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HUF & Tax Implications

By CA A. K. Jain

Hindu Undivided Family is defined as consisting of a common ancestor and all his lineal male descendants together with their wives and unmarried daughters. Therefore, a HUF consists of all males & females in the family. Daughters born in the family are its members till their marriage and women married into the family are also members of the HUF.

In this context, "Hindu" mean all the persons who are Hindus by religion. Section 2 of the Hindu Succession Act, 1956, elaborately declares that it applies to any person, who is a Hindu by religion and it includes a Virashaiva, a Lingayat or a follower of Brahmo, Prathana or Arya Samaj, a Buddhist, Jain or Sikh. In CWT In the case of Smt. Champa Kumari Singh (1972) 83 ITR 720, Supreme Court held that the HUF includes Jain Undivided Family. HUF is a separate entity for taxation under the provisions of sec. 2(31) of the I. T. Act. It means that the one person can be assessed as an individual and also as a Karta / Chief of his family.

HUF Formation - An HUF is automatically constituted with the marriage of a person. No formal action is required to create an HUF. The HUF being the result of birth, possession of joint property is only an appendage of the HUF and is not necessary for its constitution. So, one person cannot form an HUF. Family is a group of people related by blood or marriage. However, the property held by a single co-parcener does not lose its character of Joint Family property solely for the reason that there is no other male or female member at a particular point of time. Once the co-parcener marries, an HUF comes into existence as he alongwith his wife constitutes a Joint Hindu Family. This was held in the case of Prem Kumar v. CIT, 121 ITR 347 (All.)

It can be noted that, the technical status of an HUF continues even in the hands of females after the death of sole male member. Even after the death of the sole male member, the original property of the HUF remains in the hands of the widows of the members of the family and the same need not divided amongst them.

An HUF need not consist of two male members- even one male member is enough. The understanding that there must be at least two male members to form an HUF as a taxable

entity is not applicable. - *Gauli Buddanna v. CIT*, 60 ITR 347 (SC); *C. Krishna Prasad v. CIT* 97 ITR 493 (SC) and *Surjit Lal Chhabda v. CIT*, 101 ITR 776 (SC). A father and his unmarried daughters can also form an HUF. *CIT v. Harshavadan Mangladas*, 194 ITR 136 (Guj.)

Nucleus of HUF - With several rulings it is now established that, nucleus or ancestral joint family property is not required for the existence of the HUF.

Karta - He is the person who manages the affairs of the family. Generally, the senior most male member of the family acts as Karta. However, any other male member can also act as Karta with the consent of the other member. *Narendrakumar J. Modi v. Seth Govindram Sugar Mills* 57 ITR 510 (SC).

Property - The HUF property may consist of ancestral property, property allotted on partition, property acquired with the aid of joint family property, separate property of a co-parcener blended with or thrown into a common family pool. The provisions of sec. 64 (2) of the Income Tax Act, 1961 have superseded the principles of Hindu Law, in a case where a co-parcener impresses his property with the character of joint family property.

Female members cannot merge her separate property with joint family property, but she can make a gift of it to the HUF. *Pushpadevi v. CIT* 109 ITR 730 (SC). Female members can also bequeath their property to the HUF, *CIT v. G.D. Mukim*, 118 ITR 930 (P & H).

Multiple Family Structures - An HUF can consist of several branches or sub-branches. For example, a person with his wife and sons constitutes an HUF. If the sons have wives and children, they also constitute smaller HUFs. If the grandsons also have wives and children, then they also constitute HUFs. It is irrelevant whether the smaller HUFs hold any property. Nucleus property can be acquired by partition of bigger HUF or by gifts from any member of the family or even by a stranger or by will with intention of the donor or the testator that the said gift or bequest will form the HUF property of the donee. An HUF can be composed of a large number of branch families, each of the branch itself being an HUF and so also the sub-branches of more branches. *CIT v. M.M.Khanna* 49 ITR 232 (Bom).

Tax planning through HUF -

- (i) Increase the number of assessable units through the device of partition of the HUF.
- (ii) Create separate taxable units of HUF through will in favour of HUF or gift to HUF.
- (iii) Enter into family settlement / arrangement.
- (iv) Payment of remuneration to the Karta and also to other members.
- (v) Providing loans to the members of the HUF.
- (vi) Gift to members.

Partition of HUF - The tax liability can be reduced by partition of the HUF. This can be easily done in a case where the partition results in separate independent taxable units. Suppose an HUF consists of father and two sons and there are two business establishments, a house property and other sources of income with the HUF. If the members of the HUF have no other sources of income then partition of the HUF can be done by giving one business establishment to each of the sons, house property to the father and dividing the other sources in such a manner so as to make the partition equitable. Such a partition of HUF will reduce the tax liability considerably. The position may, however, be different in a case where the members of the HUF have got high individual incomes. In such a case it is not advisable to break or partition the HUF. The HUF should be allowed to continue as a separate taxable unit.

In case, where the HUF has only one business establishment, which can not be physically divided, it may be converted into a partnership firm or a company. At present, rate of firm's tax and the rate of tax in case of a company, is 30% flat, therefore conversion of HUF business into a partnership or a company is not advantageous. The incidence of, in such a case, can be better reduced by payment of remuneration to the members of the HUF. Partial partition of HUF is also a very effective device for reducing its tax liability. Partial partition is recognized under the Hindu Law. However partial partition of an HUF is no more recognised by the Income Tax Act. The provisions of sec. 171 partial partitions can still be used as a device for tax planning in certain cases. An HUF not hitherto assessed as undivided family can still be subjected to partial partition because it is recognized under the Hindu Law and such partial partition does not require recognition u/s. 171 of the Income Tax Act, 1961. Thus a bigger HUF already assessed as such, can be partitioned into smaller HUFs and such smaller HUFs may further be partitioned partially before being assessed as HUFs. Besides any HUF not yet assessed to tax can be partitioned partially and thereafter assessed to tax.

