S. 56(2)(x) - BURNING ISSUES

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Recap

Gift Tax Act to S. 56(2)(v)
To…
S.56(2)(vi)
S. 56(2)(vii)
S. 56(2)(viia)
And finally, S.56(2)(x)……

Is it for taxing gifts? S.

Consideration – Meaning

Section 2(d) of the Indian Contract Act, 1872:

"When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise…."

Definition of gift under Gift Tax Act, 1958

U/s. 2(xii) of the GTA :

"Gift means the transfer by one person to another of any existing movable or immovable property made voluntarily and without consideration in money or money's worth, and includes the transfer or conversion of any property referred to in section 4, deemed to be a gift under that section."

Absence of money or money's worth!

Does the absence of words 'in money or money's worth' make a difference?

Whether 'Consideration' in sub-clause (a) to have the same meaning as in sub-clause (b) item(B) or sub-clause(c) item B –

Item (B) of sub-clause (b) & (c) require a comparison & hence it will fail mathematically if a wider meaning of 'Consideration' is adopted.

Valuable consideration is the answer – valuable in eyes of law.

E.g. *Bittan Bibi v. Kunnu Lal AIR 1952 All. 996 (FB)*

Forbearance to sue at the request of debtor is a valid consideration.

Aggregation

- Whether a set-off is permissible? Eg. Shares of several companies are purchased

	Consideration	FMV
A	2,00,000/-	2,40,000/-
B	2,00,000/-	1,60,000/-
C	2,00,000/-	2,30,000/-
Total	**6,00,000/-**	**6,30,000/-**

- Whether B to be ignored and A & C be taxed at Rs. 70,000/-? Or aggregate FMV of Rs.6.30 lacs to be seen vis a vis aggregate Consideration of Rs. 6 lacs so that the difference is below Rs. 50000?
- Language suggests comparison with aggregate FMV.

Subject matter of receipt

Immovable property → Land & Building or both

Shares & securities → Whether definition of ‘securities’ in the valuation Rules can be taken?

But in the absence of a definition in the Act, can the delegated legislation define a term which shall affect the very chargeability of a transaction?

Delhi High Court, in case of Chamber of Tax Consultants v. Union of India [2018] 400 ITR 178, observed that *"To elaborate, if the power to notify standards has to be exercised consistent with the recognised ASs that do not contradict any principle recognized in the Act or as explained in judicial precedents, it would be a permissible exercise of the delegated power of notifying ASs."*

Therefore, while exercising delegated legislative power, the executive must not legislate something which is in contradiction of any provisions of the Act.

Rule 11U defines terms and expression used in Rule 11UA while laying down methods for valuation. Rule 11U, while defining such terms/expressions, went to define ‘securities’ which is defined as ‘property’ in the Statute.

Since the intention of section 56(2)(x) is to deter understatement on sale of certain properties, the term 'securities' defined by the Rules does not contradict provisions of the statute.

Even Companies Act defines 'securities' under section 2(81) as *"securities as defined in clause (h) of section 2 of the Securities Contracts(Regulation) Act, 1956"*.

Therefore, had the said term not been defined in the Rules, one would certainly refer to Securities Contracts (Regulations) Act, 1956 to look for meaning of the term.

Even Companies Act defines 'securities' under section 2(81) as *"securities as defined in clause (h) of section 2 of the Securities Contracts(Regulation) Act, 1956"*. Therefore, had the said term not been defined in the Rules, one would certainly refer to Securities Contracts (Regulations) Act, 1956 to look for meaning of the term.

If the property received is stock-in-trade, can it be argued that it is not covered by sec 56(2)(x)? If yes, will it be chargeable u/s 28 as business income?

In a recent Tribunal decision, *ITO v. Trilok Chand Sain [2019] 101 taxmann.com 391 (Jaipur - Trib.)*, it was held that agricultural lands fall under definition of an immovable property, hence, covered under ambit of section 56(2)(vii)(b), it is immaterial whether they fall under definition of capital asset or stock-in-trade.
With due respect, the decision does not seem to be a correct proposition as it ignores the express language of Clause (d) of the Explanation to clause (vii) of sec 56(2), without any discussion on the same.

Can a property be received without consideration – as stock in trade?

