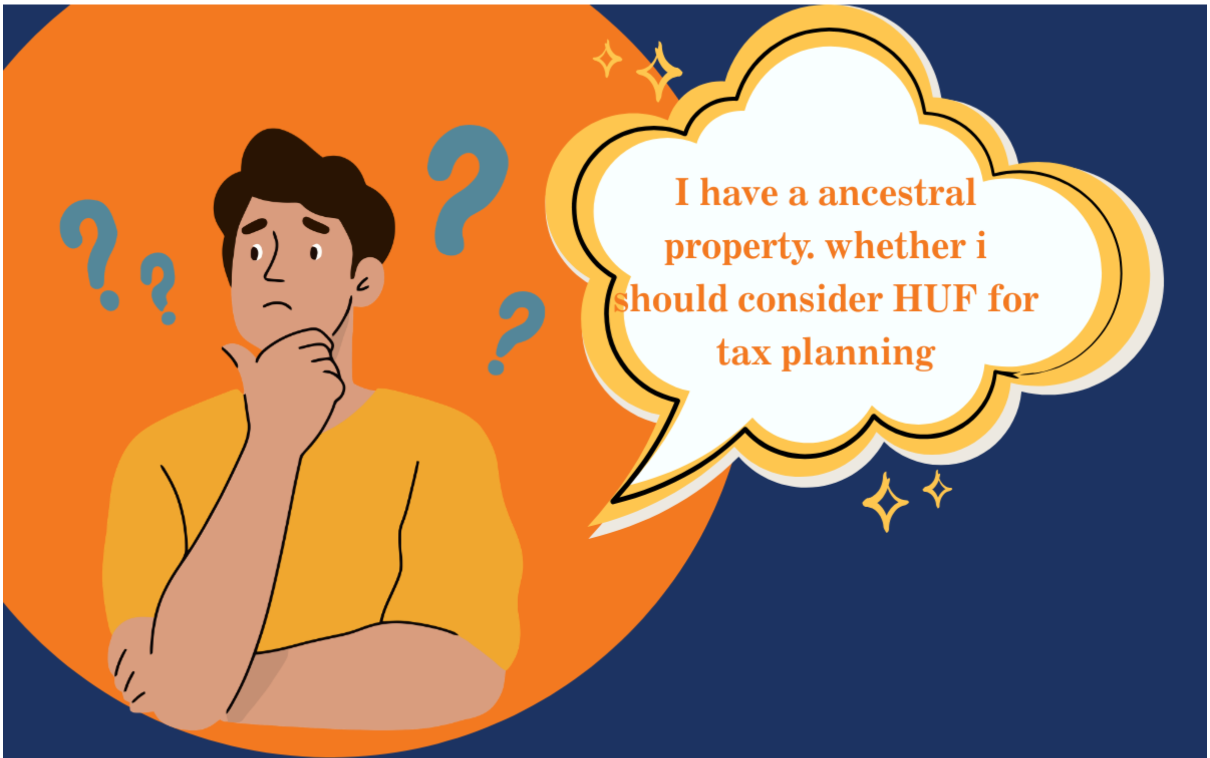
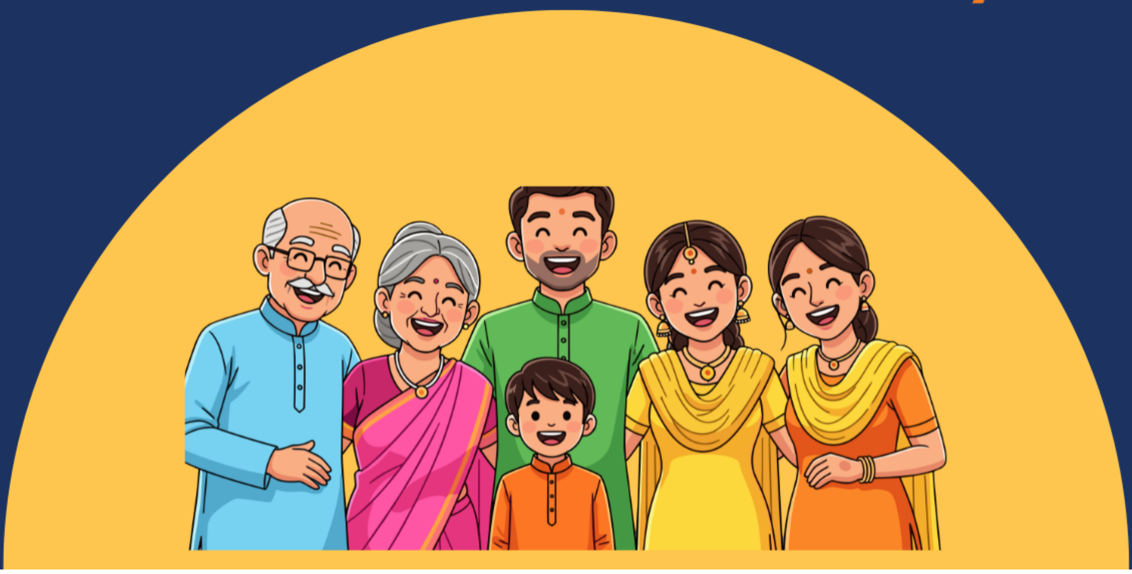


