



CLUBBING PROVISIONS AND THE CUMULATIVE TEST: A DOCTRINAL ANALYSIS OF J.M. MOKASHI V. COMMISSIONER OF INCOME TAX (1994) AND ITS IMPACT ON SECTION 64(1)(II) INTERPRETATION

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INTRODUCTION

This case, adjudicated by the Bombay High Court, centres on whether the income earned by the assessee's wife shall be clubbed with the husband's income under Section 64(1)(ii) of the Income Tax Act 1961. The Income Tax Officer included her salary in the husband's taxable income, citing her lack of requisite qualifications to substantiate the salary as an independent income. This case highlights the importance of interpreting the concept of "substantial interest" and the criteria for professional qualifications within the context of tax law.

AD REM CONCEPTS

As per **Section 63 of the Income Tax Act 1961**, a 'transfer' includes any settlement, trust, covenant, agreement, or arrangement. The provision further states that a transfer is revocable only if it fulfils either of the following conditions:

1. It 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
2. It, in any way, gives the transferor a right to reassume power directly or indirectly over the whole or any part of the income or assets.

Section 62 of the Income Tax Act of 1961 provides for the 'Transfer irrevocable for a specified period'. It specifies that the provisions for revocable transfer shall not apply to any income arising to any person under a transfer in the following cases:

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- By way of trust which is not revocable during the lifetime of the beneficiary, and, in the case of any other transfer, which is not revocable during the lifetime of the transferee; or
- Made before the first day of April 1961, which is not revocable for a period exceeding six years.

Provided that the transferor derives no direct or indirect benefit from such income in either case. However, notwithstanding anything contained in section 62(1) of the Income Tax Act 1961, all income arising to any person under any such transfer shall be chargeable to income tax as the income of the transferor as and when the power to revoke the transfer arises, and shall then be included in his total income.

Section 64 of the Income Tax Act, 1961 deals with clubbing of income to prevent tax avoidance through transfers of income or assets among family members. It mandates that, under specified circumstances, such as income earned by a spouse, a minor child, or through assets transferred to certain relatives, the income will be included in the taxable income of the individual transferring the assets or having a substantial interest in the source of income. This ensures the proper assessment of tax liability and prevents misuse of income distribution within families.¹

FACTS OF THE CASE

This case revolves around a practising physician and cardiologist, Dr. J.M. Mokashi, who employed his wife, Smt. Jayashree J. Mokashi as a receptionist-cum-accountant in his medical practice. Smt. Jayashree J. Mokashi had completed her first year of Arts from Bombay University, and Dr. Mokashi paid her a salary of Rs. 8100 during the assessment year 1978-79. This amount of Dr. Mokashi's income was included by the Income Tax officer by applying Section 64(1) (ii) of the Income Tax Act.² Dr. Mokashi challenged this decision by filing an appeal with the Appellate Assistant Commissioner of Income Tax, but his appeal was rejected, and the order of the Income Tax officer was affirmed. Dr. Mokashi further filed a second appeal before the Income Tax Appellate Tribunal. Due to the existence of conflicting findings from several Tribunal Benches on identical matters, this dispute became more complicated, and this

¹ "Topic 5: Income of Other Persons – One Stop Destination for DU LLB Students" (One Stop destination for DU LLB students, September 3, 2017) <https://dullbonline.wordpress.com/category/llb-vi-sem/taxation-laws/topic-5-income-of-other-persons/> accessed December 23, 2024

² Income Tax Act 1961 (Act 43 of 1961) (India)

resulted in the case being sent to a special bench for hearing and final judgment via an order dated 15 October 1980. Dr. J.M. Mokashi challenged the orders of both the Income Tax Officer and the Appellate Assistant Commissioner before the special bench, primarily concerning the interpretation of Section 64(1)(ii) and its applicability to his professional practice and the salary that he paid to his wife.

