

# TAX PLANNING THROUGH

HUF

&

FAMILY ARRANGEMENT

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# What is Tax Planning ?

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- Analysis of a financial situation, or plan, from a tax perspective.
- The purpose is to ensure tax efficiency and plan one's finances in the most optimized manner.
- It allows a taxpayer to make the best use of the various tax exemptions, deductions and benefits to minimize their tax liability.
- Tax planning is a legal way of reducing income tax liabilities.

# Types of Tax Planning

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- **Purposive tax planning:** Planning taxes with a particular objective in mind.
- **Permissive tax planning:** Tax planning that is under the framework of law
- **Long range and Short range tax planning:** Planning done at the start and end of a fiscal year respectively.

# Tax Planning Objectives

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- Reduction in overall tax liability
- Economic stability
- Growth
- Litigation minimization
- Productive investment.



Tax  
Planning

# Tax Planning-Evasion-Avoidance

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- **Tax planning:** It is a way to reduce tax liability by taking full advantages provided by the act through various exemptions, deductions, rebates and relief **(uses benefits of the law)**.
- **Tax avoidance:** It is an exercise by which the assessee legally takes advantage of the loopholes in the Act.**(uses loopholes in the law)**.
- **Tax evasion:** It is the illegal way to reduce tax liability by deliberately suppressing income or sale or by increasing expenses etc., which results in reduction of total income of the assessee. **(overrules the law)**

# Tax Planning – Ethical ?

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- Questions have been raised as to whether tax planning with a view to reduce the amount of tax payable is ethical or moral. We do not purpose to go into the questions but have indicated as to what is the law of the land today as interpreted by the judiciary and how an intelligent taxpayer can make use of it for his own benefit without falling foul of the law.
- Once a transaction is found to be genuine one, merely because it has been entered into with a motive to avoid tax, it would not become a colorable device attracting any disqualification. (*CIT v. Special Prints Ltd. (2013) 356 ITR 404 (Guj.)* Also see *Union of India v. Azadi Bachao Andolan (2003) 263 ITR 796(SC)*).

# Hindu Undivided Family (HUF) as Tax Planning Tool

# What is HUF ?

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- Under Section 4 of the Income Tax Act, 1961 tax is payable by every person.
- The term 'Person' as defined u/s 2(31)(ii) of the Income Tax Act, 1961 includes a Hindu Undivided Family.
- The term HUF has not been defined under the Income Tax Act as it has well defined connotation under Hindu Law. The expression 'HUF' must be construed in the sense in which it is understood under the Hindu Law. (*Surjitlal Chhabra v. CIT 101 ITR 776 (SC) and CIT v. Gomedalli Laxmi Narayan 3 ITR 367 (Bom.)*)



# What is HUF ? (contd...)

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- Hindu Undivided Family consists of a common ancestor and all his lineal descendants together with their wives and unmarried daughters.
- Therefore, a HUF consists of all males & females in the family. Daughters born in the family are its members till their marriage and women married into the family are also members of the HUF.
- Hindu Succession Act, 1956 applies to any person who is Hindu by religion including Hindu Sampradayas (Arya Samaj, Swaminayan, Brahma Samaj and also those professing Sikh, Jain or Buddhist religion.

# What is HUF ? (contd...)

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- Family is a group of people related by blood or marriage. A Hindu male with his wife and children automatically constitutes the HUF. No formal action is required to create an HUF.
  
- Only one person cannot form an HUF.
  
- An HUF need not consist of two male members-even one male member is enough.
  
- A father and his unmarried daughter can also form an HUF.

# Who is Karta ?

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- He is the person who manages the affairs of the family . Normally the senior most male member of the family acts as Karta. However, any other male member can also act as Karta with the consent members. (Narendrakumar J. Modi Vs Seth Govindram Sugar Mills 57 ITR 510 (SC)).
  
- A woman can be a Karta after the demise of the male head in three situations;
  - when the sons are minors and she acts as their guardian.
  - when the male members are not in a position to act as Karta and have given her the permission to manage the family affairs. &

# Benefits of HUF

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- The creation of Hindu Undivided Family helps the tax payers to save their taxes in a legal manner.
- It will enjoy the benefits of Income Tax Slab Rate i.e. Income would be tax free up to the specified limits and would then be taxed progressively at 10%, 20% & 30% resulting in tax saving.
- Deduction available u/ch. VIA; (Sec 80C, 80D, 80DD, 80DDB, 80G, 80TTA and 80 IA/ IAB/ IB/ IC/ ID/ IE/ JJA).

# What is HUF Property ?

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- Property acquired by joint efforts of all the members of HUF.
- By gifts from outsiders or from father, brothers, sisters of the Karta who are not members.
- Gift of self acquired property by father to son's HUF.
- HUF through will.
- Creation of new HUF's through partition of an

# Stock Market, Mutual Funds &

## HUF's

- HUF can have a separate Demate Account.
  
