

## Discussion Note

### **Gender, Property and Institutional Basis of Tax Policy Concessions: Investigating the Hindu Undivided Family**

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One of the most significant contributions of the Hazari report was the *official* identification of the 'business group' as the basic institutional unit of organisation of Indian monopoly capital. The group in this view consisted of a number of related and unrelated activities controlled by a single central decision-making authority and thereby functioning as a co-ordinated organisation (Hazari 1967). This meant that besides a high degree of product concentration, monopoly capital in India consisted of the predominance of a few representative units of organisation of capital in most areas of industry. The key houses of business, both old and new, found ways to maintain control over decision making through the institutional structure of the *family run business house*.

There were two ways in which the family control over the organizational structure of business groups and the ownership of wealth generated through these structures were maintained. The first had to do with the legal provisions of 'corporate governance' structures which facilitated the optimum mix of various forms of registered companies like partnerships, private limited companies, unregistered and registered public limited companies under the umbrella group through interlocking share-holdings. These were done within the enabling legal provisions of the Indian Partnerships Act of 1932 and the Companies Act of 1956. Apart from risk spreading, this also ensured avenue to escape the minimal restrictions on expansion under Monopolies and Restrictive Trade Practices after 1973. It was also important for labour deployment and control with employers often making sure that each company only had less than seven employees and pre-empting any possibility of trade union formation since the stipulations of the Trade Union Act of 1926 (Das Gupta 2010).

The second avenue was through the use of Hindu Undivided Family as a legal tax entity separate and distinct from individuals and corporate entities recognised by tax law. While all other body corporate recognised in corporate and individual income tax laws are defined on the basis of company law, the HUF as a legal entity in Indian tax law is defined on the basis

of Hindu personal law. An important initiative by the state in the post-independence period was to perpetuate the 'Hindu Undivided Family' (HUF) as a legal entity under Section 2 of the Income Tax Act 1961. However this entity was defined *a priori* not in the company laws but in the process of codification of Hindu Personal laws in the four bills passed successively in 1955-56 *before* post-independence corporate and tax law 'reforms'.

While the organisation of the 'business house' was legally sanctioned through multiple legislations spanning corporate and tax laws and forms the object of studies in 'corporate governance', the institution of the 'family' has fallen in the ambit of codification of 'personal laws'. The first aspect is significant in the organising of the institutional basis of concentration of capital combining the modalities of ownership and control. The second has implications for both accumulation and concentration. The relationship between the two and the regimes of accumulation in independent India has been largely unexplored in the otherwise growing corpus of literature on the relation between the family owned business group and 'corporate governance' and public policy in not only India, but also in USA, Canada, Europe, Hong Kong, Taiwan, Japan, South Korea, China and Pakistan (Mehta 2006; Gulzar and Wang 2010). Exploring the relationship between the two, this note is an attempt to contribute to the fledgling academic discussion on the peculiar form of the HUF as a distinct form of property holding for the purpose of taxation (Dewan 2009).

The singular political action in the first decade after independence was the codification of Hindu Personal laws as the starting point in 'nation-building' – a political process that continued for more than nine years from 1947 to 1956. The political polarisation around the bills for codification led to compromises in which the bill was never passed in its original form as had been proposed by Dr B R Ambedkar (who resigned from the Union Cabinet in protest after agreeing to many of the changes that were inserted at various stages of the debate) and was subsequently broken down into four separate acts on marriage, guardianship, succession and adoption passed between 1955 and 1956. The key figures behind the strategic dilution of the bill and separation of the various had been Jawaharlal Nehru, N G Ranga, and Pattabhi Sitaramaiyya<sup>1</sup>. All of these together had very significant implications for the subsequent institutionalisation of the Hindu Undivided Family as the institutional basis of organisation of the business group. First, a Hindu was defined as anyone who was not a

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<sup>1</sup> The Select Committee which proposed amendments on marriage rules consisted of Giani Gurmukh Singh Musafir, Sardar Hukum Singh, M. Ananthasayanam Ayyangar, Deshbandhu Gupta, G. Durgabai, Renuka Ray, Ramnath Goenka, Bakshi Tek Chand, Lala Achint Ram, Ch. Ranbir Singh, Mahabir Tyagi, and Thakur Das Bhargava.

