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Tax Planning through HUF & Family Arrangements

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A family consisting of parents & their children living together as a unit has played a crucial role in the evolution of human society.

Under section 4 of the Income Tax Act, 1961, tax is payable by 'every person' and the word 'person' as defined in section 2(31)(ii) of the Income Tax Act includes a 'Hindu Undivided Family'.

No separate definition of the expression of Hindu Undivided Family (HUF) has been attempted in any of the direct tax laws because the term has a definite connotation under the Hindu law. The Supreme Court in Surjitlal Chhabra v. CIT 101 ITR 776(SC) and Bombay High Court in CIT v. Gomedalli Laxshmi Narayan 3 ITR 367 (Bom) have declared that the expression HUF must be construed in the sense in which it is understood under the Hindu law.

Background of Hindu Undivided Family

Hindu Law has been discussed by various authors in the light of various judgments of courts. The said law stands amended by various enactments. Our discussion would deal with various aspects of Hindu Law which are relevant for the purpose assessment of income and wealth in the status of Hindu Undivided Family (HUF) as well as the impact of the provisions of Hindu Succession Act 1956 as amended by Hindu Succession (Amendment) Act 2005 which are relevant for the purpose of assessment of income and wealth in the status of HUF under Income Tax Act 1961.

Hindu Succession Act, 1956 applies to any person who is Hindu by religion in any of its form and any person who is Buddhist, Jain or Sikh by religion and any other person who is not Muslim, Christian, Parsi or Jew by religion.

In view of the above & Apex Court's decision in the case of Champa Kumari Singhi 83 ITR 720 SC, the concept of HUF is not only applicable to Hindus by religion but also to those professing Sikh, Jain or Buddhist religion.

Creation of Hindu Undivided Family

There is a myth that HUF can be created by the act of parties. According to Mitakshara Hindu law, it is a creature of law except in the case of adoption or reunion where HUF can come into existence by act of parties. In the case of **Bhagwan Dayal v. Reoti Devi AIR 1962 SC 287,** it has been held that HUF co-parcenary is a creation of law and **cannot be created by agreement of parties except in the case of reunion.**

The apex court in the case of **Surjit Lal Chhabra 101 ITR 776** has clearly observed: "The joint Hindu family, with all its incidents, is thus a creature of law and cannot be created by act of parties, except to the extent to which a stranger may be affiliated to the family by adoption." Thus every Hindu family is an HUF unless proved otherwise.

Hindu coparcenery:

It is to be noted that HUF is taxable in respect of income arising/accruing from ancestral properties which is also known as coparcenery property. Other incomes earned by the members are assessable as their individual income. It would therefore be appropriate to know about the coparcenary.

A Hindu coparcenary is a much narrower body than the joint family. It includes only those persons who acquire by birth an interest in the joint or coparcenary property and these are the sons, grandsons and great-grandsons of the holder of the joint property for the time being, that is to say, the three generations next to the holder in unbroken male descent. Since under the Mitakshara law, the right to joint family property by birth is vested in the male issue only, females who come in only as heirs to obstructed heritage (sapratibandhadaya), cannot be coparceners.**(Surjit Lal Chhabra 101 ITR 776; State of Maharashtra-vs- Narayan Rao Shamrao Deshmukh 163 ITR 31 SC).** This aspect of matter is important to understand whether the income earned is to be assessed in the status of HUF or not.

What is meant by ancestral /coparcenary/ joint family property with reference to HUF?

As per Hindu law, **ancestral property** means property acquired by forefathers. Therefore, any property which is received by the coparcener on partition is always considered as ancestral property. However, it is to be noted that if the coparcener is unmarried on the date of partition then income from such property would be assessed in his hands in individual capacity till he gets married, reason being that single person cannot constitute family.**(C Krishna Prasad-CIT 97 ITR 343 SC.)** It was held by the apex court that once a property gets the character of HUF/ancestral property, it continues to have such character even though holder of estate may be single. Till he gets married, he is the absolute owner and can dispose it in any manner he likes. Therefore, in the absence of family, the income from such property is liable to be assessed in individual capacity. In case, he gets married before the end of the year then, such income would be assessed in hands of HUF consisting of himself and his wife.

The expression "**Coparcenary property is wider than the expression 'ancestral property'.**

It would include the following:

- Ancestral property i.e. the property inherited from father, grandfather or great grandfather; share allotted on partition;

- Property acquired by the coparceners with joint efforts. In Madanlal-v- Yogabai AIR 2003 SC 1880, it has been held that property raised and developed by joint efforts of father and sons would be joint family property;

- Property acquired with the aid of or on account of coparcenary property.

- Property of the coparcener thrown into common hotchpots of family funds. So, a female member could not throw her self- acquired property in common hotchpots of joint family. Pushpa devi-vs-CIT 109 ITR 730 SC.

- The property received by HUF having ancestral property as gift or under a will. Intention of the donor is relevant while considering the character of the gifted property. (M.P.Periakaruppan Chettiar-vs-CIT 99 ITR 1 SC.)

The expression Joint family/HUF property is still wider–A property may not be either ancestral or coparcenary property yet may be considered as HUF property in certain cases. There may be a family with a single male member without having ancestral/coparcenery property. Such family may receive gift from relatives or friends of members of family. Further, the single male member of such family may blend his self acquired property into joint family property. Such property would neither be ancestral nor coparcenary property but certainly be HUF property. To buttress this view, reference may be made to the decision of the apex court in the case of Surjit Lal Chhabra 101 ITR 776 SC. However, in such case, it was held that income from such property would be assessable as personal income of the male person till the birth of a son.

