AIFTP & MPTA

Understanding Concept of Hindu Undivided Family and Tax Planning Through HUF

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Hindu Undivided Family – Creation & Taxation

Why HUF?

BENEFITS OF HUF

Income tax benefits

- An HUF is a separate entity For taxation
- HUF has its separate PAN card.
- HUF can run its own business to generate income.
- It can also invest in shares and Mutual Funds.
- Being a separate entity, the HUF enjoys a basic tax exemption of Rs 2.5 lakh.

BENEFITS OF HUF

Income tax benefits

- HUF can also avail of an additional income tax benefits:
- Chapter VI A – Sections 80C, 80D, 80TTA, etc.
- Section 54F, 54EC, 56

. Owning a house

. Profits generated out of the family business

. Entering into Partnership

. Acquisition of Shares, Securities

BENEFITS OF HUF

Other benefits

- Separate Property
- Attachment of Property
- Passive Income

Disadvantages of HUF

- All members have equal rights on the property.
- The common property cannot be sold without the consent of all the members.
- By birth or by marriage rights get impaired.
- Closing a HUF is a tougher task as compared to opening a HUF.
- A partition of a family with a small group may lead to the partition of the HUF.

Disadvantages of HUF

- On HUF closure, assets needs to be distributed among all the members of HUF which is a huge task.
- HUF is not a separate tax entity in general law.
- Joint families are intensely losing their importance.
- HUF members are having a dispute over the property.
- Divorce cases have augmented as a result, HUF is losing its amenity of a tax-saving tool.

Disadvantages of HUF

- With tax planning, a word of caution:
- HUF funds are joint funds of a family and cannot be equated with individual funds.
- Although as karta may have control over the HUF's funds, in the event of a dispute with a family member, the member would be justified in demanding partition of the HUF and a share in all HUF assets.

HUF

HUF

The Hindu Undivided Family (HUF) is a special feature of Hindu society. HUF is defined as consisting of a common ancestor and all his lineal male descendants together with their wives and daughters. Therefore a HUF consists of males and females. Daughters born in the family are coparcener and women married into the family are equally members of the undivided family.

At any given point of time a coparcenary is limited to only members in the four degrees of the common male ancestor and daughter.

HUF

HUF is a legal expression employed in taxation laws as a separate taxable entity. It is the same thing as “Joint Hindu Family”. It has not been defined under the Income Tax Act, as it has a well defined connotation under Hindu Law

A HUF is a separate entity for taxation under sec. 2(31) of the Income Tax Act, 1961. This is in addition to an individual as a separate taxable entity, it means that the same person can be assessed in two different capacities viz. (a) as an individual and (b) as Karta of his HUF.

HUF

Article 25 of the Constitution of India Explanation II : “ In sub-clause (b) of clause (2), the reference to Hindus shall be construed as including a reference to persons professing the Sikh, Jaina or Buddhist religion, and the reference to Hindu religious institutions shall be construed accordingly.”

Hindu Succession Act 1956 applies to any person who is Hindu by religion in any of its forms AND any person who is Buddhist, Jain or Sikh by religion And any other person who is not a Muslim, Christian, Parsi or Jew by religion

HUF

"The real question for determination is whether the word 'Hindu' preceding the words 'undivided family' signifies that the undivided family should be of those: (i) who profess Hindu religion ; or (ii) to whom Hindu law applies; or (iii) who though not professing Hindu religion have come to be regarded as HUF by judicial decisions and legislative practice. It may be mentioned that for a long time the courts and particularly the Privy Council seem to have taken the view that Jains are of Hindu origin; they are Hindu dissenters and although generally adhering to the ordinary Hindu law they do not recognise any divine authority of the Vedas nor do they practice a number of ceremonies observed by the Hindus." Champa Kumari Singhi 83 ITR 720 SC

Who is Karta

The person who manages the affairs of the family is known as the karta. Normally, the senior- most member of the family acts as karta. However, a junior male member can also act as karta with the consent of the other members.

Narendra Kumar J. Modi vs. Seth Govindram Sugar Mills 57 I.T.R. P510 (SC).

