



सत्यमेव जयते

GOVERNMENT OF INDIA

LAW COMMISSION OF INDIA

Report No.265

**Prospects of Exempting Income arising out of
Maintenance Money of 'Minor'**

March, 2017

Dr. Justice B. S. Chauhan
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D.O.No.6(3)/307/2016-LC(LS)

March 20th, 2017

Dear Shri Ravi Shankar Prasad Sir,

The Punjab and Haryana High Court, while dealing with the case **Payal Mehta v. Sanjay Sarin** referred the subject matter to the Law Commission of India for consideration as to whether the provisions of section 64(1A) of the Income Tax Act, 1961 require an amendment to provide for exemption from clubbing of minor's income accruing by way of interest on the amount deposited by one of the parents of the minor child as maintenance, at the hands of parent/guardian, under an order of the Court. The plea taken in this case is that the interest on the amount of maintenance deposited in the name of minor child should not be subjected to tax.

2. The Commission examined the issue and is of the view that the income earned by way of interest on the amount of maintenance deposited in favour of the child does not require to be exempted from being clubbed with the income of the parent/guardian, as such exemption, if granted, would open flood gates of tax evasion and would defeat the very object of inserting the provisions of section 64(1A), which had been brought to plug in the loophole to prevent the avoidance of tax, causing substantial loss or leakage of revenue.

3. The Law Commission would like to place on record, the valuable suggestions given by Shri M.R. Venkatesh, Chartered Accountant and Shri Arvind Modi, Chief Commissioner of Income Tax, New Delhi, on the subject under examination.

4. A report titled "**Prospects of Exempting Income arising out of Maintenance Money of 'Minor' "**" is placed for consideration of the Government.

Yours sincerely

With warmest regards,

B.S. Chauhan.

[Dr. Justice B.S. Chauhan]

Shri Ravi Shankar Prasad

Hon'ble Minister for Law and Justice

Government of India

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Prospects of Exempting Income arising out of Maintenance Money of ‘Minor’

1. Reference to the Commission

The Punjab and Haryana High Court, while dealing with the case ***Payal Mehta v. Sanjay Sarin***,¹ referred the matter to the Law Commission of India for consideration as to whether the provisions of section 64(1A) of the Income Tax Act, 1961 (hereinafter called the Act, 1961) require an amendment to provide for exemption from clubbing of minor's income accruing by way of interest on the amount deposited by one of the parents of the minor child as maintenance, at the hands of the other parent / guardian under an order of the Court. The plea taken in this case is that the interest on the amount of maintenance deposited in the name of minor child should not be subjected to tax, i.e., such income be not clubbed with the income of either of the parent for the purpose of imposing the tax.

2. Revisiting the provisions of the Income Tax Act, 1961

2.1 Section 64 (1A) of the Act, 1961 reads as under:

(1A) In computing the total income of any individual, there shall be included all such income as arises or accrues to his minor child, not being a minor child suffering from any disability of the nature specified in section 80U:

Provided that nothing contained in this sub-section shall apply in respect of such income as arises or accrues to the minor child on account of any—

- (a) manual work done by him ; or
- (b) activity involving application of his skill, talent or specialised knowledge and experience.

¹ 2016 SCC online P&H 4989, *vide* its judgment and order dated 27.01.2016.

Explanation.—For the purposes of this sub-section, the income of the minor child shall be included,—

(a) where the marriage of his parents subsists, in the income of that parent whose total income (excluding the income includible under this sub-section) is greater; or

(b) where the marriage of his parents does not subsist, in the income of that parent who maintains the minor child in the previous year, and where any such income is once included in the total income of either parent, any such income arising in any succeeding year shall not be included in the total income of the other parent, unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary so to do.

2.2 In this regard two other relevant provisions of the Act, 1961 also deserved to be considered:

- (i) As to deduction:- Under section 10(32) of the Act, 1961, the parents in whose hands the minor's income is clubbed is entitled to an exemption up to Rs. 1500/- per child.
- (ii) As to transfer of property: Under section 27 of the Act, 1961, income out of property transferred for no consideration to a minor married daughter.

