

TAX PLANNING THROUGH HUF, WILL & SUCCESSION PLANNING



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TAX PLANNING

- Tax planning is a **legal way of reducing** your tax liabilities in a year. It will help you to utilize the tax exemptions, deductions, and benefits in the best possible way for minimizing your tax burden. However, it should be done in a legal manner.
- Tax planning is the analysis of one's financial situation from a tax efficiency point of view so as to plan one's finances in the most optimized manner.
- Tax planning allows a taxpayer to make the best use of the **various tax exemptions, deductions and benefits to minimize their tax liability** over a financial year. Tax planning is a legal way of reducing income tax liabilities, however caution has to be maintained to ensure that the taxpayer isn't knowingly indulging in tax evasion or tax avoidance.



HUF – YOUR
PRIZE STATUS
FOR TAX
PLANNING

HINDU UNDIVIDED FAMILY



- The term “Hindu Undivided Family” (HUF) has not been separately defined under the Direct Tax Laws and, therefore, this expression must be understood as defined under the Hindu Law.
- As per Hindu Law, an **HUF is a family consisting of all lineal male descendants of a common ancestor and includes their wives and unmarried daughters.** The death of the common ancestor does not lead to the dissolution of a joint family. The next eldest male member becomes the head of the family and the family continues to exist.
- It may consist of other lineal descendants or it may consist of collaterals. Upper links get snapped and lower ones come into existence, and the joint family continues to exist. So long as the line does not become extinct, the joint family continues and can continue indefinitely, almost until eternity.

- A Hindu coparcenary is a much narrower concept than the Hindu Undivided Family and includes only male members who acquire an interest in the joint family property by birth. Such Karta- Co-parcener- male members are known as coparceners- Karta, Co-parcener & Member.
- The interest of each coparcener in the joint family property is fluctuating, capable of being enlarged by death and liable to be diminished by the birth of sons to coparceners. The eldest male member of the HUF who is vested with the authority of managing affairs of the HUF is known as “Karta”.
- As per Hindu Law, Jains, Sikhs and Indian Buddhists are also included in the definition of Hindu and, therefore, the provisions relating to HUF also apply to them- Champa Kumari Singh 83 ITR 720 (S.C.)
- As held by the Supreme Court in the case of `Gowli Buddanna v. CIT’ 60 ITR 293, under Hindu Law, a joint family may consist of a single male member and the Income-tax Act also does not indicate that the HUF as an assessable entity must consist of at least two male members.

- Moreover, in the case of `[CIT v. Veerappa Chettiar](#)' 76 ITR 467 (SC), the Supreme Court has held that even when a joint family is reduced to female members only, it continues to be an HUF, since there is a potential coparcenary as any widow by adoption can induct a coparcener into the family.
- The Gauhati High Court in the case of `[CIT v. Arvind Jhunhunwalla & Sons](#)' 223 ITR 45 has held that an HUF gets constituted immediately upon the marriage of an individual. The High Court also rejected the contention of the Income-tax Department that until there was the birth of a son in the family, the income of the HUF would be liable to be assessed in the individual case of the Karta.
- Father's HUF share Devolved upon him in share of a Firm.
- The Supreme Court in the case of [Surjit Lal Chhabda vs. Commissioner of Income-tax](#) (101 I.T.R. 776) held that a joint Hindu family, with all its incidents, is a creature of law and cannot be created by the act of parties, except to the extent to which a stranger may be affiliated to the family by adoption. Only Husband & Wife survived- No HUF as 1 more son/ male member necessary for HUF.
- In the case of [N.V. Narendranath](#) [1969] 74 ITR 190 (SC), the court held that when a coparcener having wife, minor daughters and no son receives his share of joint family property on partition, such property in hand of coparcener belongs to his Hindu Undivided Family.

