



HINDU UNDIVIDED FAMILY: EFFECTS ON INDIAN TAX SYSTEM (With emphasis on preferential treatment given to Hindus under Indian Tax Law)

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ABSTRACT

HUF that is Hindu undivided family is a household of lineal descendants from a common ancestor, comprising of male members of the family, their spouses, and spinster females. Hindu refers to anybody who meets the criteria of a Hindu as defined in Section 2 of the Hindu Succession Act, which includes Sikhs, Jains, Buddhists, and anyone who is a follower of the Brahma Samaj or the Arya Samaj. As per Section 2(31) of the Income Tax Act 1961, a HUF is a distinct tax entity. The income tax is one of the most important taxes that is collected by the government in India, however, the system is not flawless. While collecting taxes from Hindu undivided families, the government has a bias toward them, leading to big financial losses for the government.

Keywords: Ancestor, Common, Descendants, Distinct, Entity, Flawless, Hindu, Lineal

INTRODUCTION

The goal of taxation is to generate revenue to support the government in both developed and developing countries. The primary goals of taxation in India are redistribution, growth, and stability. The personal income tax revenue is among the major tax powers granted to both the Union and the States as per the constitution of India and is thus an important source of revenue. However, the system is not flawless. The presence of the Hindu Undivided Family (HUF) and the preferential treatment accorded to the HUF complicates income tax assessment and collection.¹

Other than being a bane for government revenues, all capitalist business houses of Hindu origin, whether new or old, use the HUF provision to combine family holdings and ensure control of capital within the family via transactions in the Hindu Undivided Family and individuals in the HUF who kept important positions in the share-holding and general management of the companies within the business house's fold. There was no such provision for businesses owned by any other religious minorities. No reform of this peculiar favour has ever been advocated, to the predominant religious group, especially in a democracy that promises no discrimination on the basis of caste or religion in its constitution, and vouches for the equality of one and all.²

Other property, such as houses, share certificates, cash, gold, and fixed deposits, can be held by the HUF and is not counted in the business group's asset accounting. HUF income and wealth holdings are not included in the business group's control and ownership of assets.

The family-owned business groups saw very little or no significant change during the transition period in the holding structures of the business. They continued the provision of Hindu Undivided Family accounts in personal laws, which made sure that the assets remained within the male line of descent of the family and were protected from business risk.

¹ Anurag Sanyal, "The Hindu Undivided Family : Effects on the Indian Tax System" (1995) 3 The Park Place Economist <<http://digitalcommons.iwu.edu/parkplace/vol3/iss1/17>> accessed January 20, 2022. ² Ramanujam, "HUF: Bane or Boon?" (www.thehindubusinessline.com/2006)

<<http://www.thehindubusinessline.com/bline/2006/08/12/stories/2006081202021100.htm>> accessed January 20, 2022.

Such a provision was not available to Muslim, Christian, Parsi, or Jewish-owned businesses.³

It was stated in *Murtaza Husain Khan v. Muhammad Yasin Khan* (Observation of Sundara Aiyar .J)⁴ that "the Mohammedan Law fails to distinguish between inherited and As is the case with the Mitakshara, that separates succession into "unobstructed legacy" and "self-acquired property," there really is no concept of distinction in the question of lineal and collateral succession. The same law of devolution applies to all forms of wealth, either through inheritance or self-acquired. If a custom rules the inheritance to the family property, the assumption would be that it covers the former owner's personal possessions, which he bequeathed on his death, and it is up to an individual who alleges that all those assets pick a different line of devolution than taluka to demonstrate it.

In the Income Tax Act (1961), the Hindu joint family is referred to as the Hindu Undivided Family. The joint and undivided household is a common characteristic of Hindu society; it comprised of all individuals who would be lineally inherited from the a common ancestor, as well as their mothers, wives, and unmarried 'daughters obligated there by the basic aspect of "Sapinda Relationship" or familial relationship, that is one distinctive characteristic. When the laws of inheritance are paired with the laws of succession, the HUF has a variety of options for avoiding income tax in specific cases.⁵

HUF AND ITS ANOMALY UNDER INDIAN CONSTITUTION

Hindu undivided family seems more like a company than a group of people. In the case of a Hindu undivided family, there is a community of interest and a unity of possession among all members of the family, and until partition occurs, there is common enjoyment and common possession of the Property, implying that a Hindu undivided family is not, in essence, a bunch of individuals.

