

TAX PLANNING FOR LIABILITY OF HUF¹

1. INTRODUCTION

The word 'Tax planning' defines as the most logical analysis of financial situation or plan from a tax perspective, to align financial goal with tax efficient planning. The purpose of tax planning is to discover how to accomplish all of the other elements of a financial plan in the most tax-efficient manner possible. Tax planning thus allows the other elements of a financial plan to interact more effectively by minimizing tax liability. However it does not amount to tax evasion, tax evasion defines as an illegal practice where a person, organisation or corporate intentionally avoids paying his or her tax liability.

Tax planning is possible by taking the advantage of the various provision contained in the Income-tax Act. Even If a person were to take full advantage of all the provision contained in the Income tax law specially related to exemptions and deduction, then surely he will be able to save substantial amount of income-tax for his family. However, some tax payer also do various activities to evade from paying tax and such activities are called tax evasion and it is not recognised by the income tax while tax planning do. If one can go ahead with legal ways of saving income-tax and this is possible only when we screen very carefully the provisions contained in the Income-tax Act, 1961 and find out the pointers which are of advantage looking to our facts and circumstances.

One such very smart way of saving income-tax is to think of forming a separate Tax entity in the name of Hindu Undivided Family. The creation of Hindu Undivided Family helps the tax payer to save their tax in a legal manner.

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- **What is Hindu Undivided Family?**

The Hindu Joint Family system which with its restrictive and joint ownership is one of the most cherished and striking features of Hindu institutions has really sprung from the ancient patriarchal family which can be said to be the earliest unit of Human society. The patriarchal family has been defined as “a group of natural or adoptive descendants, held together by subjection to the eldest living ascendant, father, and grand-father or great-grand father”. The Hindu father at one time was also the repository of such authority, and wives, sons, slaves and cattle were all considered to be equally his property.

As time passes, in the next stage, the despotic position of the patriarch was reduced to that of the representative of the family and there was definite improvement in the status of its members in relationship to the patriarchal head. This transition from patriarchal to the joint family must have been gradual and was brought about by an improvement in the conception of individual rights and the repercussions of the happenings in the general society upon the member of the family.

Individual's belongings to other religions are not allowed to form HUF's except Jain and sikh who are allowed to form HUF even though they are not governed by Hindu law.

- **Formation of HUF**

Step1: Create HUF deed.

The HUF deed is a written formal document on a stamp paper stating the name of the Karta and the co-parceners (members) of the HUF. The eldest male member of the HUF becomes the Karta of the HUF.

A declaration is also provided by each member of the HUF where they state the name of the Karta and also state that-

1. Karta has the authority of the accounts vested in his hands.
2. That the members are the only members of the HUF.
3. The Karta holds the right to govern all the transaction of the HUF accounts on behalf of the members.

Step 2: Apply for HUF PAN Card

As a HUF is treated as a separate entity differs from its members, a HUF is required to apply for a separate PAN Card. An application for HUF PAN Card is required to be made in Form 49A which can be furnished online as well as manually.

Once the PAN Card has been allotted, the HUF is required to file separate Income-tax Returns and can therefore claim benefits of Income Tax Slabs as well as deduction under various laws of Income tax Act. Which are available to an individual. The application for PAN Card and ITR would be signed by the Karta.

Step 3: Open HUF bank account

A HUF is also required to open a Bank Account in which it will received all payment. A HUF account can be opened in any bank account.

At the time of opening of HUF bank account for creation of HUF, the HUF is also required to have a rubber stamp. It should be rectangular and not round (RBI circular).

Once all these three steps has been completed, the HUF will then be considered as a separate legal entity and can start receiving payment and the amount received in the name of the HUF will not be taxed in the hands of an individual member of the HUF.

- **Joint family is a creature of law:**

In the case of P.C. Balasannanna v. Fourth GTO, it was pointed out that a joint family is a creature of law and not of contract. An ancestral nucleus is the pre-requisite. The ancestral asset received even on family arrangement can be treated only as joint family property. However, there should be at least two members to constitute a Hindu Joint Family.²

Even if there be one male member along with family members, it can be a Hindu Joint Family either by survivorship³ or even on partition⁴.

² C. Krishna Prasad v CIT, (1974) 97 ITR 493 (SC).