2.3 The provisions of the Act, 1961 do not allow exemption to clubbing of income of the minor in the form of interest on maintenance amount, to one of the parent's income. Therefore, the High Court observed as under:

It was opinion of the court that the exception should also be created in such cases where the maintenance is provided for the minor children.

In the opinion of the court, the circumstances of the minor having received maintenance money are different from say a minor in whose name some business has been started by either of the parent or who has been advanced some gift during the subsistence of marriage of parents. Therefore, an exception against clubbing of income from maintenance money is a desirable thing, in case of minor children residing with a single parent.

2.4 The Court also suggested insertion of a clause providing for exemption in such a situation, as a proviso to section 64(1A) of the Act, 1961.

3. Interpretation of Taxation Laws

It is not possible to interpret the provisions of s. 64(1A) of the Act, 1961 in any other manner as the language used therein is neither ambiguous nor open to two interpretations. In interpretation of fiscal statutes, equitable considerations are not relevant at all. More so, logic or reason cannot be of much avail in interpreting the taxing statute. None of the parties, i.e., the assessee or the revenue, can plead or rely on equity or hardships. Thus, nothing can be read in or implied therein, nor there can be any subtraction. Only a fair look at the language used therein is required. Considerations of anomalies or injustice do not play any useful role in construing taxing statutes unless there is some real ambiguity. Fiscal statutes cannot be considered on any presumptions or assumptions and it cannot imply anything which is not expressed nor can any assumed deficiency be supplied.²

4. Legislative history of section 64 of the Act, 1961

4.1 The purpose of enacting section 64(1A) was to design a mechanism to overtake and circumvent the tendency of the assesses to avoid or reduce tax liability by entering into settlements or

² *The Express Mill Nagpur v. Municipal Committee Wardha*, AIR 1958 SC 341; *CIT v. Karamchand Premchand Ltd*, AIR 1960 SC 1175; *Board of Revenue, Uttar Pradesh v. Rai Saheb Sidhnath Mehrotra*, AIR 1965 SC 1092; *Commissioner of Income-tax, West Bengal I, Calcutta v. Central India Industries Ltd.*, AIR 1972 SC 397; *Collector of Estate Duty v. R. Kanakasabai*, AIR 1973 SC 1214; *Diwan Brothers v. Central Bank of India, Bombay*, AIR 1976 SC 1503; *State Bank of Travancore v. Commissioner of Income Tax*, AIR 1986 SC 757; *Petron Engineering Construction Pvt. Ltd. v. Central Board of Direct Taxes*, AIR 1989 SC 501; *Commissioner of Income-tax v. Gwalior Rayon Silk Manufacturing Company Ltd.*, AIR 1992 SC 1782; *Kapil Mohan v. Commissioner of Income-tax, Delhi*, AIR 1999 SC 573; *Indure Ltd. v. Commercial Tax Officer*, (2010) 9 SCC 461; and *Bansal Wire Industries Ltd. v. State of U.P.*, (2011) 6 SCC 545.

transferring the properties in such a way that he could retain the control over or interest in the same or its income, but it may reduce the tax liability.³ Such transfers were purposely made in favour of the member of the family who was ordinarily under the protection of the assessee or was dependent on him.⁴

4.2 The constitutional validity of section 64(1A) of the Act 1961 was upheld by the Madras High Court in *K.M. Vijayan & Ors. v. Union Of India & Ors.*⁵ The legislative history of section 64(1A) has been detailed by the Court as under:

The Finance Bill, 1992, (38 of 1992), was introduced in the Lok Sabha and the same was enacted by Parliament with effect from April 1, 1993. In terms of section 35(b) of the said Finance Act, amendments were introduced in the Income-tax Act, whereby sub-section (1A) to section 64 was introduced, which reads as under:

(1A)

