

TAXATION LAWS- DIRECT AND INDIRECT

Hsst commerce M(4)

Topic : **Clubbing of Income-Set Off and Carry Forward**

Clubbing of income

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME (CLUBBING OF INCOME)

Clubbing of income means including the income of any other person in assessee's total Income. The Income Tax Act has specified certain cases where income of one person is statutorily required to be included in the income of another person if some conditions are satisfied. This inclusion is known as "Clubbing of Income" For example, if a husband diverts some part of his income to his wife to reduce his tax burden, Then such transferred income of a wife is added & taxed as income of husband only & not his wife.

A. Clubbing of Income for transfer of Income without transfer of Assets. [Sec. 60]

Section 60 is applicable if the following conditions are satisfied - The Taxpayer owns an assets. The ownership of assets is not transferred by him. The Income from the assets is transferred to any person under a settlement, or agreement. If the above conditions are satisfied, the

income from the assets would be taxable in the hands of the transferor. Example - Mr. Bachan confers the right to receive rent in respect of his house property to his friend Mr. Khan, without transferring the house itself to him. In this case, the rent received by Mr. Khan will be clubbed with the income of Mr. Bachan.

B. Clubbing of Income for Revocable transfer of Assets (Sec. 61)

Revocable transfer means the transferor of assets assumes a right to re-acquire asset or income from such an asset, either whole or in parts at any time in future, during the lifetime of transferee. It also includes a transfer which gives a right to re-assume power of the income from asset or asset during the lifetime of transferee. If the following conditions are satisfied section 61 will become applicable. An asset is transferred under a " Revocable Transfer". The Transfer for this purpose includes any settlement or agreement. Then any income from such an asset is taxable in the hands of the transferor.

Exception to Section - 61

Where the income arises to any person by virtue of transfer by way to trust which is not revocable during the life time of the beneficiary, & in case of any other transfer which is not revocable during the lifetime of the transferee Where the income arises to any person by virtue of transfer made before 01.04.1961 which is not revocable for the period of 6 years or more.

C. Clubbing of Income of Spouse [Section 64(1)(ii)]

The following incomes of spouse of an individual shall be included in the total income of the Individual. Remuneration from a concern in which spouse has substantial Interest - Concern -Concern could be any form of business or professional concern. It could be a sole proprietor, partnership, company etc. Substantial Interest - An individual is deemed to have substantial interest, if he/she beneficially holds equity shares carrying not less than 20% voting power or is entitled to not less than 20% profits at any time during the previous year.

If the following conditions are fulfilled this section [64(1)(ii)] becomes applicable] If spouse of an individual gets any salary, commission, fees etc (remuneration) from a concern. • The Individual has a substantial interest in such a concern. • The remuneration paid to the spouse is not due to technical or professional knowledge of the spouse. Then such remuneration shall be considered as income of the individual & not for the spouse.

Example- Mr. X has a substantial Interest in A Ltd. & Mrs. X is employed by A Ltd. Without any technical or professional qualification. In this case salary income of Mrs. X shall be taxable in the hands of Mr. X.

When both husband & wife have substantial Interest. Where both the husband & wife have substantial interest in a concern & both are in receipt of the remuneration from such concern, both the remuneration will be included in the total income of husband or wife whose total income excluding such remuneration is greater.

D. Income from Asset transferred to Spouse

[section 64(1)(iv)]

Income from assets transferred to spouse becomes taxable under provision 64(1)(iv) as per following conditions -

- The taxpayer is an individual.
- He/ She has transferred (directly/indirectly) an asset (other than a house property). The asset is transferred to his/her spouse. The asset is transferred without adequate consideration. Moreover there is no agreement to live apart. If the above conditions are satisfied any income from such asset shall be deemed to be the income of the taxpayer who has transferred the asset.

Example - Mr. B transfer 500 debentures of IFCI to his wife without adequate consideration. Interest Income on these debentures will be included in the Income of Mr. B

When section 64(1)(iv) is not applicable

- If assets are transferred before marriage. If assets are transferred for adequate consideration. If on the date of accrual of income, transferee is not spouse of the transferor.
- If assets are transferred in connection with an agreement to live apart.
- If property is acquired by the spouse out of pin money (i. e an allowance given to the wife by her husband for her dress & usual household expenses.)

E. Clubbing of Income from Assets transferred to son's wife [SECTION 64(1)(vi)]

Income from assets transferred to son's wife attract the provisions of section 64(1)(vi) as per conditions below -

- The taxpayer is an individual. He/ She has transferred an asset after May 31, 1973. The asset is transferred to son's wife.
- The asset is transferred without adequate consideration. In the case of such individuals, the income

from the asset is included in the income of the taxpayer who has transferred the asset.

