Hindu Undivided Family: Tool for Tax Planning For Non-Resident Indians

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Every Hindu living in the UK, irrespective of whether he holds an Indian, British, US or any other passport and regardless of whether or not he was born in India, is entitled to considerable tax savings through HUF

HUF: A separate legal entity under Indian tax law

Majority of the population in India belongs to the Hindu community. Hinduism, being an ancient religion has several old customs and traditions as well as rituals which are being followed by its members even in present times. The joint family system, where members of one family lived together under one common roof, including married brothers, their children and grandchildren, sometimes even extending to five generations, continues even today in most Hindu families. Under the joint family system, the members share houses, properties, business, income, wealth, food and their value systems and principles. Therefore, in India, a joint Hindu family is given a separate legal entity status called 'Hindu Undivided Family' (HUF) and this status is shared and enjoyed by all members of the family.

Tax savings through HUF

HUF is a good tax saving tool as it is regarded as a separate legal entity under the tax law and also assessed to tax separately as a distinct legal person. This implies that a person can file two income tax returns, one in his personal individual capacity and one in the name of his HUF. This gives the benefits of dividing his taxable income between two entities and hence, he can claim double deductions and expenses in both capacities, thereby reducing his total taxable income and tax liability substantially. For e.g. at present, the tax free income in India is Rs. 200,000 per annum. An individual can thus claim a minimum of Rs. 400,000 as total exempt tax free income, (Rs. 200,000 in his personal and an equal amount in his HUF return). In addition to the basic exemption, he can claim other specific exemptions in both capacities provided under sections 80CCA, 80CCB, 80D, 80DD, 80DDB, 80G, 80GG, 80 GGA and the rebate under section 88. A HUF also enjoys exemptions under sections 54 and 54F in respect of capital gains.

Non-resident HUF

What applies to non-resident individuals will also, in some cases, be applicable to a non-resident HUF. A HUF, whose management and control is exercised wholly outside India during the financial year. From a tax point of view, if it can be shown that all decisions concerning the family members and the affairs of the HUF were taken outside India during the relevant year, that HUF will enjoy all benefits also available to a non-resident individual and the same tax exemptions.

Resident but not-ordinarily resident HUF

A HUF can get a resident but not ordinarily status (RNOR) if the Karta or manger has been a non-resident in India in nine out of the ten preceding years or has been a resident in India in two out of the seven preceding years. Thus, where the Karta decides to return to India after his residence in any country, the HUF will not turn to resident HUF in India straightaway but it will get the benefit A NOR HUF also enjoys tax advantage in as much as on the return of the Karta, the HUF is treated as RNOR for the next nine years. The advantage of NOR status is that all income from property or investments belonging to the HUF outside India will be exempt from tax in India.

Formation of a HUF

Typically, a HUF is automatically created. As the name suggests, a HUF means a family of Hindus. However, under the Indian tax law, persons belonging to the Jain and Sikh religion can also form HUFs. The existence of a HUF requires at least two members of a family, of which at least one should be male. A HUF can also consist of the male members and female members, being their wives and unmarried daughters. Once a member of a HUF receives any ancestral property from any ancestor three generations above him, a HUF is automatically created. For example, if a married Hindu male person receives any ancestral property from his great grandfather, that property will be automatically regarded as his HUF's property. Another way to form a HUF is by receiving an asset or property by way of gift from a lineal ascendant with a specific instruction by the donor that the same is being gifted to the HUF. Although generally, a HUF always exists in a Hindu family, from a tax point of view, it is created only when it receives assets or any property or is engaged in any commercial activity. A PAN card may be issued by the Income-tax Department in the name of a HUF and an account gets created for filing of tax returns.

HUF and Hindu Coparcenary

A joint or undivided Hindu family consists of male members, their wives, unmarried daughters and widows, if any, of the deceased male members of the family. A Hindu coparcenary is a smaller body than the HUF as it can only consist of male members of the family who are entitled to or acquire a right to, by birth, an interest in the joint or coparcenary property. These are the sons, grandsons and great-grandsons of the holder of the joint property, that is, the three generations in lineal male descent from the holder. The senior most member is called the Karta (Manager), who generally manages the joint or coparcenary property, belonging to all coparceners. . A HUF should consist of at least two male members but in the event of a partition of the HUF, the smaller family can form a HUF even with a single male member if it receives a portion of the property.

