

A Common Question asked by every Tax payer: How to save tax?

An uncommon answer: “By forming a Hindu Undivided Family”

➤ What is HUF?

HUF is based on the concept of family, family which can “Own” and “Earn”. Families which can have a common regularly source of Income. This shall be taxed separately. For example, if an ancestral residential property is rented out, then the rent arising would be considered as Family’s income and not as income of individual. In real life this rent is shown as income of one individual and he pays the tax on it, however a HUF can be formed and the rent can be shown as the whole family income (HUF) and it can be taxed separately.

➤ How can a family become tax saving mechanism

HUF works on the principle of creating a separate legal entity in the eyes of law. It diversifies the income from high tax paying individuals to HUF. It avails benefits of basic exemption and benefits of chapter VIA just like every other Individual.

➤ Components of HUF

Coparcener & Member.

Coparcener is someone who has the right to demand the share of the property of family; Co-parceners are generally the Karta (Main decision maker of family, usually the Father, but Manmohan Singh had brought an amendment which stated that Females can become Karta & there can be an all female HUF as well), then sons & daughters, grandsons and great grandsons in order of their first right. Wife of the Karta is not a coparcener or even spouse are not coparceners and hence can’t demand/ ask for any share in HUF, they are just merely members of HUF.

Joining the HUF

As HUF is governed by the Hindu Law and not by the Income Tax Act, individuals belonging to other religions are not allowed to form HUF except Jain's and Sikhs who can create HUF even though they are not governed by the Hindu Law. Two entities, extremely important to know in HUF are the coparceners and members.

There's no need to fill an application form or submit KYC documents for joining an HUF. All lineal descendants of the karta, their spouses and children automatically become members of his family. Wives join the HUF as members, while children join on birth as coparceners. "Even the unborn child of a member or co-parcener has an equal share in the HUF,"

➤ FORMING OF HUF

▪ Forming Corpus:

Like every entity HUF needs to be started with capital known as corpus. The first step therefore is to form a corpus for the HUF. This can be any capital asset (property, gold, jewellery, securities, and deposits) or cash.

The best way to avoid the tax tangle is to form the HUF corpus with assets received as part of a will.

One can't transfer just any asset to your family 'hotchpot'. Such transfers are trapped under clubbing provisions under Section 64 (2) of the Income Tax Act. This means the income from these assets will be treated as that of the individual, thus defeating the very purpose for which the HUF was established.

A husband and wife can form an HUF but a wife can only be a member, not a co-parcener. Therefore, the HUF income will not be assessed separately. "Only the birth of a child will give the unit the status of an HUF for tax purposes,"

Chartered Accountants

HUF can be formed with money received as gifts from relatives. But there's again a tax implication here. While there is no tax on gifts received by an individual from specified blood relatives, the HUF does not enjoy this exemption. "The HUF is not an individual, so it has no relatives. Any money it gets will be treated as a gift from a stranger. If the value of the assets received as gifts in a year exceeds 50,000, it will be deemed as income of the HUF and taxed accordingly,"

▪ Other Manual Procedures such as:

1. Opening a bank account with the name of Hindu undivided family like "Sample HUF" with a stamp, ID Proof and the proof of the members of the family of HUF
2. **Important:** - While opening a Bank Account in the name of HUF – Banks always ask for a rectangular stamp which states the name of the HUF and also the Karta who is signing it. A round stamp is not accepted as per RBI Circular. The same applies at the time of opening of bank account of Sole Proprietor as well.
3. Apply for PAN (Permanent Account Number) of the income tax.

➤ HOW DOES HUF SAVE TAX?**▪ Saving tax by getting gifts**

One way of saving tax is by transferring the money received from strangers or family is taken as gifts in name of HUF. So if one starts his HUF called and he is getting some gifts from relatives, friends or anyone else, he can ask them to give it to "Ajay HUF" and not Ajay itself. That way the gift will be treated as income/asset of HUF and taxed separately. One important point here, if some stranger is giving gift to HUF, there is a limit of Rs 50,000 on which no tax has to be paid, but actually it can go up to Rs 2 lacs as the Taxable limit is that much, and if one also has to do investments of 1 lac (total 80c limit), then one can afford to receive up to Rs 3 lacs of gifts in a financial year and there will be no tax liability at all.