It remains to be seen that section 16 of the 1922 Act and section 64 of the 1961 Act were enacted to prevent avoidance of tax through transfer of assets directly or indirectly. Section 64(1A) includes income of the minor child irrespective of its source, in the hands of the parent having the larger income. The proviso carves out two exceptions to this case. The earlier provisions relating to clubbing were held to be valid by the Supreme Court and various other High Courts. The provisions of section 16(3)(a)(i) and (ii) of the Act which were corresponding to unamended section 64(1)(i) and (ii) of the Act of 1961 were held to be valid and not in violation of articles 14 and 19(1)(b) of the Constitution of India as can be seen from the decision of the Supreme Court in *Balaji v. ITO*, (1961) 43 ITR 393 (SC). The provisions of section 16(3)(a)(iv) of the 1922 Act corresponding to the unamended section 64(1)(iv) of the 1961 Act were held to be valid and not in contravention of article 14 of the Constitution as can be seen from *G. K. Devarajulu Naidu v. CIT*, (1963) 48 ITR 756 (Mad.) The unamended section 64(1)(i) and (ii) did not violate

³*Tulsidas Kalichand v. CIT*, (1961) 42 ITR 1 (SC).

⁴*Balaji v. ITO.*, (1961) 43 ITR 393 (SC).

⁵(1995) 215 ITR 371.

articles 14 and 19(1)(b) and (g) of the Constitution of India as can be seen from the decisions in *Smt. Shreekunwardevi Daga v. L. G. Trivedi*, ITO, (1972) 85 ITR 451; and *Smt. Savitri Devi v. CIT*, (1974) Tax LR 74 (All). Section 64(1)(iii) as substituted with effect from April 1, 1976, providing for clubbing of income of a minor who was admitted to the benefits of a partnership firm was held to be valid as can be seen from the decision in *K. Krishnaveni v. AAC* (1985) 151 ITR 83 (Mad.).

4.3 It can be seen that while introducing the Finance Bill (38 of 1992) in Parliament, the Finance Minister in his speech stated as under:⁶

It is said that the child is the father of man, but some of our taxpayers have converted children into tax shelters for their fathers. The tax law provides for clubbing of income from gifts given by parents but this does not apply to other income, including income from other gifted assets, and the practice of cross-gifting is widely used to evade clubbing. The Chelliah Committee has recommended that in order to plug this loophole, which accounts for a substantial leakage of revenue, the income of a minor child should be clubbed with that of the parent. There is merit in this suggestion and I propose to accept it. Recognising, however, the existence of a number of child prodigies, especially child artistes in our country, I propose to exclude their professional income, as also any wage income of minors, from the purview of such clubbing. The practice of clubbing the income of minor children with that of the parent for tax purposes is in vogue in a number of countries.

5. Report of Dr. Raja J. Chelliah Committee

The interim report on Tax Reforms for December, 1991, submitted by Dr. Raja J. Chelliah Committee⁷ reads as under:

⁶See: [1992] 194 ITR 17.

⁷ At para 6.38 of the Report.

At present, in India the income of the minor admitted to the benefits of any partnership is included in the income of the parent, irrespective of whether or not either parent is a partner in the same firm. Further, any income accruing to a minor from any asset transferred to him by the parents or the grandparents is included in the income of the parent or grandparent who has transferred such income-generating asset. However, in respect of all other income accruing to him, the minor is a separate taxable entity. Keeping in view the rationale for aggregation of the minor's income with that of the parents, the Committee recommends that -

- (a) All incomes of a minor, other than wage income, should be aggregated with the total income of –
 - (i) the parent having the higher income, where the total income of one parent or of both the parents happens to fall below the exemption limit for individuals;
 - (ii) any one of the parents at the option of the parents where the income of both the parents exceeds the exemption limit; and
 - (iii) if over time the income of the parent, with whom the income of the minor was aggregated earlier, goes below the exemption limit, the parent having the higher income.
- (b) It follows that the income of the minor arising from assets transferred to him or her by any one including his grandparents should be aggregated with the income of the parent as recommended above.