So, distinction must be kept in mind between the cases falling within the ratio laid down by the apex court in the cases-(Gowli Buddanna-vs-CIT 60 ITR 293 SC at 296; N V Narendernath-v- CWT 74 ITR 190 SC) and C. Krishan Prasad 97 ITR 343 SC) on one hand and the cases falling within the ratio of the decision in Surjit Lal Chhabra 101 ITR 776 SC.

Whether property inherited from father can be treated as HUF property?

As per the old Hindu law, the property inherited by a coparcener was considered as ancestral property but after the commencement of HSA 1956, the property of father devolves by testamentary or intestate succession. The father has absolute right over the property acquired by him on account of personal efforts or through borrowed funds. He can dispose of such property as he wishes. Hence, property inherited from father cannot be treated as ancestral property. **(CWT-vs-Chander Sen 161 ITR 370 SC**)

A Hindu male with his sons/daughters & grandsons constitutes an HUF but this HUF may not own any Hindu Undivided Property. This would be the situation, not very uncommon, where the family has not inherited any property.

A question arises as to how the families consisting of a father and his sons, or of brother, and the like, can acquire assets. The answer to this question constitute what is commonly called creation of assets of HUF.

1. Properties of HUF can be acquired by joint labour. If all the members of the HUF put in the joint labour then the presumption will be that the property was acquired with the help of the joint efforts of all the members is a HUF property.

2. Vesting of self acquired property in family hotchpotch can create family nucleus. Clubbing provision u/s 64(2) to be noted.

3. Gifts: A newly created HUF as a unit may receive gifts from outsiders or from father or brother or sister of the karta who are not members of the donee HUF. All such gifts will result in accretion to the family fund without attracting the provisions of Section 64(2). The only precaution to be taken is that none of the donors should be coparceners or members of the done HUF.

4. Gifts of self acquired property by father to son's HUF create HUF of the son. A father can gift his self acquired property to his sons's newly created HUF. It is essential that the gift deed should specifically mention the gift to the HUF & not to individual son.

5. HUF through will: A new family unit can also be created by a will but the intention of the bequest being for the family has to be made absolutely clear in the will.

6. Creation of new HUFs through partition of an existing HUF.

Partition of HUF property

As per Hindu law.

- Partition is a process by which a joint enjoyment is transformed into an enjoyment in severalty. Each one of sharers had an antecedent title and therefore no conveyance is required. CED-vs-Kantilal Trikamlal 105 ITR 92 SC at p 101.

- Once shares of each sharer are defined, the partition is complete. It is not necessary that it should be by metes and bounds.

- Even a single coparcener can separate himself from rest of the family.

- Even partial partition is permissible. For example, joint family business could be divided while retaining other properties as joint property.

- Where there is partition between different branches, the respective branches continue to remain in joint.

- Since partition can be effected between coparceners only, a family with sole coparcener is not amenable to partition. 111 ITR 539 Mad, CIT-v-Satpal Bansal 162 ITR 582(PH)(FB), 74 ITR 271 Guj.

Partition under section 171 of I.T. Act 1961:

- **Section 171 raises a legal fiction that an HUF**, once assessed shall be deemed to continue unless a finding of partition has been given under this section. Consequently, unless a finding is recorded under section 171 that a partition has taken place, the income from the properties would be included in the total income of the family by virtue of sub-section (1) of section 171. (Kaloomal Tapeshwari Prasad-vs-CIT 133 ITR 690 SC)

- Section 171, as originally enacted, applied to total as well as partial partition. However, sub section (9) inserted by Finance (No 2) Act 1980 recognises only complete partition. The cut of date was 31.12.1978. Thus partial partition effected after this date is not given effect to by the AO even though such partition may be legal as per Hindu Law. Hence, for the purpose of income tax assessment, the HUF shall be deemed to continue notwithstanding the partial partition and the income from all properties shall continue to be assessed in the hands of erstwhile HUF.

- It is to be noted that section 171 applies to those HUFs which have been assessed under the Act. So, in my opinion, partial partition can still take place where HUF has not been assessed without invoking this section.

- Section 171, as applicable from A.Y. 1980-81, recognises only complete partition. Explanation to this section recognizes only partition by metes and bounds i.e. the physical division of property is condition precedent. So, there is a departure from Hindu law. Even a decree of court would not be sufficient or binding on AO unless physical division takes place. ITO-vs- N K Sarada Thamptty 187 ITR 696SC; Narender Modi-vs- CIT 105 ITR 109 SC.

- Partition can be effected on demand of coparceners or suo moto by the father in his superior power even without the consent of sons. Such right can also be exercised even where sons are minors. Apoorva Shantilal Shah (Huf) Seth Gopaldas (Huf)- vs- CIT 141 ITR 558 SC.

- In case of CIT-vs-Maharani Rajlaxmi Devi 224 ITR 582 SC, the court has held that recording of partition u/s 171 is necessary even in case is falling u/s 6 of the HSA. It observed: “it must be held that though for the purpose of HUF, section 6 of the Hindu Succession Act, would govern the rights of the parties but insofar as income- tax law is concerned, the matter has to be governed by section 171(1).”

- It is mandatory that assessee must make a claim of partition at the time of making assessment u/s.143 / 144. If such claim is made, the AO is required to make an enquiry into such claim after giving notice to all the members. After making enquiry, AO is required to record a finding accepting/rejecting the claim.