Muslim, Christian, Parsi or Jew and thus by default included followers of other institutionalised religions like Buddhism, Jainism and Sikhism as Hindu, not to mention theistic practices outside the domain of organised religion like those of *adivasis*. Thus the onus was on the individual to prove if necessary that she/he is not a Hindu. To quote Dr Ambedkar,

*...The result is that if a tribal individual chooses to say that he is not a Hindu it would be perfectly open to him under this Code to give evidence in support of his contention that he is not a Hindu and if that conclusion is accepted by the Court he certainly would not be obliged by anything contained in this Bill...*

(Constituent Assembly. (Leg.) D.L Vol. I, 17th November 1947, p. 41.)

Second, it institutionalised monogamy and made polygamy illegal for Hindus; but it also instituted recognition of both Dayabhaga and Mitakshara property holdings (a compromise over the original draft) and marriage only between two Hindus into the ambit of the code. Adoption and succession was to be defined in jurisprudence by ‘custom laws’ institutionalising male lineage of descent as the ‘natural’ inheritors of property and the expropriation of any right to property of children born outside marriage. Third, it created the legal space for any Hindu male to break away from the ‘joint family’ and start a new ‘Hindu Undivided Family’ as long as he was married. Thus, even as families went nuclear, the ‘HUF’ could be perpetuated as a legal entity as each nuclear family marked the beginning of a new ‘HUF’.

The second avenue was through the use of Hindu Undivided Family as a legal tax entity separate and distinct from individuals and corporate entities. An important initiative by the state in the post-independence period was to perpetuate the ‘Hindu Undivided Family’ (HUF) as an entity recognised by Section 2 of the Income Tax Act 1961. This preserved the patriarchal rules of limiting inheritance rights of women to property and assigned the ‘Karta’ as the patriarch of the family with legal powers to represent and structure the holding of property (Sachdeva 1987). The Hindu Succession Act before the 2005 amendment made provision for a Hindu Undivided Family to ensure that property remains with the male line of descent. A son got a share equal to that of his father; a daughter got only a share in her father's share. She could not reside in the family home unless she was single or divorced, and

could not claim her share of property as long as the men of the family continued to live in it. Further, a woman's right to agricultural property was restricted to “prevent fragmentation of landholdings”. The amendment gave Hindu women equal inheritance rights in the Mitakshara Joint Family Property, but not Dayabhaga property which is the other important inheritance system based on personal laws. It also gave women the right to be co-parceners (Singh 2005). However, the status of the ‘Karta’ and the HUF as a form of property holding in a body incorporate were not affected by the amendment.

A Hindu male can be a ‘karta’ for more than one HUF accounts. Despite scores of judicial decisions, the circumstances in which a HUF comes into existence has been the subject of debate and controversy. Under the Income Tax Act, 1961, a HUF is assessed for income tax as a distinct unit of assessment. In case law, a HUF consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters; while a Hindu coparcenary is a much narrower body including only those persons who acquire by birth an interest in the joint or coparcenary property. A member of a HUF is not taxable at all in respect of any sum which he receives as such member out of the income of the family, even though the family may not have paid the tax on its income. Thus the general principle of tax law that income from an individual members' property thrown into the family coiffeur is taxable, as the income of the joint family, does not hold for a HUF. All definitions and interpretations of HUF are based on Hindu personal laws. A Hindu Undivided family (HUF) cannot enter into a partnership with other persons, as it is not a legal person, but the karta of a HUF can (Sachdeva 1987).

Thus the modification of the right to property as a universal right guaranteed by the Constitution, in favour of Hindus through the creation of the legal entity of the HUF, was the most significant intervention of the first post-independence decade.

One of the most important features of the ‘old’ regime of accumulation was the mercantile basis of Indian family owned business groups. The few explanations for this phenomenon has been rooted in the realm of either ‘behaviouralism’ or ‘culturalism’. The second observation based on studies of ‘new’ capitalists has brought to the fore the diversification of the regimes of accumulation between 1956 and 1980 (eg Damodaran 2008). The gradual demise of the managing agencies, the expansion of the basis of primary accumulation and the concentration of capital aided by the state interventions since the Second Plan, the regional dimensions of ‘new’ accumulation traced to agrarian change in the expansion of the capitalist class in

Punjab, Andhra Pradesh and Tamil Nadu. In this, it has been pointed out that one unchanging feature of the 'business group' is that it manages to retain control over diverse ventures with very little investment of family wealth and in many cases, the distinction between ownership and control gets blurred in the complexity of holding structures (Mazumdar 2006).