ANCESTRAL PROPERTY

Meaning : All property inherited by a male Hindu from **his father, father's father or father's father's father, is ancestral property. Section 15 & 16 of the Hindu Succession Act. Table 1 Class – Table 2 Class.**



- **General Understanding :-** The essential feature of ancestral property according to Mitakshara Law is that the sons, grandsons and great-grandsons of the person who inherits it, acquire an interest, and the rights attached to such property at the **moment of their birth.**
- **Case Law to understand the Concept :** -Thus, if 'A' inherits property, whether movable or immovable, from his father or father's father, or father's father's father, it is ancestral property, as regards his male issue. (AIR 1936 Orissa 331).
- A person inheriting property from his three immediate paternal ancestors holds it, and must hold it, in coparcenary with his sons, son's sons, and son's son's sons. *Dipo v. Wassan Singh* – AIR 1983 SC 846 at 847-48; The share, which a coparcener obtains on partition of ancestral property, is ancestral property as regards his male issue.

- The incidents of co-parcenership under the Mitakshara law are :
 1. The lineal male descendants of a person up to the third generation, acquire on birth ownership in the ancestral properties of such person;
 2. Such descendants can at any time work out their rights by asking for partition;
 3. Partition each member has got ownership extending over the entire property conjointly with the rest;
 4. Result of such co-ownership the possession and enjoyment of the properties is common;
 5. No alienation of the property is possible unless it be for necessity, without the concurrence of the coparceners, and
 6. The interest of a deceased member lapses on his death to the survivors.
- A **coparcenary** under the Mitakshara School is a creature of law and cannot arise by act of parties except in so far that on adoption **the adopted son becomes a co-parcener with his adoptive father** as regards the ancestral properties of the latter.” **SBI v. Ghamandi Ram – AIR 1969 SC 1330.**

PARTITION

- **Meaning :-** To divide and distribute assets / property amongst the members of the family is called partition.
- Now it has to be total and **by metes and bounds**. It can be **oral**. However, if in writing would attract stamp duty. **(Refer Bhanwari Devi v. Arvind Kumar & Anr. – AIR 2016 Rajasthan – 198)**. It can be unequal and not in accordance with share of each member. It need be recognised under Section 171 of the Income-tax Act for those which have been hithertofore assessed.
- Change in Section 171(9) w.e.f. 31/12/1979.
- Reunion possible only amongst those who partitioned. A.M.V Chettiar 215 ITR 856.



AUGMENTING PROPERTY FOR AN HUF

- The existence of an HUF is dependent on the [principles of Hindu Law](#).
- Since HUF is a creature of law, the term `creation of HUF' is a misnomer.
- It may quite often happen that an existing HUF may not own any property.
- In order to avail benefits of tax planning it is necessary for such an HUF to augment its own property.
- In fact the term colloquially used as `[creation of HUF](#)' refers to `[creating or augmenting funds for an existing HUF](#)'.

DAUGHTER & THE HUF – NOW

- On and from the commencement of the Hindu Succession (Amendment) Act, 2005, Section 6 was inserted on effect from 09/09/2005 according to which in a Joint Hindu Family governed by the Mitakshara law, the daughter of a coparcener shall :-
 1. by birth become a coparcener in her own right in the same manner as the son;
 2. have the same rights in the coparcenary property as she would have had if she had been a son;
 3. be subject to the same liabilities in respect of the said coparcenary property as that of a son,-

New Section 6 of the Hindu Succession Act.

INCOME TAXABLE BY HUF

- If an HUF contributes fund to the capital of a partnership firm, profit and interest received (from the firm) by a partner who represents the HUF is regarded as HUF income.
- This is because the income in the partner's hands arises on investment of the HUF's funds. However, if the Karta is also paid a salary by the firm for efforts put in by him, such funds would be regarded as the Karta's individual income.
- Investment profit can be regarded as the income of an HUF, particularly in cases where the HUF has paid margin money or deposits for such transactions.

