Aman Satish and Company

Stay Ahead with the Latest in Finance, Tax, and Legal Compliance.

FIN-O-SCOPE

Jan 6th, 2025

Maximize Tax Savings with HUF: A Strategic Guide for Investors

Are you looking for innovative ways to save taxes and maximize your wealth? The Hindu Undivided Family (HUF) structure offers a unique opportunity to legally reduce your tax burden while investing in Mutual Funds, IPOs, or even taking loans. Here’s how HUF can help you achieve these goals:

1. **Save Taxes While Investing in Mutual Funds**

An HUF is treated as a separate taxable entity under Indian tax laws, meaning it gets its own PAN and tax exemptions. By investing in Mutual Funds through an HUF account:

Interesting Facts

- Legal Entity: An HUF is not a corporate body but a separate legal entity created by Hindu families. It allows multiple family members to hold assets together.

Interesting Facts

- Formation through Marriage: It's automatically formed when a Hindu family gets married, as the husband and wife become members. The eldest male member (Karta) manages the family assets.
- Succession: The HUF enjoys the benefit of Hindu Succession Act, 1956, and property passed to it is inherited by the children, including daughters.
- Tax Advantages: It is considered a separate tax entity, meaning it can file its own tax return, separate from the individual members, and enjoy a separate basic exemption limit.
- Assets: The property in the HUF can only include ancestral property. However, the income from self-acquired property, gifted property, or inherited property can also be pooled under the HUF for tax purposes.

- The basic exemption limit and rebate (₹2.5–₹5 lakh) apply separately to the HUF, helping save taxes.
- Long-term capital gains (LTCG) can be offset under HUF's exemption limit, reducing the overall tax burden on mutual fund returns.
- The corpus for such investments can come from ancestral property, gifts, or business profits within the HUF.
- Example: If a family invests ₹15 lakh in equity mutual funds and earns LTCG of ₹5 lakh, splitting the gains across individual members and the HUF can lead to substantial tax savings, as HUF gains are taxed separately.

2. Use Loans from HUF Members

An HUF provides a practical way to manage liquidity and capital requirements. Here's how:

- Loan to Members: HUFs can lend money to members without attracting partition or clubbing risks.
- Tax-free Repayment: Members can repay these loans without tax implications, making this an efficient method for raising and returning capital.
- Flexibility: Since these loans are internal transactions within the family, they allow for easy fund movement without external interference.
- This approach not only avoids tax risks but also ensures seamless financial operations within the family.

3. Apply for IPOs through HUF Accounts

IPO investments offer excellent growth potential, and with HUF accounts, you can:

- Apply for IPOs using the HUF's PAN, giving the family an additional opportunity to subscribe beyond individual applications.
- Any profits from IPO allotments can be taxed in the HUF's hands, leveraging its lower tax slabs and exemptions.
- By combining personal and HUF applications, families can increase their chances of IPO allotments while optimizing tax liability on returns.

How to Get Started?

- **Create an HUF:** Eligible families (Hindus, Buddhists, Jains, and Sikhs) can create an HUF.
- **Open an Account:** Open a separate bank account and demat account in the HUF's name.
- **Start Investing:** Begin investing in mutual funds, IPOs, or use the account for internal loans.

Process of Creation of an HUF:

1. **Eligibility:**
    - It can be created by Hindus, Jains, Sikhs, and Buddhists.
    - The family must consist of a male member and his descendants (husband and wife, or any family structure with a male head).
2. **Formation:**
    - Karta: The eldest male member (father, elder brother, etc.) is appointed as the Karta. The Karta has the legal responsibility to manage and control the HUF's assets.
    - Members: The other members, such as the wife, children, and even daughters (since 2005), become coparceners in the HUF.
3. **HUF Deed:**
    - There is no legal requirement to create a written deed to form an HUF, but it's advisable for clarity. The deed will include the names of the family members, the Karta, and the properties contributed.
4. **Capital Contribution:**
    - HUF property is created from contributions from ancestral property or even self-acquired property. However, gifts from family members are allowed too.
5. **Tax Filing:**
    - Once created, the HUF files tax returns as an independent entity. The income of the HUF is distinct from the personal income of its members.
    - The Karta has to manage and supervise the family business or other investments on behalf of the HUF.
6. **Legal Status:**
    - The family can open bank accounts, buy property, and engage in any other legal activities as an entity.
7. **Change in the Structure:**
    - If the Karta dies, the next eldest male member becomes the Karta. The assets and liabilities of the HUF pass according to the Hindu succession laws.

