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CLUBBING OF INCOME

SET OFF & CARRY FORWARD OF LOSSES

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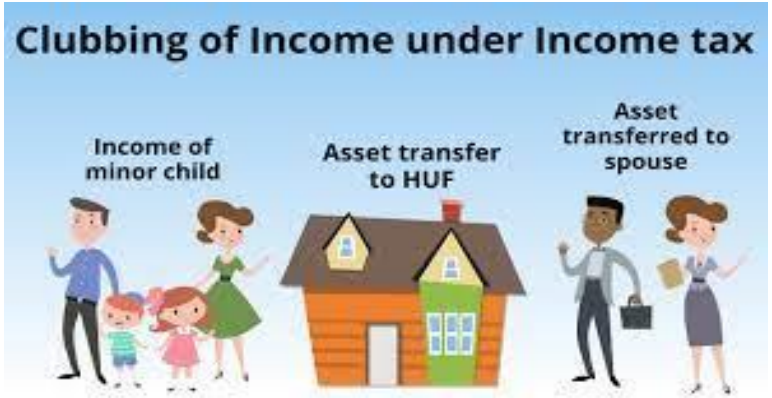
WHAT IS CLUBBING OF INCOME



- Generally an assessee is taxed in respect of his own income. But sometimes in some exceptional circumstances this basic principle is deviated and the assessee may be taxed in respect of income which legally belongs to somebody else.
- Earlier the taxpayers made attempts to reduce their tax liability by transferring their assets in favor of their family members or by arranging their sources of income in such a way that tax incidence falls on others, whereas benefits of income is derived by them .So to counteract such practices of tax avoidance, necessary provisions have been incorporated in sections 60 to 64 of the Income Tax Act.

TERMS

- Transferor- The person who transfers any of his belongings, specifically his assets/income to another person is known as Transferor.
- Transferee-The person to whom the transferor transfers his / her assets is known as transferee.
- Revocable asset - transferor reserves right to reacquire or take back anything legally which was given earlier under an agreement or settlement.
- Minor- A person who is below the age at which he or she legally becomes an adult. In India, at present a person becomes adult at the age of 18 years. (As per Indian Majority Act Section -3)

TRANSFER OF INCOME WITHOUT TRANSFER OF ASSET (SEC. 60)

Section 60 is applicable if the following conditions are satisfied:

- The taxpayer owns an asset
- The **ownership** of asset is **not transferred** by him.
- The income from the asset is transferred to any person under a **settlement, trust, agreement or arrangement.**
- The above transfer maybe **revocable or may irrevocable**.

If above conditions are satisfied ,<u>INCOME FROM THE ASSEST IS TAXABLE IN THE HANDS OF TRANSFEROR</u>

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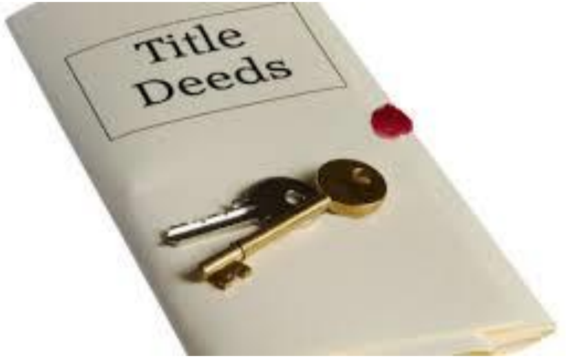
Illustration

Mohan owns Debentures worth Rs 1,000,000 of ABC Ltd., (annual) interest being Rs. 100,000. On April 1, 2005, he transfers interest income to his friend Madhu without transferring the ownership of these debentures. The interest of Rs. 100,000 is received by Madhu and it is taxable in the hands of Mohan as per Section 60.

REVOCABLE TRANSFER OF ASSETS (SEC 61)



- If an asset is transferred under a “revocable transfer” , income from such asset is taxable in the hands of the transferor. The transfer for this purpose includes any settlement, trust, agreement or arrangement.
- In any of the following cases, transfer is treated as “revocable transfer” –
  1. If an asset is transferred to a person and it is revocable during the **lifetime of transferee/beneficiary.**
  2. If the transfer contains any provision to **re-transfer** the asset(or income therefrom) to the transferor **directly or indirectly, wholly or partly**.
  3. If the transferor has any **right to reassume power** over the asset (or income therefrom) directly or indirectly, wholly or partly.