No one can make a profit out of oneself. This is axiomatic in tax law. The concept of the Hindu Undivided Family (HUF) is an exception to this principle. The same person can act as the *karta* of the HUF and also make profits in his individual name. An HUF member cannot be taxed in respect of any sum which he receives as such member out of the income of the family, even though the family may not have paid the tax on its income (Ramanujam 2006). According to Ramanujam (2006), a former Chief Commissioner of Income Tax:

*The HUF is an entity peculiar to the Indian tax law. The law recognizes it and there is nothing sham about it. Surprisingly, the Government carries out any amount of amendment to the Hindu law without looking into the revenue loss caused by the recognition of the HUF as a separate taxable entity. The HUF may be a boon to the taxpaying Hindu. But it is definitely a bane to government revenues.*

Apart from being a 'bane' to government revenues, both 'old' and 'new' capitalist business houses of Hindu origin use the provision of HUF to consolidate family holdings and ensure the control of capital within the family through transactions between the HUF and individuals within the HUF who held key positions in the share-holding and managerial patterns of the companies within the fold of the business house. No such provision was available to business houses held by Muslims or other religious minorities. No 'reform' has been ever advocated of this peculiar favour to the majority religious group in a democracy whose constitution guarantees no discrimination on the basis of caste or religion and equality of men and women.

The HUF has often been considered to be a tool for tax evasion and its importance in the holding structures of assets for the family owned business groups have not been sufficiently investigated. It is also often argued that the importance of HUF has declined in contemporary times and so there is no need to dwell on it. However, our survey of 150 business groups carried out between 2003 and 2005 reveal otherwise.

It must be noted that there has been no demand to significantly alter the fundamental definitional aspects of property rights embodied in the Partnership Act of 1932 or the

Companies Act 1956 except for a few amendments to revise upper limits of restrictions on pay and emoluments. Our survey of the holding structures of 150 business groups in India carried out in 2003-05 shows judicious use of provisions in these two legislations where each group consists of some or all of the legal forms of partnership firms, private limited companies, unlisted public limited companies and listed public limited companies. The holding structures comprises of individually owned stocks, followed by stocks held under Hindu Undivided Family accounts (except for the two business groups of 'non-Hindu' origin in our Survey – Cipla and Akbarallys), and a number of 'group' companies spread across the four forms of firms stated above. In 35 percent of the groups surveyed, stocks in group companies are not held by HUF in publicly listed companies but are held in the 'private limited' companies. The Kartas of the HUF or other HUF members however hold stocks in the publicly listed companies. Thus the payouts to the HUF as well as to the individual who is part of an HUF is simultaneously maintained. At the same time, the HUF can hold other property eg houses, cash, gold, share certificates, fixed deposits which would not be considered in the asset accounting of the business group. The income and wealth holdings in HUF do not get counted in the business group's ownership and control of assets. The central role of legal facilitation of holding structures of family owned business groups and the continuing provision of Hindu Undivided Family accounts in the personal laws that ensured assets remained within the male line of descent of family and insulated from business risk has seen no significant change in the period of transition. No such provision was available to business houses held by Muslims or Christians, Parsis and Jews.

Within the structure of the family owned business group, the importance of Hindu Undivided Family assets have not declined even as the groups in question have forged relationships based on technological dependence and spates of mergers with and acquisitions of both indigenous and foreign companies. It has only meant that the wealth holdings in HUF cannot be used for controlling stakes in the merged entity as opposed to the wealth held through 'corporate governance' structures. This means that family owned business groups were transforming themselves into multi-nationals without an increase in their total corporate liability through vertical and horizontal integration. This is possible because the laws of the land have been suitably altered to facilitate such transformation of firms in the period of neoliberal globalization by reducing the compulsory share of Indian partners in a transnational venture, dismantling of the MRTP and FERA Acts, and amendments in the National Patent Act to make it amenable to the WTO regime of product patents. However,

the laws relating to holding structures of companies remain flexible enough to accommodate the requisites of change in corporate governance but unchanging in its function to provide the legitimate basis of family owned business groups spanning the entire domain of ownership, control and individual and family based appropriation of profit in favour of the 'Hindu' defined as anyone who is not a Muslim, Christian, Parsi or Jew. In the post liberalisation period, it also provides yet another channel of 'tax-saving' on income and wealth for not only the upwardly mobile 'Hindu' families in India but also the Hindu NRIs. It is indeed incredible that nuclearisation of families socially is directly combined with proliferation of HUF accounts among middle class double income upwardly mobile 'Hindu' India.

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