ISSUES

1. Whether the Income Tax Appellate Tribunal, after taking the case's facts and circumstances into account, correctly determined that the assessee's wife's income is included in the assessee's income under Section 64(1)(ii) of the Income Tax Act.
2. Whether the phrase "concern" in Section 64(1)(ii) includes "profession" as opposed to "Business".
3. Whether the word "substantial interest" in Section 64(1)(ii), read with the explanation 2(ii), relates to a part of the total interest and not the "whole interest".
4. Whether "professional qualifications" or "technical qualifications" require formal degrees or diplomas, or can include practical knowledge and experience.
5. Whether the term "and" occurring twice in the proviso of section 64(1)(ii) be construed as "or".

RELEVANT PROVISIONS

Section 5: Total taxable income refers to the portion of income of the previous year subject to income tax in the assessment year, determined to calculate the tax liability of an individual or a company for a specific fiscal year. It is typically defined as gross total income or total income after accounting for any allowance deductions or exemptions during that tax period. The income is received/deemed to be received/ accrued/ deemed to be accrued in India. Taxable income encompasses various sources, including salaries, pensions, capital gains, rental income, business profits, investment returns, and unearned income.

Section 64(1)(ii):³ This provision specifically addresses the clubbing of a spouse's income. It stipulates that if an individual has a substantial interest in a business or profession and their spouse receives remuneration, such as salary, from that entity, the income shall be included in the individual's total income unless the spouse possesses the requisite technical or professional

³ Income Tax Act 1961, s 64(1)(ii)

qualifications to validate the remuneration as independent earnings. In the present case, Dr. Mokashi's wife lacked any such qualifications required, resulting in her income being aggregated with his.

Substantial Interest:⁴ An individual is deemed to have a substantial interest in a concern if they possess a significant shareholding or voting power within that entity. This concept is reflected in **Section 40A(2)**, which sparsely reflects on 'substantial interest' as any person holding more than 20% of the total voting power throughout the year. This criterion primarily applies to businesses or companies where the individual typically holds a majority stake. This definition is pivotal as it forms the foundation for the application of Section 64 of the Income Tax Act 1961.

Sections 60-64:⁵ These provisions collectively address diverse situations involving the clubbing of income to curb tax avoidance through asset transfers within family members. They delineate the conditions under which income derived by spouses, minor children, and other relatives may be incorporated into an individual's taxable income.

ARGUMENTS

In the matter before the Hon'ble High Court of Bombay, both sides put forth persuasive arguments concerning the inclusion of the wife's income within the husband's total taxable income under Section 64(1)(ii) of the Income Tax Act, 1961.

Arguments by the Assessee: The assessee contended that the term "concern" in Section 64(1)(ii) should not be construed to include "profession," arguing that the provision applied exclusively to businesses. As a practising physician, he maintained that his professional earnings should be treated distinctly from business income.

Dr. Mokashi further argued that the phrase "substantial interest" referred to a proportional stake rather than full ownership. Since he held 100% ownership of his practice, he asserted that the provision was inapplicable, as it was intended for scenarios involving shared interests in a business.

Additionally, he claimed that the requirement for the spouse to have 'technical or professional qualifications' should not be limited to formal degrees. Instead, it should include relevant

⁴ Income Tax Act 1961, s 40A (2)

⁵ Income Tax Act 1961, s 60 - 64

experience and knowledge that qualified her to perform her duties effectively. Emphasised that the role of a receptionist-cum-accountant did not necessitate advanced qualifications.

The assessee further argued that in the proviso to Section 64(1)(ii) stating, “Provided that nothing in this clause shall apply about any income arising to the spouse where 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”, the word “and” should be interpreted as “or,” thereby allowing either technical qualifications or relevant experience to meet the criteria for exclusion from the clubbing provisions.⁶

Arguments from the Revenue Officer of Income Tax: The Income Tax Officer maintained that the term “concern” should encompass both business and professions, emphasising that the tax laws are designed to prevent strategies aimed at tax avoidance. They argued that adopting a narrow interpretation would undermine the legislative intent of Section 64(1)(ii) of the Income Tax Act 1961. They further asserted that the definition of “substantial interest” was deliberately broad to include all forms of ownership, including full ownership in a proprietary concern. Restricting its interpretation, they contended, would defeat the objective of curbing income splitting among family members.

