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HUF as a Tax Entity under the Income Tax Act: An Examination into the Status Quo, Complications, and Issues

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The HUF is an entity peculiar to Indian tax law. It is an entity that is available to Hindus including the Jains, the Sikhs, and the Buddhists. The HUF refers to the joint family system which existed in India since ancient times. The main purpose of HUF was to preserve the family ties together and also preserve the knowledge of a trade or business within the family. It was recognized as a separate tax entity by the British who wanted to regulate commerce then. After Independence, this recognition was continued by the Government of Independent India. The concept of HUF was based on a patriarchal system of society and was designed to include religious and caste considerations in its affairs. After Independence, the Hindu personal laws were codified and many policies were introduced to encourage female education. The judiciary passed many judicial precedents which changed the nature of the joint family system and resulted in a change in the laws governing succession in India. Though it is easy to form a HUF and get assessed as a HUF, the management of the HUF is a complex affair. The Hindu personal laws that have been codified have several provisions that regulate the operation of the HUF included in each of them. The provisions of these codified Hindu laws and the Income Tax Act of 1961 have to be read together and kept in mind while operating and managing the HUF. The Income Tax Act of 1961 treats the HUF as a separate entity, it also has many provisions that diminish the benefit of forming and maintaining a HUF to some extent. In recent times, the younger generation of Indians is choosing to carry on business separate from their parent's family as the rules regarding the management of HUF are very complicated and they want to avoid legal complications in the future. In recent times many business families are choosing to hold their businesses in the form of other legal entities.

Keywords: *huf, income tax, entity, hindu personal laws, business, indian tax regime.*

INTRODUCTION

The Hindu Undivided Family is an entity peculiar to the Indian tax law. The Hindu Undivided Family commonly known as HUF is a very old concept. It has its roots in the Hindu Joint family system. In general terms, a Hindu Undivided Family refers to a group of persons who are lineal descendants of a common ancestor together with their wives and daughters. The recognition of HUF as a separate tax entity goes back to 1917. In the debate on the Super Tax Bill, 1917 a proposal was made that HUF is recognized as a distinct category for taxation, to overcome the problem of dual characteristics of being a family and business entity. In the interpretation of the colonial state, the HUF represented a joint family that was held together by strong ties of kinship and entailed a variety of joint property relations among the members. There were blurred and porous boundaries between the cultural underpinnings of the family as a social entity and the commercial existence of the family as a trading entity. These porous boundaries were a function of marriage, lineage, patriarchal ties, and trade and business. This interpretation led to the recognition of HUF as a separate tax entity which was subsequently incorporated in the Income Tax Act of 1922[1,2] which was replaced by the current Income Tax Act, of 1961.

The term Hindu Undivided Family makes it clear that it applies to those people who are 'Hindu'. The Constitution of India does not define the term 'Hindu', but it specifies to whom the Hindu Law applies. Article 25(2)(b) of the Constitution of India states that 'the reference to Hindus shall be construed as including a reference to persons professing the Sikh, Jain, or Buddhist religion'. The expression 'Hindu Undivided Family' is not defined in the Income-Tax Act of 1961. Section 4 of the Income-Tax Act specifies that income tax is payable by 'every person'. Section 2(31) defines 'Person' as including a Hindu Undivided Family. Similarly, Under Section 3 of the Wealth Tax Act, of 1957, wealth tax is chargeable on the net wealth of the Hindu Undivided

[1] Law Commission of India, 'Consultation Paper on Reform of Family Law' (*Law.Com*, 31 August 2018) 131 <https://cdnbbsr.s3waas.gov.in/s3ca0daec69b5adc880fb464895726dbdf/uploads/2022/09/2022092674.pdf> accessed 15 January 2023

[2] Chirashree Das Gupta & Mohit Gupta, 'The Hindu Undivided Family in Independent India's Corporate Governance and Tax Regime' (*South Asia Multidisciplinary Academic Journal*, 2017) <http://journals.openedition.org/samaj/4300> accessed 15 January 2023

Family. In ***Surjit Lal Chhabda v CIT***, the Supreme Court has held that the expression 'Hindu Undivided Family' must be construed in the sense it is understood under Hindu Law.[3]

TOOL FOR TAX AVOIDANCE

The institution of the joint family system now referred to as Hindu Undivided Family in India existed from historical times. The concept of the joint family system is based on the principle of 'Sapinda' meaning sharing a house, food, and worship. This principle of 'Sapinda' was the main characteristic of the joint family system in historical times. The joint family system in India came into existence due to the need of the people to ensure the family members stayed together and to preserve the knowledge of their trade or business among the members of the family. In colonial times, the British decided to recognise the joint family system as an entity under the Income Tax Act of 1922[4]. This concept of a Hindu undivided Family was later incorporated into the Income Tax Act, of 1961.