Impact of Hindu Succession (Amendments) Act 2005

The first relevant amendment is the amendment of section 6 w.e.f. 9.9.2005. Firstly, it declares that on and from the commencement of this Act, in the joint family governed by Mitakshra law, daughter of a coparcener shall, by birth become a coparcener in the same manner as the son. Consequently, she would have the same rights and subject to same liabilities as that of a son. **Thus, the scope of coparcenary has been enlarged by the Hindu Succession Amendment Act 2005.** However, it is to be noted that it not extended further to next generations of such daughter.

This amendment has a great impact on the concept of HUF and its treatment under the Income Tax Act. Under the Hindu law, joint Hindu family must have at least one male member.(CIT-vs- Sandhya Rani Dutta 248 ITR 201 SC) The court observed: "The principal question here was the capacity of Hindu females to form among themselves a HUF. No authorities to support this were brought to Court's notice; indeed they could not be, for the concept appears to be alien to the Hindu personal law which requires the presence of a male for the purposes of the constitution of an HUF."

After the amendment in section 6 of Hindu Succession Act 1956 w.e.f. 9.9.05, the daughter of a coparcener in joint family is also to be treated as coparcener on the same footing as that of a son. The discrimination between son and daughter disappears. Therefore now where a family consisting of father, his wife and a daughter existed on 9.9.05 and thereafter father dies then the remaining family of widow and daughter would constitute HUF and the principle laid down in Sandhya Rani's case (supra) would not apply. In other words, where HUF, having ancestral property exists as on 9.9.2005 but subsequently is reduced, on the death of male member, to a family having female members i.e. wife of the deceased and daughters, the income from properties of such family will continue to be assessed in the hands of HUF in view of the decisions of the apex court in Gowli Buddanna-vs-CIT 60 ITR 293 SC at 296; N V Narendernath-v- CWT 74 ITR 190 SC; the reason being that daughter of coparcener is also be considered as coparcener.

An important question arises whether daughters married before Sep 9, 2005 would become coparceners of their parental family in view of the said amendment. They cannot be considered as coparceners for the reasons given hereafter. If we read the amended section 6 carefully, it is clear that it applies only when in the joint family as on 9.9.05, the female is the daughter of a coparcener. That means that both the coparcener as well as daughters of such coparcener must be the members of such joint family as on 9.9.05. The married daughters, as per Hindu law, ceased to be members of joint family on the date of marriage itself and became member of husband's family. Accordingly, in my opinion, the daughters married before 9.9.05 cannot become coparcener of parental family. For the similar reason, where the coparcener had expired prior to 9.9.2005, the daughter of such person cannot be treated as coparcener; reason being that member of coparcenery ceased to be members of the coparcenery on his death as per Hindu law.

Consequence of Amendment made by Hindu Succession (Amendment) Act, 2005- Rights & Liabilities of a Daughter Member

- Daughter shall be a Coparcener of Hindu Family Property.
- If a Hindu dies, the coparcener property shall be allotted to the daughter as is allotted to sons.
- If a female coparcener dies before partition, then children of such coparcener would eligible for allotment assuming a partition had taken place immediately before her demise.
- No recovery is made for ancestors dues from son, grandson, or great-grandson by applying doctrine of pious obligation.
- A female member can also seek partition of the dwelling house where the family resides.
- A widow of a pre-deceased son even though remarried is now eligible for share in property as legal heir of the pre-deceased son of the family.
- A female can also dispose of her share in coparcenery property at her own will.

However, it is to be noted that the aforesaid amendments does not affect the legal position u/s 171 of I T Act 1961. The provisions of section 171 have to be complied with irrespective of the amendment of section 6 of Hindu Succession Act 1956. In case of CIT-vs-Maharani Rajlaxmi Devi 224 ITR 582 SC, the court has held that recording of partition u/s 171 is necessary even in case falling u/s 6 of the HSA. It observed: “it must be held that though for the purpose of HUF, section 6 of the Hindu Succession Act, would govern the rights of the parties but insofar as income-tax law is concerned, the matter has to be governed by section 171(1)”

It is further to be noted that the requirement under IT act is that properties have been partitioned by metes and bound as far as section 171 of the I T Act is concerned, it is not the requirement that partition must be effected through registered deed between the parties.

IMPORTANT FAQs ON HUF

Partition of HUF under Income Tax Act, 1961 and its assessment after Partition.

The Partition of HUF should be recognized as per the Income Tax Act and not as per the Hindu Law. Section 6 of the Hindu Succession Act would govern the rights of the parties but insofar as income-tax law is concerned, the matter has to be governed by section 171(1) of the Income Tax Act, 1961 [Add. CIT v. Maharani Raj Laxmi Devi [1997] 091 Taxman 020 (SC)]. The Hindu Law does not require that the property in every case be partitioned by metes and bound or physically into different portions to complete a partition. But the Income Tax Law introduced certain additional conditions of its own to give effect to the partition u/s 171.

Section 171 of the Income Tax Act, 1961 defines the partition of HUF and deals with the provisions of assessment after its partition. Thus a transaction may be treated as severance of status under Hindu Law but not a partition under 1961 Act as physical division of property is necessary under 1961 Act [CIT v. Smt. Meera Prem Sundar (HUF) [2005] 147 TAXMAN 535 (ALL.)].

The various practical aspects related to partition of HUF are discussed as under:

Q1. What is the Partition of HUF?