Hindu Undivided family



HUF: Creating One for Tax Purposes – The Nuances Explained

Many of my friends ask whether they can create a Hindu Undivided Family (HUF) and whether ancestral property income can be claimed under it. There are indeed many nuances here, and this post unpacks them.

1. An HUF Cannot Be "Created" – It Exists Automatically

An HUF is not created through a contract or deed. It comes into existence automatically in any Hindu family. In Direct Tax Laws, we use the term "Hindu Undivided Family" (HUF), which does mean a joint family under Hindu law.

When we talk about "creating an HUF" for tax purposes, we're really referring to recognizing it as a separate taxable entity in your tax records

2. When Does an HUF Become a Taxable Entity?

An HUF exists for tax purposes only if it has property or earns income that is taxable.

Seven Ways a Hindu Undivided Family Becomes a Taxable Entity:

1. On devolution of interest in coparcenary property – When a coparcener dies intestate (e.g. without a will)
2. Through specific bequest under a will – Inheritance as per will provisions
3. Upon partition in a larger HUF – When a joint family divides
4. When separated coparceners reunite – Re-joining of previously divided family members
5. Through receipt of gifts – Gifts received by the HUF
6. By blending individual property into HUF – When self-acquired property is thrown into the "hotchpotch" (common pool) with HUF property
7. Through joint labour for HUF benefit – Income generated through collective family effort

3. How Does an HUF Come Into Existence for tax purposes?

For an entity to be taxed as an HUF, it must have at least two coparceners.

Example: If a husband and wife have a son or daughter, they can constitute an HUF. The son and daughter are both coparceners and can be taxed as a separate HUF entity. However, if the HUF consists only of a husband and wife (with no children), there is only one coparcener, and this exception doesn't apply.

Exception: When funds are received through partition of a larger HUF, different rules may apply.

4. Does an HUF Need a Deed?

A formal deed is not mandatory for an HUF to exist or be recognized.

However, if the HUF intends to conduct business or engage in complex financial transactions, it is advisable to have a deed in place for clarity and record-keeping.

Starting points for tax recognition: A PAN (Permanent Account Number) is essential for the HUF to appear in tax records and be properly identified.

5. Can a Coparcener be a Member of Only One HUF?

No. In a large family, multiple HUFs can exist simultaneously.

Example: Mr. A and Mrs. A had three children: Mr. X, Mr. Y, and Mrs. Z.

1. Mr. A's HUF: Consists of Mr. A, Mrs. A, and all three children Mr. X along with his family, Mr. Y and Mrs. Z
2. Mr. X's HUF: Consists of Mr. X, his wife, their son and daughter-in-law
3. Mr. Y: Has no separate HUF because he is unmarried
4. Mrs. Z: Is a coparcener in Mr. A's HUF. She is also a member in her husband's (Mr. Z) HUF along with her son.

Result: Each of these three HUFs can have separate income and are taxed independently.