Over the years, the meaning and definition of the institution of HUF underwent many changes as a result of the various judicial precedents by the courts in India. In the current scenario, a HUF consists of two members one of whom has to be a coparcener and there need not be any property or corpus belonging to the HUF. There can be one large HUF and many smaller branches, each of them being a HUF by itself. The members of the larger HUF live separately from the larger HUF, i.e., the son and his wife may live separately from the HUF of his parents. Even though the principle of 'sapinda' meaning unity of house, food, and worship, is not followed, they are still classified as HUF under the Income Tax Act,1961. In Gowli Buddanna v Commissioner of Income Tax, the Supreme Court held that to constitute a joint Hindu family, there need not be more than one coparcener in the family, a husband, and wife can validly constitute a HUF.[5] In ***Commissioner of Income Tax v P.N.Srinivasa Rao and others***, the Kerala High Court held that a Hindu coparcenary has to be understood concerning rights by birth about an interest in the joint or coparcenary property. A family which does not own any

[3] *Surjit Lal Chhabda v CIT* (1976) SCC (3) 142
[4] *Ibid*
[5] *Gowli Buddanna v Commissioner of Income Tax* AIR 1966 SC 1523

property may still have the character of a Hindu joint family. Possession of joint family property is not a necessary requisite for the understanding of a Hindu Undivided Family. This is because a Hindu is born as a member of a joint family. A natural corollary of this is that a Hindu Undivided Family may not possess a property by inheritance.[6]

Since the meaning and definition of the concept of Hindu Undivided Family have changed over the years it has become increasingly diluted due to various judicial precedents and amendments to the law governing Hindu succession, the number of HUF assesses have increased over the years. As per the Income Tax Return Statistics released by the Income Tax Department, for the assessment year 2017-18, there were a total of 10,70,688 HUF assesses, who filed their returns[7] and for the assessment year 2018-19 there were a total of 11,30,554 HUF assesses who filed their returns.[8] Similarly, detailed data for the Assessment years 2019-20, 2020-21, and 2021-22 have not been provided by the Income Tax Department. The main intention of the Government to recognise an institution as a separate entity has lost its ground. Since the HUF is entitled to the same tax liabilities and exemptions as an individual assesses it is now being used by many as a tax avoidance tool to reduce their tax liability.

The Law Commission of India in its 'Consultation Paper on Reform of Family Law dated 31st August 2018 has noted that the Direct Taxes Enquiry Report of 1971, i.e., Wanchoo Committee had stated the institution of HUF is being used as a tax avoidance tool. The Law Commission in its Paper also states that justifying the institution on the ground of deep-rooted sentiments at the cost of the country's revenues may not be judicious.[9]

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[6] *Commissioner of Income Tax v PN Srinivasa Rao & Ors* (1998) 232 ITR 730 (Ker)

[7] Income Tax Department, 'Income Tax Return Statistics Assessment Year 2017-18' (*Version 1.0*, October 2018) 32 <https://incometaxindia.gov.in/Documents/Direct%20Tax%20Data/Income-tax-statistics-i-t-return-ay-2017-18-v1.pdf> accessed 16 January 2023

[8] Income Tax Department, 'Income Tax Return Statistics Assessment Year 2018-19' (*Version 1.1*, October 2019) 32 <https://incometaxindia.gov.in/Documents/Direct%20Tax%20Data/IT-Return-Statistics-Assessment-Year-2018-19.pdf> accessed 16 January 2023

[9] *Ibid*

BLENDING OF PROPERTY AND CLUBBING OF INCOME

In a Hindu Undivided Family, the members can also have property acquired by their efforts and in no way connected to the joint family, i.e., their self-acquired property. In such cases, a coparcener in a HUF may voluntarily decide to throw his self-acquired property into the common stock of the joint family property or transfer to the joint family for inadequate consideration. In such a case, the property loses its separate character and becomes the property of the joint family property. All the members of the HUF will then have rights over the property. This is called as the blending of property. Under Section 64(2) of the Income Tax Act, 1961, the income arising out of the such blending of property is taxed in the hands of the individual who has transferred his property to the joint family property.

Section 64(2) of the Income Tax Act, 1961 reduces the benefits of blending of property which is provided under Hindu Law. This also makes the process of forming and managing a HUF a complex process. Under this Section, the income arising out of the blended property is treated as income arising in the hands of the transferor coparcener. However, when the income arising out of such property is applied to generate further income, then such income will be deemed to be income arising from the joint family and will not be clubbed with the income of the transferor. This results in making the process of managing the HUF a complicated process.

DIFFICULTY IN MANAGEMENT OF THE HUF

A Hindu Undivided Family is an entity where all the members of the family including an unborn child in the womb of the mother have rights over the property and other assets of the HUF. Thus, if any member of the HUF purchases any property with funds from the HUF, then the such property will be jointly owned by all the members of the property and all the members of the HUF will have rights over such property. If the HUF wants to sell any of its property, it will have to obtain the consent of all the members of the HUF. This would become a cumbersome process when there are a large number of members in the HUF. Each member of the HUF may have differing opinions about the sale.

