
TAXATION OF HINDU UNDIVIDED FAMILY

P. Hariharan, BBA LLB, Alliance School of Law, Alliance University, Bangalore

ABSTRACT

India being a nation with diverse population in all aspects of life, promises secularism in its constitution. In terms of religion, Indian legal framework provides for different personal laws as the citizens practices different religions and faiths from each other. HUF is one such provision available to Hindu citizen in particular, which is when a Hindu male gets married, he becomes eligible to create a Hindu Undivided Family (HUF). Forming a HUF is simple, but most people are not aware that a HUF structure is also an effective way of saving taxes. The HUF is considered as a separate legal entity as per the Income Tax Act, 1961. However, its effect on taxation is one which has been contended by many committee's and judicial decisions. It is widely considered as tax saving tool, however the difference between tax planning and tax avoidance is very thin and is a crucial aspect to be looked into. The advantages and disadvantages of HUF in taxation will be discussed, with the negative implications that has been mooted through the years, with the help of case laws and the reports of certain important committees.

Key words: Tax avoidance, tax saving, secular, HUF

SYNOPSIS

1.1) Scope and Objectives

This research paper sheds light on the concept of Hindu Undivided Family (HUF) and the taxation of HUF. The presence of Hindu Undivided Family is analyzed and discussed its essential in the current scenario.

The Objectives of this research paper are

- a) To explain the concept of Hindu Undivided Family
- b) To shed light on the partition of Hindu Undivided Family
- c) To look into taxation of Hindu Undivided Family
- d) To elaborate the pros and cons of Hindu Undivided Family
- e) To explain the negative implication of HUF in Indian taxing system

1.2) Methodology

The research will follow the doctrinal method as it is mostly influx of data from various places. The sources are mostly secondary. We have consulted as many sources of books and Journals and also different articles and lectures of leading legal thinkers around India. Original articles and books by leading thinkers on the respective ideologies are the most important all the sources. The following methods will be relied upon to fulfil the objectives of the study and collection of necessary data. In addition various case laws of India are referred which involves this construction.

1. Study of the existing books.
2. Primary and secondary source of books and journals.
3. Internet surfing.
4. Visiting the libraries.

1.3) Research problem:

The concept of HUF has been in the use ever since the late 19th century, introduced by the colonial rule in India. Its effect on taxation is one which has been contended by many committee's and judicial decisions. It is widely considered as tax saving tool, however the

difference between tax planning and tax avoidance is very thin and is a crucial aspect to be looked into, so that the legislation comes up with new regulation without any loopholes for tax avoidance.

1.4) Research question:

Whether the age old concept of HUF in taxation, is just a tax saving tool or a concept promoting tax avoidance for selective people?

1.5) Hypothesis:

Though, the concept of HUF has many advantages and exemption with regards to taxation, that helps the member of HUF to reduce their tax liability, it also gives way for tax avoidance and disturbs the secular nature of the country and the spirit of the constitution.

2) Introduction:

The legal system of India has its duty to maintain its secularism by making different personal laws as the citizens practice different religions and faiths from each other. The Hindus, being the majority, are also governed by personal laws concerning family affairs, which includes marriage, divorce and succession. The instance a Hindu male gets married, he becomes eligible to create a Hindu Undivided Family (HUF). Forming a HUF is simple, but most people are not aware that a HUF structure is also an effective way of saving taxes.

The HUF is considered as a separate legal entity as per the Income Tax Act, 1961. The term 'HUF' in the Act is the same as meant in the Hindu personal laws. HUF is not actually defined in the Income Tax Act, 1961, but the meaning was included within the term of 'person' in Section 2(31) of the Act. It was later excluded, because the legislature wanted 'HUF' to mean the same as what it is given in the Hindu Law.

3) Hindu Undivided Family and Hindu Laws:

As per the Hindu Law, all individuals in a HUF are considered as lineal descendants of a common ancestry, which is mandatory. HUF includes their wives and unmarried daughters, who are living together. The female members such as widowed daughters, who have returned to their father's home, daughters-in-law are also considered as members of a HUF. The daughter. Generally, after her marriage to her husband, becomes a member of her husband's

HUF and ceases to be a member of her father's. A HUF consists of members who are blood-related to, married, or adopted by the family.

