

Taxation of HUF, Family Arrangements, Trust & Wills

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HUF

- An HUF is a family which consists of all persons lineally descended from a common ancestor, and also the wives and daughters of the male descendants.
- It consists of the *karta*, who is typically the eldest person or head of the family, while other family members are coparceners.

HUF

- The *karta* manages the day-to-day affairs of the HUF.
- Children are coparceners of their father's HUF.
- Once a daughter gets married, she becomes a member of her husband's HUF, while continuing to be a coparcener of her father's HUF.
- Even Jain, Buddhist and Sikh families can have HUFs.

HUF

- Under section 2(31) of the Income-tax Act, 1961, an **HUF** is considered a “person” and, therefore, is treated as a separate entity for the purpose of tax assessment.
- Often families that own ancestral properties and businesses obtain a separate Permanent Account Number (PAN) in the name of the HUF.

HUF

- This is done so that the incomes earned from the assets and businesses owned by the HUF are assessed separately, which also brings down the family's tax liability.
- An HUF is taxed on the same slab rates that are applicable to an individual income tax assessee.

Residential Status

- S.6(2) A Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year in every case except where during that year the control and management of its affairs is situated wholly outside India.
- S.6(4) Every other person is said to be resident in India in any previous year in every case, except where during that year the control and management of his affairs is situated wholly outside India.

HUF – Tax Planning

- By increasing the number of assessable units through the device of partition of the HUF;
- By creation of separate taxable units of HUF through will in favour of HUF or gift to HUF;
- Through family settlement / arrangement;
- By payment of remuneration to the Karta and other members of the HUF;
- By use of loan from HUF to the members of the HUF;
- Through gift by HUF to its members specially to the female members;

HUF & HNI

- In a case where the members of the HUF have got high individual incomes, in such a case it is not advisable to break or partition the HUF.
- The HUF should be allowed to continue as a separate taxable unit.

Partial Partition

- Partial partition of HUF is also a very effective device for reducing its tax liability.
- Partial partition is recognized under the Hindu Law.
- However partial partition of an HUF has been de-recognised by the provisions of sec. 171(9) of the Income Tax Act, 1961 according to which any partial partition effected after 31.12.1978, will not be recognized.

HUF & Gift

- The HUF can receive gifts from anybody i.e. from a coparcener, non-coparcener and even stranger. CIT V/s K Satyendra Kumar (1998) 232 ITR 360 (SC)
- What matters is the intention of the donor or testator that the property given is for the benefit of the family as a whole.
- Doner should clearly indicate that he is donating to the HUF. CIT V/s Maharaja Bahadur Singh & others (1986) 162 ITR 343 (SC).

HUF

- The Hindu Succession Act, 1956 has now been amended w.e.f. 06.09.2005.
- The effect of this amendment is that all daughters (whether married or unmarried) before or after 06.09.2005) and male members of the HUF are co-parceners of the HUF.
- Thus, the married daughter is a co-parcener of the HUF of father while she is a member of her husband's HUF but not co-parcener.

Family Arrangement (FA)

- The family arrangement should be for the benefit of the family in general.
- The family arrangement must be bonafide, honest, voluntary and it should not be induced by fraud, coercion or undue influence.
- The purpose of the family arrangement should be to resolve present or possible family dispute and rival claims not necessarily legal claims by a fair and equitable division of the property amongst various members

FA

- The parties to the family arrangement must have antecedent title, claim or interest. Even if a possible claim in the property which is acknowledged by the parties to the settlement will be sufficient.
- The consideration for entering into family arrangement should be preservation of family property, preservation of peace and honour of the family and avoidance of litigation. *Kale v. Deputy Director of Consolidation* (AIR 1976 SC 807)

FA

- The concept of family arrangement is an age old one. It is not only applicable to Hindus but also to other communities in which there is a common unit, common mess and joint living. In the case of **Bibijan Begum v. Income Tax Officer (34 TTJ 557)**, the Gauhati Bench of the Appellate Tribunal in a very elaborate judgement held that there is no bar for Mohammedans to effect a family arrangement

FA

- A family arrangement differs from partition in as much as in a family settlement there can be a division of income without the distribution of assets and there is no bar to a partial partition.
- The provision of section 271 of the Act, which places restriction on a partial positions do not apply to a family settlement

FA

- It is only when the parties reduce the family arrangement in writing with the purpose of using that writing as proof of what they had arranged and, where the arrangement is brought about by the document as such, that the document would require registration as it would amount to a document of title declaring for future what rights in what properties the parties possess.