A Hindu undivided family is treated as a separate taxable entity under section 2(31) of Income Tax Act. The law also acknowledged branch of the family as a subordinate corporate body, as demonstrated in *Rajah Sir M A Muthiah Chettiar v. Wealth Tax Officer*⁶. In such case, either the main branch or the lesser branches, can hold, seize, or sell the family's property within the legal limits.

The difference among "individual" and "Hindu undivided family" is also explained in the Business Profits Tax Act, 1947, indicating that there was a well-established legislative practice under which a Hindu undivided family was placed on its own footing prior to the coming into force of the Indian Constitution. If Entry No. 86 was intended to include an area of taxation on the capital value of assets in relation to Hindu undivided families, the entry would have explicitly said "Hindu undivided family."

³ CD Gupta, "Globalisation, Corporate Legal Liability and Big Business Houses in India" (2009) 34 Cambridge Journal of Economics 895.

⁴ (*Murtaza Husain Khan v Muhammad Yasin Khan* (1916) 38 (ILR).

⁵ Anurag Sanyal, "The Hindu Undivided Family : Effects on the Indian Tax System" (1995) 3 The Park Place Economist <<http://digitalcommons.iwu.edu/parkplace/vol3/iss1/17>> accessed January 20, 2022. ⁶ *Rajah Sir M A Muthiah Chettiar v. Wealth Tax Officer* (1964) 053 ITR 0504(Mad)

Indeed, India is referred to be a "Sovereign, Socialist, Secular, Democratic Republic." Pandit Nehru wrote in 1945⁷:

"I am convinced that the future government of free India must be secular in the sense that government will not associate itself directly with any religious faith but will give freedom to all religious functions."

Treating HUFs as independent entities jeopardizes the fundamental element of secularity contained in the Indian character. It is not true that only Hindus have "large" families.

With a minority of Muslims (12%), Jains, Christians, Buddhists and Zoroastrians having a distinct option allowing them to free themselves from tax duties is essentially discriminatory. The HUF's existence, on the other hand, may be explained by the circumstances surrounding its inception.⁸

The HUF's origins may be traced back to a 1937 revision to the Hindu Succession Act, a decade before independence, when other religions were a miniscule minority, except for Muslims (who were relatively less in number). Thus, among several other economic reasons, the British established the HUF to pamper Hindu aristocratic families and reward their allegiance by providing them with a better status than the typical Indian.

The British were able to withstand the constant efforts of Indians to liberate themselves from the "British Raj" with the assistance of the elite Hindu aristocracy. I believe the establishment of the HUF and the preferential treatment in calculating their tax responsibilities are contrary to secularity and indeed the spirit of democracy.⁹

JUDICIAL TRENDS IN DEFINING HINDU UNDIVIDED FAMILY

The "Hindu undivided family" is one of the taxable entities mentioned in Section 2 of the Income Tax Act of 1961. As a result, it is vital to comprehend the extent of the afore mentioned statement¹⁰. The Supreme Court analysed the nature of a Hindu joint family in *Bhagwan Dayal v. Reoti Devi*¹¹, Subba Rao. "The legal position may be put so," J noted. Except in the case of reunion, coparcenary is a creation of Hindu Law and cannot be formed by consent of the parties. It is either a business entity or a family unit.

The legislation also recognized a family branch as a subordinate corporate organization. The specified family unit, whether the bigger or the subordinate one, can acquire, keep, and dispose of family property within the legal limits¹². The term corporate body was introduced by Bhashyam Ayyangar.J in *Sudarsanam Maistri v. Narasimhulu Maistry*¹³,

⁷ *SR Bommai v Union of India* (1994) 3 (SCC).

⁸ Anurag Sanyal, "The Hindu Undivided Family: Effects on the Indian Tax System" (1995) 3 The Park Place Economist <<http://digitalcommons.iwu.edu/parkplace/vol3/iss1/17>> accessed January 20, 2022. ⁹Ibid.

¹⁰ KC Singhal, "Treatise on the Tax Implications of Hindu Undivided Family (HUF)" (*itatonline.org* May 18, 2015) <<http://www.itatonline.org>>.

¹¹ *Bhagwan Dayal v Reoti Devi* (1962) 287 (SC).