³ Gowli Buddanna v. CIT, (1966) 60 ITR 293 (SC).

⁴ N.V. Narendranath v CWT, (1969) 74 ITR 190 (SC).

Some of the members of a joint family cannot group themselves into an independent unit as a joint family within the larger unit. But some members can divide themselves off from the corporate body and leave rest of the members as a united group⁵.

The Supreme Court has held in the case of *Bhagwan Dayal v. Reoti Devi* that there can be an identity consisting of all the members of different branches constituting one joint family. But such a situation can be more easily envisaged and be accepted when partial or full partition takes place and a claim of HUF as between some of the members can be justified for reason other than tax⁶.

- **Dual status permissible**

The possibility of a Hindu having a dual status, one for his individual income and the other for the income earned from the joint family property held by him as Karta of his family offers saving in progressive income taxation because of lower slabs, which would otherwise levy more burdensome. It is also possible that such individual is also a member of a larger Hindu undivided family so that his income as an individual and the income from his potential shares of assets of the families of which he is either a karat or a member would have effect of splitting up the income in three hands. The law has tried to reduce the advantage of having a lower exemption limit and a higher slabs rate for a specified Hindu undivided Family, where any member of the Joint family has taxable income. Now the concept of specified Hindu Family has also been abandoned. Even prior to the omission of the distinction, the benefit of more than one status offered considerable tax reduction for most taxpayers⁷.

Ordinarily, a taxpayer would find that on proper consideration of the Hindu law on the subject would entitle him to the status of joint family, so that the nurturing of the assets of a joint family may help him to reduce the tax burden to a large extent. Where an individual's income, from say, salary or profession, is higher, the saving of joint family income, however meagre, in course of time, would result in an estate by itself with tax advantage. Where the individual income is small with joint family income larger, efforts, from tax point of view, should be in the other direction⁸.

Dual capacity has been recognised in *Vijay Prakash Toshniwal v CIT*, where an HUF obtained a contract, but the Karta sub-contracted it to himself in individual capacity, the income from such

⁵ L. Hirday Narain v ITO, (1970) 78 ITR 26 (SC).

⁶ *Bhagwan Dayal v Reoti Devi*, AIR 1962 SC 287.

⁷ TAX PLANNING, pg 108, S. Rajaratnam & B.V Venkataramaiah, sixth edition, 2012-13, Bharat law publication Jaipur.

⁸ *ibid*

sub-contract was held to be assessable only in the individual hands. The tribunal in the view that HUF is not a juristic person did not recognise the sub-contract and assessed the entire amount in the hands of the HUF. It is true that there cannot be a valid contract between the same person in two capacity, but nothing prevents the contract taken by HUF being let for execution by any member including Karta as long as the arrangement is not considered to be shame. It has to be recognised for income-tax purpose as well. There is no illegality in such a transaction.

- **Hindu law and firm**

Though a Hindu joint family as such cannot enter into a partnership, the Karta can do so. In such a case, the partnership share will be assessable in the hands of HUF of which he is the Karta. It was so held in the case of CIT v Seth Govindram sugar Mills.⁹ Any member of a joint family can enter into a partnership on behalf of the HUF. It is possible for a HUF to enter into a partnership with its member in their individual capacity even without a partition as between them as held in the case of Ratanchand Darbarilal v CIT¹⁰ and in the case of Chandrakant Manilal Shah v CIT¹¹.

In Bagyalakshmi & co.¹² it was pointed out that the status of a person, who becomes a partner in his capacity as Karta is that of trustee as regards partnership law, which recognises only an individual as a partner. In such a case, he has a dual capacity, that of an individual functioning in his personal capacity under partnership law vis-à-vis his co-partner and third parties and that of a joint family under Hindu law vis-à-vis other member of the family and direct tax laws.

Where there is a partition in a joint family, which was a partner through its Karta and there is a partition in such joint family, there is no change as far as the law of partnership is concerned, but the effect of partition under the Hindu Law will be given by assessing the shares consequent on partition in the hands of the erstwhile members in their separate hands¹³.

2. TAX EFFECT ON PARTITION UNDER HUF

⁹ (1965) 57 ITR 510 (SC)

¹⁰ (1985) 155 ITR 720 (SC).

