

Taxability of Alimony and Maintenance

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It is said Marriages are made in Heaven but separation happens much closer to tax authorities!

The crux of the matter is whether, as a result of a divorce, the alimony and maintenance payments made to a spouse are taxable in that spouse's (recipient's) hands?

To answer this question, I analyze some of the income tax ramifications involved in receiving such alimony and/or maintenance as a result of a divorce.

Capital Receipt and Revenue Receipt

The Income Tax Act, 1961 does not define the term “Capital receipt” & “Revenue receipt”. Also, it has not laid down the criterion for differentiating the capital and revenue receipt. **A general principle followed is that all revenue receipts are taxable unless as exempted by the Act and all Capital receipts are not taxable unless as provided by the Act.**

An interesting analogy that can be adopted to determine capital and revenue receipts is that of a fruit and a tree. Where an amount represents income from the disposal of the income-producing asset (ie the tree), the amount is of a capital nature. However, where an amount represents the fruit of the tree, such amount is not of a capital nature. ‘Income’ is what ‘capital’ produces, or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in certain matters, but its application is very often a matter of great difficulty, for what is principle or tree in the hands of one man may be interest or fruit in the hands of another

Let us look at section 28 to understand this idea better; certain receipts have been made chargeable to income-tax under the head “profits and gains of business or profession”. The Supreme Court in **Oberoji Hotel (P) Ltd. Vs. CIT (1999) XI SITC 109 (SC)**, has held that the question whether the receipt is the capital or the revenue has to be determined by drawing the conclusion of law ultimately from the facts of the particular case and it is not possible to lay down any single test as infallible or any single criterion as decisive. Also the Supreme Court, in **CIT Vs. Prabhu Dayal (1971) 82 ITR 804**, has held that the question whether a particular receipt is capital or income is not one of fact though it is dependant to a very great extent on the particular facts of each case, the question does involve conclusion of law to be drawn from those facts.

Is Alimony 'Consideration'?

The Income Tax Act does not contain specific provisions relating to Alimony. Analogous provisions along with relevant case laws must be studied for taxation of alimony. Let us try to understand the relevant provisions in detail. Under circumstances where there is NO divorce; when an asset is transferred by one spouse to another, for inadequate consideration, the same shall be a gift exempt from taxation u/s 56(2). Any income from the same will be 'clubbed' (i.e. included) in the hands of the transferring spouse as if the asset had not been transferred at all.

However, in the case of a divorce, the relationship between the husband and the wife ceases to exist and they will no longer be spouses. The question that arises now is if the transfer of assets or monetary funds, as alimony will be consideration?

The word consideration has not been defined under the Income Tax Act. Therefore, we need to verify its meaning from the law which govern principles of contract. Consideration has been defined u/s 2(d) of Indian Contract Act which reads as follows:

"That 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."

In India, the law of the land places an obligation on the husband to maintain his wife which arises out of the status of a marriage. Right to maintenance forms a part of the personal law. Under the Code of Criminal Procedure, 1973 (2 of 1974), right of maintenance extends not only to the wife and dependent children, but also to indigent parents and divorced wives.

Therefore, in a divorce the wife relinquishes her personal right of claiming monthly maintenance as provided under law. This relinquishment will be consideration of the wife for the receipt of alimony/maintenance and hence will not be a gift of inadequate consideration.

Taxation of Alimony

As stated earlier, the Income Tax Act does not contain provisions regarding the taxation of alimony. The definition of the term "income" contained in the said Act is merely an inclusive definition and it does not throw any direct light on the question whether the payment of monthly alimony under a decree could be regarded as "income" under the said Act. Nor is any clear guidance to be obtained from looking at the scheme of the Act and the other provisions of the said Act. If, therefore, we are to look for light, it is to the decided cases that we must turn.

In ***CIT vs Shaw Wallace and Co***, the Privy Council held that the object of the Indian Act is to tax 'income'. And 'Income' connotes a periodical monetary return coming in with some sort of regularity or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return,

excluding anything in the nature of a mere windfall. Thus income has been likened pictorially to the fruit of a tree, of the crop of field.