Who is Karta

- A Wife cannot become KARTA in normal circumstances.
- However, if co-parceners are incapable, wife can act as KARTA.
- Sushila Devi Rampuria V/s ITO (1960) 38 ITR 316 (Cal)

Coparcener / Member

- **HUF is a body consisting of persons lineally descendent up to 3 generations or 3 degrees from a common ancestor & include their wives & daughters**
- **Daughter is a co-parcener**
- **Wife is a member**
- **Only co-parcener can ask for partition**

Daughters

- The Hindu Succession Act, 1956 (amended w.e.f. 06.09.2005).
- All daughters (whether married or unmarried) and male members of the HUF are co-parceners of the HUF.
- Thus, married daughter is a co-parcener of the HUF of father while she is a member of her husband's HUF but not co-parcener.

‘Creation’ of HUF

How to “create” an HUF?

- The phrase “creating an HUF” is misleading.
- HUF comes into existence the moment you give birth to a son (or a daughter).
- Even though you may already have an HUF, it may not really exist from the tax point of view unless your HUF has assets and is deriving income from those assets.
- In order for an HUF to exist on tax records, it needs to have income.

Partition

- The property received by a coparcener on partition of the HUF is the HUF property in his hands vis-à-vis the members of his branch i.e. with his wife and a daughter.
- N.V. Narendranath v. CWT, 74 ITR 190 (SC)

Branches of HUF

- An HUF may have several branches.
- For example: an HUF is with two sons.
- When the sons marry and they have their own families they will form a branch of the bigger HUF.
- When the grandsons have families, they too will be sub-branches of the HUF.
- Each such HUF is separately assessed

Intestate Succession

- CWT v. Chander Sen (161 ITR 370)
- A person inheriting the property from his ancestor, even if he has a wife and son would receive the property absolutely and individually, in his own right and his son would not have any interest in that property.

Assets & Income

Taxation of HUF

- HUF is a separate entity for taxation under the provisions of sec. 2(31)
- Separate exemption limit under Income-tax Law of Rs. 2 L (AY 2014-15) – Rs. 2.5 L (AY 2015-16)
- Separate deduction u/s 80G, etc.
- Separate deduction u/s 80C, 80D, 80TTA.
- Separate partnership share.
- Separate Income-tax deduction on Interest for self occupied House Property

Residential Status

- HUF is treated as resident in India in every case except where during that previous year the control and management of its affairs is situated wholly outside India
- Hence it would depend upon Karta or Manager

Member's Income

- Section 10(2) - any sum of income received by an individual from Hindu Undivided Family of which he is member is exempt from tax.
- Amount received not as a member of Joint Family but in pursuance of some statutory provision, etc. would not be exempted in this clause.
- Member of joint family living apart from the other members does not effect his/her position in law to claim the right as per section 10(2).

Assets of an HUF

- This brings us to another important question: what kind of assets can be regarded as the assets of an HUF as opposed to the assets of an individual?
- Assets received in the following situations would be regarded as the assets of an HUF:

  1. Assets received on the partition of a larger HUF of which the coparcener was a member (like an HUF in which the coparcener's father or grandfather was the karta).

Assets of an HUF

2. Assets received as gifts by the HUF. Such gifts could be received from close relatives (other than HUF members) or close friends.

3. Assets bequeathed by a will that specifically favours the HUF. If there is no will, assets received on the death of a benefactor after 1956 (when the Hindu Succession Act came into force) are not regarded as HUF property, but as individual property even if assets are inherited.

How do you boost your HUF's funds?

- One way is by ensuring that gifts or inheritances meant for the benefit of all the members of a family are gifted specifically to the HUF, instead of separately to individual members of the family.
- Gift can attract tax
- In the absence of estate duty, neither the benefactor nor the recipient would attract tax on inheritance.

How do you boost your HUF's funds?

- One can also enhance an HUF's capital by borrowing funds from people who are not members of the HUF.
- Such funds should be invested by the HUF.
- This is important, as is borrowing money specifically in the HUF's name.
- Income arising on such investments would then be regarded as the HUF's income.

How do you boost your HUF's funds?

- To transfer individual funds to the HUF.
- These funds be invested in tax-free instruments, like the RBI's relief bonds, etc. tax free investments in the HUF's name.
- Since such investment income is tax-free, even if clubbed, no tax incidence.
- Income arising on the reinvestment of such tax-free income is not clubbed.