¹¹ (1992) 193 ITR 1 (SC)

¹² (1965) 55 ITR 660 (SC).

¹³ Charandas Haridas v CIT, (1960) 39 ITR 202 (SC).

- **Partition-**

A Hindu joint family gets disrupted by partition in the Hindu law. Even a partial partition is recognised under the Hindu law. There need be no division by metres and bounds for disruption of the family. But section 171 of the income-tax Act, 1961 would not recognise partial partition. It would also require a Hindu Joint family “hitherto assessed” to be continued to be assessed as such, unless there is a formal order recognising partition from the Assessing Officer giving a finding, that there has been a total partition by metres and bounds. As long as such partition order has not been passed, the mere fact of total partition, even by metres and bounds, would not avoid continue assessment as joint family¹⁴.

Procedure of partition and assessment after partition of a Hindu undivided family-

Section 171 talks about assessment after partition of a Hindu undivided family, however the act provides the procedural aspect rather than the substantive law.

Sec 171(1) A Hindu family hitherto assessed as undivided shall be deemed for the purpose of this Act to continue to be a Hindu undivided family, except where and in so far as a finding of partition has been given under this section in respect of the Hindu undivided family.

(2) where, at the time of making an assessment under section 143 or section 144, it is claimed by or on behalf of any member of a Hindu family assessed as undivided that a partition, whether total or partial, has taken place among the member of such family, the A.O. shall make an inquiry to all the members of the family.

Assessing Officer must give notice of claim for partition to all members. If the notice of the enquiry is not given to all the members, but only to some of them, the finding would not be valid. For the purpose of coming to a conclusion on the claim put forward, the AO may call for proof, direct or indirect.¹⁵ Such enquiry with every member of the family is mandatory.¹⁶

Inquiry by AO

A condition precedent to making order under section 171. In terms of section 171 of the Act, the AO is required to make an inquiry and record a finding as to whether there has been total or partial partition of the joint family property, and if so, the date on which it had taken place.

¹⁴ Gaurikanta Barkatky b CIT (2009) 313 ITR 34 (Gau.)

¹⁵ Bisweswar Lal Brijlal, in re (1930) 4 ITC 365 (Cal)

¹⁶ Ramchandra Gopalji Sughandhi v CIT (1996) 217 ITR 647 (MP)

A finding without the inquiry is no finding in the eye of Law.

Enquiry on claim

(3) On the competition of the inquiry, the AO shall record a finding as to whether there has been a total or partial partition of the joint family property, and, if there has been such a partition, the date on which it has been taken place.

Partition during the accounting year

(4) Where a finding of total or partial partition has been recorded by the AO under this section, and the partition took place during the previous year,-

a) The total income of the joint family in respect of the period up to the date of partition shall be assessed as if no partition had taken place; and

b) Each member or group of member shall, in addition to any tax for which he or it may be separately liable and notwithstanding anything contained in clause (2) of section 10, be jointly and severally liable for the tax on the income so assessed.

Partition after the accounting year

(5) Where the finding of total or partial partition has been recorded by the AO under the section, and the partition took place after the expiry of the previous year, the total income of the previous year of the joint family shall be assessed as no partition had taken place; and the provision of clause (b) of sub-section (4) shall, so far as may be, apply to the case.

Assessment and recovery: uncompleted assessment at the date of claim.

(6) Notwithstanding anything contained in this section, if the AO finds after completion of the assessment of a Hindu undivided family that the family has already effected a partition, whether total or partial, the AO shall proceed to recover the tax from every person who was a member of the family before the partition, and every such person shall be jointly and severally liable for the tax on the income so assessed.

Computation of several liability

(7) For the purposes of this section, the several liability of any member or group of members thereunder shall be computed according to the portion of the joint family property allotted to him or it at the partition, whether total or partial.

Penalty

(8) The above provisions shall, so far as may be, apply in relation to the levy and collection of any penalty, interest, fine or other sum in respect of any period up to date of the partition, whether total or partial, of a HUF as they apply in relation to the levy and collection of tax in respect of any such period.

A Karta of a HUF cannot be arrested or imprisonment for the failure of the family to pay the tax assessed. It has been held by the Supreme Court in *kapurchand shrimal v TRO*¹⁷ that no order of imprisonment may be made against the manager of the undivided family, for the default of the family to pay the tax dues.