In the landmark case of **Princess Maheshwari Devi of Pratapgarh vs CIT (1983) 33 CTR Bom 117**, the Appellant was married to Maharaja of Kotah and had later obtained a decree of nullity of the marriage from a Court of Law. She had claimed monthly alimony and gross sum as permanent alimony and the same was directed by the court. When taxation of alimony was brought into question, the Bombay High Court held that Alimony is an extension of the husband's obligation under Hindu Law to maintain his wife. The Hon'ble Bombay High Court further stated that to constitute a revenue receipt, a source for the receipts must be established and it is established in the form of the decree. Therefore, the monthly alimony being a regular and periodical return from a definite source, being the decree, must be held to be income within the meaning of the said term in the said Act. With regard to the lump-sum receipt of alimony the Hon'ble High Decided as follows:

"the point of view of taxability the decree must be regarded as a transaction in which the right of the assessee to get maintenance from her ex-husband was recognized and given effect to. That right was undoubtedly a capital asset. It is, in our view, beyond doubt that, had the amount of Rs. 25,000 not been awarded in a lump sum under the decree to the assessee a larger monthly sum would have been awarded to her on account of alimony. It is not as if the payment of Rs. 25,000 can be looked upon as a commutation of any future monthly or annual payments because there was no pre-existing right in the assessee to obtain any monthly payment at all. Nor is there anything in the decree to indicate that Rs. 25,000 were paid in commutation of any right to any periodic payment. In these circumstances, in our view, of this we do not think it necessary to consider whether the said receipt could be regarded as casual receipt or in the nature of a windfall."

Therefore, it is clear from the above that a lump-sum receipt in the form of Alimony will not be taxable in the hands of the recipient. Whereas, monthly alimony payments will be treated as income in the hands of the recipient.

The same ratio was upheld in the case of **ACIT vs Meenakshi Khanna (2013-TIOL880ITATDEL)** wherein the agreement for custody, separation and divorce was entered into on 01.12.1989 with the divorce finally taking place on 20.04.19090 and money pursuant to this agreement was agreed to be paid in monthly installments by the husband which he did not honour, on which the wife threatened to take legal action against husband resulting in a one-time settlement by him to her. The Tribunal held this one-time payment, though delayed, as a lumpsum payment relating to the divorce agreement and not taxable in the hands of the recipient (wife).

What if the alimony were in the form of a share in immovable property?
Take an example of a husband owning a house and as alimony settlement gives the wife 50% right in the house. In such a case, the transfer of the 50% right in the house to the wife itself is not a taxable event as it is nothing but in the nature of gift/settlement deed and not taxable u/S.47 of the Act as a transfer.

In other words, treatment of assets received in kind, as alimony, should be treated similar to that of an asset received on settlement/gift or family partition. In other words, it will be a “transaction not regarded as transfer” of a capital asset u/s S.47 r.w. 2(47) of the IT Act and S.49 will further detail the cost of acquisition of the asset on subsequent sale (ie it will relate to the previous owner's cost and date of acquisition)

What is the alimony were paid to wife from proceeds of a sale of a house by husband? This is again nothing but a lumpsum payment to be treated as capital receipt in the hands of the recipient i.e wife. This is the view taken by the recent decision in ***Roma Sengupta vs Commissioner of Income Tax (2016-TIOL-553-HC-KOL-IT)*** where the HC, while sidestepping the issue of ownership by assessee and her consequent S.54 exemption claim which was the issue decided on by the lower authorities, held that the assessee had only received 50% of sale consideration with respect to her matrimonial house and such consideration was to be treated as capital receipt in her hands and hence was not taxable in her hands.

While the Hon'ble High Court in the *Roma case (supra)* did not aver on the taxability of the sale of house in hands of the owner (presumably the husband in the *Roma case supra*), it implicitly follows that the seller ought to be taxed for capital gains on the sale of the house while the payments made by seller (husband) to recipient (wife) is a capital receipt on account of alimony and is not taxable in the recipient's (wife's) hands. The question of diversion of income at source by overriding title in the form of alimony payments made to wife (recipient) may not hold good here as the sale of the property by seller (husband) is the initial and separate taxable event and consequent payment is to the recipient (wife) is the non-taxable event.

Bottomline: If you are going to receive alimony payments obtain it as one lumpsum payment and avoid the taxman!

In all seriousness, it is prudent to consider and plan the taxation of alimony/maintenance receipts arising from a divorce and you should seek the advice of a professional for the same.

Thoughts? Let's discuss:

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