

SET-OFF AND CARRY FORWARD OF LOSSES, CASH CREDITS, UNEXPLAINED INVESTMENTS, UNEXPLAINED MONEYS, INVESTMENTS, UNEXPLAINED EXPENDITURE, AMOUNTS BORROWED ON HUNDI AND CLUBBING OF INCOME

By
CA Sanjay R. Parikh

A) **Clubbing of Income**

Sections 60 to 65

The provisions of sections 60 to 65 are anti-abuse provisions. In order to reduce the taxable income, people often resorted to various means. In order to loop such leakages, the provisions of section 60 to 65 have been enacted.

1) Transfer of income without transfer of assets – Section 60

As per section 60, where a person transfers any income without transferring the assets from which the income arises, he shall be chargeable to income-tax on such income.

Example : Mr. A owns certain investments. He settles the income from the investments to charity. As there is no transfer of investments but only the income, as per section 60, the income would be taxable in the hands of Mr. A.

2) Revocable transfer of assets – section 61

If a person transfers an asset and if such transfer is revocable, the income arising from such asset would be taxable in the hands of the transferor.

Example : Mr. Z makes a revocable transfer of his taxable bonds to Mrs. B. As per terms of transfer, Mr. Z can revoke or cancel the transfer. In this case, the income from the taxable bonds would be clubbed in the hands of Mr. Z.

Section 62(1) provides for certain exclusions to the operation of section 61. It specifies that in the following cases, the provisions of section 61 will not be applicable :

- a) if there is a transfer of any asset to a trust which is not revocable during the life time of the beneficiary;
- b) in case of any other transfer, it is not revocable during the lifetime of the transferee; or
- c) the revocable transfer was made before 1/4/1961, if the transfer cannot be revoked for a period exceeding 6 years.

There is a further condition by way of a proviso that the transferor does not derive any direct or indirect benefit from such income.

Sub-section (2) to section 62 provides that the provisions of section 62(1) will not be applicable after the transferor revokes the transfer.

- 3) Section 63 – explains the meaning of the terms “transfer” and revocable transfer”.

A transfer shall be deemed to be revocable if it :

- (i) Contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor, or
- (ii) It, in any way, gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets.

“Transfer” has been defined to include any settlement, trust, covenant, agreement or arrangement.

- 4) Section 64(1)(ii) – Salary, commission, fees or any other form of remuneration from a concern in which such individual has substantial interest.

However, if the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his or her technical or professional knowledge and experience, clubbing provisions will not apply.

As per Explanation 1, if the husband and wife both earn salary, remuneration, etc. from a concern in which such individual has substantial interest, the income would be included in the hands of that person whose income excluding such salary or remuneration is higher in the first year. Thereafter, it would continue to be taxed in the hands of such other person unless the AO after giving a hearing to the spouse is satisfied that it is necessary to do so.

As per Explanation 2, it is provided that an individual shall be deemed to have a substantial interest in a concern being a company, if he along with his relatives hold shares (other than preference shares) with voting power of not less than 20%. In the case of any other concern, such person along with his relatives are entitled to not less than 20% of the profits of such concern.

Case Study : *Mr. PS and Mrs. PS are doctors and are partners in the firm M/s. PS & Co. Both are working partners and are paid remuneration by the firm. The AO assessing officer Mr. PS wants to add the remuneration of Mrs. PS in the hands of Mr. PS. Is the Assessing Officer justified ?*

Case study : *Mrs. S has done her B.A. with English Honours from the Patna Women’s College affiliated to Patna University. She has also done her Post Graduation in Mass*

Communication from the Indian Institute of Mass Communications, New Delhi. She has worked with Indian Express, Mumbai, has been a reporter with "Island" Magazine, Freelance researcher attached with Platinum Communications, New Delhi and Research Coordinator with Bombay TV Production House, before she joined M/s. ABC International. M/s. ABC International is owned by Mr. S. The AO wants to disallow the salary paid to Mrs. S. Whether the AO is justified ?