FA

- Another aspect that attracts our attention is whether family arrangement, if recorded in a document, requires registration as per the provisions of section 17(1)(b) of the Indian Registration Act, 1908.
- Section 17(1)(b) lays down that a document for which registration is compulsory should, by its own force, operate or purport to create declare, assign, limit or extinguish either in present or in future any right, title or interest in immovable property

FA

- The transaction of a family settlement entered into by the parties bonafide for the purpose of putting an end to the dispute among family members, does not amount to a transfer *Hiran Bibi v. Sohan Bibi*, AIR 1914 PC 44, approving, *Khunni Lal v. Govind Krishna Narain*, (1911) ILR 33 All 356 (PC).
- It is not also the creation of an interest

FA

- It is not necessary, as would appear from the decision in Rangaswami Gounden v. Nachiappa Gounden AIR 1918 PC 196, that every party taking benefit under a family settlement must necessarily be shown to have, under the law, a claim to a share in the property.
- All that is necessary is that the parties must be related to one another in some way and have a possible claim to the property or a claim or even a resemblance of a claim on some other ground as say, affection

FA

- To record a family arrangement arrived at orally, a memorandum of family arrangement-cum-compromise is required to be drawn up wherein the properties and assets belonging to the parties to the family arrangement are required to be specified.
- Thereafter the fact of arriving at family arrangement sometime in the past with the help of well-wishers and family friends is required to be mentioned.

FA

- In the operative portion of the Memorandum of Family Arrangement-cum-Compromise the properties and business which have been allotted to different parties are required to be specified
- In order to enable the member of the family to whom a particular property is allotted on arriving at a family arrangement, a power of attorney is required to be given by a member in whose name the said property was standing prior to the family arrangement to enable the party receiving the property to deal with the property as his own

Trusts

- While the biggest advantage of a trust is the flexibility it offers to the settlor in determining the distribution of the trust property, some other advantages include -
 - (i) if structured properly, least tax burden can be achieved,
 - (ii) all the procedural formalities and associated delays in getting a probate on a will can be avoided,
 - (iii) once a trust is settled, since the settlor is no longer holding the trust property in his personal capacity, any actions against him will not directly impact the assets (ie, ring fencing of assets),
 - (iv) trust property can be utilized for the benefit of multiple generations of the family,
 - (v) settlors can exercise the degree of control they prefer,
 - (vi) the management of the trust property can become efficient and
 - (vii) if the trust is settled in compliance with applicable laws, disputes arising from succession can be wholly avoided.

ASSESSMENT OF TRUSTS

- The term “Trust” has not been defined in the Income Tax Act, 1961.
- The dictionary meaning of the word “trust” is an arrangement by which property is handed over to or vested in a person, to use or dispose it off for some particular purpose(s).
- The Indian Trust Act, 1882 defines a trust as an obligation annexed to the ownership of the property and arising out of the confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another/ himself / another and himself.

Trust

- “Public Trust” means a trust for the benefit of the public or some considerable portion of the public.
- “Private Trust” means a trust for the benefit of some limited persons such as individuals, families, etc. A private trust can be classified under two categories:
- Private Specific Trust (PST) means a trust where shares of beneficiaries are determinate/known.
- Private Discretionary Trust (PDT) means a trust where shares of beneficiaries are not determinate/known.
- “Combined Trust/ Public-cum-Private Trust” means a trust whose beneficiaries are both public as well as specific persons.

Charitable Purpose

- According to Section 2(15) of the Income Tax Act, 1961 “Charitable Purpose” includes:
- Relief of poor,
- Education,
- Medical Relief,
- Preservation of environment (including watersheds, forests and wildlife),
- Preservation of monuments or places or objects of artistic or historic interest , and
- Advancement of any other object of general public utility.

Trusts

- It may be noted that “the advancement of any other object of general public utility” is not considered as a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce, or business, or any activity of rendering any service in relation to any trade, commerce or business, for a Cess or fee or any other consideration, irrespective of the nature of the use or application, or retention, of the income from such activity.

Trusts

- **CIT Vs. ANDHRA CHAMBER OF COMMERCE (1965) 55 ITR 722 (SC)**
- Definition of the term “Charitable Purpose” is inclusive and not exhaustive. The expression is not restricted to the objects beneficial to whole mankind. An object which is beneficial to a section of the public is also a charitable object.

- **CIT Vs. BAR COUNCIL OF MAHARASHTRA (1981) 130ITR 28 (SC)**
- The expression “advancement of general public utility” includes any object beneficial to the public or a section of the public as distinguished from an individual or a group of individuals.