Illustrations:

- X transfer a house property to A. However , X has a right to revoke the transfer during the lifetime of A. it is a revocable transfer and income arising from the house property is taxable in the hands of X.

- X transfer an asset on March 31, 1961. It is revocable on or before June 6, 1963. It is a revocable transfer. Income arising from the asset is taxable in the hands of X. conversely, if X transfers an asset before April 1, 1961 and it is revocable after 6 years (say, on April 10, 1967), it is not taken as a revocable transfer.

WHEN AN INDIVIDUAL IS ASSESSABLE IN RESPECT OF REMUNERATION OF SPOUSE {SEC.64(1)(II)}

Section 64(1)(ii) is applicable if the following conditions are satisfied -

1. The taxpayer is an **individual**.
2. He/she has a substantial interest in a concern. Concern could be any form of business or professional concern. It could be a sole proprietor, partnership, company, etc
3. Spouse of the taxpayer (i.e., husband/wife of the taxpayer) is **employed** in the above mentioned concern.
4. Spouse is employed in the concern without any **technical or professional knowledge** or experience.

If the above conditions are satisfied, then salary income of the spouse will be taxable in the hands of the taxpayer.

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

- Relative – Relative in relation to an individual means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual .

- When both husband and wife have substantial interest in a concern and both are employed by the concern **without professional qualification** , remuneration will included in the total income of husband or wife whose total income, excluding such remuneration , is greater

INCOME FROM ASSETS TRANSFERRED TO SPOUSE [SEC. 64(1)(IV)]

Income from assets transferred to spouse becomes taxable under provisions of section 64 (1) (iv) as per following conditions:-

1. The taxpayer is an **individual.**
2. He/she has transferred an asset (other than a house property)
3. The asset is transferred to his/her spouse.
4. The transfer may be direct or indirect.
5. The asset is transferred otherwise than (a) for **adequate consideration**, or (b) in connection with an **agreement to live apart**.
6. The asset may be held by the transferee-spouse in the same form or in a different form.

- 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.

<u>Section 64 is not applicable in the following cases:</u>

1. If assets are transferred **before marriage**.
2. If assets are transferred for **adequate consideration**.
3. If assets are transferred in connection with an **agreement to live apart**.
4. If on the date of accrual of income, transferee is **not spouse of the transferor**.
5. 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 and usual household expenses).

In the aforesaid five cases, income arising from the transferred asset cannot be clubbed in the hands of the transferor

INCOME FROM ASSETS TRANSFERRED TO SON'S WIFE [SEC. 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**.
- The asset is transferred to **son's wife**.
- Transfer may be direct or indirect.
- The asset is transferred otherwise than for **adequate consideration**.
- The asset may be held by the transferee in the same form or different form.

If the above conditions are satisfied , then income from the asset is included in the income of the taxpayer who has transferred the asset.

INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SPOUSE [SEC. 64 (1)(VII)]

Income from 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.
- Transfer may be direct or indirect.
- Asset is transferred for the **immediate or deferred** benefit of his/her spouse.
- The transfer of asset is without adequate consideration.

If the above conditions are satisfied then income from such asset to the extent of such benefit is taxable in the hands of the taxpayer who has transferred the asset.

INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SON’S WIFE [SEC. 64 (1)(VIII)]

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

- The taxpayer is an **individual**
- The asset is transferred to any person or an association of persons.
- Transfer may be direct or indirect.
- The asset is transferred for the **immediate or deferred benefit** of his/her son’s wife.
- The asset is transferred otherwise than for adequate consideration.

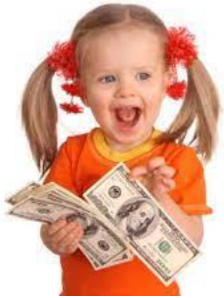
If the above conditions are satisfied, then income from the asset to the extent of such benefit is included in the income of the taxpayer who has transferred the asset.