If the transaction has any nexus with the business of the assessee, it can be received as stock in trade. In that case, the receipt may be chargeable u/s 28(i) or 28(iv).
If the transaction has no nexus with the business of the assessee, it can not be received as stock in trade. It is received as capital asset and the assessee may use it as stock in trade.
In view of section 56(2)(x) firstly the market value will be taxable as income.

Will it be allowed as a business deduction? Section 49(4) applies only in case of capital assets.

The answer can be traced in **CIT v. Groz-Beckert Saboo Ltd [1979] 116 ITR 125 (SC)**, where market value of raw material received as gift was allowed as a deduction while computing business income.

Can receipt of a deposit receipt convertible into money be considered as receipt of money?

Looking into the entire scheme of s. 56(2)(x) where, in addition to money, certain properties are also brought in tax net, the answers seems to be no. In Asstt. CIT v. Anuj Agarwal [2010]3Taxmann.com 46 (Mum.-ITAT), it was held that gift of Indian Millennium Deposit Certificate issued by SBI along with gift deed is not receipt of sum of money.

It does not even fall in the definition of securities under SCRA and hence it is outside the scope of section 56(2)(x).

Can provisions of section 56(2)(x) apply in case of interest free loans received by an assessee?

The intention of inserting these provisions explained elaborately in the paper.
Mumbai ITAT, in case of Chandrakant H. Shah v. ITO [2009] 28 SOT 315, held that *"we are of the view that this provision applies to the transactions where undisclosed/unaccounted income of a person is brought in his hand by way of purported gifts. Accordingly, the* ***loan transaction is not covered under this section*** *and, therefore, we delete this addition*

”. Delhi High Court in the case of CIT v. Mridu Hari Dalmia [1982] 133 ITR 550, observed meaning of loan as *“A transaction of a loan implies an agreement to repay the money that is borrowed”*. Hence, there is an inherent obligation to repay when a person takes a ‘loan’.

Kerala High Court in the case of CGT v. Smt. K. Nagammal [1997] 226 ITR 598, held that *"consideration" is that which creates a contractual relationship between the promisor and promisee in regard to the performance of promise and in regard to which the parties to the agreement or contract get related to each other.”*

By taking a cue from the aforesaid observation of the Hon'bleKerela High Court, the Mumbai Tribunal in Chandrakant H. Shah's case held that *"repayment obligation of the assessee by-itself a consideration for granting of loan."*

This decision has been upheld by the Hon'ble Bombay High Court, while dismissing Department's appeal at the admission stage.(ITA No. 3154 of 2009)
Also, HC of P & H in CIT v. Saranapal Singh (HUF) (2011) 237 CTR 50, held that loan transactions are not covered by section 56(2).

Can provisions of section 56(2)(x) apply even if there is no actual receipt by the assessee during the year but only a waiver of loan received in earlier year?

Remission of liability is a constructive receipt during the year in as much as it is received on own account, while earlier (at the time of receipt of loan -15 years back) 'receipt' was that by way of incurring a liability, only for being paid back and, as such, not without consideration. The second receipt, however, is without consideration. Hence, taxable u/s. 56(2)(vi) - Panna S. Khatau v. ITO [2015] 154 ITD 790 (Mumbai - Trib.).

However, section 4(1)(c) of Gift Tax Act provided for deeming a gift made by the person who was responsible for the release, discharge, surrender, forfeiture or abandonment of any debt, contract or actionable claim or of any interest in property by any person without bona fide reasons to the extent of value of such release, discharge, surrender, forfeiture or abandonment.

No such kind of situations have been prescribed under section 56(2)(x) of the Act.

Being a charging provision, it needs to be strictly construed.

In **Commissioner of Income-tax *v.* Kasturi & Sons Ltd. [1999] 103 Taxman 342 (SC)** it was held that- Wherever the Legislature intended to refer to payment in kind other than cash or money, it has taken care to provide specifically there for.

Hence, it may be strongly argued that a constructive receipt is outside the scope of section 56(2)(x).

When can an immovable property be considered to have been 'received'? Whether at the time of issue of allotment letter by builder or at the time of registration of sale deed or at the time of handing over of possession?