Example - Mr. A transfers without any consideration fixed deposit of Rs. 1,50,000 with a bank to his daughter-in-law on May 5, 2019. She earns interest income of Rs. 12,500 from such fixed deposit during the year 2019-20. So, In the given case such income shall be included with the income of Mr. A

F. Clubbing of Income from Assets transferred to a person for the benefit of spouse. [Section 64(1)(VII)]

Income from the assets transferred to a person for the benefit of spouse attract the provisions of section 64(1)(VII) on clubbing of income. If

- The taxpayer is an individual.
- He/ She has transferred an asset to a person or an association of persons. Asset is transferred for the benefit of spouse.
- The Transfer of asset is without adequate consideration. In case of such individuals income from such an asset is taxable in the hands of the taxpayer who has transferred the asset.

Example - Mr. M transfers 6% debentures of Rs. 2,80,000 of Co. Ltd. to Mr. S without adequate consideration on the condition that interest from such debenture will be utilized for benefits of Mrs. M In such case, interest income will be included in the total income of Mr. M

G.Clubbing of Income from asset transferred to a person for the benefit of son's wife [section 64(1)(VIII)]

Income from the assets transferred to a person for the benefit of son's wife attract the provisions of section 64(1)(VII) on clubbing of income. If

- The taxpayer is an individual.
- He/ She has transferred an asset after May 31, 1973.
- He/ She has transferred an asset to a person or an association of persons. Asset is transferred for the benefit of son's wife.
- The Transfer of asset is without adequate consideration In case of such individuals income from such an asset is included in the income of the person who has transferred the asset.

H. Clubbing of Income of Minor Child [Section 64(1A)]

All income which arises or accrues to the minor child shall be clubbed in the income of his parents, whose total income (excluding minor's income) is greater. However, in case parents are separated, the income of minor child will be included in the income of that parent who maintains the minor child in the relevant previous year. Exemption to parent[sec. 10(32)] An individual shall be entitled to exemption of Rs.1,500 p.a. in respect of each minor child if the income of such minor as included u/s 64(1A) exceeds that amount. However if the income of any minor child is less than Rs. 1,500 p. the aforesaid exemption shall be restricted to the income so included in the total income of the individual

When Section 64(1A) is not applicable

In case of income of minor child from following sources, the.

- income of minor child is not clubbed with the income of his parent.
- Income of minor child on account of any manual work.
- Income of minor child on account of any activity involving application of his skills, talent or specialized knowledge & experience.
- Income of minor child suffering from any disability specified u/s 80U

Loss from exempted source of income cannot be adjusted against taxable income. If income from a particular source is exempt from tax, then loss from such source cannot be set off against any other income which is chargeable to tax. E.g., Agricultural income is exempt from tax, hence, if the taxpayer incurs loss from agricultural activity, then such loss cannot be adjusted against any other taxable income.

Meaning of intra-head adjustment If in any year the taxpayer has incurred loss from any source under a particular head of income, then he is allowed to adjust such loss against income from any other source falling under the same head. The process of adjustment of loss from a source under a particular head of income against income from other source under the same head of income is called intra-head adjustment, e.g. Adjustment of loss from business A against profit from business B.

Restrictions to be kept in mind while making intra-head

adjustment of loss Following restrictions should be kept in mind before making intra-head adjustment of loss:

1) Loss from speculative business cannot be set off against any income other than income from speculative business. However, non-speculative business loss can be set off against income from speculative business.

2) Long-term capital loss cannot be set off against any income other than income from long-term capital gain. However, short-term capital loss can be set off against long-term or short-term capital gain.

No loss can be set off against income from winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.

4) Loss from the business of owning and maintaining race horses cannot be set off against any income other than income from the business of owning and maintaining race horses.

5) Loss from business specified under section 35AD cannot be set off against any other income except income from specified business (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building a housing projects, etc.).

Meaning of inter-head adjustment After making intra-head adjustment (if any) the next step is to make inter-head adjustment. If in any year, the taxpayer has incurred loss under one head of income and is having income under other head of income, then he can adjust the

loss from one head against income from other head, E.g., Loss under the head of house property to be adjusted against salary income.

Restrictions to be kept in mind while making inter-head

adjustment of loss Following restrictions should be kept in mind before making inter-head adjustment:

- 1) Before making inter-head adjustment, the taxpayer has to first make intra-head adjustment.
- 2) Loss from speculative business cannot be set off against any other income. However, non-speculative business loss can be set off against income from speculative business.
- 3) Loss under head "Capital gains" cannot be set off against income under other heads of income.
- 4) No loss can be set off against income from winnings from lotteries, crossword puzzles, race including horse race, card game, and any other game of any sort or from gambling or betting of any form or nature.
- 5) Loss from the business of owning and maintaining race horses cannot be set off against any other income.
- 6) Loss from business specified under section 35AD cannot be set off against any other income (section 35AD is applicable in respect of certain specified businesses like setting up a cold chain facility, setting up and operating warehousing facility for storage of agricultural produce, developing and building housing projects, etc.)
- 7) Loss from business and profession cannot be set off against income chargeable to tax under the head "Salaries".