The Income Tax Officer argued that the phrase “technical or professional qualifications” should carry precise meanings within the context of tax laws in India, rejecting the inclusion of mere experience without formal credentials. They maintained that Mrs. Mokashi’s lack of recognised qualifications validated the decision to club her income with Dr. Mokashi’s total taxable income. Moreover, they emphasised that Section 64(1)(ii) is explicitly intended to prevent tax avoidance through income shifting within families. Allowing exceptions based on informal or overly flexible interpretations, they argued, would open the door to misuse of tax provisions.

JUDGMENT

The High Court passed an exhaustive judgment in favour of the Revenue, taking on and resolving each major issue brought out in the case. In respect of the interpretation of the term “concern,” the court ruled that the said term encompasses a wide import and is to be construed broadly within the purview of Section 64(1)(ii). According to the court, “concern” covers all

⁶ “DR. J. N. MOKASHI – Appellant Versus INCOME-TAX OFFICER – Respondent” (Supreme Today AI) <https://supremetoday.ai/doc/judgement/03300000320> accessed December 22, 2024

types of establishments and organisations and, more specifically, business and professional activities. This also applies to companies, firms, individual proprietorships, and other bodies, for example, professional organisations and proprietary establishments. In deciding as such, the court further argued that the word "concern" has diverse meanings depending on the different contexts, and in this case, Section 64(1)(ii) requires a liberal interpretation of the word. The court particularly emphasised that the term "business" itself inherently includes professions, vocations, and callings and found no justifiable basis for excluding professional organisations from its purview.⁷ The court particularly emphasised that the term "business" itself inherently includes professions, vocations, and callings, finding no justifiable basis for excluding professional organisations from its purview.

In respect of the question of "substantial interest," the court outrightly dismissed the interpretation canvassed by the assessee. The court held that Explanation 2 serves as a deeming provision which provides for the minimum interest to be applied for Section 64(1)(ii) to apply. The court highlighted that this provision was made to widen and not restrict the applicability of the section. This would be the reason why a court held that a party having 100% interest in a concern undoubtedly falls under the term "substantial interest." The phrase was interpreted to include within its fold minimum and maximum interests, the court not considering it fair to exempt cases of 100% interest but to include merely 20% interest ones.⁸

The court gave an elaborate and subtle interpretation of technical and professional qualifications. On technical qualifications, the court held that such qualifications should specifically qualify a person to perform technical work. In this regard, the court noted that requirements may be different depending on the type of technical job, so that university degrees might not always be necessary, but the qualification must be relevant to the specific technical work being done. As for professional qualifications, the court held that these must be necessary for carrying on the particular profession and are often regulated by statute, as in the case of legal or medical professions. The court emphasised that mere knowledge or experience is insufficient to constitute professional qualification, though the specific requirements may vary

⁷ Bombay High Court, "Broad Interpretation of 'Concern' and Strict Application of Proviso in Section 64(1)(ii): Insights from Dr. J.M Mokashi v. Commissioner of Income-Tax" (July 14, 1993) [https://www.casemine.com/commentary/in/broad-interpretation-of-'concern'-and-strict-application-of-proviso-in-section-64\(1\)\(ii\)-insights-from-dr.-j.m-mokashi-v.-commissioner-of-income-tax/view#:~:text=Jayashree%20J.,the%20Tribunal%20upheld%20this%20inclusion](https://www.casemine.com/commentary/in/broad-interpretation-of-'concern'-and-strict-application-of-proviso-in-section-64(1)(ii)-insights-from-dr.-j.m-mokashi-v.-commissioner-of-income-tax/view#:~:text=Jayashree%20J.,the%20Tribunal%20upheld%20this%20inclusion). accessed December 22, 2024

⁸ Mohammed S Chokhawala, "Clubbing of Income Under Section 64" (ClearTax, September 24, 2018) <https://cleartax.in/s/section-64-clubbing-income> accessed December 23, 2024

by profession. The court made it very clear that not every qualification can qualify under the proviso; the qualification must be specific to the technical job or profession in question, and knowledge and experience alone cannot substitute for required qualifications.