Section 278C inserted by the Taxation Laws (Amendment) Act, 1975 would make the Karta liable for any offence by HUF, even for purpose of prosecution. The decision in *kapurchand shrimal's* case is no longer good in law as far as Karta is concerned. While section 278C(1) would make the Karta liable, sub-section (2) would refer to immunity of any member for any act committed without his consent or is not attributable to any neglect on his part.

Members of a disrupted Hindu undivided family have been held entitled to appeal from an order levying penalties on the family.¹⁸

Explanation

Partition means –

(i) Where the property admits of a physical division, a physical division of the property, but a physical division of the income without a physical division of the property producing the income shall not be deemed to be a partition; or

(ii) Where the property does not admit of a physical division, then such division as the property admits of, but a mere severance of status shall not be deemed to be a partition.

In the case of *V.V.S. Natarajan v. CIT*, *Dalichand Tejraj v CIT* and *CIT v Shanti Kumar Jagabhai*, it was held that a HUF consisting of one male member cannot be partitioned, but these decision were found unacceptable to the Guwahati High court in the case of *CIT v Mulchand sukaml jain*, wherein it was held that under section 6 of the Hindu Succession Act, the right of

¹⁷ (1969) 72 ITR 623(SC)

¹⁸ *Tatawartgy Narayana Murthy v CIT* (1963) 49 ITR 766 (AP).

female heir gets crystallized by deeming a partition but it is only on actual partition, that the shares get divided. Hence, there could be a valid partition between a mother and her minor son, but this could be only after the death of the minor's father.

Partial partition is derecognised-

Section 171 of the income-tax Act requires that a Hindu joint family hitherto assessed should continue to be assessed as such unless a partition has been recognised. It was once possible to have a partial partition. But an amendment to section 171 by the finance (no.2) Act, 1980 by way of insertion of sub-section (9) to the said section has derecognised any partial partition made after 31st day of December, 1978,

“Partial partition” means a partition which is partial as regard the person constituting the Hindu undivided family, or the properties belonging to the Hindu undivided family, or both.

A plain reading of this provision would mean that there has been a total partition or none at all under the income-tax law. The constitutionality of section 171(9) was questioned before the Madras High Court successfully in the case of *M.V. Valliappan v ITO*. But the decision of the madras High Court has been reversed by the Supreme Court in *Union of India v M.V. Valliappan* so that the scope for tax planning by way of partial is no longer available.

3. PARTITION- TAX PLANNING

Ordinarily, dual capacity, helps to reduce tax. But where the HUF has a large income with many coparceners, the liability of the HUF will be such, that it can be effectively reduced only by full partition dividing the assets between the members. This may help where all the members have not reached the maximum slab rate. There may be even instances where the liability could become a small fraction of the former liability on partition. Where, however, the largess of income is in respect of capital gains, on which a flat rate is applicable, a partition would not help. But even in such a case, the sale of asset after partition may enable the reinvestment benefit for

such of those members, who do not have house, to avail of the benefit of section 54F and even otherwise under section 54EA and 54 EB.¹⁹

Partial partition had helped multiple joint families, but with partial partition not being possible, one can still have three interests, firstly, as a member of larger Hindu Undivided Family with his son, secondly, with himself and his wife as smaller joint family after partition with his son and thirdly his own individual assessment.

- **Re-union**

Reunion has been recognised as a legitimate step to bring back the former status of joint family either by express or implicit agreement for reverting to the former status. The Hindu law certainly permits the parties, who have effected partition, to reunite. Such an agreement need not necessarily be in writing. An oral agreement with clear intention of the parties to reunite would bring back a joint family. The reunion is possible even among some of the partitioned members. It is possible for any of the two or more member of the joint family to come together as long as they bring back all the assets they had taken on partition. Re-union unlike partition does not require recognition. It is possible both under Mitakashtra and Dayabagha. Even where the earlier partition is by a registered deed, there could be oral reunion²⁰. The reunion should be of non-controversial character as mere the fact that the parties live together after partitioned does not mean reunion.²¹

Reunion was recognised for Income-tax purpose by the Karnataka High Court in the case of Paramanand L. Bajaj v CIT.²² it however, took the view notwithstanding the earlier precedents to the contrary to the effect that a registered partition can be undone only by a registered reunion. It is possible that none of the properties partition available at the time of reunion. The court however held that reunion must be in respect of all such properties and some properties cannot be kept out. Even if the deed does not declare all such properties, they are deemed to have been brought in. Even if only some of the parties reunite pooling with the assets allotted to them there

¹⁹ TAX PLANNING, pg 113-114, S. Rajaratnam & B.V Venkataramaiah, sixth edition, 2012-13, Bharat law publication Jaipur

²⁰ Mahalakshamma v Suryanarayana, (1928) 51 Mad. 977.