- 5) Section 64(1)(iv) – income earned by spouse out of assets transferred directly or indirectly to the spouse of such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

Case Study :: Mr. A gifts his land having market value of Rs. 1 crore to Mrs. A. Mrs. A has let out the land and is deriving income of Rs. 2 lakhs per month. The income of Rs. 24 lakhs would be taxable in the hands of Mr. A. What would be the position if the land had been sold for Rs. 50 lakhs prior to 1st April, 2003 ? Would it make a difference if the land had been transferred after 1st April, 2003 and Mr. A has paid capital gains tax on Rs. 1 crores as per the provisions of section 50C ?

- 6) Section 64(1)(vi) – income arising to the son's wife from assets transferred directly or indirectly for adequate consideration.

As per Explanation 3, in case of assets transferred directly or indirectly to the spouse or son's wife are invested by them in any business (not being capital contribution in a firm as a partner or for being admitted to the benefits of partnership), the income to be clubbed would be on pro rata basis in the ratio of contribution of assets to such concern to total assets contributed by the wife or son's wife in the concern as on the 1st day of the previous year.

In the same manner, with respect to interest from a partnership firm, the interest to be clubbed would be on pro rata basis in the ratio of assets contributed to total investment by spouse or son's wife in partnership firm as on 1st day of previous year.

Case Study : Mr. L had gifted a sum of Rs. 50 lakhs to his wife Mrs. L and a sum of Rs. 25 lakhs to his daughter in law Mrs. Y. Mrs. L has invested the money in a beauty parlour of which she is a proprietor. During the year ended 31st March, 2014 Mrs. L earned a profit from the beauty parlour of Rs. 4.50 lakhs. Mrs. Y invested the money in her proprietary concern in which she was trading in shares. She suffered a loss of Rs. 3 lakhs during the year ended 31st March, 2014. What would be the amount to be clubbed in the hands of Mr. L ?

- 7) Section 64(1)(vii) – income arising to any person or AOP from assets transferred directly or indirectly otherwise than for adequate consideration to the extent to which the income from such assets is for the immediate or deferred benefit of his or her spouse.
- 8) Section 64(1)(viii) – income arising to any person or AOP from assets transferred directly or indirectly otherwise than for adequate consideration to the extent to which the income from such assets is for the immediate benefit or deferred benefit of his son's wife.
- 9) Section 64(1A) – minor's income

All income of a minor child other than a minor child suffering from any disability of the nature specified in section 80U [i.e. disability defined in clause (i) of section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act and includes autism, cerebral palsy and multiple disabilities referred to in the said section 2] will be included in the income of the parent whose income is greater. If the parents have divorced, the income is to be clubbed in the hands of the parent who maintains the minor child in the previous year.

However, income which arises or accrues to the minor child on account of manual work done by him, or from the activity involving application of his skill, talent or specialised knowledge and experience will not be clubbed.

Once the income is included in the hands of a parent, it will continue to be so included unless the AO is satisfied, after giving the other parent an opportunity of being heard, that it is necessary to do so.

Case Study : Master Kishin has acted in the serial "Krishna" and has earned remuneration of Rs. 5,00,000/- for acting in the serial. The AO wants to add the remuneration of Rs. 5,00,000/- to the income of Master Kishin's father. Master Kishin's father requests you to guide him whether the remuneration of Rs. 5,00,000/- is taxable in his hands.

Where any income of any child is clubbed in the hands of his/her parent, the parent would be entitled to exemption of such income to the extent of Rs. 1,500/- per child whose income is includible as per section 10(32).

Case study : Mr. Z has three minor children i.e. Master A, Master B and Miss C. During the year ended 31st March, 2014, Master A had earned income of Rs. 15,000/- from certain amounts invested in bank out of the gifts received by him. Master B received income of Rs. 10,000/- and Miss C received an income of Rs. 6,000/-. What would be the amount which would be clubbed in the hands of Mr. Z ?