¹² *Rajah Sir M A Muthiah Chettiar v Wealth Tax Officer, Special Investigation Circle* (1964) 053 (ITR). ¹³ *Sudarsanam Maistri v Narasimhulu Maistry* (1901) 25 (ILR).

where the learned judge stated that the Mitakshara concept of joint family was premised on the presence of an undivided family as a corporation.

It would be sufficient to cite the Supreme Court's decision in the matter of *Surjit Lal Chhabra*¹⁴, in which the court emphasized the scope of the aforementioned term as follows:

- First and foremost, the terms "joint family" and "undivided family" are synonymous.
- The expression HUF shall be construed in the sense specified by Hindu law.
- "A Joint Hindu family comprises of persons descended from same ancestor, and also their partners and unmarried daughters." Whenever a female is married, she loses her paternal household becoming a part of her husband's family."
- Hindu current societal inherent position is the joint and undivided family. Unless proven differently, HUF members are believed being in a state of union.¹⁵
- The word 'Hindu undivided family' is used throughout the act to refer to all schools of Hindu law, not just one."
- All through the statute, the HUF refers to all systems of Hindu law.
- The argument that a Hindu undivided family must have at least two male members to qualify as a taxable entity is similarly without merit. The phrase "Hindu undivided family" is being used under the Income-tax Act to mean a Joint Hindu family household as defined under Hindu personal law. As per Hindu law, a family system can consist of single male person and widowed of departed men, and the Income Tax Act doesn't really seem to stipulate that a HUF should comprise at least 2 male members as just an ascertainable entity.¹⁶
- A man that separates with his father or brothers can nevertheless be connected with individuals about his own line. If he does have a household, he is becoming the patriarch of a separate family system, so if he inherits wealth from his brothers and father, that wealth is becoming the ancestral property of his line qua him and his male offspring.

TAX DEDUCTIONS GRANTED TO HINDU UNDIVIDED FAMILY UNDER INCOME TAX ACT, 1961

In terms of taxation, a Hindu Undivided Family (HUF) provides certain benefits.

The HUF is recognised as an independent assessable or taxable entity under the Income Tax Act and the Wealth Tax Act. As a result, HUFs are eligible for all deductions and exemptions under the IT Act, regardless of their members' income or tax liabilities.¹⁸ There are around 2 million HUFs in India, according to the Income Tax Department. The government may be examining these HUFs from the standpoint of taxpayers who use them to decrease their tax obligation.

¹⁴ *Surjit Lal Chhabra* (101) 776 (SC).

¹⁵ *Mayne's Hindu Law and Usage* (11th Edn, 14th Edn, Mulla's Hindu Law) page 323, page 284. ¹⁶ *Gowli Buddanna v CIT ; N V Narendernath v CWT* 60, 190 (SC).

¹⁷ *Bhagwan Dayal v Reoti Devi* (1962) 287 (SC).

¹⁸ Girija Gadre and Arti Bhargava, "Formation of HUF for Tax Benefit: All You Want to Know" (*The Economic Times* June 10, 2013) <http://articles.economicstimes.indiatimes.com/2013-06-10/news/39872898_1_an-huf-karta-tax-benefit> accessed January 20, 2022.

HUF tax slabs are the same as individual tax slabs, with an exemption maximum of Rs 2.50 lakhs and eligibility for all tax advantages under Sections 80C, 80D, 80G, 80L, 80TTA, and so on. It also benefits from capital gains exemptions under Sections 54 and 54F.

Section 80C of the Income-tax Act of 1961: Under Section 80C of the Income-tax Act of 1961, a person receives a tax deduction for certain investments made by him. Similarly, the Hindu Undivided Family is entitled to a tax deduction in its own right under Section 80C of the Income-tax Act of 1961. To seek this subsection 80C tax exemption, the HUF may obtain insurance policies in the identities of its individuals and pay premiums, enabling the HUF to obtain a tax deduction per section 80C. To benefit from the 80C tax, the HUF may establish and deposit to a PPF account.¹⁹

Banks, on the other hand, no longer permit the formation of a distinct PPF account of something like the HUF. The HUF, however, can make tax-deductible contributions to its individuals' PPF account. Nevertheless, in order to collect a Section 80C tax incentive, a HUF must engage extensively in Insurance Policies for its individuals or in a 5 Years Banking Fixed Deposit.²⁰