• The Partition of HUF can be categorized as under:-

1. **Partial Partition** - Partial partition means a partition which is partial as regards the persons constituting the HUF, or the properties belonging to the HUF, or both.

2. **Total or Complete Partition** – Assets of HUF are physically divided. As per explanation to section 171 of the Income Tax Act,

'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.

Therefore a transaction can be recorded as a partition u/s 171 only if, where the property admits of a physical division, such division has actually taken place. [Kalloomal Tapeshwari Prasad (HUF) v. CIT [1 982] 133 ITR 690 (SC)]

Q2. What is the tax implication of Partial Partition of HUF?

A Partial partition taken place after 31-12-1 978 is not recognized the Income Tax Act, 1961 (Sub-section 9 of section 179. Therefore even after the Partial partition, the income of the HUF shall be liable to be assessed under the Income-Tax Act as if no partition had taken place.

Q3. What is the tax Implication of Full Partition of HUF?

After the Partition, the assessment of HUF shall be made as per the provisions of Section 171 of the Income Tax Act and order to be passed by the Assessing Officer.

Q4. What is the procedure of partition and assessment after partition of HUF under Income Tax Act

The following procedure u/s 171 is prescribed under the Income Tax Act regarding partition and assessment after partition of HUF:

1. The HUF hitherto assessed as undivided shall be deemed for the purposes 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 HUF.

2. Where, at the time of making an assessment u/s 143 or u/s 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 members of such family, the AO shall make an inquiry thereinto after giving notice of the inquiry to all the members of the family.

3. On the completion 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 taken place.

4. Where a finding of total or partial partition has been recorded by the AO and the partition took place during the previous year,—

   (i) 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

   (ii) each member or group of members 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.

5. Where a finding of total or partial partition has been recorded by the AO 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 if no partition had taken place; and each member of group of members shall be jointly and severally liable for the tax on the income so assessed.

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.

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

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.

Q5. Whether the sum received by a member as and towards his share as coparcener of HUF, on its partition is taxable as income?

The sum received by a member as and towards his share as coparcener of HUF, on its partition cannot be brought to tax as income [Smt. Sudha V. Iyer v. ITO 15 taxmann.com 234 (ITAT-Mum.) [2011]

Q6. Whether setting apart of certain assets of HUF in favour of certain coparceners on a condition that no further claim in properties will be made by them, is a partition under Income Tax Act?

Setting apart of 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 and not recognised in view of section 171(9) of the Act. [ITO v. P. Shankaraiah Yadav 91 ITD 228 (2004) (ITAT-Hyd.)].

Q7. Whether there is an ipso facto partition of joint family properties immediately after the death of a male coparcener having coparcenary interest in coparcenary property?

The gist of the various pronouncements of the Hon'ble Supreme Court is that there is no ipso facto partition of joint Hindu family properties immediately after the death of a male coparcener of the Mitakshara school having coparcenary interest in the coparcenary property. The fiction given by Explanation 1 to section 6 of 1956 Act has nothing to do with the actual disruption of the status of a HUF. It freezes or quantifies the share of a female heir in the coparcenary property on account of the death of a coparcener at the relevant point of time. Therefore, there was no partition and disruption of the HUF as per Explanation 1 to section 6 of the 1956 Act, in the instant case. [CIT vs. Charan Dass (HUF) [2006]153Taxman 307(All.)

Q8. Whether the income received by members from HUF is taxable?

As per Section 10(2) of the Income-tax Act, 1961, any sum received by an individual from Hindu Undivided Family of which he is member is exempt from tax.

But the amount received not as a member of Joint Family but in pursuance of some statutory provision, etc. would not be exempted in this section. Also the position of member of joint family in law to claim the right u/s 10(2) does not get affected only with the reason that they are living apart from the other members of the family.

Taxability of Income from house property in the name of HUF

1. Self occupied one Residential House & the tax gain especially by way of Interest on Loan & Repayment of Loan

2. Deduction of 30% on Rental Income is also available to HUF.

3. Exemption from Wealth-tax the real estate of HUF – One House Wealth Tax Free (Commercial / Rented Residential)

FAQ

Q1. Whether the Property purchased with the joint fund is assessed in the hands of HUF only?

Property purchased with the aid of joint family funds, howsoever small that may be, still the property would be HUF income and cannot be income of the individual with major portion of purchase price.

The Hon'ble Madras High Court has held in the case of S. Periannan v. CIT (1991) 191 ITR 278, that "When once the estate had become the property of the assessee-Hindu undivided family on its coming into existence, there could be no change in its character by reason of the fact that, subsequently, in the books of the assessee-Hindu undivided family, the account of Sathappa Chettiar was debited with the amount which have been drawn for the purchase of the estate. In these circumstances. The Tribunal rightly held that the Grove Estate should be considered as belonging to the assessee-Hindu undivided family."

Q2. Whether the Income from House property to be charged in the hands of HUF only where property is purchased in the name of HUF?

In the case of ACIT vs. Rakesh S. Agrawal [2010] 36 SOT 148 (AHD.) it was held that: AO found that the assessee had purchased a house property from 'A'. The assessee's case was that since the investment was made in the name of HUF, it was not declared in his individual return. The AO, however, took a view that the funds for acquiring the property in question were met from the personal sources of the assessee. He thus determined annual letting value of the property resulting in certain addition to the assessee's income. On appeal, the Commissioner (Appeals) directed the AO to consider the annual letting value of the property in the hands of HUF and deleted the impugned addition.