6. Who is the "Karta" of an HUF?

The Karta is any adult member who manages the affairs of the HUF

1. Usually, the senior-most member assumes this position
2. A senior-most member can voluntarily give up their right to manage, and a junior member can be appointed as Karta by consent

3. Important: There is no legal restriction preventing the eldest female coparcener from being the Karta

7. What is Ancestral Property? Whether inheritance of ancestral property by a coparcener from HUF is taxable?

Ancestral property is property inherited from any of your three immediate male ancestors- father, grandfather and great-grandfather

Property inherited from any other relation is not treated as ancestral property.

When a Coparcener Inherits Ancestral Property Upon Partition: If a coparcener receives ancestral property from the HUF during partition, it will be taxed in the HUF of that coparcener, not in individual capacity.

Exception:

If the coparcener is unmarried at the time of partition

He becomes the absolute owner of that property. Income from such property is assessed in his individual capacity. Once he marries, the income shifts to be assessed in the HUF of himself and his wife

If a Daughter Inherits Ancestral Property from Father's HUF

Property received by a daughter from her father's joint family property becomes her absolute property. Any income generated from this property is assessed in her individual capacity only. Not assessed in the HUF of her husband.

8. Can an HUF Receive Property Through a Will?

Yes. An HUF can receive property and assets through a will from any person.

Important Considerations:

When drafting a will:

- Specifically mention in the will which portion of assets are bequeathed to the HUF
- Without explicit mention, it may be difficult to characterize the received property as HUF property
- This intention must be documented at the time of gifting (through affidavit or other means)

Taxability of transfer and income

- The property received by HUF through will is not taxable in the hands of the HUF as the transfer is exempt.
- The income earned from this property will taxable in the hands of HUF.
- If subsequently the asset is sold, the capital gains on this property will be taxed in the hands of the HUF. The cost of acquisition of the asset for the calculation of the capital gain will be cost to the previous owner. Ref: Section 40(1) of ITA 2025

9. Gifts to/by HUF –Taxation

This is a critical aspect what happens when someone *outside* the HUF gifts to it. Ref: Section 92(2) of ITA 2025 and Section 92(3)(a) and (g) of ITA 2025

Any sum of money or property received by HUF from non-relatives without consideration (or for inadequate consideration) is taxable as "Income from Other Sources" if it exceeds ₹50,000 in a financial year. Once threshold crossed, entire amount is income.

Exemptions: Even if amount exceeds ₹50,000, the following are exempt:

1. From any relative (as defined separately below)
2. Under will or by way of inheritance
3. In contemplation of death of payer

Definition of "Relative" – HUF vs. Individual (Critical Distinction)

This is where readers get confused. The term "relative" has different meanings for individual and HUF per Section 56(2)(vii).

For individuals, "Relative" includes:

1. Spouse of the individual
2. Brother/sister of individual
3. Brother/sister of individual's spouse
4. Brother/sister of either parent of individual
5. Any lineal ascendant (parents, grandparents, great-grandparents, etc.)
6. Any lineal descendant (children, grandchildren, great-grandchildren, etc.)
7. Spouse of any of the above

For HUF, Relative means: "Any member of such HUF"

Practical Examples:

Scenario 1: Friend gifts ₹60,000 cash to HUF. Friend is not a relative

The Karta of the HUF can accept gifts from strangers with no legal prohibition under Hindu Law.

Entire ₹60,000 taxable under "Income from Other Sources"

Scenario 2: Mr X gifts ₹60,000 to Mr. X's HUF

Since Mr. X is member of HUF → Exempt

Scenario 3: The Critical Edge Case Mr. X's father gifts ₹60,000 to Mr. X's HUF and Mr. X's father is not the member of Mr. X HUF. Is this exempt?

There was no mention at all about an HUF in the definition of the term 'relative' for individuals According to Rajkot and Mumbai tribunal benches, HUF is a collection of relatives, so such gifts are EXEMPT. However, Ahmedabad bench takes the opposite view, treating it as TAXABLE.

As such, the judicial position with respect to Gifts from HUF to its member post-amendment to the definition of relative now stands as under.

Case Name	*Year of judgment*	*Court*	*Transaction*	*Taxable/Not taxable*
Gyanchand M. Bardia (*supra*)	2018	Ahmedabad Tribunal	Gift from HUF to Member	Taxable
Pankil Garg (*supra*)	2019	Chandigarh Tribunal	Gift from HUF to Member	Not taxable

Safest approach: Get professional advice or structure the gift as father → son → son's HUF. Still clubbing of income from the gift will be taxed in sons hands.