INCOME OF MINOR CHILD {SEC. 64 (1A)}

- All income which arises or accrues to the minor child shall be clubbed in the income of his parent (Sec. 64(1A), whose total income (excluding Minor's income) is greater. However, in case parents are separated, the income of minor will be included in the income of that parent who maintains the minor child in the relevant previous year.
- **When clubbing is not attracted**- the following income will be taxable in the hands of minor child:
  1. Income of minor child(from all sources) **suffering from any disability** of the nature specified **under sec. 80U**. Here "disability" shall have the meaning assigned to it in clause (i) of section 2 of the Persons with Disabilities Act, 1995. Which includes Blindness , Low vision, Leprosy cured, Hearing Impairment, Loco motor disability , Mental retardation Mental illness, Autism, Cerebral Palsy
  2. Income of minor child on account of any **manual work**.
  3. Income of minor child on account of any activity **involving application of his skill** , talent or **specialized knowledge** and **experience**

Exemption under sec. 10(32)

- In case the income of an individual includes the income of his / her minor child in terms of above provisions, such an individual **shall be entitled to exemption of Rs.1,500** in respect of each minor child. Where , however, the income of any minor so includible is less than Rs.1500, the aforesaid exemption shall be restricted to the income so included in the total income of the individual.



SET OFF & CARRY FORWARD OF LOSSES

SETT OFF & CARRY FORWARD OF LOSSES

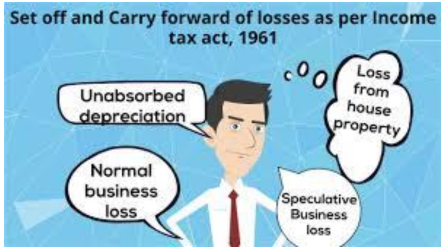
- WHAT IS SETT OFF

It refers to adjustment of losses against the eligible profits of the year.It is governed by **section 70 ans section 71** of the Act.

SETT OFF

- Intra Head Adjustment
  - Within the same head of Income (section 70)
- Inter Head Adjustment
  - With other heads of Income (Section 71)

SECTION 70 : INTRA HEAD ADJUSTMENT



- Setting off loss of one source against income from other source **within the same head**.
- Example

  Loss from textile business can be set off against profit of leather business.

Exceptions to the rule of inter source adjustment

- Loss from speculation business.
- Loss from activity of owning and maintaining race horses.
- Set off of losses against casual winnings.
- Long term capital loss.
- Loss from an exempt source of income.
- Loss from business specified under section 35AD.

Example:

X has two business – A&B.	
Profit from business A	Rs.3,00,000
Loss from business B	Rs.50,000

⬇

Taxable income from business = (3,00,000-50,000)
= Rs.2,50,000

SECTION 71 : INTER HEAD ADJUSTMENT

- Under this section, loss can be set off against income **under other heads**.
- Example

  Losses from non-speculative business can be set off against house property

Exceptions to the rule of inter head adjustment

- Loss from **speculation business**.
- Loss under the head “Profit and gains of business or profession” against income from salary.
- Loss from activity of **owning and maintaining race horses**.
- Set off of **losses against casual winnings**.
- Any loss under **capital gain**.

Y has two non speculative business income	Also, he has income from house property
Profit from business A	Rs.50,000
Loss from business B	Rs.2,50,000
Income from house property	Rs.5,00,000

Profit from business A Less: Set off u/s 70 (Business B)	50,000 (50,000) 0
Income from house property Less: Set off u/s 71.(Business A) Gross total Income	5,00,000 2,00,000 Rs.3,00,000

SUMMARY OF RULES

Income from house property -

- Salary
- Business Income
- Capital Gains
- Income from other sources

Speculation business –

- Speculation income only

Non Speculation business-

- House property
- Capital gain
- Income from other sources

Long term capital loss-

- Long term capital gain

Short term capital loss-

- Long term capital gain
- Short term capital gain

Income from other source-

- Salary,
- House property
- Business income
- Capital gain

CARRY FORWARD OF LOSSES

- Losses which could not be set off against the income of assessment year are not lapsed, but are allowed to be carried forward to be set off against the income off subsequent years.

- Carry forward of losses for each head is governed by different sections which define the number of years it can be carried forward for, against which income can be set off etc.