Proprietorship and Partnership by HUF

Q1. Whether HUF can do a business in its own name?

1. HUF can be a Proprietor of one or more than one Business concerns.
2. Separate name can be kept of HUF business entity.
3. No tax Audit of HUF business if Turnover within Rs. 1 crore (w.e.f. F.Y. 2012-1 3).
4. Business Income Computation @ 8% without books of account in case turnover is upto Rs. 1 crore – The Presumptive Basis

Q2. Can a Karta of HUF become partner in a firm?

The Hon'ble Supreme Court in Ram Laxman Sugar Mills vs. CIT [1967] 66 ITR 613 observed that a HUF is undoubtedly a "Person" with in the meaning of section 2(31), it is however not a juristic person for all purposes and cannot enter in to an agreement of partnership either with another HUF or Individual. It is open to the manager of a Joint Hindu family, as representing the family, to agree to become a partner with another person. And therefore any remuneration received by Karta would be the personal income of Karta and not the income of the HUF as

there is no real connection between the investment of the assets of HUF and remuneration received by Karta.

Q3. Whether the amount received by Karta from partnership firm as remuneration is assessed in the hands of HUF?

The remuneration received by Karta as representative of HUF cannot be treated as income of the HUF. Remuneration will be income of HUF only when there is direct nexus between family funds and remuneration paid.

In Brij Mohan vs. CIT 201 ITR 831 (1993), the Supreme Court held that where the receipt is a compensation made for the services rendered and not for the return of investment, it is to be treated as individual income of the partner.

However, where members of HUF become the partners in a firm by investment of family funds & not because of any Special Services rendered by them, then the income will belong to HUF. {Lachman Das Bhatia & Sons vs. Commissioner of Income-tax [2007] 162 Taxman 118 (Delhi)} {D.N. Bhandarkar v. CIT 158 ITR 724 Kar (1986)}

Once the character of an individual has been treated differently than HUF for the purposes of interest, there is no reason as to why that would not extend to the salary and bonus paid to such partners on account of their personal services rendered to the firm in contra-distinction to their capacity as representatives of HUF .

Therefore, the same reasoning would apply to the cases where payment in the form of salary and bonus has been made to a partner in his individual capacity in contra-distinction to his representative character of the HUF. [CIT v. Unimax Laboratories [2007] 164 Taxman 373 (P & H)].

Q4. Whether deduction is available to partnership firm u/s 40(b) in respect of salary or commission paid to a partner who was a partner in representative capacity of HUF.

As per Section 40(b)(i)
"in the case of any firm assessable as such,—
any payment of salary, bonus, commission or remuneration, by whatever name called (hereinafter referred to as "remuneration") to any partner who is not a working partner"
Partner of a firm is an individual even if he is partner as a representative of HUF

- Where assessee-firm paid salary to a partner who was actively engaged in conducting affairs of business of firm, it was to be held that requirement of Explanation 4 to Section 40(b) stood complied with, and, thus, assessee-firm would be entitled to deduction in respect of salary paid to said partner even though he was a partner in representative capacity of HUF. [P. Gautam & Co. vs. JCIT [2011] 14 taxmann.com 79 (Ahd.)]

- Salary paid to working partner even though as Karta of HUF, is received as individual and as working partner, hence allowable as deduction while computing income of firm. [CIT vs. Jugal Kishor & Sons [2011] 10 taxmann.com 82 (All.)]

- It is individuals of HUF who indirectly become partner in firm in which HUF is said to be partner and therefore provisions of Section 40(b) that prohibits deduction of payments of commission to any partner who is not a working partner, in computing income under the head PGBP, will not be applicable. Therefore deduction of any commission payable to any individual of HUF shall be allowable. [CIT v. Central Scientific Instrument Corporation [2010] 1 DTLONLINE 149 (All.)]

Q5. Whether the Salary income of wife of Karta is club in the Income of HUF?

Where a person is a partner in a partnership firm not in his individual capacity but as the karta of the Hindu undivided family, the income accruing to his wife on account of her being a partner in the same partnership firm cannot be included in the total income of such person in an individual assessment or in the assessment of the Hindu undivided family. [CIT v. Om Prakash [1996] 217 ITR 785 (SC) See also CIT v. Ram Krishna Tekriwal [2005] 274 ITR 266 , Satish Chand Gupta v. CIT [2007] 160 Taxman 224 (All.)].

Q6. Whether the Loss of erst while concern can be setoff against business taken-over by HUF?

In the case of Pratap H. Desai (HUF) v. ACIT [2009] 118 ITD 29 (Pat.) it was held that: Assessee was a partner in a firm which was dissolved with effect from 1-1-1999 and its business was taken over by the assessee in the capacity of a HUF – the assessee sought to set-off loss of the said firm against the profit of his business as HUF. Section 78(2) prohibits carry forward and set-off of losses of one person by another person except when the other person receives the losses by inheritance. Section 78 shows that where succession to business is by inheritance, then loss will be allowed to be set-off and not otherwise. Therefore, assessee was not entitled to set-off of losses of firm against his individual income.