Scenario 4: Mr. X's HUF gifts INR 1 lakh to his father and His father is not member of the HUF. Is this exempt under the gift received from relative?

As per the definition of individual the relative definition of individual does not include sons HUF. Hence a question any arise if the amount received by father from sons HUF is taxable.

Taking the opinion in the above case that HUF is nothing but a group of relatives. A view can be taken that this is also exempt. But this may be disputed by the tax authorities as it is not expressly exempted by law.

Safest approach: Get professional advice or structure the gift as Son's HUF → son → father.

Scenario 5: Can an HUF Receive Gifts from Its Own Members?

Yes. An HUF can receive gifts from its own members. The receipt of gifts from members is not taxable in the hands of HUF as it is from relative.

However, the taxation rule on clubbing is important:

When an HUF receives a gift from a member, the income generated from that gift is clubbed and taxed in the hands of the member who gave the gift—not in the HUF.

Critical: This clubbing continues forever, regardless of how long the gift has been held.

Exception to this rule: If the income earned from the gift is reinvested and generates *additional* income (secondary income), that *additional* income is taxed in the hands of the HUF itself

10. **Taxability of sum received by an individual from a HUF**

Any sum received by an individual as a member of HUF from HUF income/estate is EXEMPT. Section 11 of ITA Act 2025 (Schedule III Sl. 1)

This exemption will apply only if both the conditions are satisfied-

1. The sum has been paid out of the income of the family or the income of the estate belonging to the family in the case of any impartible estate.
2. The sum does not attract the clubbing provisions for the self-acquired property previously transferred by the individual into the hotchpotch of the HUF .

This section ensures that income taxed in the hands of the HUF is not taxed again when distributed to members.

11. Can Separate Property of Coparceners Be "Thrown into the Hotchpotch"?

Yes. A coparcener can blend his separate (self-acquired) property with the HUF's common pool. ***This is one of the common questions asked by many of my friends.*** Section 99(3) and (4) of ITA Act 2025 (clubbing of income from self-acquired property transferred to HUF)

How it works:

- The coparcener voluntarily renounces his individual right to that property
- It then becomes HUF property
- There should be clear evidence of this transfer (deed, affidavit, or documented record)

Taxation of income from blended property:

- Income generated from the blended property is clubbed and taxed in the hands of the coparcener who contributed it—not in the HUF
- This clubbing continues indefinitely.
- If the property is subsequently sold, then the capital gain on sale of the property is taxable in the hands of the coparcener who contributed it and not the HUF. Also the cost of acquisition will be cost to the coparcener who contributed it. Ref: Section 40(1) of ITA 2025.
- Post-Partition Rule: If the property is distributed to the coparcener's spouse upon partition, the income continues to be clubbed with the coparcener. If distributed to an adult coparcener (non-spouse), clubbing ceases.

In the below situations clubbing of income from the property transferred by members to HUF does not apply if

- Property must be transferred by coparcener / member to HUF. The documentation to be maintained evidencing the transfer.
- The adequate consideration was not paid by the HUF. The adequate consideration is decided based on stamp duty value for immovable property and fair market value for other property. References can be made to the income tax act (Section 92 (2)(m)) to determine adequacy.

12. When Does an HUF Cease to Exist?

An HUF ceases to exist upon complete partition.

- The HUF does NOT dissolve upon the death of the Karta
- The next senior coparcener automatically becomes the new Karta
- It is advisable to notify the Income Tax Department and banks of this change
- The HUF continues to be assessed as a separate entity
- Distribution of assets on total or partial partition of HUF to its members is a transfer exempt from capital gain. Section 70(1) of ITA 2025

Upon Complete Partition:

- All property is divided among the coparceners.
- The HUF ceases to exist as a taxable entity
- Coparceners or their HUFs become individually assessable for their respective properties

Partial Partition:

- Partial partition (dividing only some members or some property) does NOT dissolve the HUF
- Only a complete partition of all members and all property dissolves the HUF for tax purposes

Post-Partition:

- Income from joint family property till the date of partition → Assessed in the HUF's hands
- Income thereafter → Assessed in the hands of the individuals or any smaller HUF formed by the partitioning coparceners
- Partition is effective from the date assets are actually physically divided (not merely agreed upon)

Clubbing Post-Partition

- If property goes to wife via partition → Clubbing CONTINUES in the hands of the husband (who is coparcener in HUF)
- If property goes to other coparcener (not wife/ minor child of coparcener → Clubbing CEASES (separate person now)

Example

- HUF invests INR 9 lakh in FD earning ₹90,000 interest yearly (clubbed with Father's income)
- 2023: HUF is partitioned; the FD is distributed to Father's wife, father and his son INR 3 lakh each
- Result: The interest income from the FD continues to be clubbed with Father's income, even though his wife now owns it (spousal transfer).
- The interest income from FD of the adult son is taxable in the hands of the son itself. (no clubbing applies)

13. What is NOT Taxed as HUF Income? (Critical Exclusions)

Not all income earned by HUF members is necessarily HUF income. The following are specifically excluded from HUF assessment:

1. Income from Impartible Estate

Income from an impartible estate is taxed in the hands of the holder of the impartible estate as an individual, not in the HUF. The holder is deemed to be the individual owner of all properties in the estate.

Note: Impartible estate is a special category and is referenced in Schedule III of ITA 2025 as an exception to HUF member exemption for income.

2. Personal Income of Members (Individual Capacity Income)

Income earned by a member in their individual capacity is NOT HUF income, even if:

- The member is the Karta
- The member is conducting a business similar to the HUF's business

Landmark Case: *CIT v Vijay Prakash Toshniwal & Sons [2006]* - The Supreme Court ruled that income earned by the Karta in his individual capacity (even if doing business similar to HUF business) is not HUF income and cannot be assessed as HUF income.

Practical Example:

- If the Karta is an employee or consultant earning salary/fees in his individual capacity, that income is personal income, not HUF income
- If the Karta carries on a separate profession or business independently, income from that is personal, not HUF income

14. Practical Tax Planning Example: HUF Benefit Illustration

Scenario: Mr. X's Income Structure

Income Sources:

- Salary (after deductions): ₹20,25,000
- House property income (from ancestral property): ₹10,00,000
- Interest on debentures & Fixed Deposits (from ancestral property): ₹5,00,000
- Gross Total Income: ₹35,25,000

Deductions available (Old Tax Regime):

- Section 123 [80C deduction]: ₹1,50,000
- Section 126 [80D deduction] - Self ₹25,000 + Spouse ₹25,000: ₹50,000

Comparison: Tax Without HUF vs. With HUF (Table Format)

Income Category	Without HUF (Mr. X Alone)	With HUF (Mr. X as Individual)	X (HUF)
Salary	₹35,00,000	₹35,00,000	—
House property (ancestral)	₹15,00,000	—	₹15,00,000
Gross Total Income	**₹50,00,000**	**₹35,00,000**	**₹15,00,000**
Less: Sec 123 [80C] Deduction	(₹1,50,000)	(₹1,50,000)	(₹1,50,000)
Total Income	₹48,50,000	₹33,50,000	₹13,50,000
Tax Payable (Old Regime Approx)	**₹ 13,18,200**	**₹8,50,200**	**₹2,26,200**
Combined Tax (Individual + HUF)	**₹ 13,18,200**	**₹ 10,76,400**	
Tax Saving Due to HUF Formation	**₹2,41,800**		

Note: Figures are approximate and based on old tax regime slabs; actual calculations may vary based on precise slab application and surcharge/cess provisions.

Key Takeaway: HUF is a powerful tax planning tool when used correctly with ancestral property and carefully structured member compensation. However, it works only for legitimate income sources (ancestral property, gifts from non-members, inheritance). Self-acquired property transfers to HUF attract clubbing and offer no tax benefit. Always consider administrative costs versus tax savings before forming an HUF.

[Sources: Taxmann's Direct Tax Law and Practice, Bharat's Direct Tax Ready Reckoner, ICAI's Technical Guide on Taxation of HUF, Bombay Chartered Accountants Journal, August 2018, "Gift From 'HUF' and Section 56(2)" by Pradip Kapasi, Gautam Nayak & Bhadresh Doshi]