6. Transfer of Assets

6.1 In case of transfer of assets, whatever may be its nature and whatever may be its mode of transfer, the transfer is generally intentional and by free will.

6.2 The indirect transfer, by its very nature, would involve more than one transaction with an ultimate object being, to give effect to original intention of transferring assets by an individual to his or her spouse or minor child.⁸

7. The Finance Act, 2012

The word 'transfer' has been defined under section 2(47) of the Act 1961. Explanation II thereof was inserted by the Finance Act 2012 (w.e.f. 1.4.1962). It defines the term transfer so as to include and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in an asset, in any manner whatsoever directly or indirectly, absolutely or conditionally, **voluntarily or involuntarily**, by way of agreement (whether entered into in India or outside India), or otherwise notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

8. Nature of Custody and Maintenance Order

It would be worth mentioning that the issue of custody of the child and determination of the amount of his / her maintenance are of temporary nature. Both these issues are decided taking into consideration the welfare and interest of the child and not the right of either of the parent under any statute. Each case has to be decided on its own facts and welfare of the child is of paramount importance. The issue of *res judicata* is unknown in such cases as the order of

⁸See: *D M Naterwala v. CIT*, (1979) 120 ITR 848 (Bombay).

custody as well as the amount of maintenance can be varied by the court at any stage on application by either of the parents/parties.⁹

9. Arguments for seeking the exemption

The arguments which such an assessee could advance would be that the amount had been put in fixed deposit by the other spouse on the direction of the court. Thus, the said spouse had acted under legal compulsion and not under free will. The assessee had not made any transfer or deposit in favour of such minor, rather he or she is bound by the order of the court. Being the guardian, the assessee cannot use or derive any benefit from the income or part thereof for the reason that such deposit had been made for the welfare of the child as per the direction of the Court. It requires to be treated like the self-earned income of the minor, which is not to be clubbed with the income of either of the parents at par with the provisos(a) and (b) to section 64(1A) of the Act, 1961. The addition of any income arising out of maintenance money provided for the minor in such cases would adversely affect the parent/ guardian. If the income of the minor is clubbed with the income of parent/ guardian then, the tax liability will stand enhanced. Therefore, minor's income from the maintenance amount should not be clubbed with the income of the parent/ guardian.

10. Arguments for not granting exemption

10.1 The Explanation to section 64(1)A of the Income Tax Act provides for clubbing the income of the minor with the income of the guardian under both situations- when the marriage of the parents subsists and also when it does not subsist. The High Court made the reference considering the circumstances where deposit for maintenance is entirely different from transfer of assets by

⁹ See: *Rosy Jacob v. Jacob A. Chakramakkal*, AIR 1973 SC 2090; *Dr. Ashish Ranjan v. Dr. Anupama Tandon*, (2010) 14 SCC 274; *Athar Hussain v. Syed Siraj Ahmed*, AIR 2010 SC 1417; and *Shilpa Aggarwal v. Aviral Mittal*, (2010) 1 SCC 591.

parents or grandparents or starting some business in the name of minor by either of the parents or who has been given some gifts when marriage of the parents subsists. The reference has been made on principles of equity and justice which have no application in determination of tax liability. If the exemption from clubbing of income from maintenance money is granted following marital discord, based on such considerations, the same should apply to all other genuine cases. Assets are generally placed in the hands of the minor for securing the minor's future. It is true that human ingenuity has in many cases, resulted in transfer of assets to minors or spouses for the sole purpose of tax avoidance. Very frequently the grand parents of minor children place substantial assets in their name for a variety of reasons such as love and affection, absence of financial discipline on the part of parents where they may not be capable of protecting family properties and other assets. Making a minor entitled to benefits of partnership may also be dictated by such circumstances.