TAX BENEFITS FOR HUF

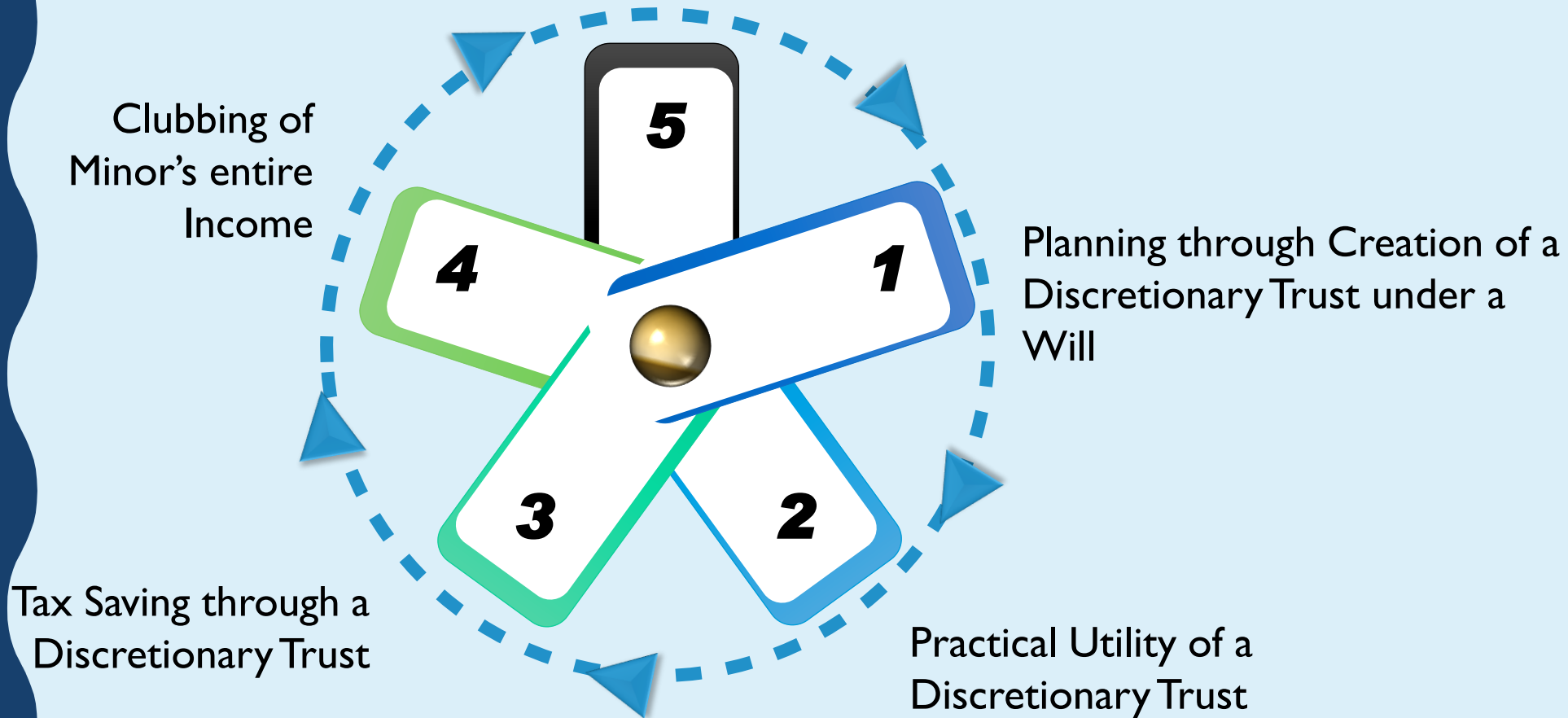
- The income or wealth of an HUF is taxed separately in the hands of the HUF itself and no part thereof is subject to tax in the hands of any member of the family by virtue of Section 10(2) of the Income-tax Act.
- Since an HUF has been granted the status of an independent tax entity just like an individual, it would also enjoy the advantages of separate personal income-tax exemption limit of Rs.2,50,000 and graded tax structure up to the maximum income level of Rs.10,00,000, deductions from gross total income under Section 80C of the Income-tax Act.



TAX PLANNING
VIA EXECUTION
OF A WILL- TRUST

TAX PLANNING VIA EXECUTION OF A WILL

Distributing properties
under a Will



DISTRIBUTING PROPERTIES UNDER A WILL

- Through execution of a Will, a person can ensure that useful tax planning benefits are availed of by his legal heirs after his death. It is common to see a testator wishing to distribute his properties amongst close members of his family.
- **For example,** when a father executes a Will, he may want to distribute his properties amongst his sons. At such a time, the father should also keep in mind the taxable income and wealth of his sons. If the sons have taxable income or wealth attracting tax at a high bracket, distribution of assets to them would further increase their income-tax.