Trust

- Onshore Trust: Normally situated in tax neutral / High tax jurisdiction .Settlor normally a non resident, can be resident also .Normally Non resident beneficiary/ies and could be resident also
- Offshore Trust : A word “offshore” indicates “off the shore”, outside the place. Normally a jurisdiction with low tax or no tax .Formed by Non Resident settlor and Non resident beneficiary/ies

Trusts

- Generally under Domestic tax laws, basis could be one of the following
- Entity level taxation - Trust itself is taxed on its income and beneficiary is either exempt from taxation or credit of taxes are given to the beneficiary/ies
- Beneficiaries are only taxed, and trust is not taxed
- Beneficiaries pay taxes on the distributed amount and Trust pays on the undistributed amount of income

Trust

- Jurisdiction of Taxation for a trust Normally, where Trust is treated as “Resident” under the tax law of the State /system
- Residential Status
- Place of management/Administration
- Place where settlor is Resident
- Place where beneficiary/ies are Resident
- Location of the Assets

Assessment

- Section 160 prescribes that the trustees of a trust shall be deemed to be representative of trust and they shall be assessed by the department.
- However, such assessment shall be made in representative capacity only. It shall not be merged with the personal assessment of trustees.

Assessment

- Section 166 provides an additional protection to the department in two ways – i) The department can make a direct assessment on the beneficiaries, or ii) even if the department has made assessment on the trustees in a representative capacity u/s 160, it can make recovery from the beneficiaries.

Exemptions

Type of Trust	Exemption u/s 11/12 of the Income Tax Act, 1961
Oral Trust	Exemption u/s 11/12 is not allowed
Private Trust	Exemption u/s 11/12 is not allowed
Public Charitable Trust/Public Religious Trust	Exemption u/s 11/12 is allowable subject to fulfillment of prescribed conditions
Combined Trust (ie. Public-cum-Private Trust)	Exemption u/s 11/12 is allowable in relation to public portion, subject to fulfillment of prescribed conditions.

11(1)(a)

- Income derived from property held under trust wholly for charitable or religious purposes
- To the extent income is applied to such charitable or religious purposes in India. Whereas such income is accumulated or set apart for such application, to the extent of 15% of the income from such property.
- In computing the 15% of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in Section 12 shall be deemed to be part of the income.

11(1)(c)

- Income derived from property held under trust for a charitable purpose, which tends to promote international welfare in which India is interested
- To the extent income is applied to such charitable or religious purposes outside India. Exemption is available only if the Board has directed such exemption.

11(1)(d)

- Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.
- 100% Exemption

Control & Management

- Another crucial aspect of planning a trust is the control and management of the trust.
- Settlers usually prefer retaining control over the trust property during their lifetime. Due to fear of losing control over trust property or losing the property entirely, settlers have an inherent hesitation in relinquishing their rights over the trust property.
- The trust deed can provide for decision making process in the trust. In case of multiple trustees, decisions of the trust can be made on majority or a unanimous basis.
- Settlers, to take full leverage, opt to relinquish their rights over the trust property and allowing the trustees to manage the trust while retaining veto powers over certain critical decisions of the trust.
- In case of a corporate trustee, the constitution documents can state how resolutions are adopted.

Trusts

- Where shares of beneficiaries are determinate or known (Sec.161)
 - Where income does not include business profits [Sec.161(1)]
 - The trustee is assessable at the rates applicable to each beneficiary.
 - Where income includes profits from business [Sec.161(1A)]
 - The whole of the income of the trust is taxable at maximum marginal rate.
- However, if such profits from business are receivable under a trust declared by any person by 'will' exclusively for the benefit of any relative, dependant on him for support and maintenance and such trust is the only trust so declared by him, then, the trustees shall be assessable at the rates applicable to each beneficiary.

Trusts

- Where shares of beneficiaries are indeterminate or unknown i.e. in case of discretionary trust [Section 164(1)]

Where income does not include profits from any business and if:

- None of the beneficiaries has taxable income exceeding maximum amount not chargeable to tax or is a beneficiary in any other trust; or
- The income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or
- The income is receivable under a non testamentary trust created before 1.03.1970 exclusively for the benefit of relatives of settlor, or member of HUF, who are mainly dependant upon settlor; or

Trusts

- The income is receivable by trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other bona fide fund created by the employer carrying on business or profession for the benefit of his employees,
- Then, income of the trust is taxable in the hands of trustees at the rates applicable to an AOP. In any other case, income is taxable at the maximum marginal rate.