In the context of capital gains there are a series of decisions which say that an allottee gets title to property on issuance of an allotment letter and payment of installments is only a consequential action upon which delivery of possession flows. However, here the context is different.
When can a thing be said to be received? Undoubtedly, without conferring absolute title on a person, he can not be said to have received it. Title gets conferred only on registration.

The following extracts from the Explanatory Memorandum to the Finance Bill, 2010 may be noted "In several cases of immovable property transactions, there is a time gap between the booking of a property and **the receipt of such property on registration,** which results in a taxable differential. It is, therefore, proposed to amend clause (vii) of section 56(2) so as to provide that it would apply only if the immovable property is received without any consideration and to remove the stipulation regarding transactions involving cases of inadequate consideration in respect of immovable property."

The above extracts of the Explanatory Memorandum seem to suggest that the date of receipt of immovable property is to be regarded as the date of its registration and not the date of receipt of its possession.

However, looking further into the context of taxability, possession is also an important factor and a person can not be said to have received a property without actual possession. **The invariable conclusion is an immovable property can be said to have been received only when both the acts – receipt of possession and conferring of title – are competed.**

When does a person receives shares? At the time of allotment or at the time of receipt of share certificate or credit in Demat account?

On the same analogy, shares can be said to have been received only on receipt **of share certificate or credit in Demat account.**
In *Sudhir Menon HUF v. ACIT [2014] 148 ITD 260, Mumbai - Tribunal* held that the shares are said to be received on their allotment.

However, with respect, it appears to be an over simplistic view.

Section 46(1) and section 46(4) of the Companies Act, 2013 explicitly provides that the share certificate issued (for shares issued physically) or record of the depository (for shares held in dematerialized form) shall be prima facie evidence of the title of the person to such shares.

Upon allotment, the recipient gets right to have title of shares in his name. However, the section triggers taxability only in the year in which the assessee 'receives' the property.

Hence, date of share certificate or date of credit in depository would be the relevant date of receipt of shares.

Is there any chargeability u/s 56 on issue of bonus shares or rights shares? What would be the consideration in case of issue of rights shares and bonus shares?

Disproportionate rights issue theory in *Sudhir Menon HUF v. ACIT [2014] 148 ITD 260(Mum)*, with respect, travels on the circumference not going to the root of the provision. Undoubtedly, the provision is introduced to counter money laundering and bogus capital building and to bring back the gift tax regime only in a new form keeping the same substance. In the context of GTA, **Supreme Court in Khoday Distilleries Ltd. vs CIT and Anr. [(2008) 307 ITR 312] held that 'allotment of shares' does not involve transfer.**

Can there be a receipt without a transfer?
Allotment creates a share. When a mother gives birth to a child, do we receive the child from her?

Circular No. 10/2018 dated 31st December 2018, though withdrawn subsequently, also answers the question.
To strike a balance, we may say that where, however a case of bogus capital building via rights issue is established by the revenue, the disproportionate rights issue theory may be upheld. But where there is no such proof of manipulations, a mere disproportionate rights issue should not trigger the provision of sec. 56(2)(x).

Valuation of Property:

Valuation of bullion? Rule 11UA is silent on valuation of bullion.

Explanation to clause (vii) of section 56(2) defines "fair market value" of property as the value determined in accordance with the method as may be prescribed.

Supreme Court, in the case of *Chandra Kishore Jha v. Mahavir Prasad [1999] 8 SCC 266*, laid down that if a statute provides for a thing to be done in a particular manner, then it has to be done in that manner and in no other manner. This proposition has been earlier laid down by Hon'ble Apex Court in the case of *State of Uttar Pradesh v. Singhara Singh AIR 1964 SC 358.*

The statute provided for determination of the value of bullion as per the method prescribed. In absence of the said method, the bullions cannot be made taxable.
Also see Mathura Agrawal v. State of M.P., (1999) 8 SCC 667 and
Govind Saran Ganga Saran v. CST, 1985 Supp SCC 205

Section 49(4) provides for taking the FMV taken u/s 56(2)(x) as the cost of acquisition.
How to determine the period of holding of such assets and from which year to claim indexation?