Gift to HUF

S 56 (*x*) where HUF receives, from any person/s—

(*a*) any sum of money, without consideration, if aggregate value exceeds Rs. 50,000, the whole of the aggregate value of such sum;

(*b*) any immovable property, or (*c*) property, other than immovable property,—

(A)without consideration, the aggregate FMV of which exceeds Rs. 50,000, the whole of the aggregate fair market value of such property;

Gift to HUF

- The HUF can receive gifts from anybody i.e. a coparcener, non-coparcener or even stranger.
- CIT V/s K Satyendra Kumar (1998) 232 ITR 360 (SC)
- What matters is the intention of the donor or testator that the property given is for the benefit of the family as a whole. “Doner should clearly indicate that he is donating to the HUF.
- CIT V/s Maharaja Bahadur Singh & others (1986) 162 ITR 343 (SC).

Gift to HUF

S 56 (*x*) where HUF receives, from any person/s:

(c) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding Rs. 50,000, the aggregate fair market value of such property as exceeds such consideration, then, the amount of free benefit is income.

Exception: From "relative" means,—

(*ii*) in case of a Hindu undivided family, any member thereof

Gift from Member

- Although it is possible for a member of the HUF to transfer his or her individual assets to the HUF, such a transfer isn't beneficial from the tax point of view.
- This is because there is no transfer of the tax liability on the income from such assets. The income would continue to be taxed in the hands of the individual who has transferred the assets, (provisions for clubbing of such income with the income of the transferor. – Section 64)

HUF can run a Business

- HUF can be a Proprietor of one or more than one Business concerns.
- Separate name can be kept for HUF business entity.
- No tax Audit of HUF business if Turnover within Rs. 100 lakhs.
- Presumptive taxation u/s 44AD applicable
- TDS (except salary) provisions applicable if turnover in preceding year exceeds 44AB limits

HUF & Partnership

- Whether HUF can be a Partner in Firm?
- Person –
- Sec. 2(31) of Income tax Act
- General Clauses Act
- Ram Laxman Sugar Mills vs. CIT [1967] 66 ITR 613 (SC)
- Rashiklal & Co. vs. CIT reported in 229 ITR 458 (1998) (SC)

HUF & LLP

- Whether HUF can be a Partner in LLP?
- ICAI asked the query to MCA : ***Whether HUF/ its Karta can become partner/designated partner (DP) in LLP?*** MCA clarified – letter dated 27.05.16 – in view of LLP Act, 2008 as per section 5 of said Act, only an individual or body corporate may be a partner in a Limited Liability Partnership. A HUF cannot be treated as a body corporate for the purposes of LLP Act, 2008. [*MCA referred to its earlier Circular 13/2013*]

HUF & LLP

- MCA further referred the Supreme Court Judgement in ***Rashiklal & Co. vs. CIT*** reported in ***229 ITR 458 (1998)***. In view of the said judgement, MCA opined that HUF cannot be a partner but its Karta or any individual of HUF can be a partner in a partnership firm in its individual capacity and not the HUF.

HUF & Salary to Partner

- HUF as a partner in firm, remuneration paid to KARTA is treated as income of KARTA in his individual capacity for the reason that KARTA is rendering his services in his Individual capacity [Explanation 4 to s. 40(b)].
- Though an HUF is a partner but only through an individual, who functions in his personal capacity *qua* the firm. Payment to such person is allowable as deduction as if paid to an individual partner. ***[ITO vs. Bharat Enterprises (2006) 103 TTJ 280 (PUNE)]***

HUF & Salary to Partner

- CIT vs Trilok Nath Mehrotra and Others (1998) 231 ITR 278, (SC) - whether it is justified to hold that salary could not be assessed in the hands of the Hindu Undivided family. The member of the HUF was a partner in the firm on behalf of the HUF. The member was paid salary as a managing partner for the services rendered by him. The salary was held to be his individual income.

HUF & Interest to Partner

S. 40(b) (iv) any payment of interest to any partner ..

Explanation 1.—Where an individual is a partner in a firm on behalf, or for the benefit, of any other person (such partner and the other person being hereinafter referred to as "partner in a representative capacity" and "person so represented", respectively),—

(*i*) interest paid by the firm to such individual otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this clause;

(*ii*) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause.

HUF & Shareholding

- Can HUF become shareholder in a Company?
- Can HUF purchase shares?
- Can HUF have a D-Mat Account?
- Whether HUF can be a subscriber for incorporation of a Company?