Section 80D of the Income-tax Act of 1961 states: The HUF may also claim a separate tax deduction for the payment of Health Insurance Premiums. Section 80D of the Income-tax Act of 1961 allows for this deduction. The maximum deduction is Rs. 25,000 per year. However, if the HUF purchases a Medi-claim Policy, for example, for older persons in the family, the sum of Rs. 25,000 will be increased to Rs. 50,000. A maximum of Rs. 5,000 can be deducted from this amount for Preventive Health Check UP. The HUF can also claim a separate tax deduction of Rs. 75,000 for maintenance, including medical treatment, of a dependent member who is a person with a disability.²¹

Section 80DD of the Income-tax Act of 1961 states that if a person has a serious handicap, the deduction is increased to Rs. 1,25,000. Section 80DD of the Income-tax Act of 1961 allows for this deduction.

Section 80DDB of the Income-tax Act, 1961: If the HUF genuinely pays for medical treatment of a certain sickness or conditions as specified in the Income-tax Act for the benefit of its members, the HUF would be permitted a deduction of up to Rs. 40,000 under section 80DDB of the Income-tax Act, 1961. Although, if such an expense is incurred for a member who is a senior citizen, the deduction will be Rs. 1,00,000.

¹⁹ "Indiaincometax.co.in" (www77.indiaincometax.co.in) <http://indiaincometax.co.in/deductions-under_section-80c> accessed January 20, 2022.

²⁰ Subhash Lakhota, "Latest News: India News | Latest Business News | BSE | IPO News" (*Moneycontrol* January 22, 2014) <http://www.moneycontrol.com/news/tax/how-can-huf-help-individual-to-save-income-tax_1007010.html>.

²¹ Ibid.

Section 80G of the Income-tax Act of 1961: HUFs can also give to authorised charitable trusts and institutions and claim a deduction under Section 80G of the Income-tax Act of 1961.

Section 24 of the Income-tax Act, 1961: The HUF is also eligible to claim a deduction for interest on self-occupied housing property of Rs. 2,00,000 in a year under Section 24 of the Income-tax Act. Therefore, the HUF is eligible for all deductions available to individuals, with the exception of Sections 80E (deduction for loans obtained for higher education) and 80GG (deduction for rentals paid).²²

PROVISIONS FOR ANTI-ABUSE RELATING TO HUF UNDER THE ACT

Though HUF is a legitimate tax-saving instrument, it has come to be utilised as a colourable device for tax evasion. Over time, tax rules have developed to keep up with human innovation. Certain sections of the Income Tax Act differ from those of the civil laws.

It is critical to understand these divergences, which are actually anti-abuse rules. Among the most important are:

- Clubbing Provision
- Gift Tax
- Mode of Partition
- Partial partition

CLUBBING PROVISION²³

Although under legal system, every person can modify his part of the property by impressing this with the features of shared estate, in tax law, these acts are banned. To reduce taxes, a member how he has renounced his title to independent property and submits the money to the Hindu Undivided Family, needs to be appraised. The mixing clause is included in Section 64(2), which stipulates that if a participant's independent property is transformed or combined with Hindu Undivided Family property, the earnings from certain estate is nevertheless taxed as the participant's income.

GIFT TAX²⁴

Whatever money, immovable property, or certain specified properties obtained without consideration by a person or HUF in excess of Rs.50,000/- (in aggregate in a fiscal year) is taxed as Income from Other Sources under section 56(2)(vii). This method of taxing gifts in the hands of the receiver was implemented in the Income Tax Act on September 1, 2004. It should be mentioned that the former Gift Tax Act of 1958 was repealed on October 1, 1998.

²² "Report No. PF/HT/011006/52 HUM-TUM" (2006).

²³ § 64(2) of Income Tax Act, 1961.

²⁴ § 56(2)(vii) of Income Tax Act, 1961.

The legislation also exempts gifts from gift tax if they are received from family or in certain other conditions. The term relative is defined strictly in this section for this purpose.

Is a present received by a HUF from any of its members considered a gift from a relative? According to the Income Tax Appellate Tribunal in Rajkot²⁵, Hindu Undivided Family is a collection of relations; therefore, a gift obtained from a HUF is exempt. So yet, no further specialists on this issue have been identified, although it may be too early to make inferences.

