Save Tax by forming HUF: benefits & drawbacks

A very effective and legal way advised by chartered accountants to *save tax is HUF* i.e. Hindu Undivided Family. In India there are many families which are undivided and the incomes earned by such families are joint income as Compared to Individual Incomes. As these are joint incomes and not Individual Incomes, these incomes cannot be taxed in the hands of any specific individual and are therefore taxed in the hands of the whole family. As these are taxed in the hands of the family, the family has a separate PAN Card as compared to Individual members of the HUF who also have a separate PAN Card.

Logic behind Forming a HUF to Save Tax

Basically the logic behind forming an HUF to save tax is to avail the benefit of an extra PAN Card legally. As the Income of the Family is not taxed in the hands of any specific Individual, a new PAN Card is allotted to the HUF and Tax would be paid by the Family using this PAN Card. As a new PAN Card would be allotted to the whole family, it will also enjoy the benefits of Income Tax Slab Rates 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.

How creating a Hindu Undivided Family Account would result in tax saving would become clearer with the help of an example.

Let’s assume there are 4 Members in a Family – Husband, Wife and 2 Children. The Income of the Husband is Rs. 25 Lakhs, Income of the Wife is Rs. 18 Lakhs. They also have a ancestral property from which they are earning rent of Rs. 8 Lakhs p.a. The rent from such a property would either be taxed in hands of the Husband or the Wife or both.

Case 1: If taxed in the hands of the Husband, the husband who is currently in the 30% Income Tax Slab Category would be required to pay 30% of Rs. 8 Lakhs i.e. Rs. 2.4 Lakhs as Tax.

Case 2: If taxed in the hands of the Wife, the wife who is also currently in the 30% Income Tax Slab Category would be required to pay 30% of Rs. 8 Lakhs i.e. Rs. 2.4 Lakhs as Tax.

Case 3: If taxed equally in the hands of both Husband and Wife i.e. Rs. 4 Lakhs each, both the Husband and Wife would be required to pay tax @ 30% on Rs. 4 Lakh = 1.2 Lakhs each by both Husband and Wife thereby leading to a total tax outflow of Rs. 2.4 Lakhs

However, there is a better way out by which you can plan your Income Tax. As this Income is arising from an asset which belongs to the whole family, this Income shall be taxed in the hands of the Family (provided an HUF is formed) and you would be able to enjoy the benefits of slab rates.

Case 4: If this Rental Income of Rs. 8 Lakhs is taxed in the hands of HUF, the tax payable by the HUF as computed as per the Slab Rates would be Rs. 70,000 to Rs. 80,000 (depending on the income tax deductions claimed by the HUF) Taxing this Rental Income in the hands of the HUF would lead to a Tax Saving of Rs. 1, 80,000 p.a. (Rs. 2,40,000 – Rs. 60,000)

For easy understanding of the concept, we explained this article using only Rental Income, but there are many other Incomes as well which arise to the family as a whole wherein the concept of saving taxes by forming an HUF can also be applied.

Benefits and Drawbacks of forming an HUF

The major advantage of creating a Hindu Undivided Family Account is that the family gets an extra PAN Card and can split the family income and thereby resulting in tax saving and reducing the tax outgo. This is the major reason why CA’s advise their clients to create a HUF and save taxes of up to Rs. 1.8 Lakhs every year (as explained above). However it should be noted that there is a disadvantage as well and that is the fact that all assets of in the name of the Hindu Undivided Family are assets of the family and not of a specific individual. All members of the family have a right in the assets of the Hindu Undivided Family (including an unborn child in the womb of a mother).

Therefore proper caution should be exercised while gifting assets to the Hindu Undivided Family as the whole family would be having a share in the assets of the family as compared to the fact that if these assets were in the name of a specific individual – only that individual would have a right over that asset.

Other Relevant Points regarding HUF

1. HUF is also required to file Income Tax Return every year just like an Individual and if the turnover of the business of the HUF is more than Rs. 25 Lakhs/ Rs. 1 Crore, tax audit under Section 44AB would also be required to be conducted by a Chartered Accountant.