Capital Gain Exemption available to HUF

General provisions applicable to HUF:

- Cost Inflation Index benefit available to Calculate Cost of the Asset.
- Tax benefit of 20% Tax on Long-term Capital Gains.
- Long-term Capital Gains Saving by investing in Residential Property u/s 54/ 54F.
- Exemption on sale of Agricultural land u/s 54B.
- Saving Tax on Long-term Capital Gain possible by investing in Capital Gains Bonds of NHAI / RECL u/s 54EC.
- Exemption from tax on LTCG on transfer of residential property if invested in a manufacturing small or medium enterprise u/s 54GB (introduced vide Finance Act, 2012)

Various practical aspects of taxability of Capital gain the hands of HUF are discussed as under:

Q1 To avail the benefit of adopting market value as on 1-4-1981, upto which date the capital asset should have become property of the previous owner?

Capital asset should have become property of previous owner before 1-4-1981 to make assessee entitled to benefit of adopting market value as on 1-4-1981 but where construction of building was completed in 1988 and possession of flat was handed over to previous owner, i.e., HUF, it could not be said that flat itself became property of HUF prior to that date and, hence, assessees were not entitled to adopt market value of flat as on 1-4-1981.In view of specific provisions of Explanation (iii) to section 48, indexing had to be allowed of the financial year in which flat was held by assessee on partition of HUF. { DCIT v. Kishore Kanungo 102 ITD 437 (Mum.) [2006] }.

Q2. Whether the benefit u/s 54 can be available on purchase of more than one residential house Properties?

A plain reading of section 54(1) discloses that when an individual assessee or an HUF assessee sells a residential building or land appurtenant thereto, he can invest capital gain for purchase of a residential building to seek exemption of the capital gain tax. The expression 'a residential house' should be understood in a sense that building should be residential in nature and 'a' should not be understood to indicate a singular number.

That when an HUF's residential house is sold, the capital gain should be invested for the purchase of only one residential house, is an incorrect proposition. After all, the property of the HUF is held by the members as joint tenants. If the members, keeping in view the future needs in event of separation, purchase more than one residential building, it cannot be said that the benefit of exemption is to be denied u/s 54(1). [CIT v. D. Ananda Basappa 180 Taxman 4 (Kar.) [2009]]

Q3. Whether to claim benefit of section 54F, residential house which is purchased or constructed has to be of same assessee whose agricultural land is sold?

To claim benefit u/s 54F, residential house which is purchased or constructed has to be of same assessee whose agricultural land is sold.

The, it is written it same view is expressed by Delhi High Court in the case of Vipin Malik (HUF) Vs CIT 183 Taxman 296 (2009), It was held that: "The agricultural land, which was sold was of the HUF of the assessee but the flat purchased in the co-operative society was not in the name of the HUF. The flat was in the individual name of the assessee along with his mother. To claim the benefit of section 54F, the residential house which is purchased or constructed has to be of the same assessee whose agricultural land is sold and it was not the case in the instant case. [Para 9]

Clearly, therefore, there was no question of applicability of section 54F in the aforesaid facts and circumstances."

Q4. Whether in terms of section 48, payment made by assessee for education, maintenance and marriage of his unmarried daughter, though under consent decree, could be said to be an expenditure wholly and exclusively incurred in connection with transfer of property?

Under section 48, any payment made by assessee for education, maintenance and marriage of his unmarried daughter, though under consent decree, could not be said to be an expenditure wholly and exclusively incurred in connection with transfer of property or could also not be considered as a cost of acquisition or cost of improvement. [Krishnadas G. Parikh v. DCIT [2008] 114 ITD 362 (AHD)].

Q5. Whether the exemption u/s 54B of the IT Act is available to HUF?

Exemption under Section 54B is also available to HUF subject to the following condition: If HUF transfer a land which is used for agricultural purposes by a HUF, the rollover relief u/s 54B is available to the HUF. The amendment is applicable on transfers made after 01-04-2013.

*Even before the amendment, exemption was being allowed to HUF.

Same view is expressed in K.S. Jain & Sons (HUF) v. ITO 173 Taxman 114 (Delhi) (Mag.) [2008], it was Held, AO was wrong in denying deduction u/s 54B to assessee on ground that assessee being an HUF was not entitled to deduction u/s 54B.

Q6. Whether exemption from Capital Gain u/s 54GB newly introduced vide Finance Act, 2012 is available to HUF?

Exemption from tax on LTCG on transfer of residential property if invested in a manufacturing small or medium enterprise. :

- Available to an Individual or HUF.
- Transfer made on or before 31st March, 2017.
- Amount is reinvested before due date of furnishing return of income u/s 139 (1)
- In Equity of a new start up SME company in the manufacturing sector in which it hold more than 50% share capital or voting rights.
- Amount is utilized by the company for purchase of new plant & machinery
- The share cannot be transferred within a period of 5 years

Taxability of gift received in cash or in kind by HUF without consideration

1. If any sum of money exceeding Rs. 50,000 is received by the HUF without consideration then provisions of section 56(2)(vii) are applicable and the same is taxable in the hands of HUF.

2. Gift received in kind by HUF without consideration is also taxable subject to the provisions of s. 56(2)(vii). The definition of relative provided under Explanation to Section 56(2) (vii) shall be amended by Finance Act, 2012. The amendment is as under:

The provisions of section 56 are amended so as to provide that any sum or property received without consideration or inadequate consideration by an HUF from its members would also be excluded from taxation [w.r.e.f. 1-10-2009].

For this purpose, clause (e) of the Explanation below section 56(2)(vii) is to be substituted to provide that in case of HUF, relative means members of the HUF.
After the amendment,
"(e) "relative" means,—
(i) in case of an individual—
(A) ******; and
(ii) in case of a Hindu undivided family, any member thereof."