- Make money by investing in shares of companies;
  - Primary Market
  - Secondary Market
  
- Enjoy Tax Free Income from LTCGs by holding shares for more than one year.
  
- Enjoy lower tax rate of 15% on STCGs.

# Tax Planning Through HUF

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- Increase number of assessable units through the device of partition of the HUF.
- Create separate taxable units of HUF through will in favor of HUF or gift to HUF.
- Family settlement or arrangement.
- Payment of remuneration to Karta and also to other members.
- Loan to the members of HUF.
- Gift by HUF to its members specifically female members.

# Multiple Family Structures

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- An HUF can consist of several branches or sub- branches.
  - A person with his wife and sons constitutes an HUF.
  - If the sons have wives and children, they constitute smaller HUF's.
  - If the grandsons also have wives and children, then they also constitute HUF's.



# Multiple Family Structures. Cont..

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- As long as Hindu society is governed by Hindu Law, a Hindu would have the right to own separate property as an Individual, as a member of bigger HUF of say his father and the smaller HUF of his Own.
- The quantum of properties of the three units and consequently the income can further be distributed in a manner most beneficial to him by resort to total partition of any families or by throwing his individual property into the common hotchpot in any of two families.

# Create Separate Taxable Units of HUF

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- It can be done through will in favor of HUF or gift to HUF.
- It is immaterial whether the giver is a male or female, whether he or she is a member or an outsider.
- What is important is the intention of the donor that the property is given for the benefit of the family as a whole.

# Family Settlement/Arrangement

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- Works as effective device for distribution of ancestral property.
- The object of the family settlement should be broadly to settle existing or future disputes regarding property amongst the members of the family.
- Since family settlement/arrangement does not involve transfer, it would not attract capital gains tax or clubbing provisions.

# Remuneration

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- Remuneration to Karta and members for the services rendered by them to the family business, is allowed as deduction from the income of HUF, provided the remuneration is reasonable and paid for service to the family for commercial or business expediency.
- Loan to members with or without interest. A device to expand business, capital or investment of the HUF.

# Gift of HUF Property

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- The Karta of an HUF cannot gift or alienate HUF property but for legal necessity, for pious purposes or in favor of female members of the family.
- Gift to female members of immovable property within reasonable limits only for dutiful purpose e.g. marriage etc.
- Also gift of movable property can be made on the occasion of marriage or for maintenance of daughter.

# Gifts received in Cash or in kind

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- Any sum exceeding Rs. 50000 received by HUF without consideration – taxable in the hands of HUF u/s 56(2)(vii).
- Gift received in kind by HUF is also taxable subject to provisions.
- The definition of the term ‘relative’ now includes in case of HUF, any member thereof.

# Whether clubbing provision applicable to HUF ?

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- As per Sec 64 (2) of the Act, if income of HUF from property converted by the individual into HUF property, then that shall be clubbed in the hands of individual & not in the hands of HUF.
- Clubbing applicable even if ; The converted property is subsequently partitioned; income derived by the spouse from such converted property will be taxable in the hands of individual.

# Illustration..1

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- Let's understand taxation of HUF with an example – After the death of his father, Mr. X decides to start an HUF with his wife, son, and daughter as members. Since Mr. X had no siblings, property held by his father was transferred in the name of the HUF. The property held by late Mr. Y earns an annual rent of Rs 7.5 lakhs. Mr. X has an income from salary of Rs 20 lakh. By creating an HUF, Mr. X can save tax, see below.



# Illustration..1 (Cont..)

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Income from various sources	Income of Mr. X before formation of HUF	Income of Mr. X after formation of HUF	Income of HUF
Salary	20,00,000	20,00,000	
Income from house property (net off Standard Deduction @30%)	5,25,000	–	5,25,000
<b>Total taxable income</b>	<b>25,25,000</b>	<b>20,00,000</b>	<b>5,25,000</b>
Ded <sup>^</sup> u/s. 80C	1,50,000	1,50,000	1,50,000
Ded <sup>^</sup> u/s. 80D	25,000	25,000	25,000
<b>Net taxable income</b>	<b>23,50,000</b>	<b>18,25,000</b>	<b>3,50,000</b>
<b>Tax Payable (Slab of A.Y. 2018-19)</b>	<b>5,33,025</b>	<b>3,70,800</b>	<b>2,575</b>
<b>Total tax paid by Mr. X &amp; HUF</b>			<b>3,73,375</b>
<b>Tax saving due to forming an HUF</b>			<b>1,59,650</b>

# Illustration..2

- If you are a salaried employee and you receive payment on account of house rent and if by chance your HUF is the owner of the house property, then it is possible for an individual to make payment of the rent to the HUF, obtain rent receipt from the HUF and submit the same to the employer and thereafter get a tax deduction on the HRA amount from the employer. Hence, for all those persons who receive HRA i.e. House Rent Allowance from their employer, for them it would be worthwhile to make payment of rent to the HUF and claim a tax deduction from the salary income by submitting the rent receipt to the employer together with copy of PAN Card of the HUF.