- In such a case, if the father distributes such properties under the Will to the sons' wives, sons' children or sons' HUFs, whose taxable income and wealth are either below taxable or in a comparatively low tax bracket, this would be extremely useful from the point of view of tax planning.
- Accordingly, any person who is expecting to receive some properties as a beneficiary from the estate of his parents or close relatives should try to ensure that such properties are received by the family members in a low tax bracket.

PLANNING THROUGH CREATION OF A DISCRETIONARY TRUST UNDER A WILL

- A testator should plan the distribution of assets under his Will in such a manner that the persons receiving such properties in the family are **either in a zero tax bracket or at a comparatively low tax bracket**. However, what can be done, in case the members of the family are in the maximum tax bracket of 31.2%?
- In such circumstances, the testator can avail the benefits of useful tax planning by creation of a Discretionary Trust under his Will. Under the provisions of Section 164 of the Income-tax Act, 1961. **Private Discretionary Trust attracts Income-tax at the maximum marginal rate of 31.2%.**

- However, in this context, there is an important exception in regard to 'One Discretionary Trust created under a Will,' in respect of which the income-tax would be applicable at the normal rates and such an entity would be taxed as a separate and distinct assessable unit.
- A Trust in which either beneficiaries are not determined, or if determined their share in the income or assets of the Trust is not determined, is known as a 'Discretionary Trust'. In case of such a Trust, the Trustees are given full rights to distribute the income and assets amongst the beneficiaries at their discretion.

PRACTICAL UTILITY OF A DISCRETIONARY TRUST

- Such a Discretionary Trust created under Will, also has considerable practical utility in a situation where the testator is a very wealthy persons and his assets are to be distributed to minor children who are yet not mature or understanding.
- The concern of the testator in such a case is how the children would be able to manage the large amount of assets.
- In such a case, the testator can create either a Discretionary Trust or in appropriate cases, even a Specific Trust by appointing Trustees, who are his close friends or family well wishes

TAX PLANNING FOR TRANSFER OF FUNDS TO WIFE BY A WILL

- During a taxpayer's lifetime any gifts made to one's wife or vice-versa, are liable to be included in the income of the donor under the provisions of Section 64(1). However, when bequests are made in favour of one's spouse through a Will, obviously there is no question of clubbing of income.
- This can result in a lot of tax saving. With the abolition of the estate duty, this device, as well as other modes of transfer of property through Wills, can be adopted.

TAX PLANNING FOR TRANSFER TO DAUGHTER-IN-LAW BY A WILL

- Under the provisions of Sections 64(1)(vi) and (vii) it is provided that where a transfer is made in favour of the daughter-in-law, either directly or for her benefit to the trustees of a trust, the income from the assets would be clubbed with the income of the donor.
- Hence, during one's lifetime, it is not possible to either make gifts in favour of the daughter-in-law or transfer assets to her through the medium of a trust. This handicap can, however, be overcome through the Will. Thus, a bequest can be made in favour of one's daughter-in-law, so as to confer on her a one, after the testator's demise.
- There would not be any clubbing the income of the daughter-in-law with the income of the executor of the deceased person's estate after the testator's death.

TAX PLANNING BY WAY OF CREATION OF A CHARITABLE TRUST THROUGH A WILL

- A person can fulfil his desire of allocating certain properties for purposes through the Will. He may declare a trust for public purposes and thus transfer the property to the trustees in such a manner that after his demise, the charitable trust so created by Will enjoys the income.
- The drafting of the charitable trust should be such that it enables the trustees of a charitable trust to obtain a complete exemption of income tax under the provisions of Section 11.
- Besides, a taxpayer could also transfer some of his properties to existing charitable trust by way of a bequest in their favour which may be so named in a Will

SUCCESSION PLANNING

- Often, the difference in opinion, talent and priorities of different stakeholders, lack of clear and direct communication, inter-personal relationships, etc. among the legal heirs' act as a major obstacle in smooth transitioning of ownership and leadership in a family business. This could invariably impact the business as a going concern and its market position. Thus, a well-planned succession ensures that the family fortune and the business legacy is well preserved.
- In the succession of a business, all family members need not have both, the ownership stake as well as engagement in the management of the business. An effective succession plan not only ensures smooth transition of ownership; it also helps owners to identify next generation leader who would take over the management of the family business. Timely identification of the successors ensures adequate grooming of the future leader and also defines the roles and responsibilities of other family members.