The amendment as above is inspired by the decision of ITAT in Vineetkumar Raghavjibhai Bhalodia v. ITO 46 SOT 97 (Rajkot-ITAT) (2011) where it was held that Gift received from HUF is gift from relative.

The following deductions under Chapter VIA available to HUF

Section as per I.T.Act, 1961	Deduction
Section 80C	Deduction available to HUF[Insurance Premium can be paid on the life of any member which does not exceed 10% of total sum assured for policies issued on or after 1st Apr, 2012]
Section 80D	Mediclaim Policy on the health of any member of the family.
Section 80DD	For maintenance including medical treatment of a dependant member of the family.
Section 80DDB	Medical treatment for any dependant member of the HUF
Section 80G	Donation to certain funds, charitable institutions ,etc.
Sections 80IA / 80IAB / 80IB / 80IC / 80ID / 80IE / 80JJA	New Industrial undertakings

Family Arrangements – Taxation & Legal Aspects

Family disputes and consequential family partition and family arrangements are not new in Indian history. Since ages, the human civilization has been exposed to disputes, settlement and arrangements within the family. The destruction of property and human lives in Mahabharata was the outcome of the family dispute that could not be resolved by partition and/or arrangement. Hence, family partition and family arrangement assume significant importance in not only preserving the property but also human lives and values.

There is no specific legislation enacted by the Government to deal with the family disputes, family partition and family arrangement. The whole concept of family partition and family arrangement has been evolved over the years and further and refined by the judiciary keeping in mind the spirit behind the family arrangement.

The main ingredients of family arrangement are:-Family; Property; Disputes and Arrangement.
Family-

Explanation 10(5) of Income-tax Act, 1961 defines the term 'family' as follows:

Family in relation to individual means:- i) the spouse and children of the individual; and ii) the parents, brothers and sisters of the individuals or any of them wholly or mainly dependent on individual.

The word 'family' is not to be understood in a narrower sense of being a group of persons who are recognised in law as having a right of succession or having a claim to share in the property dispute. It is also not correct to say that a person by reason of his inheritance alone become, ipso facto, a member of the family whose property he succeeds. The word 'family' has to be used in a broader sense and would mean all those who are connected by blood relationship or marriage and are, therefore, to be considered to be belonging to the 'family'. The girl who is married and goes to her husband's family hence ceases to be a member of her father's family, will still be considered to be a member of her father's family under certain circumstances like family settlement-arrangement etc.

Property-

Joint property in the family hotchpotch is considered for the purposes of family arrangement. Individual properties or the self-acquired properties generally don't become the subject of family arrangement. However, if the antecedent title, claim or interest in such property is shown to be in existence, family arrangement in respect of such properties can be validly arrived at. Antecedent title of the participants to the family arrangement in subject property is a guiding factor for family arrangement.

In case of Bansari Lal Aggarwal Vs. CGT [(1998) 230-ITR-114 (P&H)], in this case Punjab and Haryana High Court disregarded the family arrangement arrived at between the husband on the one side and wife & four son on the other as collusive one effected with a view to avoid payment of tax. In the said case, property owned by the assessee was an individual property. Wife and four sons had only lent money to husband to buy the said property. Mere creating an antecedent title, claim or interest of the five persons in the individual property of husband and consequently, the family arrangement decree obtained by the parties concerned was set aside on the ground of being collusive, obtained with a view to avoid payment of tax.

Disputes-

Normally a dispute in a family leads to a family arrangement. The word 'arrangement' means to come to an agreement about, to settle the dispute. The very nature of the word 'arrangement' suggest the existence of either the actual dispute or the prosperity of the persons concerned to raise the dispute in future. However, family dispute is not necessarily a prelude to the family arrangement. Though conflict of the legal claims in present or in future of generally a condition for the validity of the family arrangement, it is not necessarily so. Even the possibility and/or plausibility of bona fide disputes, which may not involve legal claim, will suffice to arrive at a valid family arrangement.

Arrangements-

The word 'arrangement' means to come to an agreement about, to settle the dispute. The process of 'arrangement' is just like the process of arbitration. The process of arrangement is not synonyms with process of determination of the rights of the parties like in a legal suit instituted in any court of law by the warring parties. The arrangement is not arrived at strictly in accordance with law of inheritance as in vogue for the time being. Consequently, even the person who has no right to inherit particular property may get some share in an arrangement arrived at. The arrangement is more about compassionate nature, arrived at to take care of mutual interest, desire to co-exist peacefully. As held by the Apex Court in number of cases, 'arrangement' with reference to family arrangement is to bring about harmony in a family and do justice to its various members and avoid in anticipation future disputes, which might ruin them all.

In the case of S.K. Sattar S.K. Mohd. Vs. Gundappa Ambadas [(1996) 6-SCC-373] Court described 'family arrangement' as a transaction between members of the same family for the benefit of the family so as to preserve the property, peace, and security of the family, avoidance of family dispute and litigation and for saving the honour of family. Such an arrangement is based on the assumption that there was an antecedent title in the parties and the agreement acknowledges and defines what title is.

TAX ASPECTS IN FAMILY SETTLEMENT :

Family settlement is mainly a medium for resolving disputes but simultaneously one should take care of the tax aspects.

Many a times, it is seen that disputes arise on death of the father without any Will. In such cases family settlement can take the place of Will if the legal heirs agree to divide the assets and liabilities among themselves in a particular manner. In such cases it is advisable to achieve the twin objective of resolution of family disputes and tax planning.