²¹ Bhagwan Dayal v Reoti Devi, AIR 1962 SC 287.

²² (1982) 135 ITR 673 (Kar.)

is no bar to a reunion.²³ As long as all the properties subjected to partition are brought back by the erstwhile co-parceners willing for reunion, there is a reunion.²⁴

- **Gift Tax Implication**

In view of the perception of the Income-tax Department, that the abolition of gifts tax has opened the door for tax evasion by routing unaccounted income as gifts, section 56(v) and 2(24)(xiii) have been inserted to treat gifts from non-relatives in excess of Rs 50000 as income. It can be inferred that this measure is a substitute for gift-tax. Even bona fide gifts from friend and non-relative would be liable to tax as income of donee, while non-genuine gifts from relative need not necessarily be exempted, though they do not fall within the scope of amendment, if they are not genuine. If they are not genuine, they cannot be treated as gifts to relatives so as to qualify for exception in section 56(v). In fact, the amount received will then be covered by section 68.

Gift of immovable property being it land or building or both, is received by an individual/HUF. The immovable property is received without consideration which exceeds the stamp duty value of the property by an amount exceeding Rs.50,000, then the amount of stamp duty value will be liable to tax.

If the gift of immovable property for a consideration which is less than the stamp duty value by an amount exceeding 50,000 then the difference between the stamp duty value and the consideration will be charged as tax for a single transaction.

However, in the following cases gift of immovable property will not be charged to tax-

- Property received from relatives.
- Property received by a HUF from its members.
- Property received on the occasion of the marriage of the individual.
- Property received under will/ by way of inheritance.
- Property received in contemplation of death of the donor.
- Property received from a local authority as defined under section 10(20) of the Income-tax Act.

²³ Godavarthy Venkamma v G. Venkatanarayana, LR 1947 Mad. 382.

²⁴ CIT v A.M. Vaiyapuri Chettiar, (1995) 215 ITR 836 (Mad)

- Property received from any fund, foundation, university, other educational institution, hospital or other medical institution, any trust or institution referred to in section 10(23C).
- Property received from a trust or institution registered under section 12AA.

Sum of money received without consideration by an individual or HUF is charged to tax if the aggregate value of such sum received during the year exceeds Rs. 50,000. Once the aggregate value of monetary gift received during the year exceeds Rs. 50,000, then the aggregate value of gift received during the year will be charged to tax.

Income tax tribunal in *Vineetkumar Raghavjibhai Bhalodia v ITO*²⁵, had understood, that where the donor is HUF in respect of a gift made to an individual member, the fact that the individual is related to every member of the Hindu Joint Family falling within the meaning of relative, exemption would be available. The Finance Act, 2012 has also made changes, where any member of a joint family including a Karta gives a gift to any other member, even if it is out of joint family property. The question of validity of such gifts under the Hindu law would be a different question, which would require to be considered.

- **Gift by HUF**

In the case of *R.C. Malpani v CIT*²⁶, the High Court was concerned with a gift of immovable property by the Karta, where the joint family had minors whose interest were protected by section 8(2) of Hindu minority and guardianship Act, 1956. The AO ignored the gift as void and continues to assess the same in the hands of the joint family. The High Court held that it was only a voidable gift and hence could not have been ignored.

The issue had come up in *CWT v K.N. Shanmugasundaram*²⁷, where it was held that aggregation provision would have no application in respect of gift of reasonable part of assets of joint family on customary occasion of the unmarried daughter. Such gifts, it was pointed out, need not be only at the time of marriage.

²⁵ (2011) 12 ITR (Trib) 616 (Rajkot)

²⁶ (1995) 215 ITR 241 (Gau.)