The provisions of Expln. 1 to section 2(42A) only say – in the circumstances mentioned in section 49(1).
Hence even if cost is determined u/s 49(4), still the capital asset is acquired by one of the circumstances mentioned in section 49(1) and hence the period of holding of donor may also be included.
An argument perhaps worth trying.

Exceptions:

(I) Receipt from any 'relative':

What about live in relationships?

a. Radhika v. State of M.P. [AIR 1966 MP 134 (SC)]
b. Chellamma v. Tillamma [AIR 2004 SC 212]
c. Madan Mohan Singh and Ors. v. Rajni Kant and Anr [Civil appeal no. 6466 of 2004]

In case of adopted son or daughter, the relationship needs to be seen from the adoptive lineage or from the biological lineage?

In India, Hindus, Sikhs, Buddhists and Jains can adopt a child under the Hindu Adoption and Maintenance Act, 1956. Section 12 of that Act provides that – *"from the date of the adoption and from such date all the ties of the child in the family of his or her birth shall be deemed to be severed and replaced by those created by the adoption in the adoptive family."*

In case of other religions, similar provision is found in section 63 of Juvenile Justice (Care & Protection of Children) Act, 2015.

To apply exception to section 56(2)(x), relations with the persons defined as ‘relatives’ should be subsisting at the time of the receipt of the gift. Hence, after adoption, relations with only adoptive family is to be seen and not with genetic or biological family.

Group of Relatives:

Can it be said that it does not make any difference if the money is received from a single relative or from a group of relatives. E.g. can we say that Gift received by member from HUF taxable?

Looking at the object of the provision, this should not make a difference whether it is received from one or from a group of relatives.

In *Vineetkumar Raghavjibhai Bhalodia vs. ITO, [2011] 46 SOT 97*, the Rajkot Tribunal held that though the definition of the term "relative" does not specifically include a Hindu Undivided Family, a 'HUF" constitutes all persons lineally descended from a common ancestor and includes their mothers, wives or widows and unmarried daughters. As all these persons fall in the definition of "relative", an HUF is 'a group of relatives'. As a gift from a "relative" is exempt, a gift from a 'group of relatives' is also exempt since the singular will include the plural.

Above decision was followed also in *DCIT Vs Ateev V. Gala (ITAT Mumbai) ITA NO.1906/Mum/2014*.

In *Kumar Pappu Singh v. DCIT [2019] 101 taxmann.com 122*, the assessee received rights shares in excess of the proportionate ratio for consideration less than fair market value from a company in which all the shareholders were his close relatives, each of them fell in the definition of 'relative'. The Visakhapatnam ITAT, considering the provisions as anti abuse measure, held that surrender of the rights of the close relatives in favour of another close relative is covered for exemption under section 56(2)(vii)(c).

However, contrary view can be found *in Gyanchand M. Bardia v. ITO [2018] 93 taxmann.com 144 (Ahmedabad - Trib.).*

Does exception of gift from relatives, apply only to Individuals & HUFs or can it be extended to all persons? If yes, how to interpret the term 'relative' in relation to persons other than Individuals and HUFs?

Firstly, since the term 'relative' is defined only in relation to individual & HUFs, it appears that such benefit was intended only for them.

Secondly, In case of other entities, wherever, exemption was to be provided, it is separately given in other clauses of the proviso – e.g. receipt from a wholly owned subsidiary.

A question arose in the case of CIT v. Britannia Indus. Ltd. [2006] 280 ITR 525 (Cal.) wherein it was argued by the department that relationship should be looked into from the perspective of individual office-bearers of the assessee. HC observed that S. 2(41) defines the term relative in relation to an individual. Therefore, it cannot be applied to a corporate body or partnership firm as it cannot have husband, wife or lineal ascendant etc. Hence the firm consisting of the relatives of the directors of the assessee company can, by no stretch of imagination, be said to be a relatives of the assessee company.

(III)Under a will or inheritance

A question arises-if an individual receives any shares or money covered by a fixed deposit by virtue of being a nominee will these receipts be exempt?

Settled proposition that nomination does not override succession laws. Nominee only receive the said sum/property in capacity as that of ‘trustee’.
[Shakti Yezdani v. Jayanand Jayant Salgaonkar [2017] 136 CLA 119 (Bom)]
However, if there are no adverse claims he may be entitled to it absolutely. This is nothing but inheritance in some other form.