Again, when the HUF decides to partition the HUF property, it will be a complex process if there are a large number of members among whom the property of the HUF will have to be divided. In some cases, due to the large number of members in the HUF, the only way to partition the property of the HUF would be by selling the HUF property and assets and dividing the sale consideration among the members. This applies where the assets and property are incapable of being divided equally among the coparceners. Here again, the process of partition may become complex and get involve lengthy legal disputes.

The only way to dissolve a HUF is by partitioning the HUF property and assets. The Income Tax Act of 1961 does not recognize partial partition which takes place after 31.12.1978. Section 171 of the Income Tax Act of 1971 deals with the partition of a HUF and its assessment. Partition under the Income Tax Act of 1961 requires physical division of the property wherever it can be physically divided and wherever the property cannot be divided to the extent to which it can be divided. The partition can be either oral or through a deed. When a joint family opts to get assessed as a HUF under the Income Tax Act of 1961, they will have to apply for a Permanent Account Number in the name of the HUF. Once the income of the joint family is assessed in the hands of the HUF, it will continue to be assessed as such until one of the coparceners claim there has been a partition in the family. Once it is established to the satisfaction of the Income Tax Department that there has been a total partition of all the property and assets of the HUF, the HUF will cease to exist and the Permanent Account Number in the name of the HUF will be extinguished.

AMENDMENT OF HINDU SUCCESSION ACT IN 2005

When the Hindu Law was codified in the years between 1955 and 1956, the patriarchal rules of limiting women's rights to inherit property was retained and the 'Karta' the eldest patriarch was given the right to decide regarding holding of property. Women were denied an equal share in any property. Specifically, they were denied any right to land on the feeble excuse of preventing the 'fragmentation of land'. Before the amendment of 2005, the Hindu Succession Act made a provision for the HUF in the Act to ensure the property would remain within the male line of descent. Before the 2005 amendment, in a coparcenary, a son got a share equal to that of his father and a daughter got only a share in her father's share. She could not claim her share of the property as long as the men of the family continued to reside in it.[10] The amendment of the Hindu Succession Act, 1956 in 2005 treating the daughters as equal coparceners along with the son from the time of their birth caused many business families to rethink forming a HUF. This is due to fear of litigation. The amendment of the Hindu Succession Act in 2005 also caused an increase in litigation across the country mainly in the form of suits for partition filed by daughters and suits filed against purchasers of joint family property by daughters in the joint family. Over the last few years, female education has been given a lot of importance as a result more and more women are aware of their rights in society. This has also resulted in an increase in divorce cases across the country. All these reasons have caused business families to think about using other legal structures within which they can house their businesses.

LACK OF INTEREST IN FORMING AND MAINTAINING HUFS

After the economy of India was liberalized in 1991, and the removal of barriers in trade and other areas people became aware of numerous opportunities like never before. Though HUF is treated as a separate entity under the tax law which helps in reducing tax liability, the younger generation is not keen on creating and maintaining a HUF due to the complex legal requirements and the costs involved in maintaining the HUF. There may be differences of opinion between the younger and older generation on how the family business has to be continued. The younger generation may prefer to carry on their business separately from that of their parent's family. They may not like to get involved in the complexities of forming and managing a HUF and opt to carry out business using other entities like private family trusts, etc which are permitted under law. In recent years due to the various judicial precedents and amendments, the law governing property and succession among Hindus has been undergoing radical change, but the Income Tax Act of 1961 has not kept pace with these changes. It has been noticed while families who are involved in some types of business are shying away from forming a HUF, the salaried

10 *Ibid*

class and other taxpayers are forming HUF with an eye on reducing their tax liability and saving tax as a HUF enjoys the same exemption and liabilities as an individual taxpayer.

CONCLUSION

In the historical period before the British colonized India, the joint family system was followed to keep the business and assets together. It was also followed to comply with the caste system that existed during those times. The British to regulate business and being unable to separate the family and business elements of the joint family system recognized the joint family system as a separate entity and called it the HUF. The HUF in the initial period existed purely because of patriarchal and societal reasons. In Independent India, the personal laws governing the Hindus were codified to regulate succession, marriage, adoption, and minority and guardianship, laws were passed to eradicate the caste system and policies were introduced to encourage female education.

In 1991, the economy of the country was liberalized, thereby opening up the Indian economy to global trade. All these factors resulted in radical changes in the socio-economic structure of the country and reduced the importance of the joint family system. In the current scenario, many large business families prefer to use other legal entities to carry on their business and ensure their business continues to exist within the family. It is only the small taxpayers who are forming the HUF to reduce their tax liability. The HUF has lost the purpose for which it came to be recognized by the British in the Indian legal system and has now become more of a tool to avoid tax. To avail of the benefit of HUF as a separate tax entity, a thorough and careful understanding of the codified Hindu personal laws and the provisions of the Income Tax Act is required to avoid complications and litigation.