²⁷ (1998) 232 ITR 354 (SC)

It is now accepted that gifts of reasonable amount out of the joint family properties to an unmarried daughter is permissible and not necessary at the time of marriage.²⁸

Gift to wife of Karta in view of maintenance is valid.²⁹ But son can contest gift by father to his second wife³⁰. But there is no gift to the son of a property to which he already has right³¹. Gift to undivided son is not valid³².

- **Obligation to daughter and sister**

As a Hindu father is legally obliged to get his daughter married, expenses in this behalf is not a taxable gift³³. Maintenance of sister is also a legal obligation³⁴.

4. CONCLUSION

The expression “Hindu Undivided Family” has not defined under the Income- tax Act. However, the essentials of HUF are (i) One should be Hindu, Jains, Sikhs and Buddhists are considered as Hindus but not Muslims or Christians. (ii) There should be a family i.e group of persons – more than one and (iii) They should be undivided i.e. living jointly and having commonness amongst them. All these three essentials are cumulative. In this project report it has been mentioned that how one can by forming a HUF can make his tax planning in a better and innovative ways. The formation of HUF under income-tax law is different to that of Hindu law as the income tax law only recognised the written deed which stating the intention of the family members to stay as a joint Hindu family. The income tax department recognised such HUF as a separate legal entity which has given it a separate PAN no. under income tax law the taxable income or the tax will be charged on the income of the HUF (income of all the member of the family). However, the Karta or any other member can form a dual status and the same is permissible by law. The income of the HUF will be taken in a separate account of HUF and if

²⁸ Guramma Bhartar Channabasappa Deshmukh v. Mallappa Channabasappa, AIR 1956 SC 510

²⁹ CGT v Valluru Venkateshwara Rao, (1980) 123 ITR 54 (AP)

³⁰ A. Perumalakkal v Kumaresan alias Balakrishnan, AIR 1967 SC 569

³¹ A. Basavaiah Gowder v CGT, (1963) 49 ITR 817 (Mad.)

³² Balachand Malviya (HUF) v CWT, (1997) 227 ITR 651 (MP)

³³ CGT v B.S. Apparao, (2001) 248 ITR 103 (SC)

³⁴ Guramma Bhartar Channabasappa Deshmukh v. Mallappa Channabasappa, AIR 1956 SC 510

there is any personal income it will be treated separately. The Karta or any other member can also enter into a contract with the HUF in which he is the member however that should not be a shame transaction, the intention should be bonafide. The HUF cannot enter into a partnership but the Karta can do so and it will be assessable in the name of HUF of which he is a Karta as well as any member of the joint family can enter into partnership on behalf of the HUF. It is also possible for a HUF to enter into a partnership with its member in their individual capacity.

Section 171 of the Income-tax Act does not recognised partial partition while on the other hand the Hindu law does recognised the concept of partial partition. The act says that a Hindu Joint family “hitherto assessed” to be continued to be assessed as such, unless there is a formal order recognising partition from the Assessing Officer giving a finding, that there has been a total partition by metres and bounds. Section 171 talks about assessment after partition of a Hindu undivided family, it is mere a procedural law which talks about the accounting year several liability, the AO investigation, penalties, etc.

The income tax law also to control the tax evasion on the name of Gift by implementing the law under section 56(v), that the gift received from non-relative if exceeds Rs 50,000 then it will be treated as income. However the income tax laws does not infringed the sentimental feelings of the relative of the donee, as the donee on several occasion which are genuine to be able to receive the gift from its relative worth more than the said amount will be allowed to be tax free for ex. Marriage of the donee, etc. while the gifts received from relative which are not genuine will not be exempted. Gift of immovable property received by an individual/HUF. The immovable property is received without consideration which exceeds the stamp duty value of the property by an amount exceeding Rs.50,000, then the amount of stamp duty value will be liable to tax. If the gift of immovable property for a consideration which is less than the stamp duty value by an amount exceeding 50,000 then the difference between the stamp duty value and the consideration will be charged to tax. It is now accepted that gifts of reasonable amount out of the joint family properties to an unmarried daughter is permissible. Gift to wife of Karta in view of maintenance is valid. Thus, HUF is considered among the most effective tax planning as it helps the tax of not only an individual but of whole of the family.