Income of HUF and Karta

All income arising out of utilisation HUF's properties and from investment of HUF's funds is income of the HUF and is separately assessed in its hands. One should be careful to declare only that income to tax in the returns of a HUF which is earned out of the HUF assets or investments. Any income, which arises out of personal income of a member will be regarded as the member's individual income and not the income of HUF.A HUF can also contribute funds or capital in a partnership firm and the share in profits arising to the HUF will be regarded as income of HUF and will be taxed accordingly in the hands of the Karta or the representative of the HUF. Therefore, a Karta can be taxed in two capacities, his personal individual capacity and as Karta, for and on behalf of the HUF. If the partnership firm gives a certain sum as salary to the Karta or manager for the services rendered by him to the HUF, such income is taxed in the hands of the Karta in his individual capacity. Since a HUF is a separate legal entity, it can earn income from several sources such as income from house property, profits from business, income from capital gains, and income from other sources. However, a HUF cannot earn income from salaries as salary is earned for personal skills and services rendered by an individual.

Assets of HUF

A HUF can hold assets such as shares, securities, jewellery, movable and immovable property. These assets can be either acquired by a HUF by way of a gift which is specifically instructed to be given to the HUF or it can receive assets on partition of a larger HUF of which its coparcener was a member and the same is treated as HUF property. Assets can also be received by a HUF by way of instructions provided in a will where the assets are instructed to be bequeathed to the HUF. However, after the enforcement of the Hindu Succession Act in 1956, if there is no will, on the death of a benefactor, the assets cannot devolve upon a HUF but only on the individual inheritors.

Tax benefits to HUF

As income from sources such as income from house property or income from business or capital gains can be taxed separately in the hands of a HUF and is not clubbed with the individual's income, there can be substantial savings in taxes as income is divided between two entities, that is, the individual and the HUF and expenses and deductions can also be claimed from both incomes, individual, as well as HUF. Further, if an individual is already employed with somebody, he can carry out a business and earn income in the name of a HUF and he can get the benefit of exemptions and deductions from that income too.

Effective tax planning through HUF

An important benefit of creation of HUF is that any income earned by an individual in his capacity as member of HUF is not taxable in his individual capacity as it is already taxed in the hands of the HUF. A HUF, being eligible for all the exemptions and deductions as are available to an individual, it results in considerable tax savings as the total personal income of an individual, who is a member of a HUF is divided into his personal capacity and in the hands of the HUF. Joint assets or properties under inheritance for the entire family can be gifted to the HUF instead of gifting to individual members of the family. This can result in tax savings as there is no gift tax or inheritance tax and clubbing of income provisions will also not apply. Similarly, a Karta of a HUF can give, by way of gifts, certain amounts or assets out of HUF properties, to its members over a period of time to gradually build assets in their names. A HUF can also build its capital by way of borrowings from non-members and the income so earned from investments of the capital will only be HUF income. Individual members may also transfer their personal funds in a HUF for the purpose of investment in tax free instruments. Income thus earned from these instruments will be tax free and cannot be clubbed with the individual's personal income. Such income, if it is reinvested in instruments, income of which is subject to tax, will also not be clubbed as only the income earned from transferred amounts is clubbed.

Important points to be borne in mind

As regards bank account of a HUF, it should be either in the name of the HUF or in the name of the Karta of the HUF with a specific declaration that the account is that of the HUF. The members should also be careful and not deposit their personal funds in the HUF bank account as only funds belonging to the HUF can be kept in it. Normally, only the Karta is authorized to sign all cheques and operate the account on behalf of the HUF. However, he may also authorize any other member of the HUF to operate the same on behalf of the HUF. A person, who desires to bequeath some property to his son or sons, may also provide a specific instruction in his will to transfer the assets on his demise to the HUF or his son or sons. This will result in effective tax savings in the hands of the beneficiary sons.

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