(IV) In contemplation of death of payer or donor

Section 56(2) doesn't refer to Indian Succession Act for meaning of the term 'in contemplation of death'. Hence, can it be inferred that the legislature intended to allow receipt of immovable property into the exception?

Chennai Tribunal in *F. Susai Raju v. ITO [2017] 163 ITD 533*, to interpret the expression 'in contemplation of death', referred to section 191 of Indian Succession Act and followed the conditions laid down therein. Hence, if definition in section 191 is held to be applied in section 56(2)(x) to give meaning to the expression 'in contemplation of death', transfer of immovable property would not fall within ambit of this exception.

Further, as per TOPA a transfer of immovable property can be effected only by a registered instrument. Hence, an immovable property can not be transferred by mere delivery on death bed.

(VII) Implications of the words "by a trust or institution registered u/s 12A or u/s 12AA" in clause (VII) to the proviso to sec 56(2)(x)?

Does it mean that even without fulfilling the condition of sec 11, receipts by a trust or institution registered u/s 12A or 12AA gets exempted by virtue of clause (VII) of the proviso?

In case, exemption is denied u/s. 11, the income of assessee is required to be computed under general provisions of Income-tax Act. *[Ajay G. Piramal Foundation v. ADIT (2014) 31 ITR(T) 226 (Delhi - Trib.)].*

Receipts of donations, etc. would fall in the residuary head of income and would be dealt with by provisions of section 56(2)(x).

On a literal interpretation it will exempt the entire donations received by a trust.

This will render the provisions of section 12 otiose. An interpretation which renders any provision in the enactment otiose, is to be avoided.

Shri Balaganesan Metals vs Ors [1987 AIR 1668, 1987 SCR (2)1173]
Akbar Badruddin Jiwani vs Collector of Customs [1990 AIR 1579, 1990 SCR(1) 369]
Hence, it may be interpreted in a reverse way that it is out of abundant caution that even if a trust fulfills the conditions of section 11, its income may not be made taxable u/s 56(2)(x). This is because, now the clause applies to all category of persons, not limited only to individuals and HUFs.

Can the recipient also claim exclusion under clause (VII) of the proviso for receipts prior to the date of application for registration or will he be eligible for exclusion only for receipts after the date of registration of trust?

Looking at the intention behind the provision such a literal interpretation to be avoided and entire receipts in the year of registration (irrespective of the date) should be eligible for exclusion.

What if a person receives financial assistance from friends, well wishers etc. (non relatives) for some need like medical or educational needs and he spends the same for that purpose?
Case of money laundering?
Case of bogus capital building?
Addition to wealth of recipient?

If no, there can not be any taxability.
[See also the discussion in the next issue.]

Clause (IX) does not refer to all the clauses of sec 47. What will be the implications of sec 56(2)(x) in the hands of transferee where the mode of transfer is covered by sec 47 & hence not liable to Capital Gain tax in the hands of the transferor, but is not included in clause (IX) of proviso to sec 56(2)(x)?
Eg. Assets received by an LLP from a company where all the conditions of sec 47(xiiib) are fulfilled?

Mumbai Tribunal in *Chandrakant H. Shah v. ITO [2009] 28 SOT 315* observed that "In the end, it can be said that several commercial considerations prevail in the business world for entering into business transactions of various types and if the revenue authorities tax such transactions in this manner, then the conduct of business would become impossible".

This decision has been upheld by the **Hon'ble Bombay High Court, while dismissing Department's appeal at the admission stage.(ITA No. 3154 of 2009)**

Proviso providing for exceptions need not be exhaustive. A proviso has four functions, as has been noticed by Supreme Court in *S. Sundaram Pillai v. V.R. Pattabiraman, [(1985) 1 SCC 591* in the following terms:

"(1) qualifying or excepting certain provisions from the main enactment;

(2) it may entirely change the very concept of the intendment of the enactment by insisting on certain mandatory conditions to be fulfilled in order to make the enactment workable;

(3) it may be so embedded in the Act itself as to become an integral part of the enactment and thus acquire the tenor and colour of the substantive enactment itself; and

(4) ***it may be used merely to act as an optional addenda to the enactment with the sole object of explaining the real intendment of the statutory provision.***”

The Mimansa Principle of Interpretation :

How to interpret the sentence
“Kakebhyo Dadhi Rakshitam” (Protect the curds from the crow).