8) Loss under the head "house property" shall be allowed to be set-off against any other head of income only to the extent of Rs.

2,00,000 for any assessment year.

9) However, unabsorbed loss shall be allowed to be carried forward for set-off in subsequent years as per the existing provisions of section 71B. (Provisions relating to carry forward of loss from house property is discussed later.)

Carry forward of unadjusted loss for adjustment in next year Many times it may happen that after making intra-head and inter-head adjustments, still the loss remains unadjusted. Such unadjusted loss can be carried forward to next year for

adjustment against subsequent year(s)' income. Separate provisions have been framed under the Income-tax Law for carry forward of loss under different heads of income.

Provisions under the Income-tax law in relation to carry forward and set off of business loss other than loss from speculative business

If loss of any business/profession (other than speculative business) cannot be fully adjusted in the year in which it is incurred, then the unadjusted loss can be carried forward for making adjustment in the next year. In the subsequent year(s) such loss can be adjusted only against income charged to tax under the head "Profits and gains of business or profession"

Loss under the head "Profits and gains of business or profession" can be carried forward only if the return of income/loss of the year in which loss is incurred is furnished on or before the due date of furnishing the

return, as prescribed under section 139(1). Such loss can be carried forward for eight years immediately succeeding the year in which the loss is incurred.

Provisions under the Income-tax Law in relation to carry forward and set off of house property loss If loss under the head "Income from house property" cannot be fully adjusted in the year in which such loss is incurred, then unadjusted loss can be carried forward to next year. In the subsequent years(s) such loss can be adjusted only against income chargeable to tax under the head "Income from house property". Such loss can be carried forward for eight years immediately succeeding the year in which the loss is incurred.

Meaning of unabsorbed depreciation, unabsorbed capital expenditure on scientific research and unabsorbed capital expenditure on promoting family planning amongst the employees

Apart from several other deductions, while computing income chargeable to tax under the head "Profits and gains of business or profession" a person is allowed to claim deduction on account for depreciation, capital expenditure incurred by him on scientific research and capital expenditure incurred by a company for promoting family planning amongst its employees.

Business income (computed as per the provisions of Income-tax Law) of Mr. Kiran before allowing deduction on account of depreciation amounted to Rs. 84,000. Depreciation as per the provisions of section 32 amounted to Rs. 1,00,000. What will be the amount of unabsorbed depreciation in this case?

It can be observed that business income before claiming deduction under section 32 on account of depreciation is Rs. 84,000 and depreciation allowable as per section 32 is Rs. 1,00,000, hence, after claiming deduction on account of depreciation of Rs. 1,00,000, there will be a loss of Rs. 16,000. This loss is on account of depreciation and, hence, loss of Rs 16,000 will be termed as unabsorbed depreciation.

Provisions under the Income-tax Law relating to set off of unabsorbed depreciation, unabsorbed capital expenditure on scientific research and unabsorbed capital expenditure on promoting family planning amongst the employees

Depreciation is first deducted from the income chargeable to tax under the head "Profits and gains of business or profession". If such depreciation could not be fully adjusted against such income chargeable to tax in that previous year, the unabsorbed portion shall be added to the amount of depreciation for the following year and shall be deemed to be the part of depreciation for that year(similar treatment would be given to other allowances as mentioned above).

However, in the case of set off, following order of priority is to be followed:

- 1) First adjustments are to be made for current scientific research expenditure, family planning expenditure and current depreciation.
- 2) Second adjustment is to be made for brought forward business loss.
- 3) Third adjustments are to be made for unabsorbed depreciation, unabsorbed capital expenditure on scientific research or on family planning.

Carry forward of loss in case of change in the constitution of business
Generally, the person incurring the loss is only entitled to carry forward the loss to be adjusted in subsequent year(s). However, in certain cases of reconstitution of the business like amalgamation, demerger, conversion of proprietary firm into company or conversion of partnership firm into company, etc., the reconstituted entity is entitled to carry forward the unadjusted loss of predecessor entity (provided that conditions specified in this regard are satisfied).

Provisions relating to carry forward of loss in case of retirement of a partner from a partnership firm Section 78 contains provisions relating to carry forward and set off of loss in case of change in constitution of a partnership firm due to death or retirement of a partner (i.e. when a partner goes out of firm by retirement or death). In such a case, the share of loss attributable to the outgoing partner cannot be carried forward by the firm. Restriction of section 78 is applicable only in case of loss and is not applicable in case of adjustment of unabsorbed depreciation, unabsorbed capital expenditure on scientific research or family planning expenditure.