SAVE INCOME TAX BY FORMING HUF: BENEFITS & DRAWBACK

About HUF

HUF means **Hindu Undivided Family**. You can save taxes by creating a family unit and pooling in assets to form a HUF. A Hindu family can come together and form a HUF. Buddhists, Jains, and Sikhs can also form a HUF. HUF has its own PAN and files tax returns independent of its members.

Tax implications of forming a HUF

A HUF is taxed separately from its members, therefore, deductions (such as under Section 80) or exemptions allowed under the tax laws can be claimed by it separately. For example, if you and your spouse along with your 2 children decide to create a HUF, all 4 of you as well as the HUF can claim a deduction for Section 80C. HUF is usually used by families as a means to build assets.

Form an HUF

While there are tax advantages of forming an HUF, you must also meet some conditions –

- One person cannot form HUF, it can only be formed by a family.
- A HUF is automatically created at the time of marriage.
- HUF consists of a common ancestor and all of his lineal descendants, including their wives and unmarried daughters.
- HUF usually has assets which come as a gift, a will, or ancestral property, or property acquired from the sale of joint family property or property contributed to the common pool by members of HUF.
- Once a HUF is formed it must be formally registered in its name. A HUF should have a legal deed. The deed shall contain details of HUF members and the business of the HUF. A PAN number and a bank account should be opened in the name of the HUF.

Taxation of HUF

- HUF has its own PAN and files a separate tax return. A separate joint Hindu family business is created since it has an entity separate from its members.
- Deductions under section 80 and other exemptions can be claimed by the HUF in its income tax return.
- HUF can take an insurance policy on the life of its members.
- HUF can pay a salary to its members if they contribute to its functioning of the HUF. This salary expense can be deducted from the income of HUF.
- Investments can be made from HUF's income. Any returns from these investments are taxable in the hands of the HUF.
- A HUF is taxed at the same rates as an individual.

Disadvantage of forming an HUF

Though HUF seems like the perfect way to save tax as a family, it comes with its own drawbacks.

- **Equal rights of members:** The greatest disadvantage of opening a HUF is that its members have equal rights on the property. The common property cannot be sold without the concurrence of all the members. Any additions to the family, by way of birth or marriage, become a member of the HUF and get equal rights. A HUF can get too large to manage.

- **Partition:** Perhaps the worst nightmare of opening a HUF is closing it down. The only way a HUF can be dissolved is by a partition. All members have to agree to dissolve the HUF. Under a partition, assets are distributed to members which can lead to a lot of disputes and can be a lot of legal hassle.

- **Joint family system losing relevance:** HUF was recognised as a separate taxable entity by the income tax department. However, in today's times, where nuclear families are the norm, HUF is losing relevance. Several cases have come to fore where couples or families are fighting it out on common household expenses, forget to pool in of assets. Divorce rates are rising and therefore, HUF as a tax vehicle is losing importance.

- **HUF continues to be assessed as such till partition:** Once a HUF is formed, you must continue to file its tax returns, unless a partition takes place. Any claim for partition is made to the assessing officer. The assessing officer, on receiving such a claim, must make an enquiry after giving due notice to the members. Income from the property which was partitioned is taxed as individual income of the member. If the member forms another HUF with his wife and children, the income of the property which was transferred from the original HUF is taxed in the hands of new HUF.

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