SECTION 71B : CARRY FORWARD OF LOSSES FROM "HOUSE PROPERTY"

- Sett off against : Future income under the head "**House Property**" only.
- Time period : maximum of **8 AY**.
- The time period is to be calculated from end of the relevant assessment year in which loss was suffered.
- Example : If loss relates to AY 2012-13 , it can be c/f up to AY 2020-21.

SECTION 72 : CARRY FORWARD OF LOSS OF NON SPECULATION BUSINESS

- Sett off against : Future income from **any business** of assesse.
- Time period : maximum of **8 AY**.
- It is not necessary that it must be sett off against **income from same business**.
- Such loss can be can 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)**

Section 73 : Loss in speculation Business

- Sett off against : Income of **speculation business only**.
- Time period : **4 AY**.
- It cannot be set off against **any other head**.
- Such loss can be can 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)

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Section 74- Carry forward of losses under the head "Capital gain"

- Sett off against :
  - **Unabsorbed Short term capital loss**

    Long term capital gains.

    Short term capital gain.
  - **Unabsorbed long term capital loss**

    Only against long term capital gains.

- Time period : **maximum of 8 AY**.
- Such loss can be can 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)**.

Section 41(5) : Set off of Loss After lapse of 8 years

- Where the business or profession referred in this section is **no longer in existence**.
- Any loss which arose in that business or profession during the previous year in which it is ceased to exist and which could not be set off against any other income of that previous year.
- Such business is **not speculation business**.
- **After discontinuation of such business** or profession, there is a receipt which is deemed as business income.

DEEMED BUSINESS INCOME INCLUDES

- Subsequent **recovery of any expense**, which was previously allowed.
- Profit on **sale of assets used for scientific research**.
- **Recovery of bad debts** which was previously allowed.
- Amount withdrawn from **special reserve**.

SECTION 73A : LOSSES OF SPECIFIED BUSINESS U/S 35AD.

- Any loss computed in respect of specified business shall be allowed to be adjusted only against profit of **some other specified business**.
- If loss **remains unabsorbed** as above, it can be carried forward
- Set off **against-Future income of specified business** only
- Time period- it shall be allowed to carried forward **without any limit**, until it is fully set off

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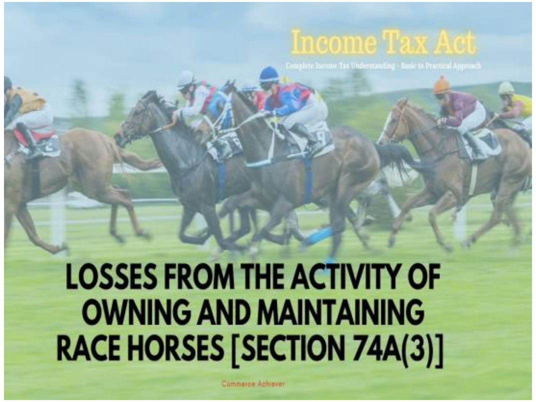
SECTION 74A: CARRY FORWARD OF LOSS OF ACTIVITY OF OWNING AND MAINTAINING RACE HORSES.

- Set off against: Future income of "**same" business only**
- Time period: **4 year** only
- Such loss 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 the section 139(1)



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SECTION 32(2) : UNABSORBED DEPRECIATION

- Inter source Adjustment (70)- **Unabsorbed depreciation** will first be set off against profit of any **other business or profession(**if any)
- Inter head Adjustment (71)- It can be set off against income of other heads, **except salaries and casual winnings.**

CARRY FORWARD OF UAD :

- Sett off against : Any income **except salaries and casual winnings**.
- Time period : **No time limit**.
- It cannot be set off even the business to which UAD pertains to has been discontinued.

Section	Losses to be carried forward	Can be set off against income	Time Limit	Mandatory to file return in the year of loss
32(2)	Unabsorbed depreciation	Any income (other than salary)	No time limit	No
71B	House property	Income from house property	8 years	No
72	Losses from non speculative-business	Income from business	8 years	Yes
73	Losses from speculative-business	Income from speculative business	4 years	Yes
73A	Loss from specified business	Income from specified-business	No Time limit	Yes
74	Short term capital loss Long term capital loss	STCG & LTCG LTCG	8 years	Yes
74A	Loss from owning and maintaining horse race	Income from owning and maintaining horse race	4 years	Yes

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Thank You!!