SUCCESSION PLANNING (CONT..)

- Succession plans are specific to the needs, dynamics and long-term objectives of each family. While some business founders may want to retain the management control of the business within the family, others may be open to the idea of professional executives taking leadership roles with ownership of business remaining with the family. The level of control desired may also differ among the family members like some members may desire to be actively involved in the day to day conduct of the business operations, others may be involved only in strategic decision-making.
- The efficacy of any succession plan lies in its effective implementation. Therefore, adequate provisions should be made in the succession plan to enable effective decision making on crucial business decision and to overcome deadlock situations. Usually, provisions are made for decision-making through simple majority for all routine matters, veto right of the patriarch or any other senior family member, appointment of protectors and mediators or intervention of a close family friend, adviser or a professional in case of a deadlock.

SUCCESSION PLANNING (CONT..)

- Further, the most important aspect is that the succession plan needs to be communicated effectively to family members and to key executives engaged in the business. Effective communication enables sharing of the vision of the promoters with their successors. For instance, where the promoters intend to cease active involvement in the business, disclosure of their intention to engage professional business managers, becomes crucial to establish a systematic process and align objectives and actions of the key stakeholders involved in the business.
- In light of the diverse range of considerations and challenges involved, there is a myriad of structures that can be put in place to meet the family goals and business objectives.
- Also, there are number of tax, regulatory and commercial considerations that one has to evaluate to determine a suitable approach to [succession planning](#). For instance, a succession plan may be structured through Trusts, Wills or a combination of both based on factors such as tax implications on transfer of assets in the hands of the owner and in the hands of the person receiving the asset as gift, stamp duty implications, etc.

SUCCESSION PLANNING (CONT..)

- There are several factors determining the mode of succession planning such as stamp duty implications may arise on transfer/settlement of immovable property in the Trust as against transfer of property without duty through a Will. Decision between a Trust and Will also depends on the personal concerns and desired results from the estate planning. While a will is a legal document which comes into play only on the demise of the patriarch, a Trust is created as well as changed during the lifetime. Moreover, implementing a Will involves a probate (i.e. court supervised) process whereas a trust is not subject to probate proceedings, thereby saving time and costs involved in transition of wealth.
- One also has to also keep in mind the regulatory requirement while creating a succession plan. For instance, where a listed company is involved, securities regulations are required to be complied with. Similarly, if family members include non-residents, the applicable foreign exchange regulations shall need to be adhered to.

SUCCESSION PLANNING (CONT..)

- In spite of the complexities and the challenges involved, a proper well thought out succession plan should ensure that business built by the owner with hard work continues to flourish for years. Further, a succession plan, implemented at the right time, provides the family an opportunity to do a trial run and evaluate the entire programme on a regular (usually annual) basis. Succession planning is thus, an important and an integral part of doing business and not an option and hence, should sit right at the heart of any family-run business organization's objectives.

FREQUENTLY ASKED QUESTIONS

- **Is succession planning also required for professionally managed businesses?**

In case of professionally managed businesses, the ownership and the management of the business are segregated. While the management of such businesses is taken care of by the professional managers, the transition of ownership of the business from one generation of the family to the another is still an aspect which requires appropriate and timely planning.

FREQUENTLY ASKED QUESTIONS

- **Can succession planning be successful and effective even if family members are spread across different continents and have varying interests?**

Most definitely. A carefully thought out and precisely implemented succession planning structure can accommodate any diversity of geographies, levels of interest in business and desired level of income accretion. More than often, generations of a family are spread outside India with the business entities continuing to hold and conduct business operations in India. In such scenarios, a structure is required which can achieve segregation of ownership and management of the business and also adequately distribute the family wealth among all the legal heirs of the family.

FREQUENTLY ASKED QUESTIONS

- **Is succession planning viable for listed companies given the rigorous regulatory oversight on such entities?**

Positively. In fact, most listed entities in India have already started realizing the merit in succession planning and have also started taking steps to put in place a structure to efficiently pass on the baton of family businesses. Due to the oversight of the securities regulator, Sebi (Securities and Exchange Board of India), the succession plan generally needs to be approved by the Sebi and also be planned in such a manner as to not violate any listing regulations and also be in accordance with the takeover regulations in place.

Thank You



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