In interpreting the proviso, it established that it contains two cumulative conditions that must be met concurrently. The first condition calls for the requirement that the spouse must possess technical or professional qualifications, which is a requirement for applying the proviso, and cannot be satisfied by mere knowledge or experience. The second requirement is that the income be solely attributable to technical or professional knowledge and experience. This requirement becomes relevant only if the first requirement is met. This second requirement aids in determining the reasonable amount of income to be excluded from the clubbing provisions. The court clarified in explicit terms that these requirements are not alternative but rather cumulative, with each of them serving a distinct purpose. Importantly, the court ruled that the reference to "knowledge and experience" in the second part cannot be used to dilute the qualification requirement in the first part.

Finally, applying these principles to the present case, the court came to the conclusion that Smt. Mokashi, with only a first-year Arts qualification and acting as a receptionist-cum-accountant, neither possessed the required technical or professional qualifications nor was she paid for rendering technical or professional services. Thus, the court held that the proviso to Section 64(1)(ii) was not applicable, and thus the income has correctly been clubbed along with the income of the assessee. This exercise of practical application of principles worked out in the judgment exhibits the systematic approach of the court in interpreting and implementing the provisions of Section 64(1)(ii). The question of "substantial interest" was categorically thrown out by the court outrightly by rejecting the very interpretation put forth by the assessee. It further held that Explanation 2 performs a deeming function to create the least amount of interest which needs to be present for Section 64(1)(ii). The court made it amply clear that the section must be given a wide ambit rather than a restrictive meaning. With such logic, the court established that anyone owning 100% interest in an enterprise surely has a "substantial interest." It determined the clause as one to include minimum as well as maximum interests; otherwise, it would make little sense to exclude 100% interest cases but allow cases with only 20% interest.

RELEVANCE & OBSERVATIONS

The case of J.M. Mokashi v. Commissioner of Income Tax centres on the interpretation and application of Section 64(1)(ii) of the Income Tax Act of 1961, which addresses the clubbing of a spouse's income under the mentioned circumstances. The facts of the above-discussed case involved Dr. Mokashi, a practising physician, employing his wife as a receptionist and accountant. Herein, the Income Tax Officer argued to include her salary in the taxable income of Dr. Mokashi, with issues arising on the interpretation of the earnings as independent. While the lower court upheld the view of the Income Tax Officer on the grounds of a lack of requisite technical or professional qualifications for consideration of separate income.

The arguments presented by both parties to the proceedings underscored key principles for the interpretation of tax laws. Herring, assessee, based their argument on the interpretation of the term "concern" shall exclude professional practices and contended that "substantial interest" was inapplicable since he wholly owned the practice. On the other hand, the Revenue Officer emphasised the statutory provisions to aim to prevent tax avoidance through income splitting among family members, advocating for a broad interpretation of the terms within Section 64(1)(ii) of the Income Tax Act 1961 to uphold its statutory intent and bring its purpose to implementation.

CONCLUSION

This case underscores the importance of clarity in tax laws regarding income attribution among family members. The decision by the Hon'ble High Court in this present case reinforced the principle that income derived from a spouse's employment can be included in an individual's total taxable income under specific conditions as laid down in the Income Tax Act of 1961, specifically in the absence of substantive evidence of requisite qualifications justifying independent earnings.

Provisions of the Income Tax Act 1961, under Sections 62 and 63 elucidate the "Transfer irrevocable for a specified period" and "Definition of 'transfer' and 'revocable transfer'" respectively by addressing circumstantial-centric scenarios regarding income attribution and deeming provisions. Appraisal of context of the case, Section 62 pertains to income arising in a partnership firm where an individual is a partner, while Section 63 deals with the concept of

deemed income in cases involving transfers or arrangements made to avoid tax liabilities.⁹ In conjunction with Section 64(1)(ii) of the Income Tax Act 1961, the provisions create a framework aimed at preventing tax evasion through familial arrangements, further ensuring that individuals do not devise to exploit their relationships to shield income from the taxation system. The case thus serves as a pertinent reminder of the legislative intent regarding the implementation of the act and the subordinate content provisions, and expertly highlights the judiciary's role in interpreting them to uphold the tax equity in India.

⁹ TGTeam, "Clubbing of Income under Income Tax Act, 1961 with FAQs" (TaxGuru Consultancy & Online Publication LLP, August 27, 2024) <https://taxguru.in/income-tax/clubbing-of-income-under-the-income-tax-act-1961.html> accessed December 24, 2024