HOW HUF SAVES TAX			
	INDIVIDUAL	HUF	TOTAL
Total INCOME	1,200,000	1,200,000	2,400,000
LESS : DEDUCTION			
80C	100,000	100,000	100,000
80D	15,000	15,000	15,000
TAXABLE INCOME	1,085,000	1,085,000	2,285,000
BASIC EXEMPTION	200,000	200,000	200,000
TAX PAYABLE	153,500	153,500	513,500
TOTAL TAX PAYABLE	307,000.00		513,500
NET SAVING IN TAX	206,500.00		

By setting up a HUF one can save tax up to
` 2, 06,500

- **Assign ancestral properties and wealth to HUF and invest it**

If family is going to receive an ancestral property or any wealth, then it's better to transfer it on HUF name so that whatever earnings happen in future in form of rental income or capital Appreciation of assets becomes income of HUF itself and taxed in its own hands. That way The total tax liability of family can be minimized.

- **Use HUF income for expenses and Insurance for Family**

As HUF enjoys separate tax benefit under sec 80C, one can use the income of HUF for buying Life & health insurance for family and the permissible deductions can be availed for tax purpose in hands of HUF, so if the total premiums for insurance requirement of family is Rs 50,000 per year, then It can go from HUF income and also the individual can exhaust his 1 lac limit separately via PPF, ELSS and other tax instruments. Also family day to day expenses can be used from HUF income. But here too there are certain conditions to be met. If the property is inherited by the individual, transferring it to the HUF will again lead to clubbing. "A person can give property and other assets to his son's HUF but it should be clearly specified that the asset is for setting up the HUF,"

One can also start the HUF with funds received on the dissolution (or full partition) of a larger HUF. If the karta wants to divide the HUF property between the co-parceners, he can transfer the fund to a newly formed HUF. If the ancestral property is sold, the proceeds received can also be transferred to the HUF.

➤ **Recent amendments in HUF rules**

(HINDU SUCCESSION ACT in 2005)

- The daughter could also be a Coparcener like the sons of the HUF.
- Daughter also continues to be a Coparcener after her marriage of that family whether she also will be a member of HUF of her husband.
- The degree of the Coparcener limited to four degree (Great Grandson) and not all the members of the family are Coparcener.
- For creating the HUF one needs to get married, there is no need to have child or children for creating the HUF.
- The female could also be a KARTA as the amended when the father unfortunately dies and she has no brother. In that condition the daughter or the mother can be the KARTA.
- In HUF there could be all the females' members also when the husband dies and she has no sons.
- The HUF can't be a partner of the firm as the HUF is not a person whereas the KARTA of HUF can be a partner of the firm.
- HUF can pay remuneration to the KARTA of family for the interest and expenditure to run the family business.

➤ Illustration

Mr. Sachin Tendulkar, if he is married then he can create an HUF in the style of "Sachin Tendulkar HUF." Suppose there are 4 adult members in the family consisting his wife Asha Tendulkar, married son Ashish Tendulkar and daughter in law Shalini Tendulkar, and all are earning and being taxed as per highest tax slab. Suppose there are deposits and investments in the name of HUF and HUF also earns an income of 1.5 lacs. Then income of Sachin Tendulkar HUF will not be considered as an income of any member of the family, but the income of HUF which is separate income in the eyes of law.

What's more, HUF enjoys the tax benefits which only an individual enjoys, i.e. Income up to two lacks is tax-free and that entity will not be liable to pay any tax. However if this income would have been added in the income of any of the family member, then they had to pay tax on that income as per highest tax slab.

Now, what becomes more interesting that Son of Mr. Sachin Tendulkar, Ashish Tendulkar can also create another HUF Sachin Tendulkar HUF, for which he will be Karta and continue being Co-parcener/Member of the HUF created by his father "Sachin Tendulkar HUF". Now this Sachin Tendulkar HUF will again become separate entity enjoying all the tax benefits an individual gets.

In this particular example we have seen that although there are 4 members in the family but 6 different entities in the eyes of law enjoying the tax benefits which are applicable to individuals.

Now even if all the Members have exhausted the benefits by investing 1 lacs each under section 80C, they can invest additional 2 lac from the 2 HUF accounts even if the investment is in the name of HUF only or any of the members of HUF.

This illustration shows how powerful tax saving tool an HUF is.

➤ **Is HUF a powerful Tax Saving Tool for You?**

HUF will be extremely efficient for those people who have a higher income and high saving rate and some form of ancestral assets which can be marked as “Family Assets”. Evaluate if HUF can really give you that kind of tax advantage or not for people who do not have high salary or who do not have a big enough family. So make sure you can get the maximum out of the HUF.