- 10.2 The High Court seems to have failed in appreciating the statutory requirement according to which the liability of paying tax seems to be of the father in view of the provisions of section 64(1A) of Act, 1961. Even otherwise the money deposited under the order of the Court by the father would have remained with him along with the liability to pay tax on income from such money if it had not been so deposited in the name of the minor. The word used therein by the legislature in its wisdom is 'maintain', that means the allowance covering the basic cost of maintaining a child or providing with necessities for life or existence and it also means to "sustain", "support", and to "bear" or "to pay or furnish the means of keeping up of". There is a distinction between having the custody of the child and liability to maintain him / her.¹⁰

¹⁰ See: Shorter Oxford English Dictionary; Section 3(b) of the Hindu Adoption and Maintenance Act, 1956; and *State of Bihar v. Mangal Sao*, AIR 1963 SC 445.

In view thereof as the father had paid the money for maintaining the child, the mother could have taken a plea that income of interest on maintenance money could be clubbed with income of the father and no cause of action could have arisen for her.

10.3 The Supreme Court in *Balaji (Supra)* dealt with the issue of classification in such cases under article 14 of the Constitution and held:

It was then said that there might be genuine partnerships between an individual and his wife and, therefore, there is no reasonable relation between the classification and the object sought to be achieved, at any rate to the extent of those genuine cases. But there is no classification between genuine and non-genuine cases the classification is between cases of partnership between husband, wife and/or minor children, whether genuine or not', and partnership between others. In demarcating a group, the net was cast a little wider, but it was necessary, as any further sub-classification as genuine and non-genuine partnerships may defeat the purpose of the Act.

10.4 In the context of clubbing the income of minor child from partnership, the Court explained as follows:

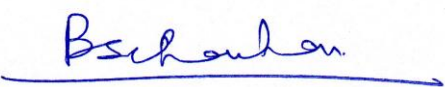
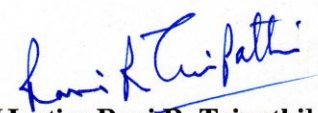
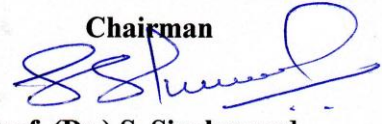
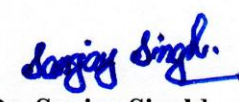
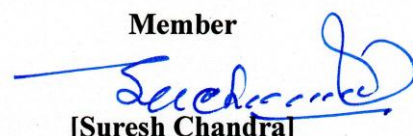

It may be that a father or a husband may have to pay tax at a higher rate than ordinarily he would have to pay if the addition of the wife's or children's income to his own brings his total income to a higher slab. But it may not necessarily be so in a case where the income of the former is not appreciable; even if it is appreciable, he can debit a part of the excess payment to his wife and children. In short, the firm, though registered, would be treated as a distinct unit of assessment, with the difference that, unlike in the case of a registered firm, the entire income of the unit is added to the personal income of the father or the husband as the case may be. *This mode of taxation may be a little hard on a husband or a father in the case of genuine partnership with wife or minor children but that is offset, to a large extent by the beneficial results that flow therefrom to the public, namely*

the Prevention of Evasion of Income Tax, and also be the fact that, by and large, the addition payment of tax made on the income of the wife or the minor children will ultimately be borne by them in the final accounting between them. (Emphasis supplied)

10.5 The aspect of equity or fairness has been addressed by the Supreme Court in the above mentioned cases. The guardian/parent can meet the tax liability directly from the income accruing to the minor without having to look for other sources.

11. Recommendations

The Commission is of the view that income earned by way of interest on the amount of maintenance deposited in favour of the child does not require to be exempted from being clubbed with the income of the parent/ guardian; as such exemption, if granted, would open flood gates of tax evasion and would defeat the very object of inserting the provisions of section 64(1A), which had been brought to plug-in the loopholes to prevent the avoidance of tax, causing substantial loss or leakage of revenue.

		
[Justice Dr. B.S. Chauhan]		
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[Justice Ravi R. Tripathi]	[Prof. (Dr.) S. Sivakumar]	[Dr. Sanjay Singh]
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