Transfer

- Sec.60 Transfer of income where there is no transfer of assets. All income arising to any person by virtue of a transfer whether revocable or not and whether effected before or after the commencement of this Act shall, where there is no transfer of the assets from which the income arises, be chargeable to income-tax as the income of the transferor and shall be included in his total income.
- Sec.61 Revocable transfer of assets. All income arising to any person by virtue of a revocable transfer of assets shall be chargeable to income-tax as the income of the transferor and shall be included in his total income.

Registration

- In order to claim exemptions under Section 11 and 12 of the Income Tax Act, 1961, a trust needs to be registered under Section 12AA of the Income Tax Act, 1961.
- Every trust shall make an application to the CIT or Director of Income Tax (Exemption) in the prescribed format and along with prescribed documents.
- The prescribed form is Form No. 10A.

Documents

- Form No.10A
- Copy of Registration Certificate under Public Trust Act
- Certified copy of Trust Deed
- Certified copy of Objects Clause
- List of names and addresses of all the trustees
- Copy of PAN of all trustees
- Audit Reports (maximum three years)
- Undertaking
- Affidavit of the Managing Trustee for utilization of the objects only.

WILL

- A Will is a legal declaration made by a person during his lifetime with regard to disposal of his properties after his death.
- The Will does not take effect from the date of its execution. It speaks from the death of the testator.
- During the Testator's lifetime, the Will is an ambulatory document, revocable at any time and having no legal effect

Will

- No prescribed form for a Will; only needs to be signed and attested
- Can be in any language; no technical words need to be used
- Two witnesses must attest a Will; one preferably a doctor
- They should sign in the presence of each other and the person making the Will.
- In India, the registration of Wills is not compulsory
- The Will should provide for the appointment of executors, though not mandatory.
- No stamp duty is required to be paid for executing a Will.

IMP

- It must be intended to come into effect after the death of the testator: A gift to take effect the life time of the donor is a deed of settlement and not a Will. And
- It must be revocable by the testator at any time. Although Wills are usually made for disposing property, they can also be made for appointing executors, for creating trusts and for appointing testamentary guardians of minor children. Section 63 of the Indian Succession Act, 1925 provides that a Will is liable to be revoked or altered by the maker of it at any time when he is competent to dispose of his property by Will.

WILL

- A Will has to be Written but a verbal will is permitted in Defence Personal.
- However, a verbal will is not valid if you have a valid, written will. If you have no written will, a verbal will can be valid with regard to any property you own, except land.
- Property that can be transferred under a verbal will includes stocks, bonds, cars, coin collections, jewelry and appliances.
- A verbal will is valid only if know you are dying and say what you want in your will to two competent, disinterested witnesses.
- The witnesses must put the will in writing and sign the transcription within ten days.

Without a Will

- If you die without leaving a valid legal Will, you are said to have died 'Intestate'.
- The law dictates who will inherit your Estate and in what proportions.
- The law also decides who will have responsibility for administering your Estate (your Personal Representatives).
- Such an decision may create a disputes and some family hurdles among the family members.

Joint Wills?

- No it is not possible to have a joint Will they must be individual Wills.
- However “Mirror Wills” are quite common.
- A mirror Will is when a spouse or partner make almost identical Wills, or even identical Wills, leaving for example, everything to each other respectively should one partner perish and if both perish together then direct to children.
- If they have no children then to a named beneficiary's.
- This is where major differences often occur say, for example, the husband could leaves his possessions and estate to his siblings and the wife leaves her possessions and estate to her siblings.

Contesting a Will

- Wills are often contested by peoples. Some common grounds on which wills are contested are as follows-
- That the person was of not sound mind.
- The Testator lacked testamentary capacity to sign a will.
- The person was unduly influenced into signing a will/ a will is made under pressure.
- The will was procured by fraud.
- The Will is not signed before two witnesses.
- The name of family members is not mentioned in will.

Registration

- A person should make a Will in a sound mind and should have the will Registered with the Registrar of Sub Assurances in presence of two witnesses registrar will also ask for Indentify proof, Doctor Certificate, Residential proof of person who makes Will, Identity proof of witness expenses are very nominal

Marriage

- If you marry or enter into a civil partnership, your Will is revoked.
- This is because there is an assumption that you would wish to provide for your new spouse or civil partner.
- There is an exception to this rule if you have made your Will 'in anticipation of' marriage / entering a civil partnership.

THANK YOU