Legal aspects and partition of HUF -

- (i) Assets distribution in the course of partition would not attract any capital gains tax.
- (ii) No gift tax liability.
- (iii) No clubbing of incomes u/s. 64.

Create Separate Taxable Units - It is now well settled law that there can be a gift or will for the benefit of a Joint Hindu Family .It is immaterial whether the giver is male or female, whether he or she is a member of the family or an outsider. What matters is the intention of the donor that the property given is for the benefit of the family as a whole. Suppose there is an HUF consisting of Karta, his wife, his two sons, daughter-in-law and grand children. A gift or will can be made for the benefit of the two smaller HUFs of the sons. The bigger HUF will continue as a separate taxable unit even after the death of the Karta. There may also be a case where the father or mother has self acquired properties. They have a son and his family but

there is no ancestral property as a corpus of their family. Then, father & mother or both can leave their property for the benefit of their son's family, through their respective wills.

Family Settlement / Arrangement - Family settlements / arrangements are also effective devices for the distribution of ancestral property. The object of the family settlement should be broadly to settle existing or future disputes regarding property, amongst the members of the family. The consideration for a family settlement is the expectation that such settlement will result in establishing or ensuring amity and goodwill amongst the members of the family. Since family arrangement does not involve transfer, it would not attract gift tax, capital gains tax or clubbing. By a family arrangement tax incidence is considerably reduced or it may even be nil. Suppose a family consists of Karta, his wife, two sons and their wives and children and its income is Rs. 6, 00,000/-. The tax burden on the family will be quite heavy. If by family arrangement, income yielding property is settled on the Karta, his wife, his two sons and two daughter-in-law, then the income of each one of them would be Rs.100,000/- which would attract no tax & if the assessment year is 2007-08, then the tax liability would be reduced from Rs. 100,000/- to nil.

Remuneration to the Karta & members - The other important measure of tax planning for an HUF is to pay remuneration to the Karta and its members for the services rendered by them to the family business. The remuneration so paid would be allowed as a deduction from the income of the HUF and thereby tax liability of the HUF would be reduced, provided the remuneration is reasonable. The payment must be for service to the family for commercial or business expediency. *Jitmal Bhuramal v. CIT 44 ITR 887(SC)*.

Loan to the Members - If the business, capital or investment of the HUF is expanding then such expansion can be done in the individual names of the members of HUF by giving loans to the members from the HUF. The HUF may or may not charge interest on the loans given. Where after partition of an HUF, two members became partners in three firms on behalf of their respective HUFs and they also became partners in a fourth firm, the funds were obtained by means of loans from other three firms, the share incomes of the members from the fourth firm was assessable as their individual income only. *CIT v. Champaklal Dalsukhbhai, 81 ITR 293 (Bom.)*.

Gift of Assets to Members - Generally, the Karta of an HUF cannot gift or alienate HUF property but he can make certain gifts to the female members. Gift of immovable property within reasonable limits, can also be made by a Karta to his wife, daughter, daughter-in-law or even to a son out of natural love and affection. Gift of immovable property within reasonable limits can be made only for dutiful purpose e.g. marriage of a daughter etc.

If the HUF has surplus funds or property, then, the Karta can make gift of movable assets to his wife, daughter or daughter-in-law at one go or over a period of time. However, it may be noted that with effect from 1.10.98, the applicability of Gift Tax is no more in force. Therefore, no Gift Tax will be payable by a person making the gift from on or after 1.10.98. However, w.e.f. 1.10.2004 Gift received from other than relatives exceeds Rs.25,000/- then that amount is liable to Income Tax u/s. 57. It may be remembered that gift for marriage or maintenance of daughter is not liable to Gift Tax. Further clubbing provisions of sec. 64 would not be applicable if the gift is validly made in accordance with the rules of Hindu Law. Besides, if a gift made to the minor daughter of the Karta is valid then the provisions of sec. 60 of the Income Tax Act would not be attracted. *CIT v. G. N. Rao*, 173 ITR 593 (AP). Whereby, section 60 relates to transfer of income where there is no transfer of assets.

Other Tax Planning -

- (i) Transfer of individual property to the family.
- (ii) Family reunion after partition.
- (iii) Inheritance by succession

Partnership Firm & HUF - An HUF cannot become a partner in a firm. The Karta or a member of the HUF can represent the HUF in a firm. A female member can also represent HUF in a partnership firm, *CIT v. Banai Industries* 119 ITR 282 (Pat.). Where remuneration was received by a member of HUF from a firm, where he was partner on behalf of HUF for managing firm's business such remuneration was his individual income, *CIT v. G. V. Dhakappa* 72 ITR 192 (SC); *Premnath v. CIT* 78 ITR 319 (SC). However, income received by a member of HUF from a firm or company is taxable as the income of the HUF, if it is earned with or without the aid of family funds, otherwise it is taxable as the separate income of the member, *P.N. Krishna v. CIT* 73 ITR 539 (SC). Members of HUF can constitute Partnership without affecting a partition or without disturbing the status of joint family. *Ratanchand Darbarilal v. CIT* 15 ITR 720 (SC). However, on viewing at the present rate of firm's tax, conversion of HUF business into partnership is not advantageous.