Converting a student's property rights into HUF assets (in excess of Rs.50000/- pa) may be a double-edged blade, having clubbed provisions solely on a single side and gift tax provisions on another. Gifts given by a bigger Hindu Undivided Family to a smaller Hindu Undivided Family would be liable to gift tax underneath the Income Tax Act, even if they were permissible under legal system. It is essential to be conscious of these risks and to proceed with caution.

MODE OF PARTITION²⁶

Partition signifies the end of the Hindu family's undivided existence. A single intent to punish would've been adequate to end the combined existence and lead in a civil law division. A formerly contracting party would then enjoy that land as tenants-in-common till the land is divided by treatment meted and bounds. The Privy Council recognized this as an established legal rule.²⁷

The income tax situation, on either side, is not really the same. Section 171(1) states that a Hindu Undivided Family subjected to taxes should be subjected until the assessing officer registers a division finding. Moreover, the Comment to Section 171 describes partitioning as a characteristic that is divided into metes and limits. In which the ownership doesn't really allow this split, it is authorised, and a mere division of the standing also isn't deemed partitioning.

The legislation appears to be designed to prevent division of conveniences made between the parties with altering the terms of enjoying of property. Moreover, this refutes the notion that divides were made verbally for no reason than tax reduction.

PARTIAL PARTITION²⁸

Under civil law, a division can be either whole or partial. A complete partition is one in which all of the properties are divided among all of the people who are qualified to receive a portion. A partial partition, on the other hand, may be partial in terms of either individuals or things, or both.

The greater the number of HUFs, the greater the tax benefits. At some point, ingenious methods of propagating HUFs through the utilisation of partial partitions were created.

²⁵ *Vineetkumar Raghavjibhai Bhalodia v. ITO* (IT Appeal Nos. 583 (Rjt.) of 2007 and 601 (Rjt.) of 2008). ²⁶ Explanation to §. 171.

²⁷ *Approvier v. Rama Subba Aiyar* (1866) 11 MIA 75 (PC).

²⁸ § 171(9) of Income Tax Act, 1961.

To take advantage of the tax benefits, several HUFs were artificially established inside one Hindu Undivided Family with a plethora of variations and combinations of qualities and people. Section 171(9) was added by the modification that took effect on December 31, 1978, and it does not recognise a partial division.

Consequently, if there is a true partial division and a few properties are given to some of the members of the HUF, the revenue from these properties is taxed in the control of the HUF as if there's no split.

Under the Income Tax Act²⁹, a fictitious division by virtue of section 6 of the Hindu Succession Act, 1956 is also insufficient. Section 171 requires that a partition fully comply with the standards.

CONCLUSION

The tax statutes have seen insignificant revisions throughout time. To avoid tax evasion by HUFs, the government has attempted to evolve the taxation system and its provisions of the legislation throughout time. Since then, investment in a PPF under the guise of an HUF has been prohibited; the property any individual wants to move into the hotchpotch is treated as a transfer, and capital gain tax, in addition to the levy of a transfer stamp, is applicable in almost all states in India; and income arising

out from the property transferred towards the HUF shall be clubbed into the individual's hand under the section 64(2) of Income Tax Act 1961.

However, such revisions are insufficient, and that does not alter the fact that Hindus continue to have a significant unfair advantage as a result of the present legislation. Law thus, should be applied uniformly to all people of the country.

Uniform law for any and all people is desirable for national unity. The Indian Constitution encourages secularism, yet lawmakers elected to establish distinct personal laws for all religious identities from the start of independence. The creation of distinct personal laws resulted in preferential treatment of one religion over another.

Secular activists and citizens, on the other hand, enjoy expressing their views on the Uniform Civil Code and Muslim Personal Law. Nobody talks about the favourable status accorded to HUF in the Indian Income Tax Act. It should be reminded that charity begins at home. The majority community should change provisions in legislation that benefit them. As a result, before the majority forces the minority to embrace a unified civil code, the majority should eliminate the advantages it has chosen for itself.³⁰

²⁹ *CIT v. R.B. Tunki Sah Baidyanath Prasad* (212) ITR 632 (SC).

³⁰ Mazin Khan, "Tax Benefits of Hindu Undivided Family (HUF)" (*The Milli Gazette — Indian Muslims Leading News Source* December 29, 2012) <<http://www.milligazette.com/news/5381-tax-benefits-of-hindu-undivided-family-huf>> accessed January 20, 2022.

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