Does it mean the curds should be protected from crows but should be allowed to be eaten by dogs, cats, etc? The word 'crow’ is only used in an illustrative sense here.

Hence all genuine business restructuring cases are outside the ambit of section 56(2)(x).

(X)"from an individual by a trust created or established solely for the benefit of relative of the individual"

In this case, the donee (beneficiary) should be the relative of the donor, whereas in clause (I), the donor should be the relative of the donee. Practical difficulty may arise, where one of the beneficiary is relative of the donor but the other is not!

Does the assessee need to fulfill ICG (Identity – creditworthiness – genuineness) test in case of amounts claimed to have been received as gifts? Can there be any taxability u/s 68, which in turn will invite sec 115BBE? Or is it possible for a person to launder his illegal income like bribe etc. by showing gifts under section 56(2)(x) and paying tax thereon?

Intention behind section 68?
Intention behind section 56(2)?
Even 56(2)(x) provides – receives from any person or persons…
If ICG failed – section 68.
Even if ICG passed – if without consideration –s. 56(2)(x)

Laundering illegal income in the guise of 56(2)?

State of Madhya Pradesh v. Awadh Kishore Gupta (Date of judgement : 18-11-2003)(Appeal (Crl.) 292 of 1997) [(2004) 1 SCC 691, 697]

(See K. Ponnuswamy v. State of Tamil Nadu Inspector of Police – Appeal (Crl.) No. 759 of 2001 – judgement dated 31-7-2001) [(2001) 6 SCC 674]

Is there an element of double taxation in application of section 56(2)(x) in the hands of buyer and application of section 50C or 50CA in the hands of the seller? Is section 49(4) an answer?

Buyer and seller are two different persons.
Inference of 50C or 50CA – cash received but not accounted for.
Inference of 56(2)(x)-cash paid but not accounted for.
Where is double taxation?

What if personal obligation of one person is met by another person - Applicability of Section 56(2)(x)?

It is a case of constructive receipt.

Is buyback of shares at less than FMV taxable in the hands of the company undertaking the buyback?

Sub-section (7) of section 68 of the Companies Act, 2013 mandates the company to extinguish and physically destroy the shares or securities bought back within seven days of the last date of completion of buy-back. Hence, it is clear that a company cannot 'hold' its own shares or securities.
How then it is a property?
If not, no occasion of taxability u/s 56(2)(x)
[Vora Financial Services (P.) Ltd. v. ACIT [2018] 96 taxmann.com 88 (Mumbai - Trib.)]
SC judgement in the case of CTO vs State Bank of India (Civil Appeal No. 1798 of 2005)

Does S. 56(2)(x) apply to sum received by a partner on retirement from a firm, in excess of balance standing to his capital account? What if a partner at the time of retirement takes a movable property or an immovable property? – covered by 45(4)

Surrendering his right, title and interest in the Firm, would be 'adequate consideration' for the purpose of section 56(2)(x). Thus, the said excess cannot be brought to tax in hands of the retiring partner. [Smt. Vasumati Prafullachand Sanghavi v. DCIT [2018] 168 ITD 585, Pune Tribunal]

Also, there can be an argument that the consideration, being surrender of partnership rights, interest and title, cannot be determined and as such the machinery to compute the income fails.

Therefore, in view of CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294 (SC), such receipt cannot be subjected to tax under section 56(2)(x).

In case of introduction of a capital asset as capital contribution by Partners in Partnership Firms, can section 56(2)(x) be invoked in the hands of the firm?

Rationale of Sunil Siddharthbhai v. CIT [1985] 156 ITR 509 (SC) should still apply.

How to do valuation of quoted shares which are allotted to shareholders from promoters quota for a lock-in-period suffering restriction on free transferability?

Marketability is one of the most important factor in valuation.
In case of shares received with a lock- in-period , the transferability gets restricted.
Hence during the lock in period, they should be considered as unquoted shares.

CWT v. Thirupathy Kumar Khemka [2013] 259 CTR 260 (Madras)


Thank
you