10) Section 64(2) – income of HUF

Where a member of a HUF introduces his personal property after the 31st December, 1969 into HUF property then :

- a) The individual shall be deemed to have transferred the converted property to the members of the family ;
- b) The income from the converted property shall be deemed to arise to the individual and not to the family;
- c) Where there has been a partition of the HUF, the income derived from such property received by the spouse, shall be clubbed with that of the individual.

11) Section 65

It is provided that where such income is clubbed, the department can recover the taxes from the person in whose hands the income has arisen. However, such recovery would be only to the extent of tax payable on such income clubbed. For this purpose, a notice of demand is required to be served on the owner of asset.

B) **UNEXPLAINED CASH CREDITS, UNEXPLAINED INVESTMENTS, ETC.**

1) Unexplained cash Credit – section 68

Conditions :

- a) Any sum credited in books of assessee
- b) Assessee offers no explanation or explanation offered is not, in the opinion of the AO, satisfactory
- c) The sum so credited may be charged to income-tax of the assessee of that previous year.

What can be taxed :

- a) Loans taken
- b) Gifts received (from residents as well as from non-residents)
- c) Share application, share capital and share premium – Supreme Court held that share capital received by a public limited company in public issue cannot be taxed u/s. 68 – CIT v. Lovely Exports Pvt. Ltd. (2008) 216 CTR 195 (SC).

Two provisos inserted from A.Y. 2013 -14

As per 1st Proviso, in the case of a company, other than a company in which the public are substantially interested, is found to have credited any amount by :

- a) Share application money
- b) Share capital
- c) Share premium
- d) Or any such amount by whatever name called

Any explanation offered shall be deemed to be not satisfactory unless :

- a) The person, being a resident in whose name such credit is recorded in the books of such company also offered an explanation about the nature and source of such sum so credited; and
- b) Such explanation in the opinion of the AO has been found satisfactory.

As per 2nd proviso, the 1st proviso will not be applicable if the investment is by a venture capital company or a venture capital fund.

The section uses the word “may” which gives a discretion to the AO. It is not necessary that in all cases for the amount to be treated as the assessee’s income – CIT v. Noorjahan P. K. (1999) 237 ITR 570 (SC)

If books of account not maintained, section 68 is not applicable. Bank pass book is not books of account of assessee –CIT v. Bhaichand H Gandhi (1983) 141 ITR 67 (Bom)

What the assessee has to establish :

- a) Identity of the person
- b) Capacity of the person giving the loan, gift, etc.
- c) Genuineness of the transaction.

Initial onus on assessee. Once basic documents furnished, onus shifts to department.

Where assessee had filed confirmation letters along with Income Tax numbers and summons issued were returned back, department not having made any efforts to locate parties on the basis of Income Tax numbers, could not justify addition – CIT v. Orissa Corporation Ltd. (1986) 159 ITR 58 (SC).

Case Study : Mr. D is a small man doing carpentry work and earning an income of Rs. 50,000/- to Rs. 60,000/- per annum. His sister’s brother in law, Mr. CA being a chartered accountant was assisting him in filing his return of income. During the year ended 31st March, 2005, Mr. D gave a blank cheque to Mr. CA towards his fees. Mr. CA deposited cash of Rs. 10 lakhs and issued a bogus gift cheque to Mr. Donee. During the assessment of Mr. Donee, Mr. Donee confirmed that he had received bogus gift. The AO on the basis of the addition in the hands of Mr. Donee has reopened the assessment of Mr. D and has added the sum of Rs. 10 lakhs as his income. Mr. D seeks your opinion as to whether such amount could be added and if so, under which section ? Mr. D does not maintain any books of account.

2) Unexplained investments – section 69

Where an assessee has made investments which are not recorded in the books of account, if any, maintained and the assessee offers no explanation about the nature and source of the investments or the explanation offered is found to be not satisfactory, the value of

investments may be deemed to be the income of the assessee of the financial year in which investment made.