In the case of **Surjit Lal Chhabra vs CIT**¹, by the Supreme Court clarified, that 'Joint Family' and a 'Hindu Undivided Family' are synonymous. The court explained that a joint Hindu family are of people who are from a lineal descendant of the common ancestor and includes their wives and unmarried daughters also, and the daughters after married, will stop being a part of their father's family.

A married Hindu couple can establish itself as a HUF, if they receive any ancestral property. Hence, A new HUF can only be established after the birth of a child in the family. A HUF is established instantly when a Hindu male marries, when he is the only male in the family.

4) 'Karta' and Coparcener in Hindu Undivided Family:

A Karta of a HUF is usually the senior-most living member of the family, who acts as an leader of the family. Certain unique powers are given to the Karta, by which he gets to decide the way his family should run, how they are maintained, and who is getting what. He has the power to decide to dispose the property in case of an required situation. He also can delegate some of the powers of management of affairs to his manager. The manager not necessarily has to be a member of the HUF, and can rather be a paid employee as well.

For a long period, it was only the senior male of the family, who were eligible to be the Karta of the family. This changed in the year of 2016 with a landmark judgement. In the case of **Mrs. Sujata Sharma Vs. Shri Manu Gupta & Ors.**, it is said by the Hon'ble Court that;

*"... The impediment which prevented a female member of a HUF from becoming it's Karta was that she did not possess the necessary qualification of co-parcenership. Section 6 of the Hindu Succession Act is a socially beneficial legislation; it gives equal rights of inheritance to Hindu males and females. Its objective is to recognize the rights of female Hindus as coparceners and to enhance their right to equality apropos succession."*²

The Supreme Court held that the daughters of a HUF can also become Karta. This led to the expansion of the rights of females under Section 6 of the Hindu Succession Act, 1956.

¹ Surjit Lal Chhabra v. CIT, AIR (SC 1976).

² Mrs.Sujata Sharma v. Shri Manu Gupta & Ors., CS (OS) (2011).

A Coparcener is a person who shares equal part of the inheritance of an undivided estate or in the rights to it with the others. Though a HUF consist of a very large number of members including female members as well as distant blood relatives in the male line, it was initially only the males who were within 4 degrees in lineal descendent from the common male ancestor are considered as the coparceners. However, this was changed after the amendment of Hindu Succession Act, 2005, granting equal rights to women also and now daughters too can be coparceners of HUF.

The coparceners have their rights in their ancestral property, from the instant they are born. It is important to under the difference between a coparcener and member of HUF. Being a member of HUF does not make an individual a coparcener. But to be a coparcener, one must be a member of HUF. A coparcener is a male or female, who comes within the 4 levels of the lineal descent from the common male ancestor.

5) Partition of Hindu Undivided Family:

Under Hindu Law, when the status of Hindu Family gets to an end, the notional division of properties within the members happens, and the joint ownership of property is also ended. But division of the properties by metes and bounds is not necessary for an effective partition. However, according to tax laws³, division by metes and bounds is necessary for the partition to be effective.

Partition under Hindu Law is classified into two methods: Total or Partial. In total partition all the members ends to be part of the HUF and all the properties gets terminated to be properties owned to the respective HUF. The Partition is partial vis-a-vis members, some of the members are excluded on partition and the remaining members resumes to be the members of the family. Sometimes, it can also be vis-a-vis properties, where some of the properties are divided within the members, and the other properties remained as the HUF properties.

The process of Partition is recognized differently between the Hindu Laws and tax laws. Under Hindu Law, the division of properties by metes and bounds is not mandatory for recognition of partition, while in case of tax laws, division of properties by metes and bounds is essential. Under Section 171(9) of Income-tax Act, 1961, partial partitions is not be recognised, which is contrary to the stance of Hindu Laws.