It is open to the Karta of the family who is single co-parcener with the widowed mother and un-married sisters to allow the properties to the un-married sisters in lieu of the claim of marriage and maintenance through the family settlement- C.I.T. v. Narain Dass Wadhwa [1980] 123 ITR 281 (P&H).

Following the Supreme Court decision in the case of Sahu Madho Das v. Mukand Ram AIR 1955 SC 481, Madras High Court held in C.G.T. v. Pappathi Anni [1981] 127 ITR 655 (Mad.) that an agreement between widowed mother and son for division of property to be family

arrangement not attracting gift tax as the parties genuinely and bonafide, thought that both mother and son had right to half share in the property left behind by the father and that allotment of property to son or the mother was not without any consideration.

The family settlement is the best medium of planning the distribution of the assets in such a way that assets may pass to those who may have to bear the least possible tax. As already stated the division of assets through family settlement is not a transfer, therefore it neither attracts capital gain tax nor gift tax - CIT v. A.L. Ramanathan 159 CTR (Mad) 255. The clubbing provisions of section 64 of the Income Tax Act are also not attracted to the family settlement. But one should be careful and cautious. The family settlement should be bonafide, otherwise it may fail. In a case before the Madhya Pradesh High Court in S.R. Kalani (HUF) v. C.I.T. [1989] 177 ITR 259(MP), a partnership was formed by family arrangement giving a lump sum amount to the mother under family settlement. On the basis thereof, she was admitted as a partner in the firm with the Karta of HUF, her only son. Earlier, it was claimed as a partition which was rejected and the family was assessed in the status of HUF as before. Later on the plea of partition was given up and it was claimed that the mother was given a sum of rupees one lakh in lieu of her right to maintenance under the family arrangement. It was found on the facts that the mother did not withdraw any amount for her maintenance. The story of quarrel with her daughter-in-law was also found incorrect because she made a gift of her jewellery to the daughter-in-law after the alleged family arrangement. Thus, the family arrangement was not found to be bonafide and was rejected by the Court.

In the case of Roshan Singh Vs. Zile Singh [AIR 1988 SC 881] the Supreme Court held that parties to a Family arrangement set up competing claims to the properties and there was an adjustment of the rights of the parties. By family arrangement it was intended to set at rest competing claims amongst various members of the family to secure peace and amity. The compromise was on the footing that there was antecedent title of the parties to the properties and the settlement acknowledged and defined title of each of the parties.

In the case of CIT Vs. A.N. Naik Associates [265 ITR346, Bom], by the Memorandum of Family Settlement dated 30th January, 1997 it was agreed between the parties thereto that the business of six firms as set out therein would be distributed in terms of the family settlement as the parties desired that various matters concerning the business and assets thereto be divided separately and partitioned. Under the terms and condition of the settlement, it was set out that the assets proposed to be divided in partition under the settlement were held by the firms and the individual partners. With reference to the firms, the manner in which the firms were to be reconstituted by retirement and admission of new partners was also set out. Based on these documents and subsequent deeds of retirement of Partnership an order of the assessment was made holding that the respondents was liable for tax on capital gains. The Tribunal held that the business continued to be run and there was no dissolution of the firm and consequently Sec. 45(4) of the Act was not attracted.

SAVING OF STAMP DUTY AND TRANSFER EXPENSES:

The expenses on stamp duty and registration charges may be avoided if the Panchnama or Memorandum of Settlement or any similar document containing proof of division of the family property is registered with the Registering Authority. Such registration will provide contempranious proof of ownership of respective property by its recipients as per family settlement.

Conclusion

The real perception in the approach made by the courts is that the family settlement is a conciliatory and a pacific mean of division of property and if by consent of parties, the matter has been settled, it should not be allowed to be reopened by the parties to the agreement on frivolous or untenable grounds.

Family arrangement being a modification and alteration of title among parties having antecedent rights and interest does not result in any kind of transfer. It is analogous to allocation of properties under a partition of a HUF and hence no conveyance is de rigueur. Now, the terms of a family arrangement may have tax saving effect because the property is deconcentrated and divided. This would certainly go to minimize taxation if the distribution of income resulting there from comes in for taxation at lower slab rate as a result of such diffusion.

However, it should be kept in mind that family arrangement or settlement should not be entered into with an object of escaping tax. It then becomes a fraud. The unparalleled intent of family arrangement is fortification of family vanity, unanimity and tranquility. So, if one aims family settlement or arrangement as a device to save tax it would certainly cast a cloud on the authentic and genuine parties of the whole transaction. It would result in contrive to delude the income. The arrangement should be made in good faith. Good faith can be stated to be the essence of the family arrangement.

It should not be made with a view to circumvent provisions of law relating to stamp duty or provide an advantageous position with regard to stamp duty and registration costs. It must not be in the nature of extinguishing or limiting the rights of a family member who is not a consenting party to the arrangement. It should be in the nature of settling disputes, promoting harmony and not in the nature of inciting disputes or disrupting the harmony. There should not be any fraud or undue influence played in any member or members of the family. It must be a voluntary arrangement.

In view of the widespread practice of using this mode of transaction for avoiding capital gains tax and stamp duties, family arrangements are looked upon with greater degree of suspicion by the Income-tax Department and other Government authorities. Therefore, it is all the more important to strengthen the documentation of family arrangement in line with the above ingredients. Otherwise, the litigation within the family may be extended to the various revenue departments also.