INCOME IN INCOME TAX ACT

When income of other person is included in our income and taxable in our hands, then such an example is called Clubbing of Income. The income clubbed in our income is called deemed income. The provisions of clubbing of income applied only to individuals and not to assesses of different categories like firm/ Hindu Undivided family/ Company etc.

Let's take an illustration to understand this situation:

² SGA Law Offices- Issue 22, November 2015
SGA LAW - 2015 Issue 12

³ <https://www.taxmann.com/post/blog/743/provisions-of-clubbing-of-income-under-income-tax-act-1961/>

Suppose Kapil has a total income of Rs 3,00,000. It comprises salary income worth Rs. 2 lakhs rental income of Rs. 1 lakh. With the sole purpose that the income should fall below the basic exemption limit, Kapil transfers rental income without transferring the house ownership to his wife. Now, while calculating tax, Kapil's taxable income shall be taken at Rs. 3,00,000 not Rs. 2,00,000. This is because of provisions of Clubbing of Income under the Income tax Act.

(A) Income tax provisions on Clubbing of Income:

INCOME TAX PROVISION	TRANSACTIONS
S.60	Transfer of Income without Transfer of Asset
S.61	Revocable Transfer of Asset
S. 64(1)(ii), 64(1)(iv), 64(1)(vii)	Clubbing of Income of Spouse
S.64(1)(vi), 64(1)(viii)	Clubbing of Income in case of Son's Wife
S.64(1A)	Clubbing of Income of Minor Child
S.64(2)	Clubbing of Income & Hindu Undivided Family

III. APPLICABILITY OF CLUBBING OF INCOME

There are different situations which attract the provisions of Clubbing of Income. Let us glance through them:

(A) Transfer of Income without Transfer of Asset [Section 60]:

When an assessee transfers the income without transferring the ownership of the assets from which such income is obtained. Such income will be subject to taxation in the hands of transferor assessee. For instance, the rental income, when the owner of the property asks his

tenant to make the rental payments in the name of his spouse or offsprings or parents.

The illustration given below will make the concept clear:

Abhay owns a house in Jodhpur and is earning rental income of Rs 20,000 per month. In an attempt to save tax, he asked his tenant to pay the rent by issuing a cheque in favour of wife. In this case though the income is received in Abhay's wife account, it will be taxed to Abhay as he transferred merely the income source and did not transfer the legal ownership of the house.

People resort to tax-planning tactics by transferring income to their family members by way of first drafting an agreement for transfer of income without the legal ownership transfer of assets and then take rental cheques in their family member's name. However, this is not a fool proof method to save tax.

(B) Revocable Transfer of Asset [Section 61]:

When an assessee transfers an asset to another person with a clause in the transaction that allows transferor to take back the ownership sometime in future. This situation is called Revocable Transfer. When a '*revocable transfer*' of asset is made then any income from that asset shall be subject to taxation in hands of transferor. For example, Farhan transferred his house property to Hrithik. There is a clause in agreement that asset will transfer back to Farhan after 2 years. As per the provisions of clubbing of income, any income arising to Hrithik from such house during 2 years will be included in Farhan's income only.

Let us get further insights into Clubbing of Income in case of spouse, son's wife, minor child and HUF.

(C) Clubbing of Income of Spouse [Section 64(1)(ii), 64(1)(iv), 64(1)(vii)]:

The commonly adopted practice to save tax is by transferring income in the name of our spouse. There are special provisions to monitor such transfers. All the different situations are discussed as below:

1. My spouse works in a firm in which I have substantial interest.

Substantial interest implies that when a person is entitled to 20% or more share of profits (in case of firm) or not less than 20% voting power. There are 2 aspects in this example, discussed as below:

My spouse has employment because of	Provision of Clubbing of Income is not
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his/ her professional/ technical expertise	<p>applicable.</p> <p>In simpler words, that reward will be taxable in the hands of my spouse only.</p> <p>For e.g.:</p> <p>I am a partner in a firm and entitled to 40% share in profits of that firm.</p> <p>My wife is employed in the same firm as a manager and getting Rs 20,000 per month, in her professional capacity then such income shall not be clubbed in my hand.</p>
Absence of professional/ technical expertise.	Any reward received by my spouse from such forms all be clubbed and taxable in my hands only.

- **The nature of transferred gift is altered by the transferee:**

At times a gift transferred which was not taxable previously is invested further in such a manner that it starts yielding income. In all such cases where nature of asset is altered by the transferee spouse provisions of section 64(1)(iv) are applicable and clubbing of income is bound to take place. Example: Mr Shahrukh gifted his wife Gauri Rs 5,00,000. Gauri invests this amount in a FD and starts earning an interest on the same. Is this interest income subjected to taxation in the hands of Mr Shahrukh?

The gift of Rs 5,00,000 has been made to Gauri, the wife so it will not be taxable. But the interest earned on FD will be taxable in the hands of Mr Shahrukh in accordance with the provisions of section 64(1)(iv).

- **Any asset transferred made to a third person:**

Such transfer must have occurred without consideration or with inadequate consideration to ultimately benefit spouse now or at some future date.

(D) Clubbing of Income in case of Son's Wife [Section 64(1)(vi),64(1)(viii)]

Clubbing of income provisions is applicable in case of any transfer of income made to daughter-in-law.

Example:

Asset has been transferred to daughter-in-law without any adequate consideration:

In this case, any income generating from that asset will become taxable in our hands.

(E) Clubbing of Income of Minor Child [Section 64(1A)]:

Any income earned by a minor child less than 18 years of age is clubbed in the hands of either of his parents, whose income (excluding minor child income) is greater.⁴

In accordance with Income Tax provisions there are certain instances which the clubbing of income provisions will not apply. These are:

- i. When minor child is suffering from any disability as per Sec. 80U, or
- ii. When income is obtained by minor through physical strenuous work or
- iii. Income earned by minor child through his abilities etc. For example: Kids participating in reality shows abs winning prizes.

(F) Clubbing of Income of Major Child:

A major child follows the same principles of taxation that is applicable to an individual up to 60 years of age. So, if our major child is earning income above Rs 2,50,000 (before any deduction), Then he is liable himself to file his income tax return. No clubbing of income provisions shall be applicable here.

(G) Clubbing of Income & HUF [Section 64(2)]:

Income Tax provisions consider HUF as an assessee that is liable to file income tax return. If any of our personal assets has been transferred to the HUF without any adequate consideration. In such case, all income from such asset shall be taxed in our hands.

IV. CONCLUSION

“Where there’s a will, there’s a way.”

There a lot of tactics and tricks to save our hard-earned money from the clutches of taxation. Proper tax planning is a must. One can avoid clubbing of income by gifting money to one’s wife or daughter-in-law before marriage If one gives any money after marriage then clubbing provisions shall apply. Also, if one is living with his parents and the house is in their name. Then we can pay rent to them and claim exemption of house rent allowance. One can further claim deduction u/s 80D by getting a health insurance for one’s family. Similarly, one should

⁴ <https://www.freedmaxick.com/services/tax/international-tax-services/expatriate-tax-planning/>

prefer loan over gift. It should be borne in mind that Investments should be through Joint Account so that taxability of interest income arises in the hands of the primary holder and it can help us save on taxes. All such steps can be undertaken to reduce tax liability because it is the wearer who knows where the shoe pinches.

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