HUF & Shareholding

- **Vickers Systems International Limited v. Mahesh P. Keshwani [(1992) 13 Com Cases 317 (CLB)]**
- HUF as member HUF is not a juristic person, although it is a person for purposes of the Income-tax Act, 1961. HUF is represented by its Karta. There is no legal bar on HUF to invest its money in shares and securities and the Companies Act does not prohibit membership of HUF. In case of an HUF, the shares can be registered in the name of 'A' as Karta of HUF as held in

Partition

Partition of HUF

- As per section 171(9) of the Income-tax Act, 1961 the Partial Partition after 31-12-1978 is not recognised.
- Even after Partial Partition the income of the HUF shall be liable to be assessed under the Income-tax Act as if no Partial Partition had taken place.

Full partition of HUF

Explanation (a) to s. 171(9) 'Partition' means: -

1. Property admits of a physical division, a physical division of property, but physical division of income without a physical division of the property producing the income shall not be deemed to be a partition; or

2. Property does not admit of a physical division, then such division as property admits of, but a mere severance of status shall not be considered partition;

3. Assessment after Partition as per s. 171 and order to be passed by the Assessing Officer

Partition of HUF

- Partition need not be by Metes & bounds, if separate enjoyment can, otherwise the secured and such division is effective so as to bind the members - *Cherandas Waridas 39 ITR 202 (SC).*
- Members of HUF can live separately and such an act would not automatically amount to partition of HUF - *Shiv Narain Choudhary v. CWT 108 ITR 104 (All.)*

Judicial Decisions - Partition

- In order to be acceptable or recognizable partition u/s 171 the partition should be complete with respect to all members of HUF and in respect of all properties of HUF and there should be actual division of property as per specified shares allotted to each member. – *Mohanlal K. Shah (HUF) v. ITO 1 SOT 316.*
- Setting apart certain assets of HUF in favour of certain coparceners on the condition that no further claim in properties will be made by them is nothing but a partial partition and not a family arrangement not recognised in view of s. 171(9) – *ITO v. P. Shankaraiah Yadav 91 ITD 228.*

Judicial Decisions - Partition

- The property received by a coparcener on partition of the HUF is the HUF property in his hands vis-à-vis the members of his branch i.e. with his wife and a daughter.
- *N.V. Narendranath v. CWT, 74 ITR 190 (SC)*

- A widow steps into shoes of husband and can demand partition
- *CIT vs. Mulchand Sukmal Jain (1993) 200 ITR 528 (Gau.)*

Legal aspects of Partition

- Distribution of the assets of an HUF in the course of partition, would not attract any capital gains tax liability as it does not involve a transfer – S. 47(i)
- On the basis of the same reasoning distribution of assets in the course of partition would not attract any gift tax liability, and
- There would be no clubbing of incomes u/s. 64 as it would not involve any direct or indirect transfer.

Typical Issues

Whether a person with wife and two daughters only can have HUF?

- The expression ‘Hindu undivided family’ in the Income-tax Act is same as a joint family which may consist of a single male member and widows of deceased male members. In Dr Prakash B Sultane v CIT ([2005] 148 Taxman 353) the Bombay High Court held that that the property does not lose its character merely because at one point of time there was only one male member or one co-parcener.

Whether a single person can have HUF?

- A Single person, male or female, doesn't constitute a family. 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 along with his wife constitutes a Joint Hindu Family.
- Prem Kumar v. CIT , 121 ITR 347 (All.)
- 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)

With no mail member, can there be a HUF?

- Joint Family continues even in the hands of females after the death of sole male member :
- Even after the death of the sole male member so long as the original property of the Joint Family remains in the hands of the widows of the members of the family and the same is not divided amongst them; the Joint Hindu Family continues to exist.
- CIT v. Veerapa Chettiar, 76 ITR 467(SC)

When with no mail member can there be a HUF?

- Joint Family continues even in the hands of females after the death of sole male member :
- Even after the death of the sole male member so long as the original property of the Joint Family remains in the hands of the widows of the members of the family and the same is not divided amongst them; the Joint Hindu Family continues to exist.
- CIT v. Veerapa Chettiar, 76 ITR 467(SC)

Partition of HUF

- Unequal Distribution on partition :
- The Supreme Court held that there is no liability to Gift Tax if there is an unequal distribution of assets amongst members of the family on partition.
- Commissioner of Gift-Tax v. N. S. Getti Chettiar, 82 ITR 599


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