Certain cases where addition could be made :

- a) Deposit found in bank account
- b) Investments made out of undisclosed sources
- c) Unexplained investment in construction of building

3) Unexplained money, etc. – section 69A

Where an assessee is found to be the owner of any money, bullion, jewellery or other valuation article, which is not recorded in the books of account and the assessee gives no satisfactory explanation about the nature and source of acquisition of the same or the explanation is not satisfactory, the money or the value of bullion, jewellery, etc. may be deemed to be the income of the assessee of the financial year in which he is found to be owner.

Mainly to cover cases where during search and seizure certain assets are found.

4) Amount of investments, etc. not fully disclosed in books of account – section 69B

Where the value of investments, bullion, jewellery, etc. is not fully disclosed, the difference between the value and the values recorded in books of account may be added under this section.

5) Unexplained expenditure, etc. – section 69C

Where it is found that the assessee has incurred any expenditure, which is not recorded in his books of account, such expenditure may be deemed to be income of the assessee of the year in which such expenditure is incurred.

Earlier, on the addition being made, assessee's used to claim the expenditure as business expenditure. With a view to disable such practice, the proviso now specifically provides that such expenditure will not be allowed as a deduction under any head of income.

6) Amount borrowed or repaid on hundi – section 69D

If the assessee borrows any money on hundi otherwise than by an account payee cheque or repays any money borrowed on hundi otherwise than by an account payee cheque, the

amount so borrowed or repaid shall be deemed to be the income of the previous year in which the amount was borrowed or repaid.

- As per Board Circular No. 204 dated 24th July, 1976, the term `hundi' denotes, in common parlance, an indigenous instrument in vernacular language which can be used by the holder thereof to collect money due thereon without using the medium of currency. It may also be regarded as an indigenous form of a bill of exchange expressed in vernacular language which has been in use in the mercantile community in India for the purpose of collecting dues. The Board has specified that the following characteristics are found in most of the hundis :
 - a) A hundi is payable to a specified person or other or negotiable without endorsement by the payee.
 - b) A holder is entitled to sue on a hundi without an endorsement in his favour
 - c) A hundi accepted by the drawee could be negotiated without endorsement.
 - d) If a hundi is lost, the owner could claim a duplicate or a triplicate from the drawer and present it to the drawee for payment. Interest can be charged where usage is established.

- The Board has vide the said circular, also clarified that if the amount is added when the amount is borrowed on hundi, the same amount will not be taxed on its repayment.

Sr. No.	Section	Nature of addition	What can be taxed ?	Year in which taxable
1.	68	Unexplained Cash credits	a) Unexplained loans b) Unexplained Gifts, local as well as non-resident c) Share Capital including share application	Previous year in which amount credited in books of account

			money, share premium, etc.	
2.	69	Unexplained investments	Unexplained investments not recorded in books of account maintained	Previous year in which amount invested
3.	69A	Unexplained money, etc.	Unexplained money, bullion, jewellery or valuable article	Previous year in which asseesse is found in possession of money, bullion, jewellery or valuable article
4.	69B	Amount of investments, etc. not fully disclosed in books of account	Investments, money, bullion, jewellery or other article not fully disclosed in books maintained	Previous year in which investment made or bullion, jewellery or other article is found in possession
5.	69C	Unexplained expenditure	Expenditure incurred out of unknown sources	The year in which expenditure is incurred
6.	69D	Amount	Amount	Amount

		borrowed or repaid on hundi	borrowed or repaid otherwise than by an account payee cheque	borrowed or repaid otherwise than by an account payee cheque. If addition is made of amount borrowed, same amount cannot be added when repaid (Refer Board Circular No. 204 dated 24/7/1976)
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Position with respect to inter head adjustment (Section 70)

