

TEST 9 CLUBBING

Illustration 1

The following information is given by X for the year ending March 31, 2021:

1. On April 10, 1973, X had transferred shares in a foreign company to Mrs. A (his daughter - in - law) without any consideration. During the previous year 2020 - 2021, Mrs. A has received dividend of Rs.4,10,000 from the foreign company.
2. On April 10, 1993, X had transferred debentures of Tata Chemicals to Mrs. A without any consideration. During the previous year 2020 - 2021, Mrs. A has received interest of Rs.3,90,000 from Tata Chemicals. Every year Mrs. A deposits interest income in fixed deposit with SBI and during the previous year 2020 - 2021, fixed deposit interest received from SBI is Rs. 40,000.
3. X transfers 1,000 9% debentures of Rs.100 each to Y on the condition that X will have a right to receive 10% interest during X lifetime.
4. X transferred a building to his friend Z on June 15, 2009 on the condition the building will revert back to X after the death of Z. monthly rental income from building is Rs.45,000.

Determine the income of different persons in the aforesaid cases for the assessment year 2020 - 2021.

Solution

1. Shares in foreign company - Shares were transferred before June 1, 1973 to daughter - in - law without consideration. Clubbing provisions are not applicable if an asset was transferred to daughter - in - law before June 1, 1973. Dividend income from foreign company of Rs.4,10,000 will be taxable in the hands of Mrs. A.
2. Debentures of Tata Chemicals - Debentures of Tata Chemicals were transferred in 1993 to Mrs. A (daughter - in - law of X) without consideration. Interest income of Rs.3,90,000 will be taxable in the hands of X. interest on debentures is deposited in fixed deposits in SBI. Interest from SBI is taxable in the hands of Mrs. X.
3. 9% debentures - 9% debentures are transferred to Y on the condition that X will enjoy 10% interest income during his lifetime. It is revocable transfer. The entire interest income of debentures of Rs.9,000 will be taxable in the hands of X.
4. Building - Building is transferred to Z. The transfer is not revocable during the lifetime of Z. When a transfer is not revocable during the lifetime of transferee, it is known as "irrevocable" transfer. Rental income from building is taxable in the hands of Z. (and not as income of X)

Illustration 2

X, an individual, is engaged in the business of money - lending. On April 1, 2020, he advances Rs.10,00,000 to his HUF at the market rate of interest of 12 per cent per annum. During the previous year 2020 - 2021, HUF earns Rs.4,00,000 as profit on the money advanced by X (before paying interest). Determine.

1. Is the amount of net income of HUF (i.e. Rs.4,00,000 minus 12 per cent of Rs.10,00,000) includible in the income of X under section 64(2)?
2. Does it make any difference if X is not engaged in the business of money lending?
3. Does it make any change in the applicability of section 64(2), if money is advanced at the rate of 4 per cent whereas the market rate of interest is 12 per cent?
4. Will the transaction come within the scope of sections 60 to 64, if X foregoes his right to receive interest on the sum so advanced before the date of accrual?

Solution

By advancing loan to the HUF, it cannot ordinarily be said that the lender has transferred any asset to HUF without adequate consideration, if the money is advanced at the market rate of interest. In the light of this observation, the specific points raised in the problem can be answered as follows:

1. Section 64(2) is not applicable, as it is not the case of transfer or conversion of separate property into HUF's property. As such, no part of HUF's income can be clubbed with X's income.
2. If the money is advanced at the market rate of interest, it does not make any difference whether X carries on money - lending business or not. In the given case, section 64(2) is, therefore, not attracted even if X does not carry on money - lending business.
3. If money is advanced at lower than market rate of interest, section 64(2) cannot be invoked, as the advance / loan does not amount to throwing of assets in common stock of the family or transfer of assets to the family. The Income Tax Department may, however, invoke section 60 which covers transfer of income without transfer of assets. Transfer, for the purpose of section 60, includes any agreement or arrangement. Therefore, giving advance at less than market interest rate will amount to transfer of income without transferring asset. Accordingly, excess of interest at market rate over 4 per cent per annum is chargeable to tax in the hands of X under section 60.
4. If X foregoes his right to receive interest, the case will be clearly covered by section 60. Income arising from the asset will be clubbed with the income of X.

Illustration 3

X submits the following information for the year ending March 31, 2021:

1. Son of X (date of birth: August 31, 2002) has a fixed deposit of Rs.40,00,000 in PNB (rate of interest 7 per cent)
2. Minor daughter of X owns a business. For the previous year ending March 31, 2021, her income from business is Rs.(-) 70,000.
3. On October 4, 2014, X gifted Rs.5,00,000 to Mrs. X. This amount (along with her own funds) is used in setting up a sole proprietor business by Mrs. X. On April 1, 2020, her investment in the business is Rs.11,00,000 and for the year ending March 31, 2021 income from the business is Rs.2,78,000.
4. Salary income of X is Rs.11,85,000
5. X holds 10 per cent shares in A Ltd. (a closely held manufacturing company). On June 10, 2020, X transfers these shares by way of gift to Mrs. X. Mrs. X takes a loan of Rs.2,10,000 on January 1, 2020 from the company. Accumulated profit of the company on this date is Rs.40,00,000.
6. X is entitled for a deduction of Rs.90,000 under section 80CCC.
7. Income of Mrs. X for the assessment year 2021 - 2022 is Rs.3,00,000.

Determine the net income and tax liability of X for the assessment year 2021 - 2022.

Solution

1. Son of X becomes major on August 31, 2020. Interest income from April 1, 2020 and August 31, 2020 is taxable in the hands of X. It comes to Rs.1,16,667 (i.e. $\text{Rs.40,00,000} \times 0.07 \times 5 \div 12$). Interest income from August 31, 2020 onwards will be taxable as income of X's son.
2. Income (or loss) of minor child is taxable in the hands of parents. Consequently, Rs.(-) 70,000 will be clubbed in the hands by X in 2020 - 2021. Proportionate income from business will be taxable in the hands of X. it comes to Rs.1,26,364 (i.e. $\text{Rs.2,78,000} \times \text{Rs.5,00,000} \div \text{Rs.11,00,000}$).
3. If a closely held company gives a loan or advance to a shareholder (who holds 10 per cent or more of equity shares in the company), such loan or advance (to the extent it does not exceed accumulated profit of the company) is treated as deemed dividend under section 2(22)(e). In this case, Rs.2,10,000 will be deemed as dividend. It is, however exempted under section 10(34).

Computation of income and tax liability:

	Rs.
Salary (i.e. Rs.11,85,000 - standard deduction)	11,35,000
Business income	
- Business of minor daughter	(-) 70,000
- Business of Mrs. X	1,26,364
Income from other sources	

- Interest income of son (Rs.1,16,667 - exemption of Rs.1,500)	1,15,167
- Deemed dividend of Mrs. X	Nil
Gross total income	13,06,531
Less: Deduction under section 80CCC	90,000
Net income (rounded off)	12,16,530
Tax on net income	
Income tax	1,77,459
Add: Health and education cess	7,098
Tax liability (rounded off)	1,84,560