³ Income-tax Act, 1961

6) Residential status of Hindu Undivided Family:

Income which is earned in India, or Indian income is taxable in India, irrespective of the person earning the Indian income is residing within the country or abroad and is a non-resident. While, the foreign income of a person only becomes taxable in India, when the person resides in India. However, a person foreign income, while not residing in India is not taxable in India.

In Income Tax, taxpayers are divided into 3 categories, on the basis of their on their residential status;

- Non-resident
- Resident and ordinary resident
- Resident but Not ordinary resident

The residential status of HUF under the Income Tax Act is known by analysing the number days the recipient is present in the country. The residential status of HUF is not the same for all assessment years, as it depends upon the relevant previous year.

According to Section 6(2) of Income Tax Act, 1961, A Hindu undivided family is supposed to be a resident of India, only when the management and control of its affairs are partly or fully situated in India. The Karta or the manager of the family has to be resident in India for at least minimum 2 years out of 10 years, which is, at least 730 days or more in the preceding previous year. Also, The place where he manages and controls his HUF should be in India.

A Hindu undivided family being a resident and an ordinarily resident in India depends on the Karta/manager of the HUF. He has to reside in India for at least 2 years of the 10 previous years, immediately preceding from the immediate previous year, otherwise, He must be in India for a period of at least of 730 days or more during 7 previous years immediately preceding from the relevant previous year.

If in the relevant previous year, the Karta or manager doesn't satisfy any of the conditions or both the conditions as per clauses (a) and (b), then he is treated as resident but not ordinarily resident in India.

A HUF becomes a non-resident in India when during the previous year to the assessment year, the Karta has been residing outside India, and the control and management of the HUF and it's affairs were managed outside India.

7) ADVANTAGES OF HUF AND BENEFITS IN TAXATION:

A HUF, for the purpose of taxation, is assessed as a separate entity. HUF is considered as a individual person as per section 2(31) of the Income tax Act, 1961⁴ and it thereby is eligible for the threshold exemption of income of Rs 2.5 lacs and is also taxed according to the individual tax slab rates. This proved to be alternative way in saving a lot of income, which if not would have been paid to the government as taxes. So, if there are 3 members in HUF, earning about 10 lakhs each in total, per year, if it were a normal-individuals in a normal family, then each member pays a certain amount according to the tax slab as tax, which would be a larger sum than what an HUF might pay as tax for the same amount of 30 lakh. So basically, the tax slab will be applied multiple times for the individuals in a family, whereas for an HUF only a single application is done.

The HUF is entitled for claiming deduction on interest on self-occupied house property, as per section 24(b) of Income tax act,1961, of Rs. 2,00,000. Also, as per section 24(b) of it act *“In respect of let-out property, actual interest incurred on capital borrowed for the purpose of acquisition, construction, repairing, re-construction shall be allowed as deduction”*⁵, basically, HUF can take deduction on the interest on loan paid for a property and can also let it out at the same time.

HUF can avail for separate deduction, as it is identified as separate individual under the act. Some of the deductions are under Section-80C of the IT act 1961, up to Rs 1.5 lakh for investments, up to Rs 25,000 under Section-80D for Mediclaim and for the same, if it is senior citizen Up to Rs 50,000 is available, also 80TTA up to Rs 10,000 and for senior citizens up to Rs 50,000. since two pan cards can be applied, an individual, who is a member of HUF, can file two income tax returns. Therefore, the members can avail this deduction irrespective of the deduction claimed on individual capacity.

Similarly, HUF can avail Section 54 and section 54F,54B 54EC of Income tax Act,1961, to claim capital gain exemptions. Deductions to HUF are also available in respect of medical treatment of dependent or disabled family members, Deduction U/S 80G in respect of donations can also be claimed by HUF.⁶

⁴ Income tax Act, 1961 § 231.

⁵Income tax Act, 1961 § 24(b).

⁶Diganth Raj Sehgal, *Status of a Hindu undivided family in India - iPleaders*, IPleaders (July 25, 2020), blog.ipleaders.in/status-hindu-undivided-family-india/.