# Illustration..3

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- Loan HUF;
  - HUF can receive loan from any person including interest free loans from its members.
  - Such amount can be invested in income generating assets.
  - Income from such assets, is not going to club.

# Illustration..4

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- A member of the HUF throwing his money into the common pool or the family hotchpots, is out of question, thanks to Sec.64(2) which would tax the income earned by the HUF on the money in the individual member's hands only.
- But the clubbing provision can be bypassed if the HUF invests the money in instruments yielding tax-free income. The tax-free income than can be reinvested to earn even taxable income. Income on income is out of clubbing provisions.

# Partition of HUF

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- The tax liability can be reduced by partition of HUF, especially where partition results in separate independent taxable units.
- Partial partition of HUF may also be used. (subject to provisions of section 171 of the Income Tax Act, 1961.)
- The sum received by a member as and towards his share as coparcener of HUF, on its partition, is not subjected to tax as income. [Smt. Sudha V. Iyer Vs ITO 15 Taxmann.com 234 (ITAT-Mum)(2011).

# Eyes on HUF

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- In spite of the efforts of the legislature to render this tool as ineffective as possible by a spate of amendments in the recent past, it has not lost all its efficacy.

# FAMILY ARRANGEMENT

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- It is arrangement between the members of a family descending from a common ancestor or near relation trying to settle their differences and disputes, solve their conflicting claims once and for all to buy peace and bring about harmony and goodwill in the family, by an equitable distribution of assets and properties amongst the members of family.
  
- Main components of Family Arrangement
  - Family
  - Property
  - Dispute
  - Arrangement

# Family

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- The term family in this context is not to be understood in the narrow sense of being a group of persons who are recognised in law as having a right of succession or having a claim to a share in the property under dispute though it necessary to have some common tie between parties to such family arrangements, it need not be between the persons who are commonly understood as a family (blood relation or marriage).
- The term ‘family’ has to be used in a broader sense. It is not necessary that there should always be a legal claim as member, even if there is a possible claim or resemblance of a claim, it is sufficient e.g. married daughters or sisters.



# Property

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

# Dispute

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- Normally a dispute in the family leads to a family arrangement. The family arrangement is aimed at settlement of disputes and differences, existing or future.

# Arrangement

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- The term 'arrangement' means to come to an agreement about, to settle the dispute. The consideration for entering into such a family arrangement should be preservation of peace and honour of the family and avoidance of litigation.

# Taxability of Assets received in succession.

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- Section 56 (x): - following are liable for Income Tax;
  - Any sum received without a consideration exceeding Rs. 50,000/-
  - Any immovable property without a consideration or with inadequate consideration exceeding Rs. 50,000/-
  - Any property other than immovable property exceeding Rs. 50,000/-
  
- Exceptions : this clause shall not apply to any sum of money and any property received;
  - From any relative (as defined)
  - On the occasion of the marriage of an individual

# Taxability of Assets received in succession. Cont..

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- Provision of sec. 68 of the Act needs to be considered, it says;  
*‘under any sum of fund is credited in the books of assessee maintained for any previous year and assessee offers no explanation about the nature and source thereof or the explanation offered by him is not in opinion of the assessing officer satisfactory the sum so credited may be charged to income tax as the income of the assessee of that previous year.’*
  
- Rate of tax for income made taxable u/s. 68 has been prescribed u/s. 115BBE.
  - if disclosed in return of income :60% + 25% S.C. = 77.25%
  - if added during assessment: 77.25% + 10% (Sec. 271AAC) = 83.25%
  - In case of misreporting of income: 83.25% + 200% Penalty (Sec. 270A(8))

# Taxability of Assets received in succession. Cont..

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- Conditions to comply with Sec. 68 for assets received in succession ;
  - Identity of the person from whom credit received
  - Credit worthiness
  - Genuineness of transaction.

# Taxability of Assets received in succession. Cont..

- Jewellery which can be considered as explained;
- CBDT Circular in context of search & seizure proceedings provides;

## Gold Jewellery & Ornaments

500 gms - Married Lady

250 gms - Unmarried Lady

100 gms - per male member

Declared in wealth tax return.

Applying the above analogy, it can be considered as explained assets.

# Transfer by Gift or WILL ?

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- Is it better to receive a gift of property from a close relative in his/her lifetime or under a WILL ?
- Both are exempted from Income Tax by virtue of Sec.56(x).
- Is the WILL expected to be challenged ? Deciding factor.



THANK YOU

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