Example

To illustrate the tax-saving benefits of structuring income under an HUF, consider the following scenario:

Revised Assumptions for Tax Calculation:

1. Salary Income (Individual): ₹10,00,000
2. LTCG: ₹5,00,000
3. LTCG Exemption: ₹1,25,000
4. HUF Basic Exemption: ₹3,00,000, as both HUFs and Individuals follows the same tax slabs with a 0% tax rate up to ₹3,00,000.
5. LTCG Tax Rate: 12.5%

Interesting Facts

- Independent Tax Entity: Enjoy separate tax exemptions and deductions.
- Tax Benefits: HUF offers an additional tax exemption of ₹2.5 lakh under the Income Tax Act, and the property income can be split for tax savings.
- Generational Legacy: HUF accounts can remain operational for up to three generations, ensuring long-term wealth preservation.
- Diverse Opportunities: Invest in mutual funds, IPOs, or utilize loans to optimize both growth and taxes.
- Estate Planning: It aids in smooth property succession without disputes among family members.
- Partition in a Hindu Undivided Family (HUF) refers to the division of its property and assets among members, leading to either partial or complete separation.

Interesting Facts

- Under Section 171, a full partition is recognized as a transfer, dissolving the HUF.
- Income is divided among members and taxed individually.
- Section 171(9) does not recognize partial partitions for tax purposes.
- The HUF continues to file returns and is taxed as an entity for undivided assets.
- Partial partitions are not treated as gifts under tax laws.
- Full Partition is Suitable for families aiming for permanent separation of property and independent ownership.
- Partial Partition is Ideal for dividing specific assets temporarily while retaining joint ownership of remaining property.

Tax Calculations for Individual:

- Tax on salary income: After applying the slab rates, the tax liability on ₹10,00,000 amounts to ₹50,000.
- Taxable LTCG after exemptions: ₹5,00,000 - ₹1,25,000 = ₹3,75,000.
- Tax on LTCG: ₹3,75,000 × 12.5% = ₹46,875.
- Total tax liability for the individual: ₹50,000 (salary) + ₹46,875 (LTCG) = ₹96,875.

Tax Calculations for HUF:

- Taxable LTCG after exemptions: ₹5,00,000 - ₹3,00,000 (basic exemption) - ₹1,25,000 = ₹75,000.
- Tax on LTCG: ₹75,000 × 12.5% = ₹9,375.
- Total tax liability for the HUF: ₹9,375.

Key Insight:
Since HUFs cant have Salaried income, the tax liability on LTCG is significantly reduced due to the straight exemption of ₹3,00,000 available under Tax Slab. In this example, the individual's total tax liability of ₹96,875 is reduced to ₹9,375 when LTCG is channeled through an HUF, resulting in tax savings of ₹87,500.

This highlights how the strategic use of HUF provisions can effectively minimize tax burdens while ensuring compliance with tax laws. If you'd like to learn more about how to set up an HUF or how to leverage it for tax savings, feel free to contact us. Our team is here to assist you every step of the way.

Disclaimer

Aman Satish and Company, Chartered Accountants
💼 604, 6th Floor, RG TradeTower, Netaji Subhash Place, Pitampura, Delhi- 110034 | ✉ Email: aman@ascconsultants.in | 📞 Mobile: +91-9999-20-3399
Follow us on: https://www.linkedin.com/company/aman-satish-and-company/
amansatishandcompany.blogspot.com