2. Due Date of filing of Income Tax Return of the HUF would be 31st July of the Assessment Year. However, in case the Tax Audit is required to be conducted, the Due Date of filing of Return would be 30th Sept.

3. The Karta of the HUF has the power to sign all documents on behalf of the HUF. However, he may also permit other adult members to have this power.

4. A adopted child can become a member of the HUF but he cannot become a co-parcener. The difference between a member and a co-parcener is that the co-parcener cannot ask for partition of the HUF.

5. HUF's are recognized all over India except Kerala wherein HUF's are not recognized. This de-recognition was done by Kerala Joint Family System (Abolition) Act, 1975 with effect from 01.12.1976.

6. The HUF may be a resident or a non-resident in India depending on where the control of the HUF is residing.

How to start HUF & create HUF Deed?

Creation of HUF

HUF stands for Hindu Undivided Family wherein the Income that is being earned belongs to the whole family and not to any specific individual. As the Income is being generated in the hands of the whole family, this income cannot be taxed in the hands of the family but is taxed in the hands of the HUF. And, therefore HUF is considered as a separate entity for the purpose of Income Tax Act and the HUF has a separate PAN Card and a separate income tax return is filed for the same.

A HUF automatically comes into existence when a person gets married and starts his family. It is not necessary that this new family should also have kids. The day when boy and groom get married, they have formed a HUF.

Although a HUF is automatically formed at the time of marriage, it is always advisable to have a written agreement as the Banks and Income Tax Dept ask for the HUF Deed. It is not necessary that HUF is created on the day of marriage itself and can be created at any point of time in future.

Creating a HUF is not a difficult task and the steps involved in creating a HUF are explained below.

How to create HUF

To create a HUF, 3 things are required i.e.

Step 1: Create HUF Deed
Step 2: Apply for HUF PAN Card
Step 3: Open Bank Account of HUF

These 3 steps have been explained below in details

Step 1: Create HUF Deed

The 1st Step in creating a HUF is to create the HUF Deed. The HUF Deed is a written formal document on a Stamp Paper stating the names of the Karta and the Co-parceners (Members) of the HUF. The eldest male member of the HUF becomes the Karta of the HUF. A declaration is also provided by each member of the family where they declare the name of Karta and also state that –

1. Karta has the authority of the accounts vested in his hand

2. That the members are the only members of the HUF

3. The Karta holds the right to govern all the transactions of the HUF accounts on behalf of the members.
The names of the members of the HUF and the name of the HUF are also required to be stated in the HUF Deed at the
time of creation of HUF. The name of the HUF is usually the name of the Karta followed by the word HUF.

For eg: If the Karta of the HUF is Suresh Kumar, the name of his HUF would be Suresh Kumar HUF. It also states the capital with which the HUF has been initiated. There are various sources through which Capital can be introduced in the HUF. Recommended Read: How to create Capital in HUF Format of a HUF Deed are given in this link. Most notary public agents have such formats and help in creating of HUF at a nominal fee. The fees charged by notary public agents for creating a HUF Deed Format are a few hundred only. Creating a HUF Deed is not mandatory and PAN Card and Bank Account can be opened without HUF as well but it's always better to have a written document in place.

Step 2: Apply for HUF PAN Card

As a HUF is treated as a separate entity different from its members, a HUF is required to apply for a separate PANCard. An application for HUF PAN Card is required to be made in Form 49A which can be furnished online as well as manually. HUF PAN Card Application can be made online through this link: https://tin.tin.nsdl.com/pan/form49A.html
Once the PAN Card has been allotted, the HUF would be required to file separate Income Tax Returns and can therefore claim benefit of income tax slab rates and also claim most of the income tax deductions which

are available to an Individual. The application for PAN Card and the Income Tax Return would be signed by the Karta.