HUF can maintain a separate DEMAT Account and can also invest in a mutual fund. HUF can carry on business but not profession but funds should be of HUF and can pay remuneration to Karta and other family members. Also the salary paid to the members of the HUF can be deducted from the income of the HUF itself and exempted from tax as per section 10(2) of the Income tax Act, 1961. The same can be confirmed from the supreme court judgement in the case of *Jugal Kishore Baldeo Sarai vs Commissioner Of Income-Tax*, where it held that “*if a remuneration is paid to the karta of the family under a valid agreement which is bonafide and in the interest of, and expedient for, the business of the family and the payment is genuine and not excessive, such remuneration must be held to be an expenditure laid out wholly And exclusively for the purpose of the business of the family and must be allowed as an expenditure under s. 10(2) (xv) of the Act.*”⁷

8) DISADVANTAGES OF HUF:

I) The major disadvantage in creating a HUF is that all its members have equal rights over the HUF property. The common property cannot be sold, let out or leased, without a nod from all the members. Any new member of the HUF by way of birth or marriage or adoption, get equal rights over the property right from their membership. Thus, it becomes very difficult to manage when the family becomes too big. It might also take more time in making drastic decisions.

II) Another excruciating aspect of HUF is dissolving such family. Partition is said to be the only way a HUF can be legally dissolved. Thus, HUF is dissolved when the inheritance is completely partitioned and the members have nothing to share with in common, with regard to the property. All members have to be in concurrence in dissolving the HUF. In the case of *Mohanlal K. Shah (Huf) vs Ito*, the court reiterated that “*In order to be acceptable or recognizable partition under section 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*”⁸. Thus the distribution process may give rise to issue regarding the quotient of shares and may lead to long legal hassle.

III) HUF, was a concept introduced by the British before independence. However, HUF is losing its relevance in the modern world where nuclear family is the norm. In this fast moving world the family structure have completely changed, as many move and diversify in their field

⁷ Jugal Kishore Baldeo Sarai v. Commissioner Of Income-Tax, AIR (SC 1967).

⁸ Metchem Canada Inc. v. Deputy Commissioner Of Income Tax, (ITR-MUM 2005).

of work. This has affected largely in the growth HUF in the modern times and also Divorce rates are rising and therefore, HUF as a tax saving mechanism is losing importance.

IV) Since Karta is wholly responsible for the HUF decisions, he may be overburdened and at times even be held responsible for other member's actions, which he may not be qualified to handle. There is also a major issue of over-dominance by the Karta, who could arbitrarily use his powers since no member can interfere in his management.

9) IMPLICATION OF HUF ON TAXATION:

The HUF found its legal recognition in the late 19th century and the British colonial gave its legal recognition under its Income tax act in 1922. This act gave the status of a separate and distinct tax entity for the HUF. The legal category of the HUF has existed in the tax code since then. One of the major reasons for implementing such favorable tax structure to the member of HUF, was to gain the support of the Hindu feudal lords that were in power in certain parts of the country. The British, used schemes like this to gain their trust to further colonize the whole of the country. This age-old concept is still in procedure under the current enactment of Income tax act, 1961. As discussed earlier, though the concept provides many advantages to the members of the HUF, there are more than several undesirable effects on the taxation system itself, which can affect the society at large.

The expert committee on direct taxes, which was also known as Wanchoo Committee in 1971, in its recommendations for reforms in tax laws, opined that the HUF as a separate entity, was used for tax avoidance. However, the difference between tax evasion and tax avoidance is very thin, so is the difference between tax planning and tax avoidance. Tax evasion is illegal and deprives the nation's duty to run the country by collecting legitimate tax dues, whereas, tax avoidance is the practice of incorporating legal loopholes in reducing the total tax liability for a body or a person. The committee tried to point out that, the current system of tax laws lacks stringent rules to curb any tax avoidance processes. As per the current tax regime, a mere three member i.e., husband, wife and their own child or adopted, can form an HUF. This has caused numerous people to create HUF for the purpose of saving tax, without any motive to run a family business and develop a sense of unity and trust among the members of the family, which was said to be one of the sole reasons for creation of such scheme.