Sr. No.	Nature of loss	Whether set off available ?	Remarks
1.	Income from house property	Yes	
2.	Business loss other than speculation loss and specified business referred to in section 35AD	Yes	
3.	Business loss in any business referred to in section 35AD	No. Such loss can be set off only against income from another specified business.	73A(1)
4.	Speculation loss	No. Speculation	Section 73(1)

		loss can be set off only against any other speculation income.	
5.	Short Term Capital Gains	Yes, Loss can be set off only against short term capital gains or long term capital gain	Section 70(2)
6.	Long term capital gains	No. Loss can be set off only against long term capital gain	Section 70(3)
7.	Loss from the activity of running and maintaining race horses	No. Can be set off only against any other business of running and maintaining race horses	Section 74A(3)
8.	Income from other sources (excluding from the activity of running and maintaining race horses	Yes	

Position with respect to intra head adjustment (Section 71)

Sr. No.	Nature of loss	Whether set off available ?	Remarks
1.	Income from house property	Yes	71(1) and 71(2)

2.	Business loss other than speculation loss and specified business referred to in section 35AD	No. Business loss can be set off against any other income except Salary Income	71(2A)
3.	Specified business referred to in section 35AD	No.	73A(1)
4.	Speculation loss	No	Section 73(1)
5.	Short Term Capital Gains	No	Section 71(3)
6.	Long term capital gains	No.	Section 71(3)
7.	Loss from the activity of running and maintaining race horses	No. Can be set off only against any other business of running and maintaining race horses	Section 74A(3)
8.	Income from other sources (excluding from the activity of running and maintaining race horses	Yes	71(1) and 71(2)

Set off and carry forward of losses

Sr. No.	Nature of loss	Section under which carry forward allowed	No. of years for which carry forward allowed
1.	Income from house	71B	Eight assessment

	property		years immediately succeeding the assessment year for which the loss was first computed.
2.	Business loss other than speculation loss	72	<p>Eight assessment years immediately succeeding the assessment year for which the loss was first computed.</p> <p>However, if covered u/s. 33B – loss will be considered to be the loss of the year in which business re-established, reconstructed or revived. Carry forward would be available for seven years immediately succeeding the year in which business is revived, etc.</p>
3.	Unabsorbed business loss (not being speculation loss) and depreciation in case of amalgamation, demerger, etc.	72A	- Loss will be considered to be loss of the previous year in which amalgamation, etc. takes place

			<ul style="list-style-type: none"> - It will be allowed to be carried forward for 8 years immediately succeeding the year in which the amalgamation, demerger, etc. takes place. - Certain conditions to be fulfilled - If conditions not complied with, loss/depreciation allowed earlier would be deemed to be income of the year in which condition not fulfilled.
4.	Accumulated loss (other than speculation loss) and unabsorbed depreciation in scheme of amalgamation of banking company	72AA	Loss and unabsorbed depreciation would be considered to be of the year in which amalgamation takes place and would be allowed to be carried forward for 8 years immediately

			succeeding the year in which amalgamation takes place.
5.	Carry forward and set off of losses and unabsorbed depreciation on reorganisation of co-operative banks	72AB	<ul style="list-style-type: none"> - Conditions to be fulfilled - Loss or unabsorbed depreciation would be allowed to amalgamated co-operative bank as if the amalgamation had not taken place i.e. for the balance period - If conditions not complied with, loss or depreciation allowed would be deemed to be income of the year in which condition not complied with.
6.	Speculation loss	Section 73	Four years immediately succeeding the assessment year in which loss occurred Explanation to

			section 73 – Deeming fiction
7.	Specified business referred to in section 35AD	73A	No time limit specified for set off and carry forward of loss
8.	Capital Gains	74	Eight assessment years immediately succeeding the assessment year for which the loss was first computed.
9.	Loss from the activity of running and maintaining race horses	74A	Four assessment years immediately succeeding the assessment year for which the loss was first computed.

As per section 80, the losses computed u/s. 72(1), 73(2), 74 and 74A will not be allowed to be carried forward and set off unless a loss return is filed by the due date for filing the return of income.