Step 3: Open HUF Bank Account

A HUF is also required to open a Bank Account in which it will receive all payments. A HUF Account can be opened in any bank account. At the time of opening of HUF Bank Account for creation of HUF, the HUF would also be required to have a Rubber Stamp of the HUF and all documents pertaining of the HUF should be properly stamped. This rubber stamp should be rectangular as Round Stamps are now not accepted (RBI Circular) Once all the above 3 steps are completed i.e. the HUF Deed has been created, PAN Card has been allotted and the Bank Account has opened, the HUF is now a separate legal entity and can start receiving payments and the amounts received in the name of the HUF will not be taxed in the hands of the individual members of the HUF.

Members of HUF

As *HUF* stands for Hindu Undivided Family, individuals belonging to other religions are not allowed to form HUF's except Jain and Sikh who can create HUF even though they are not governed by the Hindu Law. An HUF consists of Karta: Karta is generally the father of the family who has the right to do all the things for the family and takes all the decisions on the behalf of the family. Co-Parceners: Coparcener is the person who has the right to demand the share of the property of family if he/she wants to part away with the family with his/her share. Not all members of the HUF are its coparceners. The co-parcenery extends to four degrees down the family hierarchy in the following manner:

1st degree: Holder of ancestral property for the first time.
2nd degree: Sons and daughters
3rd degree: Grandsons.
4th degree: Great grandsons.

How to create HUF Capital and put Money in HUF Account?

How to create HUF Capital

There are certain ways through which HUF Capital can be created and some of the most popular methods to infuse capital in a HUF is by receiving gifts in such a manner that they don’t attract any tax. Some of the most effective and popular methods of creating HUF Capital by receiving gifts without attracting any tax are:-

1. Gifts from Relatives of the Members of HUF As per Section 56(ii) of the Income Tax Act, gifts received from the relatives of the members of HUF are fully exempted from the levy of tax. As gifts received from relatives of the members of HUF is fully exempted from tax, How to create HUF Capital There are certain ways through which HUF Capital can be created and some of the most popular methods to infuse capital in a HUF is by receiving gifts in such a manner that they don’t attract any tax. Some of the most effective and popular methods of creating HUF Capital by receiving gifts without attracting any tax are:-

2. Gifts received at the time of marriage Gifts received at the time of marriage of any member of the HUF are fully exempted from the levy of

Income Tax. However, gifts received at the time of marriage of daughter are not exempted and are taxable.

3. Ancestral property Your ancestral property is not only your own and belongs to the whole family i.e. the HUF. The Ancestral property can be transferred to the HUF to create capital of the HUF.

4. Aggregate Value of Gifts is less than Rs. 50,000
If the aggregate value of gifts received from any person during a financial year does not exceed Rs. 50,000, then this whole amount is exempted from levy of any tax. There is no limit on gifts received from family members and this limit of Rs. 50,000 is only for gifts received from non-relatives.

5. Gifts received from members of the HUF If a gift is received from members of the HUF, and then the income generated from these funds would get clubbed and taxed in the hands of the member making the gift. However, if this income is invested in tax-free instruments, the members making the gift will not have to bear extra tax burden as the income is already tax free. And on maturity of this instrument, the HUF can invest the money anywhere and in any way in which it likes and the income won't be clubbed. In other words, Income generated from Income won't get clubbed.

Capital created by HUF through Income earned from the capital created by the HUF, it can earn further income and generate more capital. The HUF can earn income from all sources (except Salary) and the income so earned would help the HUF create more capital. Some examples of sources from where a HUF can earn more income are:-

1. Through any Business
2. Investing in Shares and Mutual Funds,
3. Investing in Real Estate

4. Investing in fixed deposits
5. Through Rental Income
6. Various other sources

The income earned by the HUF would be taxable as per the Income Tax Slabs and the HUF is also required to file income tax returns just like Individuals. All income tax deductions are also available to HUF just like they are available to an Individual. Moreover, if the turnover of the business of the HUF is more than the limit specified under Section 44AB i.e. Rs. 25 Lakhs/ Rs 1 Crore, it would also be required to get an audit conducted by a Chartered Accountant.