Ever since the intervention of the Wanchoo Committee and the K N Raj Committee, the lower tax rates for HUF were increased to match the tax rates of the individual income tax payer. As

per section 10(2) of the act, a member of a HUF is not taxable at for any amount received as a HUF member as remuneration out of the income of the family, even though the family may not have paid the tax on its income. So, the privilege of the HUF, here, cannot be ascertained by how much tax a HUF paid, but how much of its wealth is not taxed at all by virtue of it being declared as 'family income'. This is a loophole used by many HUF to reduce tax liability. Also, a person can be a member of more than one HUF thus reducing his tax multifold. This only has an adverse effect on the government's functioning. The committees were not able to point out the exact figure of wealth that the HUF's are not taxed for, because of this the members of HUF enjoyed such privilege using loopholes.

In the case of *Surjitlal Chhabda vs Commissioner of Income-Tax*⁹, The assessee had declared to transfer his self-acquired property towards the HUF, by impressing upon the self-acquired property to HUF, with a motive to reduce the tax liability. The court observed that His ownership of the property and its income in fact remains the same as before. The existence of a wife and daughter would make no big difference to his ownership over the property. The assessee being the sole male member of the family, his right to that property and the income arising out of it shall remain exactly the same as it was when he received that income from Kathoke Lodge as his separate property. His position as a member of the joint family after the declaration would be the same as that of a sole surviving coparcener, but it is now settled law that a person who for the time being is the sole surviving coparcener is entitled to dispose of the coparcenary property as if were his separate property. For that purpose, the court held that property is treated in law as his separate property and is liable to pay taxes. In this instance the court has found the main motive of the assessee to avoid large sum of tax, by transferring his own property to HUF. Recent times the number of HUF created for the very same purposes prove that it secretly is used as tool to promote tax avoidance. The families had separate division in the HUF itself, which functioned on its own.

Moreover, another major implication of the HUF on the society itself is that it does not promote equal treatment of various religion in the country, India in its preamble, state itself as country that is "Sovereign, Socialist, Secular, Democratic, Republic." HUFs as a separate entity goes against the basic concept of secularity that has been embodied in as the spirit of Indian constitution. Obviously, it's not true that only the Hindus have "big" families. With a minority of Muslims, Christians, it is implicitly discriminatory for Hindus to have a separate option,

⁹ Surjitlal Chhabda v. Commissioner Of Income-Tax, (ITR-Bom 1970).

which enables them to exempt themselves from their tax liabilities which is not applicable for other religions. The existence of the HUF, for the reason mentioned earlier, and the superior treatment of assessing their tax liabilities are not in accordance with secularity and not in the spirit of democracy. This view is from the step taken by the Kerala legislation in not recognizing the HUF as a tax entity by virtue of the 'Kerala Joint Hindu Family System (Abolition) Act, 1975'. But even such step is extreme, since the Hindu joint family has separate enactments guiding succession and other personal acts, which have been proven useful over the years.

CONCLUSION:

The objective of taxation in a country is to raise revenue from tax for the purpose of maintaining the government both in developed and developing countries. In India the primary objectives of taxation include redistribution, growth, and stability. Among the major tax powers vested by the constitution to both the Union and the States, the personal income tax is one of the most important sources of revenue. But the current system has its flaws. The existence of the Hindu Undivided Family (HUF) and the superior or the special treatment given to the HUF complicates the whole process of assessment and collection of income tax.

By the recommendations of various committees it is clear that the HUF is an old concept, which has outlived the main motive of its introduction into legal structure of the country. Yet it has somehow continued to exist and now promotes tax avoidance with the legal loopholes.

Though it proves to be a tax saving tool for members of HUF, it threatens the secular aspect of the nation. Not that it should be abolished completely, as done by the Kerala legislation by 'Kerala Joint Hindu Family System (Abolition) Act, 1975', but only that its consideration in taxation must be restricted or new regulations with higher tax rate must be introduced to stop the tax avoidance.